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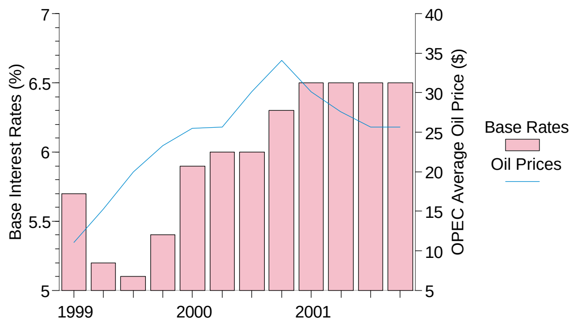
Weekly Economics Briefing

Base rates will have to rise says National Institute

HIGHER BASE RATES BUT LOWER OIL PRICES?



% change unless stated	1999	2000	2001
Real GDP	2.2	3.2	3.6
RPIX Inflation	2.3	2.0	2.2
ILO Unemployment	6.0	5.5	5.3
Manufacturing Output	-0.1	1.6	2.9
Base Interest Rates	5.34	6.04	6.50

Source: National Institute Economic Review

Base interest rates will have to rise by another 0.5% by the turn of the year according to economists at the National Institute for Economic & Social Research. Their latest assessment of the economy suggests that monetary policy risks becoming too loose as the economic expansion continues apace.

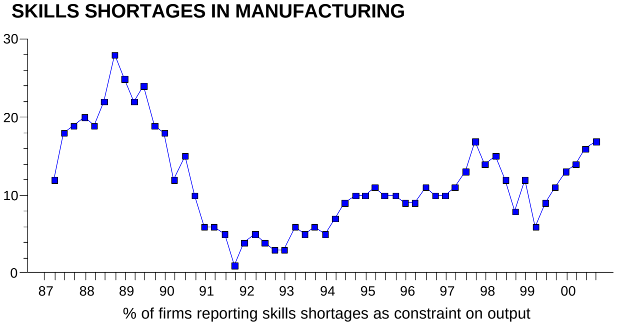
The recovery in output and employment since 1992 is already the second longest sustained period of growth since 1945. However real national output is only 26% higher since the recovery began. This compares with a 31% rise in output from the 1981 trough to the 1989 peak. The current expansion in the economy has been more balanced than the 1980s and partly as a result of this we have seen a continuation of steady growth and low inflation.

The National Institute model of the economy calculates that the economy as a whole is close to an **equilibrium** at present. In other words, the actual level of national output is close to its long-run potential level and unemployment in the labour market is close to the Natural rate. If there is another pick-up in the rate of growth there is a danger of faster wage inflation in the labour market—but the strong exchange rate is helping to keep inflationary pressure under control. And, low inflation is an important factor holding down the annual growth in basic pay settlements.

Manufacturing industry is poised to enjoy faster growth next year. Export sales to North America are rising strongly and productivity growth is healthy.

Skills shortages in manufacturing at highest for ten years

SKILLS SHORTAGES IN MANUFACTURING



The October CBI Industrial Trends Survey found that manufacturing firms are finding skilled labour shortages an increasingly important constraint on output. 17% of firms cited labour shortages as a limitation on future output levels—double the figure in the July 1999 survey and the highest figure for over ten years.

Shortages of skilled workers are still not as severe as those experienced in the late 1980s but a growing scarcity of skilled employees is a factor that may drive wage inflation higher in the months to come.

Manufacturing confidence remains fragile

The October **Industrial Trends Survey** from the Confederation of British Industry finds little improvement in overall business confidence. The net balance of businesses expecting an improvement in the economy over the next four months stands at –9 (up a tick from –10 in July) but employment and investment intentions remain weak and there has been a rise in the percentage of firms operating below full capacity. Economists at the CBI are calling for the Bank of England to keep interest rates on hold for the foreseeable future. And they are lobbying the government for further cuts in corporate taxation next year to promote higher levels of investment.

Export Optimism

The export optimism index recovered some ground in October. The balance of firms expecting an increase in export orders in the next four months rose from –18 to –6. This series has been volatile over the last four years. The pound has continued to fall against the US dollar but has surged further against the Euro.

