

# Disinflation in the United Kingdom 1979–1983\*

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The paper analyses the mechanism by which disinflation was achieved in the United Kingdom and attempts to estimate the costs implied in this process.

In common with many other OECD countries, the United Kingdom is now experiencing a rate of inflation lower than at any time since the 1960s. It is too soon to say what the benefits of a lower rate of inflation will be; if it is maintained in the future will it result, for example, in growth rates of real output similar to those achieved in the 1960s? It is not too soon, however, to give a preliminary account of the mechanism by which the momentum of inflation has, for the present at least, been broken. We can also attempt to count the cost of that achievement in terms of lost output and employment.

## 1. Inflation in the United Kingdom and the World

Table 1 shows the growth rate of consumer price indices in the United Kingdom and in the average of all OECD countries year by year since 1970. The timing of the upswings and downswings are similar in the two series. The United Kingdom shared the world experience of acceleration in the early 1970s followed by incomplete deceleration up to 1978. The pattern in the second phase from 1979 to 1983 was broadly similar, but with some interesting differences.

In the mid-1970s the acceleration of inflation in the United Kingdom was exceptionally sharp and exceptionally prolonged. In 1975 the United Kingdom inflation rate was speeding up whilst the rate on average for the OECD was slowing down. The experience of those years made an even deeper impression on public opinion in the United Kingdom than in most other countries and contributed to a profound change in the emphasis of economic policy, its objectives, methods and priorities.

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\* I am grateful to Simon Brooks for preparing the simulation results reported in this paper.

Inflation in the United Kingdom did not rise as sharply in the second wave of acceleration, associated with the second 'oil shock', as it did in the first wave, associated with the first 'oil shock'. Moreover, the United Kingdom rate of inflation fell back from 1981 to 1983 at least as sharply as inflation in the rest of world. The reduction from 18 per cent in 1980 to 4.5 per cent in 1983 was abrupt by any standards (comparable to the remarkable experience of Japan between 1974 and 1978 when inflation fell from nearly 25 per cent to under 4 per cent).

## 2. Expectations and Outturns

In 1982 and 1983, forecasters in the United Kingdom had the almost unique experience of an unexpectedly low rate of inflation.<sup>1</sup> Table 2 sets out the record of National Institute forecasts over this period, but it is perhaps more remarkable that the official Treasury forecasts of the retail price index were also too high in the Budget statements of 1982 and 1983.

Here again there is a contrast with the experience of disinflation in the latter half of the 1970s. As inflation slowed down progressively from over 20 per cent to under 10 per cent between 1975 and 1978, the National Institute, in common with most other forecasters, tended if anything to expect a more abrupt deceleration.

The slower rate of *world* inflation in 1982 and 1983 may also have been, to some extent, a surprise. The National Institute overforecast the average growth of consumer price indices for all OECD countries in both years by a small margin. Inflation was, in particular, unexpectedly low in the United States.<sup>2</sup> This information about expectations is of importance for several reasons. First because it is now commonly accepted that expectations play an important part in the generation and maintenance of inflation. A confident expectation that inflation would slow down could have been in some degree self-fulfilling. When the Medium Term Financial Strategy was announced in 1980 it was suggested by some economists that it would achieve a relatively painless victory over inflation because it would influence expectations directly. What the evidence of actual expectations data suggests is that expectations did not run ahead of the process of disinflation but rather

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<sup>1</sup> The experience of inflation forecasting at the National Institute since the early 1960s is summarised in a note in the Economic Review for February 1984.

<sup>2</sup> These comments are based on examination of the forecasts published in the National Institute Review but the quantitative conclusions would be similar if national or OECD sources were used instead.

**Table 1: Inflation in the United Kingdom and the World**

Consumer prices: Percentage change from Preceding Year.

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
UK	6.4	9.4	7.1	9.2	16.0	24.2	16.5	15.8	8.3	13.4	18.0	11.9	8.6	4.6
Total OECD	5.6	5.3	4.7	7.8	13.4	11.3	8.6	8.9	7.9	9.8	12.9	10.5	7.8	5.3

Source: OECD

**Table 2: Inflation Forecasts and Outturns**

Consumer Prices: Percentage change to the fourth quarter of the year shown from the fourth quarter of the preceding year. Forecasts published in the February Economic Review.

