Economic commentary

The growth of output in the main industrial countries has continued to exceed expectations. Prospects for growth next year also seem rather brighter now, even though activity in the United States has slowed sharply. Recovery continues in many of the non-oil developing countries and has spread further among the smaller industrial countries.

In the United Kingdom, output and demand appear to have been growing more slowly this year than last, even if allowance is made for the coal strike. The non-oil deficit has continued to rise, while manufacturing production has shown more sluggish growth.

Although the rise in output seems to have slowed, there has been little change in the underlying rate of earnings growth and labour costs per unit of output appear to have increased quite sharply, especially in manufacturing. The effect of this on UK competitiveness has been offset so far by sterling's depreciation, but at the cost of additional pressure on the price paid by industry for raw materials and fuel. Despite these cost pressures, retail prices have continued to rise at about 4½%–5%.

As real rates of return recovered further, the company sector was in substantial financial surplus in the first half of the year and, more recently, companies have borrowed less from the banking system and rebuilt their bank deposits. In contrast, the personal sector increased the scale of its borrowing and added less to its bank and building society deposits in the third quarter.

Growth in **the major countries** *has been faster than expected . . .*

The seven largest industrial economies together grew in real terms at an annual rate of 5½% in the first half of 1984. Growth was most rapid in the United States, where real GNP was rising at over 8% per annum, and in Japan where it grew at over 6% per annum. In the major European economies expansion was much more modest, GNP growth averaging 2% per annum in the first half of the year. The recovery in the major countries has so far been heavily dependent on growth in consumer spending, although business fixed investment and stockbuilding have recently made a growing contribution. The increase in business fixed investment was particularly strong in the first half of 1984 in the United States (up 23% at an annual rate) the United Kingdom (22%) and Japan (11%); in France and Italy, however, there was little sign of any sizable investment upturn and in Germany, where output and confidence were seriously dented by industrial unrest, capital expenditure actually fell.

GNP[(a)] growth in the major economies
Percentage changes on previous period (annual rates); at constant prices; *seasonally adjusted*

	1982	1983 Year	1983 H2	1984 H1
Canada	-4.4	3.3	7.0	3.6
France	1.9	1.0	1.1	2.0
Germany	-1.1	1.4	2.7	1.7
Italy	-0.4	-1.2	1.9	2.5
Japan	3.3	3.1	5.0	6.3
United Kingdom(b)	2.1	3.2	4.2	2.3
United States	-1.9	3.3	7.2	8.3
Total of 7 countries	**-0.3**	**2.5**	**5.0**	**5.5**

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

. . . but recently in the **United States** *has slowed sharply*

The disparity between growth rates in the United States and Japan and in Europe appears to have diminished somewhat in recent months. The growth of total output in the United States is estimated to have slowed from an annual rate of 10% in the first quarter to 2% in the third. The growth of consumer spending appears to have been checked while earlier falls in interest rates (in real as well as in nominal terms), which had helped stimulate residential and business investment, were

Contributions to GNP[(a)] growth in the major economies

Changes in components (annual rates) as a percentage of GNP:(b) at constant prices: *seasonally adjusted*

	United States, Canada and Japan			Europe(c)		
	1982	1983	1984 H1	1982	1983	1984 H1
Private consumption	1.1	2.4	3.1	0.6	1.0	0.7
Private fixed investment	-0.7	0.9	2.5	-0.3	0.2	0.1
Public expenditure	0.3	0.1	0.5	0.2	0.3	0.3
Stockbuilding	-1.0	0.3	2.1	0.6	-0.1	0.9
Domestic demand	-0.4	3.6	8.1	1.2	1.3	2.0
Net trade	-0.2	-0.3	-0.5	-0.6	—	-0.4
GNP	**-0.7**	**3.3**	**7.5**	**0.6**	**1.3**	**1.7**

(a) Or GDP.
(b) Components may not add to totals, because of rounding.
(c) France, Germany, Italy and the United Kingdom.

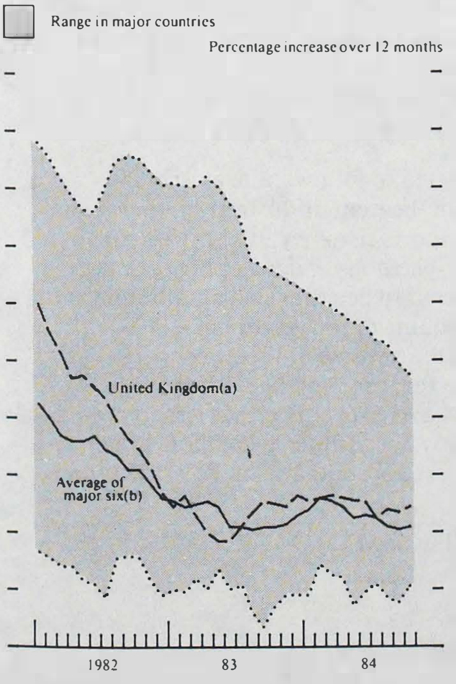
Labour costs in manufacturing in the major economies[(a)]

Percentage change on previous period at an annual rate

	1982	1983 Year	1983 H1	1983 H2	1984 H1
Hourly compensation	9.2	5.3	5.1	3.9	5.0
Productivity(b)	3.2	4.5	4.0	6.3	4.5
Actual unit labour costs	5.8	0.8	1.1	-2.3	0.5
of which:					
United States	*6.6*	*-0.7*	*0.1*	*-4.3*	*1.8*
Germany	*4.3*	*-1.3*	*-5.7*	*-0.7*	*0.6*
Japan	*-2.8*	*-1.1*	*0.3*	*-5.3*	*-4.7*
United Kingdom	*4.4*	*0.6*	*-0.2*	*1.1*	*6.8*
Normalised unit labour costs(c)	6.0	2.3	2.2	1.1	2.2

(a) Canada, France, Germany, Italy, Japan, United Kingdom and United States.
(b) Output per man-hour.
(c) Unit labour costs adjusted for differences between cyclical and trend growth of productivity (source: IMF).

Consumer price inflation in the major economies *shows little sign of any rise*



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

reversed in the first half of 1984; and net imports continued to meet a substantial proportion of domestic demand as the dollar rose and competitiveness deteriorated further. Since the summer, however, interest rates have fallen back, US banks' prime lending rates in late November reaching their lowest levels since March.

