



**H M TREASURY**

---

---

**THE ECONOMY:  
SUPPLEMENTARY MATERIAL TO  
THE FINANCIAL STATEMENT AND  
BUDGET REPORT**

**17 March 1998**

---

---

---

# THE ECONOMY: SUPPLEMENTARY MATERIAL TO THE FINANCIAL STATEMENT AND BUDGET REPORT

---

## Contents

Introduction .....	1
The degree of spare capacity .....	3
GDP .....	4
The personal sector .....	6
Investment and stockbuilding .....	8
Trade and the balance of payments .....	10
Pattern of financial balances .....	13
The labour market .....	15
Financial developments .....	17
Inflation .....	19
Comparison with independent forecasts .....	20
Comparison with Pre-Budget Report forecast .....	21
Summary tables .....	22

---

# THE ECONOMY

---

## Introduction

---

The March 1998 Financial Statement and Budget Report (FSBR), published by HM Treasury on 17 March, includes a discussion of economic developments and prospects (Annex A). This document provides additional information to that contained in the annex, in the form of detailed charts and tables. It is the same set of charts and tables as included in Section 1 of the November 1997 Pre-Budget Report publication 'The Economy and the Public Finances: Supplementary Material'.

**Forecast ranges** As in the Pre-Budget Report, the economic forecast is presented in terms of ranges. These ranges are intended to provide an indication of how differing degrees of supply side improvement offer the prospect of a more favourable path for the economy over the next few years.

The figures at the lower ends of the forecast ranges are intended to be deliberately cautious, and make no allowance for any improvement in supply side performance. They are based on a trend growth rate of 2¼ per cent a year, in line with both the post-war average and the average over the last full cycle, and are the basis of the projections of the public finances set out in Annex B of the FSBR.

The figures at the upper ends of the forecast ranges are based on the assumption that improved labour market performance delivers a fall in the sustainable rate of unemployment (the NAIRU) of ½ percentage point a year through both 1998 and 1999 and ¼ percentage point through 2000, equivalent to trend output growing by 2¾ per cent a year through 1998 and 1999 and gradually reverting to the assumed rate of 2¼ per cent by the end of 2000.

Within the range of outcomes for GDP growth, the forecast path for inflation is assumed to be invariant. This is a highly stylised assumption that is made for the illustrative purpose of focussing on the real benefits of lower wage pressure. It amounts to assuming that the supply side benefits show up quickly in employment and output, abstracting from transitional adjustment through wages and prices. In practice, lower wage pressures would be likely for a time to show up partly in lower inflation before the full effects on employment and output came through.

Ratios of demand components to GDP are also assumed to be largely invariant within the forecast ranges for GDP growth. This stylisation is based on the assumption that factors affecting the NAIRU (and employment) are unlikely to have much effect on the sustainable real wage, which is mainly determined by productivity. In this case, income and expenditure shares in GDP would tend not to vary much within the forecast ranges for GDP growth.

Where applicable, the forecast ranges are shown in the following set of charts and tables.

