Economic commentary

Recent months have seen disturbed financial conditions, particularly in the United States. These are discussed in other parts of the Bulletin. *It is not clear how far, if at all, such developments will adversely affect economic developments and prospects, with which this commentary is concerned.*

Economic activity in North America continues to grow rapidly. Partly as a result, smaller industrial countries and developing countries (including some of the most heavily indebted) have seen a marked strengthening in their balance of payments, affording a measure of reassurance and relief. Bank forecasts for the world economy are set out on page 159. Interest rates and financial conditions in general are a source of particular uncertainty.

In the United Kingdom, allowing for the loss of coal production, activity has continued to pick up, bringing some increase in recorded employment. Domestic costs (the GDP deflator) and retail prices have been rising at about 5% a year, although industry's material costs have grown faster in the last year and pay settlements in industry (according to CBI sources) appear to have edged up in the course of the current round.

The changes in the financial positions of various sectors noted in the March Bulletin *have to some extent been reversed: the personal sector's surplus has recovered while an increase in capital spending has contributed to a fall in the recently very large financial surplus of industrial and commercial companies.*

Recovery in the world economy *spreads; monetary policy remains directed at containing inflation*

The US economy grew at an annual rate of nearly 10% in the first quarter, though preliminary indications suggest some slowing down in the second. There are some tentative signs that the gap between growth rates in North America and those in other industrial countries is shrinking, and this is expected to continue (see page 159).

GNP[a] in seven major economies

Percentage changes (annual rates); at constant prices; *seasonally adjusted*

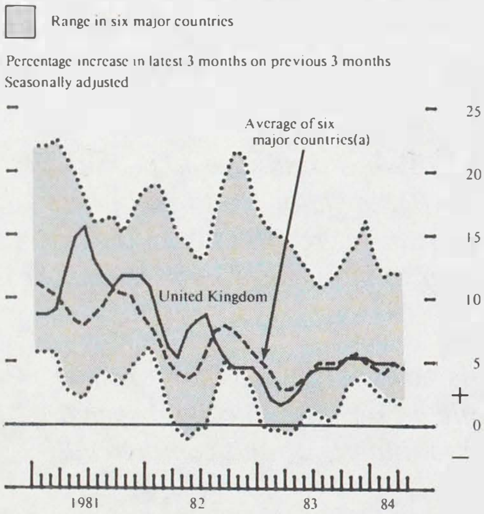
	1981	1982	1983	
	Year	Year	H1	H2
Canada	3½	−4½	4½	7
France	½	1½	½	¾
Germany	− ½	− 1	2¼	2¾
Italy	—	− ½	− ¾	¾
Japan	4	3½	1¾	5
United Kingdom(b)	−1½	2	4¼	2½
United States	2½	− 2	3¼	7½

(a) Or GDP.
(b) Average estimate of GDP.

GNP in the OECD area as a whole grew at an annual rate of 5% in the second half of 1983. By far the most rapid growth was in North America—7½% a year in the United States and 7% in Canada. In the United States, domestic demand increased at some 8½%–9%, led by consumer spending and a brisk revival of business fixed investment (which may also have been encouraged by more favourable depreciation provisions); housing investment, though weaker than earlier in the year, was still buoyant; and a turn-round in the stock cycle added to growth. Despite the size of the Federal deficit (some $180 billion, equivalent to 5½% of GDP, in calendar 1983), public spending was a minor element in the expansion of demand (although the fiscal deficit, which was virtually the same percentage of GNP as in 1982, must have expanded in cyclically-adjusted terms). The US external trade deficit grew, however, so the increase in GNP in the second half of last year fell short of the growth in domestic demand.

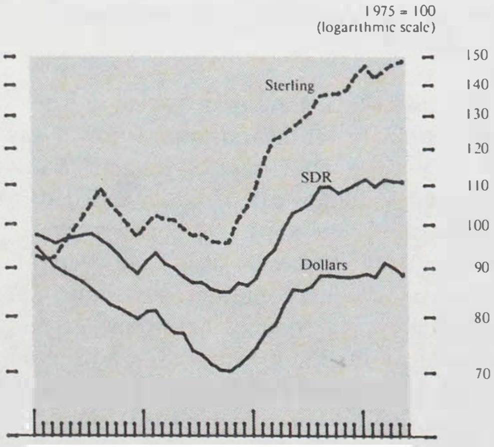
Recovery quickened in Japan in the second half of last year, GNP growing at an annual rate of 5%. Growth appears to have

Consumer price inflation *is averaging about 5% in the main industrial countries.*



(a) Canada, France, Germany, Italy, Japan and United States.

Commodity prices[a] *have tended to level out after sharp increases.*



(a) 'Economist' all-items index.

continued in the first quarter. In contrast to the United States, exports grew rather more quickly than imports, no doubt a reflection of earlier improvements in Japan's competitive position and the pattern of demand in the world economy as well as the initial cyclical position of the two countries. Consequently GNP grew substantially faster than domestic demand, which rose by only 3% at an annual rate, after no growth at all in the first half year. As in the United States, business fixed investment recovered briskly; the growth of consumer spending eased back.

The picture in the main industrial economies of continental Europe remains mixed. In Germany, activity picked up, but GNP still grew at a comparatively modest $2\frac{1}{2}$%–3% a year in the second half of 1983; in Italy, the contrast between the two halves of last year was more marked, though growth of GDP in the second half of the year was still only $\frac{3}{4}$% (at an annual rate). In each case, recovery continued in the first quarter. In France, on the other hand, there was no domestic recovery at all in the course of last year, home demand falling at an annual rate of no less than $2\frac{3}{4}$% in the second half. An improvement in the foreign trade position was sufficient to give a small rise in GDP.

Except in North America (and to a very slight degree, Japan) growth in activity so far has not brought falls in unemployment, and the labour market in the main industrial countries generally remains slack. Pay increases have remained low; and with rapid (probably mainly cyclical) growth in productivity, unit labour costs have actually fallen in domestic currency terms in several countries and have been moderate elsewhere. Labour costs have therefore put no upward pressure on inflation. Profit margins have undoubtedly widened, though from an unusually low level. Altogether, the GDP (or GNP) deflator, the comprehensive measure of domestic costs, fell slightly in the second half of last year in Japan, and rose at the subdued (annual) rate of $3\frac{1}{2}$%–$3\frac{3}{4}$% in Canada, Germany and the United States. In France and Italy, the rise in domestic costs was considerably larger, but slackening. Very preliminary estimates for the first part of this year suggest some acceleration in North America and Japan, but a further slowing down in the growth of domestic costs in Europe—including the United Kingdom. Broadly speaking, commodity prices have levelled out.

The recovery in the main industrial countries therefore shows some unusual features. It is dominated by developments in North America: indeed, revival in Germany and Japan is slow by the standards of earlier cycles, and France and Italy have hardly participated in the recovery so far. In Germany and Japan (and the United Kingdom), growth so far has not noticeably reduced unemployment. Second—and the two points may be related—recovery has not so far brought much increase in domestic cost inflation in the major industrial countries. A small rise in consumer price inflation on a twelve-month comparison partly reflects virtually stable consumer prices in some countries in early 1983; there has been no quickening of consumer prices since the middle of last year.