In the larger continental European countries, latest indications are that the still tentative recovery continues, and in some cases is strengthening, with consumer spending the principal motive force. GNP in France, Germany and Italy together is estimated to have grown by 2½% in the year to the third quarter of 1984. Business investment has remained fairly subdued and government policies have mostly precluded any short-term stimulus from the public sector. Activity in Germany, where industrial unrest contributed to a fall in GNP in the second quarter, is estimated to have recovered substantially in the third quarter, assisted by a large rise in exports. Underlying growth rates have been more modest in Italy and France but activity may have quickened in the summer.

Costs and prices *remain subdued . . .*

Differences in the extent of recovery have been reflected in labour market conditions. In the United States, the unemployment rate has fallen continuously, from an average of 10½% in the fourth quarter of 1982 to an estimated 7½% in the third quarter of this year. Industrial restructuring and demographic factors, as well as the slower growth of output, have contributed to a continuing rise in unemployment in France, Italy and the United Kingdom; in Germany the improvement around the turn of the year has since been reversed. Despite differences in the demand for labour, the growth of earnings has either moderated or remained stable in most countries. In the seven major countries together, average earnings and hourly compensation in manufacturing grew at around 5% per annum in the first half of 1984, much the same as in 1983. Productivity, however, has generally grown rapidly this year and the rise in unit labour costs in manufacturing is estimated to have been very modest, perhaps ½% at an annual rate in the first half of the year. In Japan unit labour costs continued to fall quite sharply.

Cost pressures from raw material inputs have also become less acute for the major industrial countries as a whole although, because of exchange rate movements, the United States and Japan have benefited more than the European economies. The oil market has remained weak, with demand sluggish, while the spot prices of a number of non-oil commodities have fallen this year. With labour and other input costs contained, there has been little sign of any rise in price inflation; retail prices on average in the main industrial countries have been rising more slowly since the turn of the year, the rate of inflation falling most notably in those countries where it is highest.

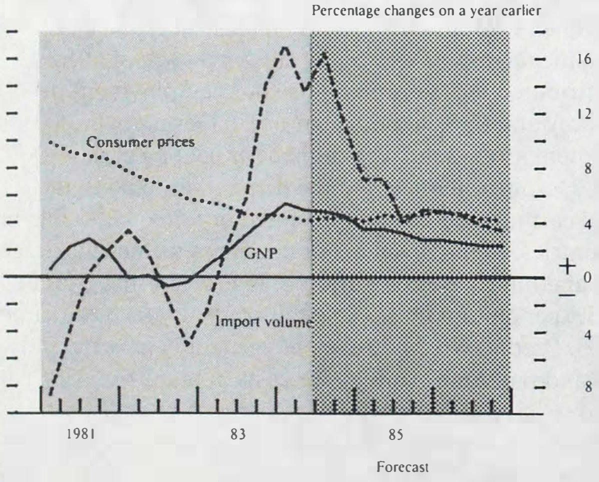
. . . and world trade *grows*

The strong recovery in the United States and Japan, and even the more modest growth in the other major industrial countries, has provided a considerable stimulus to world trade and to activity in the rest of the world. The total volume of

World economic prospects—latest Bank forecasts

The outlook for the world economy is in general rather brighter than it appeared earlier in the year. In the seven major industrial countries, domestic demand seems likely to grow by nearly 5½% this year and by a further 3½% next year. In the United States, domestic demand is expected to slow from 10½% at an annual rate in the first half of 1984 to 3% in the second half of 1985. Growth in the major European countries is expected to remain slower than in the United States next year but with less likelihood of a downturn, domestic demand increasing by 2%–2½%. The differences in output performance will be even less marked than this, as the growing trade deficit of the United States holds back growth of US output relative to domestic demand, and stimulates output in the other major countries. A more even and pervasive recovery in world trade should benefit further the smaller industrial countries and a number of developing countries (especially those whose trade is more closely linked to Europe than to North America), but the oil exporting countries may suffer from weak growth in energy demand and falling real oil prices.

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



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

In the United States, real interest rates remain higher than at the start of the recovery and a less expansionary fiscal policy is now envisaged. The growth of expenditure on fixed investment, stockbuilding and personal consumption is likely to moderate. In Japan and the continental European economies, personal consumption may grow more rapidly in 1985 and 1986, as real personal disposable incomes rise faster and recorded saving ratios fall further (especially in France and Italy, where inflation may continue to slow). Business investment is also expected to remain strong throughout in Japan but to be subdued in continental Europe.

The unemployment rate in the major countries as a whole is expected to average around 7¾% this year compared with 8½% in 1983, but the fall will be entirely

Demand and output in the seven major economies[a]

Percentage changes

	1982	1983	Forecasts 1984	1985	1986
Domestic demand	**0.1**	**2.7**	**5.4**	**3.4**	**2.5**
of which:					
Private consumption	1.5	2.9	3.4	3.4	2.7
Private fixed investment	-3.4	3.4	9.5	5.4	3.9
Public expenditure	1.6	1.0	2.2	2.4	1.6
Stockbuilding(b)	-0.4	0.2	1.1	-0.1	-0.3
Net exports (+)/imports (–)(b)	-0.3	-0.2	-0.5	-0.2	-0.1
GNP(c)	-0.3	2.5	4.9	3.2	2.4

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

in North America, where some further progress is likely in 1985. In Europe and Japan, no significant improvement is expected in the next two years. In view of this, any upturn in wage inflation seems likely to be modest. Wage inflation could accelerate in the United States (from 3½% in 1984 to perhaps 5% per annum in 1985 and 1986) as a lagged response to tighter labour market conditions. In France and Italy, a further reduction in the rate of earnings growth is expected as inflation continues to subside.

In the major industrial countries as a whole, earnings are expected to rise at an underlying rate of around 5½% in both 1985 and 1986. With productivity rising by 3% this year but slowing in 1985–86, unit labour costs (in local currencies) are expected to grow by only 2½% this year and by some 4% per annum in 1985–86. Other costs are also likely to be subdued as commodity prices remain weak. Even though further growth of company profits is expected in most major countries, consumer price inflation seems likely to continue to average around 4½% per annum, with some further falls in countries where inflation is still relatively high. Except in the United States and the United Kingdom, however, the recent and prospective growth of profits represents only a partial recovery from the previous substantial deterioration and is likely to provide only a limited stimulus to business investment.

World trade is expected to follow quite closely the pattern of activity in the main industrial countries, the volume of world imports rising by 9¼% in 1984 and a further 5% in 1985. The non-oil developing countries in general are expected to benefit substantially, and the smaller industrial countries to a lesser but still welcome extent, as the volume of their exports grows by 14% in aggregate this year and by a further 7½% in 1985. UK markets have grown by rather less than world trade, and this may well continue, even though their slowdown may be less abrupt than that of world trade.

