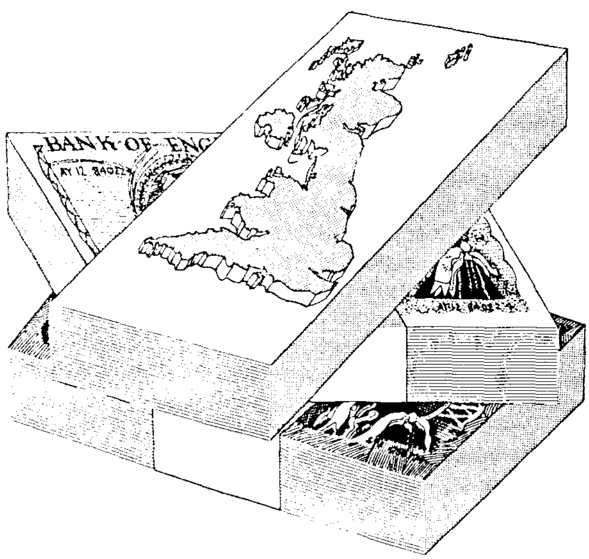
THE BRITISH ECONOMY



OVERVIEW

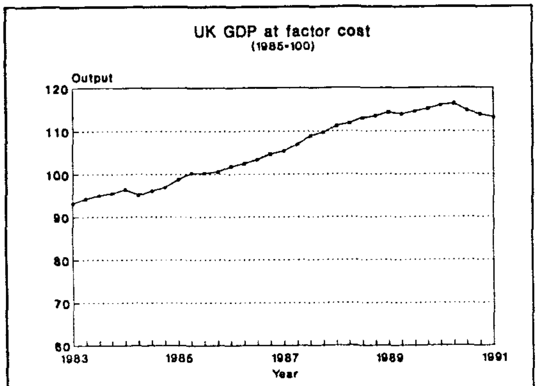
With the provisional estimate of a 0.3% increase in GDP in the third quarter the recession has technically come to an end. However, the upturn is very weak and hesitant. The rate of recovery over the next two quarters will be largely governed by the extent to which consumers raise spending by taking on new credit.

MACROECONOMIC TRENDS

In the second quarter of 1991, the average measure of GDP at constant market prices - 'real' GDP - fell by 0.6%, compared with a reduction of 0.5% in the first quarter and reductions of 0.9% and 1.2% 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 last year. Over the year to the second quarter 'real' GDP is estimated to have fallen by 3.7% - a fall of 3.2% if oil is excluded - following the falls of 2.1% and 1.5% during the year to the first quarter 1991 and fourth quarter 1990. In contrast, increases of 0.6%, 2.5% and 1.9% were recorded in the years to the third, second and first quarters of 1990, respectively.

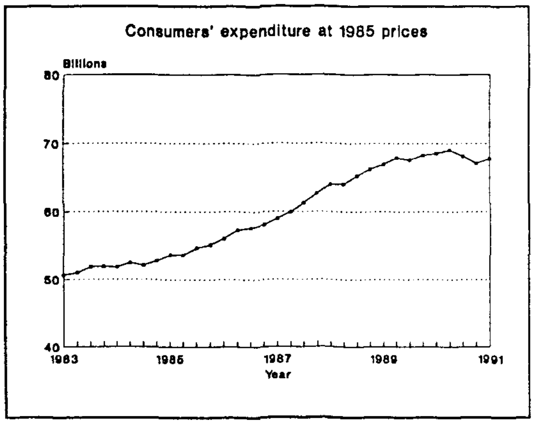
Preliminary estimates of the output-based measure of GDP - which is usually taken to be the most reliable indicator of short-term change - in the third quarter of 1991, suggest that activity rose by 0.3% compared with the previous quarter to a level 2.3% lower than the third quarter of 1990. Manufacturing and service sector output remained unchanged. Within the service sector, the output of distribution, hotels and catering increased by 0.3%, while the output of the energy sector rose by 4% in the third quarter. When oil and gas extraction are excluded, the output measure of GDP is estimated to have fallen by 0.25% in the most recent quarter.

