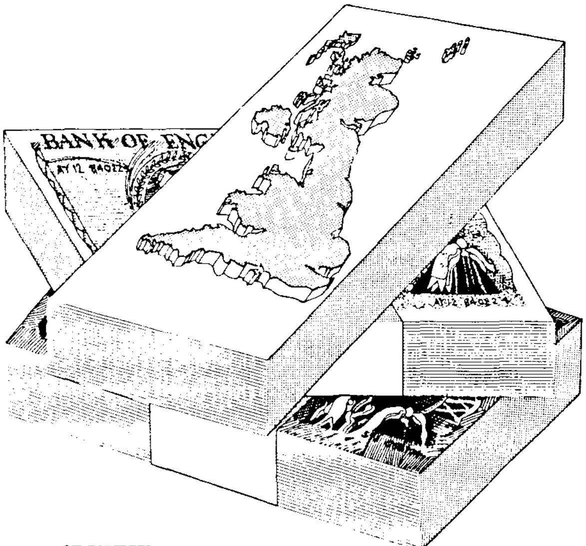
THE BRITISH ECONOMY



OVERVIEW

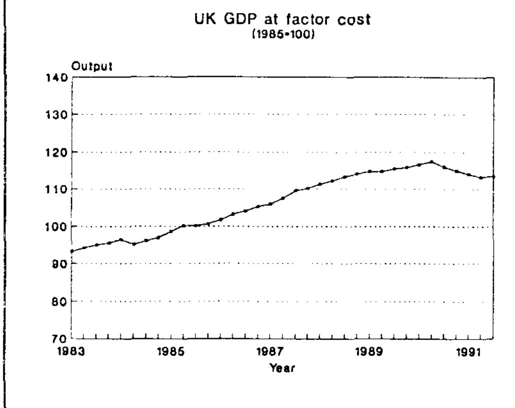
The recession in non-oil GDP has continued for six quarters with the real value of output falling by just under 4% since the second quarter of 1990. The present recession is therefore the longest since the Second World War, although the fall is still not as rapid, or as deep, as in the 1979-81 recession where the decline in non-oil GDP from peak to trough occurred over five quarters and amounted to 6.2%. Considerable uncertainty exists over the course of demand over the next few months, with consumption unlikely to exhibit strong growth. The likely outturn for GDP growth during 1992 is for an increase of no more than 1%.

MACROECONOMIC TRENDS

In the third quarter of 1991, the average measure of **GDP at market prices - 'money' GDP** - rose by 1.1%. After allowing for inflation and adjusting for factor costs, **GDP** rose by 0.2% during the quarter, compared with a reduction of 0.7% in the second quarter and reductions of 0.9%, 0.9%, and 1.2% respectively in the preceding three quarters. Over the year to the third quarter 'real' GDP is estimated to have fallen by 2.3%.

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 fourth quarter of 1991, suggest that activity *fell* by 0.3% compared with the previous quarter to a level 1.7% lower than the fourth quarter of 1990. Manufacturing output is estimated to have fallen by 1.2%, and output in the service sector by 0.2%. In contrast, the output of the energy sector is estimated to have risen by 2.8% in the fourth quarter. When oil and gas extraction are excluded, GDP is estimated to have fallen by 0.4% in the most recent quarter.

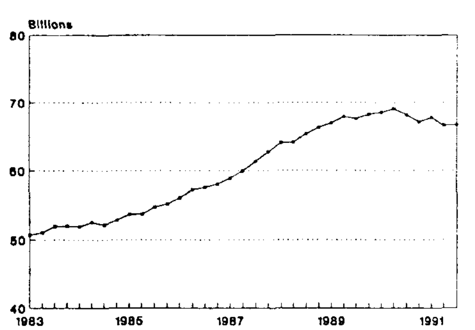
In the fourth quarter of 1991, the **output of the production industries** is provisionally estimated to have fallen slightly by 0.1% over the preceding quarter to a level 0.6% below that produced in the same period a year ago. As noted, manufacturing experienced a drop in output of 1.2% in the fourth quarter, while the energy sector increased production by 2.8%. Within manufacturing, Chemicals output rose by 0.4%, while output in the remaining key sectors fell. In Metals the fall was 0.4%, in Other manufacturing 0.8%, in Food, drink & tobacco, 1%, in Textiles 1.1%, in Other minerals, 1.5%, and in Engineering, 1.9%. Output in the investment and consumer goods industries fell between the latest two quarters by 1.8% and 0.7% respectively, while production of intermediate goods rose by 0.8%.



