

TOO GOO TO LAST? THE ECONOMY IN 2000

In this end of year special we provide an overview of the key economic developments in the UK economy over the past twelve months. Has 2000 been another year of success and progress for the economy? What are the main risks to the benign economic outlook over the next twelve months?

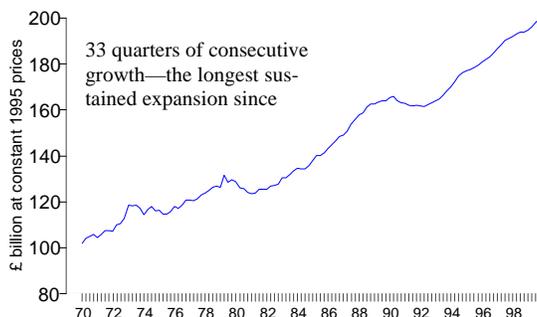


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THE BRITISH ECONOMY IN 2000—AN OVERVIEW

REAL NATIONAL OUTPUT FOR THE UK ECONOMY

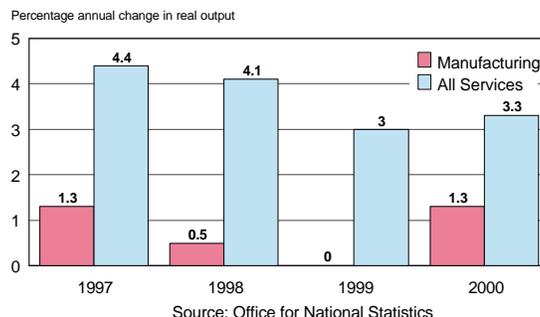


Economic Growth

2000 was a year of above trend growth. Real GDP is estimated to have grown by 3% during the year—the eight consecutive year of expansion and the longest sustained increase in real national output for over thirty years. The service sector provided the bulk of this rise in output with a 3.3% increase in production.

Manufacturing responded well in the second half of the year, but the sector as a whole managed only a 1.3% jump in production. Those industrial sectors linked to the growth of the New Economy did best. Total industrial production grew 1.6% during the year.

OUTPUT IN SERVICES AND MANUFACTURING



The Three-Speed Economy

The relative fast growth of services and slower growth in manufacturing hides significant variations in performance *within* each sector.

In the service sector, transport and communications had another excellent year as did business services. However retailing has continued to struggle. Within manufacturing, 2000 has been another disastrous year for “traditional old economy” industries such as textiles and footwear and steel. However manufacturers of the hardware necessary power the ICT sector have enjoyed bumper increases in output and profits.

MACROECONOMIC SUMMARY TABLES

Selected Macroeconomic Indicators for the UK

	Household Spending	Real Disposable Income	Household Savings Ratio	Real GDP	Industrial Production	Unemployment (Claimant Count)
	% Change	% Change	% Of disposable income	% Change	% Change	% Of labour force
1994	2.7	1.3	9.4	4.4	5.4	9.2
1995	1.6	2.6	10.3	2.8	1.8	8.1
1996	3.7	2.2	9.4	2.6	1.1	7.4
1997	4	3.8	9.3	3.5	1.0	5.5
1998	3.9	0.1	5.8	2.6	0.8	4.7
1999	4.4	3.5	5.1	2.2	0.5	4.3
2000	3.6	2.6	3.5	3.0	1.6	3.7

Inflation and Interest Rates

Inflation continues to surprise!

Underlying inflation (RPI inflation minus mortgage interest payments) averaged just 2.1% in 2000—the lowest rate for over thirty years. Data released by the European Commission at the end of December showed that inflation in the UK measured using the harmonised index of consumer prices (HICP) was just 1% during the year. This figure put Britain at the top of the league table for European Union countries with the best inflation performance.