## The degree of spare capacity

Chart 1a: CBI capacity utilisation in manufacturing

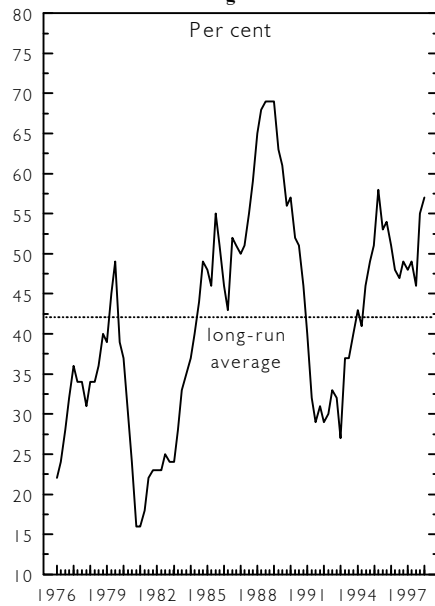


Chart 1b: BCC survey of capacity utilisation

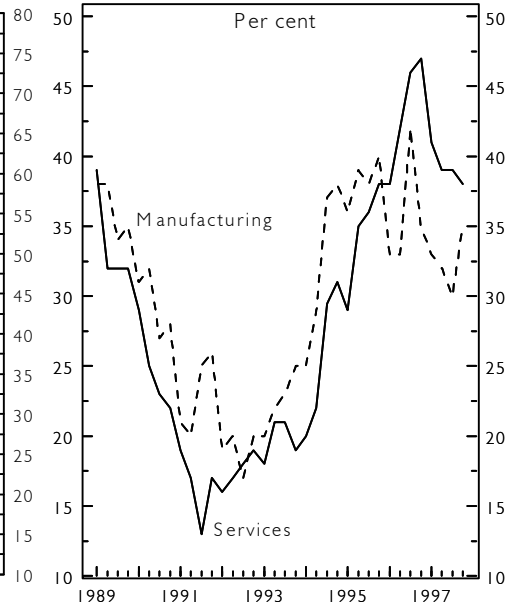


Chart 2a: CBI survey of skilled labour shortages

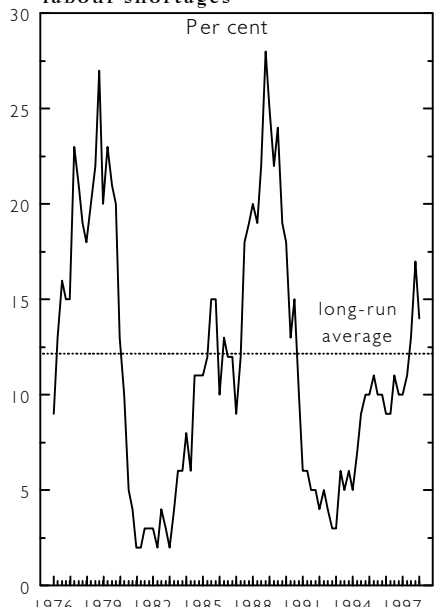
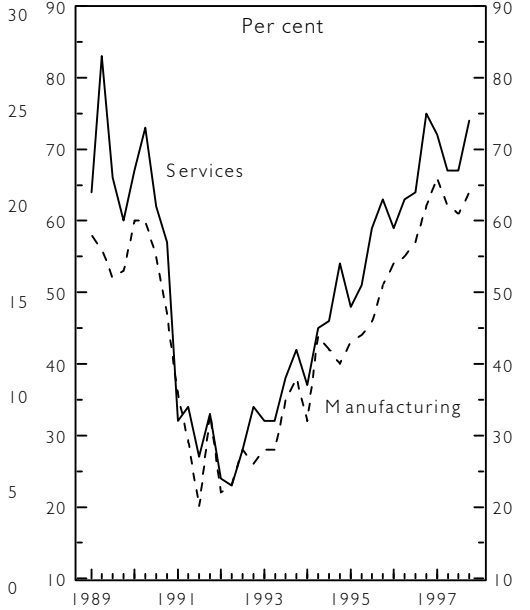
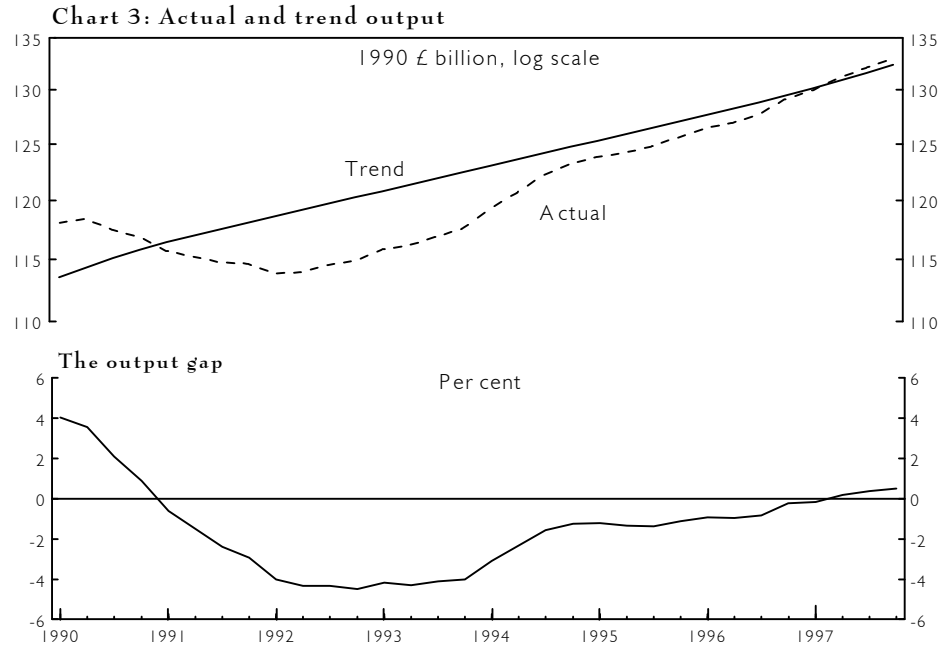
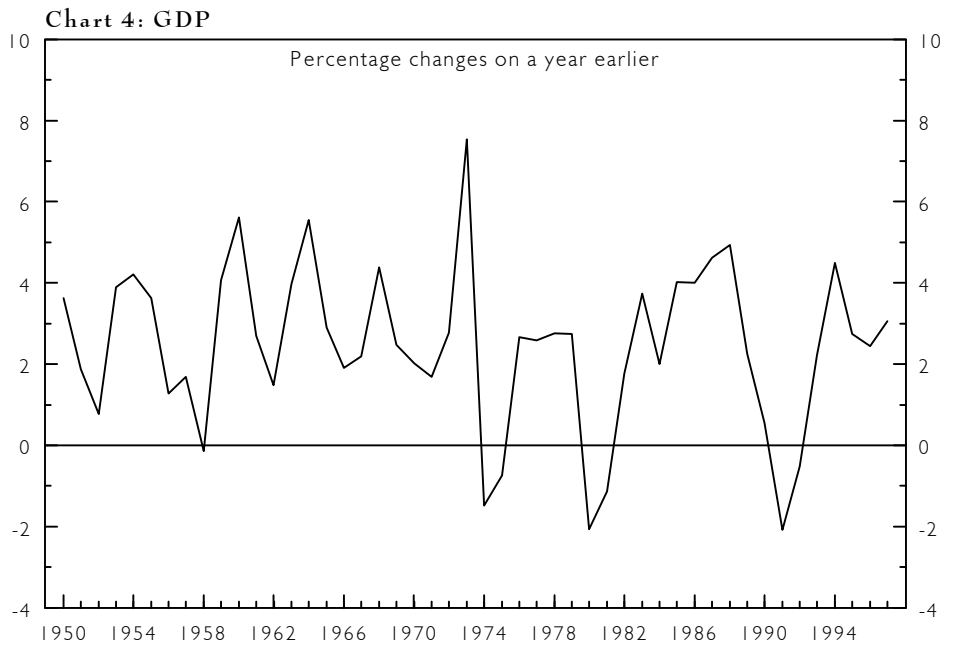


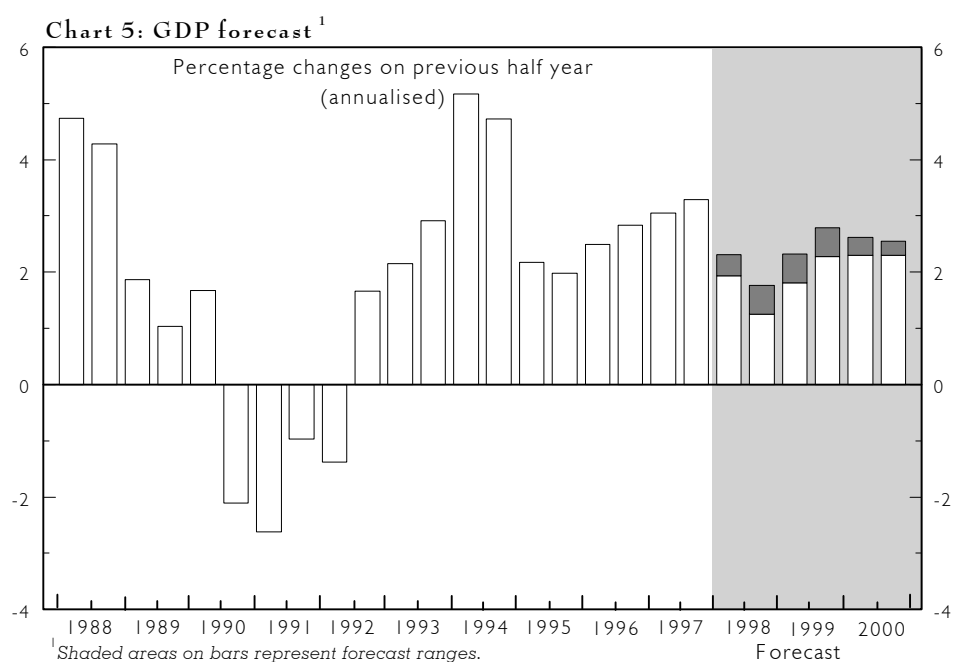
Chart 2b: BCC survey of recruitment difficulties





## GDP

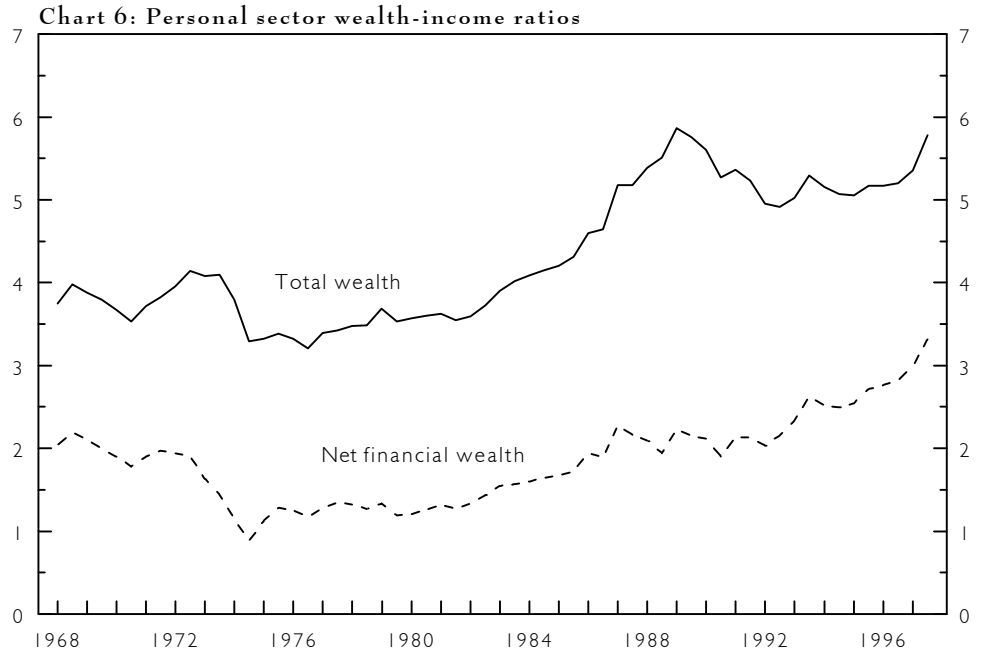


**Table 1: Contributions to GDP growth<sup>1</sup>**

	Percentage points, unless otherwise stated			
	1997	Forecast		
		1998	1999	2000
Final domestic demand	4¼	4 to 4¼	2¼ to 2¾	2½ to 2¾
Stockbuilding	0	-¼	¼	0 to ¼
Total domestic demand	4	3¾ to 4¼	2½ to 3¼	2½ to 3
Net trade	-½	-1¾	-½	0
less factor cost adjustment	¾	0 to ¼	¼	¼ to ½
<b>GDP growth, per cent</b>	<b>3</b>	<b>2 to 2½</b>	<b>1¾ to 2¼</b>	<b>2¼ to 2¾</b>

<sup>1</sup> Components may not sum to total due to rounding and omission of statistical discrepancy.

