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Approved For Release 2009/10/06 : CIA-RDP85T00875R00160001

CIA/OER/IM 68-147

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DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

International Finance Series No. 9

The UK Economy One Year After Devaluation

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ER IM 68-147
November 1968

Copy No. 91

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
22 November 1968

INTELLIGENCE MEMORANDUM

International Finance Series No. 9

The UK Economy One Year After Devaluation

Summary

On the first anniversary of the devaluation of the pound sterling, the prospects for the United Kingdom bringing its external accounts into balance are not encouraging. A devaluation of 14.3 percent, bringing the pound to $2.40, was undertaken last November to stimulate British exports and depress British imports. While export growth has met targets, imports have been much higher than expected, and consequently trade deficits have persisted.

Prospects for 1968 as a whole are for an overall deficit in the balance of payments on the order of $1.4 billion, up considerably from 1967. The hoped-for payments surplus in the second half of 1968 will not be realized. The pound sterling remains a highly vulnerable currency. Lack of improvement in Britain's trade performance or an external shock, such as a substantial devaluation of the franc, could soon lead to great pressure for a new devaluation of sterling, perhaps with a new fixed rate being established after allowing sterling to "float" in the foreign exchange markets to freely establish its own level. Britain

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of Current Intelligence.

no longer has enough reserves to permit a protracted defense of the pound.

The failure to hold down imports results mainly from the failure to keep consumer demand from rising. The British had hoped through tax increases and wage restraint to cut real wages (purchasing power) and personal consumption and thereby depress the demand for imports. But a tough austerity budget was not put into effect until April 1968, four months after devaluation; during this interim, consumers continued to spend heavily and imports boomed. Since April the new taxes have cut into consumer purchasing power, but imports have not declined from the high level of the first quarter. In the meantime, there have been a number of inflationary wage adjustments which have boosted consumer incomes and hence demand for imports.

Partly because of buoyant world demand, UK exports have grown rapidly and may benefit further from the devaluation. While export prices have fallen in terms of dollars, they have risen somewhat in terms of sterling, in most cases probably more than costs of production in Britain, which have also been raised by the higher cost of imported materials. Consequently, British producers are making higher profits on most of their export sales, and this could stimulate investment in export-oriented industries. Increasing export capacity would take a long time, perhaps a year, to be reflected in Britain's trade, however.

In the meantime, continued domestic inflation could squeeze out the profit edge remaining from the devaluation. Preventing inflation will not be easy; labor is likely to resist any attempts at a tough wage policy. The loss of work time through strikes was unusually large this year and would probably increase further if the government tried harder to hold down wages.

The tentative forecast for the British balance of payments in 1969 is for a surplus, perhaps on the order of $600 million, and is based on the assumption that the growth of exports will continue apace, while imports will be significantly slowed. This projection could be upset by a number of contingencies, including a significant shortfall in world demand, devaluation of the franc, the failure of consumer demand in the United Kingdom to be controlled, or the inability of the government to restrain wages and prices. It would be helped by an upward revaluation of the Deutsche mark, which would improve the competitive position of Britain's exports. Even the achievement of a substantial surplus in 1969 would not give Britain a respite from balance-of-payments pressure. Because of the enormous debt accumulated in the losing battle to defend sterling at the pre-November 1967 parity, Britain's surpluses have been mortgaged in advance for some time to come.

Background

1. The devaluation of sterling on 18 November 1967 was only one, if the most dramatic, of a series of measures taken by the British government to strengthen the balance of payments and thereby open the way to rejuvenating the sluggish British economy. Britain's basic problem has been that its exports did not grow fast enough to earn the foreign exchange needed to pay for imports, except at low rates of economic growth. Another problem has been the low level of official reserve assets in relation to short-term liabilities to foreigners. Because of these problems, every post-war boom in Britain has been cut short prematurely by a balance-of-payments crisis.

2. To attack the balance-of-payments problem, the British government since 1964 has taken the following action:

(a) Made an attempt at economic planning in order to encourage investment in advanced and export-oriented industries -- 1964-65.

(b) Imposed a surcharge (a special tax) of 15 percent on imports -- introduced on 26 October 1965; revised to 10 percent on 27 April 1966; and removed on 30 November 1966.

(c) Instituted voluntary restraints on investment flows to non-sterling area countries -- May 1966.

(d) Froze wages for about a year -- from July 1966 to July 1967.

(e) Tightened credit and raised interest rates -- at various times since 1964; most recently in October of this year, when consumer credit was tightened.

(f) Imposed a special tax on services (a so-called "selective employment tax") to stimulate a reallocation of labor to industry.

(g) Devalued the pound 14.3 percent on 18 November 1967.

(h) Planned long-term cuts in government expenditures, especially military expenditures -- announcement on 16 January 1968; general cuts were primarily for fiscal years 1968/69 and 1969/70 -- with significant military cuts planned in fiscal years 1969/70-1970/71.

(i) Introduced the most austere peace-time budget in decades, involving a sharp increase in taxes -- April 1968.

(j) Adopted an "incomes policy" to hold the growth of wages and other incomes to 3½ percent over 12 to 18 months -- March 1968.

3. In addition to these measures, the United Kingdom in defense of sterling borrowed huge sums from the United States, other European countries, and international financial institutions. The net indebtedness resulting from these borrowings since 1964 requires significant repayments in dollars before 1971.

4. These were extremely powerful measures. One trouble was that the measures were scattered over a considerable time period and were introduced piecemeal in response to recurrent crises rather than as a part of an integrated package, so that their effect was greatly weakened. Britain used most of its international credit and the Labor Party used up much of its credit with British labor before the devaluation. The heavy foreign indebtedness accumulated to defend the sterling parity has made it far more difficult to borrow abroad since the devaluation. The imposition of a wage freeze before the devaluation has made British labor less willing to accept

wage restraint since then. Moreover, the "austerity budget" did not come into effect until four months after the devaluation, a lag which was bound to delay and weaken the effectiveness of the latter measure.

5. In spite of the pre-devaluation efforts, the UK balance of payments ran deficits every year during 1964-67 (see Table 1). Cumulatively, the deficit on current account and long-term capital account combined came to about $4.5 billion over the four-year period. The various restrictive measures imposed in late 1964, and the subsequent wage freeze, reduced the deficit from almost $2.2 billion in 1964 to about $250 million in 1966. The principal gains came from a reduction in capital exports and a leveling off of imports, the latter a reflection of near stagnation in output. A resumption of growth in the domestic economy coupled with the crisis in the Middle East caused a substantial rise in imports and a drop in exports in 1967. In turn, these events generated a massive speculative outflow of capital which forced the devaluation of sterling in November. For the year as a whole, the deficit on long-term and capital accounts came to $1.3 billion (£490 million).