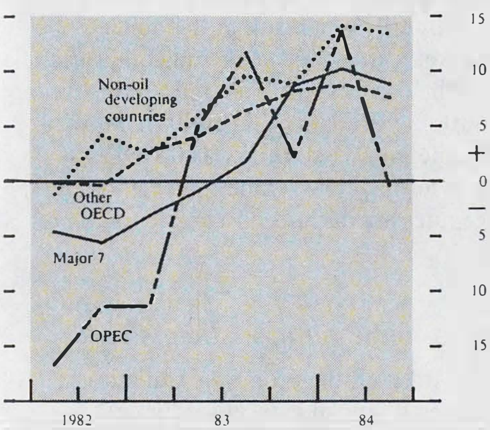
World trade and UK markets

Percentage changes

	1982	1983	Forecasts 1984	1985	1986
World trade	-0.4	2.1	9.2	4.9	4.1
UK markets	—	-0.1	6.1	3.9	3.8

Export volumes *are generally rising strongly*

Percentage change on previous year



Changes in effective exchange rates[(a)] and short-term interest rates since January 1983

Percentages

	Level in Jan. 1983	Total change(b) from January 1983 to: 1984 Jan.	July	Oct.	Nov.
Canada					
ERI	*89.5*	+ 3.2	− 1.5	+ 0.6	+ 0.2
Interest rate	*9.9*	− 0.1	+ 3.0	+ 2.1	+ 1.2
France					
ERI	*74.3*	−12.0	−11.6	−13.9	−13.2
Interest rate	*12.7*	− 0.4	− 1.1	− 1.9	− 2.2
Germany					
ERI	*128.4*	− 4.0	− 3.1	− 5.7	− 4.9
Interest rate	*5.8*	+ 0.3	+ 0.3	+ 0.3	+ 0.2
Italy					
ERI	*53.4*	− 9.2	− 9.6	−12.5	−12.4
Interest rate	*19.1*	− 1.0	− 2.3	− 1.6	− 1.6
Japan					
ERI	*145.9*	+ 8.0	+5.4	+ 7.1	+ 7.5
Interest rate	*6.5*	− 0.1	−0.2	− 0.2	− 0.2
United Kingdom					
ERI	*81.9*	—	− 4.3	− 7.7	− 7.6
Interest rate	*11.2*	− 1.7	− 0.3	− 0.6	− 1.3
United States					
ERI	*118.4*	+11.1	+15.2	+20.1	+18.1
Interest rate	*8.4*	+ 1.1	+ 3.2	+ 2.0	+ 0.7

(a) Exchange rate index (ERI) 1975 = 100.
(b) Percentage changes in exchange rate index and percentage point differences in domestic three-month interest rates since January 1983.

imports to the seven largest industrial countries grew by more than 17% per annum, while the volume of world trade as a whole rose by almost 11% per annum, in the first half of the year. In the United States, rapid growth of demand and deteriorating competitiveness as the dollar appreciated, led to a 33% per annum surge in import volume which accounted for almost half the rise in world trade. The US deficit on current account is now expected to more than double in 1984 to around $100 billion. In the other major economies the rise in import volumes was more modest, but still much faster than the growth of domestic demand. Their exports were also rising strongly and the current accounts of Canada and the major European countries were fairly close to balance in the first half of the year. Low inflation continued to sustain Japanese competitiveness despite the rise in the yen's effective exchange rate; the buoyancy of demand in Japan's markets in south east Asia and North America, and terms of trade gains, contributed to a sharp rise in Japan's current account surplus to record levels.

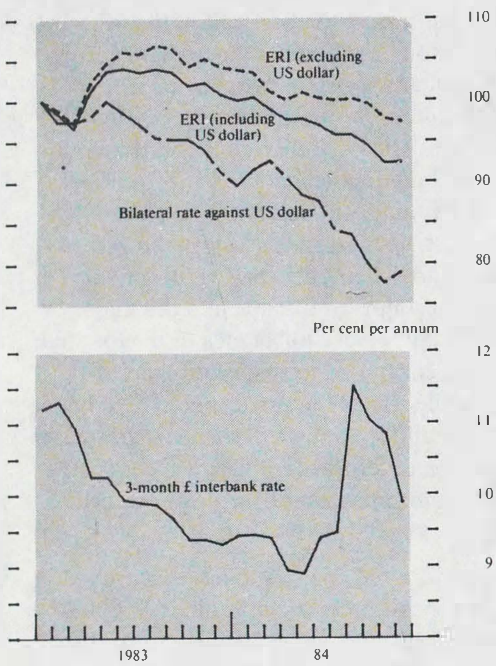
The strong growth in world trade appears to have improved considerably the external position of the non-oil developing countries as a group (see page 465). It has had less impact so far on the OPEC and smaller industrial countries. Sluggish growth in world energy consumption has meant little overall increase in the volume of OPEC countries' exports; the substantial reduction in their imports has continued and seems unlikely to be reversed next year. In the smaller industrial countries, domestic demand has been constrained by tight fiscal and monetary policies, and import volume rose by only 1¼% in 1983. More recently, however, growth of activity in these countries has been largely led by exports which, in the first half of this year, increased in volume at 9½% per annum. With import volumes rising by 6% per annum in the same period, the current account position of the smaller industrial countries moved from deficit to small surplus. (World current account developments are discussed further on page 464.)

The weak demand for imports among the smaller industrial and OPEC countries (as well as in a number of non-oil developing countries) largely accounts for the generally slower growth of UK export markets since the end of 1982 than of world trade. This disparity continued in the first half of 1984, when UK markets grew by only 7% per annum but world trade increased by almost 11% per annum. The overall growth of UK markets seems likely to be rather slower next year, even though demand is expected to strengthen in the major European and a number of the smaller OECD countries, but world trade growth is likely to slow down much more abruptly.

Interest rates *fall . . .*

Exchange rate developments have reflected fluctuating market perceptions of the US dollar. Domestic pressures, including the strength of demand and the size of the budget deficit, took US 3-month CD rates above 11½% in July (their highest level for two years), adding further to the strength of the dollar. Few of the other major countries responded by raising their interest rates on this occasion, accepting exchange rate depreciation (essentially against the US dollar) instead. Since the summer, however, interest rates in the United States and in a number of other countries have generally been moving downwards while,

Sterling exchange rates and interest rates[(a)]



(a) Average of daily rates.

