



**AIB Group Treasury
Economic Services Unit**

UK Data Support A Gradual Easing Bias

After two years of keeping the official interest rates at 6.00% the Bank of England announced a 0.25% reduction in the base rate today. No statement of explanation accompanied the announcement but next week's Quarterly Inflation Report should provide plenty of opportunity to explain the reasoning behind the move. After today's move the key question is how long and how deep the monetary easing phase is going to be. We retain the view that there is little need for the Bank of England to ease rates aggressively.

Markets tend to group the UK economy with the US rather than regarding it as being more closely related to the eurozone, as trade links would suggest. However, there is little sign as yet that the UK is being affected by the US slowdown and the economic outlook looks reasonably healthy. In contrast with the US, consumer and business confidence remains high. Business activity surveys from the manufacturing and services sectors are also showing sharp disparities. In January the UK PMI manufacturing survey climbed to 52.0 from 51.3 the previous month. The NAPM index in the US declined for the sixth month running, falling from 44.3 to 41.2. The UK CIPS services index slipped marginally to 57.1 from 57.6 in December with growth remaining well above the threshold of 50 that indicates expansion. The corresponding survey in the US dropped 11 points. There was also good news on the retail side. A survey by the Confederation of British Industry showed annual retail sales rising at the fastest pace since May 2000. Add to this a tight labour market and a gradual pick-up in wage inflation and a sharp correction in monetary policy seems very unlikely. There are uncertain and unquantifiable risks from the US but today's reduction should help secure a soft landing in the UK.

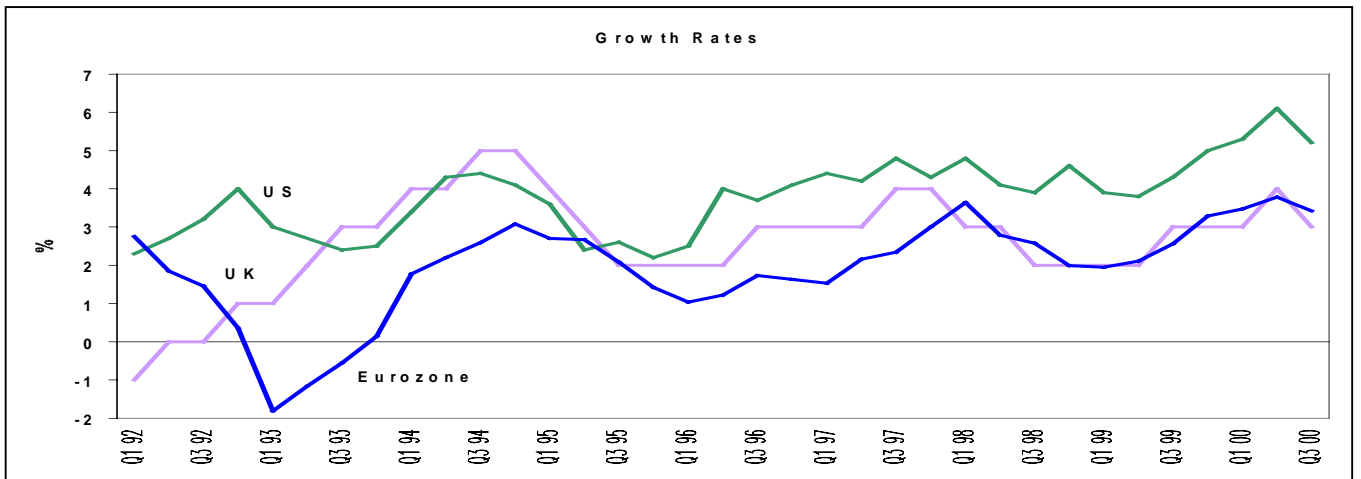
If data continue to show a divergence in US and UK growth this should reassure markets and provide some support for sterling. Over recent weeks sterling has failed to benefit to the extent that one might expect from the downturn in the US. Again, this is a function of the perceived links between the US and UK economies. With UK rates remaining relatively high (if Canada follows that last Fed cut the UK will have the highest interest rates in the G7) we anticipate further gains in the GBP/USD with \$1.50 a target by the end of Q1.

	% Exports to:		% Imports from:	
	US	Europe	US	Europe
1996	12	57	13	56
1997	12	56	14	54
1998	13	58	14	55
1999	15	59	13	54

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UK Growth Rates Closer to Eurozone Than US



Confidence Levels Diverge

