



**HALIFAX FINANCIAL SERVICES**

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## **UK economy prospers since sterling's ERM exit 15 years ago**

This month marks the 15th anniversary of the Pound's withdrawal from the European Exchange Rate Mechanism (ERM) in 1992. The UK Treasury later estimated the cost of 'Black Wednesday' (16<sup>th</sup> September 1992) at £3.4 billion.

New Halifax Financial Services research shows that sterling's ejection from the ERM marked the start of a substantial improvement in the UK's economic performance.

In September 1992, the UK economy was in recession and interest rates and inflation were both in double figures. During the subsequent 15 years, the UK economy has delivered an impressive combination of steady and sustained growth together with low and relatively stable inflation and interest rates.

### **The key findings are:**

- The UK economy has grown for an unprecedented 60 successive quarters since leaving the ERM in 1992.
- The UK has grown significantly more quickly following sterling's ERM departure compared with the preceding 15 years.
- The UK economy has been significantly more stable over the past 15 years compared with the preceding 15 years.
- Interest rates have been lower and fluctuated within a narrower range since sterling's ERM exit compared with the previous 15 years.
- Inflation has also been lower and less volatile in the past 15 years compared with the previous 15 years.
- Sterling is currently trading around \$2, a level last achieved just before sterling's ERM exit in September 1992.

More....

**For further information contact Halifax Press Office**  
**Halifax plc is a subsidiary of HBOS plc**  
**Halifax plc, Registered Office: Trinity Road, Halifax, West Yorkshire, HX1 2RG**  
**Registered in England No. 3474881**  
**Tel: 01422 333829 Fax: 01422 333007**  
**(Out of Hours Tel: 01422 333256)**  
**Website: <http://www.HBOSplc.com> Email: [pressoffice@halifax.co.uk](mailto:pressoffice@halifax.co.uk)**  
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## ECONOMIC GROWTH

The UK economy has grown for an unprecedented 60 successive quarters since leaving the ERM in 1992.

- No other OECD<sup>1</sup> economy can match the UK's unbroken 15 years of positive economic growth. The UK's unbroken stretch has helped to move it from the 6th largest OECD economy at the start of 1992 to the fourth largest OECD economy now. The UK has overtaken both Italy and France during the past 15 years and is now behind only the US, Japan and Germany.
- The UK's growth performance in the past 15 years has been the best amongst the five largest economies in the world (the 'G5') with the exception of the USA.

### Economic Growth in the world's 5 largest economies

Country	Quarters of Continual Growth <sup>1</sup>	Average Growth (pa)
		1992 Q2 – 2007 Q2
United Kingdom	60	2.8%
United States	23	3.2%
Japan	10	1.3%
France	16	2.0%
Germany	11	1.5%
'G5' Average	24	2.2%

Source: Thomson Datatstream

<sup>1</sup> Calculated from 2007 Q2 (2007 Q1 for the other countries) back to the last quarter of negative GDP growth.

The UK has grown significantly more quickly in the past 15 years compared with the preceding 15 years.

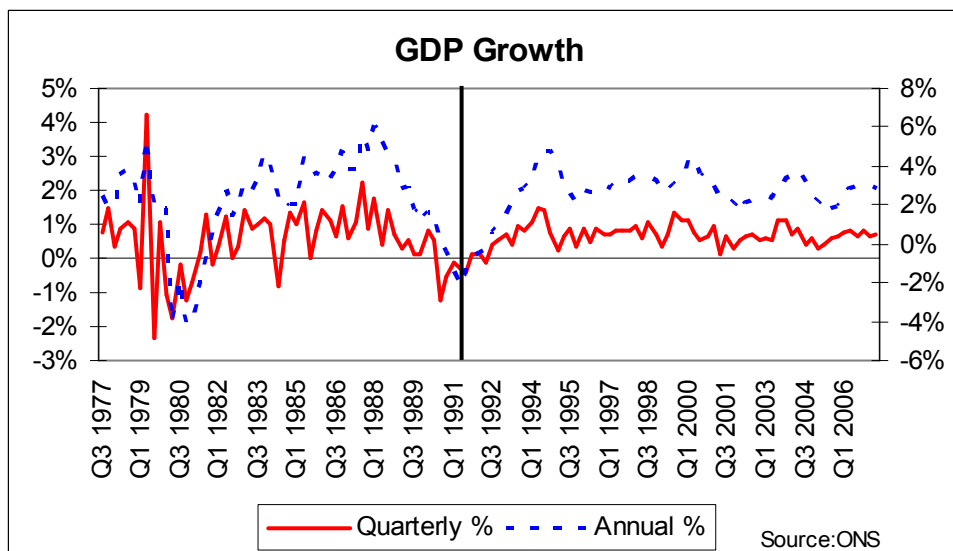
- Over the 15 years from 1992 Q3 to 2007 Q2, the level of GDP in the UK has increased by 53% after adjustment for inflation, from a quarterly level of £202bn to £310bn. During the 60 quarters before 1992 Quarter 2, the level of GDP increased by 32% after adjustment for inflation, from a quarterly level of £152bn to £201bn.
- During the 15 years since 1992 Quarter 3, the UK economy has expanded at an average annual rate of 2.8%. Over the preceding 15 years, the UK economy expanded at an average annual rate of 2.0%.