Growth of GDP and industrial production

1980 = 100, seasonally adjusted
Percentage change on previous quarter in italics

	1983	1984		
	Q4	Q1	Q2	Q3
Recorded GDP(O)	105.0	104.8	104.8	105.0
	+1.1	*-0.2*	—	*+0.2*
'Underlying' GDP(O)(a)	105.0	105.3	106.1	106.3
	+1.1	*+0.3*	*+0.8*	*+0.2*
Recorded industrial production	103.5	102.8	100.7	100.5
	+1.5	*-0.7*	*-2.0*	*-0.2*
'Underlying' industrial production(a)	103.9	104.3	104.2	104.0
	+1.5	*+0.8*	*-0.1*	*-0.2*

(a) Recorded index adjusted for official estimates of coal strike effects.

Output by sector

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

	GDP (O)(a)	Production and construction		Services
		Total	of which: Manufacturing	
Weights in GDP (O):	*1.000*	*424*	*266*	*554*
1979	+ 3.1	+ 3.4	− 0.3	+ 3.1
1980	− 2.9	− 6.5	− 8.5	− 0.5
1981	− 1.7	− 4.6	− 6.3	+ 0.3
1982	+ 2.0	+ 1.8	—	+ 1.9
1983	+ 2.9	+ 3.5	+ 2.3	+ 3.0
1983 H2	+ 4.9	+ 6.2	+ 5.1	+ 4.1
1984 H1	+ 0.7	− 2.1	+ 0.1	+ 2.3

(a) Includes agriculture, forestry and fishing as well as production, construction and services.

for a time, the dollar continued to appreciate. During the course of October, the dollar's rise was checked. And in November its exchange rate index was on average 2% down, as US interest rates fell sharply amid signs of a distinct slowing of economic growth.

. . . *but* **sterling** *remains unsettled*

In the United Kingdom (as in Canada) interest rates rose in July, and banks' base lending rates climbed from $9\frac{1}{4}$% to 12%. Since then UK market interest rates have gradually declined and base rates have fallen to $9\frac{1}{2}$%–$9\frac{3}{4}$%, largely reversing the earlier rise. Sterling's exchange rate index continued to fall during August and September, primarily as a result of the dollar's strength. In October, market fears about weakening oil prices and an intensification of the coal dispute were reflected in a more general depreciation. With the strength of the dollar and of oil prices fluctuating during the month, sterling was on average slightly higher in effective terms in November. (Developments in interest and exchange rates are discussed in greater detail on pages 455 and 469.)

Output and demand at home *remain sluggish . . .*

The coal strike continued to cloud the economic statistics as well as periodically affecting financial market sentiment. Output of the economy as a whole appears to have been flat so far this year. If allowance is made for the loss of coal output and other direct effects of the dispute, the output measure of GDP was growing by about $1\frac{3}{4}$% per annum between the fourth quarter of 1983 and the third quarter of 1984. The service industries, which helped to sustain the economy in recession and in the subsequent recovery, appear to have been responsible for much of this growth. Accounting for about 55% of GDP(O), public and private sector services together seem to have been rising by about $2\frac{1}{2}$% per annum during the first three quarters of the year. Output of the production industries, however, fell back after the turn of the year, even when allowance is made for the effects of the coal mining dispute. Production of oil and natural gas was reduced during the spring and summer, when North Sea maintenance work was particularly extensive. The index of manufacturing output, which had fallen back in the first quarter, has since been rising, albeit at a much slower rate than during 1983: output of the electrical and instrument engineering industries has been growing very rapidly this year, chemicals and paper and printing output has risen fairly steadily, but production in most other manufacturing sectors has shown little overall growth or has fallen.

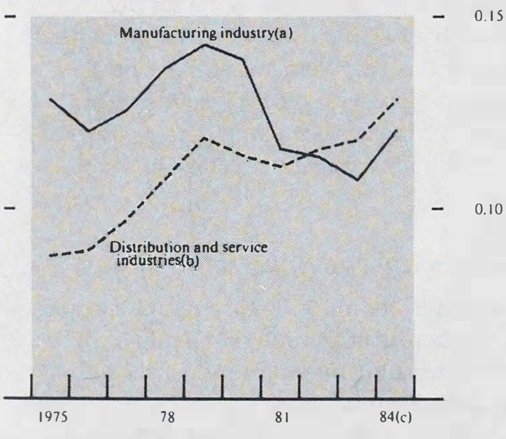
The expenditure measure of GDP also points to some slowing down of activity in the first half of the year but it is difficult to quantify the effects of the coal strike on the individual components of demand. Total fixed investment, which had increased at an annual rate of almost 6% from the beginning of 1981 to the end of 1982, grew at over twice that rate between the second half of last year and the first half of 1984, with total private sector investment rising at an annual rate of 18%. Growth of fixed investment, however, was insufficient to offset the contractionary impact on GDP of destocking, and a deterioration in the net trade position in the second quarter.

Contributions to the change in GDP

Changes in components as a percentage of GDP

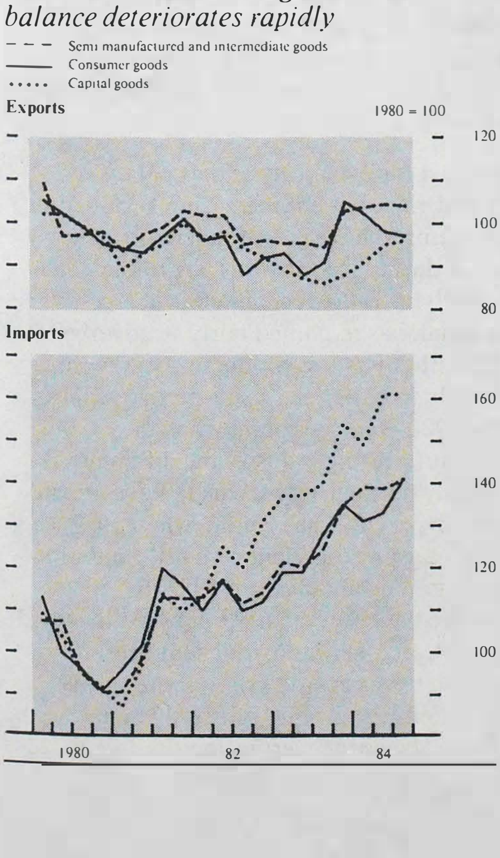
	1982	1983			1984	
		Year	Q3	Q4	Q1	Q2
Consumer spending	0.7	2.9	1.3	0.2	−0.4	0.6
Government consumption	0.2	0.6	−0.1	0.3	−0.1	0.1
Fixed investment	1.3	0.9	0.2	1.0	1.3	−0.6
Stockbuilding	0.8	0.7	0.7	−0.2	−0.9	−0.1
Exports	0.3	0.3	−0.3	1.6	0.7	−0.3
Total final expenditure	**3.3**	**5.5**	**1.8**	**3.0**	**0.6**	**−0.3**
Imports	−1.1	−1.6	−0.1	−1.5	0.1	−1.0
Factor cost adjustment	−0.7	−0.4	0.1	0.1	0.1	−0.1
GDP(E)	**1.4**	**3.4**	**1.8**	**1.5**	**0.8**	**−1.4**
Memo item						
GDP(O)	*2.0*	*2.9*	*1.8*	*1.1*	*−0.2*	—

Investment/output ratios *in manufacturing are still lower than in previous recoveries*



(a) Including leased assets.
(b) Output defined as GDP (O) *less* output of manufacturing, North Sea oil, public corporations and some government expenditure.
(c) 1984 based on average of first three quarters.