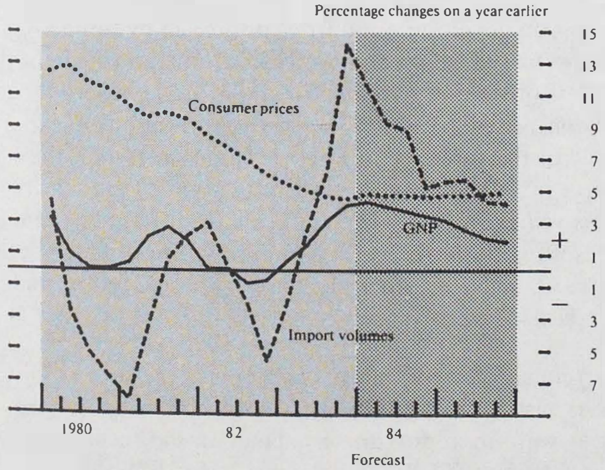
A third feature of the recovery so far concerns fiscal and monetary policies, interest and exchange rates, and the pattern

World economic prospects—latest Bank forecasts

Prospects for the world economy now appear rather brighter than last autumn. In the seven major industrial countries GNP may grow by 4% this year, though a slower rate is expected in 1985. Continuing recovery of world trade should improve the position of the smaller industrial and developing countries. Little change is expected in real commodity prices and, with unit labour costs showing little growth, world inflation should remain subdued.

The prospects for higher activity in the main industrial countries are not attributable to more expansionary policies. In its initial stages, the recovery in the major economies was led by consumer spending, housebuilding and a turn-round in the stock cycle, with business fixed investment recovering towards the end of last year. Consumption is expected to continue its growth this year, helped by substantial increases in total personal income in North America, before fading somewhat in 1985. Saving ratios are not, in general, expected to fall further. Business investment is currently growing very fast in the United States and may continue to do so for a time; it may also grow strongly in Germany and Japan (and will continue to revive in the United Kingdom to judge from survey evidence). Domestic demand in the seven main industrial economies grew at an annual rate of 5% in the second half of 1983; it may grow at about 4½% in 1984 before slowing down in 1985.

Prices, GNP and trade growth *in seven major economies*.[a]



(a) Canada, France, Germany, Italy, Japan, United Kingdom, United States.

The difference between growth rates of domestic demand in North America and Japan on the one hand and much of Europe on the other is expected to persist this year but to close in 1985 as growth slows down in North America and picks up in the European economies. To some extent trade flows have already tended to even out the growth of GNP (compared with domestic demand), and are expected to continue to do so this year: weak competitiveness (as well as cyclical pressure) is expected to bring a further deterioration in US trade; in other major countries, trade flows are on the whole expected to contribute to growth of GNP (or to be less contractionary).

Any improvement in unemployment (reductions in which have so far been virtually confined to North America) is nevertheless expected to be modest. In these circumstances any quickening of wage inflation seems likely to be small (except possibly in the United States, as a delayed response to rapidly changing conditions in the labour market); indeed, in the countries with higher inflation rates (France and Italy) the growth of average earnings may continue to moderate. Cyclically favourable productivity performance should then keep the growth in labour costs very low indeed in national currency terms, especially in Europe and Japan. Profit margins will probably widen further, though from an historically rather low level. This could further strengthen business fixed investment and so longer-term prospects.

Demand in seven major economies[a]

Percentage change

	1981	1982	1983	Forecasts 1984	1985
Domestic demand	1.2	0.1	2.7	4.4	2.3
of which:					
Consumption	1.5	1.3	2.4	2.7	2.1
Fixed investment	0.8	−2.7	2.5	7.1	4.1
Stockbuilding(b)	−0.2	−0.4	0.2	0.8	−0.1
Net exports(b)	0.6	−0.4	−0.3	−0.5	0.1
GNP	**1.8**	**−0.3**	**2.3**	**3.8**	**2.4**

(a) Canada, France, Germany, Italy, Japan, United Kingdom, United States.
(b) Percentage contribution to GDP or GNP.

Other elements in world inflation are expected to remain subdued. Commodity prices have levelled out after a period of rapid growth from autumn 1982. Prices of foodstuffs in particular were affected by exceptional weather last year, and are now expected to be more stable. Excess capacity in metals remains despite stronger demand. On balance, commodity prices are expected to change little in real terms in 1984 and 1985; oil prices are expected to remain broadly stable in nominal terms (although developments in the Middle East could clearly upset this expectation). Consumer price inflation in the main industrial countries seems likely to continue to average about 5%, probably slowing in the countries with above-average inflation.

World trade and UK markets

Percentage change

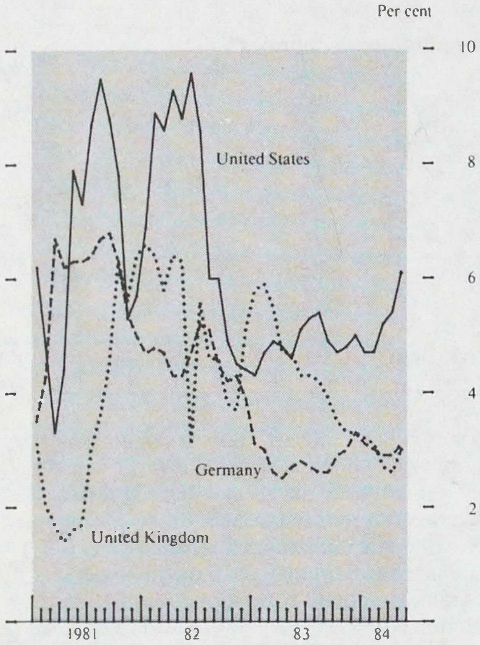
	1981	1982	1983	Forecasts 1984	1985
World trade(a)	1.1	−1.2	1.4	6.3	4.3
UK markets	2.9	−0.8	−1.1	4.7	3.8

(a) Growth averaged 5½% a year between 1971 and 1980.

These developments are likely to be accompanied by stronger growth of world trade (especially this year) from which the smaller industrial countries and the less developed countries will benefit. UK markets may grow more slowly than world trade generally, but any deceleration next year may be modest because of the changing pattern of activity and trade.

Apart from the oil price, uncertainties mainly concern the course of the US economy following a period of exceptionally rapid growth; the response of business investment to rising profits; the durability of the better trend in productivity in a number of countries; and the pattern of exchange rates and interest rates as they respond to any major disturbance in financial markets.

The **real interest rate**[(a)] *in the United States has risen sharply since March.*



(a) Nominal 3-month rates less the change in prices in the two preceding and the two following quarters (partly forecast for recent quarters).

of current account and financing flows. Broadly speaking, fiscal policy has eased since 1981 in the United States (and to a much smaller extent in Canada) but has tightened in the other major overseas economies, all the more so if allowance is made for changes in cyclical positions. Monetary policy in the United States (as in other important countries) has been directed at containing inflation. A consequence has been upward pressure on interest rates in the United States contributing to a strong dollar. The strength of the dollar has been associated with a marked loss of US industrial cost competitiveness, contributing to a huge deterioration in the current account of the US balance of payments. Meanwhile, Japan has moved into substantial current account surplus; the external positions of the European economies have changed rather more modestly.

Any assessment of current account developments must acknowledge the large statistical discrepancy in the accounts. It appears, nevertheless, that the deterioration in the US trade position (of $25 billion in 1983) has been mirrored in the position of non-oil developing countries, whose trade balance with the United States improved by $19 billion last year. Latin American countries accounted for about $11 billion of this. Bilateral trade flows are, of course, an inadequate guide to the effects of developments in the United States, which are more diffuse; working in the opposite direction, US interest rates and the cost of servicing a mainly dollar-denominated debt are important elements affecting the external position of developing countries. Altogether, the current account balance of payments of the non-oil developing countries improved by some $26 billion in 1983, a process which continued throughout the year. Most of the improvement came in trade, where the change comprised a 3%–3½% increase in the volume of exports, a 2% cut in the quantity of imports (much less than the reduction in 1982 but still harsh in relation to growth in previous years) and a 2%–2½% improvement in their terms of trade resulting from the rise in commodity prices which began in late 1982. Their recorded deficit on interest, profits and dividends also improved somewhat.