## The personal sector



**Table 2: Personal expenditure and income**

	Percentage changes on a year earlier			
	1997	Forecast		
		1998	1999	2000
Consumers' expenditure	4½	3¾ to 4	1¾ to 2¼	2¼ to 2½
Real personal disposable income	4¼	2 to 2½	1¼ to 1¾	2 to 2¼
Saving ratio (level, per cent)	11	9½	9¼	9

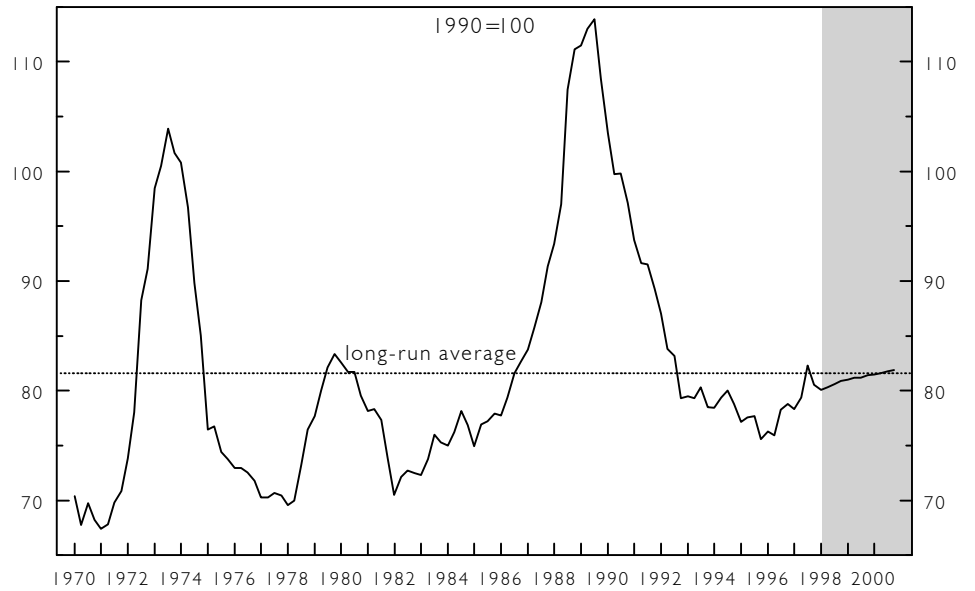
Chart 7: Housing turnover and prices



<sup>1</sup> Halifax index, 1983=100, left-hand scale.

<sup>2</sup> Particulars delivered, thousands, right-hand scale.

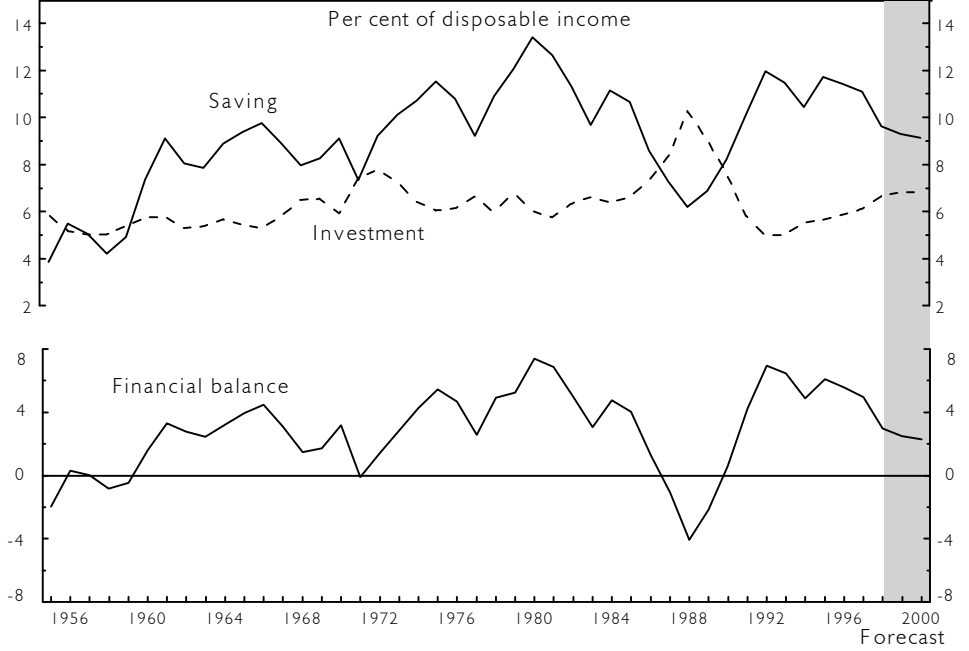
Chart 8: House price-earnings ratio<sup>1</sup>



<sup>1</sup> Ratio of DETR house price index to wages and salaries per head.

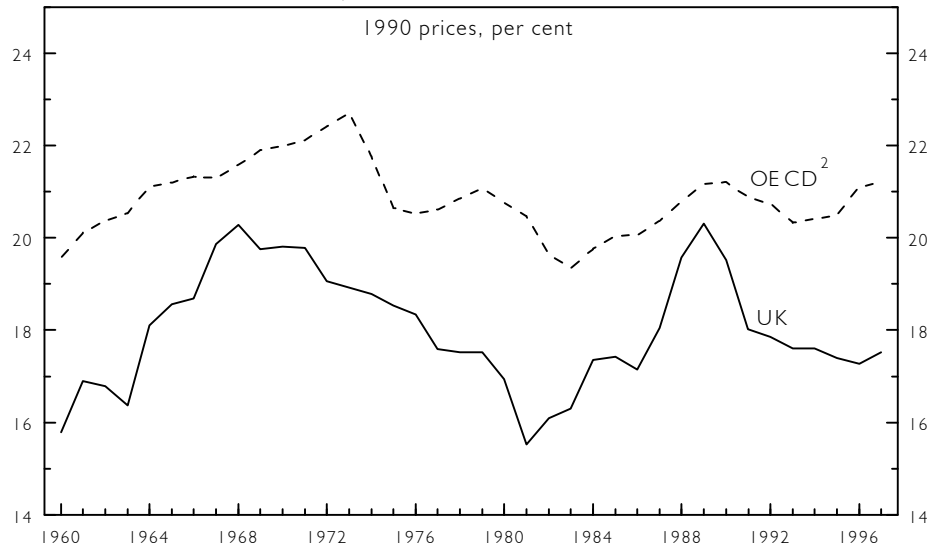
Forecast

Chart 9: Personal sector financial balance



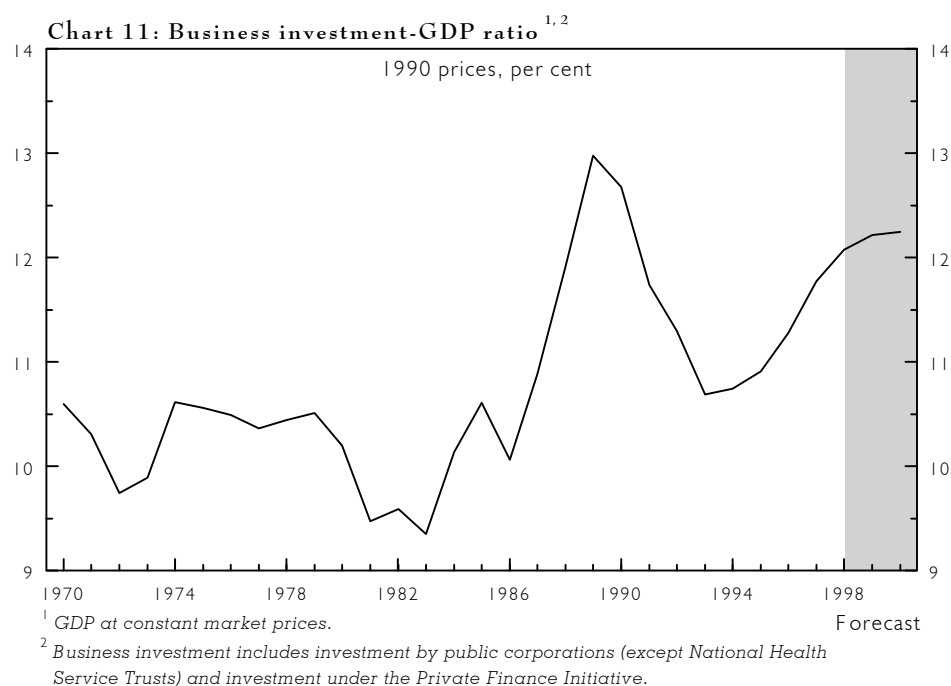
## Investment and stockbuilding

Chart 10: Whole economy investment-GDP ratio<sup>1</sup>



<sup>1</sup> GDP at constant market prices.

