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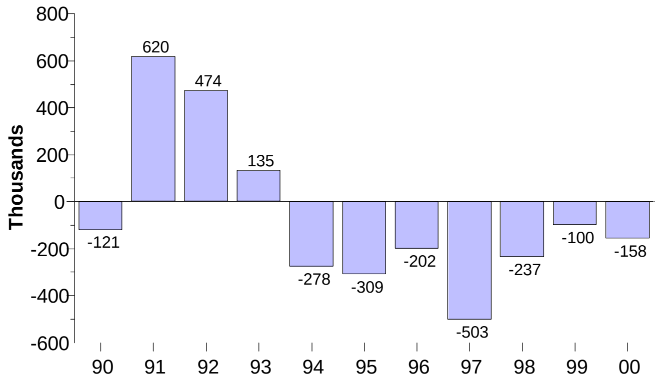
Weekly Economics Briefing

Volume 3 Issue 6 18 February 2001

UK Unemployment now 5,000 off the 1 million

UNEMPLOYMENT FALLS BY 160,000 IN 2000



Gordon Brown (speaking at Labour's Spring Conference)

In the coming election we will seek from the British people a mandate to create and then sustain full employment over the next decade. And not just in one region but all regions of our country. The next stage is to match the unemployed without jobs to the skills shortages that need action and I call on employers to join us in sector by sector initiatives to meet skill shortages in IT, construction, retail, and financial services indus-

Stronger than expected labour market figures taken unemployment close to one million

Claimant count unemployment fell by a seasonally adjusted 25,5000 during January taking the number of people out of work and claiming benefit to just 5,000 over the one million level. Some economists have been predicting that a slowdown in the UK domestic economy allied to the chill winds from lower growth in the United States will cause the labour market to turn this spring. With the UK's much vaunted flexible labour market, it is possible for firms to hire and fire labour with greater freedom and lower cost. In the event the data for January was much stronger than expected. The number of people out of work but actively seeking a job is now at its lowest level since September 1975. The alternative labour market survey measure provided extra evidence of rising employment with a fall of 22,000 in the three months to the end of December. The number of unfilled job vacancies surged to another high of 395,000 (an increase of over 13,000 on the previous month). The stock of unfilled jobs is now just over 40% of total unemployment—another record!

UK ECONOMY AT A GLANCE—MONETARY POLICY AND SPENDING

		1998	1999	2000	2001 Forecast
Bank Base Interest Rates	Per Cent	7.2	5.3	6.0	5.8
Mortgage Interest Rates	Per Cent	8.6	7.0	7.6	7.4
Household Spending	% Change	4.0	4.5	3.9	3.1
Household Savings Ratio	Per Cent of Disposable Income	5.8	5.2	3.7	3.8
Spending on Durable Goods	% Change	8.0	6.2	7.6	8.8

Forecasts for 2001 from Royal Bank of Scotland

THE UK LABOUR MARKET

Strong performance

By most criteria, the performance of the UK labour market in recent years has been remarkably good. Both measures of unemployment (the claimant count and the labour force survey) have fallen steadily. ILO unemployment averaged 5.3% last year (one of the lowest in the European Union) and total employment has risen by over two million.

Peaks in the labour market?

How close is the UK labour market to reaching a peak? Is Gordon Brown stretching credibility when he talk of eliminating unemployment within the next ten years? At what point would we expect the unemployment figures to start rising? Or will we se further falls in unemployment but with the risk of an acceleration in wage inflation triggering a rise in interest rates later on this year?

The trade-off has improved

Since 1993 the underlying rate of inflation has been essentially flat—month to month changes in inflation have stayed remarkably close to the government's inflation target. But the unemployment rate has marched lower and lower in virtually every month! There has undoubtedly been an improvement in the trade-off between unemployment and inflation resulting from a reduction in the natural rate of unemployment and a fall in the NAIRU (non-accelerating inflation rate of unemployment).

