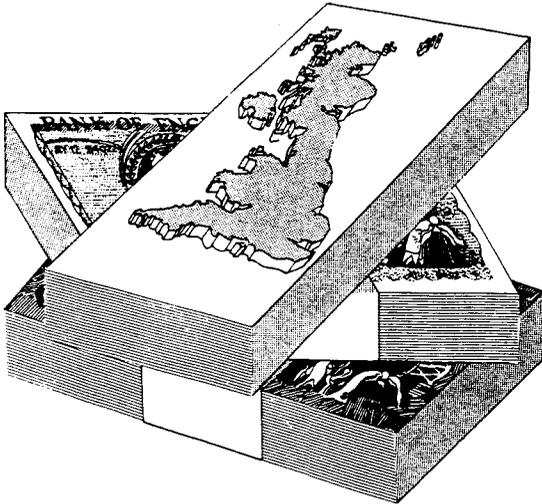


THE BRITISH ECONOMY



OVERVIEW

The recession continues to persist with very few signs of a sustained expansion of output in the near future. Consumer demand remained weak throughout the summer, which, coupled with turmoil on the international currency markets, is depressing business confidence and diminishing the prospect of much improvement in output growth during the remainder of the year.

MACROECONOMIC TRENDS

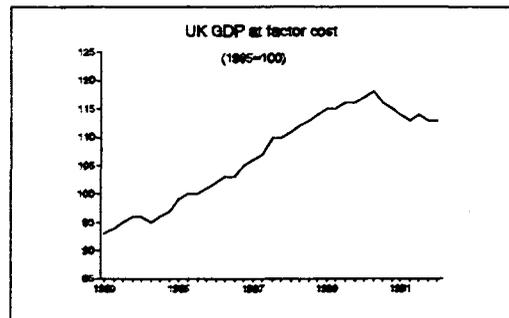
In the first quarter of 1992, the average measure of GDP at market prices - 'money' GDP - rose by 0.4%. After allowing for inflation and adjusting for factor costs, GDP fell by 0.5% during the quarter, compared with a fall of 0.3% in the fourth quarter 1991, a slight increase of 0.2% in the third quarter and reductions of 0.9%, 0.8%, 0.9%, and 1.1% respectively in the preceding four quarters. When oil and gas are excluded 'real' GDP fell by 0.3% in the first quarter. Over the year to the first quarter, 'real' GDP is estimated to have fallen by 1.5%, and by 4.2% since the recession began after the second quarter 1990.

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 1992, suggest that activity fell by 0.1% compared with the previous quarter. When oil and gas extraction are excluded, GDP is estimated to have risen by 0.1% in the most recent quarter, reflecting another large fall in energy sector output with oil and gas extraction falling by 4.3%. Output of the service sector is estimated to have remained unchanged in the second quarter, while

manufacturing output is again estimated to have risen by 0.4%.

The output of the production industries in the second quarter of 1992 is provisionally estimated to have fallen by 0.5% over the preceding quarter with output remaining unchanged from the same period a year ago. As noted, manufacturing experienced an increase in output of 0.4% in the first quarter, while production of oil and gas decreased by 4.3%. Manufacturing output in June was 7.5% below the second quarter 1990 peak. Within manufacturing, Other manufacturing output rose by 0.8%, Metals output fell by 1.1%, Food, drink & tobacco output rose by 1.1%, output in the Chemicals sector fell by 1.4%. Output rose in Textiles by 0.5%, in Other minerals by 0.4%, and in Engineering by 0.7%. Output in the investment and consumer goods industries rose between the latest two quarters by 0.5% and 0.7% respectively, while production of intermediate goods fell by 1%.

GDP remains largely flat but with some indication of a gradual pick up in manufacturing. Nevertheless, it is clear that the present recession is more prolonged than most people predicted and it is likely to be some time yet before sustained quarterly output increases are recorded.



The CSO's co-incident cyclical indicator for July 1992, which attempts to show current turning points around the long-term trend, rose sharply, although the index for the month was based on partial information and so should be viewed with caution. The index appears to have bottomed out in April of this year and has risen slowly in May, June, followed by the larger increase in July. However, confirmation of an upturn must await more complete information for July and data for subsequent months. The shorter leading index, which attempts to indicate turning points about six months in advance, rose in February and March and continued to rise to June but with no change evident in July. 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 of

last year and this fall continued into January, February and March. Since then, the index has fluctuated based on partial information.