The current account balance of payments of the smaller OECD countries also strengthened last year; in aggregate, these countries were in approximate balance in the second half, following deficits of $20–25 billion in both 1981 and 1982. Some of these countries also have amassed considerable external debt and the improvement in their current position was welcome.

Balance of payments positions are discussed at greater length on pages 180–1.

UK costs *continue to increase slowly, but* import prices *have picked up*

About three-quarters of employees having settled in the current pay round, CBI sources suggest settlements averaging some 6% in manufacturing and slightly more in some service industries. Public sector settlements are averaging 4½%–5%. Average earnings continue to rise at some 7¾% in the whole economy and 9½% in manufacturing industry, where rising overtime and bonus payments are most prevalent.

Current account summary

$ billions: *seasonally adjusted*

	1982	1983			1984
	Year	Year	Q3	Q4	Q1
Total OECD	− 29	−23	− 6	− 9	−12
of which:					
Major economies(a)	*− 5*	*−15*	*− 5*	*− 9*	*−12*
Other	*− 24*	*− 8*	*− 1*	*—*	*—*
Oil exporting economies	− 14	−13	+ 5	+ 1	..
Other developing economies	− 66	−40	−10	− 6	..
Other economies(b)	—	3	1	—	..
Total(c)	−109	−73	−10	−14	..

(a) Canada, France, Germany, Italy, Japan, United Kingdom and United States.

(b) South Africa and the centrally planned economies.

(c) This discrepancy reflects errors and omissions arising from incomplete coverage, timing differences and other statistical deficiencies.

Pay, productivity and labour costs in manufacturing industry

Percentage change from a year earlier(a)

	1980	1981	1982	1983	1984
Settlements(b)	+16	+ 9	+7¼	+5¾	+6
Average earnings	+21½	+12½	+9¾	+9	+9½
Less productivity (output per head)	+ 4	− 6¾	−4	−7	−5½
Unit wage costs	+25¾	+ 5½	+5½	+1¾	+3½
Background factors:					
Output	− 9¾	− 2¾	−1¼	+2¾	+3
Employment	− 6¼	− 9	−5	−4	−2¼
Average weekly hours worked per operative	− 3½	+ ½	+ ¾	+1¼	+1½

(a) Third quarter on third quarter—approximately the timing of a pay round—except for 1984, where the figures relate to changes in the year to the first quarter or to the three months to April.

(b) As monitored by the CBI.

Labour costs, profit margins and the GDP deflator

Percentage change from a year earlier

	1980	1981	1982	1983	
	Year	Year	Year	H1	H2
Labour costs per unit of output (whole economy)(a)	+22¼	+10¼	+ 5	+ 4½	+ 4½
Profits etc per unit of output (whole economy)(b)	+13¼	+11¾	+17½	+22¼	+15¼
Profits etc per unit of output excluding North Sea operations(c)	+ 8¼	+ 8½	+16½	+19	+16½
GDP deflator	+19	+10¼	+ 6½	+ 6½	+ 5¾

(a) Income from employment divided by the output measure of GDP. Employers' contributions to national insurance and other pension schemes are included.

(b) Gross trading profits of companies plus gross trading surpluses of public corporations etc, less stock appreciation, divided by the output measure of GDP.

(c) As in (b), but excluding North Sea operations from profits and GDP.

Domestic costs and import prices

Percentage change from a year earlier

	1977–81	1982	1983		1984
	Average	Year	H1	H2	Q1
GDP deflator	+13½	+ 6½	+ 6½	+ 5¾	+ 4½
Deflator for imports (goods and services)	+ 7½	+ 7¾	+ 8¾	+ 7	+ 6¼
of which: (a)					
Food, drink and tobacco	+ 3	+ 6½	+ 8	+ 9½	+10¼
Basic materials	+ 3½	—	+ 3	+11	+16
Fuel	+20	+14½	+ 8	+ 4½	+ 5
Semi-manufactures	+ 6	+ 5½	+ 6	+ 7½	+ 8¾
Finished goods	+ 6¼	+ 8¾	+11¼	+ 7	+ 4½
Memo item:					
Commodity prices in sterling ('Economist' index)	+ 3¾	− 4	+21½	+39½	+23½

(a) These figures are average values (obtained by dividing the value of imports in each category at current prices by an estimate of their value at 1980 prices), and not unit value indices.

Settlements and particularly bonuses appear in many cases to be related to higher output per head. In manufacturing, productivity has continued to rise at about 6% a year, though in the rest of the economy its growth will have been considerably slower, perhaps 2%–2½%. Broadly speaking, rather under a half of this differential in productivity growth has been reflected in higher average earnings in manufacturing. Consequently unit wage costs in manufacturing have been rising more slowly than in the economy as a whole.

Income from employment represents about two-thirds of total domestic income. Employment costs therefore constitute by far the largest element in domestic production costs. Profit margins are the other main element in domestic 'costs'. Profit margins widened considerably between early 1981 and the latter part of 1983, but may subsequently have ceased to do so, at any rate for a time, the continuing growth of profits and profitability being explained by rising activity in the economy. Domestic unit costs (measured by the GDP deflator) increased by 5½% between the fourth quarters of 1982 and 1983, a rate which has since fallen.

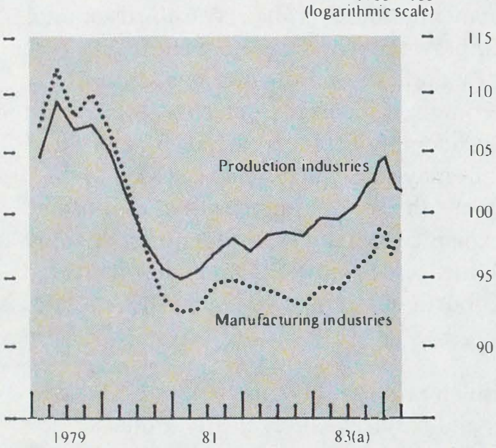
Import prices are also an important component of UK prices, as imports of goods and services satisfy nearly a quarter of domestic spending. In the last two years or so import prices have risen by nearly 8% a year on average, somewhat faster than domestic costs. This is a change from the experience of immediately preceding years, import prices having fallen in relation to the GDP deflator since 1977. The prices of different categories of imports behave by no means uniformly. Imported fuels and raw materials in most cases are bought at prices determined by market conditions outside the United Kingdom; their sterling prices will also reflect changes in the exchange rate. Many food imports are covered by the Common Agricultural Policy; their sterling prices bear only a limited relationship in the short term to the market exchange rate, world prices, or conditions in the UK market. Finally, the prices of imported manufactured goods appear to be determined both by production costs in the country of origin and by trading conditions in the United Kingdom.

The low level of import prices in relation to the GDP deflator in 1977–81 was a result of low commodity prices worldwide, the strength of sterling, and deeper recession in the United Kingdom than elsewhere. Conditions in the last year or so have brought a revival of import prices in relation to domestic costs, though they are still comparatively low.

Prices of imported food and materials are also low in relation to world commodity prices, which have risen by over 50% in sterling terms since the third quarter of 1982. The relationship between import prices and world spot market prices (which is what the 'Economist' index mostly measures) is a loose one, since many commodities are bought on contractual terms at prices which are much less volatile than prices in the spot market.

