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PRIME MINISTER

ECONOMIC PROSPECTS

Flu A

I minuted you on 12 October on the preliminary results of the Treasury's autumn short-term forecasting exercise and indicated that I had asked for further work to be done. I have now reviewed the outcome with officials and should very much welcome the opportunity of a discussion with you.

2. I fear that we are in some difficulty. This is because, although I should prefer not to, under the terms of the Industry Act we are statutorily obliged to publish a forecast by the end of November (technically by 20 November, though some slippage is possible). And by convention the published material includes a forecast for the RPI (on this occasion it would be for the fourth quarter of 1980) which it would be difficult to omit or conceal since a prices assumption for broadly the same period will have to appear in the Government Actuary's statutory report on the National Insurance contributions review published at about the same time. Our expectations on prices will in any case also be apparent from the announced decisions on cash limits.

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3. The problem on the RPI arises from the figure of 17 per cent which emerges in the forecast. To publish this would be disastrous for expectations and, as you yourself have pointed out, carry self-fulfilling risks. I am clear that we cannot publish this and I regard it in any case as being unnecessarily pessimistic.

4. I have had a long discussion with officials to explore what alternative lower figure could be justified on a different view of the key underlying assumptions. If we were to take a more optimistic view of the course of the exchange rate and interest rates - in effect assuming a constant exchange rate and constant interest rates, including the mortgage rate - the forecast figure would come down to about 15 per cent. This would be a plausible (but less than satisfactory) figure to publish. To go below this - say, to 14 per cent - would entail taking a optimistic view of the outcome on earnings in the present pay round; the forecasters have assumed 14 per cent in the private sector, excluding the effects of overtime etc, which already looks rather optimistic.

5. 15 per cent would, I suppose, be "defensible". It is worse than the figure in the Budget forecast (13½ per cent with a variant of 14 per cent) but this is explicable in terms of the further oil price increases since June and the higher than expected level of pay settlements. But, although there is some risk of straining credibility and creating problems when we set the remaining public service and central Government cash limits, 14 per cent could be considered if you thought the expectational arguments should be given greater weight.

Flas B



6. I do not, however, think we could go below 14 per cent. Apart from the general question of credibility, the cash limits problems would be more acute. A lower figure might at the same time make our decisions on the RSG cash limit look lax and also present us with severe problems on the cash limits yet to be set. We want them to be tight; but not so unreasonably tight as to make breaches inevitable, with damaging consequences for cash limits as a whole.

7. For the rest, the Industry Act forecast will need to show figures for GDP and its main components and the balance of payments. These will be substantially worse than in the Budget forecast, but this is inescapable and in line with other recent forecasts. By convention a PSBR forecast has also been given (on this occasion it would be for 1980-81), but, provided we have reached a decision on whether to publish a medium-term financial plan, I see no reason to include it. It seems unnecessary to forecast so far in advance a figure subject to such large margins of uncertainty; and if we can announce that we shall in due course be publishing a financial plan, I see no reason to expect adverse market reaction.

The Chancellor  
will be comm-  
formed separately  
on this.

TJ  
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8. I referred above to the Government Actuary's report. John Biffen has minuted you separately on your query on whether the figures have to be published at all and on the unemployment assumption underlying the 1980-81 Public Expenditure White Paper. If previous practice on publication is followed, the figures the Government Actuary uses (which are attributed to the Government) must be broadly consistent with the Industry Act forecast and those used for other purposes (eg cash limits). On this basis, and subject to our decision on the RPI

Flas C



figure on the forecast, I propose that the Government Actuary should be instructed to use the following assumptions:-

RPI per cent increase November 1980 on November 1979	→ 14 per cent or - 15 per cent
Average earnings increase financial year 1980-81 on 1979-80	- 14 per cent
Average number wholly unemployed (Great Britain) financial year 1980-81	→ - 1.6m
Average number wholly unemployed (great Britain) financial year 1979-80	- 1.25m

9. The unemployment assumption would be a little lower than that (1.65m) underlying the Public Expenditure White Paper. But it reflects a more up to date assessment and no unemployment figure will be included in the published Industry Act forecast. The Actuary's Report does not normally attract much attention; but we obviously cannot bank on this.

10. It would be very helpful to be able to discuss these issues with you early next week. I am particularly anxious to settle the assumptions for the Actuary so that the National Insurance review can go forward. In the meantime if you should wish to see the full (and rather lengthy) Treasury report on the forecast, I will arrange to let you have a copy. But since it is largely written round assumptions which I find unduly pessimistic I doubt if you need bother with it.

*G. H.*

(G.H.)

2 November 1979

*Yes please*