

No economy is immune to the impact of the current global slowdown or the events of 11 September. But because the Government has taken tough decisions since 1997 to create a platform of macroeconomic stability, the UK is in a better position than on previous occasions to cope with turbulence in the world economy. The economic challenge is to maintain stable growth through these testing times, while continuing to work to deliver stronger productivity growth and employment opportunity for all. Rising to this challenge is imperative in order to maintain the foundations for meeting the Government's objectives for reducing poverty and delivering high quality public services.

The Pre-Budget Report shows that:

- since Budget 2001, G7 activity and trade have been weaker than expected. For the first time since 1974, there has been a significant and simultaneous slowdown of growth in the US, Europe and Japan. Following the terrorist attacks of 11 September, heightened uncertainty and declining confidence have further weakened demand and delayed the recovery in the major economies. By raising security and insurance costs, the attacks may also have had a negative impact on supply;
- in the UK, economic growth has remained relatively strong during 2001 despite the weaker external environment. Employment is now over 1.2 million higher than in spring 1997 and unemployment has been at its lowest since the 1970s. Inflation has remained lower for longer than at any time since the 1960s, allowing the Monetary Policy Committee to cut interest rates to levels not seen since 1964. Fiscal policy is supporting monetary policy this year and next in smoothing the path of the economy over the cycle;
- the UK economy has been affected by the global slowdown. Growth in the UK's major export markets slowed dramatically during 2001. Business investment has fallen, and business confidence, which was already weakening, has deteriorated further since 11 September. The global slowdown also appears to have had a negative impact on consumer confidence; and
- although UK consumer spending growth is expected to moderate, it should continue to cushion the impact of weaker world demand in the short term. UK GDP is forecast to grow by $2\frac{1}{4}$ per cent this year, the lower end of the Budget 2001 forecast range, and by between 2 and $2\frac{1}{2}$ per cent next year. Stronger and more balanced growth is expected to resume from the middle of 2002 as the world economic recovery gathers pace.

INTRODUCTION^{1,2}

A1. This annex discusses economic developments since Budget 2001 and provides updated forecasts for the UK and other major economies in the period to 2004. It begins with an outline of world economic developments and prospects, which will have a significant influence on the UK economy over the forecast period. The subsequent discussion sets out the key features of the UK forecast and the associated risks, followed by a more detailed assessment of sector-specific issues.

THE WORLD ECONOMY

Overview

A2. The world economy has slowed significantly since Budget 2001, with sharp declines in world trade growth, investment, industrial production and stock markets. G7 activity has been weaker than anticipated at the time of the Budget, and growth in developing countries has slowed as weaker activity in the industrialised economies, depressed commodity prices and increased risk aversion have taken their toll. The terrorist attacks of 11 September have added to the downward momentum in world activity and are expected to delay the global recovery. However, the decisive response by policy-makers in the US and Europe is expected to support a recovery which gathers pace from mid-2002.

Table A1: The world economy

	Percentage changes on a year earlier				
	2000	Forecast			
		2001	2002	2003	2004
<i>Major 7 countries¹</i>					
Real GDP	3½	1	¾	3	2½
Consumer price inflation ²	2½	2	1½	1½	1½
World trade in goods and services	11¾	1¼	1¾	7¾	7
UK export markets ³	11¼	1	1¾	6¾	6

¹ G7: US, Japan, Germany, France, UK, Italy and Canada.

² Per cent, Q4. For UK, RPIX.

³ Other countries' imports of goods and services weighted according to their importance in UK exports.

¹ The UK forecast is consistent with national accounts and balance of payments statistics to the second quarter of 2001 released by the Office for National Statistics on 25 September, and output, income and expenditure data for the third quarter released on 22 November. A detailed set of charts and tables relating to the economic forecast is available on the Treasury's internet site (<http://www.hm-treasury.gov.uk>), and copies can be obtained on request from the Treasury's Public Enquiry Unit (020 7270 4558).

² The forecast is based on the assumption that the exchange rate moves in line with an uncovered interest parity condition, consistent with the interest rates underlying the economic forecast.

G7 activity

A3. The slowdown in G7 activity during 2001 has been sharper than anticipated at Budget time. Falling manufacturing output has been a particular feature of the slowdown across the G7, with the sharpest falls in the US and Japan. Prior to 11 September, most analysts had revised down their growth forecasts for 2001, but were expecting a G7 recovery to begin by the end of the year. Consensus forecasts for G7 growth fell by around 0.5 percentage points between March and August this year. However, the events of 11 September have further weakened demand, with the consensus now expecting recovery to be delayed until the middle of 2002.

Table A2: Consensus forecasts for GDP growth in major economies¹

	Percentage changes on previous year			
	March 2001		November 2001	
	2001	2002	2001	2002
USA	1.9	3.4	1.1	0.7
Euro-area	2.7	2.9	1.5	1.5
Japan	1.2	1.7	-0.5	-0.6

¹ 'Consensus forecasts', Consensus Economics Inc.

A4. The Pre-Budget Report forecast for G7 GDP growth this year has been scaled back to 1 per cent from 2 per cent at Budget 2001, reflecting weaker world prospects prior to 11 September and the further effects of the terrorist attacks. Looser policy and lower commodity prices are now expected to support a recovery in the US and the Euro-area from the middle of 2002, with G7 growth forecast to strengthen from $\frac{3}{4}$ per cent in 2002 to 3 per cent in 2003 as the recovery gathers pace.

A5. In the US, falling stock prices and rising unemployment were already beginning to weigh on consumer confidence prior to 11 September, and preliminary estimates show that the economy contracted during the third quarter. Business and consumer confidence deteriorated further after the terrorist attacks. The short-term disruption, increased risk aversion and weak domestic demand are expected to depress activity further in the fourth quarter, and the outlook is now more uncertain. However, monetary and fiscal policy have responded rapidly following the attacks and, together with the cuts in taxes and interest rates implemented earlier in the year, should provide a timely boost to the economy, with the scope remaining for further policy loosening. The policy response is expected to support a recovery which begins in mid-2002 and gathers pace during the second half of the year.

A6. Economic activity in the Euro-area has been much weaker than expected at Budget 2001. The impact of weaker external demand has been only partly offset by recent interest rate cuts. Germany has been particularly affected by the world slowdown and, amongst other factors, continued weakness in the construction sector.

A7. Renewed weakness in Japan is largely attributable to the sharper than anticipated deterioration in the external economic environment. The new Government's commitment to a much needed programme of structural reform is likely to exert further downward pressure on growth and inflation in the short term, but should yield significant long-term benefits.

Box A1: The ICT revolution and US prospects

During the 1990s, the information and communications technology (ICT) sector was one of the most innovative in the US economy. Technological advances and intense competition drove down quality-adjusted prices for computers and peripheral equipment by over 70 per cent between 1995 and 2000. Private investment in ICT goods rose at an average annual rate of 16 per cent¹ during the 1990s, accelerating to an average annual rate of 20 per cent between 1995 and 2000. In 2000, it accounted for 4.7 per cent of US GDP and made up more than one third of all private non-residential fixed investment.

There has been growing support for the view that 'capital deepening' through ICT investment, and the related diffusion of know-how, have contributed to an acceleration in US trend productivity since the mid-1990s. On the other hand, some have argued that recent productivity gains can largely be attributed to cyclical factors. The nature of the US recovery will be determined by which of these views is true. Assuming the trend rate of productivity growth has risen, the US economy should be able to resume stronger output growth relatively quickly. However, if the gains were primarily cyclical, a more prolonged period of lower growth may be required to return the US economy to a sustainable growth path.

First estimates of US labour productivity growth in the third quarter of 2001 showed a slowdown to 1.8 per cent on a year earlier, following growth of 3.0 per cent in 2000 and 2.3 per cent in 1999. However, slower productivity growth is typical during economic downturns, and it will only be possible to assess the full extent of any acceleration in underlying productivity performance once the economic cycle is complete.

Looking ahead, the factors driving high levels of ICT related investment during the 1990s remain in place. Technological progress in semi-conductor production will continue to bring down ICT prices, and can be expected to encourage further ICT related capital deepening. Studies suggest that, since 1971, real ICT investment has increased by more than 1 per cent for every 1 per cent decline in relative prices of ICT goods². Moreover, high rates of depreciation will also provide an incentive for firms to upgrade ICT goods at a faster rate than other forms of capital, while subdued inflationary pressures and low interest rates should continue to support the substitution of capital for labour.

¹ Information processing equipment and software, US national income and product accounts.

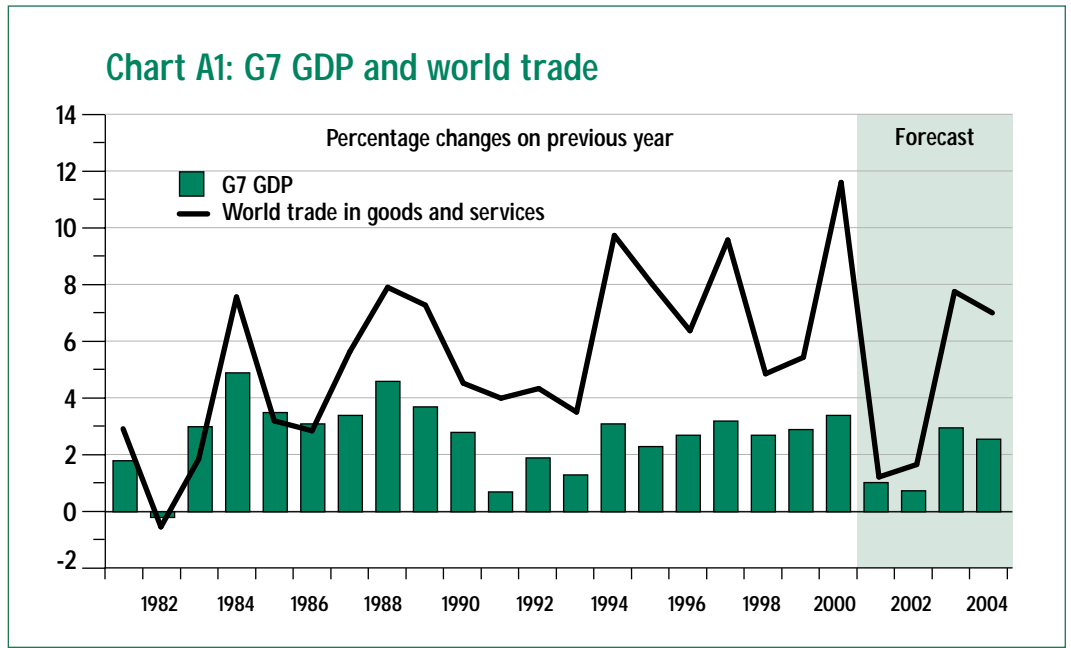
² *Does the new economy measure up to the great inventions of the past?* Robert Gordon, NBER working paper W7833, August 2000.

