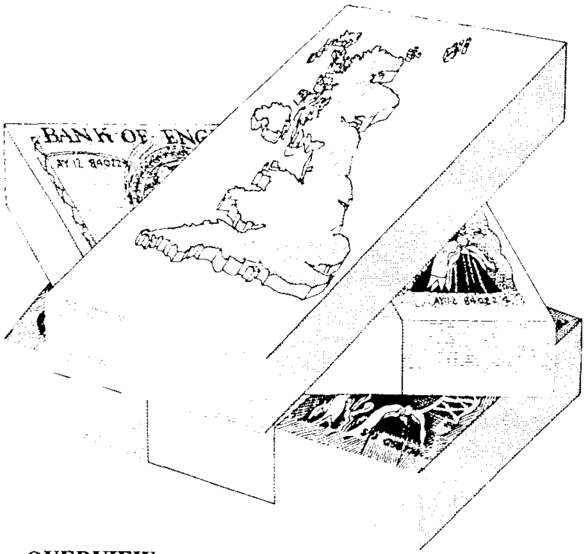
THE BRITISH ECONOMY



OVERVIEW

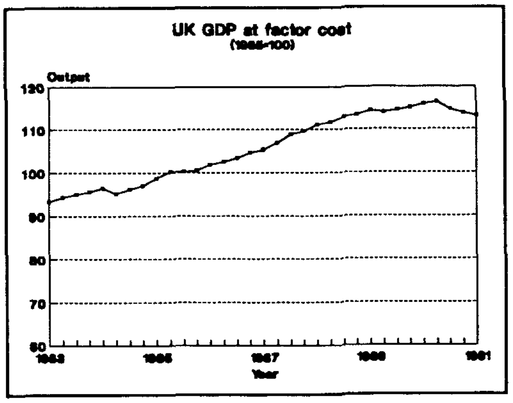
The most recent data indicate the UK economy is continuing in the trough of the recession and that there is unlikely to be much of an upturn before 1992.

MACROECONOMIC TRENDS

In the first quarter of 1991, the average measure of GDP at current market prices - nominal or 'money' GDP - rose by 0.3% during the quarter to a level 3.2% higher than the same period a year earlier. The rate of growth of money GDP was therefore significantly slower than the 1.4% recorded during the fourth quarter of 1990 and below the average for the preceding three quarters of the year. After allowing for price changes, the average measure of GDP at constant market prices - 'real' GDP - fell by 0.5% in the first quarter compared with reductions of 0.9% and 1.4% in the fourth and third quarters of 1990, respectively, and increases of 0.9% and 0.4%, respectively, during the second and first quarters of the year. Over the year to the first quarter 'real' GDP is estimated to have fallen by 2.1% following the fall of 1.5% during the year to the fourth quarter and increases of 0.6%, 2.5% and 1.9% in the years to the third, second and first quarters of 1990, respectively. When measured at constant factor cost - ie. after subtracting taxes on expenditure minus subsidies - GDP fell by 0.6% in the first quarter, compared with a 0.9% fall in the fourth quarter of 1990, a 1.2% fall in the third quarter, and the small 0.3% increase recorded in the second quarter of last year. Using this measure, the decrease between the first quarters of 1990 and 1991 was 2.5%, compared with a decrease of 1.3% in the year to the fourth quarter 1990 and increases of 0.6%, 2.3% and 1.6% over the year to the previous three quarters.

Preliminary estimates of the output-based measure of GDP - which is usually taken to be the most reliable indicator of short-term change - in the second quarter of 1991, suggest that activity fell by 0.9% compared with the previous quarter to a level 3.7% lower than the second quarter of 1990. Manufacturing output fell by 0.5% in the latest quarter. Service sector output also fell by 0.5%, while the output of the energy sector fell by 2.9% in the second quarter.

GDP has now fallen for four successive quarters from the third quarter last year at rates of 1.4%, 0.9%, 0.5%, and 0.9% respectively. These figures are consistent with our prediction in the March Commentary that negative or zero growth was likely to persist for the first two quarters of 1991 at least. However, if the preliminary figures for the second quarter 1991 are not revised appreciably then it appears that while the rate of decline progressively slowed for three quarters, suggesting that a turning point may have been near, the greater fall in output in the second quarter suggests that the economy is continuing in the trough of the recession and may be taking longer to turn up than originally expected. On these data, it appears unlikely that there will be much of an upturn before 1992.



