

Revision on the Economic Cycle

Economic growth is an increase in **real national output** or an expansion of the economy's long-run **productive potential**. It is measured by the percentage change in **real GDP** or **GNP**. Inevitably there are **fluctuations** in the rate of growth from year to year and from quarter to quarter. This is true both for the UK and every other economy.

A distinction needs to be made between **short run growth** - resulting from making greater use of available resources to increase output and **long-run growth** - which comes from expanding the productive potential of the economy through improvements to the supply-side of the economy.

Economic fluctuations—the business cycle

Variations in growth are part of the **business** or **trade cycle** - the real volume of national output does not rise or fall at a uniform rate. Different stages of the economic cycle can be identified:

Recession: A fall in real output - associated with a fall in demand for goods and services and a contraction in employment, investment and profits. Since 1945, the British economy has experienced five full calendar years when national output has fallen. The last recession lasted for nearly two years from the summer of 1991 to the autumn of 1992.

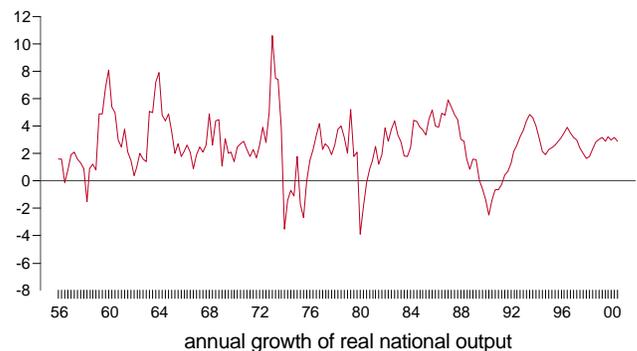
Recovery: A rebound in national output (either from higher consumer demand, government spending, investment or an increase in net exports). The recovery phase can see strong output growth without causing inflation because there is plenty of spare capacity left in the economy. The UK economy entered the last recovery phase in the autumn of 1992.

Boom: Fast growth - where the actual rate of growth exceeds the long run trend rate of growth. The boom can have demand and/or supply-side causes but there is a risk of demand-pull and cost-push inflation emerging. This is because of excess aggregate demand for goods and services and shortages of factor resources.

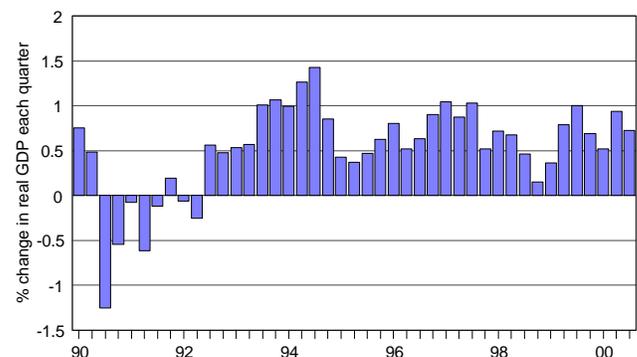
Slowdown: This phase of the cycle follows on from a cyclical boom. The rate of growth of output slows down relieving some of the demand-pull inflationary pressure. A sharp slowdown may develop into a full-blown recession (known as a "hard-landing") or the slowdown may be mild (a "soft-landing") in which case real output and incomes continue to rise albeit at a slower rate. The Bank of England is currently trying to engineer a gradual slowdown for the econ-

All economies see fluctuations in the rate of economic growth—this revision briefing focuses on the UK and USA

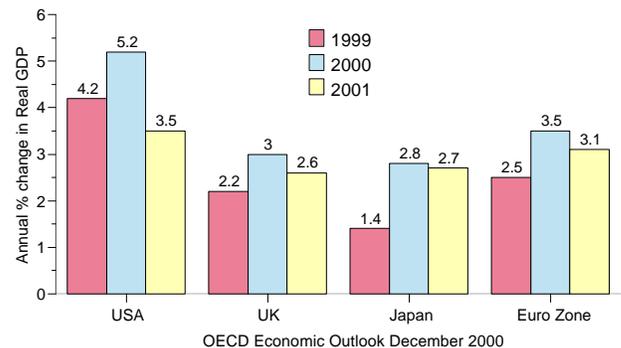
THE UK HEADS FOR A DECADE OF SUSTAINED GROWTH



NATIONAL OUTPUT RISES EACH QUARTER SINCE 1999



OECD FORECASTS STEADY GROWTH INTO 2001



omy—after eight years of sustained growth. Most city forecasts predict that growth will slow down in 2001—and this should help to keep inflation under control.

The **economic cycle** for the British economy over the last forty years is shown in the top chart. Since the last recession the UK has enjoyed the longest sustained rate of growth for over 30 years. This growth is forecast to continue into 2001. The latest OECD Economic Forecast has penciled in growth of 2.6% for the UK next year – slightly below the growth anticipated for the members of the Euro Area.