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Forecast	4.0	7.7	4.6	5.1	15.8	18.9	10.3	12.2	8.0	9.9	15.4	9.6	9.6	7.9
Outturn	7.0	7.8	7.5	10.1	19.9	23.6	14.1	12.2	9.2	16.9	13.6	10.8	6.6	4.9

Source: NIESR

lagged behind the achieved rate of inflation, confirming and consolidating it, but not playing the initiating role.

Secondly, the evidence that the slowing down was to some extent unexpected may throw some light on the mechanism by which it worked. Inflation forecasting both in the National Institute and the Treasury is based on models which relate prices to lagged costs. Short-run mistakes in forecasting prices are especially likely to occur when profit margins are cut or when there are unforeseen changes in the exchange rate.

### 3. The Counter-Inflation Strategy

The inflation 'pause' of 1978 owed something to the incomes policy then in force.<sup>3</sup> A 'norm' of 10 per cent for pay settlements between July 1977 and July 1978 was tolerably well respected. An attempt to substitute a 5 per cent 'guideline' in July 1978, however, was unsuccessful and the structure of negotiated pay restraint collapsed. The Conservative Government elected in May 1979 was opposed to any form of incomes policy and since that time the whole burden of the counter-inflation strategy has rested on monetary and fiscal policy.

Monetary targets were first introduced by the Labour Government in 1978. They were seen as a substitute for the earlier regime of DCE targets negotiated with the IMF and, partly for that reason, they were defined in terms of a broad monetary aggregate, M3 or latterly 'sterling M3'. This includes the wholesale money market liabilities of banks as well as their retail deposits and therefore tends to reflect the overall size of banks' balance sheets. In 1980 it was made the focal point of the new Medium Term Financial Strategy (MTFS) by the Conservative Government.

Table 3 shows the time-path of a broad and a narrow monetary aggregate together with the rate of inflation in the United Kingdom. It is important to look first at the history of the early to mid 1970s because this experience was important in forming opinion, and policy, in the United Kingdom when the first MTFS was devised. In 1972 and 1973 the broad monetary aggregates grew very rapidly indeed as quantitative credit controls on the banking system were replaced by a new method of control designed to permit free competition. The narrow monetary aggregates grew quite slowly because the banks were expanding by bidding for wholesale rather than retail deposits and because interest rates were rising. Two years later came the great

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<sup>3</sup> The successive phases of income policy as described in the Calendar of Economic Events included in the Economic Review for February 1984.

explosion of inflation associated with the first 'oil shock' amplified by wage indexation. It was widely believed in the United Kingdom that this experience vindicated broad monetary aggregates as indicators of inflation two years ahead and therefore as potential targets or control variables. The narrow aggregates were thought to have encouraged a dangerous complacency. As incomes policy crumbled in the late 1970s many commentators and policymakers were converted to 'broad money' monetarism as the only remaining refuge.

What followed may seem a strange irony of fate. The monetarists conquered inflation, but in doing so they falsified monetarism. In 1980 and 1981 as output fell abruptly and unemployment rose steeply, the broad money targets were missed, rebased, redefined, and then missed again. As Table 3 shows, M3 in 1980 grew faster than at any time since 1973. This was in part the result of another attempt to stimulate competition between banks, but more significantly the result of 'distress lending' by banks to companies facing financial crisis as output and profits fell. If the two-year lag of the early 1970s had indeed been systematic, inflation should have accelerated sharply in 1982, or 1983 at the latest. In fact those were the years when the success of the counter-inflation strategy became clearly established.

There has been, as one might expect, a drift back in recent years of monetarist from sterling M3 to narrow aggregates such as M1, or notes and coin. As the table shows, the narrow aggregates grew very slowly, especially in 1980, thanks to a sharp rise in interest rates. In retrospect the MTFs might have presented a more coherent framework for policy if the narrow aggregates had been in the centre from the start. It is generally recognised, however, that both M1 and notes and coin (M zero) are influenced quite profoundly by institutional and structural changes.

The exclusive emphasis on monetary targets in the early versions of the MTFs is now discredited. The targets remain, but they are qualified by reference to other indicators including the exchange rate and even the 'state of the economy' rather broadly defined. They now play a role in policy-making in the United Kingdom not unlike that played by monetary aggregates in other European countries. They are one factor amongst many to be taken into account when strategic choices are made. The multiplicity of aggregates ensures that they often cancel each other out. This is not monetarism.

**Table 3: Inflation and Monetary Aggregates**

Percentage change to fourth quarter of the year shown from the fourth quarter of the preceding year.