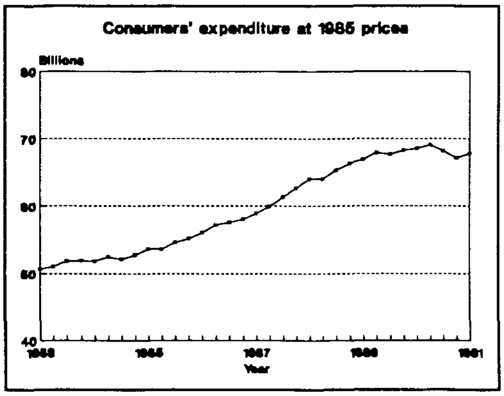
The CSO's coincident cyclical indicator for June 1991, which attempts to show current turning points around the long-term trend, continues to decline, reflecting further falls in all its component series. This indicator has fallen continuously since the peak of August 1988. The shorter leading index, which attempts to indicate turning points about six months in advance, also continues to decline, although the rate of decline now appears to be slower than in the year to January 1991. This would appear to offer further confirmation that there is little prospect of much of an upturn before the end of the year. The longer leading index, which purports to indicate turning points about one year in advance, appears to have exhibited a turning point in April or May 1990. However, after June the index more or less stagnated until January of this year after which it did begin to show positive signs of upward movement. This might be interpreted as suggesting that the recovery will only be weakly evident during the second half of this year and that it will be 1992 before much improvement is recorded.

In the first quarter of 1991 real consumers' expenditure - seasonally adjusted - rose by 0.4% after falling by 1.6% in the fourth quarter of 1990, by 0.6% in the third quarter and increasing by 1% and 1.4% in the second and first quarters, respectively. Spending during the first three months of the year therefore stood 0.7% below the same period a year earlier, compared with a 1.5% fall over the year to the fourth quarter and the increases of 2.1%, 2.7% and 3% recorded over the years to the third, second and first quarters, respectively. In the first quarter, expenditure on durable goods rose again by 3% after the earlier falls of 7.2% in the fourth quarter of 1990, a 2% reduction between the second and third quarters and a 1% fall in the first quarter. Durable expenditures now stand at a level 8.7% lower than a year earlier. Non durable goods expenditure also rose in the first quarter by 1% after falling by 0.4% in the fourth quarter and 1% the third quarter of 1990. Non durable expenditures now stand at a level 1% above the first quarter 1990. Expenditure on services fell by 1% in the first quarter 1991 after falling by the same amount in the previous quarter and remaining broadly unchanged between the second and third quarters of 1990.

The provisional official retail sales figures - seasonally adjusted - for July, recorded a further slight increase of 0.3% after the 1.5% increase in June and the significant fall in April and the slight fall in May. These data may indicate that retailing is beginning to come out of the recession. However, the July CBI/FT Distributive Trades Survey provided little indication that a revival in consumer spending had begun with sales appearing to be at or below the levels recorded in the same month a year ago.

The underlying determinants of consumers' spending remain weak. The latest consumer credit figures for June show that the cumulative amount of outstanding credit (excluding bank loans) recorded a net increase of only £22 million after falling by £436 million in May and increasing by £335 million, £153 million, £94 million and £94 million in April, March, February, and January, respectively. These changes continue to be well below those reported towards the end of last year where increases of £141 million, £229 million, £342 million, £331 million and £196 million were reported in December, November, October, September and August, respectively.

The saving ratio fell slightly to 9.8% in the first quarter from 10.7% in the fourth quarter 1990. This compares with 9.1% in the third quarter, 6.9% in the second quarter and 7.8% in the first quarter. The savings ratio averaged 8.7% in 1990 compared to 6.6% in 1989 and 5.2% in 1988. Data from the Bank of England show that the personal sector moved into surplus in the first three quarters of 1990 after the record deficit of 1988. Improvements in the savings ratio are attributed by the Bank to people being discouraged from consumption spending, despite rising real incomes, owing to stagnation in the housing market. Real personal disposable income fell by 0.6% in the first quarter, after increases of 0.3% and 1% rise in the fourth and third quarters of 1990, respectively. RPDI was 1.5% higher in the first quarter 1991 than in the same period in 1990.