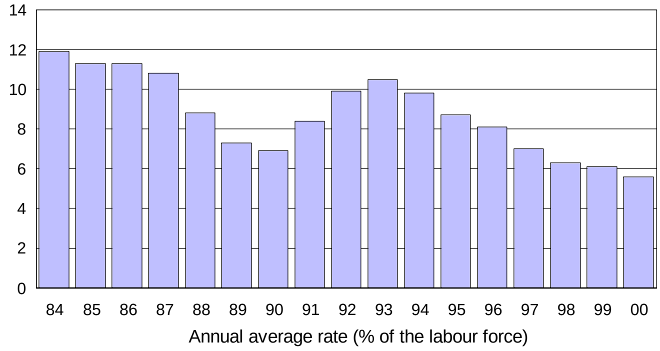
Partly this is the result of lower price inflation itself—because a fall in inflation means that workers are more likely to accept basic pay settlements that do not threaten a resurgence in prices. Another factor has been the beneficial effects of a more flexible labour market and the long-term effects of increases in education and training spending plus special employment measures in getting some of the structurally and frictionally unemployed back into work.

But the labour market does remain **tight**—by which we mean, the total demand for labour is high relative to the active supply of labour available to fill those jobs. A 13,000 increase in the stock of unfilled vacancies in January alone suggests that labour shortages may be-coming more widespread. Will this cause a sharp pick-up in wages and earnings? Earnings growth is hovering around the 4.0—4.5% mark at the moment—close to the top of the Bank of England's tolerance level. If unemployment continues to fall well below the one million mark in the second half of the year, the Monetary Policy Committee may have to unwind some or all of the interest rate cuts this spring.

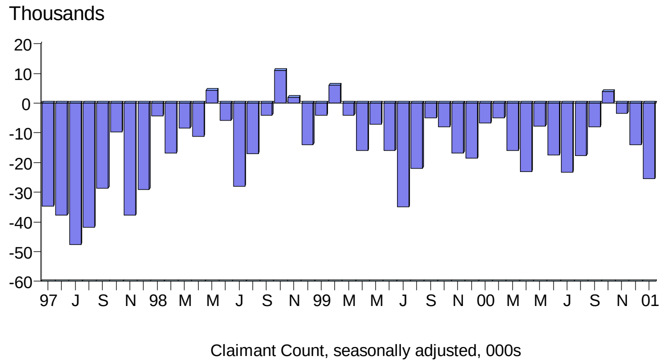
Public Sector Workers seek higher pay

Pay increases for workers in the public sector have fallen behind workers in private sector over recent years. The annual growth of earnings has outpaced inflation but the relative pay of millions of public sector employees has fallen. The government recognises that labour shortages in key government services are now becoming acute—threatening the delivery of government targets in education and health. Higher pay will clearly be needed in the short term but reversing the decline in relative pay rates will take many years . And conditions of service are often more important in attracting people into these jobs.

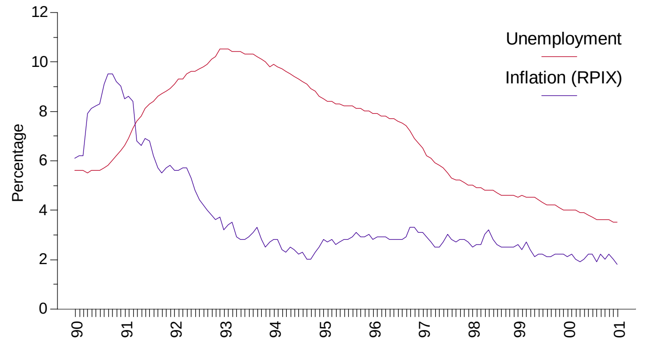
UK UNEMPLOYMENT ON LABOUR FORCE SURVEY



MONTHLY CHANGES IN CLAIMANT UNEMPLOYMENT



A TRADE-OFF BETWEEN UNEMPLOYMENT AND INFLATION?



WAGES AND EARNINGS—RELATIVE PAY DIFFERENCES			
% change	**1998**	**1999**	**Nov 2000**
Whole Economy	5.2	4.7	4.2
Manufacturing	4.7	3.8	4.5
Private Sector Services	6.1	5.2	4.5
Government (Public) Sector	3.2	4.1	3.6

Annual % change, data for 2000 is 12 months to November

Exchange Rate Regimes

Floating and Fixed regimes

Since September 1992 the United Kingdom has operated with a floating exchange rate regime. The value of sterling against other currencies is driven purely by market forces of supply and demand. The government does not have an explicit target for the exchange rate. And, the Bank of England does not intervene to influence the value of sterling.