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Narrow Money (M 1)	8.8	9.4	14.9	5.3	11.1	13.6	10.8	21.9	16.2	9.1	4.1	10.5	12.2	10.8
Broad Money (£ M 3)	9.4	12.9	24.6	27.2	10.5	6.7	9.4	10.2	15.1	12.7	19.1	13.2	9.8	11.1
Inflation (c. p. i.)	7.0	7.8	7.5	10.1	19.9	23.6	14.1	12.2	9.2	16.9	13.6	10.8	6.6	4.9

Source: Economic Trends

**Table 4: Exchange Rate and Competitiveness**

Percentage charges to the fourth quarter of the year shown from the fourth quarter of the preceding year.

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Effective Exchange Rate	—	—	—	—	—	—	- 17.9	+ 5.8	- 2.4	+ 9.8	+ 13.2	- 10.5	- 0.7	- 6.7
Relative Unit Labour Costs	+ 3.2	+ 2.6	- 9.1	- 9.0	+ 13.6	+ 3.5	- 16.6	+ 10.9	+ 6.8	+ 20.1	+ 27.9	11.8	- 1.8	- 6.6

Source: Economic Trends

#### 4. The Exchange Rate and Competitiveness

In an open and inflationary economy such as the United Kingdom the exchange rate must play a crucial role in the success of any economic strategy. Monetarism apart, two episodes in the history of the 1970s were formative for the counter-inflation strategy of the first Thatcher Government. The first experience was the fall of sterling in 1976 which confirmed instinctive fears of dynamic instability and was halted only by a deal struck with the IMF after prolonged negotiation. The second experience was the upward pressure on sterling in 1977 which was strenuously, and quite successfully, resisted, but which required interest rates to be reduced to an inappropriately low level, contributing (perhaps) to the inflationary pressures of 1979.

The lesson drawn from this experience, and reinforced by the tenets of monetarism, was that the best exchange rate policy was to have no policy at all. The strong upward pressure on sterling in 1979 and 1980 was not resisted. Interest rate decisions were taken on purely domestic grounds, giving the main weight to broad money. The result was a deterioration of relative cost competitiveness on a quite unprecedented scale. Table 4 shows the movement in the IMF index of relative unit labour costs (not 'normalised'). The cumulative deterioration through 1979 and 1980 was over 50 per cent. Arithmetically this is in large measure explained by the relative growth of unit labour costs in own currency terms and only to a lesser extent by the appreciation of sterling. Nevertheless the exchange markets, and also the monetary authorities, were conscious of what the implications for the competitiveness of British industry of appreciation rather than depreciation at that time must be.

It remained, and will always remain, something of a mystery why the market carried sterling so high in 1980. Both the announcement of the MTFs and the increase in the value of North Sea oil must have been important, but their relative importance is hard to discern. Our best guesses at the National Institute are embodied in the exchange rate equation used on our model. That model was used to construct a counter-factual simulation of the United Kingdom economy without oil.<sup>4</sup> Even in the counter-factual case where there is no oil under the North Sea at all (and never was) the exchange rate rises significantly in 1980 because of the increase in interest rates. We shall never know for certain how much higher interest rates contributed to the rise of sterling: the striking fact remains that interest rates were raised

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<sup>4</sup> *Atkinson, Brooks and Hall (1983).*

rather than lowered at a time when sterling was quite exceptionally strong.

From 1981 to 1983 sterling depreciated against a trade-weighted composite of currencies. The effective exchange rate index was 82 at the beginning of 1984, which is close to its average level in 1977 and 1978. The restoration of competitiveness, however, was less complete. Relative unit labour costs in manufacturing were probably about 20 per cent higher at the end of 1983 than in 1978. (An even larger remaining loss is indicated by a 'normalised' series, but it is difficult to judge how large a cyclical correction to productivity growth is now appropriate.) Export prices on the other hand were not at the end of 1983 very far from the relativity recorded in 1978, the remaining loss of competitiveness being about 7 per cent.

It is to be expected that the development of the United Kingdom's oil reserves, and the increase in their value in 1979 should result in some lasting appreciation of the real value of sterling relative to other industrial countries dependent on imported oil. Nevertheless it would seem that the real appreciation of sterling in 1979 and 1980 went well beyond that which could be sustained for that reason.

Medium-term projections<sup>5</sup> suggest that a substantial external deficit might soon open up if the United Kingdom economy were now to grow at a rate sufficient to reduce unemployment.