6. The devaluation took the pressure off the pound for only two or three months. The general loss of confidence in paper money following the November 1967 sterling devaluation coupled with a lack of improvement in the British trade position generated speculation of a new devaluation during February and March, which did not abate until the Washington meeting in March that created a dual market for gold and the announcement about the same time of an austerity budget in Britain. Even then, sterling's position remained highly insecure until a group of the major financial powers agreed in September 1968 to extend a line of credit of about $2 billion to Britain as insurance against withdrawals of sterling assets by foreign governments (the British in turn guaranteed the value of a large part of these assets against any future devaluation). Currently the pound is still one of the world's weakest major currencies. It has been driven to its lower

Table 1

United Kingdom: Balance of Payments
1960-67

Million £

	1960	1961	1962	1963	1964	1965	1966	1967
Balance on current account	-265	-4	+112	+111	-399	-91	+15	-404
Merchandise trade balance	-406	-152	-102	-80	-537	-272	-136	-637
Imports (f.o.b.) a/	4,138	4,043	4,095	4,362	5,001	5,037	5,203	5,562
Exports (f.o.b.)	3,732	3,891	3,995	4,282	4,466	4,777	5,108	5,023
Balance on long-term capital account	-192	+68	-98	-148	-370	-203	-104	-86
Balance on current and long-term capital accounts	-457	+64	+14	-37	-769	-294	-89	-490
Balancing item (including errors and ommissions)	+299	-25	+75	-73	+41	+67	-10	+175
Overall balance	-158	+39	+89	-110	-728	-227	-99	-315

a. Including payments for US military aircraft and missiles.

support level as a result of the poor October trade figures and the speculation based on the possibility of revaluation of the Deutsche mark and a devaluation of the franc. If there should be a substantial devaluation of the franc, the pound might have to be devalued again, perhaps after being allowed to float -- that is, to find its own level in the foreign exchange markets. If the German mark is revalued upward, the competitive position of British exports, and hence the position of the pound, would be improved.

The Economy: Projections and Performance

7. Shortly after devaluation, the British treasury forecast a return to surplus in international payments in the latter part of 1968 and an annual surplus of $1.2 billion (£500 million) in 1969. Achievement of this goal was based on an expectation of a substantial slowdown in the volume of imports and a rapid expansion of exports (see Table 2). The increase in the volume of imports of goods and services for the first half of 1968 was to be only 2.3 percent greater than in the second half of 1967. This was to be followed by a decline of 1.7 percent in volume of imports during the second half of the year. Thus it was hoped that by the second half of 1968, imports of goods and services would have increased by only 0.6 percent in terms of constant prices above those of the comparable period of 1967. A growth of 13 percent in the volume of exports was projected for the same period.

8. To enable these massive changes in international trade and payments to take place and to provide for continued improvements in later periods, the British government planned a substantial reallocation of resources in favor of exports and investments at the expense of personal consumption. While national product in constant prices was to grow 3 to 4 percent between the second half of 1967 and the last half of 1968, fixed investment was to rise 6 percent and personal consumption per capita was to decline almost 2 percent.

Table 2

Projected Response of Foreign Transactions and Consumption to Devaluation a/

Percentage Change in Volume

Period	Imports of Goods and Services		Export of Goods and Services		Consumption Expenditures	
	Forecast	Performance	Forecast	Performance	Forecast	Performance
First half 1968 over second half 1967	+2.3	+6.1 b/	+12.8	+11.8 b/	-0.4	+0.9 b/
Second half 1968 over first half 1968	-1.7	+0.5 c/	+0.3	+2.9 c/	-1.5	-2.3 c/
Second half 1968 over second half 1967	+0.6	+6.6 c/	+13.1	+15.1 c/	-1.9	-1.4 c/

a. Based on national accounts.
b. Based on actual returns.
c. Based on revised forecast.

9. The instruments of this reallocation were to be the devaluation, increased taxes, and wage policy. The cost of living was expected to rise about 5 percent in 1968, whereas the growth of wages was to be held to 3½ percent. Thus real wages were to decline, and, with taxes higher, the decline in consumption was to be even larger.

10. Actual developments have deviated considerably from the government projection. Industrial production has risen about 3 percent over last year's level, which implies that the rate of growth in national product has been slightly less than planned. But the planned reallocation of resources away from consumption has not occurred. Consumption expenditures rose almost 1 percent in the first half of 1968, compared with the second half of 1967, although a small decline had been planned. Manufacturing investment has fallen. Exports of goods and services have done well -- the increase of 11.8 percent in volume during the first half of 1968 fell only slightly short of the target. But imports of goods and services have been far in excess of expectations. Imports shot up during the first quarter of 1968 and have since remained at a high level -- some 6 percent above the equivalent period of 1967. The boom in imports results mainly from a four-month lag after devaluation in the introduction of the austerity budget and the failure of import prices to rise as much as anticipated.

Trends in International Payments

11. The UK balance of payments in the first half of 1968 -- there are no balance-of-payments data yet available for later periods -- shows substantial deficits in both the current and the long-term capital accounts. The seasonally adjusted deficit on current and long-term capital accounts combined totaled some £500 million ($1.2 billion), up approximately 22 percent in sterling terms and 14 percent in dollar terms from the large deficit in the second half of

1967.* The current account deficit of some £335 million ($800 million) -- compared with £320 million ($800 million) for the second half of 1967 -- is attributable to rapid growth of imports and a fall in the surplus on invisibles from the 1967 average level. The long-term capital account was aggravated by a substantial increase in net outflow of private capital of about $329 million. However, a single transaction involving investments in the United States by Royal Dutch/Shell accounted for $211 million of the total increase.

12. The major element in the international payments picture for Britain during 1968 has been the continuation of the large merchandise trade deficit (see Figure 1). Following a decline from the unusually high levels associated with the dock strike of October-November 1967, the merchandise trade deficit did not decline markedly until August 1968. Optimism grew when the September returns showed a seasonally adjusted trade deficit at about the August level, but this renewed confidence was seriously shaken by the appearance of an increased deficit in October. Indeed, the October performance led to active speculation against the pound, which (in concert with other disturbances in international money markets) drove it to its lowest level in 10 months.