In addition to domestic labour costs, profit margins and import prices, the retail price index is also affected by such items as rent, rates, mortgage costs, and indirect taxes. Tax changes announced in the Budget directly increased prices in April and

Industrial production *still appears to be rising, allowing for loss of coal output.*



(a) Monthly data from 1983 Q4.

May by somewhat more than last year, but the extra effect was offset by a reduction in mortgage rates early in April. Local authority rates and rents rose less than last year.

Output and demand *continue to revive, though unevenly . . .*

Notwithstanding the fall in coal output resulting from the miners strike, industrial production in the first quarter in total was virtually unchanged from the fourth quarter of last year, while manufacturing output, virtually unaffected by the strike, increased slightly to a level 3½% above the first quarter of 1983. Output growth in the last year has been strongest in chemicals, electrical engineering, metals and vehicles, while mechanical engineering remains depressed, despite the recent revival in investment spending. Respondents to CBI surveys continue to expect manufacturing production to grow in a wide range of industries. Total output (GDP, output measure) edged up in the first quarter, when it was 3% higher than a year earlier and 6¾% above the low point in 1981.

Growth of total output quickened in the course of 1983; total demand (GDP, expenditure measure) rose by a similar amount during the year, but its quarterly movements were more volatile and the discrepancy between the different measures of GDP remained large. In the first quarter of this year, GDP (expenditure) rose by just over ¼%. Falls in consumer spending and stocks were more than offset by higher fixed investment and an improvement in the trade balance in volume terms. Discrepancies in the national accounts continue to cloud understanding of the sources and strength of recovery in economic activity.

Recorded consumer spending fell quite sharply in the first quarter, by over 1¼% (in volume). This followed an increase in the fourth quarter of less than ½% while in the previous eighteen months consumer spending had grown by 6½%. Spending on cars and on household durable goods was well down after considerable earlier strength. The course of retail sales in April and May, however, suggested some recovery of consumer spending from the setback in the first quarter.

Changes in domestic final spending, stockbuilding, the trade balance and output[a]

£ billions, 1980 prices

	1980 Year	1981 Year	1982 Year	1983(b) H1	1983(b) H2	1984(b) Q1
Domestic final spending (at market prices)	−2.1	−3.5	+4.7	+4.2	+3.8	+1.0
Stockbuilding	−5.7	+0.6	+1.6	+3.7	−0.9	−1.9
Net trade balance(c)	+2.4	+0.7	−1.4	−1.6	−1.8	+1.4
Indirect taxes less subsidies	+0.6	+0.8	−0.9	−0.6	−0.5	+0.1
GDP expenditure measure (at factor cost)	**−4.8**	**−1.4**	**+4.1**	**+5.7**	**+0.6**	**+0.6**
GDP output measure	**−6.5**	**−3.7**	**+3.1**	**+1.8**	**+4.4**	**+0.4**

(a) Output at 1980 prices is GDP in 1980 multiplied by the index of output.

(b) Seasonally adjusted, at an annual rate.

(c) The change in exports of goods and services, less imports.

Weak growth of consumer spending in the fourth quarter was associated with a 1 percentage point rise in the saving ratio to 9%. This was the first increase for nearly two years; indeed, the saving ratio had fallen from a peak of 15½% in the second half of 1980 to 8% in the middle of last year. Readier availability of personal credit (particularly in the form of mortgage lending) was probably a factor, as perhaps was the falling relative price of many consumer durables. To some extent, however, the fall in the saving ratio may be attributed to falling inflation—as inflation declines, less saving is needed in order to maintain the 'real' value of people's monetary assets.[1] A corollary is that the saving ratio should level out as inflation levels out, which broadly speaking has happened in the past year. Continued growth in consumer spending would then depend on real personal disposable income, which rose in the fourth quarter but, on first indications, fell somewhat in the first quarter of this year.

(1) See also page 166, and the article on page 231.

Industrial investment and investment intentions[(a)]

£ millions, 1980 prices

	Manufacturing(b)	Construction, distribution and some services(c)
1979	8,170	10,280
1980	7,280	9,860
1981	5,760	9,620
1982	5,470	10,440
1983	5,170	11,380
Projections		
1984	5,790 (+12%)	12,320 (+8%)
1985	6,140 (+ 6%)	'A further increase although the rise may be smaller than in 1984'

(a) Department of Trade and Industry survey, June 1984.

(b) Including assets leased.

(c) Excluding assets leased out.

Industrial fixed investment, by contrast, expanded by over 8% between the third quarter of last year and the first quarter. Investment in the construction, distribution and service industries (up by 7¼% over this period) had already been growing for some time. Investment in manufacturing industry, on the other hand, had been very low, even with leased assets included. Indeed, in the first half of last year manufacturing investment was nearly 40% below the rate in the peak year of 1979. The growth of 13% in the latest six months is expected (on the basis of the Department of Trade and Industry's survey of investment intentions) to be followed by further growth during the rest of this year and next to give year-on-year increases of 12% and perhaps 6% in 1984 and 1985. Manufacturing investment would still, however, be less in 1985 than in any year in the 1970s. The (more modest) growth in investment in distribution and services would carry it well above the level of earlier years.

Manufacturers' stocks fell back slightly in the first quarter, following a sizable increase in the previous three months. Most of the change was in stocks of materials and fuel. Wholesalers added to their stocks for the second quarter running, but retailers reduced theirs despite the weakness of retail spending. Retailers' stocks continue to look rather low in relation to sales.

Employment, hours and unemployment

Thousands: seasonally adjusted

Average hours are an index 1980=100

	Mid-year			Dec.	Mar.
	1979	1981	1983	1983	1984
Employed labour force(a)	25,360	24,300	23,690	23,870	..
Employment(b) in:					
Production and construction	9,050	7,920	7,140	7,080	7,060
Services	13,210	13,090	13,100	13,280	..
Average hours(c)	*103.7*	*98.6*	*100.9*	*102.6*	*102.5*
Unemployment(d)	1,230	2,420	3,100	3,110	3,170

(a) United Kingdom. Includes self-employed and armed forces. Figures for 1983 and 1984 include Department of Employment adjustment for possible underestimation.

(b) Great Britain. 'Services' includes public administration.

(c) Representing average weekly hours worked by operatives in manufacturing industry.

(d) Adults in the United Kingdom. 1983 and 1984 figures allow for the measures announced in the 1983 Budget (which in effect led some 160,000 men aged over sixty to de-register).

. . . *with some effect felt in* the labour market

The recovery in output has been reflected in some rise in employment (up by 120,000 between March and December last year, according to preliminary estimates), and in more overtime and less short-time working in manufacturing industry. In manufacturing, however, and indeed in production industries as a whole, the number of jobs diminished over the same period, and continued to do so in the first quarter of this year.

The underlying rise in unemployment (after rough allowance for special factors[(1)]), although much slower than previously, may not have slackened further since mid-1983. The coincidence of rises in both employment and unemployment reflects an increase in the population of working age and also the tendency for some jobs to be filled by people (especially, in the services sector, by women) many of whom would not have been included in the count of those claiming benefit.

Trade in goods other than oil[(a)]

Volumes, 1980 = 100: *seasonally adjusted*

	Exports	Imports
1981	98.8	103.6
1982	98.8	111.9
1983 Q1	96.7	116.8
Q2	94.7	117.7
Q3	93.8	119.9
Q4	102.1	129.7
1984 Q1	102.9	130.1
April	103.8	136.8

(a) Excluding the more erratic items.