Trade in manufactured goods—*the balance deteriorates rapidly*



Consumer spending, which has made the principal contribution to the recovery since mid-1981, has been growing more slowly this year, although retail sales have been fairly buoyant, rising by 4% in the year to November. There is some evidence, however, that retail sales in mining areas have been depressed.

Manufacturing investment has risen further in the third quarter, albeit less rapidly than at the turn of the year; although some 17% higher than at its trough in the first quarter of 1983, investment is still smaller in proportion to output than in previous periods of recovery. Fixed investment by the construction, distribution and financial industries fell back a little during the second and third quarters after the exceptionally rapid growth recorded in the first quarter but, taking the first three quarters together, it was still 13% higher than in the same period last year, and higher in volume and in relation to output than ever before. The Department of Trade and Industry's recent survey of investment intentions suggests that the volume of manufacturing investment will be some 12% higher this year than last but will rise more slowly, by perhaps 7%, next year and may fall in 1986; the growth of investment by the construction, distribution and selected service industries is expected to be about 10% this year and 9% in 1985, with a smaller increase in 1986. Stocks were run down rapidly in the wholesaling, energy and water supply industries, and in manufacturing to a lesser extent, during the first half of 1984. In the third quarter, however, there was little further change in manufacturers and distributors' stock levels. Stocks have fallen back in relation to output over the last two years, close to the levels seen before stock relief was introduced in 1975.

. . . and the deficit on **non-oil trade** *increases*

Net trade was an important component of growth in the UK economy around the turn of the year. The trade balance has since deteriorated. The oil surplus fell sharply in the second quarter as coal output dropped and more oil was used for electricity generation, as maintenance work reduced North Sea output and as tensions in the Gulf led to precautionary stockbuilding. It recovered markedly in the third quarter but was still almost 25% less than in the first quarter. The deficit on non-oil trade has continued to grow, in value and volume terms, exerting a contractionary influence on domestic output. In the first ten months of this year the non-oil deficit was already £3 billion greater by value than in 1983 as a whole.

The deficit in manufacturing trade grew particularly rapidly, and in the ten months to October was one and a half times as large as in the whole of 1983. Although exports of intermediate and capital goods have risen since the middle of 1983, imports have grown by more; the trading position in cars and other consumer goods has also deteriorated considerably. The volume of manufactured goods exported showed little overall growth between the first and third quarters of 1984 while imports were rising by 7½% per annum. This unexpected deterioration, which took place at a time when UK export markets were growing quite strongly and manufacturers' competitiveness was broadly sustained by sterling's depreciation, may go some way towards explaining the subdued performance of manufacturing output so far this year. Although there was a sharp rise in the volume

Balance of payments: current account

£ billions: *seasonally adjusted*

	1981	1982	1983 Year	1984 H1	1984 Q3
Visible trade	+3.4	+2.1	−1.1	−1.5	−1.7
of which:					
Oil	*+3.1*	*+4.6*	*+6.9*	*+3.9*	*+1.7*
Non-oil	*+0.2*	*−2.5*	*−8.0*	*−5.3*	*−3.4*
Invisibles	+3.6	+2.8	+3.4	+1.5	+1.1
of which:					
Services	*+4.5*	*+3.7*	*+3.9*	*+2.1*	*+1.3*
IPD	*+1.1*	*+1.2*	*+1.7*	*+0.7*	*+0.5*
Transfers	*−1.9*	*−2.0*	*−2.2*	*−1.3*	*−0.7*
Current balance	**+6.9**	**+4.9**	**+2.3**	**—**	**−0.5**

Figures may not sum to totals because of rounding.

Changes in employment in Great Britain

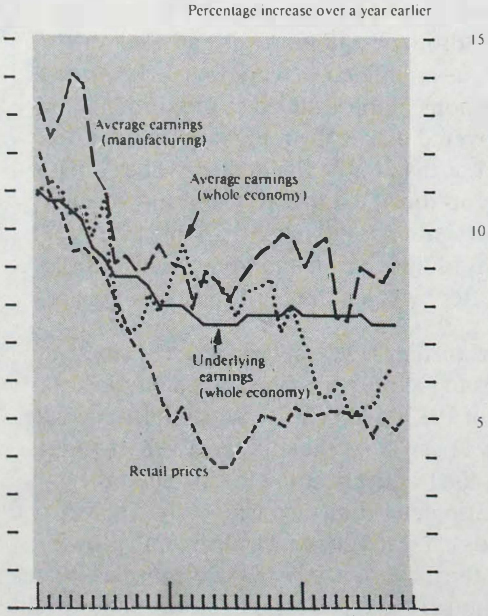
Thousands: *seasonally adjusted*

	Employees				Total employed labour force(a)
	Full-time	Women working part-time	Manu-facturing	Services	
Level at December 1981	**17,270**	**3,836**	**5,949**	**13,068**	**23,531**
Change in 6 months to:					
1982 June	− 168	+ 35	− 137	+ 30	− 106
Dec.	− 244	+ 19	− 162	− 44	− 192
1983 June	− 136	+ 105	− 102	+ 123	+ 5
Dec.	+ 30	+ 109	− 40	+ 185	+ 178
1984 June	− 21	+ 55	− 19	+ 97	+ 69

(a) Employees in manufacturing and services plus those in agriculture, construction and energy and water supply, plus self-employed and HM forces.

Average earnings *are still rising notably faster than* prices

Percentage increase over a year earlier



of non-oil exports, especially of manufactured goods, in October non-oil import volumes rose by even more (perhaps in part as importers took steps to avoid congestion at the ports in November when payment procedures for VAT changed).

