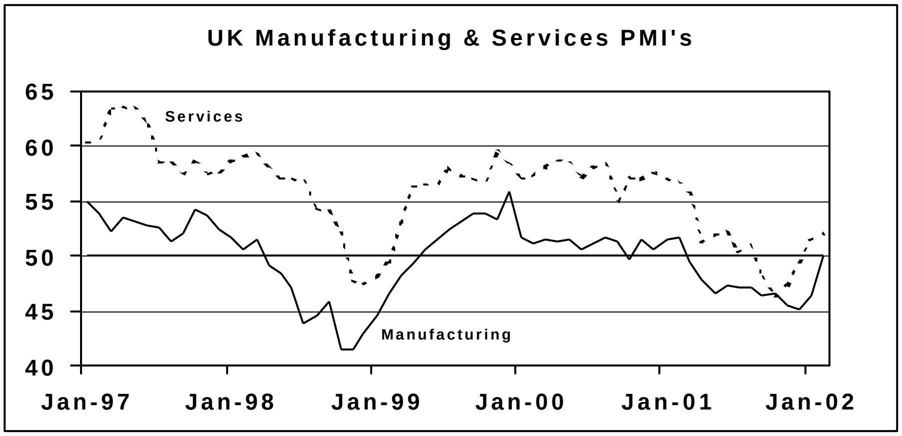
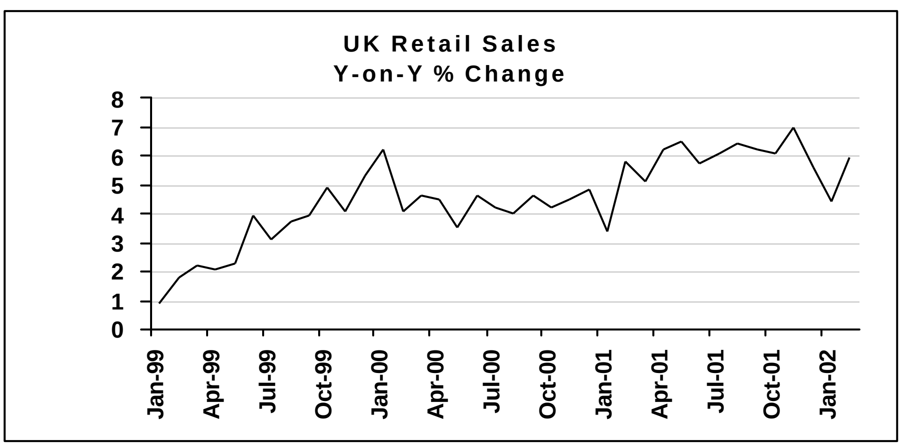
BoE In No Hurry to Hike Rates

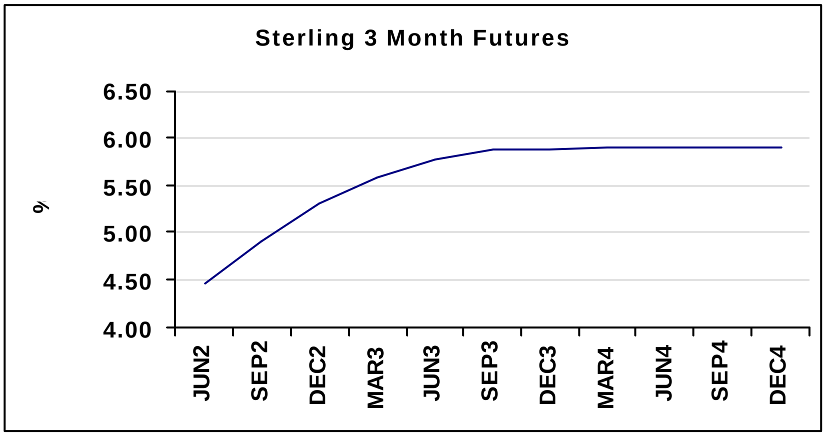
The Bank of England has left interest rates unchanged at 4.0% since November of last year. In easing monetary policy in 2001 the BoE's main objective was to protect the domestic economy from the global downturn. In this regard, data released over the last month indicate that the recovery in the global economy is gaining momentum. In terms of the UK itself, statistics suggest that the economy troughed in the closing months of 2001, with forward looking indicators pointing to a pick up in activity in the months ahead. Both the manufacturing and services PMI's were back above the "50 level" in March and the CBI's February survey signaled improving fortunes for the manufacturing sector for the first time in seven months.



Survey evidence would indicate that consumer demand, which was the mainstay of the economy throughout last year, is not in danger of collapsing. While sales volumes have fallen back somewhat in recent months, and there is a danger of further cooling going forward, demand remains relatively robust. After two months of weak data, stronger than expected retail sales for February indicate that the UK consumer is still alive and well and spending. The strength of consumer demand continues to buoy the services sector of the economy.



As economic conditions improve markets have become increasingly aggressive in their outlook for UK interest rates with 3-month futures showing rates at 5.30% (versus current 4.18%) by year end. However, while we agree that rates will most likely be back at their pre-September 11 level by December, there seems little risk of a short-term move in policy. BoE Governor Eddie George has gone out of his way to dampen speculation of rate hikes, repeatedly reassuring markets that last year's easing is unlikely to be reversed anytime soon.



As well as George's comments, the minutes of the last MPC meeting, which resulted in a 9-0 vote in favour of steady policy, also indicate that the BoE is in no hurry to tighten rates. The committee felt overall prospects for the global economy had improved since it last met. These signs of broad-based strength apparently convinced the two 'doves,' Wadhwani and Allsopp, who voted in favour of a rate cut in February, to go with the consensus in March. Looking at the domestic economy, the MPC felt that although there were signs that public consumption may be slowing, it remained in very good health, as evidenced by housing and automobile sales. However, the committee was very relaxed on the inflation outlook.

In its last inflation report the BoE projected that the RPIX (which excludes mortgage interest payments) would bump along at around 2.0% through this year before drifting back to the 2.5% target in 2003. Following the sharp spike upwards in January, which saw the RPIX jump to 2.6% y-o-y from 2.1% in December, underlying inflation fell back below its target rate in February. The RPIX rate declined to 2.2% in February, as sharp rises in seasonal food prices in the previous month unwound. Base effects should aid in keeping the RPIX rate down around 2% in the months ahead, although it could edge higher again later in the year.

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28 March 2002