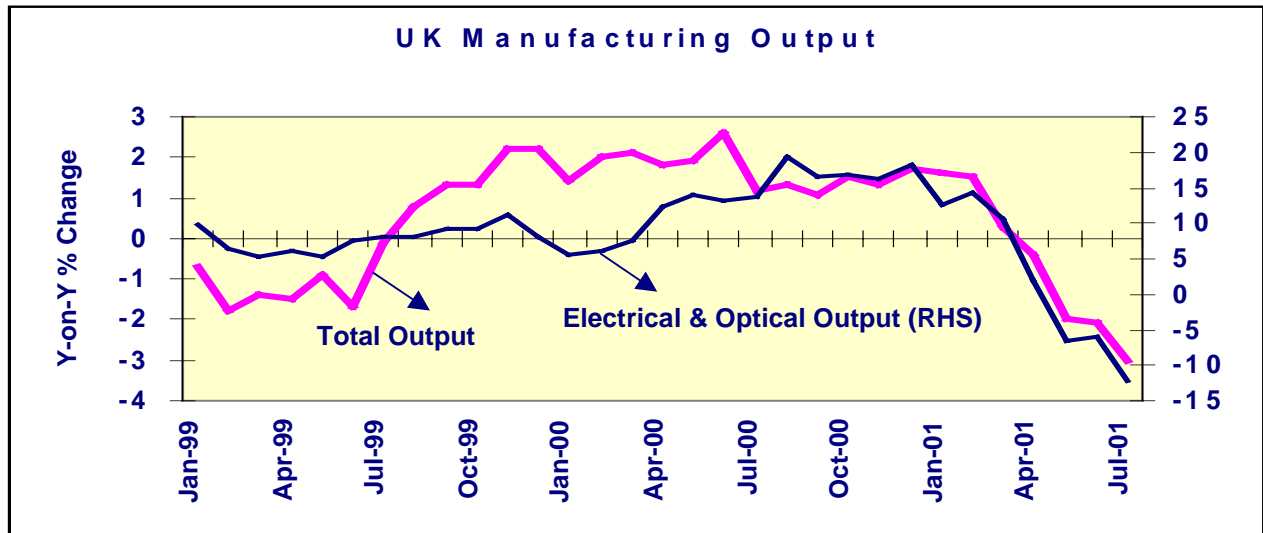


Poor Manufacturing Numbers Not Enough For a Move to 4.75%



This week's Bank of England monetary policy meeting coincided with the news that, after a modest rebound of 0.3% (m-on-m) in June, UK manufacturing output fell by 0.9% in July. On an annual basis, output was down 3.0%, its lowest level since January 1992, when the economy was in full blown recession. After two consecutive quarters of negative growth, July's numbers point to another negative performance in Q3 and a deepening of recessionary conditions. (Two consecutive quarters of negative output signal a technical recession). While UK manufacturers are dealing with an overvalued currency, it is the slump in the global economy that is largely responsible for the downturn in the sector. In particular, over-capacity and declining demand in the ICT sector are hitting output. This is not UK specific but applies to manufacturing sectors right across the global as producer grapple with the US-led, investment driven downturn. More than half of this month's fall in production was due to a 4.1% drop in electrical and optical output. This sector accounts for 10-12% of total output. Over the last three months output from this area has fallen by 10.4%, knocking about 1.2% of total production. Faint signs that manufacturing in the US has bottomed (August's better than expected manufacturing NAPM report) offer some glimmer of hope but the short-term outlook for UK manufacturing is bleak.

Despite the problems being faced by the manufacturing sector the BoE, as expected, left interest rates on hold at 5.00% this month. The buoyancy in the housing market, resilient of consumer spending and strong labour market means that there is little risk of an outright recession in the UK. The services PMI for August showed a slight improvement in activity over the previous month with the headline index rising to 50.9 from 50.3 in July. Both the employment and prices charged index edged up, suggesting that employment remains firm and that pressure on prices (in this sector) will persist. Evidence from the housing market was also upbeat with the Halifax house price survey showing house price inflation up 1.5% (m-on-m). On an annual basis, house prices have risen by 10.9%. Therefore, we stick to our view that interest rates will stay unchanged at 5.0% for the time being but the BoE will move again if the labour market and consumer spending show signs of unwinding more quickly than anticipated.

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