## 5. Prices and Costs

The exchange rate appreciation ensured that the growth of import prices played a relatively minor part in the rise and fall of the inflation rate from 1978 to 1982. The contrast of this period with the mid-1970s is illustrated by Table 5 which shows the growth of the deflators for consumer spending, gross domestic product and imports of goods and services. In 1973 and 1974 the United Kingdom shared with the rest of the world the experience of a powerful inflationary impulse from the first oil price 'shock'. The momentum of inflation was maintained and the process of deceleration delayed by the further impulse from import prices in 1976 when the exchange rate fell sharply. In the late 1970s by contrast the growth of import prices was relatively constant from year to year and usually lower than the growth of either consumer prices or total home costs. (The exception was 1981 when the exchange rate fell back a little after its rapid appreciation in the two preceding years.)

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<sup>5</sup> For example those reported in the Economic Review for November 1983.



**Table 5: Prices and Costs**

Percentage change to the fourth quarter of the year shown from the fourth quarter of the preceding year.

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Consumer Price Index	7.0	7.8	7.5	10.1	19.9	23.6	14.1	12.2	9.2	16.9	13.6	10.8	6.6	4.9
GDP Deflator	9.6	12.1	9.2	9.9	21.5	23.8	12.5	11.1	11.3	15.9	18.8	6.2	7.2	5.4
Imports Deflator	5.6	3.1	6.5	32.6	35.1	13.4	26.6	4.7	5.7	10.7	5.4	13.1	3.6	7.0

Source: Economic Trends

**Table 6: Wages and Productivity**

Percentage change to fourth quarter of the year shown from the fourth quarter of the preceding year.

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Wages and Salaries	12.7	8.7	14.7	15.1	24.5	22.8	11.2	10.4	15.0	20.0	14.0	6.7	5.8	7.6
Employment	- 0.7	- 2.1	2.0	1.7	0.4	- 1.0	- 1.0	0.3	1.5	0.5	- 2.4	- 3.0	- 1.6	0.3
Output	2.2	1.8	4.7	3.2	- 2.1	- 1.6	4.0	1.5	3.8	2.3	- 6.0	0.9	1.7	3.5

Source: Economic Trends

Table 6 shows, for the same periods, the growth of the total wage bill in relation to employment and to output. In the mid-1970s, the very rapid growth of wages reflects the existence of an incomes policy based on indexation. This helped to perpetuate and amplify the impulse from import prices. The experience of the late 1970s is different. The acceleration of wages in 1979 was substantially the result of the breakdown of incomes policy (and some rash promises on public sector pay made during the election campaign of that year).

Had formal indexation been generally applied during this period it would not, thanks to the appreciation of the exchange rate, have produced the disastrous results of the mid-1970s. On the other hand it might not have achieved the fall in the rate of wage inflation observed in the early 1980s. The relative moderation of wage inflation in this period probably owes much to the recession and the consequent rise in unemployment. The National Institute model includes an equation relating the growth of earnings to price inflation, to the level of real earnings relative to trend and to unemployment, both as a level and a rate of change.<sup>6</sup> With hindsight such an equation can explain much of the movement of earnings through the 1960s and 1970s, suggesting perhaps that successive phases of incomes policy did not play as decisive a role as they appeared to play at the time. The abrupt slowing down of wage costs per unit of output in 1981 and 1982 owed much to the good productivity performance of those years. As usual productivity fell back sharply in 1980, the first year of the recession, but a continuing fall in employment after output had begun to recover a little meant that the growth of productivity in the later years of the recession was more than just the improvement one would expect at that stage in the cycle. It seems likely that the severity of the recession persuaded, or indeed obliged, firms to 'rationalise' their production methods in response to financial pressure.<sup>7</sup> The consequent rise in unemployment then played its part in shifting the balance of bargaining strength in the labour markets, thus producing a generally lower rate of wage settlements. The recession may also have contributed to the slowing down of inflation by other, less familiar, routes. The growth of sterling import prices, in 1981 particularly, when the exchange rate fell, was slower than previous experience would have suggested. It seems that the intense competition for a share of the diminished market during the recession is the most likely explanation. There was perhaps

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<sup>6</sup> The equation and the research underlying it are described in *Britton* (1983), Chapt. 5.

<sup>7</sup> The behaviour of manufacturing employment in the recession is considered by Simon Wren-Lewis in a special article in the *Economic Review* for May 1984.

also some tendency for retail margins to narrow, or for shops to make use of 'special offers' or other sales inducements.