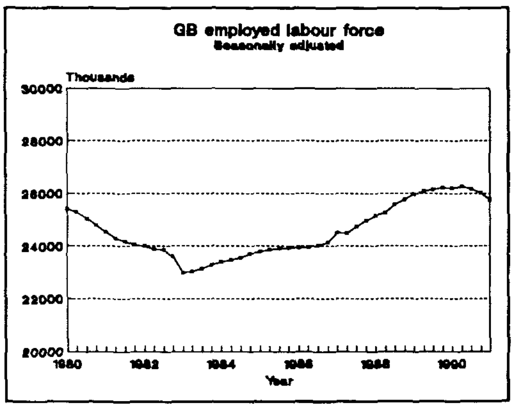


The underlying increase in average weekly earnings in the year to June was provisionally estimated to have been 8.25%. This contrasts with the 8.5% and 8.75% increases in the year to May and April respectively. The underlying increase has been slowly moderating after the peak increase of 10.25% in the year to July 1990. Nevertheless, the current rate of increase still remains above consumer price inflation.

General government final consumption fell by 0.4% in the first quarter after falling by 0.5% during the fourth quarter and 0.7% in the third quarter of 1990. Spending increased during the first two quarters of the year. At the end of the first quarter the new level was 0.7% higher than a year earlier. Government final consumption in 1990 was 1.7% above the level in 1989.

Real gross fixed investment continues to decline. In the first quarter a 2.8% fall was recorded to a level 9.8% below the same period in 1990. Provisional estimates of real capital expenditure in manufacturing for the second quarter of 1991 suggest a fall of 21% over the first quarter compared with - on revised figures - a 4.5% fall in the previous quarter. The level of manufacturing investment in the second quarter was therefore almost 20% below that in the second quarter of 1990. Over the same period investment in vehicles is estimated to have fallen by 44%, investment in plant and machinery by over 27% and by over 26% for new building work. These figures offer further confirmation of the retrenchment in investment noted in recent Commentaries.

Turning to the balance of payments, the deficit on current account for the first quarter 1991 rose to £2.6 billion, after - on revised figures - the £1.6 billion deficit in the fourth quarter 1990, the £1.9 billion deficit in the third quarter, a £5.1 billion deficit in the second quarter of 1990, and a £5.2 billion deficit in the first quarter. For 1990 the deficit therefore amounted to £13.8 billion, compared with a deficit for 1989 of £19.9 billion, £15.4 billion in 1988 and £4.3 billion in 1987. On visible trade, the first quarter deficit fell slightly to £2.8 billion, compared with £3.0 billion in the fourth quarter 1990 and £3.7 billion, £5.3 billion, £5.9 billion, and £4.8 billion, respectively, in the previous four quarters. The surplus on the oil account was £0.2 billion in the first quarter, compared with £0.3 billion and £0.4 billion in the fourth and third quarters of 1990, respectively.



In the second quarter of 1991, the output of the production industries is provisionally estimated to have fallen by 1.1% compared with the previous quarter. The fall in output has therefore increased compared with the preceding quarter. In manufacturing industry, output fell by 0.5% which represented a reduction on the fall of 1.3% recorded in the first quarter and was significantly less than the 3% fall registered in the fourth quarter of 1990 - the sharpest quarterly fall since the 1981 recession. Manufacturing output now stands 6.6% lower than in the second quarter of 1990. As usual there were clear variations within the sector, although in the second quarter more industries experienced an increase in output than experienced a fall. Chemicals output rose by 1.7%, Metals by 1.6%, Other minerals by 1.5%, and Food, drink and tobacco output rose by 0.6%. In contrast, Engineering production fell by 1.5% and Other manufacturing by 0.3%. In contrast to the previous quarter, the output of the energy sector fell by 2.9% to a level 4.6% lower than in the same period a year ago.

Output in the investment and intermediate goods industries fell between the latest two quarters by 1.5% and 1.4% respectively, while production of consumers goods fell by 0.3%. Performance in the second quarter of 1991 in principal market sector appears to have deteriorated again after the relative improvement in the first quarter.

