Weekly Bulletin – 19th March 2007

Last week proved to be a very quiet week with UK and EUR rates little changed, although US rates managed a small reduction. New economic information in the UK was in short supply with only the latest labour market figures to stir up any interest. After the concern shown by the MPC, and Mervyn King in particular, over the danger that inappropriately high wage settlements would lead to second round inflation, January's figures proved to be reassuring. While the headline rate rose from 4.0% to 4.2%, this was entirely due to bonus payments. If one excludes bonuses, average earnings growth actually fell from 3.7% to 3.6%. While the annual pay round still has a couple of months to go, it appears likely that Mervyn will be shown, again, to have been spotting imaginary demons. Our theory for last week being so quiet was down to the hordes not practising their networking abilities at MIPIM being busy pouring money down the throats of the bookmakers at Cheltenham.

This week is likely to see rather more action with the release of several key economic statistics combined with the release of the minutes from the last MPC meeting and what will almost certainly be Gordon Brown's last Budget. To add it bit of overseas influence, the FOMC will also announce the result of its deliberations on monetary policy on Wednesday.

The main economic release of the week is likely to be that of the latest inflation figures tomorrow. After the, very welcome, surprise that the CPI measure fell from 3.0% to 2.7% the previous month, the market is hoping for another small reduction to 2.6% in February's figures, although the headline number, which is influenced by the recent rate increases, is expected to rise to 4.4%. The point about the inflation figures is that they only have another couple of months before they really start to fall . Thereafter, the rise in energy costs that occurred last year, combined with an actual reduction in gas prices will see the CPI measure drop very rapidly. Current projections show most commentators expecting CPI inflation to fall to its 2.0% target level by June, or possibly earlier, and to hit about 1.5% by the end of the year.

If the MPC are going to raise rates again, they need to get on with it as it will be very hard to justify a further rate hike when the targeted inflation measure is in virtual freefall. While they will find all sorts of reasons not to reverse the recent rate hikes when inflation starts to fall down to its target level, some even genuine ones, if the inflation figures announced this week do show a further reduction, and with the knowledge of the reductions to come, the market may start to waver in its belief that another rate hike is a certainty.

Tomorrow also sees the release of the latest money supply figures and public finance data. This bulletin has tipped the money supply figures, having been ignored for a decade or more, to become an increasing influence on monetary policy as they are running at high levels. This month's figures are expected to show a small reduction, but not sufficient for them to cease becoming a concern for any reawakened and budding monetarist on the MPC. The latest government borrowing figures are likely to give the Chancellor a boost in being able to claim that the current deficit is in line with his previous forecasts. Neither of these statistics is likely to have much influence on the market.

Thursday sees the release of the latest consumer spending figures. Last month's data surprised the market when they emerged with a remarkably large monthly fall of 1.8%. With unofficial surveys projecting a rather more healthy picture, the market is expecting a reversal of much of this fall in February. Forecasts range for a monthly increase of between 0.5% and 1.0%. However, it will take a much bigger figure to remove the growing perception that the recent rate increases are having a major impact on consumer spending. Certainly it would appear that retail sales in the first quarter of 2007 will, at best, be flat and would provide another reason for the MPC to stay its hand from any further rate action.

The minutes of this month's MPC meeting are released on Wednesday. Most forecasters are expecting a repeat of the 7 -2 split at the previous meeting with Messrs Sentance and Besley continuing to press for a further rate hike. However, analysts will be concentrating on the contribution of the other members to see what is likely to change them from their current 'wait and see' policy having not had sufficient time to gauge the impact of January's rate hike.

Budgets have become rather boring these days as any new initiative is announced in November. Gordon will probably spend a reasonable amount of time preening himself on the accuracy of his forecasts for both economic growth and government debt as befits a man who confidently expects to move next door within the next few months. We would expect a fairly neutral budget with the inflation-linked rise being applied to the income tax threshold levels and it being recouped by its application to NICs as well as to the normal culprits of alcohol and tobacco. No doubt there will be something there to placate the green, education and health pressure groups.

The FOMC meeting is expected to produce another 'no change' verdict. However, the US debt market is a pretty volatile beast at the moment and the accompanying statement is quite likely to cause the market to move in one direction or the other. While dealers in the UK market have a lot to focus on this week, apart from the length of the Chancellor's speech, it would not come as a surprise if the main influence on UK rates was inherited from the other side of the Atlantic.

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