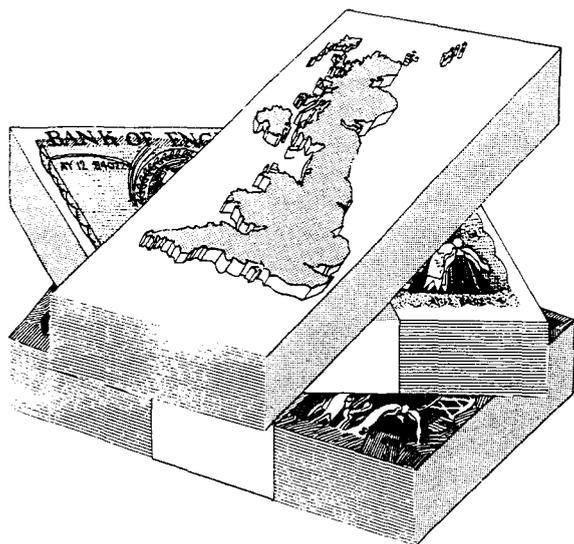


THE BRITISH ECONOMY



OVERVIEW

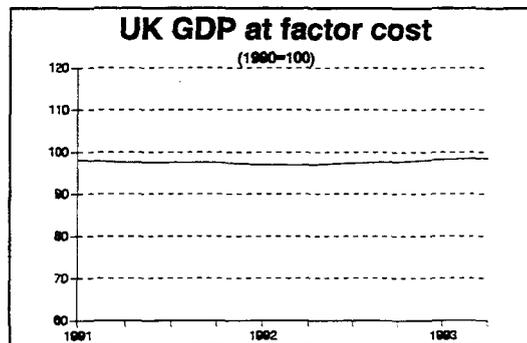
The economy continues to recover but even though we are eighteen months into the recovery there is still considerable uncertainty about the pace and durability of the recovery.

MACROECONOMIC TRENDS

In the third quarter of 1993, the average measure of **GDP at market prices - 'money' GDP** - rose by 1.2%. After allowing for inflation and adjusting for factor costs, **GDP** grew by 0.6% during the quarter, compared with a rise of 0.5% in the second quarter, and a rise of 0.5% in the first quarter. Over the year to the third quarter, 'real' GDP is estimated to have risen by 1.9%, and remains 2% below the level attained when the recession began after the second quarter 1990. When oil and gas extraction are excluded 'real' GDP is estimated to have risen by 0.5% in the third quarter and by 1.6% over the same period a year ago.

The **output of the production industries** in the third quarter 1993 is provisionally estimated to have risen by 1% over the second quarter, with output rising by 2.8% compared with the same period a year ago. Within production, manufacturing experienced a *decrease* in output of 0.1% on the previous three months, output of the other energy and water supply industries rose by 5.5%, and

production of oil and gas rose by 7.5%. Manufacturing output in September was 5.2% below the second quarter 1990 peak. The output of the **service sector** is provisionally estimated to have risen by 0.5% in the third quarter.

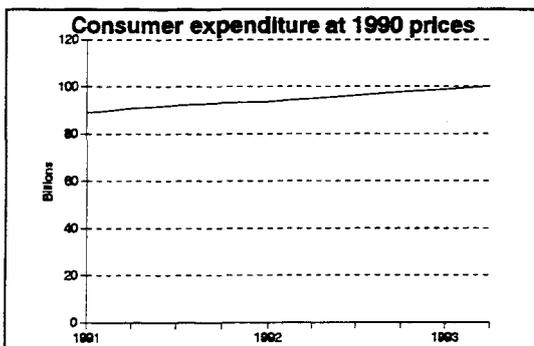


The CSO's **co-incident cyclical indicator** for September 1993, which attempts to show current turning points around the long-term trend, rose slightly. The index has been steadily rising since May of last year, suggesting an upturn in the spring of 1992. The **shorter leading index**, which attempts to indicate turning points about six months in advance, is maintaining the increase which began last autumn. 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 that year. This fall continued until January 1992, whereupon it rose to March 1993 and has been falling since that month.

In the third quarter of 1993, **real consumers' expenditure** rose by 0.9% after rising by 0.5% in the second quarter, and rising by 0.4% in the first quarter. Spending during the third quarter 1993 rose by 2.4% on the same period a year earlier. Detailed data on the components of consumers' expenditure will not be available until the full set of accounts for the third quarter is published on 20 December 1993.

The provisional official **retail sales** volume figures - seasonally adjusted - for October, 1993, rose by 0.1% above the September level. Over the year to

October, the volume of sales rose by 3.2%. Taking the three months to October, the volume of retail sales rose by 0.9% to a level 3.5% up on the same period a year ago. The **CBI Distributive Trades survey** for October indicates that retailers enjoyed a marginally higher rate of sales growth during the month, with a balance of +26% reporting sales growth compared with +25% in the previous month's survey. However, the survey reveals some marked variations across sectors of the retail trade. Sellers of clothing and books reported a big increase in sales whilst grocers and chemists reported a marked slow-down in sales growth, and off-licences and confectioners experienced falling sales. Amongst the different categories of retailers, single-outlet retailers reported an accelerating fall in sales. Sales growth was particularly concentrated in the large multiples and in mail-order firms. Variations in sales are reported to reflect the end of discounting in some sectors, but generally these data suggest that retail sales growth is not very solidly based.