<sup>2</sup> Source: OECD.

**Table 3: Gross domestic fixed capital formation**

	Percentage changes on a year earlier			
	1997	Forecast		
		1998	1999	2000
Whole economy <sup>1</sup>	4¾	4¾ to 5¼	2¾ to 3¼	2½ to 2¾
of which:				
Business <sup>2,3</sup>	7¾	4½ to 5	3 to 3½	2½ to 3
Housing <sup>2</sup>	7½	4¼ to 4½	1¾ to 2¼	1¾ to 2
General government <sup>2,4</sup>	-15¾	14	4¼	1½

<sup>1</sup> Includes transfer costs of land and existing buildings.

<sup>2</sup> Excludes net purchases of land and existing buildings.

<sup>3</sup> Private sector and public corporations (except National Health Service Trusts) non-residential investment. Includes investment under the Private Finance Initiative.

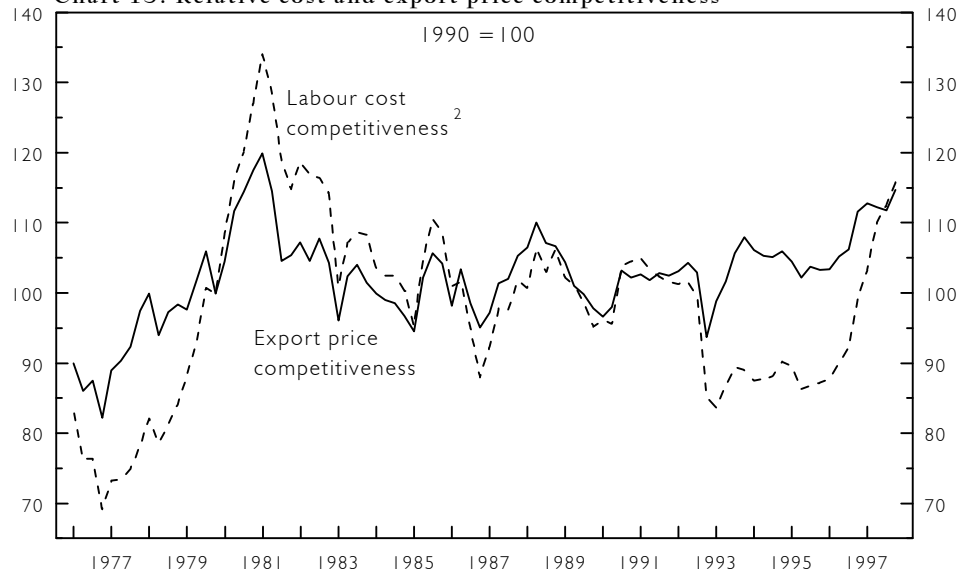
<sup>4</sup> Includes National Health Service Trusts.

Chart 12: Whole economy stock-output ratio



## Trade and the balance of payments

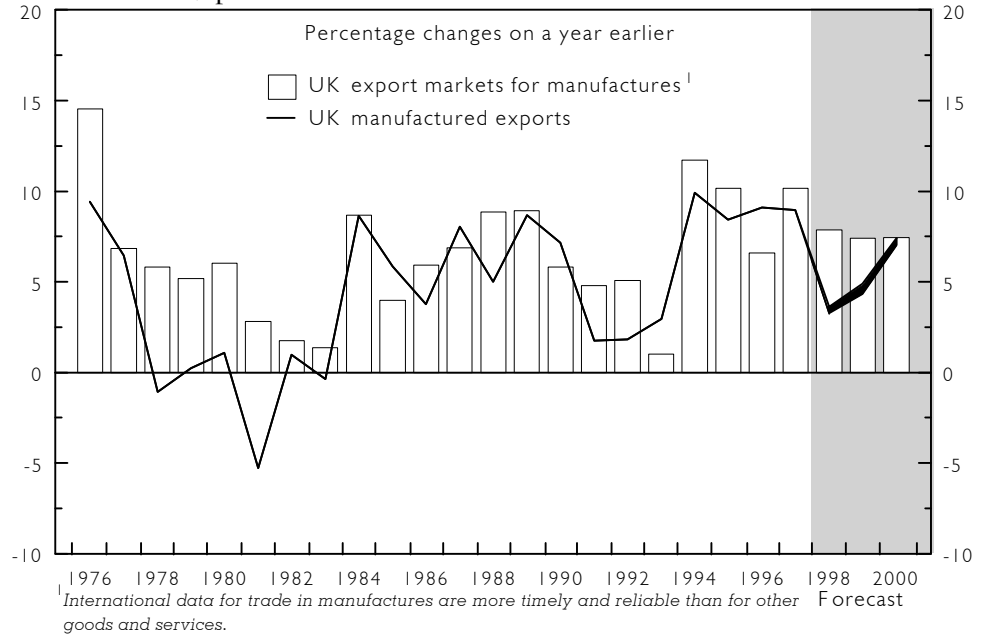
Chart 13: Relative cost and export price competitiveness<sup>1</sup>



<sup>1</sup>A fall means competitiveness has improved.

<sup>2</sup>Against major 15 industrial countries.

**Chart 14: Exports and overseas demand**



**Chart 15: Imports and total final expenditure**

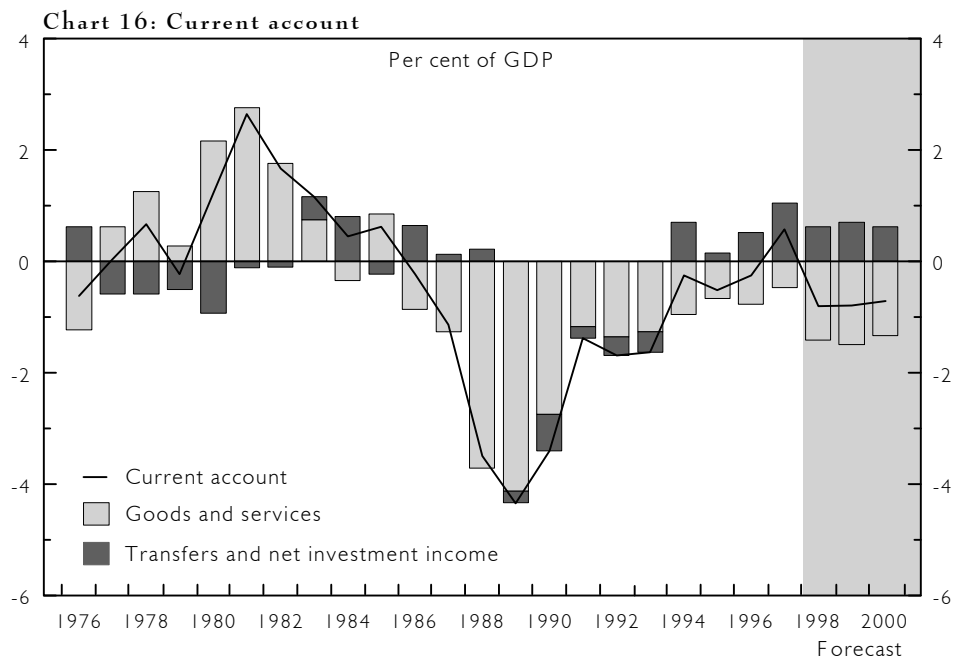


**Table 4: Trade in goods and services**

	Percentage changes on a year earlier					£ billion Goods and services balance
	Volumes		Prices <sup>1</sup>		Terms of trade <sup>2</sup>	
	Exports	Imports	Exports	Imports		
1997	8	9¼	-4¾	-6¾	2	-3¾
<i>Forecast</i>						
1998	3¼ to 3½	7½ to 8	-1¾	-2½	¾	-11¾
1999	4½ to 5	5½ to 6	1¾	1¼	¾	-13
2000	6 to 6¼	5½ to 5¾	1½	1½	¼	-12

<sup>1</sup> Average value indices.

