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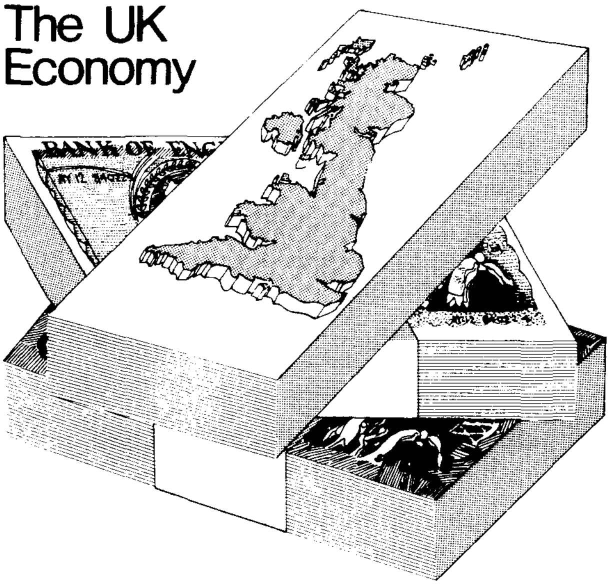
The UK Economy



Gross Domestic Product in the United Kingdom increased by close on 3% in 1978. This growth, however, was largely concentrated in the first half of the year, the level of activity showing little change in the third and fourth quarters. Consumer expenditure was the most buoyant component of aggregate demand, increasing by 5.5% in volume terms over its 1977 level. This buoyancy reflected the rapid growth in real personal disposable income which took place last year following three successive years of decline. Purchases of consumer durables, deferred during these preceding years, recovered strongly, leading in turn to a rapid rise in imports. Exports by contrast performed poorly, rising at a considerably slower rate than in the preceding two years. The current account of the balance of payments remained marginally in surplus for the year as a whole, but at a level considerably below official predictions.

Labour market conditions did not improve markedly on those of 1977. The slow rate of growth of industrial production was mirrored by a slight increase in manufacturing employment. On the supply side registered unemployment declined marginally despite the natural increase of the labour force. Average earnings increased by 14.5%, a figure which masks considerably more rapid growth in the private sector of the economy. Given a year on year rate of price inflation of 8.2% the implied real income growth would have been substantial even in the absence of the income tax concessions introduced in late 1977 and early 1978.

A broad continuation of these trends is to be expected in 1979. It now appears that average earnings will rise by 13-15% in the course of the current pay round. Inflation, though again accelerating, is unlikely to be sufficiently high to prevent a further increase in real personal incomes and consequential growth in the volume of consumption, albeit at a somewhat slower rate than in 1978. The associated slackening in import demand, coupled with a more buoyant external market should ensure a continuing surplus on the current account during 1979.

The implied rate of GDP growth, of the order of 2½% (1½% if oil is excluded) is unlikely to induce any significant fall in the level of unemployment. Indeed, given the current stance of exchange rate and monetary policy and the upward trend of labour supply, further increases in unemployment must be contemplated, both in the immediate future and in the medium term. Current rates of income increase are incompatible with the professed monetary policy of the government. Assuming that the incoming administration does not relax the present upper limits on money supply growth, the short term consequences of the current pay round must be increased unemployment. In the medium term the current pressure on profits from rising earnings and a strong exchange rate must act to inhibit investment and thereby employment growth. In such circumstances it is imperative that increases in employers' national insurance contributions are not used as the major instrument to attain the required level of public sector borrowing.

Insulated by oil revenues, the UK economy appears to be settling down to a period of what will be, by British standards, reasonably rapid growth of the order of 2-3% annually. Oil revenues will ensure that there will be no external constraints on this disappointing performance, and will also serve to fund a large, if slowly declining, public sector borrowing requirement. On present monetary policies, inflation must settle in the range of 9 - 12%, implying a gentle depreciation of sterling against the currencies of Britain's trading partners. Such a scenario does not augur well for unemployment, which can at best stabilise, but will most likely rise slowly given the expected rapid growth in the labour force.

The debate on the disposal of oil revenues will continue but the critical choice appears to have already been made, these funds are to be used largely to sustain the growth of personal consumption. Given Britain's high marginal propensity to import, the current account of the balance of payments is likely to, at least, remain in rough balance during this period. Debate on the disposal of the foreign exchange reserves to be earned from Britain's status as a net oil exporter is therefore equally pointless under this scenario, which unfortunately seems the most likely outturn given current policies and attitudes.