The underlying determinants of consumers' spending continue, on balance, to strengthen. The **consumer credit** figures for September show that net lending to consumers by finance houses and other specialist credit grantors (excluding bank loans) more than doubled to £489m, following increases of £225m, £204m, £213m and £118m, in August, July, June, and May, respectively. Consumer credit therefore rose by £918m in the third quarter compared with an increase of £525m in the second quarter and a rise of £400m in the first quarter. The **saving ratio** fell slightly in the second quarter of 1993 to 10.1%, a decrease of 0.2 percentage points on the 10.3% recorded in the first quarter. The underlying increase in **average weekly earnings** in the year to September 1993 is provisionally estimated to have been 3% and the underlying annual increase in average earnings continues to fall. In the year to January 1992, the

figure was 7.25%, while in the year to January 1993 it was 4.75%. Further reductions have occurred throughout this year. **Real personal disposable income** is now estimated to have risen by 0.3% in the first quarter 1993 to a level 1.4% higher than in the same period in 1992. In the second quarter RPDI is estimated to have fallen by 1.6%.

General government final consumption rose by 0.2% in the third quarter 1993, after rising by 0.9% in the second, and falling by 0.4% in the first quarter. Government consumption in the third quarter 1993 was 1.1% higher than in the corresponding quarter of 1992.

Real gross fixed investment rose in the third quarter 1993. Gross domestic fixed capital formation rose by 1.3% after falling by 2.9% in the second quarter and rising by 0.7% in the first quarter. Detailed data on investment by category will be available after 20 December when the full accounts for the third quarter are published. Overall, real investment was 1% higher in the third quarter than in the same period in 1992.

Turning to the **balance of payments**, the deficit on **current account** for the second quarter 1993 was, on revised figures after seasonal adjustment, £2.43bn, compared with £2.56bn in the first quarter. On **visible trade**, the second quarter deficit stood at £3.06bn compared with £3.08bn in the first quarter. The surplus on the oil account rose from £418m in the first quarter to £536m in the second quarter. Following the completion of the Single European Market at the end of 1992, customs declarations - the former source of trade statistics - are no longer required. A new system (INTRASTAT) has been developed, to be used in all EC countries, to provide intra-EC statistics. Because this is a new system, the intra-EC trade data are not very robust, take longer to appear than extra-EC trade and are likely to be subject to greater revision than previously until the system beds down.

THE LABOUR MARKET

Employment and Unemployment

The level of UK seasonally adjusted claimant unemployment fell in October by 49,000, the largest monthly fall for four and a half years, bringing total UK unemployment to 2,855,100. Unemployment fell in each of the UK standard regions, and the national figure represents an unemployment rate of 10.2%, with the male and female rates of 13.7%

and 5.5% respectively. The reduction in unemployment in the quarter to October is 61,200 and unemployment is now 137,200 lower than the peak in January. However, whilst unemployment does appear to be on a downward track, the situation is still rather tentative in that there were small increases in unemployment in July and August. This rather fragile improvement in the labour market is also reflected in the unfilled vacancies figures. This is a rather erratic series, with a lot of monthly variation. However, over the last year there has been a persistent, though not monotonic, increase in the unfilled vacancies figure, which stood at 134,400 in October, a 6,800 (5.3%) rise in the previous three months and a 20,900 (18.4%) rise over the previous year.

The UK employment data are less up to date, but they reinforce the limited nature of the labour market recovery. For the quarter to June 1993, there was an increase of 42,000 (0.2%) in the UK workforce in employment, so that the total stood at 24,934,000. This is the first quarterly increase since June 1990 (when employment reached the peak of 26,937,000) but it is still 523,000 (2.1%) lower than the June 1992 figure. This quarter's rise has been solely concentrated in female employment, which increased by 65,000, whilst male employment fell 22,000. The employment expansion has also been primarily amongst the self employed, whose numbers increased by 75,000 (2.6%), whilst there was a very small increase in employees in employment and falls in employment in HM Forces and those on work related government training schemes. UK manufacturing employment shows small increases in the first two quarters of 1993, reversing a downward trend that has run continuously since the third quarter in 1989. However, the more recent GB figures indicate that in the third quarter of this year manufacturing employment fell again, and at 4,185,000 the September figure is 27,000 (0.6%) lower than the June 1993 and 124,000 (2.9%) lower than the September 1992 figures.