External trade *figures highly erratic, but the current account remains in surplus*

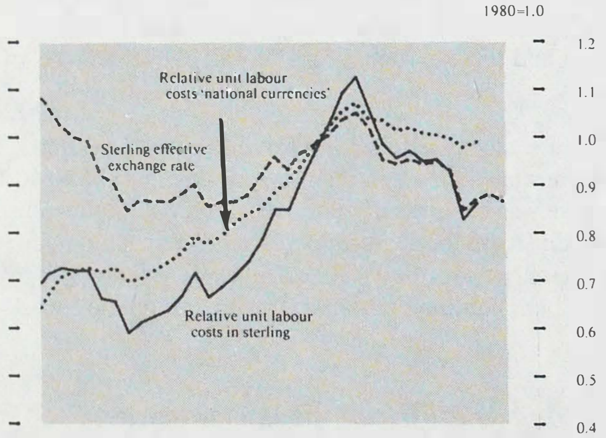
The variability of the monthly trade statistics makes it difficult to pick out a trend. In the first quarter as a whole, the volume of non-oil exports (excluding the usually erratic items) rose by a further ¾%. Non-oil imports rose by a more modest ¼%. The record deficit on visible trade in April was partly explained by a £400 million fall in the surplus on trade in oil, and did not represent the underlying position. It appears nevertheless that the underlying increase in non-oil imports continues to be strong, while non-oil exports may have levelled out after a rapid increase since the middle of 1983.

(1) Special employment measures and changes announced in the 1983 Budget reducing the requirement for men over sixty to register.

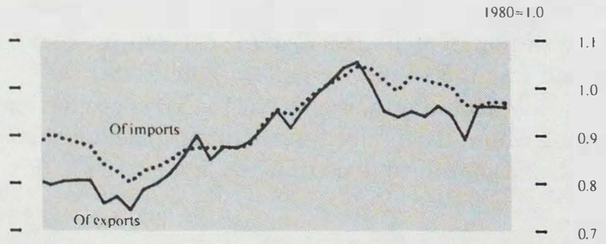
Competitiveness of manufacturing industry[1]

Sterling is currently about 5% lower in effective terms than in spring 1983, and unit labour costs in UK manufacturing industry have risen only some 3%–4% in the last year. Even more favourable developments in costs in some other industrial countries mean, however, that UK industrial cost competitiveness may have worsened slightly over the past year, following quite large gains since 1981.

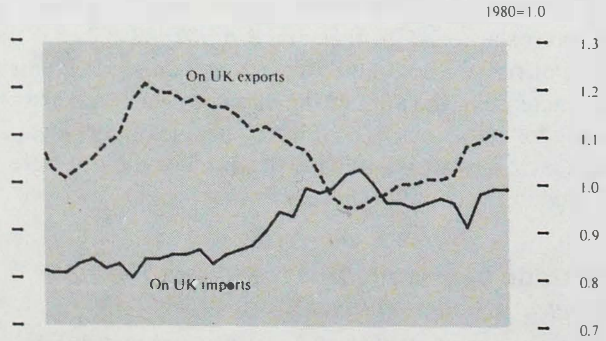
Relative unit labour costs



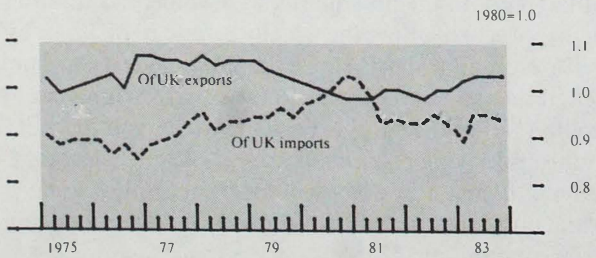
Relative prices



Margins



Relative profitability



Between 1975 and 1981, unit labour costs in UK manufacturing industry rose faster than in other industrial countries (in national currency terms). Earnings rose faster here, and productivity usually grew more slowly. UK competitiveness worsened rapidly, the more so as sterling rose between 1978 and early 1981. Between early 1981 and last year, a considerable improvement in the United Kingdom's relative cost performance coincided with a tendency for sterling to decline, and substantial gains in cost competitiveness were made. These gains, however, only partly reversed the earlier losses.

Measuring competitiveness in terms of unit labour costs alone is not always appropriate. Labour costs may not adequately represent all production costs. Moreover, unit labour costs are highly cyclical (mainly because productivity tends to vary with the level of output) and cyclical adjustment is difficult to apply (the figures in the chart are not, in fact, cyclically adjusted). Most important, however, manufactured goods are often differentiated products for which a single world price is unlikely to prevail: in these circumstances, relative prices may determine sales independently of costs, at least for a time. Two measures of relative price are therefore shown opposite. The first is the ratio of UK manufacturers' domestic selling prices to prices of imported manufactured goods—the higher the figure, the greater the price inducement to buy imports. The second, the ratio of UK prices of exported manufactured goods to foreign manufacturers' wholesale prices, is a measure of the price competitiveness of UK goods in overseas markets. Like unit labour costs, the series show a substantial but uneven improvement since 1981 after an earlier deterioration.

Relative prices influence the quantity of UK exports *demanded* by overseas buyers (or imports demanded in the UK market). They are generally less variable than relative costs, because competitive market conditions deter producers from changing prices fully in line with costs. Consequently profit margins reflect changes in competitiveness: but changes in them may also represent an aspect of competitiveness because they may influence the *supply* of UK exports (and the supply to the United Kingdom of foreign-produced manufactures). Thus the higher are UK export prices in relation to unit production costs in UK manufacturing industry ('margins' chart) and in relation to selling prices in the UK market ('relative profitability' chart), the greater is the inducement to sell abroad; similarly for inducements to foreign manufacturers to supply the UK market. These measures, too, show a general improvement since 1981.

(1) The measures of competitiveness discussed here were described fully in an article in the September 1982 *Bulletin*, page 269.

UK export markets
Percentage changes at annual rates; *seasonally adjusted*

	1981	1982	1983	
	Year	Year	H1	H2
Total UK export markets	2.9	-0.8	-1.6	4.0
of which:				
OECD	- 2.0	0.7	1.4	6.2
Non-OECD	12.2	-3.6	-8.5	-1.3
Markets in manufactures	3.2	-2.8	3.1	4.1

Current account balance of payments
£ billions; *seasonally adjusted*

	1980	1981	1982	1983		1984
	Year	Year	Year	H1	H2	Q1
Visible trade	+1.5	+3.7	+2.4	-0.3	-0.2	-0.1
of which:						
Oil	*+0.3*	*+3.1*	*+4.6*	*+3.4*	*+3.6*	*+2.3*
Other	*+1.2*	*+0.5*	*-2.2*	*-3.6*	*-3.9*	*-2.4*
Services	+4.3	+4.2	+3.9	+2.4	+1.9	+1.1
Interest, profits, dividends	-0.1	+1.3	+1.6	+0.4	+1.0	+0.3
Transfers	-2.1	-2.0	-2.1	-1.0	-1.2	-0.4
Current account	**+3.6**	**+7.3**	**+5.8**	**+1.5**	**+1.4**	**+0.8**

The rapid growth in exports after last summer was probably a response to the quickening recovery in markets abroad in the second half of last year. The growth was concentrated in the OECD countries; indeed the United Kingdom's markets outside the OECD area continued to shrink, though much more slowly than in the first half of the year (and, indeed, more slowly than in 1982).

The growth in imports of manufactured goods was strong in the year to the first quarter. A rise of about 10% in the volume of finished goods imports was broadly spread among capital goods, consumer products and intermediate items.