In the first quarter of 1992, real consumers' expenditure fell by 0.7% after falling by 0.1% in both the fourth and third quarters of 1991, by 1.6% in the second quarter, and by 0.2% in the first quarter. Spending during the first quarter 1992 therefore stood 1.8% below the same period a year earlier. In the first quarter, spending on durables fell by 2%, while clothing and footwear expenditure fell by 4.6% and 4.1%, respectively.



The provisional official retail sales volume figures - seasonally adjusted - for July, fell by 0.3% after remaining largely unchanged between April and June. Over the year to July, sales fell by 0.6%. Taking the three months to July, the volume of retail sales rose by 0.3% to a level 0.5% up on the same period a year ago. These data underline the current weak state of UK consumer demand.

The underlying determinants of consumers' spending remain weak. The consumer credit figures for May show that the cumulative amount of outstanding credit (excluding bank loans) fell by £19m. The amount of outstanding credit has been falling since August except for a small net increase of £13m in February. In the first quarter of 1992, the balance of outstanding credit fell by £120m suggesting that consumers are still putting a lot of emphasis on reducing the debt overhang and spending is weak as a result. On the other hand, bank and building society lending continues to be relatively buoyant.

The savings ratio rose in the first quarter of 1992 to 11.5% from 10% in the fourth quarter of 1991 after falling 11.1% to 10.4% between the second and third quarters. The savings ratio averaged 10.3% in 1991 compared to 8.9% in 1990, 7% in 1989 and 5.4% in 1988. Real personal disposable income rose by 1% in the first quarter of 1992 to a level 0.4% higher than in the same period in 1991.

The underlying increase in average weekly earnings in the year to June is provisionally estimated to have been 6%, the smallest increase for 25 years. This compares with a 7½% increase in the year to March.

General government final consumption fell by 1.1% in

the first quarter of 1992 after rising slightly by 0.1% in the fourth quarter of 1991, increasing by 0.4% in the third quarter, remaining largely unchanged in the second quarter and rising by 1% in the first quarter. Government consumption in the first quarter 1992 was 0.6% higher than in the corresponding quarter of 1991.

Real gross fixed investment appears to have ceased declining. In the first quarter of 1992 gross domestic fixed capital formation rose by 1.4% - the first quarterly rise since early 1990 - to a level 2.2% below the same period a year earlier. Investment in vehicles, ships and aircraft rose by 1.1%, while investment in plant and machinery rose by 3.3%, investment in dwellings fell by 4.1% and in other new buildings and works it rose by 1.9%. Over the year to the fourth quarter vehicles etc investment rose by 6.4%, plant and machinery fell by 1.8%, dwellings fell by 1.6%, and other new buildings etc fell by 4.8%. Provisional estimates of capital expenditure by manufacturing industries in the second quarter 1992 indicate that investment was 3% higher than in the first quarter but 3% lower than in the second quarter 1991.

Stockbuilding by manufacturers, wholesalers, retailers and other industries in the second quarter 1992 is estimated to have decreased by £1093m (1985 prices, seasonally adjusted), compared with a fall of £385m in the first quarter. The ratio of manufacturers stocks to output (Q4 1984 = 100) fell from 77.0 at the end of March to 76.3 at the end of June. The ratio stood 79.4 at the end of September 1991 and had fallen to 78.8 by the end of December 1991. So, by the middle of this year there was clearly no evidence of manufacturers building up their stock holdings in anticipation of an expansion in demand later in the year.

Turning to the balance of payments, the deficit on current account for the first quarter of 1992 was, after seasonal adjustment, £2.6bn compared with £1.4bn in the fourth quarter 1991, £1.1bn in the third quarter, £0.3bn in the second quarter and £2.4bn in the first quarter. For 1991 the current account deficit was £5.2bn compared with £16.1bn in 1990 and £20.4bn in 1989. On visible trade, the first quarter deficit rose to £3.1bn from £2.6bn in the fourth quarter 1991, £2.3bn in the third quarter, £2.2bn in the second quarter and £3bn in the first quarter. Within this account, the surplus on oil fell to £428m from £481m in the fourth quarter 1991, £315m in the third quarter, £209m in the second quarter and £213m in the first quarter. The surplus on invisibles in the first quarter 1992 remained largely unchanged at £2.3bn compared with £2.9bn in the third quarter 1991, £2.3bn in the second quarter, and £1.4bn in the first quarter.