It now seems clear that the small positive increase in GDP growth recorded in the third quarter 1991, while technically signalling the end of the recession, was largely the outcome of buoyancy in the energy sector. When oil and gas extraction are excluded the economy still remained in recession at the end of the year. The apparent significant worsening of performance in manufacturing in the fourth quarter is a clear cause for concern. The sector has been in decline since the second quarter of 1990 and by the fourth quarter of 1991 output had fallen by just under 8% compared with an estimated fall in GDP of just under 4%. The recession is now clearly the longest - six quarters for non-oil GDP - since the Second World War although the decline in output has yet to match the fall recorded in the 1979-81 recession. Nevertheless, the recession is certainly much more protracted than most commentators expected a year ago and there is currently little tangible evidence of an upturn.

The CSO's **co-incident cyclical indicator** for December 1991, which attempts to show current turning points around the long-term trend, rose slightly. The indicator marginally rose in November but can best be characterised as being flat since September of last year. The **shorter leading index,** which attempts to indicate turning points about six months in advance, rose in June but fell back again in November and December. The **longer leading index,** which purports to indicate turning points about one year in advance, had been rising strongly since January 1991, but began to fall back again in November and December. These indicators suggest that the smooth climb out of recession which appeared to be signalled a few months ago is not materialising, moreover they are not inconsistent with fears of a 'double-dip' recession. The prospects for the course of output therefore remain very uncertain over the coming months.

In the third quarter of 1991, **real consumers' expenditure** fell slightly by 0.1% after falling by 1.6% in the second quarter, and 0.2% in the first quarter. Spending during the third quarter therefore stood 2.3% below the same period a year earlier. In the third quarter, spending on durables rose by 4%, but this was largely a reflection of the 14.2% growth in spending on motor vehicles which was artificially stimulated by the introduction of the new registration letter in August. Expenditure on other durable goods, for example, fell by 3.5% during the same period. Moreover, spending on motor vehicles was just under 15% lower in the third quarter compared with the same period in 1990.



The provisional official **retail sales** figures - seasonally adjusted - for January, rose modestly by 0.4% compared with a 0.9% fall in December. The increase over the year to January therefore stood at 0.9%. Taking the three months to January, the volume of retail sales rose by 0.4% indicating that spending may be gradually starting to turn up. However, the figures for January were to some extent distorted by a 3.5% increase in sales of food. In contrast, the very important household goods sector recorded a decline of 4.3% in sales volumes after rising in December. The **CBI Distributive Trades Survey** for January also indicated a rise in sales volumes in distribution for that month. Moreover, a net balance of 16% of distributors expected sales to increase further in February. Overall, then, the recent data on consumers' spending, retail and distributive trades might be taken as suggesting that a small revival began to occur at the beginning of this year. Further data are, however, clearly required before we can be certain that the trend is indeed positive.

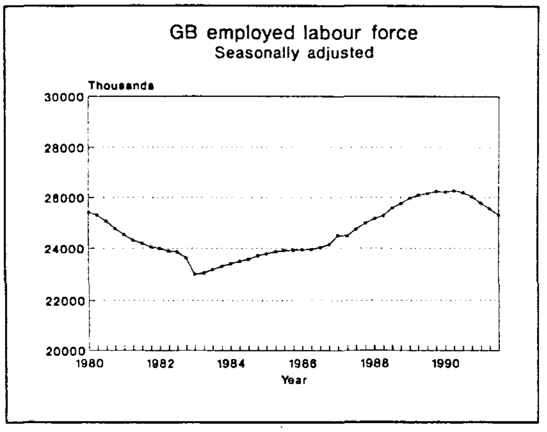
Nevertheless, the underlying determinants of consumers' spending remain relatively weak. The **consumer credit** figures for December show that the cumulative amount of outstanding credit (excluding bank loans) fell by £196m. The amount of outstanding credit has been falling since August and the fall in December was over three times greater than average monthly fall during the preceding four months.