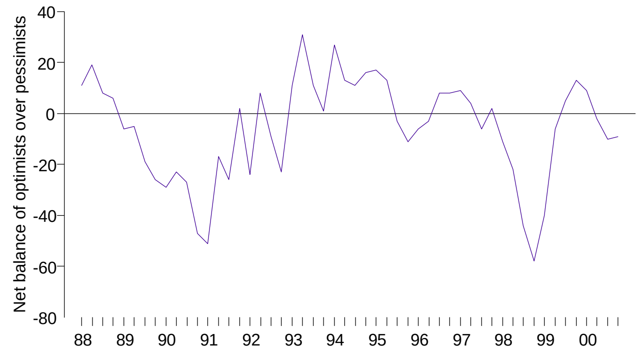
Spare Capacity

The percentage of manufacturing firms operating below full capacity increased from 56% in July to 59% in October. This figure has remained relatively stable over the last few surveys—manufacturing industry successfully avoided a full scale recession in 1999 but output growth this year across the entire sector is likely to average less than 1 per cent. In October, 91 % of businesses reported that their present productive capacity will be adequate to meet expected demand. Given that productivity growth is rising more strongly, it is possible for many businesses to meet rising demand by using their existing factors of production more intensively. Indeed employment continues to decline.

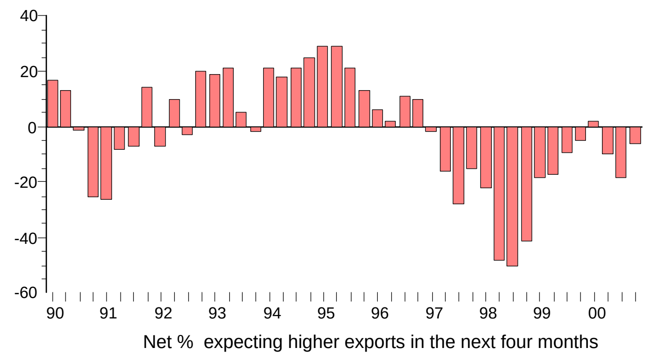
Planned Investment

Investment intentions remain extremely weak—both for spending on new buildings and plant and machinery. The real value of manufacturing investment fell by 14.7% in 1999. This year the National Institute expects to see a 5.1% increase in gross capital spending. It will take a significant rebound in overall business confidence for planned investment spending to recover more strongly than forecast.

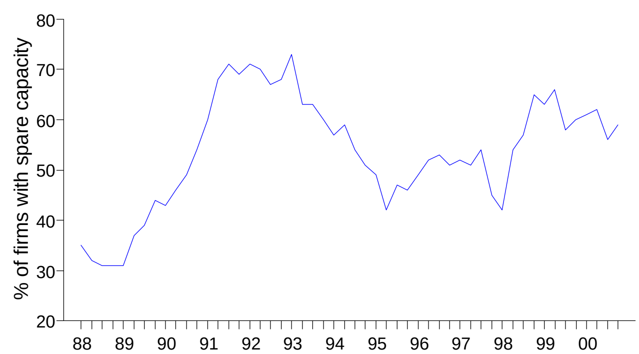
CBI MANUFACTURING BUSINESS CONFIDENCE



MANUFACTURING EXPORT OPTIMISM REMAINS WEAK



SPARE CAPACITY IN MANUFACTURING INDUSTRY



Factors limiting investment (%)	Jan 2000	Oct 2000
Inadequate rate of return	54	51
Internal finance shortage	15	20
Problems in raising external finance	4	6
Cost of finance	4	3
Uncertainty over demand	45	44
Labour shortages	7	7

Demand uncertainty limits investment

Low profitability and uncertainties about demand are the main constraints on capital expenditure according to the CBI survey. In October 2000, 51% of firms claimed that an inadequate net rate of return limited their capital spending whilst 44% cited uncertainty about demand as a key factor. 20% of businesses are constrained by a shortage of internal finance but interest rates are well down the list of factors impacting on final investment decisions. The CBI is calling for £3 bn worth of corporate tax cuts in the forthcoming Budget as part of a strategy to boost planned investment spending.

The latest snapshot of wages and earnings highlights the worst and the best paid jobs in the British economy.