Member nations of the Euro Zone have fixed their currencies against each other irrevocably (no realignments are possible) for three years, before the Euro comes into common circulation on the 1st of January 2002. Their fixed exchange rate system has been accepted by the financial markets. Currency traders speculate on the value of the Euro which floats against other currencies.

ECB Intervention

The European Central Bank (ECB) intervened on three occasions late last year in a bid to support the Euro from falling further against the dollar. The perception gained ground that the Euro had become under-valued against both the dollar and the yen. With the US economy slowing sharply and the Federal Reserve now cutting interest rates there is every chance that the Euro will claw back some of its value during the rest of this year.

The dollar has been on an upward cycle for nearly six years—exchange rates exhibit a tendency to both rise and fall over long term cycles—currency dealers will be analysing the prospects of a significant worsening in dollar sentiment in the markets over the coming months.

Countries with different exchange rate regimes

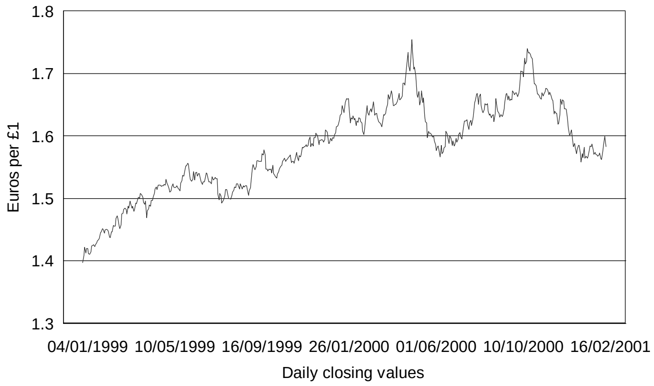
Countries with fixed exchange rates often impose tight **controls on capital flows** to and from their economy. This helps the government or the central bank to limit inflows and outflows of currency that might destabilise the fixed exchange rate target,

The **Chinese Renminbi** is essentially fixed at 8.28 renminbi to the US dollar. Currency transactions involving trade in goods and services are allowed full currency convertibility. But capital account transactions are tightly controlled by the State Administration of Foreign Exchange.

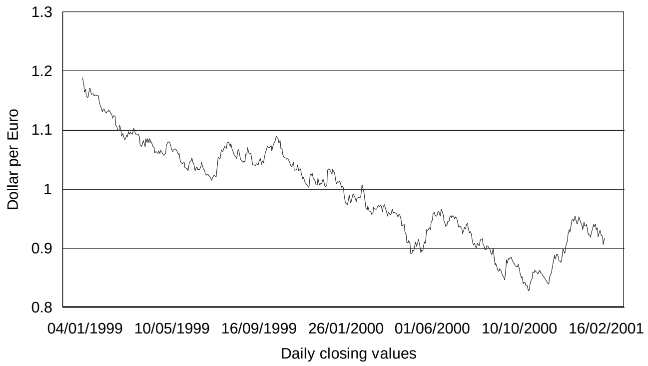
The **Hungarians** have a semi-fixed exchange rate against the Euro with the **forint** allowed to move 2.5% above and below a central rate against the Euro. The Hungarian central bank must give permission for overseas portfolio investments on a case by case basis. The **Russian rouble** is in a managed floating system but there is a 1% tax on purchases of hard currency.

In contrast, the **Argentinian peso** is pegged to the US dollar at parity ($1 = 1 peso) but international trade transactions (involving current and capital flows) are not subject to stringent government or central bank control.