Forecast issues and risks

A8. Short-term prospects across the G7 depend heavily on private consumption, which has been the main driver of recent growth. Weakening labour market conditions and the possibility of further equity price falls present downside risks to consumer confidence, while the current weakness of business sentiment could also prove more prolonged than expected, depressing business investment further. Lower short-term growth prospects could also raise concerns about the willingness of investors to continue financing the US current account deficit, prompting an abrupt correction in the US dollar and financial market instability.

A9. On the other hand, if the impact of the terrorist attacks on confidence proves to be more short-lived than anticipated, the policy loosening witnessed this year might stimulate a world recovery which is either stronger, or begins earlier, than expected.

A10. Looking further ahead, evidence from the US suggests that the potential remains for ongoing productivity gains from the use of information and communications technology (ICT) (see Box A1), while the implementation of structural reform in Japan should improve its long-term growth prospects. However, the events of 11 September may prompt a reallocation of resources towards intermediate inputs, such as security and insurance, reducing a little the productive potential of those economies affected by an ongoing threat from terrorist attack.



World trade

A11. Following rapid growth of nearly 12 per cent in 2000, world trade contracted in the first half of 2001 as G7 growth slowed and demand for highly traded ICT capital goods collapsed. The slowdown in world trade growth has been much sharper than expected at Budget time, and the forecast for 2001 has been revised down from $6\frac{3}{4}$ per cent to just $1\frac{1}{4}$ per cent. However, this weakness is expected to be short-lived. World trade is projected to grow by $1\frac{3}{4}$ per cent in 2002 and by $7\frac{3}{4}$ per cent in 2003 as the global recovery gathers pace and demand for ICT capital goods recovers. UK export markets are expected to recover broadly in line with the pick-up in world trade, growing by $1\frac{3}{4}$ per cent in 2002 and $6\frac{3}{4}$ per cent in 2003.

Emerging markets and developing countries

A12. Prior to 11 September, weaker external demand, low commodity prices, increasing risk aversion and deteriorating conditions in international financial markets were already affecting the world's developing economies (see Box A2). These pressures are likely to persist as G7 economic activity remains subdued. Many Asian emerging markets have been particularly affected because of the openness of their economies and their heavy dependence on trade in ICT related goods. Excluding the crisis year of 1998, the IMF expects economic activity in emerging Asia during 2001 to be weaker than at any time over the past 20 years. Elsewhere in the world, Latin American economies have been affected by the slowdown in the US and reduced access to international capital markets, while emerging European economies have seen their growth prospects curtailed by weaker economic developments in the Euro-area.

Box A2: The impact of the world slowdown on developing countries

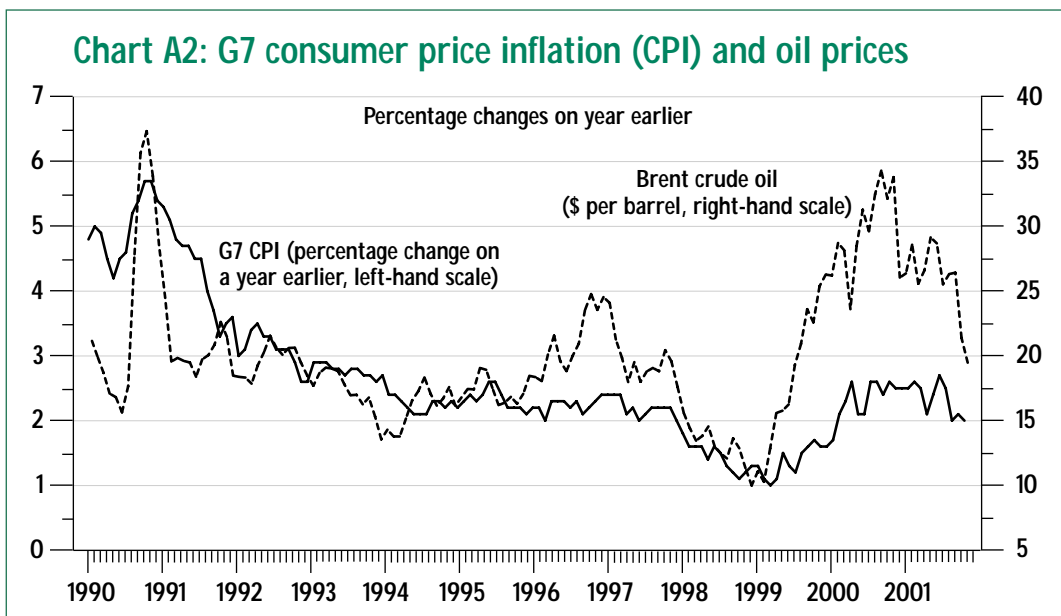
Economic growth is key to tackling the range of problems faced by the world's poorest countries. The global slowdown is likely to have a significant impact on many of these economies. The World Bank estimates that growth in the developing world will slow from 5.5 per cent in 2000 to 2.9 per cent in 2001, and that the events of 11 September will further reduce developing country growth by between $\frac{1}{2}$ and $\frac{3}{4}$ percentage points in 2002 as economic recovery is delayed around the world.

Developing countries have been particularly affected by the fall in commodity prices associated with weaker world demand during 2001. Non-oil commodity prices have fallen by 7 per cent this year, and agricultural commodity prices have fallen by 5 per cent since 11 September. A flight to quality has raised the cost of emerging and developing country borrowing, while foreign direct investment to emerging markets fell by 5 per cent in the first half of this year and is expected to decline further. A slump in tourism has also affected certain regions: in Africa, travel and tourism account for 10 per cent of merchandise exports, and 65 per cent of Caribbean holidays were cancelled in the aftermath of 11 September.

Even before 11 September, the human cost of the world slowdown was high. The World Bank has estimated that, as a result of the attacks, as many as 10 million more people may be forced to survive on less than \$1 a day, and between 20,000 and 40,000 more children under five may die as poverty worsens. Africa will be worst affected, with nearly half of the effects expected to be concentrated there.

Oil and commodity prices

A13. Weaker global demand and good harvests have put downward pressure on almost all primary commodity prices in 2001. Non-oil commodity prices have fallen back after a brief rally last year, and oil prices have recently fallen to two-year lows as the world economic slowdown has fed through into oil demand. The outlook for oil prices has become much more uncertain in the aftermath of the terrorist attacks. High stock levels are expected to keep agricultural prices in check during 2002, while metals prices should pick up once growth resumes.



G7 inflation

A14. Despite a sharp increase in the second quarter of the year, largely explained by a rise in oil prices, G7 headline inflation has fallen since the beginning of 2001. Core inflation, which excludes energy and food prices, has been low and stable throughout the year. As world demand has weakened, prices of intermediate inputs and oil have fallen. With inflationary pressures fading, G7 inflation is expected to remain at 2 per cent in the final quarter of 2001 and to decline to 1½ per cent thereafter.

UK ECONOMY OVERVIEW

Table A3: Summary of forecast

	2000	Forecast			
		2001	2002	2003	2004
GDP growth (per cent)	3	2¼	2 to 2½	2¾ to 3¼	2¼ to 2¾
RPIX inflation (per cent, Q4)	2	2¼	2¼	2½	2½

The economy in 2001

A15. No country can fully insulate itself from external developments, and the UK economy has been affected by the deterioration in the world economy during 2001. However, UK growth has remained relatively robust. Inflation has remained slightly below the Government's 2½ per cent target for most of the year, allowing the Monetary Policy Committee to take decisive action to sustain domestic demand growth in the face of weaker external conditions. Fiscal policy has supported monetary policy in maintaining stable economic growth. The outbreak of Foot and Mouth Disease (FMD), though clearly affecting certain sectors and regions more than others, appears to have had a minimal effect on aggregate GDP (see Box A3).

A16. With output growth holding up relatively strongly, employment continued to grow in the first half of 2001, and unemployment remained at its lowest rates since the 1970s on both the International Labour Organisation (ILO) and claimant count measures. A pick-up in average earnings growth earlier in the year suggested that the economy was operating slightly above potential, though labour market pressures now appear to be easing. Employment levelled off over the summer, and headline average earnings growth has fallen back to the 4½ per cent rate deemed consistent with trend productivity growth and the Government's inflation target. The economy is currently judged to be operating close to potential, with unemployment only slightly below the NAIRU³, which has itself fallen significantly in recent years.

A17. Underpinned by the strong performance of the labour market, household consumption has grown by over 1 per cent a quarter so far during 2001. The buoyancy of consumption has played an important role in supporting GDP growth in the face of weaker external demand. However, recent growth rates are unlikely to be sustainable. Survey data indicate that consumer confidence has moderated towards its long-run average in recent months, and consumption growth is expected to return to rates more consistent with its longer-term determinants by early 2002.