The New Earnings Survey

There was clear evidence that the introduction of the National Minimum Wage is starting to narrow wage and earnings differentials within the labour market. In the year to April 2000, average gross earnings for full-time employees (based on a sample of one per cent of people in employment) were £21, 842. Average gross hourly earnings for full-time workers on adult pay rates was £10.28 per hour in April 2000 (a rise of 2.3% on 1999). Hourly earnings for full-time women grew by 3% compared with a 2% rise for male full-time employees.

At the bottom end of the pay ladder, the earnings of the bottom 10 per cent of workers jumped by 4.2% during the year (rising to an average of £198 a week) whilst the earnings of the best paid jobs increased by slightly over 2% (average gross earnings increased to £662 a week)

Impact of the National Minimum Wage

In spring 2000 there were 300,000 jobs (1.2 per cent) with pay less than the national minimum wage rates held by people aged 18 or over in the United Kingdom. This is down from 580,000 in 1999 and 1.5 million in 1998. In spring 2000 there were 50,000 jobs held by 18 to 21-year-olds with pay less than £3.00 per hour and 250,000 jobs held by those aged 22 and over with pay less than £3.60 per hour.

It appears that the minimum wage has helped to take 280,000 people over the pay floor benchmark - although the trade unions and pressure groups such as the Low Pay Unit continue to argue for a significant and substantial increase in the minimum wage level. A rate set at half of median hourly earnings for full-time workers would imply a minimum wage of £5 per hour.

Top and Bottom of the Pay Ladder

The highest-paid men were company treasurers and financial managers, earning on average £1,162 per week; the highest-paid women were doctors, earning £837 a week. The lowest-paid men were kitchen porters whose gross earnings from a full-time job averaged just £192 a week, and the lowest-paid women were bar staff on £173.

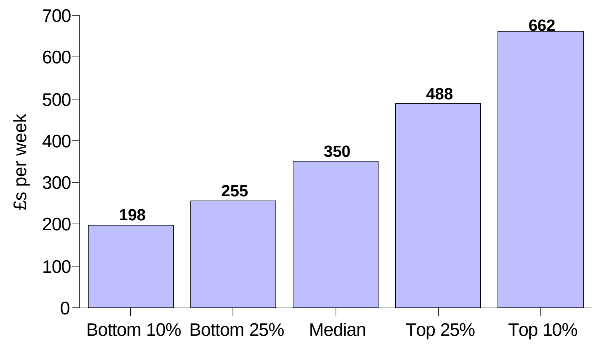
The Gender Gap Remains

The New Earnings Survey shows that women now earn on average 81.6 per cent of the pay of their male counterparts. Men saw their pay rise 2.1 per cent but women gained 3 per cent.

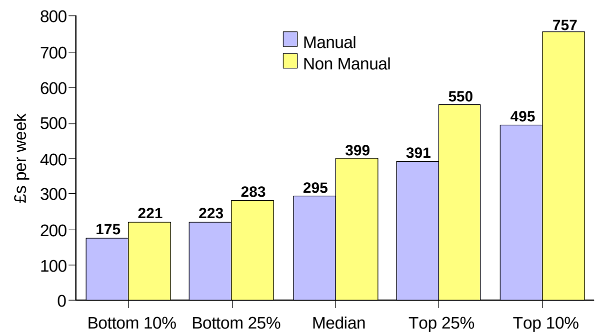
The pattern was more pronounced among part-timers - women's pay surged more than 5 per cent while male earnings were unchanged. Again this reflects the impact of the National Minimum Wage where the gains in income have been concentrated most among low paid workers in part-time jobs in the service sector.

The 2000 New Earnings Survey

DISTRIBUTION OF GROSS WEEKLY EARNINGS IN 2000



GROSS WEEKLY EARNINGS - MANUAL AND NON-MANUAL



Regional Pay

Average full-time weekly earnings for people working in London rose to £530 last year - a figure that is nearly £100 higher than the next regional average. Pay increased most rapidly in the North-East last year with a 4.7% rise in earnings for full-time workers

Private versus Public Sector

Earnings in private sector jobs continue to outstrip those of employees in the public sector but the gap is little more than £4 per week (£406.60 in the private sector against £412.30 in the private sector). There is little difference between earnings in manufacturing (£407) services (£411) and construction (£413).