Despite the partial recovery in the oil surplus to £1¾ billion and a surplus of over £1 billion on invisible trade, the current account is estimated to have moved further into deficit in the third quarter. Were it not for the coal dispute, however, the current account would probably have been in modest surplus.

Employment *increases more slowly . . .*

Employment rose less strongly in the first half of 1984 than in the second half of 1983. This could be a further sign that growth in the economy may have slowed or a consequence of a continuing strong increase in productivity not apparent from the official output statistics. Employment in the service industries (and principally of women working part time) has been growing less rapidly this year than last and has been largely offset by falling employment in other sectors, though employment in manufacturing has been falling more slowly. Unemployment has continued to rise, on average by some 14,000 a month so far this year.

. . . but cost pressures *appear to be rising*

Despite apparently slower economic growth, average earnings in the economy as a whole rose at an underlying rate of 7½% in the year to September (after adjustment for industrial action and delays in settlements). The annual pay round which ended in the summer was the first for four years in which wage settlements failed to decline significantly, averaging about 5¾% across the economy as a whole. In manufacturing industry, average earnings rose by 8¾%, some 3% more than the average rate of wage settlements. Part of this 3% earnings drift reflects increases in overtime, concentrated in the latter part of 1983; the remainder is attributable to payment-by-results, shift premia and other productivity-related pay schemes, and to changes in the composition of the work-force. As retail prices rose over the same period by 5%, real earnings of those in work have thus continued to increase.

With total output (adjusted for the effects of the coal dispute) rising by just over 2% and employment increasing, productivity in the whole economy seems to have grown much more slowly during the past year than during the previous pay round when it rose by 3½%. The underlying rate of increase in average earnings, on the other hand, has remained fairly steady over the past two years and, with much less productivity growth, unit wage costs seem likely to have been rising almost half as fast again as during the 1982–83 wage round when they increased by 4¼%. In manufacturing industry the difference is even more marked. Hourly productivity seems to have grown very much less than in the previous pay round, whereas growth of average hourly earnings accelerated a little and unit labour costs, which had risen by about 1% in 1982–83, are estimated to have increased by more than 6% between the third quarters of 1983 and 1984. In other industrial countries earnings in manufacturing have generally risen more slowly than in the United Kingdom, but productivity growth has been maintained, so that, in local currency terms, the rise in unit

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	+6	+6
Average hourly earnings	+25	+12½	+9¼	+7¾	+8¼
Output per person-hour	− 1¼	+ 6½	+3½	+6½	+2
Unit wage costs(c)	+26½	+ 5¾	+5½	+1¼	+6¼
Unit labour costs(d)	+21¾	+ 6	+3¾	+1	+6¼
Background factors:					
Output	− 9¾	− 3	−1	+3¼	+1½
Employment	− 6¼	− 9	−5	−3¾	− ¾
Average weekly hours per operative(e)	− 3½	+ ½	+ ¾	+1¼	+ ½

(a) Third quarter on third quarter—approximately the timing of the pay round.

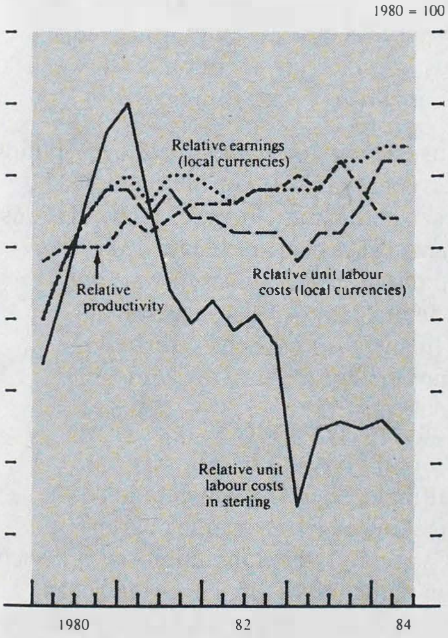
(b) As monitored by the CBI.

(c) Average hourly earnings less output per person-hour.

(d) Unit labour costs include effects of national insurance on unit wage costs.

(e) Manual workers only.

The fall in sterling has offset the rise in **relative costs in manufacturing industry**[a]



(a) Ratio of UK costs to average in 13 overseas countries.

labour costs over the past year has been much less. The fall in sterling, however, has so far sheltered UK manufacturing industry from a deterioration of labour cost competitiveness in common currency terms.

Labour costs in the economy as a whole, and in manufacturing in particular, appear on the basis of the output statistics to have been adding noticeably to the cost pressures on industry this year (although the removal of the final 1% of the national insurance surcharge in October will have provided some offset). World spot prices of commodities have weakened this year but sterling's depreciation has contributed to a 9% rise in UK manufacturers' input prices for raw materials and fuel over the twelve months to November. Excluding inputs to the food, drink and tobacco industries, the rise was over 12%.

Manufacturers' output prices have been fairly steadily 6¼% higher than a year earlier since the winter, perhaps 1% less than the rise in total input costs (taking labour, materials and fuel costs together) and 1% or so more than the rate at which private sector retail prices have been rising. In 1982 and 1983 manufacturers had increased their profit margins and retailers had benefited from a rapid rise in sales. Some of the rise in costs this year may have been absorbed in profit margins in expectation of some recovery in the exchange rate which would reduce the sterling cost of inputs from abroad. At the same time, however, manufacturers took advantage of sterling's depreciation to increase their profit margins on export sales.

The performance of retail prices, in spite of the apparent pressures on costs, has so far been encouraging. Even though there was a substantial increase in the housing cost component when mortgage rates were raised, on average by some 2¾%, at the end of the summer, the annual rate of retail price inflation has remained at or below 5% in each month from July to October, whereas in the first half of the year it was running slightly above 5%. If the effect of higher mortgage rates (which have since fallen) were disregarded, retail prices in the three months to October would have been little more than 4% higher than a year earlier. The continuing stability of retail price inflation has been helped by the modest increase in nationalised industries' prices over the past year, and by good harvests which have held down prices of seasonal foods.

Company finances and investment *are fairly buoyant although profits growth is checked.*

Gross trading profits[1] of industrial and commercial companies (ICCs), grew strongly in the first quarter, but fell back in the second. In the first half of the year, profits were some 22% higher in nominal terms than in the corresponding period of 1983. For non-North Sea companies, real pre-tax profitability averaged 7% in the first half of the year[2]—a return to the levels of the late 1970s but still some way short of rates typical before 1973.

While profits have risen strongly overall, total appropriations from company income have risen only modestly during the

(1) Net of stock appreciation.