The **saving ratio** did fall slightly in the third quarter to 10.9% from 11.2% in the second quarter of 1991 after rising from 9.2% in the first quarter. The savings ratio averaged 8.9% in 1990, compared to 7.1% in 1989 and 5.4% in 1988. **Real personal disposable income** fell slightly by 0.2% in the third quarter of last year, after rising by 0.6% in the second quarter and falling by 1.6% in the first quarter. RPDI was 0.6% lower in the third quarter 1991 than in the same period in 1990.

The underlying increase in **average weekly earnings** in the year to December is provisionally estimated to have been 7¼%. This compares with a 7½% increase in year to October and November. The underlying increase has been slowly moderating after the peak increase of 10¼% in the year to July 1990. The current rate of increase still remains above the rate of consumer price inflation.

General government final consumption rose by 0.4% in the third quarter of 1991 to a level 1.3% higher than in the third quarter 1990. Spending remained largely unchanged in the second quarter after rising by 1% in the first quarter. In subsequent quarters we should expect to see further increases following the government expenditure increases signalled in the Autumn Statement.

Real gross fixed investment continues to decline. In the third quarter gross domestic fixed capital formation fell by 2.5% to a level 10.9% below the same period a year earlier. Investment in vehicles, ships and aircraft fell by 21.9% in the third quarter, while investment in plant and machinery fell by 1%, investment in dwelling rose by 2.3% and in other new buildings and works it fell by 1.7%. Over the year to the third quarter vehicles etc investment fell by 25.8%, plant and machinery fell by 8.1%, dwellings fell by 9.4%, and other new buildings etc fell by 11.2%. Provisional estimates of investment in manufacturing in the fourth quarter last year indicate a fall of 0.6% over the previous quarter to a level 14% below the same quarter in 1990. For 1991, investment in manufacturing was 15% down on 1990, with investment in vehicles etc decreasing by 39%, in plant and machinery by 15% and by 9% for new building work. The CSO's Autumn survey of manufacturers' investment intentions suggests a rise of 2% in the volume of spending in 1992 with a larger increase expected in 1993.



Stockbuilding by manufacturers, wholesalers and retailers in the fourth quarter 1991 is provisionally estimated to have decreased by £969m (1985 prices, seasonally adjusted), compared with a fall of £229m in the third quarter. The ratio of manufacturers stocks to output (Q4 1984 = 100) fell from 79.4 at the end of September to 78.8 at the end of December 1991. So by the end of last year there was clearly no evidence of manufacturers building up their stock holdings in anticipation of an expansion in demand in the new year.

Turning to the **balance of payments,** the deficit on **current account** for the third quarter 1991 was, after seasonal adjustment, £1.3bn compared with £0.1bn in the second quarter and £2.7bn in the first quarter. The likely outturn for the 1991 is for a current account deficit of £5.7bn compared with £15.2bn in 1990 and £20.4bn in 1989. On **visible trade**, the third quarter deficit rose to £2.3bn from £2.1bn in the second quarter and £3bn in the first quarter. Within this account, the surplus on **oil** rose to £304m from £260m in the second quarter and £224m in the first quarter. The surplus on **invisibles** fell to £1bn from £2bn in the second quarter and £0.3bn in the first quarter.

THE LABOUR MARKET

Employment and Unemployment

In September 1991, the seasonally adjusted figure for UK employees in employment stood at 25,938,000. This figure has now fallen for five successive quarters: the decline over the last quarter was 234,000 (0.9%), over the last six months 460,000 (1.7%) and over the last year 875,000 (3.3%). Sectoral disaggregation indicates employment falling in both manufacturing and services, and over the last year the absolute fall in both these sectors has been very similar: 352,000 and 331,000 respectively. However, the larger initial scale of service employment means that the proportionate decline over the year in manufacturing (6.9%) is over three times that in services (2.1%). The decline in manufacturing employment continued to December 1991 in the more up to date British figures. The employment fall in the last quarter was 59,000 (1.3%), though this is the smallest fall since the third quarter of 1990.