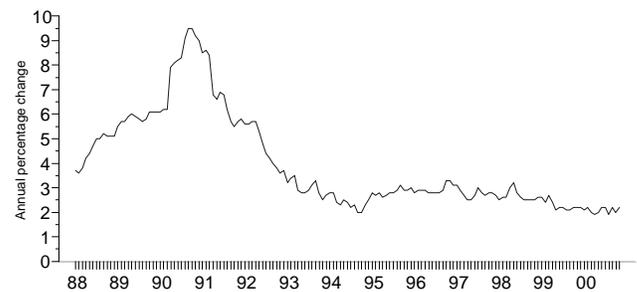
The headline inflation data continue to surprise on the downside—especially given the potentially inflationary consequences of another year of above trend growth; rising oil and other input prices, a boom in the housing market, and a further sustained fall in unemployment. There has clearly been an improved trade-off between unemployment and inflation. And, the economy seems better placed to maintain a healthy growth of output and employment without experiencing accelerating inflation.

What explains the continued low inflation? Four factors provide the core of the explanation:

1. The **strong exchange rate** has held down the cost of imported products and continues to exert a strong anti-inflationary discipline on UK exporters and businesses facing competition from imports
2. **Profit margins** have been squeezed—partly because of the high exchange rate—but also because of the increasingly competitive domestic economic environment
3. The **labour market reforms** of the last twenty years have made the British labour market more flexible, allowing a reduction in structural unemployment .
4. **Inflation expectations** have fallen—leading to a slower growth of wages and earnings than at similar stages of previous economic cycles.

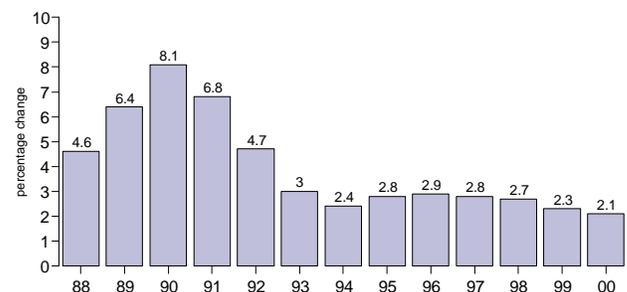
No change in base rates for ten months during 2000—one of the longest periods of rate stability for many years.

THE GOVERNMENT'S CHOSEN INFLATION TARGET



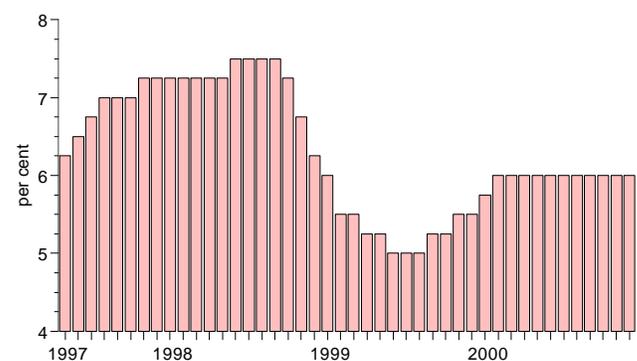
RPIX inflation - monthly data

UK RETAIL PRICE INFLATION DROPPED TO 2.1% IN 2000



RPIX - excludes mortgage interest payments

UK INTEREST RATES SINCE BANK INDEPENDENCE



Inflation and Interest Rates—Selected Summary Data

	All Items RPI	RPIX	Unit Labour Costs	Average Earnings	Short Term Interest Rate	Sterling Exchange Rate Index
	% Change	% Change	% Change	% Change	Per Cent	1990=100
1995	3.4	2.8	1.3	2.3	6.7	84.8
1996	2.4	3.0	2.4	2.3	6.0	86.3
1997	3.1	2.8	3.3	4.4	6.8	100.5
1998	3.4	2.6	4.3	4.4	7.3	103.9
1999	1.5	2.3	4.0	5.0	5.4	103.7
2000	2.9	2.1	2.1	4.4	6.2	107.2

The Labour Market

The labour market continued to surprise economists during 2000. Unemployment fell to a twenty five year low and employment reached record levels.

