



## Weekly Bulletin – 4<sup>th</sup> June 2007

The global debt markets continued to see rates drift higher over the course of last week, but it was a fairly muted affair in comparison with some recent movements. For the UK market, the economic messages were unhelpfully conflicting. Mortgage applications showed a larger fall than had been expected, but any encouragement that might have provided was offset by the CBI distributive trades survey.

The latter had been expected, by some, to show a very large fall from the exceptional 44 reading that it managed last month. However, this month's reduction to 31, in comparison with an average of 15 over the past year, hardly indicated that any slowdown in the housing market might be having an impact on consumer spending. This was backed up by the latest GfK consumer confidence survey that showed a positive move from -6 to -2 in May. This is the best reading that has been achieved in the past two years.

With little further information to help them, the MPC meet later this week to decide whether to leave rates on hold or whether to raise them again for a second consecutive month. We rather get the feeling that the market has drawn back from the likelihood of there being a rate increase this month, although some economists are now suggesting a July rate hike. The logic behind this suggestion is that it will give a greater period of time for the MPC to judge whether the recent rate rise has had an impact. It is difficult to see what difference an extra month will make given the Bank of England submission that it takes 12-18 months for a rate change to have a noticeable effect.

We think that this week's decision is likely to be a close run event. Nobody could accuse the MPC of not preparing the market for a further rate rise. They have almost over achieved in this respect with the market trading on the basis that 6.00% base rates are a certainty and are due to be with us before the end of the year. With that in mind, there seems very little point in not raising rates this week and we suspect that Messrs Sentance and Besley will almost certainly vote for this outcome – whether they can convince enough of the Bank of England cabal to join them is more questionable. Meanwhile, there is almost no doubt over the result of the ECB's meeting this week with an almost

unanimity across various surveys of forecasters that the ECB will raise its refinancing rate a further quarter to 4.00%. For a long time the theory was that 4.00% would represent the point at which the ECB would feel it had removed 'monetary accommodation'. The press conference following the meeting will be closely monitored to see if President Trichet provides some support for this theory. However, whether he does or does not, it would seem just as likely that the ECB will decide to go straight through the removal of a weak monetary policy stance to deciding that it needs to tighten policy.

This is particularly likely to be the case if the unemployment figures continue to improve with the result that consumer spending revives in the major economies. While the first indication for eurozone inflation for May remained unchanged at 1.9%, unemployment fell to 7.1%. In Germany, retail sales leapt by 2.6%, being the first sign that the German consumer is recovering from the VAT rise of earlier this year.

While we would not expect Trichet to suggest that the ECB will do anything other than analyse each bit of economic news as it arrives, it would be surprising if he did anything to assuage the markets' belief that another couple of small rises in the refinancing rate are in the pipeline.

This week sees little in the way of new domestic economic data. The BRC retail sales monitor, to be released today, will be analysed to see if it supports last week's CBI survey result, but we doubt if the result will have much influence with most commentators preferring to wait for the release of the official retail sales figures later in the month. The CIPS survey on the service sector is released on Tuesday and is expected to show a small decline in activity levels. However, as these are already at very healthy levels, a small reduction is hardly consequential. Finally, on Friday, the latest manufacturing output and industrial production figures are released. Given the survey evidence, both are expected to reflect the strong market despite the strength of the pound.

A quiet week is in prospect in the lead up to the ECB and, in particular, MPC meetings.

**JCD Rathbone**