(2) Since publication of the 'Company profitability and finance' article in the September *Bulletin*, estimated real rates of return have been revised downwards for recent periods as a result of new capital stock estimates and revised quarterly profits figures.

past year, profits due abroad and UK taxes showing the greater increase, with oil company transactions predominant. In contrast, interest payments have remained more or less flat, the recovery of profits leading to a progressive reduction in income gearing (the proportion of disposable income required to meet interest payments) since the end of 1981. In the second quarter, income gearing rose slightly as profits dipped and in the third quarter it may have risen a little more when short-term interest rates rose.

Industrial and commercial companies' income, spending and financial transactions

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

	1981	1982	1983		1984
			Year	H2	H1
Income					
Gross trading profits(a):	7.5	8.9	10.8	11.5	12.5
of which:					
Non-North Sea	4.8	5.7	6.9	7.3	8.1
Total income(b)	9.7	11.1	13.3	14.1	15.1
	8.8	*9.9*	*10.7*	*11.2*	*11.8*
Allocation of income *(payments–)*					
Dividends, interest, profits due abroad	–3.8	–4.1	–4.4	–4.5	–4.8
UK taxes	–2.2	–2.6	–3.1	–3.3	–3.6
Undistributed income	3.7	4.4	5.8	6.3	6.8
	3.3	*3.9*	*4.7*	*5.0*	*5.3*
Spending (–) on fixed assets and stocks	–3.1	–3.4	–3.9	–4.2	–4.3
	–2.8	*–3.0*	*–3.1*	*–3.4*	*–3.3*
Financial surplus (+)/ deficit (–)	**0.8**	**1.1**	**2.0**	**2.2**	**2.7**
	0.7	*1.0*	*1.6*	*1.7*	*2.2*
Balancing item	–0.4	–1.1	–0.5	0.2	–3.1
Financial transactions(c)	**–0.4**	**—**	**–1.5**	**–2.4**	**0.4**
of which:					
UK company securities	–0.3	–0.3	–0.4	–0.3	–0.8
Net investment abroad(d)	–0.8	–0.4	–0.2	–0.1	–2.7
Liquid assets	–1.2	–0.8	–1.6	–2.6	0.7
Other financial assets	–0.3	–0.4	–0.5	–0.7	0.2
Trade credit etc(e)	0.1	–0.4	–0.1	–0.7	0.7
Capital issues	0.4	0.3	0.5	0.6	0.4
Bank borrowing(f)	1.4	1.7	0.4	1.1	1.8
Other loans, mortgages	0.1	0.2	0.2	0.2	0.2

(a) Net of stock appreciation.
(b) Including interest, other property income and income from abroad.
(c) Inflow of funds (+), outflow (–).
(d) Investment overseas and overseas investment in the United Kingdom.
(e) Accruals adjustment, net unremitted profits and net trade credit.
(f) Including Issue Department holdings of commercial bills.

The rise in profitability from the very low level reached in the recession is thought to have contributed to the buoyant investment expenditure in the first half of the year, providing internal funds and perhaps highlighting the potential returns on new capital projects. It is notable, however, that a much greater proportion of CBI survey respondents claim to be investing to increase efficiency than to expand capacity. Destocking was substantial in the first half of the year but in the third quarter manufacturers' and distributors' stocks were virtually unchanged. CBI surveys indicate still further scope to reduce stock/output ratios, to which the abolition of stock relief, announced in the Budget, might give added impetus.

The large financial surplus of companies amounted to £5½ billion in the first half of the year, compared with £8 billion in 1983 as a whole. The estimates of companies' income, appropriations and capital expenditure are always difficult to reconcile with their recorded financial transactions. Whereas income and appropriations data for the first half of 1984 suggest that companies were in large financial *surplus*, the statistics of financial transactions point to net *borrowing* by companies.

ICCs' financial transactions during the second quarter were dominated by the Shell Group's buy-out of minority shareholdings in its US affiliate, Shell Oil, which totalled \$5.2 billion (most of this taking place during the quarter). Within the aggregate ICCs account, the transaction was reflected principally in a £2½ billion reduction of foreign currency bank deposits which had been built up in the second half of 1983. The counterpart to this transaction appears in the summary statistics as net investment abroad, which in total was sharply higher. Following a surge in the first quarter, ICCs' bank borrowing slowed to a more moderate £1 billion in the second. Ordinary share issues revived a little, to £0.4 billion, in the second quarter but fell back again to £¼ billion in the third.

Company liquidity, as measured by the Department of Trade and Industry's surveys of some 260 companies, fell back appreciably during the first half of the year but, despite a further fall in the liquidity of manufacturing companies (perhaps reflecting the further rise in capital expenditure), showed little further change in the third quarter. In total, ICCs reverted to their 1983 position as net suppliers of funds to the banks, borrowing a further £1¼ billion but increasing their deposits by over £1¾ billion.

Real incomes fall but **personal sector** *consumption and capital spending rise*

Real personal disposable income (RPDI) fell back during the first two quarters of the year and on average was no higher than in the second half of 1983. As a result of the coal strike and

Personal sector income, saving and finance

£ billions: seasonally adjusted at annual rate; 1980 prices(a)

	1981	1982	1983		1984	
			Year	H2	H1	Q3(b)
Personal disposable income	**158.1**	**158.5**	**161.6**	**163.4**	**163.4**	..
less Consumers' expenditure	136.7	138.1	144.0	145.8	146.1	146.4
Saving	21.4	20.4	17.6	17.6	17.3	..
less Capital expenditure	9.0	10.4	11.3	11.4	11.6	..
Financial surplus (+)/deficit (–)	**12.4**	**10.0**	**6.3**	**6.2**	**5.7**	..
Acquisition of financial assets (+)	26.4	26.1	25.5	25.3	27.7	..
of which:						
Bank deposits	*3.6*	*3.2*	*2.3*	*– 0.8*	*2.5*	*1.0*
Building society deposits	*6.4*	*8.5*	*8.3*	*9.8*	*10.4*	*8.1*
Total borrowing (–)	– 13.0	– 15.9	– 15.9	– 15.4	– 16.1	..
of which:						
For house purchase	*– 8.5*	*– 11.8*	*– 11.4*	*– 10.9*	*– 12.4*	*– 12.5*
Bank borrowing(c)	*– 3.6*	*– 4.1*	*– 3.9*	*– 3.8*	*– 3.1*	*– 4.1*
Balancing item	– 1.0	– 0.2	– 3.3	– 3.7	– 5.9	..

