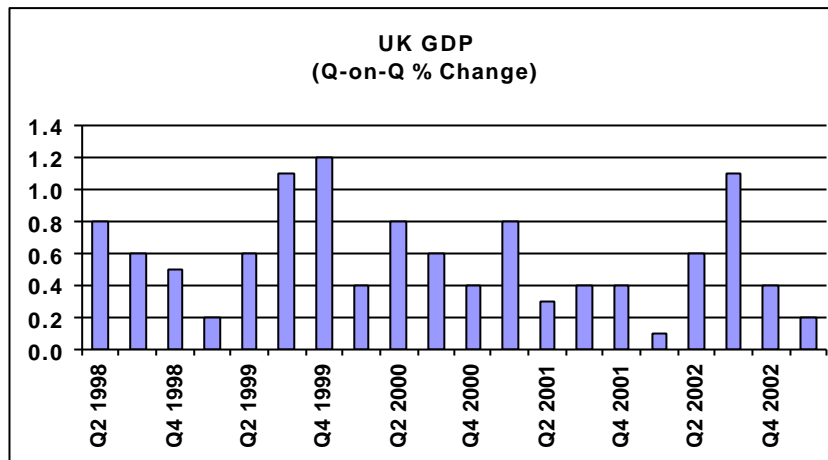


UK Growth Disappoints in Q1



The UK economy grew by just 0.2% in the first three months of 2002. This was below expectations and continued the subdued picture evident in Q4 2002 when growth was 0.4%. On a year-on-year basis, the economy expanded by 2.3%. Construction output growth continued strongly in the first quarter, as it has done for over two years now. Manufacturing output was estimated to have risen, though total production industries output probably fell back as a result of declines in oil and gas and other extraction and energy supply output. Service sector growth of 0.3% was lower than is usually expected.

By all accounts below trend growth has continued into Q2. Consumer spending continues to cool and manufacturing activity is subdued. However, UK macro-economic policy is very stimulatory so the economy looks well placed to take advantage of the global upswing which is expected to commence later in the year. Investment should pick up, given improving corporate balance sheets. Meanwhile, exports should benefit from the weakening of sterling. The continuing strong housing market, stock market recovery and solid real disposable income growth should support household spending. The BoE also continues to pursue a monetary policy directed at bolstering consumer demand.

In addition, UK fiscal policy remains supportive of demand. Despite depressed tax revenues, the Chancellor, in his recent 2003 Budget, chose to avoid raising additional taxes. Rather, he is allowing borrowing to take the strain of providing for the government's increased spending plans. Thus, we expect GDP to rise towards trend later in 2003, with growth averaging some 2.0% for the year as a whole. Growth next year could average around 2.7%.

Nevertheless, today's data boosts the chances of another rate cut from the BoE. Sterling has weakened, while the RPIX rate has picked up to 3%, and is expected to rise even further. However, the MPC may well put more emphasis on continuing weak growth than a temporary spike in inflation. Thus, another 0.25% cut is possible in the UK in the coming months.

Geraldine Concagh
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