³ Non-accelerating inflation rate of unemployment.

Box A3: Measuring the macroeconomic impact of Foot and Mouth Disease

Although the final overall macroeconomic impact of the FMD epidemic still cannot be determined, the broad magnitudes involved are now clearer.

The agricultural sector carries a weight of less than 2 per cent in real GDP, of which a third is livestock production. Following internationally established national accounting practice, the contribution of livestock production to GDP is measured by the natural growth in the stock plus births. The lost value of culled animals is scored as a 'catastrophic loss' rather than as a temporary reduction in output, and the effects of movement restrictions are offset by higher work-in-progress within GDP. FMD related livestock slaughter therefore has no immediate effect on agricultural output or GDP: the lost output accrues over time from the foregone growth of the stock and the effects on birth rates arising from a smaller breeding stock. This is likely to have reduced GDP in 2001 only marginally.

Expenditure on tourism, the other sector most likely to have been affected by FMD, is equivalent to around 5 per cent of UK GDP. While the number of overseas visitors has fallen during 2001, both inbound tourism and business travel to the UK will also have been affected by the world economic slowdown. The scale of the fall in the number of business travellers – whose decision to travel is less likely to have been affected by perceptions surrounding FMD – suggests that, prior to 11 September, around one half of the fall in overseas visitor numbers during 2001 had been the result of FMD.

By contrast, there appears to have been little impact on the UK economy as a whole from lost domestic tourism to directly affected areas. Trips to the countryside foregone because of FMD appear to have been replaced by spending elsewhere in the economy, either in alternative tourist locations or on goods and services unrelated to tourism. UK visitor numbers to overseas destinations have also risen only modestly, providing little evidence that UK holidaymakers have substituted foreign holidays for visits to affected areas.

While the effect on GDP in 2001 is therefore estimated to have been modest relative to normal fluctuations – less than 0.2 per cent of GDP – the impact on severely affected regions has been much more pronounced. To address these difficulties, the Government acted decisively to contain and eradicate the disease and to assist those worst affected by the outbreak. Details of the Government's response are provided in Chapter 7.

A18. The Budget 2001 forecast anticipated subdued business investment growth this year, as firms took steps to reduce indebtedness. Weaker than expected external demand has also led firms to postpone capital spending during the year. Business investment fell between the second half of 2000 and the first half of 2001, and with a further fall in the third quarter of 2001 it was 2.7 per cent lower than a year earlier. Nonetheless, measured at constant 1995 prices, it remains close to a record share of GDP, following a number of years of strong ICT related growth. General government investment has grown very strongly during 2001, increasing by 20 per cent in the year to the second quarter.

A19. UK exports contracted during the second and third quarters of the year as external demand weakened. UK export markets are now forecast to grow by just 1 per cent this year, compared with 6 per cent forecast at the time of Budget 2001. The impact of weak exports on the trade balance has been offset by lower imports, as domestic demand for intermediate and investment goods has fallen. The widening in the trade deficit has therefore been more moderate than anticipated at Budget time, despite strong household consumption. The combination of strong consumer demand and weak export market growth has, however, widened the divergence in performance between exporters and firms producing mainly for domestic markets.

A20. The terrorist attacks on the US have had an impact on the UK economy. Business confidence has fallen since 11 September, and weaker external demand and a more uncertain outlook have encouraged firms to postpone investment. The fall in consumer confidence has been less marked, and the decisions taken by the Monetary Policy Committee to cut interest rates in the aftermath of the attacks appear to have supported households' confidence in their own finances and helped sustain consumer spending. With consumer demand holding up and net trade exerting less of a drag on GDP growth than expected at Budget time, the impact of faltering global growth on the UK economy has shown up mainly in weaker business investment.

The labour market

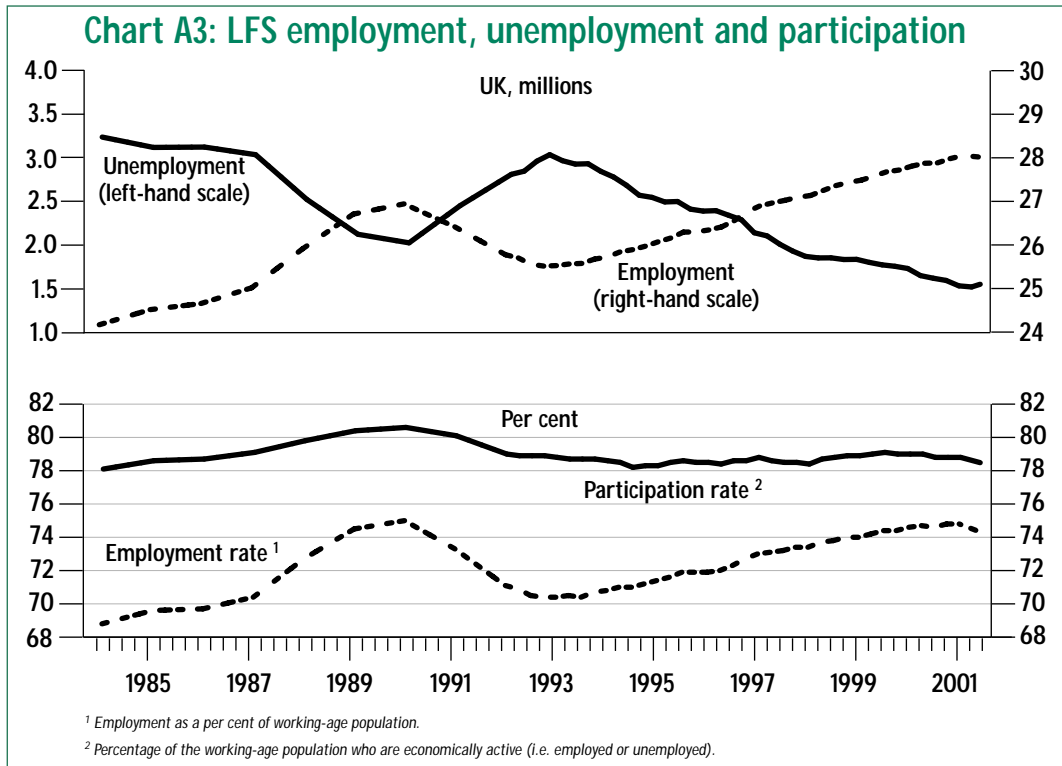
A21. After a temporary pause during autumn 2000, employment growth picked up into 2001, but employment flattened over the summer as the effects of the world economic slowdown reached the UK. Employment growth appears to have followed the pattern of output growth with roughly a two to three quarter lag. The Labour Force Survey (LFS) employment rate has remained close to its historic high of 75 per cent during 2001, a level last reached in spring 1990 at the peak of the economic cycle. Historically high employment rates are now being achieved with the economy operating very close to potential, highlighting the marked improvement in labour market performance in recent years.

A22. In the third quarter of 2001, LFS employment was up by almost 160,000 on a year earlier, while full-time employment was up by over 240,000. This accounts for growth in total hours worked over this period outpacing growth in total employment, reversing the trend over the previous four years. Full-time employment has continued to rise recently, with the latest modest fall in total employment more than accounted for by a drop in female part-time employment.

A23. Strong growth in the population of working age over the past year, partly reflected in rising inactivity, explains why higher employment has been mirrored less than one-for-one in lower unemployment. Nonetheless, recent ILO unemployment rates have been at their lowest since the 1970s. The ILO unemployment rate fell to 4.9 per cent in the three months to May, somewhat below most estimates of the NAIRU. It has since edged back up above 5 per cent in the three months to September.

A24. The claimant count rate continued to fall through to August, to just 3.1 per cent, its lowest rate since 1975, before ticking up in October. Claimant unemployment over 12 months duration fell by more than 20 per cent in the year to October, and its share of the total has fallen to under 20 per cent, compared with over 36 per cent in early 1997. Moreover, the New Deal for young people has now virtually eliminated longer-term (over six months) youth unemployment.

A25. Headline average earnings growth has fallen back to 4½ per cent, suggesting that labour market pressures are easing, although annual earnings growth excluding bonuses remains higher at around 5 per cent. Looking ahead, increases in employment within the public sector and among associated private sector subcontractors will provide support to the labour market.



A26. The economy's productivity performance strengthened during 2000, with output per job rising by 2.3 per cent across the economy and by 5.8 per cent in the manufacturing sector. However, weaker output growth during 2001 has driven a cyclical slowing in productivity growth, with particularly subdued growth in output per hour reflecting the recent strength of total hours worked. This cyclical effect, and the temporary pick-up in earnings growth earlier in the year, caused year-on-year growth in unit wage costs to rise to 3.5 per cent in the second quarter, but there are now signs of easing. The Government's drive to promote competition, enterprise, innovation and skills should lead to improved UK productivity performance over the longer term, as explained in detail in Chapter 3.

A27. A modest pick-up in the working-age inactivity rate over the past year highlights the ongoing challenge of increasing the economy's labour supply and long-term growth potential. A lower participation rate in the 16-24 age group, probably associated with increased participation in full-time education, can explain a small part of the rise. However, most of the increase in the inactivity rate is attributable to females in the 25-49 age group and males in the 35-49 age group. A more detailed examination of current labour market inactivity and the Government's approach to tackling it can be found in Chapter 4 and in a separate Government paper to be published shortly⁴.