STERLING AGAINST THE EURO



THE EURO AGAINST THE DOLLAR



The Euro has declined against the dollar for most of the period since its inception in 1999. Much of this was due to a heavy traffic of foreign investment flows out of the Euro Zone into the booming US economy. Euro land interest rates are now at 4.75% and US rates are heading lower. This is unlikely to be enough to take the Euro close to parity with the dollar in the near term

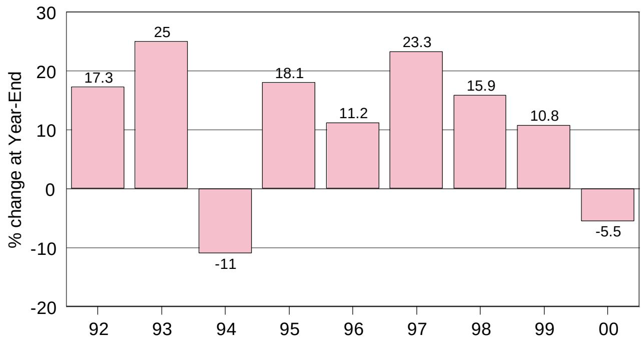
CURRENCY REGIMES AND CAPITAL CONTROLS

Country	Exchange Rate Regime	Capital Controls
Chinese Renminbi	Fixed rate	Strict controls
Indonesian Rupiah	Floating currency	No capital controls
Malaysian Ringgit	Fixed at 3.8R/US$	Extensive controls
Argentinian Peso	Pegged with US $	No controls
Turkish Lira	Managed Float with the Euro	No controls
South African Rand	Floating currency	No controls
Thai Baht	Floating rate	Portfolio outflows are monitored
	Thai central bank must approve foreign exchange transactions greater than $5000	

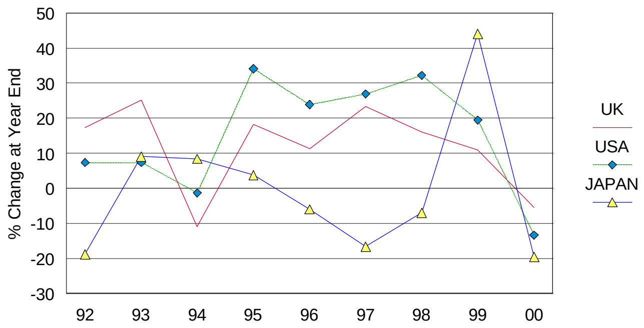
Rates of Return from Shares

RISK AND RETURN FROM EQUITIES 1971-2000			
	Average Return from Equities (%)	Risk (Standard Deviation)	Ratio of Return to Risk
USA	10.2	16.1	0.6
Japan	11.2	30.3	0.4
Germany	10.9	24.7	0.4
UK	14.4	29.7	0.5
Period of the data covers 1971—2000 inclusive			

ANNUAL RATES OF RETURN FROM THE UK STOCK MARKET



INTERNATIONAL RETURNS FROM EQUITIES



Rates of Return from International Stock Markets

Financial investment in stocks can be a risky business! International markets move in a volatile manner from day to day and over longer periods of time. Investors need to consider both the **risks** and **returns** from their decisions. This is true for individual stocks as well as the composite indices for national stock markets.

2000 was a poor year for global share values. Data from the Morgan Stanley Capital International Equity Index shows that **equity prices** in the United States were 13.3% lower at the end of 2000 than at the beginning of the year. There has been a small rebound in the opening months of 2001, but this fall in valuations is in stark contrast the an average return of 15.2% per year between 1992-2000. Much of this decline in share prices can be attributed to the sharp falls in technology stocks that form the basis for the NASDAQ index.

UK equity prices fell by 5.5% last year—the worst performance for the FTSE since 1994 and a dramatic reversal of five years of double digit percentage increases in share values. The average rise in prices has been 11.7% since 1992—one of the factors behind the substantial improvement in household sector financial wealth in the late 1990s. This increase in wealth has helped to stimulate higher consumer demand for goods and services.

The decline in prices last year has knocked investor confidence—but cumulative total returns over the last eight years have been impressive. G7 nations are expecting slower growth this year. And, many companies have announced profit warnings in recent months. But stock markets are forward looking. If the slowdown in mild rather than severe and if interest rates head lower, we can expect a better year for stock investors in 2001.

WEB SITES ON MONOPOLY

Office of Fair Trading
www.oft.gov.uk

Competition Commission
www.competition-commission.gov.uk/

OFGEM (Energy Regulator)
www.ofgem.gov.uk/

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The Energy Levy—will it cost jobs?

A crisis in the UK fishing industry

Weekly Briefing
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