THE LABOUR MARKET

Employment and Unemployment

The figure for the UK workforce in employment in March 1991 was 26,394,000. This is the third successive quarter in which total UK employment has fallen, with declines over the last quarter of 253,000 (0.9%) and over the last year of 434,000 (1.6%). The sectorally disaggregated figures continue to show manufacturing as being particularly hard hit: UK employment in manufacturing has been declining since September 1989, with falls in the quarter to March 1991 of 99,000 (2.0%) and over the year of 210,000 (4.0%). This decline is continued in the British manufacturing data with a 1.9% fall for the quarter to June. However, this does not mean that other sectors are unaffected by the recession: employment in all sectors is now falling. In services, UK employment has been declining for three quarters, with a decline in the quarter and year to March of 108,000 (0.7%) and 120,000 (0.8%).

The provisional figure for UK seasonally adjusted unemployment stood at 2,368,100 in July 1991. This corresponds to an overall unemployment rate of 8.3%, with male and female rates of 11.0% and 4.7% respectively. UK unemployment has now been rising for sixteen successive months and stood at 5.7% in July 1990. The major increase in unemployment, both in absolute and relative terms has been for males. Whilst accompanying the rise in unemployment there has been a general fall in the number of notified vacancies of 21,200 (16.9%) for the quarter and 68,500 (40.0%) for the year to July 1991, in the last month there has been a small increase in the number of vacancies of 1,300 (1.2%).

Earnings and Productivity

The provisional actual annual increase in the British whole economy average earnings for June 1991 was 7.1% with an underlying increase of 8.25%. The underlying figure is higher than the actual figure because arrears of pay were lower than a year ago and timing adjustments were made for employees who had not received an increase in the last twelve months. The level of underlying wage increases has fallen monotonically since its peak of 10.25% in July 1990, its present value being the lowest since July 1989. The fall in the underlying wage inflation is particularly marked in services, where the underlying increase for June was 7.75%, against a figure for manufacturing of 8.5%.

The labour productivity performance of the economy continues to be very poor. For the whole economy, productivity in the first quarter of 1991 was 0.4% higher than the previous quarter but was still 0.9% lower than a year earlier. Data for manufacturing productivity tells a slightly more optimistic story, there being a 1.5% increase in labour productivity over the quarter to June 1991. However, even in manufacturing, productivity is

1.1% lower than the previous year. Again, the combination of high wage inflation and negative productivity growth has led to very large increases in unit labour costs. For the whole economy, unit labour costs in the first quarter of 1991 were 10.0% higher than their level a year earlier: for manufacturing, the June 1991 unit labour costs were 9.1% above the figure for the corresponding month in 1990. However, there is evidence in both the whole economy and manufacturing figure that the rate of increase of unit labour costs is falling.

PROGNOSIS

The most recent data indicate the UK economy is continuing in the trough of the recession and that there is unlikely to be much of an upturn before 1992.

GDP has now fallen for four successive quarters with the rate of decrease increasing in the second quarter, the most recent quarter for which data are available. The shorter leading index, which attempts to indicate turning points about six months in advance, continues to decline, offering little prospect of much of an upturn before the end of the year, while the longer leading index, which purports to indicate turning points about one year in advance, appears to suggest that the recovery will only be weakly evident during the second half of this year and that it will be 1992 before much improvement is recorded.

However, signs that the recession is weakening are evident in some sectors of the economy.

Real consumers' expenditure rose in the first quarter after falling in the previous two quarters. And increases in retail sales in June and July may indicate that retailing is beginning to come out of the recession. The saving ratio fell slightly in the first quarter perhaps indicating an increased propensity to spend in the near future. However, consumer borrowing remains relatively depressed so there is unlikely to be a significant spurt in consumer spending during the remainder of the year. Export volumes are relatively buoyant and there is a good chance with world trade expected to grow by 3% this year that exporters will benefit from the general upturn in the world economy and the recently lower levels of the exchange rate. Whether this will be sufficient to give much of a kick start to the whole economy remains an open question. In contrast, investment remains considerably depressed with manufacturing investment level falling by one fifth over the past year. Such contractions will continue to have a depressing effect on key parts of the economy and do not augur well for the competitive supply position of UK economy when domestic demand does begin to rise next year.