Cost competitiveness (affecting both sides of the trade account) probably worsened slightly between early 1983 and (on very preliminary estimates) the first quarter of this year. Unit labour costs in manufacturing increased only modestly, but they appear to have fallen (in domestic currency terms) in some other industrial countries; and sterling appreciated by $1\frac{1}{2}$% over the period. In 'effective' terms (with due allowance for lagged effects of actual changes) labour cost competitiveness was probably already improving around the turn of the year and the tendency for both export and import prices to rise faster than industry's domestic selling prices and costs suggests that competitiveness has been improving on some other measures. (Various measures of competitiveness are discussed opposite).

The terms of trade have deteriorated in the last year, but not markedly so; the non-oil terms of trade are still close to the historically rather favourable level of 1980, despite the strong rise in world commodity prices since late 1982.

In the first quarter, the deficit on non-oil trade was matched by a surplus on trade in oil, much as it had been in the fourth quarter of last year. The surpluses on services and interest, profits and dividends were little changed, but a smaller deficit on transfers (despite the absence of a refund from the European Community budget) raised the surplus on current account to over £0.8 billion—a little above the quarterly average in 1983, itself revised substantially upwards. A feature of capital flows in the first quarter was the doubling, to £3 billion, of recorded outward portfolio investment; the whole of the increase was accounted for by a change in the composition of UK banks' assets abroad, from loans to marketable securities.

Main features of sectoral positions[1]

The most recent information suggests that the developments in financial positions noted in the March *Bulletin* (page 20) have been in some measure reversed. Thus the personal sector's surplus grew in the fourth quarter; by contrast, the financial surplus of industrial and commercial companies diminished. These developments reflect the changing composition of demand as recovery continues and broadens.

Personal sector *surplus begins to grow again*

A feature of the fourth quarter was the coincidence of rapid growth in real personal disposable income (RPDI)—up by

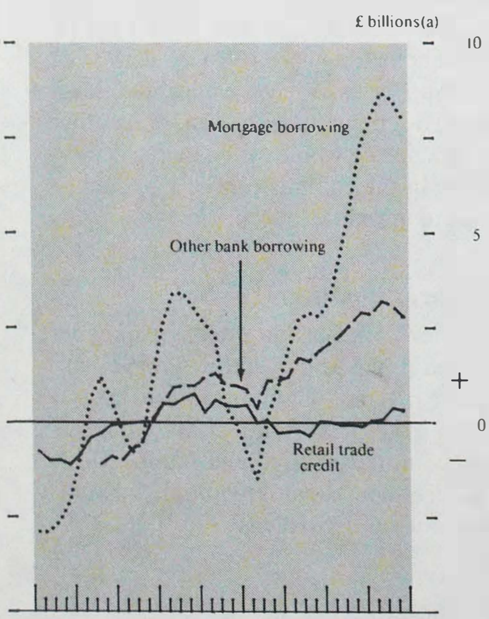
(1) The article on page 212 discusses sectoral positions in recent years.

Personal sector income, saving and financial transactions
£ billions, 1980 prices(a)

	1979	1980	1981	1982	1983
Personal disposable income	**158.3**	**160.6**	**156.6**	**155.9**	**158.1**
Saving	20.3	23.3	19.0	16.5	13.3
Net capital transfers (receipts +)	0.2	0.3	0.2	0.4	0.8
Tangible investment (expenditure −)	− 8.7	− 7.6	− 7.2	− 8.6	− 9.4
Net acquisition of financial assets	**11.8**	**15.9**	**12.0**	**8.3**	**4.7**
Transactions in financial assets:					
Liquid assets	17.7	16.6	14.3	15.1	13.3
Securities etc	− 1.6	− 1.3	0.1	− 0.7	− 0.1
Life assurance and pension funds	11.9	11.9	11.5	10.7	11.0
Borrowing (−):					
From banks	− 3.1	− 3.0	− 3.6	− 4.1	− 3.8
Other	− 9.4	− 7.5	− 9.3	−11.9	−12.4
of which house mortgages	*− 7.6*	*− 7.3*	*− 8.5*	*−11.7*	*−11.5*
Balancing item	**− 3.6**	**− 0.9**	**− 0.8**	**− 0.6**	**− 3.2**

(a) Nominal amounts divided by the deflator for consumers' expenditure (1980=100).

Personal borrowing, *especially on mortgage, has increased sharply in real terms since 1980.*



(a) Nominal flows at an annual rate divided by the deflator for consumers' expenditure.

1½%—and comparatively slow growth in consumer spending. The saving ratio accordingly rose by one point, to 9%, the first increase for nearly two years, and the sector's financial surplus, which in the previous year had almost halved, rose substantially.

Among the main sources of growth in RPDI last year, average earnings rose substantially faster than prices, as they have done almost throughout the recession and recovery, and the total number of people at work rose, whereas the number had fallen in 1980–82. A real increase in most main income tax allowances and thresholds in the 1983 Budget boosted disposable incomes.

However, the course of income looks rather different if adjustment is made for the effect of inflation on the real value of net personal holdings of monetary assets, to indicate the amount which people could spend without eroding the real value of their capital. As the March *Bulletin* showed (page 15), the adjusted saving ratio had earlier fallen considerably less than the ratio conventionally defined, and began to rise in spring 1983. Most of the difference between the two measures of income and saving is accounted for by the path of inflation, which fell sharply between 1980 and early 1983 but has since levelled out at about 5%. With the rate of inflation little changed, the two measures of income have recently followed a similar path.

The figures in the table summarising personal sector income, saving, capital expenditure and financial transactions since 1979 are in constant prices, to eliminate the effect of overall price changes, but are not 'inflation adjusted' (in the sense described above).(1) Whereas the flow of saving fell between 1980 and 1983, capital spending (mainly on houses) increased; the sector's financial surplus in 1983 was less than a third (in constant price terms) of the amount in 1980. Most of this change was reflected in an increased rate of borrowing, especially on mortgage: the acquisition of liquid financial assets fell somewhat, but payments to life assurance and pension funds, the other main form in which the personal sector acquires financial assets, were broadly maintained. The growth of borrowing in real terms over a period when personal income on balance declined raised the stock of personal sector debt outstanding from 42% of a year's income in 1980 to 57% in 1983—above the high level reached by this ratio in the early 1970s. Over the same period, the proportion of income taken by interest payments increased from 6.1% to 6.4%. Previous *Bulletins* have suggested explanations for this phenomenon: the end of hire-purchase restrictions in 1982, and the generally readier availability of personal loans (especially house mortgages, with the incursion of the banks into this field and keener competition among the building societies) have almost certainly been important.

Mortgage finance *continues to exceed additions to the private housing stock*

The net flow of mortgage lending has grown very rapidly in recent years and exceeded £14 billion (at current prices) in each of 1982 and 1983—a far greater amount than the estimated

(1) Inflation-adjusted sectoral accounts are discussed in the article on page 231. The measures presented there include a further adjustment to provide for the maintenance of physical capital, that is, depreciation at replacement cost and stock appreciation.