13. Throughout the period since devaluation, observers have been hard pressed to discern clear trends in British trade. A congeries of disturbing influences has made it difficult to distinguish when export increases represented sustainable achievements and when demand for imports was on the wane. Thus the devaluation itself was undertaken during a long dock strike, and the effects of this strike on trade levels tended to depress the base from which short-term comparisons are made. The interpretation of import data is confounded by a consumer boom in early 1968 that anticipated the restrictive budget of March. Subsequent events that upset the interpretation of British trade returns included the May-June

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** Different equivalent dollar values result from different exchange rates before and after devaluation.*

strikes in France and the adjustment of trade to the introduction of Kennedy Round tariff cuts.

<u>The Export Performance</u>

14. Devaluation has been followed by a substantial increase in the sterling value of exports. As is shown in the upper part of Figure 2, the sterling value of UK merchandise exports for the first half of 1968 was up nearly 13 percent at an annual rate over the full-year performance for 1967. A similar comparison between the first half of 1968 and the first half of 1967,* however, shows an advance of closer to 11 percent in terms of sterling value and only about 4 percent in terms of quantity. Thus some 7 percentage points in the advance appear to represent increased prices for British exports resulting from the increased costs of imported raw materials, efforts of exporters to obtain a higher profit, and changes in the composition of exports. The second of these factors probably was of considerable importance in the first part of this year, when it was still possible to meet some export orders out of inventories of finished goods or through manufacture from raw materials already imported.

15. In dollar terms, British exports ran at a lower annual rate in the first half of 1968 than in 1967, indicating that while the quantities sold increased, there was an even greater price decline, when exports are measured in dollars. An exception to this pattern was the remarkable growth in exports of miscellaneous manufactures, a trade category that includes a wide variety of consumer goods. An early improvement of performance in dollar terms was not expected, because it was believed that considerable time would be needed to expand foreign markets and British output. Nevertheless, by mid-1968 it was still unclear whether Britain would be able to reverse the steady decline over the years in its share of exports of manufactures from the industrial nations (see Figure 2). This long-term trend has affected the full range of UK

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* *Data adjusted for seasonal factors.*

exports of manufactures, which together account for about 85 percent of total exports.

16. Some heartening signs of significant improvement in UK exports became apparent in the third quarter of 1968, as the seasonally adjusted monthly export data moved up from some £500 million toward the level of £550 million (see Figure 1). Available data suggest that this advance was spread over a broad front of manufactures and was not restricted to a few commodities (see Figure 3, which compares monthly exports in 1968 and 1967 for major export categories). One facet of this improvement was a slight gain -- as compared with earlier years -- in the UK share of the US market during June-August (see Figure 4).

17. A number of closely related questions arise out of the British export experience since devaluation. Foremost among these is the issue of whether the rapid growth of exports thus far is primarily attributable to the stimulative effects of devaluation or is largely the result of rapid growth of world demand. Import demand in the UK's principal trading partners (especially the United States and other developed nations) appears to have been unusually strong. Thus total imports and imports by the developed nations grew in value by 7½ and 8½ percent, respectively, between the first half of 1967 and the first half of 1968.* Even allowing for some price increases, it still seems likely that these rates exceeded the growth in the quantity of UK exports, which amounted to a little more than 4 percent during the same period.

18. Two other key questions bear on the use to which British exporters have been able to put the potential, relative price gain from devaluation

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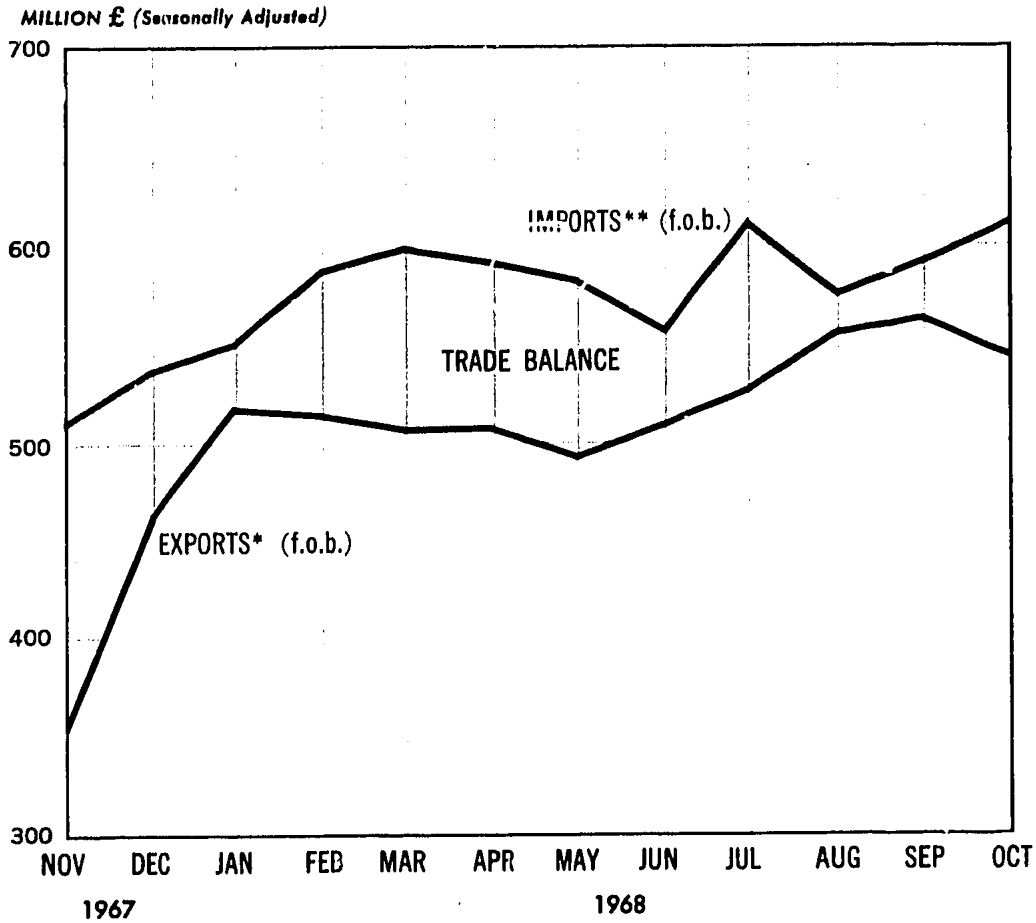
* *These periods are chosen rather than comparing growth since devaluation in November because of the unusual depressing effects of the dock strike on fourth-quarter trade of the United Kingdom.*

Figure 1

UK TRADE BALANCE NOVEMBER 1967-OCTOBER 1968



*Includes re-exports.
**Excludes US Military Aircraft.