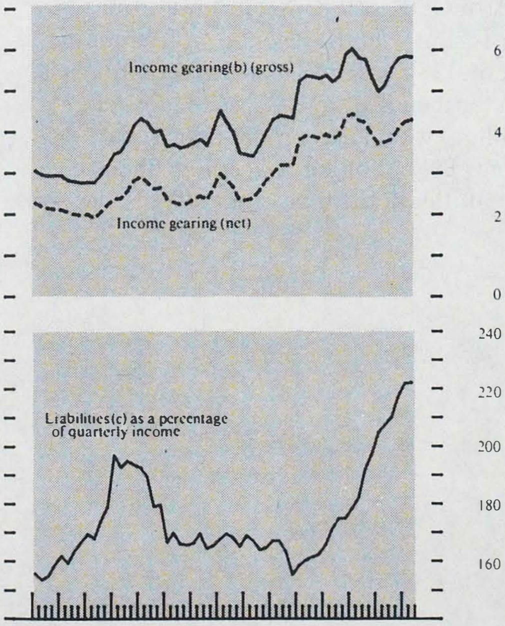
.. not available.

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

(b) Partly estimated.

(c) Other than for house purchase.

Household sector(a) debt ***is historically high***



(a) Personal sector, excluding net contributions to life and pension funds.

(b) Household sector interest payments as a percentage of household income.

(c) Stock of mortgages, bank borrowing and retail trade credit outstanding with the household sector.

delays in some wage settlements, total wage and salary earnings fell in real terms. Personal disposable income in the second quarter was also constrained by the fall in interest rates. The personal sector, as a net holder of financial assets, is a net recipient of interest and dividends; a fall in interest rates therefore tends to reduce personal disposable income but it also tends to stimulate consumption relative to saving and both these effects serve to reduce the saving ratio. As RPDI fell and the volume of consumer spending recovered from end-1983 levels, the saving ratio fell, to around 10% in the second quarter, its lowest level for several years.(1) Consumer spending fell slightly in the third quarter, but real average earnings appear to have risen rather faster.

Personal sector capital expenditure, which had reached record levels in 1983, was stronger still in the first half of 1984. Spending on home improvements rose very strongly in the second quarter in advance of the cut in local authority grants from 90% to 75% (applied from the end of March to new applications, but not to work already approved) and also, perhaps, because of the forthcoming imposition of VAT on such work. Investment in new housing on the other hand fell: fewer houses were completed in the second quarter (although there was a recovery in the third quarter); the Royal Institute of Chartered Surveyors report particularly low demand for housing in mining areas.

The personal sector financial surplus fell in real terms, by more than 20% in the second quarter. Building society deposits grew less strongly in the second and, especially, in the third quarter, as competing interest rates rose and as the 28th issue of national savings certificates (withdrawn in mid-September) proved particularly attractive. Personal sector borrowing from banks and building societies, especially mortgage borrowing, rose strongly in the second quarter. Equity withdrawal from the housing market, which helped to sustain the growth of consumers' expenditure last year (much of it on durable goods), increased further in the first half of 1984. In the third quarter borrowing on mortgages slowed slightly, in part perhaps because of higher interest rates.

Public sector *spending and receipts are both higher than expected*

The March Budget envisaged a PSBR for the current financial year of £$7\frac{1}{4}$ billion; the Chancellor's Autumn Statement gave a higher figure of £$8\frac{1}{2}$ billion. Government receipts in 1984/85 are now expected to be some £$1\frac{1}{2}$ billion greater than thought in March with North Sea oil revenues sharply higher, partly as a result of the strength of the dollar. More than offsetting this, however, local authorities have continued to overspend on capital account, interest payments have been higher than expected, health and social security provisions are also greater, and the coal dispute may add some £$1\frac{1}{2}$ billion to the PSBR (mainly through higher expenditure but also via lower tax revenues). Because of the timing of a number of transactions and new measures, the PSBR is expected to be more than usually concentrated in the first part of the financial year: in the seven months since March, the PSBR had already totalled

(1) The recorded level of saving has been revised upwards with the publication of the 1984 national income Blue Book, as a result of the reclassification of expenditure on structural improvements to housing from consumer spending to investment in housing.

£7.7 billion (not seasonally adjusted). Thereafter, the acceleration of VAT payments on imports, which came into force in November, will increase the flows of revenue for a few months. And the first instalment of the British Telecom privatisation issue has now been received.

In his Autumn Statement, the Chancellor of the Exchequer indicated that, although government expenditure in the current year was likely to exceed the £126½ billion planning total set in March, the plans outlined for 1985/86 would aim to keep spending within the planning total of about £132 billion in the last White Paper. This objective implies a small cut in real spending next year (which mainly reflects the assumed ending of the coal strike). Without the strike, public spending would be rising by about 5% at current prices in both 1984/85 and 1985/86; in real terms it would be broadly flat. The higher costs now expected for some programmes next year, including health and social security, the European Community and agricultural intervention, and interest support for ECGD, are to be met elsewhere, including extra sales of council houses and other state assets.

On the basis of the planning total of £132 billion and the assumption of 8% GDP growth in nominal terms in the Autumn Statement, public expenditure (including debt interest) would be equivalent to 41% of GDP in 1985/86, its lowest since 1979/80. On this basis, and with the revenue projections in the Autumn Statement, the government's medium-term financial strategy assumption for the PSBR in 1985/86 (equivalent to 2% of GDP, or £7 billion) would leave room for a 'fiscal adjustment' of perhaps £1½ billion for the coming financial year. The projection for this at the time of the 1984 Budget was £2 billion.

General government expenditure and the PSBR(a)

£ billions: *March Budget projections in italics*

	1984/85		1985/86	
General government expenditure	128	*126½*	132	*132*
Interest payments	16	*15½*	16½	*15½*
National accounts adjustment(b)	4½	*4½*	5½	*4½*
Total (national accounts basis)	**148½**	***146***	**154**	***152***
General government receipts	140	*138½*	148½	*146½*
Implied fiscal adjustment(c)	—	—	1½	*2*
General government borrowing requirement (GGBR)	9	*8*	7	*7½*
Public sector borrowing requirement(d)	**8½**	***7¼***	**7**	***7***
PSBR as percentage of GDP	2½	*2¼*	2	*2*

Sources: *Financial Statement and Budget Report 1984/85* and *Autumn Statement, 1984.*

(a) Columns may not sum due to rounding.
(b) Adjustment to convert expenditure to national accounts basis: see *Financial Statistics* Table 2.4.
(c) Available to reduce taxes or raise expenditure from the level projected in the table.
(d) PSBR is equal to GGBR plus net borrowing by public corporations other than from central government.