A28. The National Minimum Wage (NMW) was increased with effect from October 2001, in line with the recommendations of the Low Pay Commission (LPC). The main rate was raised from £3.70 to £4.10. Earlier in the year, the LPC concluded that the NMW had not had any

⁴ *The Changing Welfare State: Employment Opportunity for All.*

discernible impact on overall employment, inflation or the wider economy. The new rate is broadly the same level relative to average earnings across the whole economy as when the NMW was first introduced, giving little reason to believe that the recent increase will have any adverse macroeconomic effects. The LPC estimated that the increase in the main rate from £3.70 to £4.10 would raise total wage costs by between 0.1 and 0.3 per cent. The youth rate, which applies to workers aged between 18 and 21, was also increased in October 2001, from £3.20 to £3.50. The NMW, and other elements of the Government's strategy to make work pay, are also discussed in Chapter 4 and the forthcoming paper.

Trend output growth

A29. Table A4 provides a simple decomposition⁵ of estimated trend output growth in recent years, and shows the neutral assumptions underlying the GDP forecast ranges presented in this annex. The economy is still judged to have been operating around its potential in the first half of 1997 and mid-1999, and revisions to GDP⁶ and workforce jobs data since Budget 2001 have not significantly changed the assessment of trend rates of growth.

Table A4: Contributions to trend output growth

	Estimated trend rates of growth ¹ , per cent per annum				
	Trend labour productivity ²		Trend employment rate ⁴	Population of working age ⁵	Trend output
	Underlying ³	Actual			
	(1)	(2)	(3)	(4)	(5)
1990Q4 to 1997H1	2.0 ⁶	2.1	-0.2	0.3	2 ¹ / ₄
1997H1 to mid-1999	1.9	1.7	0.5	0.5	2 ¹ / ₂
Forecast ⁷	2.0	1.9	0.1	0.5	2 ¹ / ₂

¹ Treasury analysis based on the judgement that 1990Q4, 1997H1 and mid-1999 were on-trend points of the output cycle. Trend output growth is estimated as non-oil Gross Value Added growth between on-trend points for the past, and by projecting components going forward. Estimated trend growth rates for employment and labour productivity allow for employment lagging output. Figures independently rounded. Columns (2) + (3) + (4) = (5).

² Output per workforce job.

³ Adjusted for effect of changes in employment rate, i.e. assuming the employment rate had remained constant.

Column (1) – column (2) = (1–a). column (3), where a is the ratio of new to average worker productivity levels. The figuring is consistent with this ratio being of the order of 50 per cent, consistent with LFS data on relative entry wages.

⁴ Ratio of workforce jobs to working-age household population.

⁵ UK household basis.

⁶ Estimated from regression of productivity growth on employment rate growth and the output gap over a complete output cycle from 1986Q2 to 1997H1.

⁷ Neutral case assumptions underlying the mid-points of the GDP growth ranges from 2002Q1.

A30. In line with the approach adopted in Budget 2001, the Pre-Budget Report forecast assumes trend output growth of slightly above 2¹/₂ per cent between the first half of 1997 and the start of the forecast period, consistent with observed GDP growth rates and judgements on the output gap. The Pre-Budget Report forecast ranges are anchored on the neutral assumption of 2¹/₂ per cent annual trend output growth from the start of 2002, with the contribution from trend employment growth expected to be modest in the period ahead. Working-age population growth is assumed to average ¹/₂ per cent per annum over the forecast period, a cautious judgement based on the latest published projections from the Government Actuary's Department⁷.

⁵ In this framework, the contributions of the capital stock per worker and total factor productivity to trend output are subsumed in estimated labour productivity (output per worker).

⁶ Published in the 2001 edition of the *UK National Accounts* (Blue Book).

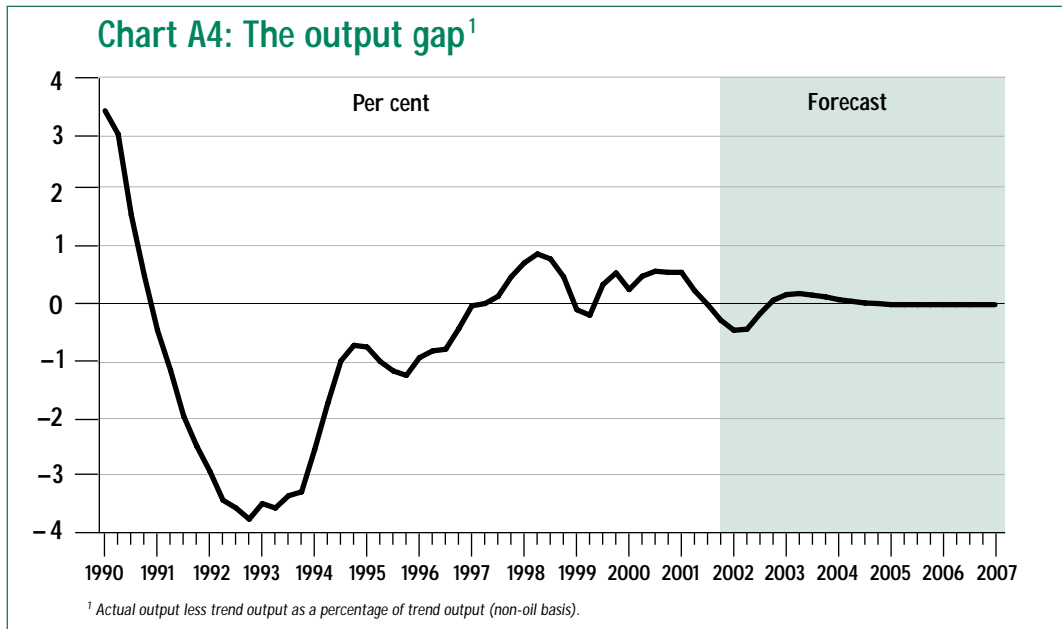
⁷ 2000-based population projections for the United Kingdom and constituent countries, published on 15 November 2001 and available from www.gad.gov.uk.

A31. The potential extent of the productivity ‘spill-over’ from rapid growth in ICT investment, and the associated upside potential to future trend growth in the UK, is subject to a wide range of views. Despite recent downward revisions to US productivity estimates, the data continued to show a marked acceleration in US productivity growth since the mid-1990s. High levels of investment in ICT products, which accounted for over 15 per cent of whole economy fixed investment in the UK in 1999, should ensure that the UK is well placed to benefit from any ICT related productivity gains.

Output and demand

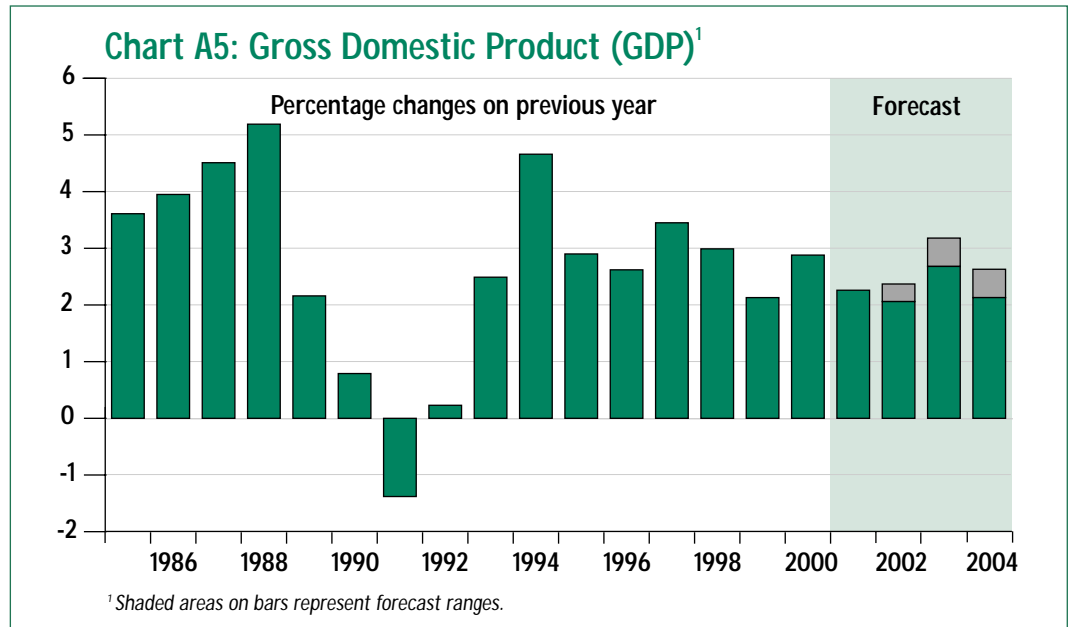
A32. Evidence from the labour market suggests that the economy was operating slightly above potential in the first half of 2001. Latest official labour market data, backed up by recruitment surveys, point to easing pressures in the labour market. Business survey indicators also suggest that capacity constraints have diminished, with demand pressures receding. The economy therefore appears to be operating close to its potential level at present, consistent with trend output growth of just over 2½ per cent in recent years. However, any assessment of the present output gap will remain subject to considerable uncertainty until a full range of official and private survey-based data is available for the second half of 2001.

A33. Growth in the UK has remained relatively strong despite the world slowdown. In the second quarter, it eased only modestly below trend, and is estimated to have edged up to 0.5 per cent in the third quarter. The short-term outlook has weakened since 11 September, and a period of below trend growth is expected to lead to a small negative output gap opening up around the turn of the year.



A34. The decisions taken by the Monetary Policy Committee to cut interest rates since 11 September appear to have provided support to households’ confidence in their own finances, reducing the risk of a sharp slowdown in consumer spending. Nonetheless, heightened uncertainty is expected to contribute to a moderation of household consumption growth to rates more clearly consistent with its longer-term determinants. Business confidence has deteriorated sharply since 11 September, and surveys indicate weak near-term investment intentions. Weaker external demand, as a result of the delayed global recovery, will also mean that net trade exerts a significant drag on growth in the near term.