<sup>2</sup> Ratio of export to import prices.

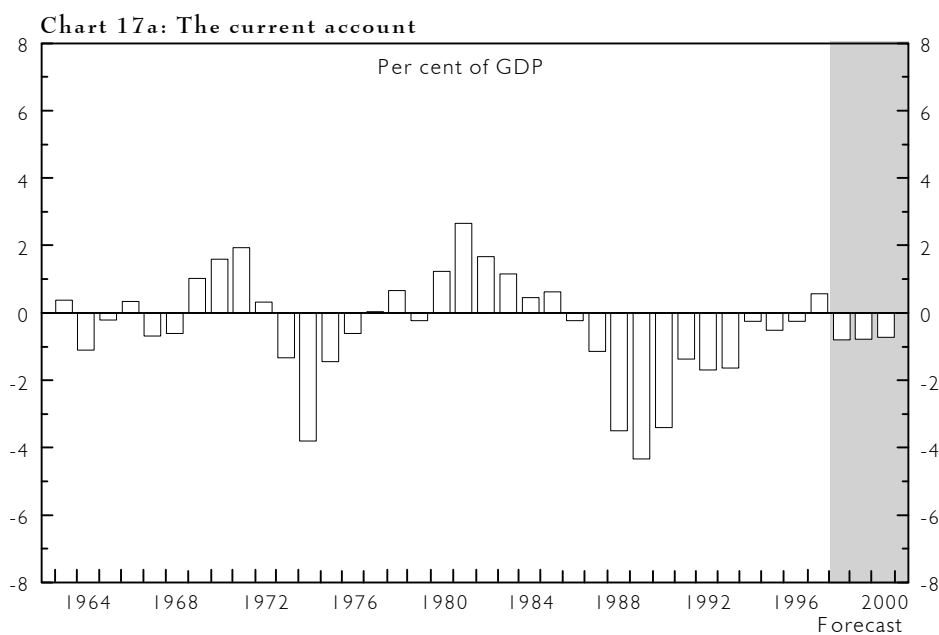


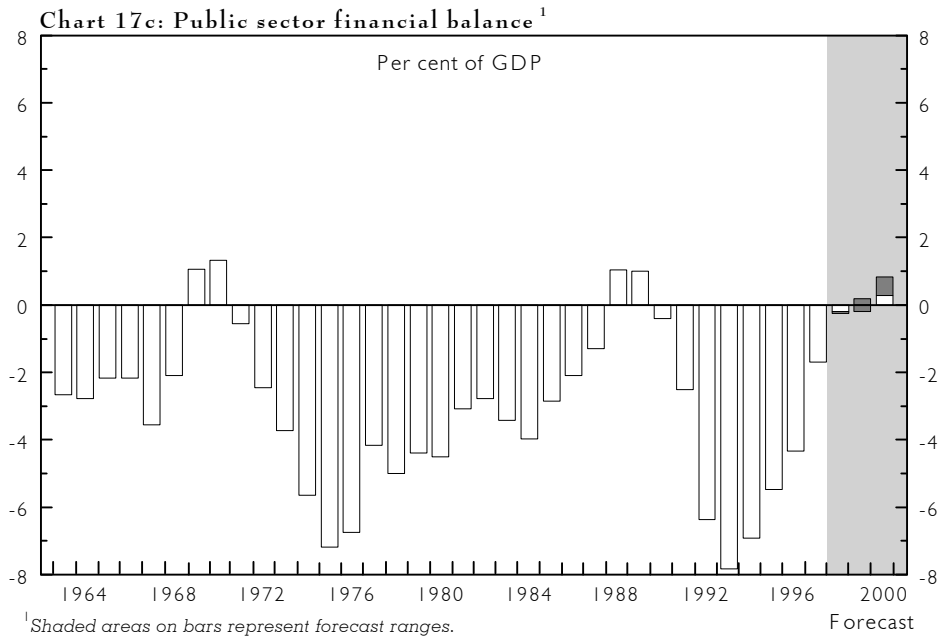
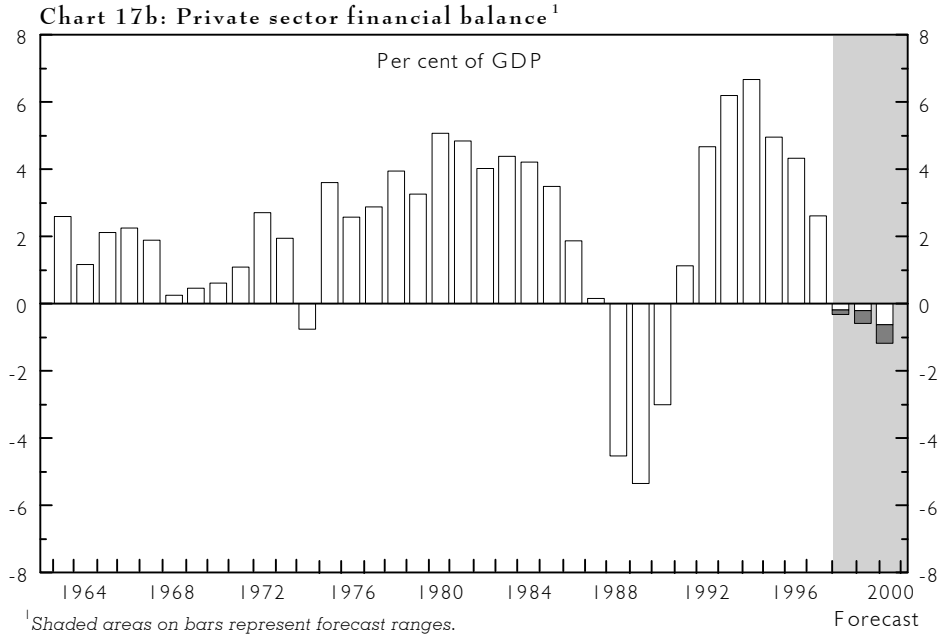
**Table 5: The current account**

	£ billion						Current balance
	Non-oil goods	Oil	Services	Total goods & services	Transfers	NII <sup>1</sup>	
1997	-17½	4½	9¼	-3¾	-4	12¼	4½
<i>Forecast</i>							
1998	-24	4¼	8	-11¾	-6½	11¾	-6½
1999	-26½	6	7¾	-13	-6	12¼	-6¾
2000	-26	6¼	7¾	-12	-6½	12	-6½

<sup>1</sup> Net investment income.