## 6. Fiscal Policy

The recent recession came earlier in the United Kingdom than in other industrial countries and nowhere else was it so deep and long lasting. Several attempts have been made to 'explain' the recession by distinguishing the contributions of the world environment, fiscal and monetary policy.<sup>8</sup> Different econometric models produce rather different conclusions, especially about the role of the exchange rate. For present purposes the interest of these studies centres on the effect of fiscal policy. The question is complicated by the *form* which fiscal policy changes took. In the June Budget of 1979, the balance of taxation was shifted from income tax to VAT adding directly to prices and delaying the deceleration in price inflation resulting from the recession. Some of the cuts in public spending programmes implemented at about the same time also involved increasing charges for government services and reductions in the subsidisation of nationalised industries. These also added to the price level. When these direct effects on prices are taken into account the net effect of fiscal policy on the rate of inflation is small and even ambiguous in sign. Results for 1981 and 1982 obtained by Artis using the National Institute and Treasury models attribute to fiscal policy a reduction in gdp of about 2.5 to 3 per cent. Even so, the net effect on inflation is estimated as (at best) only 1 or 2 percentage points a year.

## 7. A Model Simulation with a Constant Real Exchange Rate

The contribution of exchange rate appreciation to the reduction in the rate of inflation can be investigated by constructing a 'counterfactual' simulation of the period on a macroeconomic model in which the real exchange rate is held constant at its value in early 1978. The results of such a simulation using the National Institute model<sup>9</sup> are shown in Table 7. Before commenting on the results, however, it is important to draw attention to the limitations of exercises of this kind.

Almost any model would predict a substantially faster inflation rate over this period had the real exchange rate not appreciated, but the

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<sup>8</sup> See Artis, Bladen-Hovell, Karakitsos and Dwolatzky (1984) and 'Factors Underlying the Precent Precession', Papers presented to the Panel of Academic Consultants, Bank of England, July 1981.

<sup>9</sup> For a full description of the model see Britton (1983). The model used for these simulations includes some minor modifications.

Table 7

**Model Simulation With A Constant Real Exchange Rate**

	Actual	Simulation	Difference
<i>Inflation Rate (percentage change on a year earlier in the consumer price index)</i>			
1978 (Q 4)	9.2	9.6	0.4
1979 (Q 4)	16.8	20.3	3.5
1980 (Q 4)	13.3	20.2	6.9
1981 (Q 4)	10.5	16.6	6.1
1982 (Q 4)	6.8	10.9	4.1
1983 (Q 4)	5.6	6.9	1.3
<i>Exchange Rate (Effective Rate Index)</i>			Percentage Difference
1978 (Q 4)	80.6	75.7	— 6.1
1979 (Q 4)	88.5	74.5	— 15.8
1980 (Q 4)	100.2	63.2	— 36.9
1981 (Q 4)	89.7	65.6	— 26.9
1982 (Q 4)	89.2	72.0	— 19.3
1983 (Q 4)	82.6	69.1	— 16.3
<i>Real Exchange Rate (Relative Export Prices)</i>			
1978 (Q 4)	103.8	99.2	— 4.5
1979 (Q 4)	110.9	99.2	— 10.6
1980 (Q 4)	124.5	99.2	— 20.5
1981 (Q 4)	111.1	99.2	— 10.7
1982 (Q 4)	108.2	99.2	— 8.3
1983 (Q 4)	103.4	99.2	— 4.1
<i>Gross Domestic Product (1975 = 100)</i>			
1978 (Q 4)	108.9	109.1	0.2
1979 (Q 4)	110.6	111.6	0.9
1980 (Q 4)	105.3	107.8	2.4
1981 (Q 4)	105.6	108.9	3.1
1982 (Q 4)	106.7	108.8	1.9
1983 (Q 4)	109.8	110.9	1.0

quantitative results would differ substantially as between models. The specification of the equations for wages and for prices are particularly important, and in both cases the speed of response is difficult to estimate. Moreover, the conventions adopted in carrying out the simulation will also influence the results, perhaps substantially. For the simulation reported here we defined the real exchange rate as the index of relative *export* prices which enters the equation for the volume of exports. We assumed, perhaps not altogether plausibly, that nominal interest rates would be the same in the counter-factual case as in actuality. This is a convenient benchmark, but unchanged *real* interest rates or even unchanged money supply would also have been defensible.