The estimated third-quarter increase in GDP of 0.3%, if subsequently confirmed, suggests that the UK recession technically ended in that quarter. This outturn is consistent with the prediction in earlier Commentaries that negative growth was likely to persist for the first two quarters of 1991 at least. However, the latest data suggest that the upturn is tenuous, with the movement into positive growth largely due to the buoyancy of the energy sector. It would therefore appear that any recovery that does occur is likely to continue to be slow and hesitant for two further quarters at least. On these data, it appears unlikely that there will be much of an upturn before the middle of 1992.



The CSO's coincident cyclical indicator for September 1991, which attempts to show current turning points around the long-term trend, declined slightly, reflecting further falls in all its component series. This indicator has fallen continuously since the peak of August 1988, but recent movements suggest a turning point is near. The shorter leading index, which attempts to indicate turning points about six months in advance, rose in August and continued to rise in September, offering further support that an upturn of some sort would occur during the final half of the year. The longer leading index, which purports to indicate turning points about one year in advance, appeared 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 began to show positive signs of upward movement gaining further momentum after July. This might be interpreted as offering further support for the view that the recovery will not be of much significance until the middle of next year.

In the second quarter of 1991 real consumers' expenditure fell by 0.2% after rising by 0.4% in the first quarter and 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 second three months of the year therefore stood 1.7% below the same period a year earlier, compared with 0.7% and 1.5% falls over the year to the first and fourth quarters, respectively, and the increases of 2.1%, 2.7% and 3% recorded over the years to the third, second and first quarters of 1990, respectively.



The provisional official retail sales figures - seasonally adjusted - for October, fell sharply by 0.5% after rising by 0.3% in September. In the three months to October, sales volumes fell by 0.3% to a level 0.3% below the same period a year earlier. These data would appear to confound the view that retailing is beginning to come out of the recession. However, in the October CBI Distributive Trades Survey a net balance of 20% of retailers reported an increase in sales, the sharpest year-on-year increase for twelve months. In wholesaling, a net balance of 13 percent of respondents reported an increase in sales volumes, although this was lower than the balance of 17% reporting sales increases in September. It would appear that consumers' spending is slowly starting to turn upwards but the upturn is slow, patchy and hesitant.

The underlying determinants of consumers' spending remain weak. The consumer credit figures for September show that the cumulative amount of outstanding credit (excluding bank loans) fell by £107m after a fall of £26m in August, an increase in July of £187m, a £22m increase in June and a fall of £36m in May. In preceding months outstanding credit rose £335m, £153m, £94m and £94m 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 £141m, £229m, £342m, £331m and £196m were reported in December, November, October, September and August, respectively.

The saving ratio fell slightly to 10.1% in the second quarter from 10.8% in both the first quarter and the fourth quarter 1990. This compares with 9.8% in the third quarter 1990, 7.7% in the second quarter and 8.4% in the first quarter. The savings ratio averaged 9.2% in 1990 compared to 7.1% in 1989 and 5.4% in 1988. Real personal disposable income fell by 0.9% in the first quarter, after falling by 0.3% in the first quarter and increasing by 0.5% and 1.6% in the fourth and third quarters of 1990, respectively. RPDI was 0.9% higher in the second quarter 1991 than in the same period in 1990.

The underlying increase in average weekly earnings in the year to September was provisionally estimated to have been 7.75%, the same increase as reported in the year to July and August. This compares with the 8%, 8.5% and 8.75% increases in the year to June, 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 rose by 2% between the second half of 1990 and the first half of 1991. Spending fell by 0.5% in the first quarter after falling by 0.5% during the fourth quarter and 0.7% in the third quarter of 1990. At the end of the first half of the year the new level was 2.8% higher than a year earlier. Government final consumption in 1990 was 2.75% 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. During the first half of 1991 investment was 7% lower than in the second half of 1990 and 12.4% below the level in the first half of 1990. Provisional estimates of real capital expenditure in manufacturing for the third quarter of 1991 suggest an increase of 1.9% over the second quarter after the fall of 5.2% in the second quarter. The level of manufacturing investment in the third quarter was therefore more than 12% below that in the third quarter of 1990. Over the same period investment in vehicles is estimated to have fallen by 34%, investment in plant and machinery by 14% and 1% for new building work. These figures underline the continuing retrenchment in investment.