## Pattern of financial balances





## The labour market

Chart 18: Total and long-term<sup>1</sup> unemployment

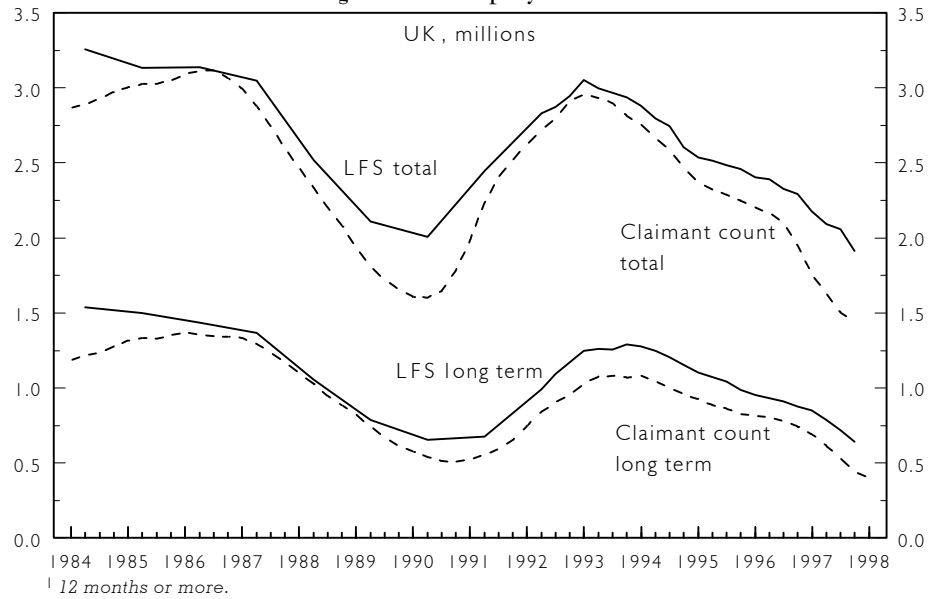


Chart 19: LFS employment, unemployment and the participation rate

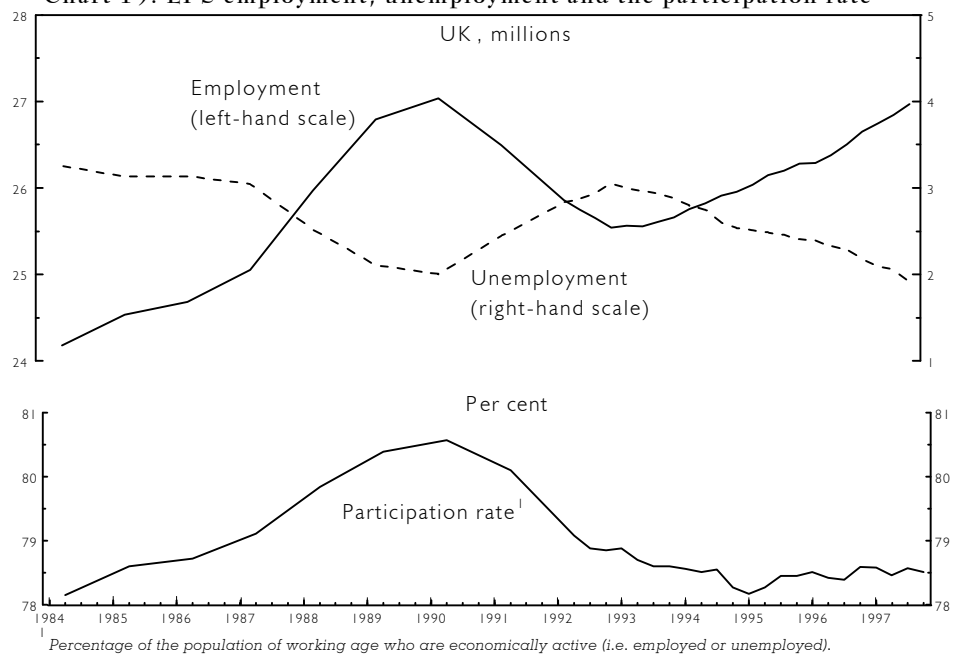
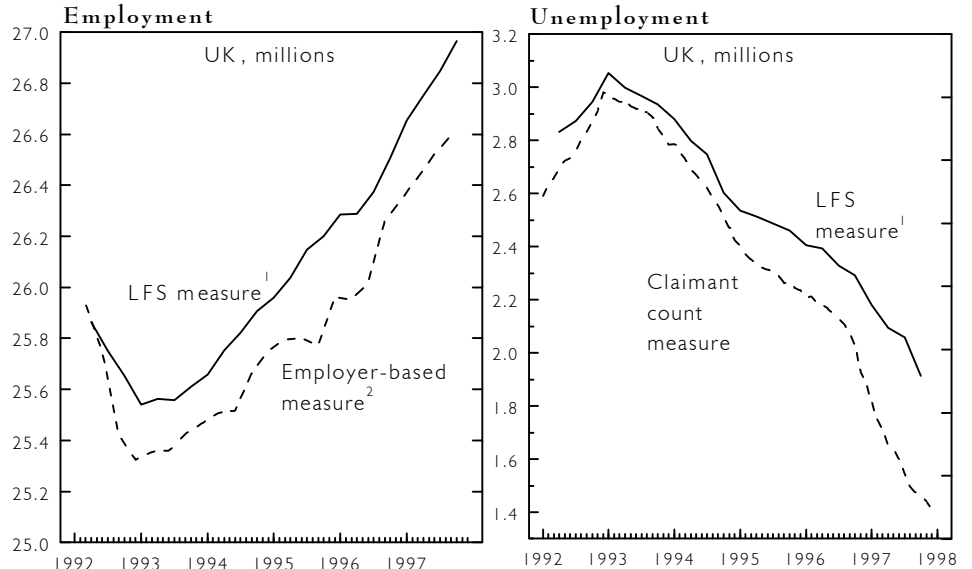


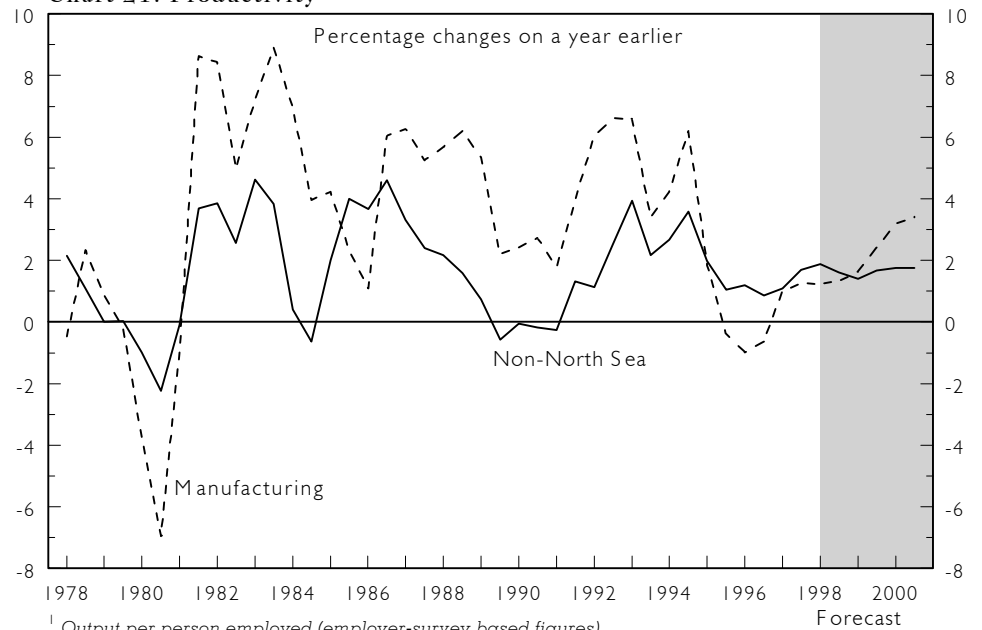
Chart 20: Employment and unemployment



<sup>1</sup> LFS data recorded against central month of each LFS quarter. LFS winter quarter refers to December to February, spring to March to May, etc.

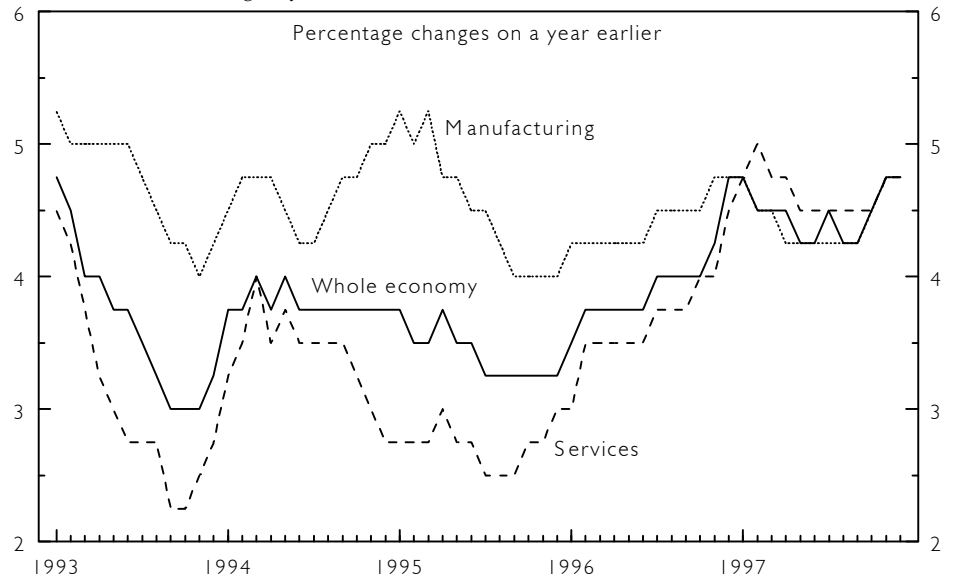
<sup>2</sup> UK workforce in employment.