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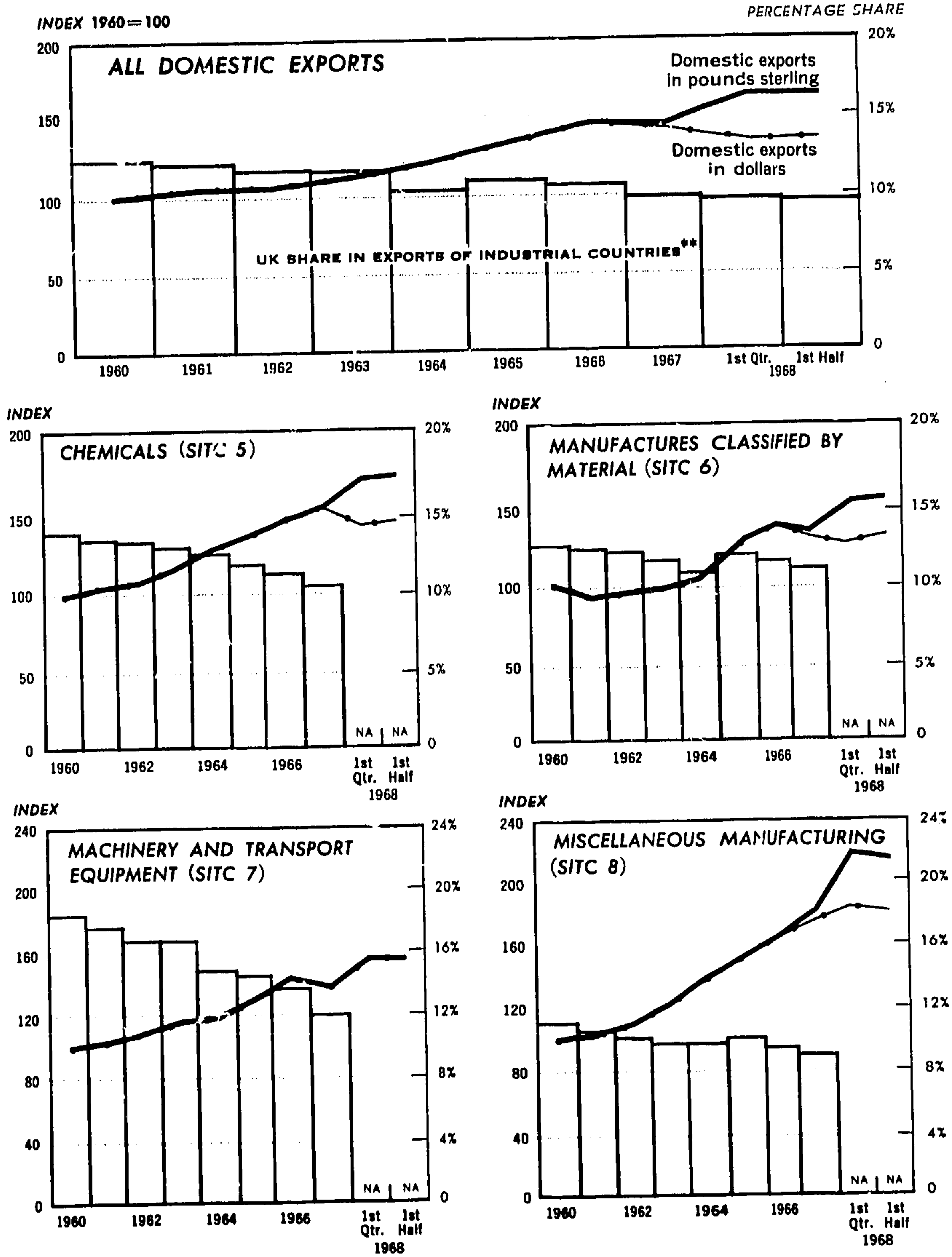
Figure 2

INDEXES OF UK EXPORTS AND UK SHARE OF EXPORTS* OF INDUSTRIAL COUNTRIES, 1960-68



*Excludes re-exports

**The term "Industrial Countries" denotes those countries which were members of the Organization for Economic Cooperation and Development in 1967. (Primarily the US, Canada, Japan and Western Europe.)