Turning to the balance of payments, the deficit on current account for the second quarter 1991 fell to £0.8bn, after, after - on revised figures - the £2.6bn deficit in the first quarter, the £1.9bn deficit in the fourth quarter 1990, the £2.2bn deficit in the third quarter, a £4.9bn deficit in the second quarter of 1990, and a £5.3bn deficit in the first quarter. For 1990 the deficit therefore amounted to £14.4bn, compared with a deficit for 1989 of £20.4bn, £15.5bn in 1988 and £4.3bn in 1987. On visible trade, the second quarter deficit fell to £2.1bn, compared with £3.0bn in the first quarter and £3.2bn, £4bn, £5.4bn, and £6bn, respectively, in the previous four quarters. The surplus on invisibles rose to £1.3bn in the second quarter from £0.4bn in the first quarter, while the surplus on the oil account was £0.3bn in the second quarter, compared with £0.2bn, £0.3bn and £0.4bn in the first quarter 1991, and fourth and third quarters of 1990, respectively.

In the third quarter of 1991, the output of the production industries is provisionally estimated to have increased by 1.1% compared with the previous quarter, thus reversing the fall of the same percentage which occurred in the preceding quarter. In the third quarter, industrial production stood at a level 2.2% lower than the same period in 1990. In manufacturing industry, output remained unchanged after the 0.5% fall in the second quarter, a 1.3% fall in the first quarter and the significant fall of 3% registered in the fourth quarter of 1990 - the sharpest quarterly fall since the 1981 recession. Manufacturing output now stands 5.3% lower than in the third quarter of 1990. As usual there were clear variations within the sector, although as in the second quarter more industries experienced an increase in output than experienced a fall. Chemicals output rose by 3.7%, Metals by 0.9%, Other minerals by 1.7%, Textiles by 0.6% and Other manufacturing by 0.5%. In contrast, Engineering production fell by 1.6% and Food, drink and tobacco output fell by 0.1%. In contrast to the previous quarter, the output of the energy sector rose by 4% to a level 7.2% higher than in the same period a year ago.

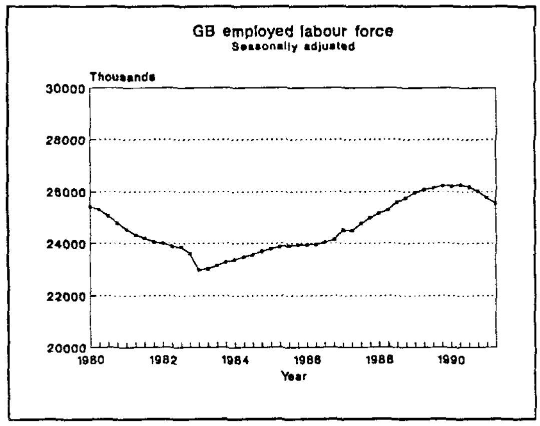
Output in the investment and consumer goods industries fell between the latest two quarters by 1.3% and 0.2% respectively, while production of intermediate goods rose by 2.7%.

THE LABOUR MARKET

Employment and Unemployment

The UK workforce in employment in June 1991 totalled 26,177,000. For the fourth successive quarter, total UK employment has fallen: the decline over the last quarter is 221,000 (0.8%), over the last six months 474,000 (1.8%) and over the last year 712,000 (2.6%). Sectoral disaggregation indicates that manufacturing employment is falling more rapidly and has been falling over a longer time period than employment in other sectors. For example, UK service employment declined continuously for the four quarters to June: the employment loss for the year is 255,000 (1.6%), with a decline of 54,000 (0.3%) in the last quarter. However, manufacturing employment has decreased monotonically for seven quarters up to June, with the proportion loss over the last four quarters of 5.6% and over the last quarter of 1.9%.

