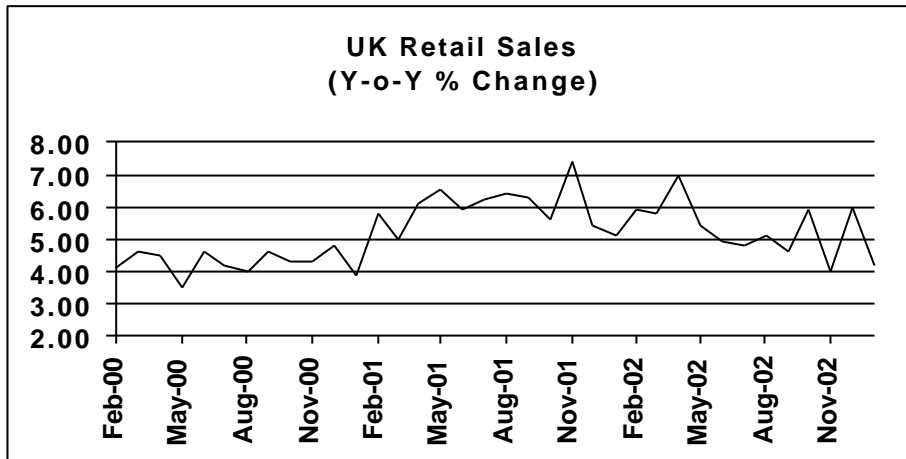
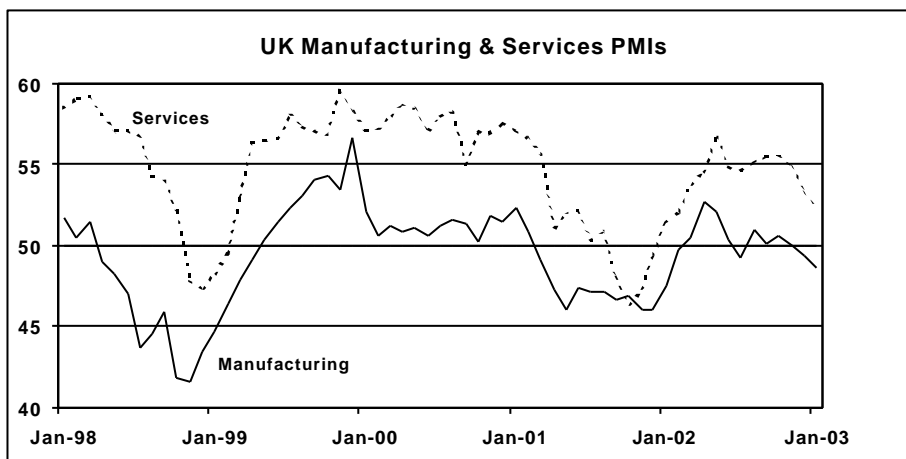


## UK Economy on Borrowed Time ?

During the current slowdown in the global economy the UK has been one of the bright spots. This outperformance has been mainly due to the strength of consumer demand. However, in January the volume of retail sales fell 1.0%. On a year-on-year basis sales were up 4.2%, compared to 6.0% in December. This decline was well in excess of market expectations.



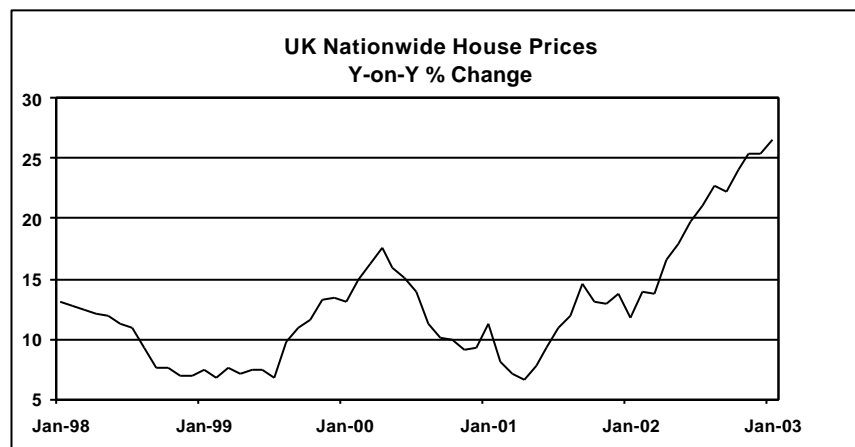
Some caution is needed in interpreting the figures. The January 2003 sales period covered four weeks, while the January 2002 period covered five weeks. A calendar adjustment was made to account for this difference making it difficult to read too much into one month's numbers. The data have nonetheless raised questions about the sustainability of the UK consumer and have added to fears that the economy has finally succumbed to the pressures of a weaker global environment. If the trend seen in the opening weeks of the year continues throughout the quarter, a slump in spending will have a significant dampening effect on economic growth over the period.



Recent indicators, such as the PMI and CBI surveys indicate that the manufacturing sector hovers close to recession. In January, the manufacturing PMI was at its lowest level for a year, falling to 48.6. The fall reflected a further contraction of overall order books in January, as well as sharp cuts to capacity in the form of job losses and the reduction of raw material and semi-manufactured input inventories. Exports and investment may pick up slightly over the course of the year but any rebound is likely to be moderate, with the global economy only expected to show a modest recovery and corporate profitability remaining under pressure.

It is true that there have been some signs that consumer demand is waning. However, the Bank of England continues to pursue a monetary policy that is aimed at shoring up consumer confidence levels and bolstering spending. In addition, UK fiscal policy remains supportive of domestic demand. Furthermore, the labour market remains relatively tight. Despite the slowdown in the global economy and below trend growth at home, the UK continues to enjoy historically low unemployment, with the jobless rate at 3.1%. Thus, we expect consumer spending to grow at a relatively robust rate again in 2003.

Growth could be at risk if house prices were to fall sharply. Again, this does not form part of our central forecast. There has been little evidence of anything more than a modest deceleration in house price inflation. The exceptionally low level of interest rates which currently prevails in the UK (and the prospect of further easing in the months ahead), combined with low unemployment and a lack of alternative investment opportunities, do not constitute a backdrop for a crash in the housing market.



Despite last week's data we feel that the UK economy will continue to outperform the eurozone and will return to trend growth in the second half of the year as the global economy recovers. Although near-term risks are weighed to the downside we expect the economy to grow by 2.4% for the year as a whole, up from 1.7% in 2002 and only just below trend.

**Geraldine Concagh**

**21 February 2003**