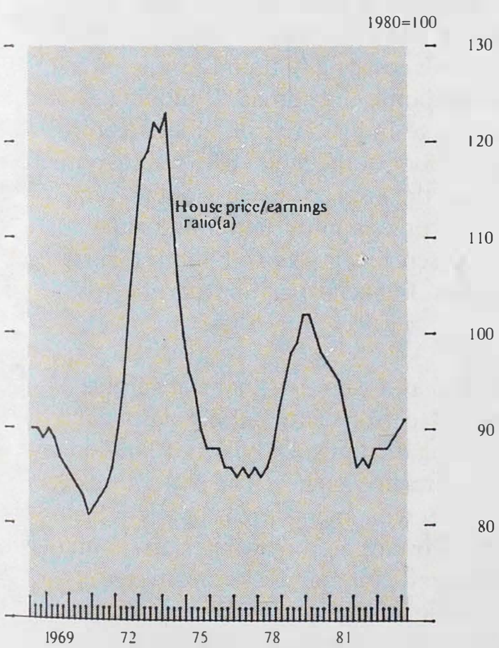
Net advances for house purchase to the personal sector

£ millions, 1980 prices (a)

	1979	1980	1981	1982	1983
Building societies	6,130	5,720	5,680	6,730	8,650
Banks	690	500	2,040	4,200	2,830
Other (b)	700	1,070	790	740	60
	7,520	7,290	8,510	11,670	11,540

(a) Nominal amounts divided by deflator for consumers' expenditure 1980=100.
(b) Mainly insurance companies and local authorities.

House prices *have risen faster than* **average earnings** *since early 1982.*



(a) Department of the Environment mix-adjusted index of house prices divided by average earnings.

value of increases in the privately-owned housing stock.[1] The difference, of over £6 billion in each of the two years, was available for consumer spending, to acquire financial assets, or to repay other forms of borrowing. The rate of 'equity withdrawal' from the housing market has, however, fallen since early 1983, though it may now be rising again.

The shares of banks and building societies in the provision of mortgage finance have changed markedly in recent years. In the 1970s, building societies supplied about 85% of advances, and the banks' share was small. The banks' share rose five-fold between 1980 and 1982, to no less than 36% of the total, mainly at the expense of building societies; it then fell to a quarter last year. The stock of mortgage loans outstanding is so large in relation to flows of new lending, however, that the proportion of total outstanding mortgages provided by the building societies at the end of last year had fallen only to 75%, compared with 82% five years earlier. Bank loans on mortgage increased from less than 5% of the total outstanding in 1978 to over 15% in 1983. Most of the rest—a rapidly declining proportion—was provided by insurance companies and local authorities.

House prices on average continue to rise faster than earnings; but there is little reason to suppose that the rate of increase has accelerated beyond the 10%–12% prevalent for much of 1983. The relative rise in house prices may have stimulated last year's strong revival of new building for the private sector.

The company sector *financial surplus is reduced as capital spending rises*

The financial surplus of industrial and commercial companies in the fourth quarter of 1983 was estimated at just under £1½ billion. Their income continued to grow, but more slowly, and was more than matched by increased appropriations and expenditure on fixed assets and restocking. In the context of the year as a whole, however, these fourth quarter movements were quite modest and the total financial surplus for 1983 was almost as large as the combined surpluses of the two previous years.

Industrial and commercial companies' profits, which had risen quite strongly in the third quarter of last year, grew less rapidly in the fourth. The real pre-tax rate of return on non-North Sea operations has shown a considerable recovery since 1981 and approached 7% in the fourth quarter, but is still quite low by the standards of the 1960s and early 1970s. Preliminary national income figures suggest that the growth in profits continued in the early months of 1984.

Company appropriations, which showed little movement earlier in the year, rose in the fourth quarter, mainly as a result of higher UK taxes and profits due abroad. Dividend payments were also higher in the quarter, but interest payments fell. Overall, companies' undistributed income was much as in the

(1) This comprises: the value of new houses built for the private sector; publicly-owned houses sold to the private sector (mostly council houses sold to sitting tenants); and improvements (but not spending on repairs and maintenance), with an allowance for demolitions. The rise in the prices of houses already in private hands is not included. Although a general rise in house prices will undoubtedly raise the demand for mortgage finance from new house buyers and people trading up, the proceeds remain within the private sector; for the sector as a whole, the increase in the price of houses already privately owned does not need financing.

Industrial and commercial companies' income, spending and financial transactions

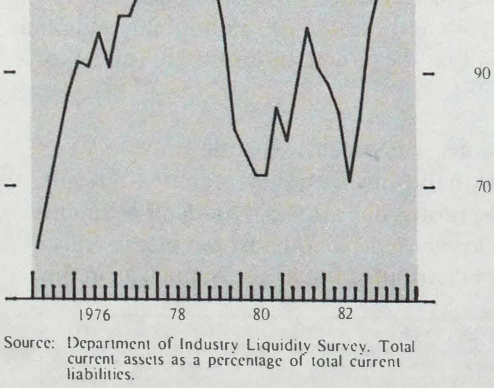
£ billions at quarterly rate; seasonally adjusted
Figures in italics are at 1980 prices

	1981	1982		1983		
	Year	H1	H2	H1	Q3	Q4
Income						
Gross trading profits: (a)						
North Sea operations	2.7	2.9	3.5	3.7	4.0	4.3
Other	5.0	5.5	5.9	6.6	7.3	7.6
Total income (b)	9.8	10.4	11.5	12.4	13.7	14.2
	8.9	*9.0*	*9.6*	*10.2*	*10.9*	*11.2*
Allocation of income (payments–)						
Dividends, interest, profits due abroad	–4.0	–4.5	–4.2	–4.4	–4.8	–5.2
UK taxes	–2.2	–2.5	–2.6	–3.1	–3.0	–3.3
Undistributed income	3.6	3.4	4.6	4.9	5.9	5.7
	3.3	*3.0*	*3.8*	*4.0*	*4.7*	*4.5*
Spending (–) on fixed assets and stocks	–2.8	–3.4	–2.8	–3.5	–3.5	–4.3
	–2.5	*–3.0*	*–2.3*	*–2.9*	*–2.8*	*–3.4*
Financial surplus (+)/deficit (–)	0.8	–0.1	1.8	1.4	2.4	1.4
	0.7	*–0.1*	*1.5*	*1.1*	*1.9*	*1.1*
Financial transactions (acquisition of assets+/ borrowing–)						
Trade investments etc	1.5	1.5	1.5	0.8	1.8	0.5
Liquid assets	1.1	0.4	1.2	0.6	1.4	3.9
Borrowing:						
From banks (c)	–1.4	–2.1	–1.3	0.3	–1.6	–0.9
Other	–0.8	–1.0	–0.6	–1.5	–1.5	–1.4
Balancing item	0.4	1.1	1.0	1.2	2.3	–0.7

(a) Net of stock appreciation.
(b) Including interest and other property income.
(c) Including Issue Department transactions in commercial bills.

Company liquidity *is at its strongest for some years.*

Seasonally adjusted Per cent



Source: Department of Industry Liquidity Survey. Total current assets as a percentage of total current liabilities.

third quarter. For the year as a whole, undistributed income (net of stock appreciation) amounted to approximately £21 billion, some £5 billion more than in 1982.

Capital spending, which had been rather subdued even in nominal terms in spite of the growth in company income, rose sharply in the fourth quarter. Expenditure on fixed capital moved ahead and quite a pronounced swing from destocking to stockbuilding took place. In the first quarter preliminary figures suggest a further increase in industrial fixed investment but a small decline in manufacturers' stocks, notably of raw materials, fuels and work in progress. The rise in fixed investment bears out earlier survey evidence, and, as noted earlier, recent surveys suggest that it will continue in the remainder of this year and into next.

The rise in investment spending reduced industrial and commercial companies' financial surplus from £2½ billion to a still substantial £1½ billion in the fourth quarter. They seem to have continued to borrow from banks and from other sources, and to have built up funds, especially liquid assets, on a considerable scale both at home and abroad. It should be noted, however, that there is a large and variable difference (shown as the balancing item at the foot of the table) between identified financial transactions and the financial balance of the company sector estimated from income, appropriation and capital accounts. In 1983, the discrepancy was £4 billion, making assessment of companies' financial position particularly difficult.