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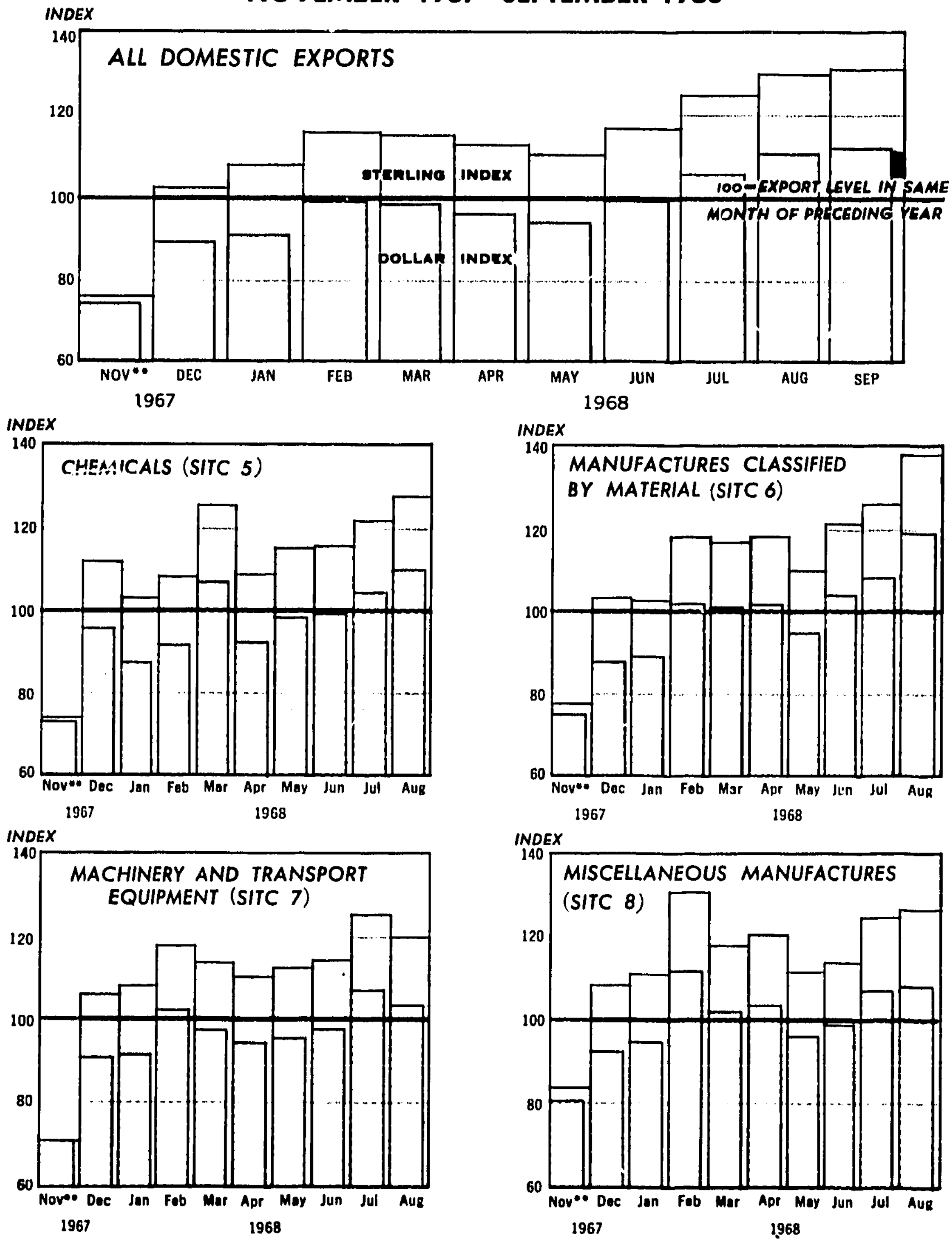
Figure 3

MONTHLY UK EXPORTS* SINCE DEVALUATION COMPARED WITH THOSE FOR THE SAME MONTHS OF THE PRECEDING YEAR NOVEMBER 1967 - SEPTEMBER 1968



*Data exclude re-exports.

**Dollar trade data for November not directly comparable to sterling series.

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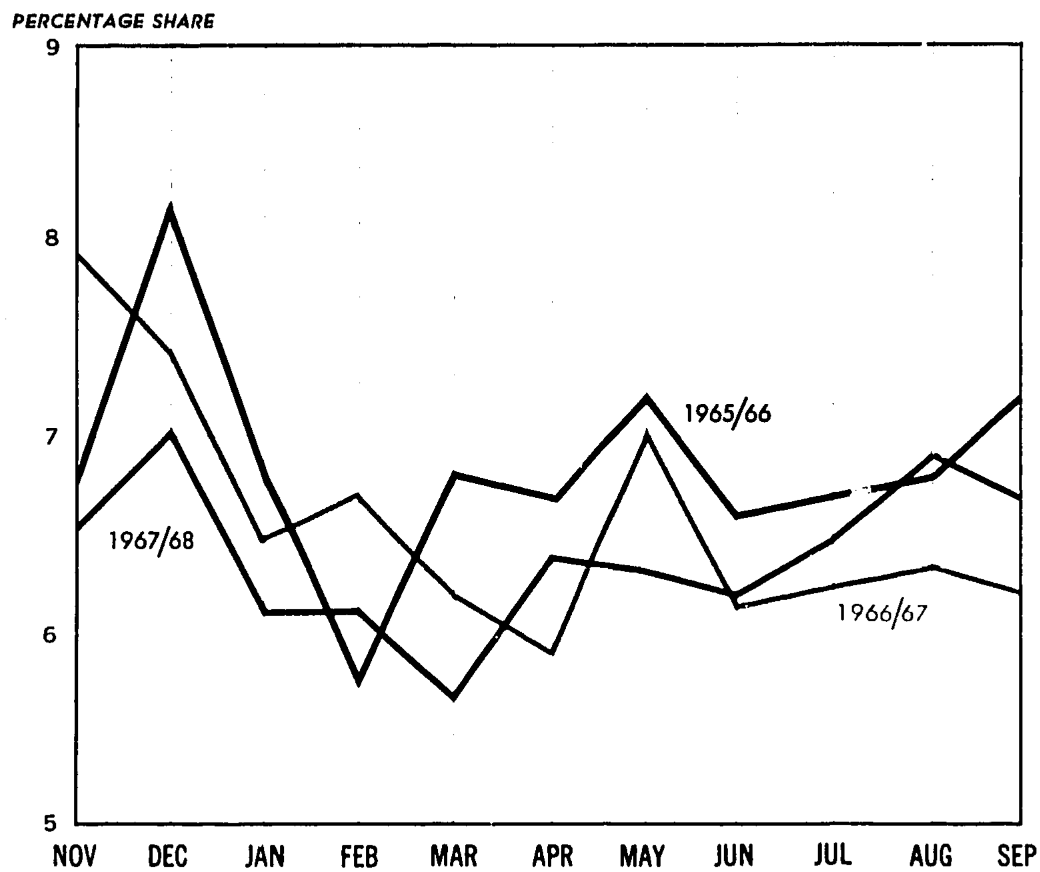
Figure 4

UK SHARE OF US IMPORTS
NOVEMBER-SEPTEMBER PERIODS, 1965-68



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of the pound.* The first of these is whether the stimulative effects of devaluation are to be achieved principally through increased profits to the British or reduced prices to foreign importers of their goods. The second relates to how long devaluation will take to yield the desired substantial improvements in Britain's export performance compared with that of other countries. Fragmentary evidence suggests that the prices of key British exports were competitive before devaluation and that greater profits will play a more important long-run role than lower prices in increasing British exports. A large share of British exports is made up of machinery, transport equipment, and other sophisticated manufactures for which considerations other than price exert an important influence on sales. There is also some limited indication that the level of labor costs in key manufacturing industries in the United Kingdom is higher than in most other industrial countries and that comparable export profits were correspondingly lower before devaluation. Increased UK competitiveness in world markets will take longer if it comes through increased export profits than if it derives almost exclusively through decreased export prices. The long-run gains in competitiveness from increased profits for British exporters will come from expansion of productive capacity in exporting industries and from increased export marketing and related services abroad. It is hoped that the favorable effects of either increased profits or decreased export prices derived through devaluation will not be erased by more rapid increases in British prices or labor costs than in competing countries. Although data are scarce, it does not appear that to date labor costs have risen significantly faster in Britain than in other major industrial countries.