British manufacturing data are more current than the UK figures. They indicate employment still falling in manufacturing, with a decline in the last quarter to September of 87,000 (1.8%).



The provisional figure for UK seasonally adjusted unemployment stood at 2,472,900 in October 1991, an overall unemployment rate of 8.7%, with male and female rates of 11.6% and 4.9% respectively. UK unemployment has now been rising for nineteen months in succession, the absolute increase over the year to October 1991 being 606,100. However, the rise in unemployment has been slowing down over the last three months to October and in the final month, unemployment in the Northern Region, Wales and Scotland actually fell. Although the seasonally adjusted stock of unfilled vacancies at Jobcentres rose slightly in July and August, they fell again in September and October to 103,500, a decline over the quarter of 500 (0.5%) and over the year of 42,000 (28.9%)

Earnings and Productivity

The provisional actual annual increase in British whole economy average earnings up to September 1991 was 7.8%, virtually identical to the underlying increase of 7.75%. The level of underlying wage inflation has been falling consistently for the last 14 months. The fall in services continues to be the most pronounced: the underlying rate in this sector declined from 10% in September 1990 to 7.5% in September 1991, compared to the corresponding change in manufacturing over the same period from 9.5% to 8% in July 1990.

For the whole economy, the most recent figures continue to show a very poor performance: in the second quarter of 1991, productivity was 0.2% higher than the previous quarter but 1.6% lower than the same quarter of 1990. Data for manufacturing productivity is rather more encouraging. Between the second and third quarter of 1991 there was a 2% rise in manufacturing productivity, though the annual rise was only 1%. These results mean that the unit labour costs in the whole economy were still rising at a very rapid rate of 9.3% to the second quarter of 1991. However, the annual of increase of unit labour costs in manufacturing has shown a marked fall in the very recent past, from 10.9% in the second quarter to 6.7% in the third quarter and 5.5% in September of 1991.

PROGNOSIS

With the provisional estimate of a 0.3% increase in GDP in the third quarter the recession has technically come to an end. GDP has therefore increased, all be it slightly, after four successive quarters of diminishing aggregate output. However, the upturn is very weak and hesitant; the latest increase largely being accounted for by the relative buoyancy of the energy sector. The principal components of aggregate demand remain weak and the rate of recovery over the next two quarters will be largely governed by the extent to which consumers are ready to take on new credit. Despite survey evidence in October of rising consumer confidence this has still to be translated into increased borrowing and spending commitments as the recent retail sales figures show. Lower interest rates, reduced mortgage payments and falling inflation have all served to increase households real disposable income and so raise confidence. But real personal disposable income has, nevertheless, only risen by less than one percent over the past year and has been falling in recent quarters. Also while the recent small reduction in the saving ratio will make some contribution to consumer spending it is unlikely to have much impact on spending on major items such as durables for which borrowing is usually necessary. Moreover, the scale of repossessions in the housing market is serving to depress house prices, while unemployment continues to rise; factors which are likely to diminish the willingness of households to take on new credit. It is arguable, however, that it is the rate of increase in unemployment that is important to consumer confidence and not the level per se; since the rate of increase is currently declining, unemployment should now be much less of a constraint on consumer spending than earlier in the year.

Against this background it is surprising that the Treasury's latest forecast, contained in the Autumn Statement, puts such faith in a pick-up in consumer spending as the main driving force behind the UK economy's predicted recovery in 1992. GDP is forecast to grow by 2.25% in 1992, compared with a predicted fall of 2% in 1991. Consumer spending is expected to rise by 2.5% after a fall of 0.75% during 1991. The recent evidence on consumer behaviour might appear to suggest that the Treasury's forecast is somewhat optimistic. Moreover, the Treasury are also predicting a reversal of destocking with stock building taking place during 1992 on a scale which adds 0.75% to the overall rate of growth. While a reversal of destocking invariably plays a key role in the early phases of an upturn there must be doubts that it will occur on the scale that the Treasury predicts. However, a recovery of stock levels offers a once-and-for-all contribution to output levels and does not provide the basis for sustained growth; this is why the role of the consumer is so central to the scale and timing of the recovery.