A35. Earlier macroeconomic policy action will help to support the pick-up in UK growth as world economic activity recovers during the second half of 2002. Greater certainty surrounding future levels of external demand is expected to prompt a significant improvement in business sentiment. Business investment is projected to accelerate rapidly from the second half of the year, following a period of deferral and balance sheet consolidation. With consumption growth moderating, the UK is expected to return to more balanced growth.



A36. The anticipated pick-up in UK export volume growth through 2002 is likely to be offset by stronger growth of imports as demand for intermediate and investment goods recovers. The resumption of growth in major export markets is expected to support a strong recovery in UK manufacturing output. In particular, a recovery in demand for ICT capital goods, following recent weakness in the UK and overseas, should provide support to the high-technology sector. The forecast showing a decline in manufacturing output in 2002 disguises a marked acceleration in the second half of the year. The annual comparison is also affected by base effects associated with the sharp fall in output during 2001.

A37. GDP is forecast to grow by between 2 and 2½ per cent in 2002, with net trade continuing to exert a drag. Growth is expected to move temporarily above its trend rate from the middle of 2002 so that the negative output gap closes by the end of the year. With inflation forecast to be slightly below target throughout 2002, there is room for the economy to operate slightly above potential during 2003, before RPIX inflation edges back up to target by the end of the year.

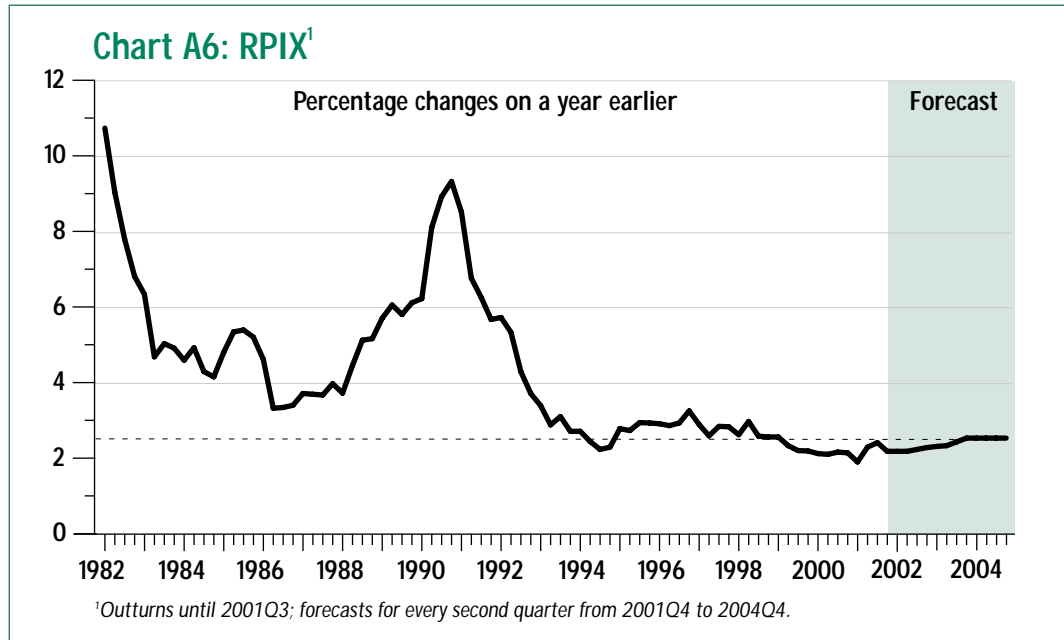
A38. The risks to the Pre-Budget Report forecast are compounded by the more uncertain outlook for the world economy. In the UK, the possibility of a further weakening of business and consumer confidence prompted by continuing uncertainty about the global economic outlook poses the clearest downside risk. A delayed or more gradual global recovery would directly affect UK exports and deter the projected pick-up in business investment. The potential knock-on effects, particularly on the labour market and equity prices, would also impact on the household sector. Conversely, the scale of the policy response already witnessed in the US and Europe raises the possibility of a much stronger than expected global recovery, and a faster than expected pick-up in UK growth during 2002.

A39. There is also a risk that consumption growth will remain stronger than expected as a result of weaker household saving. Recent strong consumer spending has been funded in part by increased borrowing. Low interest rates have ensured that debt-servicing costs have remained affordable. However, with household debt at historically high levels, any further deterioration in households' financial balances would raise the likelihood of a sharper correction in consumption further in the future. These risks underline the importance of the Government's monetary policy framework in ensuring interest rates are set in a forward-looking manner.

A40. In the past, the combination of rising private sector debt and a deteriorating current account position has sometimes been an early indicator of a large positive output gap, and such periods of unsustainable growth have typically preceded sharp adjustments in output and expenditure. On the other hand, widening financial imbalances may equally arise at times of weak external demand, temporarily depressing export volumes relative to imports, and in present circumstances are judged consistent with the economy operating close to potential.

Inflation

A41. The UK economy is continuing to experience its longest period of sustained low inflation since the 1960s, with RPIX inflation picking up during the course of this year but averaging slightly below the Government's 2½ per cent target. The modest increase in underlying inflation has, to an extent, reflected temporary factors that are expected to unwind next year. Reductions in official interest rates have exerted downward pressure on headline RPI inflation.



A42. Upward contributions to inflation have come from a variety of sources, and have more than offset the negative effects from excise duties and lower petrol pump prices. In particular, adverse weather conditions last year led to a sharp pick-up in seasonal food prices earlier this year, and the outbreak of FMD increased retail meat prices. Seasonal food prices have fallen since their June peak, but still remain abnormally high. Price inflation in the utilities sector turned positive in August, as earlier price cuts dropped out of the annual comparison.

A43. Broader upward pressure on inflation has stemmed from goods prices. Core goods price inflation, which excludes food, petrol and oil, turned positive in July for the first time since summer 1999. Buoyant retail sales growth appears to have taken some of the pressure off retailers' margins. In contrast, core service sector inflation, which excludes rent and utilities components, has remained around or just above 5 per cent for much of 2001.

A44. Price pressures further back in the supply chain have eased during the year. Annual producer output price inflation has slowed from over 2 per cent at the end of 2000 to close to zero in recent months. With falling oil and non-oil commodity prices, and weaker world prices for a wide range of goods, annual producer input price inflation has been negative since July. However, given the pick-up in growth of unit wage costs during the first half of 2001, there has been a further slight squeeze on producer margins.

A45. RPIX inflation is projected to be slightly below the Government's 2½ per cent target through the turn of the year, partly reflecting recent reductions in petrol pump prices, and to remain below target during 2002 as weaker price pressures in the supply chain feed through into retail prices. Recent trends in commodity prices are likely to persist while global growth remains weak, and domestically generated cost pressures are expected to ease as UK output moves a little below potential during 2002. Food price and housing depreciation components should also exert downward pressure on annual RPIX inflation during 2002, as this year's sharp increases drop out of the annual comparison. The small positive output gap forecast to emerge in 2003, coupled with upward pressure on non-oil import prices from the anticipated pick-up in world growth, should bring RPIX inflation back to target by the end of 2003.

A46. Domestic price pressures could, however, prove stronger than currently assessed. For example, the recent pick-up in unit wage cost growth could prove more persistent than expected, while the scope for consumer spending to remain buoyant might encourage retailers further to rebuild margins. The outlook for UK inflation is also affected by the considerable uncertainties surrounding the external environment. Domestic inflationary pressures could well remain more subdued if the world downturn proves more protracted than expected, while a sharper than expected global recovery would apply upward pressure to imported inflation. A sudden sharp change in the value of sterling against the euro or the dollar could also alter the cost of imported goods. As noted earlier in this annex, uncertainty surrounding the outlook for oil prices has heightened.

A47. GDP deflator inflation has averaged 2¼ per cent so far in 2001, up from 1¾ per cent in 2000. Much of this increase can be explained by higher consumers' expenditure deflator inflation, which had been unusually low relative to RPIX inflation in 2000 as a result of coverage differences. The differential between the two inflation rates has subsequently narrowed and is expected to diminish further through 2002, pushing up GDP deflator inflation to 2½ per cent.

Independent forecasts

A48. The average independent forecast for GDP growth in 2001 has fallen steadily during the year, from 2.6 per cent at Budget time to 2.2 per cent in November, as world developments have surprised on the downside. Nevertheless, the average growth forecast for 2002 remained at or above 2½ per cent for much of the year, but has fallen to 1.9 per cent since the terrorist attacks of 11 September. Independent forecasters expect RPIX inflation to remain close to target, reflecting credibility of the new framework for monetary policy.

A49. The average forecast for the current account balance in 2001 is marginally below the Pre-Budget Report forecast, and most independent forecasters expect the deficit to widen in 2002. As always, there is a wide range of views around the independent average.

Table A5: Pre-Budget Report and independent¹ forecasts

	Percentage changes on a year earlier unless otherwise stated					
	2001			2002		
	Pre-Budget Report	Independent		Pre-Budget Report	Independent	
Average		Range	Average		Range	
Gross domestic product	2¼	2.2	1.9 to 2.7	2 to 2½	1.9	0.4 to 2.8
RPIX (Q4)	2¼	2.3	1.9 to 2.7	2¼	2.3	1.7 to 3.5
Current account (£ billion)	-14	-16.5	-23.3 to -10.0	-26¾	-23.6	-35.2 to -16.0

¹ 'Forecasts for the UK Economy: A Comparison of Independent Forecasts', November 2001.

UK FORECAST IN DETAIL

The household sector

A50. Latest official data indicate that consumer spending has grown by more than 1 per cent in each quarter so far this year. Record levels of employment, strong real disposable income growth, low interest rates and housing market gains have all continued to support consumer spending, despite the weakening world outlook.