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* *The potential gain is considerably less than the full amount of devaluation because of the high import content of UK exports and various other factors. Thus initial estimates pointed toward some 7 percentage points remaining for price decreases or profit increases from the 14.3 percent devaluation.*

The Import Performance

19. The behavior of British imports since devaluation has surprised many observers. Although a decline in the quantity of imports was not expected, the actual rate of increase considerably exceeded expectations, especially during the first part of 1968. The value of imports at an annual rate for the first nine months of 1968 was up almost 20 percent in sterling terms and 5.5 percent in dollar terms above that of 1967. Moreover, the quantum index of imports had grown by more than 7 percent from November 1967 through August 1968. While the big jump occurred during the first quarter, there is evidence of a renewed growth in imports since June.

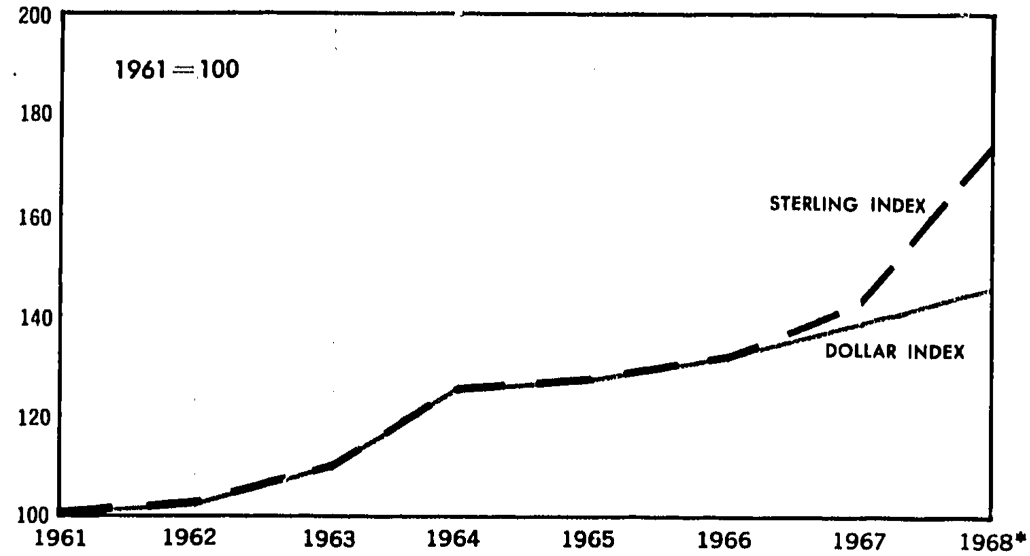
20. The rapid growth of imports in the first half of 1968 is a continuation of a secular trend, in which imports increased at an average annual rate of 6 percent during 1961-67 (see Figure 5). Although total UK imports have grown less rapidly than those of all industrial countries, UK imports of manufactures have grown faster (see Figure 6). The slow growth of British industrial production, while holding down the demand for imported raw materials, has tended to divert consumer and investment demand to imported manufactures. The fact that manufactured goods have significantly led overall increases in UK imports is apparent in the comparison of monthly imports during the first six months of 1967 and 1968 (see Figure 7).

21. Consumer spending continued to grow rapidly from devaluation through March because the principal restrictive measures did not take effect until April. Indeed, earlier announcements of forthcoming fiscal constraints served only to spur the consumer boom. Imports, for which there was already some pent-up demand as the result of the dock strikes, surged forward with the general increase in consumer spending. In addition, high levels of public spending before the start of the new fiscal year exerted an upward pressure on imports. An important element in the 7 percent advance in the quantum index of imports

Figure 5

GROWTH AND COMPOSITION OF UK IMPORTS, 1961-68

GROWTH OF UK IMPORTS, 1961-68
(c.i.f.)



*Index for 1968 is based on seasonally adjusted data for first three quarters of year.