Chart 21: Productivity<sup>1</sup>



<sup>1</sup> Output per person employed (employer-survey based figures).

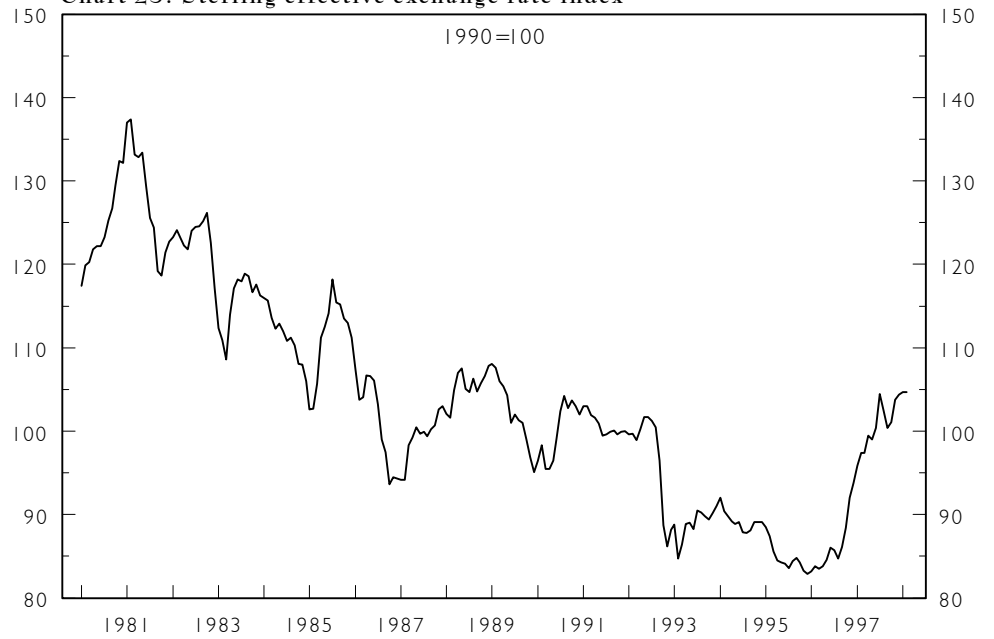
Chart 22: Earnings by sector<sup>1</sup>

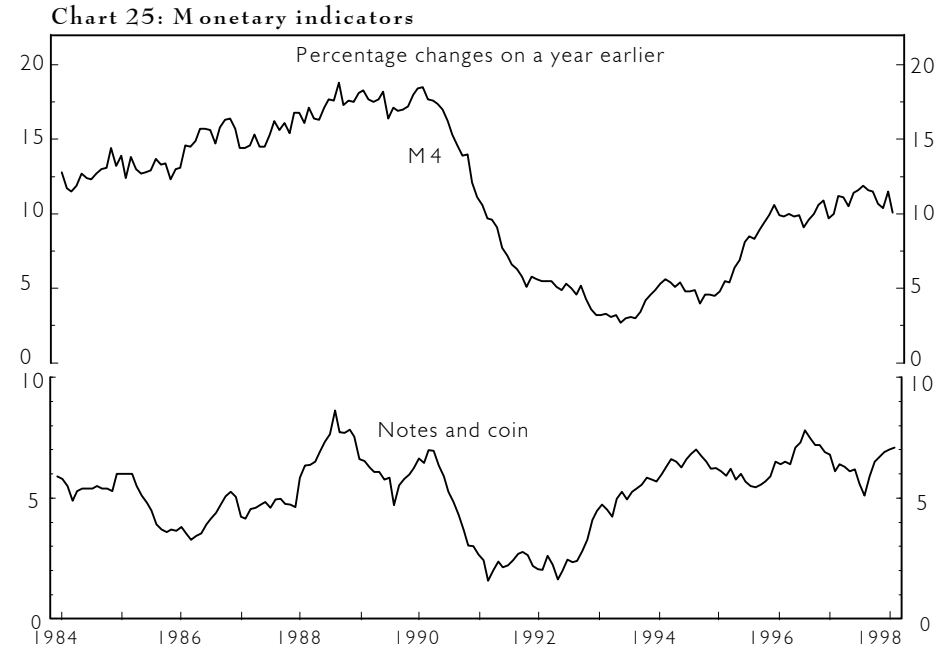
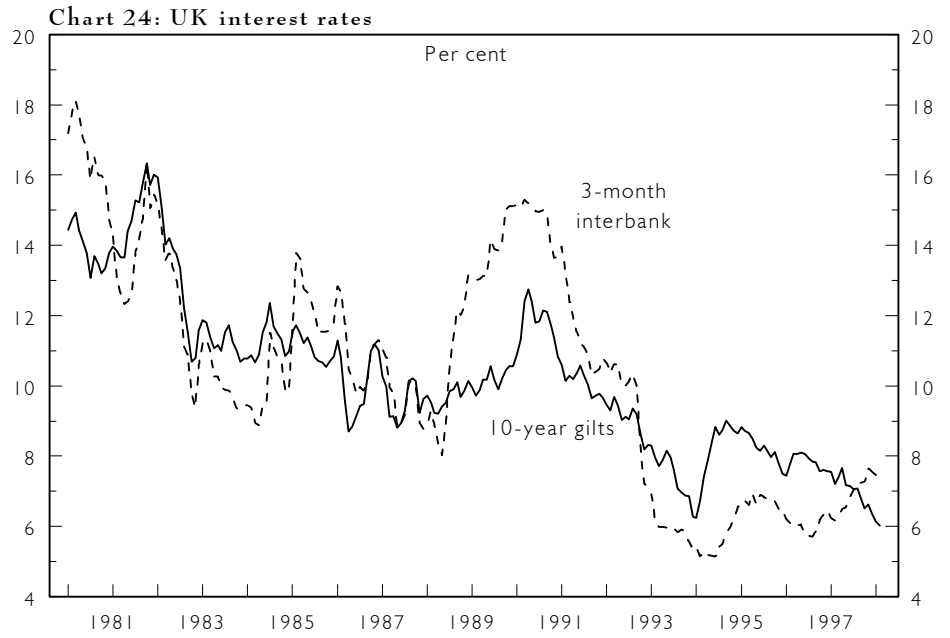


<sup>1</sup> Underlying average earnings.