Table A6: Household sector¹ expenditure and income

	Percentage changes on previous year unless otherwise stated				
	Forecast				
	2000	2001	2002	2003	2004
Household consumption ²	4	4	2¾ to 3	2¼ to 2¾	2 to 2½
Real household disposable income	4¼	4	3¼ to 3½	2 to 2½	2½ to 3
Saving ratio (level, per cent)	5	5	5	5	5½

¹ Including non-profit institutions serving households.

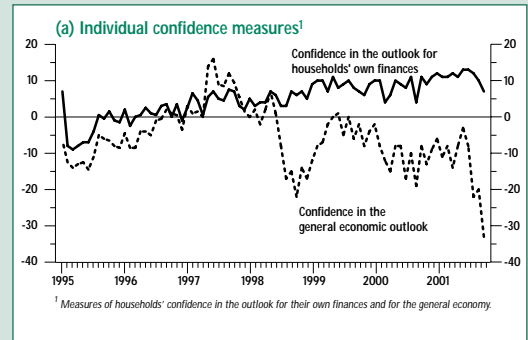
² At constant prices.

A51. Household consumption has played an important role in supporting GDP growth during 2001 as external demand has weakened. However, the Pre-Budget Report forecast assumes that consumption growth will return to rates consistent with its longer-term determinants by early 2002. Wealth effects are likely to provide less of a boost to consumption following recent declines in equity prices and first signs of lower house price inflation. Confidence in the economic outlook was already falling before 11 September and, combined with the further deterioration since the attacks, should have a moderating influence on consumption growth (see Box A4). Real disposable income growth is also forecast to slow as labour market pressures ease.

Box A4: Consumer confidence and the prospects for consumer spending

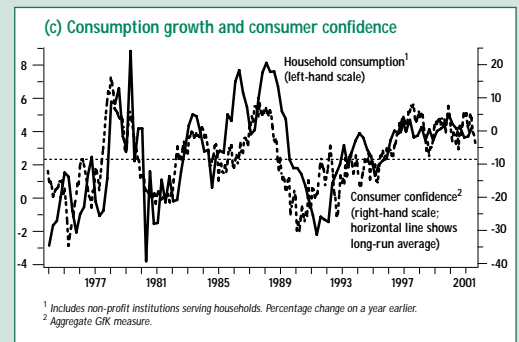
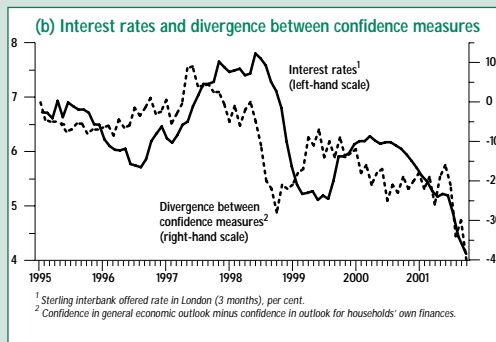
Consumer confidence in the UK started the year close to record levels according to the aggregate GfK indicator¹. Confidence has fallen back in recent months, as world economic prospects have deteriorated, but still exceeds its long-run average. Despite falling consumer confidence, household consumption has continued to grow rapidly during 2001.

Recent movements in the aggregate consumer confidence measure have masked significant divergences between some of its individual components (chart a). In particular, while confidence in the general economic outlook has fallen significantly below its long-run average, households' confidence in their own financial position has held up strongly. A similar pattern emerged during 1998, when global financial instability prompted a sharp downturn in confidence in the general outlook for the UK economy.



As in 1998, the MPC has responded to the more uncertain outlook by cutting interest rates. The divergence between the two confidence measures during both these periods suggests that pre-emptive monetary policy action can sustain confidence in household finances during temporary periods of heightened economic uncertainty (chart b).

Over longer periods, consumption growth tends not to be divorced from aggregate consumer confidence (chart c). The recent weakening of confidence is therefore expected to contribute to a moderation of household consumption growth to rates more consistent with its longer-term determinants. On the other hand, further support to household finances should flow from the recent easing of monetary policy, helping to offset the effect of falling confidence on consumption in the short term and reducing the likelihood of a sharper slowdown in consumer spending.



¹ Consumer confidence indicators published by Martin Hamblin GfK (Gesellschaft für Konsumforschung), on behalf of the European Commission.

A52. Household consumption is expected to grow by $2\frac{3}{4}$ to 3 per cent in 2002 and by $2\frac{1}{4}$ to $2\frac{3}{4}$ per cent in 2003. As consumption growth returns to more sustainable levels, the saving ratio is projected to pick up modestly by the end of the forecast period. Greater confidence in economic stability, low inflation and long-term job security may have reduced the desired level of precautionary saving compared with the high levels seen in the mid-1990s.

A53. The clearest risk to consumption is that continued uncertainty or a delayed G7 recovery leads to a further fall in consumer confidence. Conversely, the scale of the recent policy loosening in the UK, and the possibility of a sharper than anticipated global recovery, pose upside risks to consumption. With household debt already at record levels relative to disposable income, further increases in borrowing to fuel continued strong consumption growth would increase the risk of a sharper adjustment in the future. With the economy operating close to potential, financial markets anticipate that interest rates will remain low. Debt-servicing costs are therefore not expected to prompt a sharp retrenchment, in contrast to the early 1990s' experience.

Companies and investment

A54. The UK corporate sector has been affected by the slowdown in the world economy and the slump in global demand for ICT related goods (in 1999 the ICT goods and services sector accounted for 7 per cent of UK output). Externally exposed sectors have been disproportionately affected, with falling output of investment and intermediate goods driving a contraction of manufacturing output in the UK, although to a lesser extent than in some other G7 economies. Output in the electrical and optical equipment sector, which is closely correlated with ICT manufacturing output and accounts for 2.8 per cent of UK GDP, has fallen by almost 20 per cent since the end of 2000. This fall directly accounts for over 50 per cent of the total fall in UK manufacturing output over the period. By contrast, production of consumer goods has increased during 2001, and the service sector has continued to register robust growth, supported by the strength of domestic consumption.

A55. At the time of Budget 2001, business investment growth was expected to be subdued this year as firms attempted to reduce indebtedness. In the event, business confidence has fallen during the year, reflecting weaker external demand and increasing uncertainty surrounding the economic outlook. Weaker corporate profitability and stock market falls have also constrained firms' investment plans, and business investment has slowed more sharply than anticipated this year as firms have deferred investment. In the first half of 2001 it was down almost 2 per cent on the second half of 2000, and it fell further in the third quarter.

A56. Business surveys show a sharp deterioration in confidence among manufacturers and a weakening of service sector optimism since 11 September. Short-term movements in confidence indicators often overstate the longer-term effects of unexpected events, but heightened uncertainty increases the likelihood that firms will postpone investment decisions.

Table A7: Gross fixed capital formation

	Percentage changes on previous year				
	2000	2001	2002	2003	2004
Whole economy ¹	4 ³ / ₄	1	2 to 2 ¹ / ₄	4 ³ / ₄ to 5 ¹ / ₄	2 ³ / ₄ to 3 ¹ / ₄
of which:					
Business ^{2,3}	5	0	¹ / ₄ to ¹ / ₂	4 ¹ / ₂ to 5	2 ¹ / ₄ to 3
Private dwellings ³	2 ¹ / ₂	-4 ³ / ₄	- ³ / ₄ to - ¹ / ₂	2 to 2 ¹ / ₂	2 to 2 ¹ / ₂
General government ^{3,4}	8 ¹ / ₂	21 ¹ / ₂	18 ¹ / ₂	10 ¹ / ₂	6 ¹ / ₂

¹ Includes costs associated with the transfer of ownership of land and existing buildings.

² Private sector and public corporations' (except National Health Service Trusts) non-residential investment. Includes investment under the Private Finance Initiative.

³ Excludes purchases less sales of land and existing buildings.

⁴ Includes National Health Service Trusts.

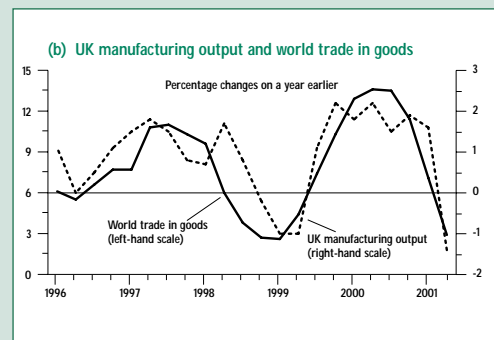
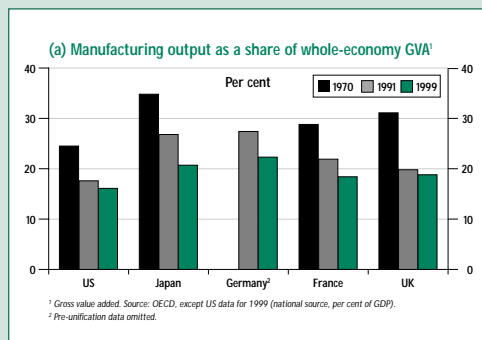
Box A5: Recent manufacturing performance in historical perspective

The UK manufacturing sector includes many of our most innovative businesses and plays a crucial role in generating growth in productivity, exports and R&D. But this has been a difficult year for manufacturing companies. As the world economy has slowed during 2001, UK manufacturing output has declined. At the same time robust household consumption has supported strong growth in service sector output, prompting renewed concerns about the divergent performance of these two sectors.