The latest travel trends data finds that the strong pound is causing an even greater trade deficit in tourism for the UK economy

A 13% increase in spending by UK residents travelling overseas contributed to a record £9.5 billion deficit in travel on the UK balance of payments last year. Information released by the annual Travel Trends survey this week shows that UK residents made a record 53.9 million visit abroad in 1999 - a rise of 6% on the year before. Total spending when overseas climbed to £22 billion - a level twice that recorded in 1991.

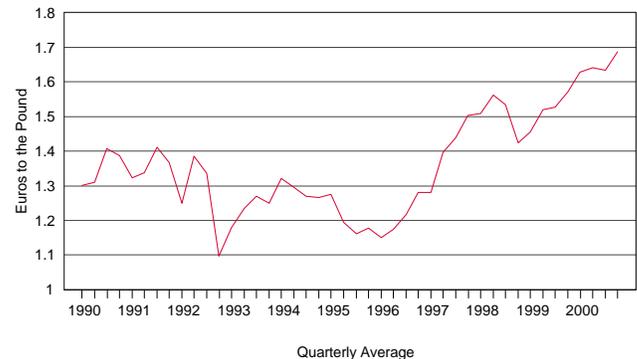
The rapid growth of overseas travel can be explained by a combination of factors. Firstly real incomes have risen as the economy has grown over the last eight years. The chart opposite shows the quarterly level of real personal disposable income since 1994. As average living standards have increased, so the market demand for foreign holidays has expanded reflecting the high income elasticity of demand for overseas travel. A second factor is the falling real cost of travel to short and long-haul destinations. This has reduced the relative price of foreign travel compared to holidays taken in the UK. The British tourist industry has come under fire in recent years for not providing sufficiently good standard holidays at value for money prices. Last year British residents made 4.5 million day trips spending an average of £100 on each visit. Over 75% of these trips were made to France with a significant percentage of these being made via the Channel Tunnel.

Undoubtedly the main short term factor has been the strength of sterling against the Euro. An appreciating currency increases the real purchasing power of UK residents travelling overseas both for business and leisure purposes. The sharp decline in the Euro's value has provided a major boost to the attractiveness of foreign holiday destinations whilst at the same time making London and other leading UK tourist venue appear much more expensive to overseas visitors.

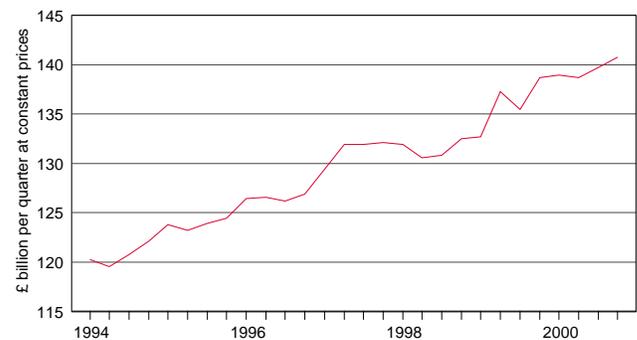
Sterling has lost ground against the US dollar—indeed visits from North American tourists have held up well over the last two years. The main problem is in the decline in visitor numbers from other countries inside the European Union. Fewer people are travelling to the UK and they are staying for shorter periods because the high sterling exchange rate reduces their purchasing power. The structural problems facing the UK tourist industry have been made much worse by the transition of sterling from a *soft currency* to *hard currency* status.