COMPOSITION OF UK IMPORTS, 1967

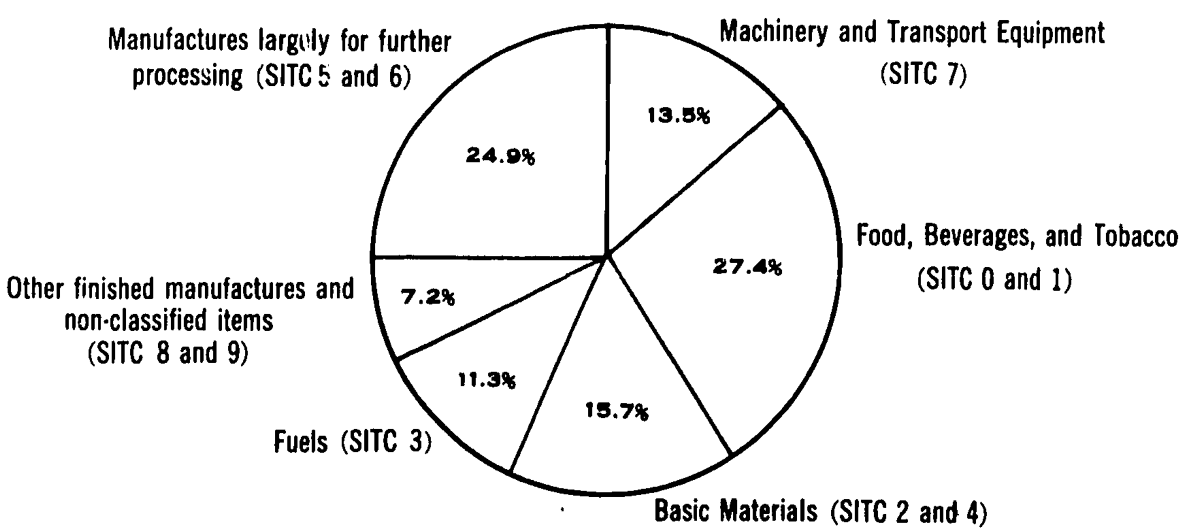


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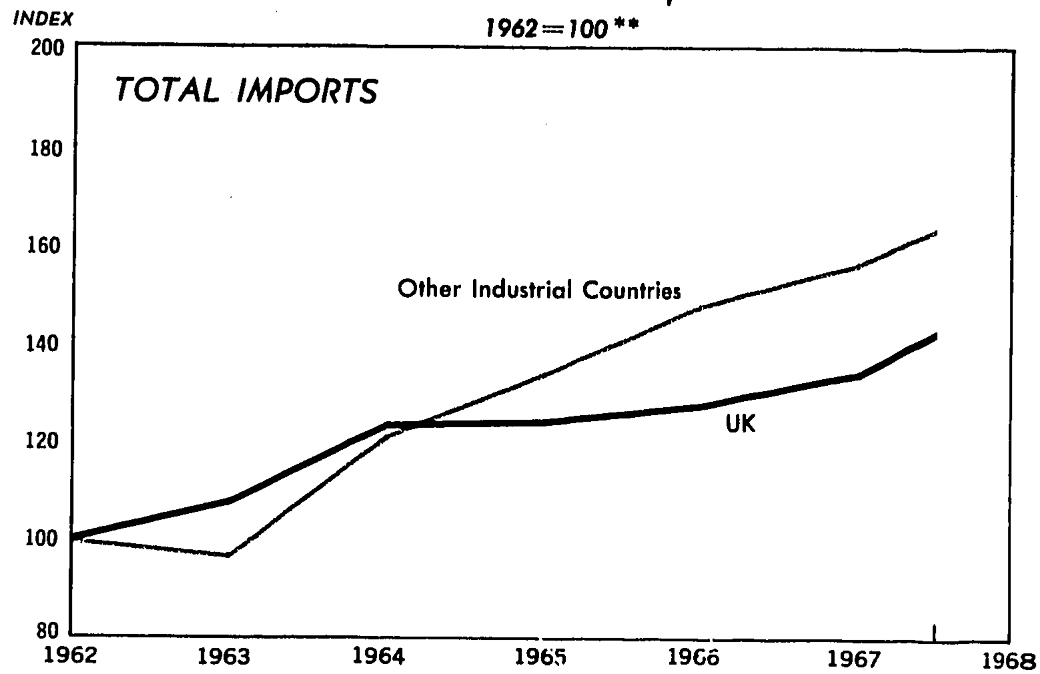
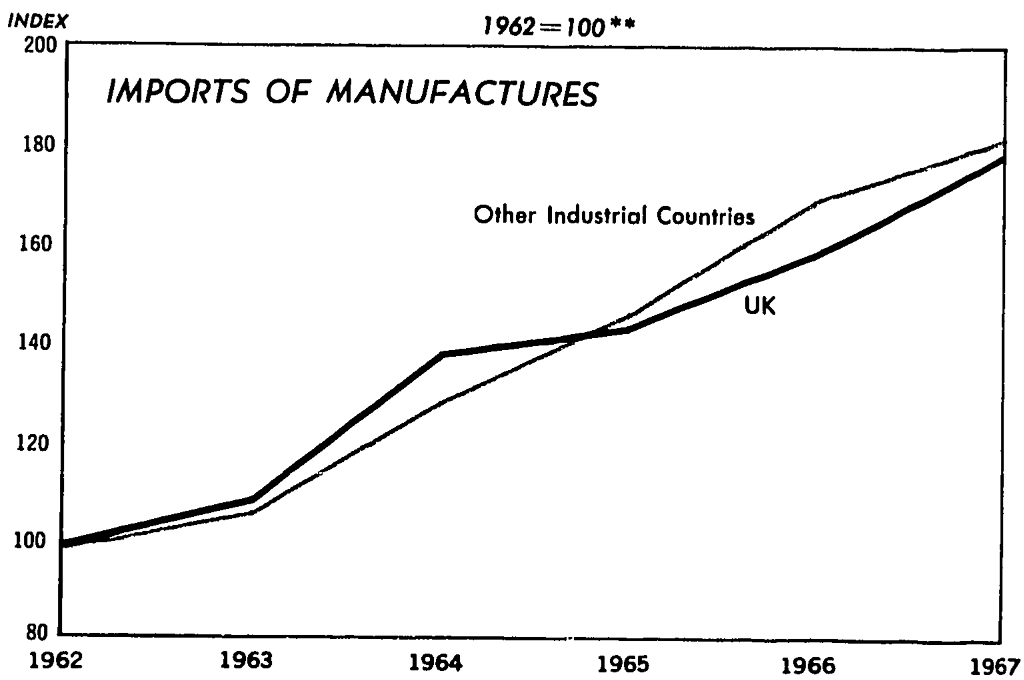
Figure 6

INDEXES OF UK IMPORTS AND COMPARABLE IMPORTS OF INDUSTRIAL COUNTRIES*, 1962-68





*The term "Industrial Countries" denotes those countries which were members of the Organization for Economic Cooperation and Development in 1967. (Primarily the US, Canada, Japan and Western Europe.)