Earnings and Productivity

In September 1993, the annual rate of increase in British average weekly earnings continued the downward trend which has been virtually uninterrupted since July 1990. The seasonally adjusted actual increase for the whole economy stood at 2.9%, with an underlying increase of 3%. The actual rate is below the underlying rate because arrears of pay were higher in September 1992 than September 1993. The underlying increase has

fallen from 3.75% in June 1993, and 5.5% in September 1992. The decline in wage inflation continues to be more marked in services than manufacturing: for services, the September underlying annual wage inflation level was 2.5%, against the corresponding figure for manufacturing of 5.0%. Again if this is compared to the same figures for September 1992, manufacturing average earnings were increasing by 6%, whilst the figure for services was 5.5%. Clearly, wage inflation is higher in manufacturing and dropping more slowly.

Seasonally adjusted whole economy productivity levels increased by 0.4% in the second quarter of 1993. This is a rather modest increase given recent achievements, though productivity was still 4.4% higher than the previous year and only a little lower than the first quarter figure of 4.5%. The large increases in manufacturing productivity that have occurred over the last two years appear to be levelling off. However, labour productivity in this sector is still 4.3% higher than a year ago, though this has to be contrasted with the figures for the last two quarters of 7.0% and 7.6%. When the productivity results are combined with the wage inflation figures they show whole economy unit labour costs falling very slightly in the second quarter of the year, and they remain 0.9% lower than the second quarter of 1992. In manufacturing the position is not quite so sanguine. Unit labour costs rose 1.3% in the third quarter of 1993, but they still registered a 0.6% decline over the full year.

PROGNOSIS

The economy continues to recover, but even though we are eighteen months into the recovery there is still considerable uncertainty about its pace and durability. GDP, including oil, grew by 0.6% in the third quarter, suggesting an overall rate of growth for 1993 of just under 2%. However, manufacturing output fell by 0.1% in the third quarter and the balance of optimism reported in the CBI Survey, which is confined to manufacturing, has weakened recently. Buoyant oil and energy production is adding about 0.1 percentage points to the quarterly growth rate, while the 0.5% growth experienced in services constitutes the core of the economy's current growth.

At present, though, GDP growth is being fuelled by consumers' expenditure rather than investment or net trade. But, while retail sales are seen to be expanding, growth appears slow and not particularly broadly based. Real incomes are expected to remain

flat or fall slightly this year and to increase marginally next year. A more rapid growth in consumption will require further falls in the savings ratio and a greater willingness of consumers to take on debt. The savings ratio does tend to fall during a recovery and further reductions are likely to be helped by the presently low level of nominal interest rates. Despite the significant increase in consumer credit in the third quarter, and the low level of interest rates, it appears unlikely in the foreseeable future that the consumers' willingness to take on new debt will approach the levels attained in the late 1980s.

The growth rate in 1994 appears unlikely to rise much above 2.6%. The measures introduced in the recent Budget would appear to have very little short-term macroeconomic impact. However, the question remains whether the growth in nominal demand during 1994 will be sufficient to attain even this growth rate. Inflation is relatively subdued. A flattening yield curve suggests inflationary expectations are low. Domestic price competition in, for example, food retailing and an apparent switch in imports from low-cost areas such as Eastern Europe, East Asia and Latin America, have further moderated price increases in recent months. In addition, and contrary to received wisdom, the devaluation of sterling has had very little effect on producer prices. Underlying inflation will, however, rise in 1994 in part due to once-and-for-all changes in administered prices and indirect taxes. The headline rate of inflation will also rise sharply for one-off reasons as the effect of lower mortgage rates drops out of the calculation and as mortgage interest tax relief is restricted to 20% from next April, and to 15% in April 1995. The crucial issue for the future track of inflation, therefore, is the extent to which wage bargaining responds to what would be a temporary increase in recorded inflation due to the above one-off effects. We are less sanguine about this possibility than many other commentators. The possibility of a significant "wage push" in the mid-to-latter part of 1994 remains a real possibility as the economy recovers further, a possibility which will be exacerbated if, as we argued in the June Commentary, the Government continues to attempt to hold pay in the public sector to unrealistically low levels.

For the moment though, the main question is the extent to which there is a deficiency of demand in the British economy. One hopeful feature of the present situation is the evidence of falling unemployment, rising productivity and, from the

CBI Survey, declining spare capacity. However, such data appear to hang uneasily with weak GDP growth and static or falling employment. While published data for employment lag behind unemployment data it does appear that there may have been some under recording of employment growth during the year due to the sampling frame of the DE's employer-based survey under representing the better employment performance of small to medium-sized firms, noted in the British Chambers of Commerce Survey. Equally, as the November NIESR Review points out, the new trade statistic collection procedures for intra-EC trade appear to have underestimated the volume of trade during the year, with the result that the contribution of net trade to growth may be greater than the official statistics allow. Even if growth is a little stronger than the picture painted by the official statistics, there is not only the question of whether demand is enough to support a sustained recovery but also the issue of available capacity. If, as some commentators suggest, the present output gap is quite small, then only a rapid and sustained expansion of investment and training will allow a return to the growth performance achieved in the late 1980s.