Such divergence has not been confined to the UK, and a decline in the share of manufacturing output in the economy has also been a long-standing feature common to mature industrialised economies. Manufacturing's share in the UK has been moving in line with trends across the industrialised world since the 1970s (chart a). As incomes grow, the shifting composition of consumer demand tends to reduce the relative demand for manufactured goods. In the UK, it is estimated that the declining share of manufactures in domestic demand has accounted for perhaps as much as three quarters of manufacturing's relative decline over the past 30 years. Most of the relative decline cannot therefore be explained by trade competitiveness.

Moreover, the distinction between manufacturing and service sector performance is less clear than the aggregate figures suggest. Within the manufacturing sector, certain industries have grown strongly. Between 1995 and 2000, output of electrical and optical equipment grew by 45 per cent. The chemicals related industries have also grown steadily in recent years. The relatively strong performance of these highly export-intensive sectors again suggests that differing fortunes between manufacturing and services are not solely attributable to exposure of the manufacturing sector to international competition and the exchange rate. Indeed, despite the weakness of the euro in recent years, the UK's trade in goods deficit with EU countries has not widened.

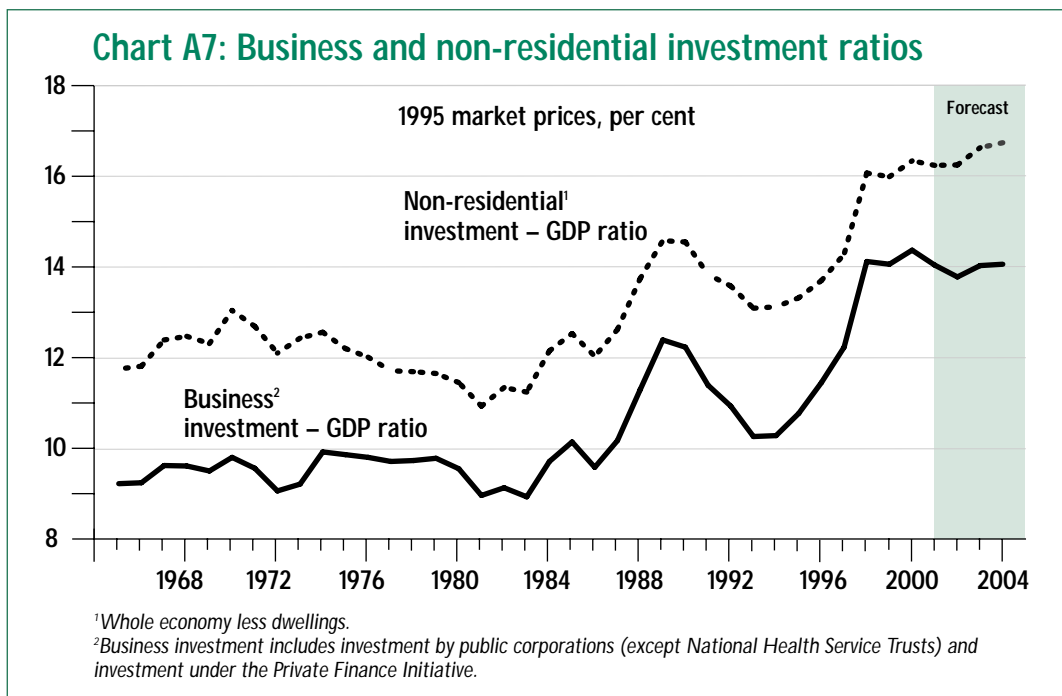
Manufacturers in the UK, and across the industrialised world, have been affected by weaker external demand and the recent sharp fall in world trade growth (chart b). After a number of years of strong growth, the collapse in demand for ICT related goods during 2001 has had a particularly significant impact: over 50 per cent of the downturn in total UK manufacturing output this year can be accounted for by falling output in the electrical and optical equipment sector. In contrast, certain manufacturing sectors have continued to grow: output in the chemicals related industries in the third quarter was 4 per cent higher than a year earlier.



UK manufacturing output is expected to recover sharply as growth in the major economies picks up from the middle of 2002 and demand for ICT related goods strengthens. In view of the importance of manufacturing to closing the productivity gap between the UK and its competitors, the Government has taken important steps to support manufacturers in their efforts to raise productivity and investment, as described in Chapter 3.

A57. Business investment is forecast to remain subdued in the first half of 2002, but to accelerate sharply as the G7 recovery gathers pace, profitability improves and postponed investment plans come on stream. ICT investment is expected to recover in the UK and elsewhere as ongoing technological improvements increase the incentive to upgrade the existing capital stock, providing renewed impetus to the ICT sector.

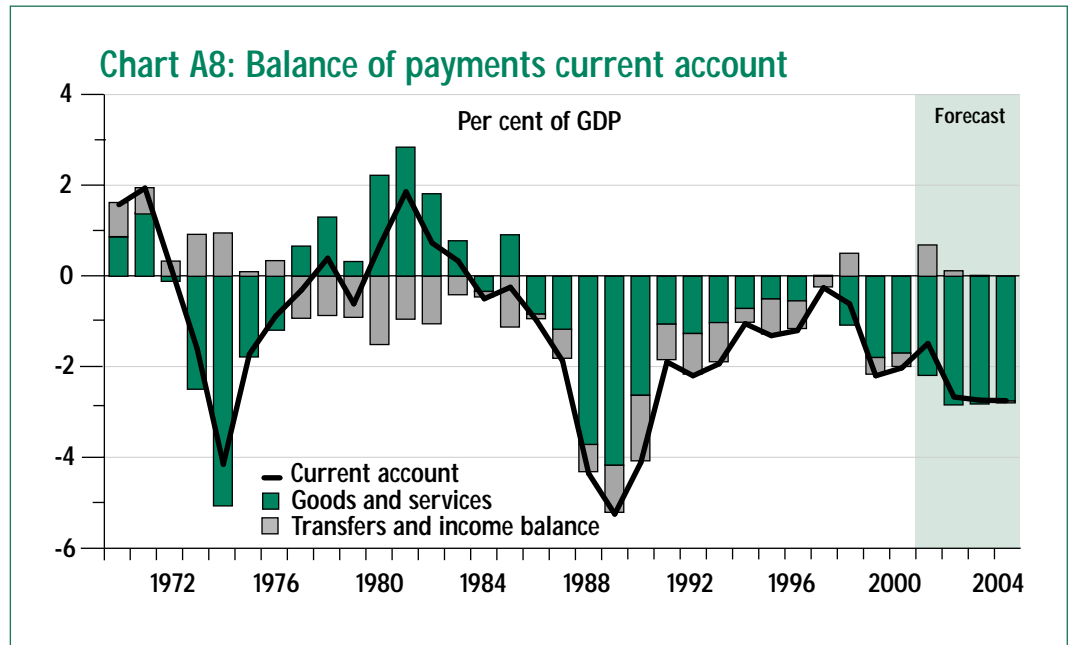
A58. Business investment is expected to remain close to a record share of GDP when measured in constant (1995) prices. When measured at current prices the share is lower, reflecting the decline in the relative price of investment goods since 1995, though it has still risen sharply over the period. Whole economy investment will continue to be supported by strong growth in general government investment, which is projected to increase by over 21 per cent in 2001 and over 18 per cent in 2002.



Trade and the balance of payments

A59. The pattern of UK trade has been heavily affected as world demand, particularly for highly traded ICT goods, has weakened. Lower external demand for intermediate components and investment goods, which together account for around 40 per cent of UK goods exports by volume, contributed to declines in exports in the second and third quarters of 2001. Imports have also fallen, as weaker ICT related manufacturing output and investment have reduced demand for imported intermediate and capital goods.

A60. The deficit on trade in goods and services is forecast to widen to 2 per cent of GDP in 2001, with net trade expected to subtract $\frac{3}{4}$ of a percentage point from GDP growth. In recent years, the deficit on trade with EU countries has remained very modest relative to the deficit with non-EU countries. However, margins on exports to the EU have been squeezed further, and the EU balance partly reflects the UK's position as a net exporter of oil to the EU. The non-EU goods deficit has shown signs of levelling off, with a sharp contraction of imports from south-east Asia through 2001 probably reflecting the impact of weakening ICT manufacturing output on demand for imported components.



A61. Official estimates of the current account deficit during the 1990s have been revised upwards, partly reflecting the inclusion of estimates of tobacco and alcohol smuggling in the balance of payments figures for the first time. However, latest figures show that the deficit narrowed slightly in 2000, and it is now forecast to narrow a bit further to around £14 billion in 2001. An unusually strong investment income balance in 2001 more than accounts for the narrowing.

Table A8: Trade in goods and services

	Percentage changes on previous year					£ billion Goods and services balance
	Volumes		Prices ¹		Terms of trade ²	
	Exports	Imports	Exports	Imports		
2000	10 ¹ / ₄	10 ³ / ₄	1 ³ / ₄	¹ / ₂	1 ¹ / ₄	-15 ³ / ₄
<i>Forecast</i>						
2001	³ / ₄	2 ¹ / ₂	- ¹ / ₄	- ¹ / ₄	0	-20 ³ / ₄
2002	¹ / ₄ to ¹ / ₂	2 ³ / ₄ to 3	- ¹ / ₄	- ¹ / ₄	0	-28
2003	6 ³ / ₄ to 7 ¹ / ₄	6 ¹ / ₄ to 6 ³ / ₄	2 ¹ / ₂	2 ¹ / ₂	0	-29
2004	6 to 6 ¹ / ₂	5 ¹ / ₂ to 6	2 ³ / ₄	2 ³ / ₄	0	-30

¹ Average value indices.

² Ratio of export to import prices.

A62. Export volumes are expected to remain subdued during early 2002, but to accelerate sharply as the G7 recovery gathers pace from the middle of the year. Export prices and exporters' share in UK export markets are forecast to remain broadly flat in 2002. However, the economic recovery may encourage exporters to rebuild margins later in the year. Import volumes are expected to pick up more strongly as domestic business investment and manufacturing output recover during the second half of 2002. As a result, with export growth temporarily depressed relative to imports, the deficit on trade in goods and services is expected to widen further, and net trade is forecast to continue to exert a significant drag on GDP growth in 2002.