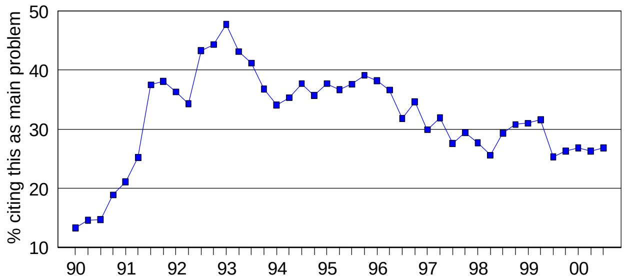
AVERAGE GROSS WEEKLY EARNINGS

	Manual	Non Manual	Part Time
April 1999	314	445	127
April 2000	321	465	132
% Increase	2.3	4.5	4.1

New Earnings Survey—sample taken April 2000

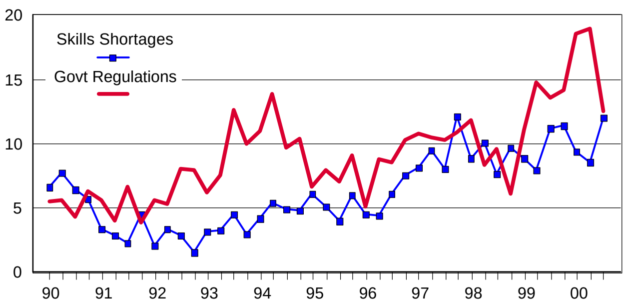
Data Watch—Small Business Survey

LOW TURNOVER HOLDS BUSINESS BACK



Source: Nat West Small Business Survey Q3 2000

SKILLS SHORTAGES NOW APPEARING



National Westminster Small Business Survey

The third quarter report from the Nat West Small Business Survey suggests that skills shortages are becoming an increasing problem for smaller-scale enterprises. 12% of the 758 businesses replying to the survey cited shortages of skilled employees as the main problem currently facing their business—the highest figure since the autumn of 1997. The proportion of businesses worried most about the impact of government regulations and paperwork declined to 12.5% in September from 18.9% during the summer.

Low turnover and a lack of business remains the major problem holding back small business. 26.8% of respondents put this at the top of their list of concerns—this figure has declined from 1999 when there were genuine fears of an economic recession and is well down on the figure in the early 1990s.

Fears of inflation (0.3%), problems with interest rates (0.9%) and access to finance (2.1%) barely concern the vast majority of people involved with small businesses. Of slightly more concern is the size of the tax burden on small and medium scale enterprises (7.4%) and the ever-present competitive threat from big business (6.4%).

Minimum Wage—The Textiles Industry

Many commentators feared that the UK textile industry would be among the worst affected by the introduction of the National Minimum Wage last year. The sector was already facing intense competition from low-labour cost suppliers overseas. And output and employment had already been badly hit by the effects of the strong pound over the last four years. More recently the decision by Marks and Spencer to source more of their clothing from outside the UK dealt a hammer blow to a number of Britain's larger textile and clothing manufacturers. The industry has suffered from somewhat archaic wage and payments systems and a horrendously high rate of labour turnover, particularly among younger workers where annual turnover can sometimes exceed 90%.

A recent study by Incomes Data Services has focused on how the textile industry has fared since the introduction of the national pay floor. Their conclusion is that the NMW itself has had no real impact on the rate of job losses in the industry and that most firms have successfully managed the transition to a minimum basic pay rate of £3.60—taking the opportunity to modernise their wage systems and introduced greater flexibility into worker contracts and production processes.

Many textile firms have **consolidated** their wage payment systems—increasing the basic rate of pay to £3.60 per hour (or above) and at the same time reducing the performance-related pay component known as piecework pay. This has created some problems in maintaining productivity levels in the industry (traditionally productivity has been boosted by workers exceeding productivity targets and therefore supplementing their earnings). This has encouraged some firms to increase spending on worker supervision and offer overtime only to the most productive workers.

With unemployment at low levels, the tightness of the labour market has provided further problems for textiles firms offering pay rates only just above the NMW benchmark. Younger workers in particular are moving into the retail sector where pay rates are higher and the work is less strenuous.