The figures show, in 1983 as a whole, a financial surplus of some £6½ billion (estimated from national accounts data) accompanied by borrowing of almost £8 billion, £2 billion of it from banks, partly in foreign currency. The pattern was very uneven during the year, net repayments to the banks in the first half being followed by substantial borrowing. Capital market borrowing by industrial and commercial companies was a record in 1983 (£2.3 billion). Their total borrowing was nonetheless at a rather lower rate than in 1982, and less was from banks. (In 1982 companies borrowed £6½ billion from banks alone). Identified acquisitions of financial assets by companies during 1983 amounted to £10½ billion, of which £6½ billion—twice as much as in 1982—was in liquid assets. Between 1982 and 1983, industrial and commercial companies switched from being net takers of funds from the banking system to net suppliers.

The figures for the company sector as a whole probably conceal a wide range of experience. Examination of a large number of company accounts suggests that there has been some widening of the dispersion of company financial positions in the current economic recovery. This may help explain the coincidence of large-scale company borrowing and accumulation of liquid assets. But altogether these developments suggest a general strengthening of corporate balance sheets.

Banking statistics indicate that the accumulation of liquid assets by companies may have moderated in the first quarter of this year while borrowing from banks (predominantly in the form of commercial bills subsequently bought by the Issue

Department) accelerated. The survey of over 260 large companies conducted by the Department of Trade and Industry nevertheless points to some improvement in liquidity in the first quarter (regaining the position of the third quarter of 1983). The liquidity ratio of the sample is at its highest level since 1978. Over the past year, the liquidity positions of both manufacturing and non-manufacturing companies have improved substantially.

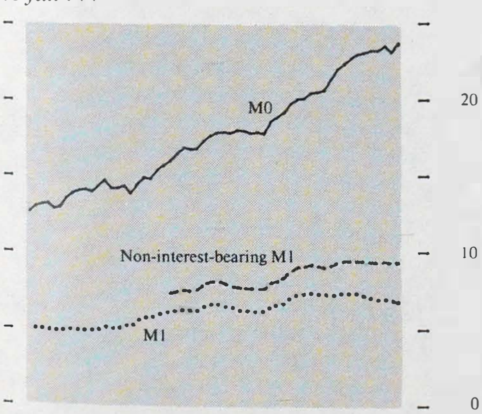
Bank lending and money

£ billions, 1980 prices(a)

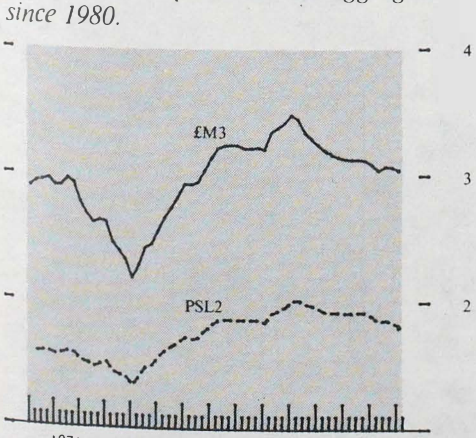
	1979	1980	1981	1982	1983
Bank lending in sterling					
To the private sector	+10.3	+10.0	+10.2	+14.7	+10.2
of which:					
Personal sector	*+ 3.9*	*+ 3.3*	*+ 5.6*	*+ 8.2*	*+ 6.8*
Industrial and commercial companies(b)	*+ 4.0*	*+ 5.1*	*+ 3.0*	*+ 4.8*	*+ 1.1*
Non-bank financial institutions	*+ 2.3*	*+ 1.6*	*+ 1.7*	*+ 1.7*	*+ 2.2*
To the public sector	+ 1.8	+ 2.4	+ 0.2	− 1.9	− 1.6
To overseas (net of overseas sterling deposits)	− 3.6	− 0.2	+ 0.6	− 0.3	− 1.0
Money					
Notes and coin held by the public	+ 0.9	+ 0.7	+ 0.5	+ 0.4	+ 0.6
£M3	+ 7.9	+10.9	+ 8.4	+ 6.7	+ 7.6

(a) Nominal amounts divided by the GDP deflator (1980=100).
(b) Includes Issue Department transactions in commercial bills.

Whereas the **velocity of circulation**[(a)] *of M0 has risen steeply, that of M1 has tended to fall . . .*



. . . as has that of the broader aggregates since 1980.



(a) Velocity is measured by GDP at current market prices (annual rate) divided by the monetary aggregate. Figures for the latest quarter are estimates. The scale is not the same in the two charts.

The monetary sector *has lent an increasing proportion of its funds to the personal sector.*

Financial developments in other sectors can in part be traced in the banking statistics.

Flows expressed at 1980 prices (by dividing nominal amounts by the GDP deflator) show strong but uneven growth in sterling bank lending to the personal sector since 1980. This possibly reflects the overall decline in the personal sector's financial surplus; indeed, the revival of the financial surplus during the course of last year was matched by an easing in the growth of such lending. The course of bank lending to industrial and commercial companies has been more erratic. It grew by a large amount in 1980 and again in 1982 (and during the latter part of last year following earlier repayment of bank debt).[1] Bank lending in sterling to other financial institutions grew very fast in real terms last year. Such lending does not correspond to changes in these institutions' combined financial surplus or deficit, which is very small, but rather to the scale of their operations as intermediaries, the nature of the assets acquired by them, and the relative cost of bank finance. As regards other sectors, the public sector has repaid debt to the banks overall since 1980 (borrowing from the non-bank private sector and from abroad having more than financed the PSBR). The overseas sector has borrowed sterling from the banks, but has usually added greater amounts to holdings of sterling bank deposits: despite the large surplus on the UK current account balance of payments each year since 1979, therefore, the overseas sector has been a net supplier of sterling funds to the banks.

The total of these items bears only a loose relationship to the banking sector component of sterling M3 (£M3), since adjustments for foreign currency items and the banks' non-deposit liabilities (mainly capital and reserves) are both large and variable. In addition, £M3 includes notes and coin held by the public, increases in which have tended to diminish in recent years.

The personal and company sectors have, since 1980, added to their holdings of bank deposits at a faster rate than the rise in money national income (and, presumably, faster than the value of their transactions, a magnitude not revealed by the national accounts).[2] The velocity of circulation of £M3 has accordingly fallen in recent years, after a long rise from a low point in 1974. The velocity of circulation of M0, by contrast, has risen persistently though not steadily, a development implicit in the tendency for the real value of notes and coin in circulation

(1) Allowing for the inclusion in bank lending of Issue Department holdings of commercial bills.
(2) The growth of nominal GDP has slowed to about 8% a year, an increasing proportion representing real growth and a falling proportion representing inflation.

to fall, and reflecting the growing habit of effecting transactions through banks and building societies.

In sharp contrast to M0, M1 (which includes chequing accounts with banks) has recently tended to grow faster than money national income, with the growth of its interest-bearing component especially pronounced. The monetary targets announced in the Budget are consistent with a continued rise in the velocity of M0, and approximately constant velocity of £M3.

Statistics for M2 (a measure of retail transactions balances, including some deposits with building societies) are available for too short a period for a clear trend in its velocity to be detected. The widest aggregate, PSL2, which includes most deposits with building societies, has behaved rather like £M3, its velocity of circulation rising between 1974 and 1980. Since then, PSL2 has been increasing more quickly than national income, so its velocity has fallen. The growth of PSL2 reflects the strength of mortgage finance and the role of building societies in its provision.