THE LABOUR MARKET

Employment and Unemployment

The UK workforce in employment numbered 25,565,000 at March 1992. This figure has fallen now for seven

quarters in succession, and the reduction in total employment over the last year was 774,000 (2.7%). However, the decline in employment of 64,000 (0.2%) for the last quarter is the smallest quarterly reduction during this recession. Moreover, female employment actually rose 39,000 (0.3%) and employment in services increased 68,000 (0.4%), both for the first time since June 1990. More up to date employment figures are available for British manufacturing. These show a further decline to June 1992, although the reduction over the quarter was only 28,000 (0.6%), again the lowest reduction in manufacturing employment since June 1990, though employment has been falling in manufacturing continuously since September 1989.

The provisional estimate for UK seasonally adjusted claimant unemployment in July 1992 was 2,753,400, an overall unemployment rate of 9.7%, with the separate male and female rates standing at 13.0% and 5.3% respectively. UK unemployment has now been rising continuously since March 1990: the increase in the last quarter was 58,100 and in the last year 390,900. Although there appears to be a gradual fall in the rate at which unemployment is rising, month on month changes in unemployment are very variable, and show no consistent downward trend. Continuously increasing unemployment has been associated with a fluctuating number of job vacancies. In the quarter to July 1992, the seasonally adjusted level of unfilled vacancies in Jobcentres fell by 8,800 (7.4%) to 110,800. However, there was a small increase in vacancies in July and the vacancy total was 6.6% higher than the corresponding figure for July 1991.

Earnings and Productivity



After a slight reversal in February and March of this year, the increase in British average earnings continued its downward trend in the quarter up to June. Seasonally adjusted, the actual increase in average earnings for the whole economy in June stood at 5.8%, with an underlying increase of 6%. This is to be compared with underlying increases of 10% in June 1990, 8% in June 1991 and 7.5% in March 1992. It is clear that over the last two years there has been a gradual, but persistent, reduction in wage inflation. This fall has occurred across all sectors, but was particularly marked in services in the year up to April 1992. However, in the last two months

for which data are available, the underlying annual increase in wages in manufacturing has fallen slightly below that for services, and at June was 6%, against 6.25% for services.

Although the level of productivity, as measured by output per employee, remained unchanged in the first quarter of 1992, it was still 1.6% higher than in the corresponding quarter of 1991. Whilst the figures have improved over the last year, the general productivity performance of the whole economy has been very patchy in the recent past, with productivity in the first quarter of 1992 only 1.4% higher than in the first quarter of 1989. Manufacturing productivity has shown a more marked improvement with annual increases of 3.4% up to June 1992 and 4.2% for the second quarter. These results, combined with the wage inflation figures mean that the unit labour costs in the whole economy continued to rise at the substantial annual rate of 5.8% to the first quarter of 1992. Whilst over the last 18 months there has been a sharp reduction in the annual increase in whole economy unit labour costs, there is clearly some distance to go to get to the zero inflation target that the government seems to have adopted. In manufacturing the position is rather better, with the annual increase in unit labour costs to June of 2.4% and to the second quarter of 1992 of 1.7%. This contrasts very distinctly with the 10.5% annual increase in manufacturing unit labour costs of only a year ago.

PROGNOSIS

The recession continues to persist with very few signs of a sustained expansion of output in the near future. GDP has fallen by 4.2% in the eight quarters since the last peak in the second quarter of 1990. Nevertheless, the data do suggest that the contraction of output ceased in the first half of the year. When oil and gas are excluded the provisional figures for the second quarter suggest a slight 0.1% increase in GDP, with manufacturing output increasing by 0.4%. In addition, the CSO's co-incident cyclical indicator bottomed out in April and rose in the subsequent three months. Total investment also rose in the first quarter for the first time since early 1990, while manufacturing investment rose in the second quarter. Moreover, while total stockbuilding continued to decrease in the second quarter, manufacturers began to increase stocks of materials and finished goods.

However, the persistent weakness of consumer demand through the summer, labouring under high real interest rates and continuing high levels of personal debt, and the effects on business confidence of turmoil in the international currency markets, suggests that output will remain flat for much of the remainder of the year and perhaps beyond. The short-term prospects for the British economy have deteriorated considerably in recent months.