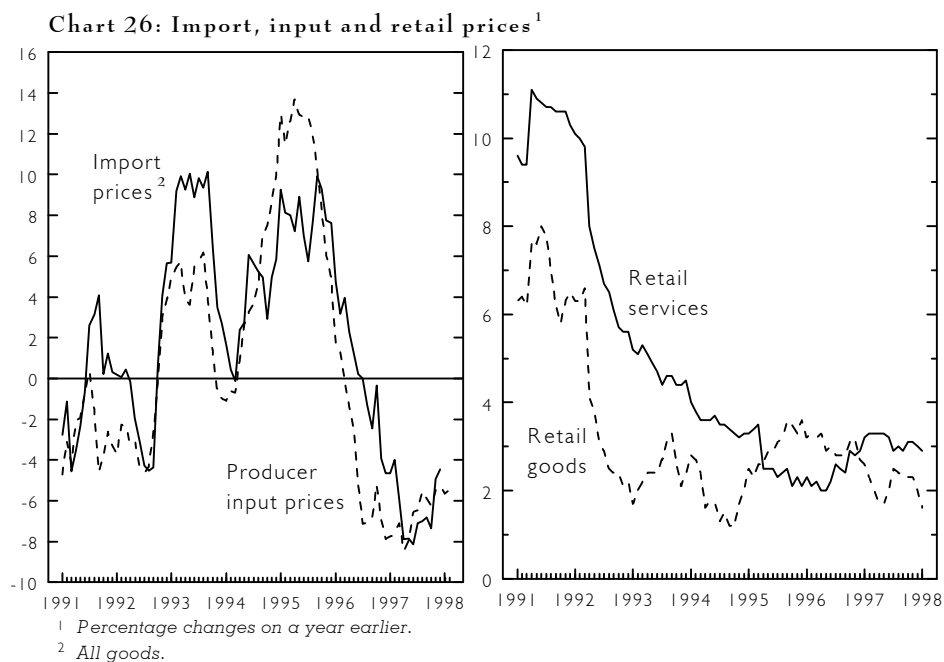
## Financial developments

Chart 23: Sterling effective exchange rate index





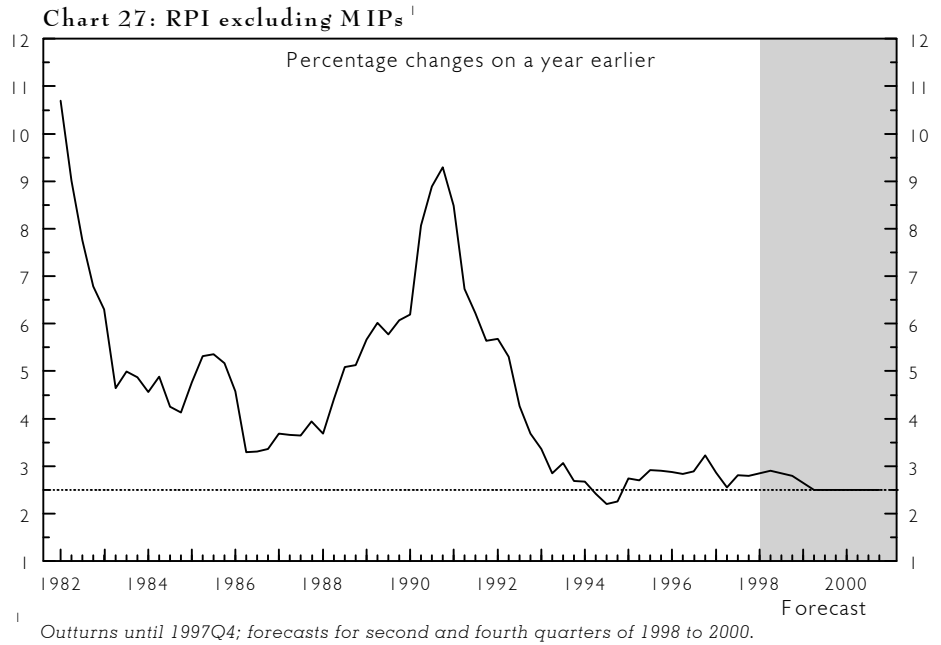
## Inflation



**Table 6: Retail and producer output prices**

	Percentage changes on a year earlier							
	1997		Forecast					
	Q2	Q4	1998		1999		2000	
	Q2	Q4	Q2	Q4	Q2	Q4	Q2	Q4
RPI excluding MIPs	2½	2¾	3	2¾	2½	2½	2½	2½
Producer output prices <sup>1</sup>	½	½	1	2	2½	2¼	2¼	2¼

<sup>1</sup> Excluding the food, beverages, tobacco and petroleum industries.



## Comparison with independent forecasts

**Table 7: Budget and independent<sup>1</sup> forecasts**

	Percentage changes on a year earlier unless otherwise stated					
	1998			1999		
	March Budget	Independent		March Budget	Independent	
Average		Range	Average		Range	
Gross domestic product	2 to 2½	2.3	1.5 to 3.2	1¾ to 2¼	2.0	1.3 to 3.4
RPI excluding MIPs (Q4)	2¾	2.7	2.0 to 3.7	2½	2.7	2.0 to 4.4
Current account (£ billion)	-6½	-6.8	-18.0 to -0.9	-6¾	-7.2	-21.3 to 6.6

<sup>1</sup> "Forecasts for the UK Economy: A Comparison of Independent Forecasts", March 1998.

## Comparison with November Pre-Budget Report forecast

**Table 8: Comparison with Pre-Budget Report forecast**

		Percentage changes on a year earlier unless otherwise stated	
		November 1997 Pre-Budget Report	March 1998 Budget
Gross domestic product	1998	2¼ to 2¾	2 to 2½
	1999	1½ to 2	1¾ to 2¼
	2000	2¼ to 2¾	2¼ to 2¾
RPI excluding MIPs	1998Q4	3	2¾
	1999Q4	2½	2½
	2000Q4	2½	2½
Current account (£ billion)	1998	-7¼	-6½
	1999	-7¾	-6¾
	2000	-7	-6½

**Table 9: Summary of economic prospects**<sup>1</sup>

	Percentage changes on a year earlier unless otherwise stated					
	1997	Forecast <sup>2</sup>			Average errors from past forecasts <sup>3</sup>	
		1998	1999	2000	1998	1999
<b>Output at constant prices</b> <sup>4</sup>						
Gross domestic product (GDP)	3	2 to 2½	1¾ to 2¼	2¼ to 2¾	¾	1½
Non-North Sea GDP	3¾	2 to 2½	1½ to 2	2¼ to 2¾	¾	1¼
Manufacturing output	1½	0 to ½	1 to 1½	2¼ to 2½	¾	2¾
<b>Expenditure components of GDP at constant prices</b> <sup>4</sup>						
Domestic demand	3½	3¼ to 3¾	2¼ to 2¾	2¼ to 2½	¾	1¾
Consumers' expenditure	4½	3¾ to 4	1¾ to 2¼	2¼ to 2½	¾	1½
General government consumption	-½	1¼	2	2	¾	1
Fixed investment	4¾	4¾ to 5¼	2¾ to 3¼	2½ to 2¾	1½	4
Change in stockbuilding <sup>5</sup>	0	-¼	¼	0 to ¼	¼	½
Exports of goods and services	8	3¼ to 3½	4½ to 5	6 to 6¼	1½	2
Imports of goods and services	9¼	7½ to 8	5½ to 6	5½ to 5¾	2	3½
<b>Balance of payments current account</b>						
£ billion	4½	-6½	-6¾	-6½	8¼	11¼
per cent of GDP	½	-¾	-¾	-¾	1	1¼
<b>Inflation</b>						
RPI excluding mortgage interest payments (Q4)	2¾	2¾	2½	2½	½	1
Producer output prices (Q4) <sup>6</sup>	½	2	2¼	2¼	½	1½
GDP deflator at market prices (financial year)	2¾	3	2½	2½	1	1¼
<b>Money GDP at market prices (financial year)</b>						
£ billion	797	834 to 837	872 to 880	914 to 925	11½	17¼
percentage change	6	4½ to 5	4¾ to 5¼	4¾ to 5	1¼	2

<sup>1</sup> Data in this chapter are consistent with the output, income and expenditure estimates and other series for the period to the fourth quarter of 1997 released by the Office for National Statistics on 13 March 1998.

<sup>2</sup> Despite the assumption that ratios of variables to GDP are largely invariant within forecast ranges, the growth ranges for GDP components do not necessarily round to the ½ percentage point ranges for GDP growth. This reflects the GDP growth ranges themselves being rounded, and assumed invariance of the levels of public spending and counterparts within the forecast ranges.

<sup>3</sup> Average absolute errors in spring/summer forecasts over past ten years. The average errors for the current account are calculated as a percent of GDP. The £ billion figures are calculated by scaling the errors as a percent of GDP by money GDP.

<sup>4</sup> Further detail on GDP and its components is given in Table 10.

<sup>5</sup> Per cent of GDP.

<sup>6</sup> Excluding the food, beverages, tobacco and petroleum industries.