A63. Thereafter, the current account deficit is projected to level off at around $2\frac{3}{4}$ per cent of GDP, well below past peaks. Import and export volumes are expected to expand at broadly similar rates from 2003, with import growth below the brisk rates seen between 1996 and 2000, reflecting weaker household consumption growth. However, a more prolonged world slowdown or stronger than anticipated household consumption would pose risks to this forecast.

Table A9: Summary of economic prospects¹

	Percentage changes on a year earlier unless otherwise stated					Average errors from past forecasts ³
	2000	2001	Forecast ²		2004	
			2002	2003		
Output at constant market prices						
Gross domestic product (GDP)	3	2 $\frac{1}{4}$	2 to 2 $\frac{1}{2}$	2 $\frac{3}{4}$ to 3 $\frac{1}{4}$	2 $\frac{1}{4}$ to 2 $\frac{3}{4}$	1
Manufacturing output	1 $\frac{3}{4}$	-1 $\frac{3}{4}$	- $\frac{3}{4}$ to - $\frac{1}{2}$	2 $\frac{1}{4}$ to 2 $\frac{3}{4}$	1 $\frac{3}{4}$ to 2 $\frac{1}{4}$	1 $\frac{3}{4}$
Expenditure components of GDP at constant market prices⁴						
Domestic demand	3 $\frac{1}{2}$	3	2 $\frac{3}{4}$ to 3 $\frac{1}{4}$	2 $\frac{3}{4}$ to 3 $\frac{1}{4}$	2 $\frac{1}{4}$ to 2 $\frac{3}{4}$	1 $\frac{1}{4}$
Household consumption ⁵	4	4	2 $\frac{3}{4}$ to 3	2 $\frac{1}{4}$ to 2 $\frac{3}{4}$	2 to 2 $\frac{1}{2}$	1 $\frac{1}{4}$
General government consumption	1 $\frac{1}{2}$	3	4 $\frac{3}{4}$	2	2	1 $\frac{1}{4}$
Fixed investment	4 $\frac{3}{4}$	1	2 to 2 $\frac{1}{4}$	4 $\frac{3}{4}$ to 5 $\frac{1}{4}$	2 $\frac{3}{4}$ to 3 $\frac{1}{4}$	2 $\frac{1}{2}$
Change in inventories ⁶	- $\frac{1}{4}$	- $\frac{1}{2}$	0	$\frac{1}{4}$	0	$\frac{1}{4}$
Exports of goods and services	10 $\frac{1}{4}$	$\frac{3}{4}$	$\frac{1}{4}$ to $\frac{1}{2}$	6 $\frac{3}{4}$ to 7 $\frac{1}{4}$	6 to 6 $\frac{1}{2}$	2 $\frac{1}{4}$
Imports of goods and services	10 $\frac{3}{4}$	2 $\frac{1}{2}$	2 $\frac{3}{4}$ to 3	6 $\frac{1}{4}$ to 6 $\frac{3}{4}$	5 $\frac{1}{2}$ to 6	2 $\frac{1}{2}$
Balance of payments current account						
£ billion	-18 $\frac{1}{2}$	-14	-26 $\frac{3}{4}$	-28 $\frac{3}{4}$	-30 $\frac{1}{2}$	5 $\frac{3}{4}$
per cent of GDP	-2	-1 $\frac{1}{2}$	-2 $\frac{1}{2}$	-2 $\frac{3}{4}$	-2 $\frac{3}{4}$	$\frac{1}{2}$
Inflation						
RPIX (Q4)	2	2 $\frac{1}{4}$	2 $\frac{1}{4}$	2 $\frac{1}{2}$	2 $\frac{1}{2}$	$\frac{3}{4}$
Producer output prices (Q4) ⁷	1 $\frac{3}{4}$	0	$\frac{3}{4}$	2	2 $\frac{1}{4}$	1
GDP deflator at market prices	1 $\frac{3}{4}$	2 $\frac{1}{4}$	2 $\frac{1}{2}$	2 $\frac{1}{2}$	2 $\frac{1}{2}$	$\frac{3}{4}$
Money GDP at market prices						
£ billion	943	988	1032 to 1036	1086 to 1095	1137 to 1151	13
percentage change	4 $\frac{3}{4}$	4 $\frac{3}{4}$	4 $\frac{1}{2}$ to 4 $\frac{3}{4}$	5 $\frac{1}{4}$ to 5 $\frac{3}{4}$	4 $\frac{3}{4}$ to 5 $\frac{1}{4}$	1 $\frac{1}{4}$

¹ The forecast is consistent with the national accounts and balance of payments statistics to the second quarter of 2001, released by the Office for National Statistics on 25 September 2001, and output, income and expenditure data for the third quarter, released on 22 November.

² The size of the growth ranges for GDP components may differ from those for total GDP growth because of rounding and the assumed invariance of the levels of public spending within the forecast ranges.

³ Average absolute errors for year-ahead projections made in autumn forecasts over the past ten years. The average errors for the current account are calculated as a per cent of GDP, with £ billion figures calculated by scaling the errors by forecast money GDP in 2002.

⁴ Further detail on the expenditure components of GDP is given in Table A10.

⁵ Includes households and non-profit institutions serving households.

⁶ Contribution to GDP growth, percentage points.

⁷ Excluding excise duties.

Table A10: Gross domestic product and its components

	£ billion at 1995 prices, seasonally adjusted									
	Household consumption ¹	General government consumption	Fixed investment	Change in inventories	Domestic demand ²	Exports of goods and services	Total final expenditure	Less imports of goods and services	Plus statistical discrepancy ³	GDP at market prices
2000	557.9	151.4	157.8	2.5	870.0	285.4	1155.4	328.9	-0.4	826.1
2001	580.7	156.0	159.3	-1.0	895.2	287.2	1182.4	337.1	-0.5	844.8
2002	596.1 to 597.9	163.4	162.5 to 163.0	-1.2 to -0.7	920.7 to 923.6	288.1 to 289.0	1208.8 to 1212.5	346.6 to 347.6	0.0	862.2 to 864.9
2003	608.9 to 613.8	166.5	170.3 to 171.6	0.3 to 1.6	946.0 to 953.5	307.7 to 310.1	1253.6 to 1263.6	368.3 to 371.2	0.0	885.3 to 892.4
2004	621.2 to 629.3	170.0	175.0 to 177.2	0.3 to 2.5	966.5 to 979.0	326.3 to 330.5	1292.8 to 1309.5	388.6 to 393.6	0.0	904.2 to 915.8
2000 1st half	276.5	75.4	77.0	1.5	430.6	140.1	570.7	160.3	-0.1	410.3
2nd half	281.3	76.0	80.8	1.0	439.4	145.3	584.8	168.6	-0.2	415.9
2001 1st half	287.1	76.8	80.4	0.8	445.1	147.2	592.3	171.3	-0.5	420.5
2nd half	293.6	79.2	78.9	-1.9	450.1	140.0	590.1	165.8	0.0	424.3
2002 1st half	296.5 to 297.1	81.4	80.2 to 80.3	-1.5 to -1.4	456.5 to 457.4	141.8 to 142.0	598.3 to 599.4	170.5 to 170.8	0.0	427.8 to 428.6
2nd half	299.6 to 300.8	81.9	82.3 to 82.7	0.4 to 0.7	464.2 to 466.2	146.3 to 146.9	610.5 to 613.1	176.1 to 176.9	0.0	434.4 to 436.3
2003 1st half	302.9 to 305.0	82.6	84.4 to 85.0	0.5 to 1.1	470.5 to 473.7	151.4 to 152.4	621.9 to 626.1	181.6 to 182.9	0.0	440.3 to 443.2
2nd half	306.0 to 308.8	83.9	85.9 to 86.6	-0.3 to 0.5	475.5 to 479.9	156.2 to 157.7	631.7 to 637.5	186.7 to 188.4	0.0	445.0 to 449.1
2004 1st half	309.1 to 312.7	84.8	86.9 to 88.0	-0.2 to 0.8	480.6 to 486.2	160.8 to 162.7	641.4 to 648.9	191.7 to 193.9	0.0	449.7 to 454.9
2nd half	312.2 to 316.6	85.2	88.0 to 89.3	0.4 to 1.7	485.9 to 492.8	165.5 to 167.8	651.4 to 660.6	196.9 to 199.7	0.0	454.5 to 460.9
	Percentage changes on previous year ^{4, 5}									
2000	4	1½	4¾	-¼	3½	10¼	5	10¾	0	3
2001	4	3	1	-½	3	¾	2¼	2½	0	2¼
2002	2¼ to 3	4¾	2 to 2¼	0	2¾ to 3¼	¼ to ½	2¼ to 2½	2¾ to 3	0	2 to 2½
2003	2¼ to 2¾	2	4¾ to 5¼	¼	2¾ to 3¼	6¾ to 7¼	3¾ to 4¼	6¼ to 6¾	0	2¾ to 3¼
2004	2 to 2½	2	2¾ to 3¼	0	2¼ to 2¾	6 to 6½	3 to 3¾	5½ to 6	0	2¼ to 2¾

¹ Includes households and non-profit institutions serving households.

² Also includes acquisitions less disposals of valuables.

³ Expenditure adjustment.

⁴ For change in inventories and the statistical discrepancy, changes are expressed as a per cent of GDP.

⁵ Growth ranges for GDP components do not necessarily sum to the ½ percentage point ranges for GDP growth because of rounding and the assumed invariance of the levels of public spending within the forecast ranges.