<sup>1</sup> OECD (Organisation for Economic Cooperation and Development) is a club comprising the 30 most advanced economies in the world.

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## The UK economy has been significantly more stable over the past 15 years compared with the preceding 15 years.

- During 1977 Q3 -1992 Q2, GDP fell in 15 quarters – one in four - with the UK economy experiencing recessions during both the early 1980s and early 1990s.
- The annual rate of GDP growth has varied within a much narrower range in the past 60 quarters, fluctuating between a low of 0.6% (1992 Q3) and a high of 4.8% (1994 Q3). This compares with a low of -4.1% (1980 Q2) and a high of 6.0% (1988 Q1) in the preceding 15 years.



## INFLATION

### Inflation has been lower and less volatile since the UK left the ERM.

- The annual rate of headline Retail Price Index (RPI) inflation has averaged 3% over the last 15 years. This is 6 percentage points below the 9% average during the preceding 15 years.
- Whilst the annual rate of RPI inflation recently reached its highest in over a decade, at 4.8% in March, it was nonetheless substantially lower than the 16.6% peak recorded in the 15 years before sterling's ERM exit.

## POUND / DOLLAR EXCHANGE RATE

The pound is currently valued at around \$2, a value it last hit shortly before the currency's ERM exit.

- Heavy selling of the pound for foreign currencies resulted in the value of the pound falling against the US dollar around 16th September 1992. By Christmas 1992, the pound had fallen in value to \$1.50.

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## **INTEREST RATES**

**Interest rates have been lower and fluctuated within a narrower range during the past 15 years compared with the previous 15 years.**

- Official interest rates have remained in single figures since they were cut to 9% six days after 'Black Wednesday'. Rates have averaged 5.5% in the past 15 years, reaching a low of 3.5% in 2003.
- During the previous 15 years, base rates were frequently in double figures, averaging 11.7%, peaking at 15% during October 1989 to October 1990 – twice the peak in the past ten years - and falling to a low of 5.25% during 1994.

**Halifax Financial Services economist, Tim Crawford, commented:**

"The UK economy has undoubtedly delivered an impressive combination of steady and sustained growth together with low and relatively stable inflation and interest rates since sterling's ERM exit 15 years ago. The UK's new-found economic stability is the dream of both the public and policymakers during the turbulent 1970s and 1980s.

Whilst the pound's ERM departure proved to be a catalyst for the UK's much improved economic performance, we cannot conclude that the previous cycles of economic boom and bust have been eradicated. Economic policymakers will need to remain vigilant if the next 15 years are to prove as successful as the past decade and a half."

Ends.

## **EDITORS' NOTES**

### **Background to the ERM crisis**

The fundamental sterling problem in September 1992 was a result of the dollar's rapid depreciation against the deutschmark at the time. Tied as it was to the ERM, the pound was hence appreciating to unsustainable levels against the US currency due to its tie to the German currency as a consequence of its membership of the ERM. With a large proportion of British exports priced in dollars, a pound/dollar correction was well overdue, but ERM membership prevented this. Speculators put further pressure on sterling by borrowing pounds (and also lire) and selling them for DM, in the expectation of being able to repay the loan in devalued currency and to pocket the difference.

On September 16<sup>th</sup> 1992, the British government announced a rise in base rates from 10% to 12% in an effort to persuade speculators to buy pounds. Despite this and a promise later the same day to raise base rates again to 15%, dealers kept selling pounds, convinced that the government would not stick with its promise. By 19:00 that evening, Norman Lamont MP, then Chancellor, announced that Britain would leave the ERM and rates would remain at the new level of 12%.

The Treasury spent £27bn of reserves in propping up the pound; the Treasury calculates the ultimate loss was only £3.4bn.

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