**Index computed on the basis of dollar values.

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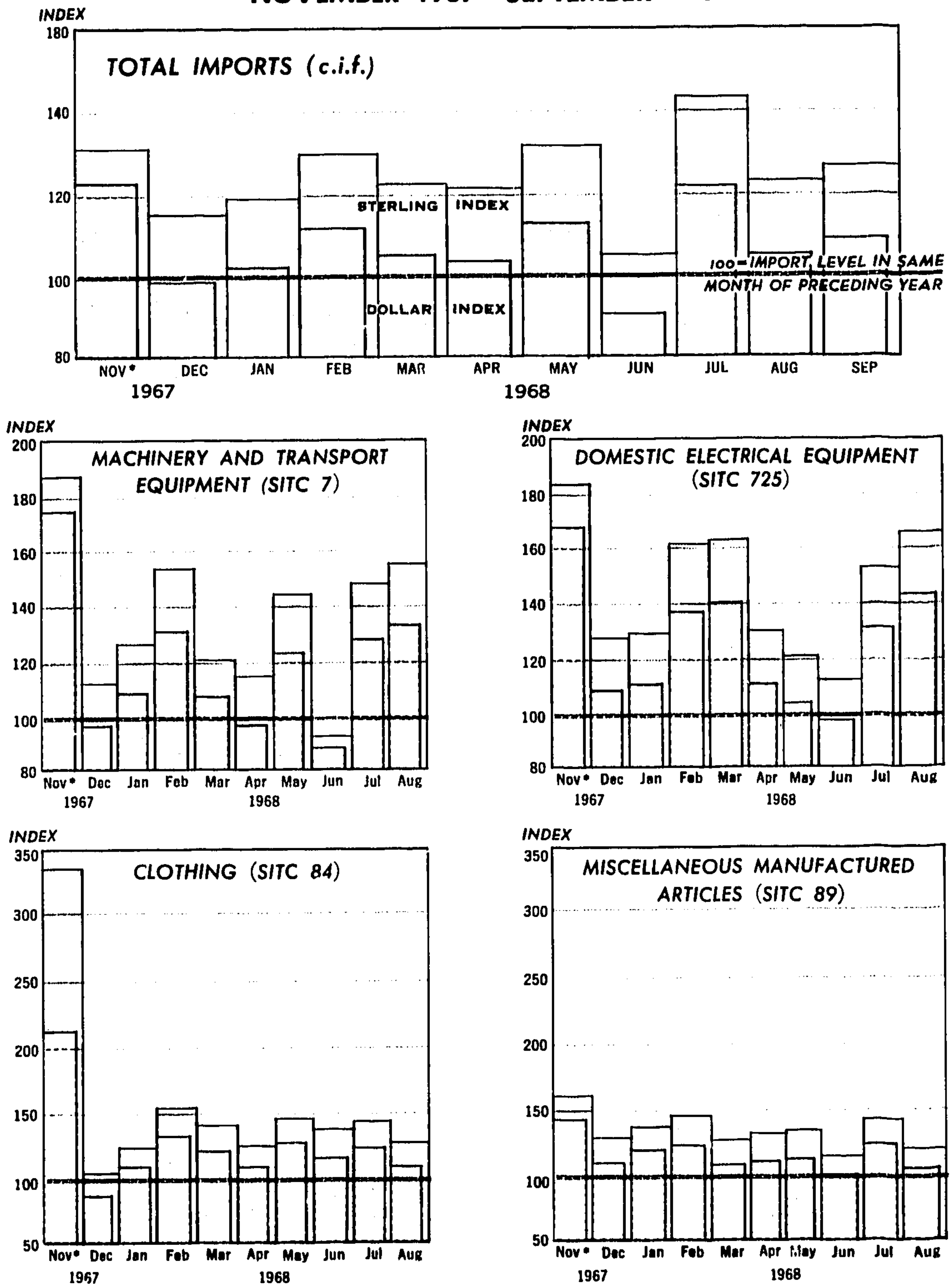
Figure 7

MONTHLY UK IMPORTS SINCE DEVALUATION COMPARED WITH THOSE FOR THE SAME MONTHS OF THE PRECEDING YEAR NOVEMBER 1967 - SEPTEMBER 1968



*Dollar trade data for November not directly comparable to sterling series.

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between November and March was the failure of import prices to rise as much as anticipated. Thus import prices rose only about 10 percent from October 1967 through June 1968, compared with a projected increase of 12 to 13 percent for the post-devaluation period. Probable reasons for the failure of import prices to rise by the extent anticipated include price cuts by overseas suppliers to meet competition and the significant share of goods coming from countries that also devalued.

22. Prospects for imports in the remainder of 1968 are difficult to gauge. The unit-value index for imports has remained steady since March, suggesting that the price increases resulting from devaluation are largely exhausted. A high rate of consumer spending was evident into November. On 1 November 1968 the government enacted new consumer credit restrictions intended to achieve substantial reductions in consumer spending on durables. Late in November the government indicated that it was contemplating additional monetary and fiscal measures, including reduction in bank credit and a 10-percent increase in the purchase tax on a wide variety of consumer goods. A major wage settlement in November within the engineering industry raised the possibility of increasing difficulty in constraining increases in money incomes. Together, these developments suggested that significant reductions in consumer spending and imports probably will not be achieved in 1968 and will require stringent government policies well into the first half of 1969.

The Balance of Payments in 1968 and 1969

23. Initial projections of a return to surplus in the balance of payments during 1968 were clearly too optimistic. Prior to the announcement of the large trade deficit for October, revised estimates for 1968 called for an overall deficit in the balance of payments of about £575 million ($1.4 billion). Even this revised estimate will probably prove too favorable, however, for it depended heavily on a strong improvement in the merchandise trade account for the fourth quarter. The cumulative balance on the current and long-term capital accounts for the first and second quarters of 1968 (see Table 3)

Table 3

United Kingdom: Quarterly Balance of Payments
First Quarter 1967 - Second Quarter 1968

Million £ a/

	1967				1968	
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr
Balance on current account	+25	-110	-20	-299	-168	-169
Merchandise trade balance	-42	-140	-97	-358	-215	-250
Imports (f.o.b.)	1,378	1,391	1,345	1,448	1,669	1,661
Exports (f.o.b.)	1,359	1,280	1,268	1,116	1,477	1,442
Balance on long-term capital account	-1	+1	-20	-66	-132	-25
Balance on current and long-term capital accounts	+24	-109	-40	-365	-300	-194
Net seasonal influences	-12	+55	-71	+28	+16	+68
Balance on current and long-term capital accounts (unadjusted)	+12	-54	-111	-337	-284	-126
Overall balance	+160	+12	-202	-285	-331	-100

a. *Seasonally adjusted unless otherwise specified.*

already had accounted for about 75 percent of the estimated annual deficit.

24. Longer term prospects for the UK balance of payments depend on a wide range of foreign and domestic influences. A revised semi-official estimate (in mid-1968) of the balance-of-payments position for 1969 called for a surplus of £250 million ($600 million). There is already some feeling in international circles that the growth of world trade in 1969 may be off somewhat from the 8 percent of 1968. Another unsettling international factor is the specter of devaluation of the French franc and the international repercussions therefrom, which could easily offset what remains of Britain's competitive edge from devaluation of the pound. A prominent domestic influence on trade levels is the unremitting attack from vocal elements of the Labor Party on the government's incomes policy, which may make it increasingly difficult to maintain wage discipline. A significant non-price factor influencing the competitive position of British exporters could be the loss of work time to strikes, which wasted considerably more labor hours in the first nine months of 1968 than in any comparable period since 1962. The present high level of consumer demand also clouds the outlook for 1969. Moreover, an even more difficult test of government resolution in monetary and fiscal restraint may come this winter, when increases in unemployment could be higher than usual.

25. In sum, prospects are for a modest balance-of-payments surplus in 1969 at something less than the revised estimate, provided world trade remains buoyant, the franc is not devalued, UK consumer demand subsides, and the UK government is able to constrain domestic wage and price growth to the rates achieved in the first year since devaluation.