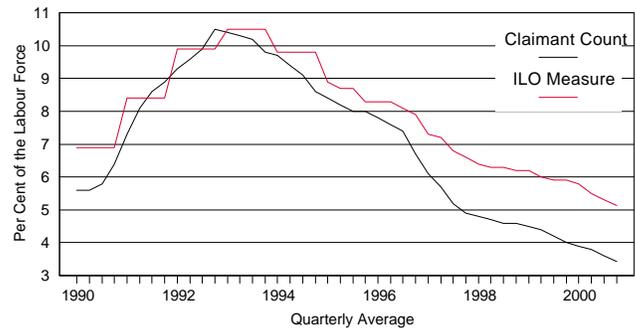
By the end of 2000 it seemed that the pace of job creation in the UK labour market was beginning to slow down. Claimant count unemployment rose in October for the first time in two years and the average monthly fall in unemployment in the final months of the year dropped to 3,000 compared to over 18,000 per month during the summer.

During 1997, the average monthly change in claimant unemployment was 42,000. By 1998 it was down to 20,000 and during 1999 the monthly decline had nudged down to 8,3000. These figures reflect the fundamental problem of bringing unemployment down beyond the natural rate when much of the remaining unemployment is long-term and structural in origin.

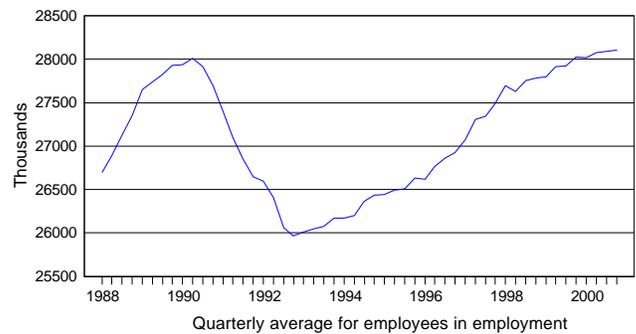
Nonetheless, 2000 will go down as another excellent year for the labour market. Total unemployment declined to a twenty five year low (settling at 3.6% of the labour force) and the number of people in paid work crept over the 28 million barrier—the highest recorded figure for the British economy.

The number of job vacancies remained high throughout the year. In November 2000, over 375,000 registered vacancies remained unfilled—suggesting that the total number of jobs available was well over one million. Some commentators are pointing to a potential “jobs crisis” for the UK in the near term with many thousands of (predominantly public sector) jobs remaining vacant because of a lack of suitably qualified people and the problems created by the severe regional imbalance in house prices between northern regions and London & the South East.