The provisional estimate for UK seasonally adjusted unemployment in January 1992 was 2,604,100, an overall unemployment rate of 9.2%, with the separate male and female rates standing at 12.2% and 5.1% respectively. UK unemployment has now been rising for twenty two months in succession, and the increase from January 1991 being 712,500. Although the rise in unemployment appeared to be slowing up to October 1991, in the last quarter of the year the rise in unemployment has started to increase again and the figures for January record the largest monthly increase since August, with unemployment rising in all UK regions. On the other hand, in the quarter to January 1992, the seasonally adjusted level of unfilled vacancies in Jobcentres rose by 18,500 (17.9%) to a figure of 122,000, although this is still 15% lower than the level for January 1991.

Earnings and Productivity

The provisional actual annual increase in British whole economy average earnings up to December 1991 was 6.6%, though the underlying increase was somewhat higher at 7.25%. The level of underlying wage inflation has been falling slowly, but consistently, for the last 17 months, when it stood at 10.25%: the fall in last quarter has been from 7.75%. The reduction in underlying wage inflation has been most marked in services, falling from 10% in June 1990 to 7% in December 1991: for manufacturing the decline over the same period has been from 9.5% to 7.75%.

For the whole economy, the most recent productivity figures continue to show a very poor performance. Whilst in the third quarter of 1991 the increase in labour productivity was 0.9%, the increase over the year was only 0.6%. Data for manufacturing productivity are a little better. Between the second and third quarter of 1991 there was a 1.7% rise, though again the annual rise was lower at 0.9%. These results mean that the unit labour costs in the whole economy continued to rise at the rapid annual rate of 7.0% to the third quarter of 1991, though this is a sharp reduction from the figure of 10.1% for the first quarter of 1991. Moreover, the annual increase in unit labour costs in manufacturing has shown a much sharper decline in the recent past, from 10.9% in the first quarter of 1991 to 6.8% in the third quarter, and this decline continued in the months to November when the annual rate for manufacturing stood at 3.7%.

PROGNOSIS

The recession in non-oil GDP has continued for six quarters with the real value of output falling by just under 4% since the second quarter of 1990. The present recession is therefore the longest since the Second World War, although the fall is still not as rapid, or as deep, as in the 1979-81 recession where the decline in non-oil GDP from peak to trough occurred over five quarters and amounted to 6.2%. Nevertheless, the fall in GDP of 2.5% during 1991 is the steepest annual fall in output since 1931 when output fell by 5.5%. Against this background it is difficult to be confident that the recession has bottomed out and that a rapid and smooth climb to trend levels of growth will be quickly realised. Prospects in the world economy have deteriorated with the Bank of England predicting that growth in Britain's six main trading partners will be 2% this year compared with its earlier forecast of 3%. Business confidence remains low and has fallen recently in some sectors. Stockbuilding and stock:output ratios continue to fall. All of which suggests that industry is not very sanguine about the prospects for demand over the coming months.

The key unknown over the next few months is the behaviour of the consumer. If consumer spending begins to rise strongly then the economy will soon be back to positive growth. However, the signs are not good. Consumers continue to cut back on debt. The saving ratio has fallen slightly but remains high and there are no obvious indications that it is firmly set on a downward path. Real personal disposable income fell slightly during 1991. Asset prices are not strong, with the housing market reporting the lowest turnover since 1977 and prices either static or still falling. Finally, reported consumer confidence continues to decline although more slowly than in early 1991. Lack of confidence may also be fuelled by electoral uncertainty in the run-up to the general election and, as the Bank of England recently noted, the growing realisation that membership of the ERM precludes the traditional policy options of monetary expansion and devaluation.

Against this rather depressing background must be set the evidence that high street spending appeared to be picking up at the beginning of the year, and that the usual automatic fiscal stabilisers are helping to revive the economy. In addition, the cut in the mortgage rate and the decision to suspend stamp duty on house purchases are soon likely to have a favourable effect on the housing market and perhaps general consumption. But if we learned anything after the progressive increase in interest rates in 1987 and 1988 it is that such measures take a long time to work whether it be increases or decreases in rates. Our best judgement is that the positive growth will resume this year but it will not be strong and the likely outturn for GDP during 1992 will be no more than a 1% increase and probably somewhat less.