

NEW MINERVA REPORT

Cloud Gordon Land

The Labour Party conference appeared to be a strange insight into a parallel universe. Gordon Brown's speech was that of a man claiming to be the new leader of the party. The significant omission from his speech was anything to do with the economy. Next day Tony Blair's speech suggested he is refusing to relinquish power and will be leader for longer than Gordon wants, or indeed needs.

Yes, needs! If Gordon is the heir apparent, he will need Tony to go pretty soon, before the economy comes back to haunt Gordon. In the previous week, Gordon finally admitted that his forecasts for the UK economy were too high, and revised them down from 3-3.5% to 2-2.5%. GDP Growth for the second quarter of 2005 was just 0.5%. If you annualise this, you just get to Gordon's 2%. However, the first quarter saw growth of just 0.3%. Overall the last four quarters of the UK economy have produced GDP growth of 1.5%, which is the weakest since the first quarter of 1993. Unless the second quarter's figures are the beginning of an acceleration in growth, even Gordon's revised figures will prove too optimistic. Retail sales figures in August may give him some comfort, up 0.8%, but these probably reflect a shift of the summer sales into August. Judging from the sounds being heard from the retailers, the consumer is still keeping his hands in his pockets.

Another of Gordon's big boasts has fallen by the wayside, that of productivity. The second quarter productivity rose 0.5%. The annual rate was at its lowest level in 14 years. With both Tony and Gordon telling us how we must be prepared for the winds of change blowing from emerging China and India, these figures make for pretty poor reading. It was only a year ago when we were being told that there had been a positive upward shift in the UK's productivity numbers.

Unfortunately for Gordon, the Bank of England may not be able to come to his aid. The Bank of

England's remit is to create price stability, which is defined as an inflation rate, as measured by the Consumer Price Index (CPI), of 2%. If this rate gets more than 1% either side of this, the Governor of the Bank must write an open letter to the Chancellor explaining why, and what they are going to do about it. You may remember that in June 2000, Gordon changed the measure of inflation from the Retail Price Index (RPI) to CPI. We were told this was to make our inflation more internationally comparable. Cynics thought it was to lower our inflation rate, as CPI excludes many of the housing costs. Well, if the cynics were right, Gordon may well be getting his comeuppance. Last month CPI rose 2.4%, which is the highest rate since this measure was recorded back in June 1997. On the other hand, RPI actually fell to 2.8%. The reason was that housing components not in the CPI, saw a fall in prices. In particular depreciation costs. This represents the amount home owners need to spend to maintain their property, and is calculated using house prices, which rose by less than last year. Both indices are being hit by rising energy costs. This is not likely to fall. In the same way that we expected the US's Federal Reserve to increase interest rates last month, we would not expect the Bank of England to lower rates whilst CPI is rising. The minutes of the last Monetary Policy Committee showed a unanimous vote for leaving rates unchanged.

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Paul Warner
Investment Director
& Editor of the
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