UK Travel Trends in 1999

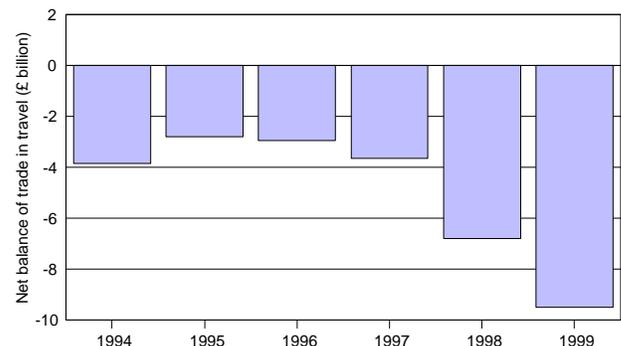
STERLING-EURO EXCHANGE RATE



REAL PERSONAL DISPOSABLE INCOME



UK RUNS A LARGE DEFICIT IN TRAVEL

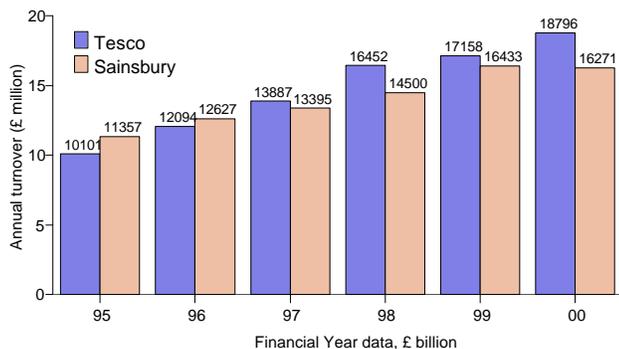


KEY POINTS

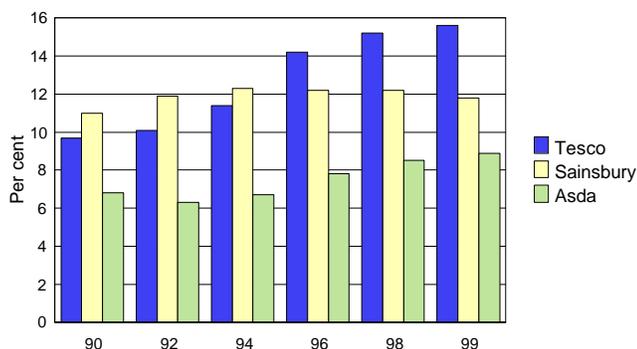
- An extra 2.7m overseas holidays visits in 1999
- 8 million business visits made overseas in 1999
- Over 2 million "shopping trips" made to France in 1999 with an average spend of £140 per trip
- Long haul destinations becoming more popular as prices fall—notably to Central America, South America and the Caribbean

Battles in Food Retailing

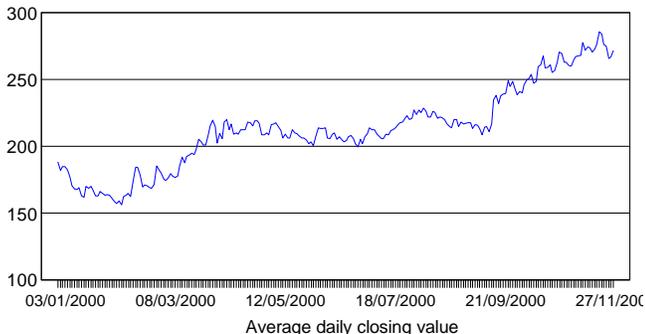
BATTLE OF THE CHECK-OUTS



MARKET SHARE OF LEADING THREE



TESCO SHARE PRICE DURING 2000



Tesco is making further progress in the battle for supremacy in food retailing

The UK food retailing sector has experienced tough times in recent years. Profit margins have been falling, the industry has been subjected to detailed scrutiny by the Competition Commission and the share prices of several leading national food retailers have taken a battering. The industry is increasingly price sensitive as the battle for market share grows in intensity with each succeeding month. Price-driven supermarkets such as Asda(Walmart) and Tesco are gaining a rising share of total sales at the expense of Sainsbury and Marks and Spencer - traditionally located towards the upper end of the market.

Tesco is the UK's largest supermarket operator (see the top chart) and announced this week its best financial performance for over three years. Like for like sales were up by 5.1% in the third quarter of 2000 - defying predictions that the ongoing petrol crisis might have damaged sales growth at many of their out-of-town outlets. Total group sales were up 13% over the same period. Tesco is achieving rapid sales growth from its overseas businesses in Asia and Eastern Europe.

Several leading city analysts are now upgrading their profits forecasts for Tesco despite the ever expanding price war with Sainsbury and other retailers. Pre-tax profits for Tesco in the calendar year 2000 were £933 million (against £842 million in 1999). Turnover has continued to grow at a healthy pace - rising to £18.8 billion this year (£17.1 billion in 1999).

Prices of food items continue to fall in its shops (Tesco reported price deflation of 0.2% in the third quarter) but Tesco's strategy is shifting towards non-food sales where the value added is greater. The retailer is aiming to take a significant share of the market for audio-visual equipment over the next two years and utilise the success of its online business to expand sales of other household goods.

The stock market has responded to Tesco's above average market performance. Tesco's shares are now trading between 275-280p.

RECOMMENDED WEB SITES

Statistics on UK Tourism
www.staruk.org.uk/

Cheltenham College Economics Department
www.cheltcoll.gloucs.sch.uk/web/depts/economics/economics.htm

Bradfield College Economics Department
www.bradfieldcollege.org.uk/departments/economics.html

Tutor2u Economics www.tutor2u.net
 Tutor2u Economics is a resource for students and teachers. There are hundreds of pages of revision notes, links and a Discussion Forum. Visit the site and improve your grades

NEXT WEEK'S ECONOMICS BRIEFING

Revision Briefing on: The Supply Side of the Economy

The Importance of Business Surveys

The Collapse in the value of Hi-Tech Shares

Weekly Briefing

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