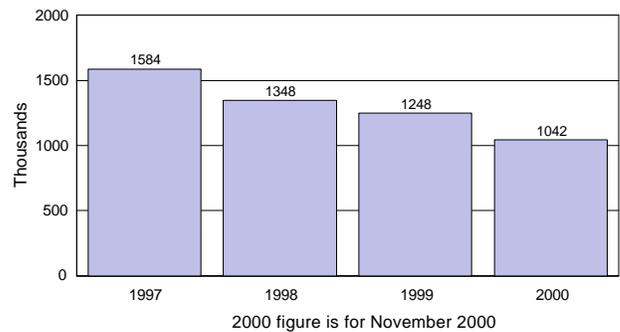
CLAIMANT COUNT AND LFS UNEMPLOYMENT



TOTAL EMPLOYMENT IN THE UK ECONOMY



CLAIMANT COUNT UNEMPLOYMENT

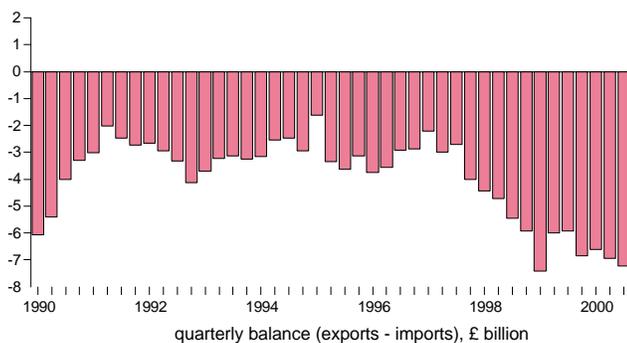


THE UK LABOUR MARKET—SUMMARY DATA

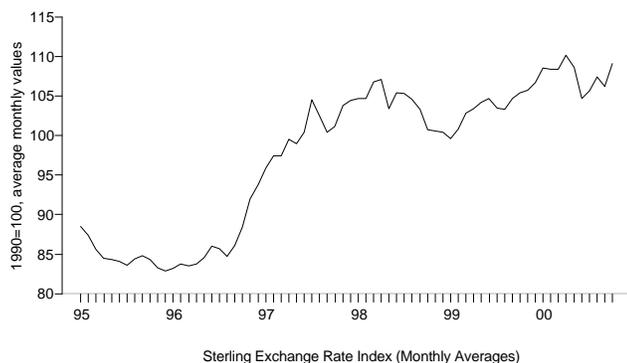
		1998	1999	2000
Manufacturing Employment	000s	4,152	4,050	3,966
Total Employment	000s	27,305	27,649	27,949
Economically Inactive	000s	17,161	17,049	17,060
Unemployment (LFS)	000s (Labour Force Survey)	1,828	1,765	1,621
Unemployment Rate (LFS)	% of labour force	6.3	6.0	5.5

Trade and The Exchange Rate

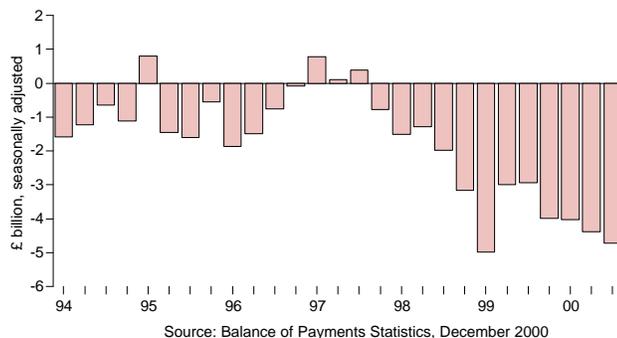
RECORD TRADE DEFICIT IN GOODS DURING 2000



STERLING HAS GENUINE STATUS AS A HARD CURRENCY



UK TRADE BALANCE IN GOODS AND SERVICES



STRONG POUND HITS TRADEBUT MANUFACTURING RESPONDS

The gap between imports and exports grew during this year. British exporters struggled hard to maintain their share of overseas markets. The pound remained strong in the currency markets, and this made life difficult for manufacturing businesses. Many firms opted to cut their profit margins in order to protect their existing sales. But the fall in the price of imports has been an incentive for UK consumers when making their purchases. This combination of a strong pound (which gives people a significant boost to their real purchasing power) and a high level of demand fuelled by the strong domestic economy—has contributed greatly to the trade gap.

Excluding oil, the balance of trade in goods is forecast to be £35.7 billion this year—nearly £5 billion higher than in 1999. The UK's trade surplus in services has dipped a little this year. It will come in above £10 billion for the fourth year in a row, but this is clearly insufficient to compensate for the enormous deficit in goods.

Overall the current account (which also includes net investment income from overseas assets and net transfers from the UK to the rest of the world) will be in deficit this year. The likely out-turn is a current account deficit of £14.5 billion (or 1.5% of GDP) - a figure which in itself is not really a problem. For countries such as the UK, a modest deficit on the current account is easily financed by net capital inflows.

World trade has soared this year. The global economy is enjoying a substantial increase in output and income—the UK economy would be better placed to benefit from this with a more competitive exchange rate. But it may have to learn to live with a strong currency for some time to come.

TOP WEB SITES ON THE UK ECONOMY

Bank of England:
www.bankofengland.co.uk

National Statistics
www.statistics.gov.uk/ukin_figs/default.asp

Her Majesty's Treasury
www.hm-treasury.gov.uk/e_info/overview/index.html

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NEXT WEEK'S ECONOMICS BRIEFING

A rebound for the UK Coal Industry

Business Failures drop by 6% during 2000

Will a fall in Sterling threaten UK Inflation during 2001?

Weekly Briefing
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