According to the model simulation the consumer price index would by the end of 1983 have been about 20 per cent higher had the real exchange rate been held at the level of 1978. Inflation would have peaked in early 1980, at about 25 per cent rather than 20 per cent, and it would have continued in the range of about 15 to 20 until the first half of 1982. Thus the inflationary experience of that period would have been both more severe and longer lasting than it was in actuality. Our experience over the years 1979-82 would in fact have been very similar to the experience of prolonged high inflation in the mid-1970s. By the end of 1983, however, it would not have been substantially higher than it was in actuality.

To maintain a fixed level of export price competitiveness would, according to the simulation, have required some depreciation in 1978, no change in the effective rate during 1979, and a more substantial depreciation, about 15 per cent during 1980. In 1981 and 1982, however, the exchange rate could have appreciated so that its level at the end of 1982 would not have been very different from its level at the end of 1979. This is very different from the course of the exchange rate in actuality over this period, but not perhaps an implausible outcome, particularly if one imagines that in the counter-factual case the United Kingdom was a full member of the European Monetary System.

The model simulation suggests that the recession would have been less severe had the real exchange rate been held constant. Exports would have been much higher and consumer spending much lower. (The unemployment level in the simulation for the end of 1983 is about 300 thousand lower than in actuality, but the gap is narrowing.) Thus the simulation suggests a fairly simple 'trade-off' between inflation and output over the period. Had the real exchange rate been held constant the cumulated loss of output during the recession would have been reduced by about 9 per cent, but the cumulated inflation rate would

have been increased by about 20 per cent. The rather surprising conclusion is that the course of both output and inflation at the end of the period would have been relatively little changed.

Real life, however, is more complicated than any econometric model. We cannot really know how the economy would have responded to another episode of prolonged and high inflation, nor can we know how much lasting damage could have been avoided had the recession been less severe. It is very difficult to believe, however, that no harm has been done by an appreciation of the real exchange rate of some 20 per cent over three years in terms of relative export prices (and much more in terms of relative wage costs) which was then substantially reversed over the next three years. It is hard to believe that such a hostile environment for trade and investment would ever have been deliberately planned.

### **8. The Prospect for Inflation**

In his Financial Statement for 1984 the Chancellor of the Exchequer held out the prospect of inflation in the United Kingdom slowing down further to 4.5 per cent through the year in terms of the retail price index. Looking further ahead he made his plans on the assumption that the growth of the gdp deflator would fall from 5.5 per cent in 1983 to 3 per cent in 1988 - 9. This was assumed to be consistent with real gdp growth averaging 2.25 per cent a year over the five-year period.

Two related problems might suggest a less optimistic view of the outlook. First there is little scope for a further reduction in inflation based on a real appreciation of the exchange rate. On the contrary growth rapid enough to reduce unemployment significantly would open up a large current account deficit at the existing level of the real exchange rate. Probably, therefore, we should look for some gain in relative cost competitiveness in the next few years. This throws the whole burden of the counter-inflation strategy onto domestic costs. The hope must be either that pressure for real wage growth has abated or else that output can grow at such a rate that real wage aspirations can be satisfied. The doubt arises from the need to generate simultaneously sufficient real growth to satisfy those aspirations whilst also adding to employment and providing an adequate margin for profits. If those objectives cannot be achieved simultaneously the danger is that inflation will soon re-accelerate if unemployment falls. If growth does not accelerate, however, unemployment will stay at 13 per cent for a year or so, and in the next cyclical recession it will begin to rise again. If that were to happen the victory over inflation would seem a very hollow one.

### Summary

The recent recession came earlier in the United Kingdom and was deeper and longer lasting than in all other industrial countries. The main reason for the great loss in output and employment was the strong upward pressure on sterling beginning in 1979 and the dramatic deterioration in relative unit labour costs. Fiscal policy played only a minor role. For monetary policy the exclusive emphasis on monetary targets was discredited by the experience with the behaviour of different monetary aggregates.

### Zusammenfassung

Die jüngste Rezession im Vereinigten Königreich setzte früher ein, war tiefer und dauerte länger als in allen anderen Industrieländern. Der Hauptgrund für den großen Verlust an Produktion und Beschäftigung ist in der starken Aufwertung des Pfundes ab 1979 und der dramatischen Verschlechterung in den relativen Lohnstückkosten zu sehen. Die Fiskalpolitik spielte nur eine untergeordnete Rolle. Für die Geldpolitik haben die Erfahrungen mit der Entwicklung verschiedener Geldmengenaggregate die Ausschließlichkeit von Geldmengenrößen als monetäre Zwischenziele diskreditiert.

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