city FOCUS

By **Hugo Duncan**

Red letter day: Bank governor Mervyn King has seen his credibility questioned like never before

No love is lost over inflation

IT MAY have been written on Valentine's Day, but this was no love letter from Mervyn King to George Osborne. Instead it was the 10th 'Dear Chancellor' missive from the Bank of England Governor to explain why inflation is so far out of control.

Published yesterday, it did not make pretty reading, but it could have been so much worse. Inflation on the Consumer Prices Index jumped from 3.7pc in December to 4pc last month – double the 2pc target, the highest since November 2008, but, for once, no more awful than feared.

'Inflation is likely to continue to pick up to somewhere between 4pc and 5pc over the next few months,' wrote King. He said it will 'remain above the target for this year, before falling back in 2012'.

This has been King's line throughout – but his credibility, and that of the Bank, is being questioned like never before.

So what does it mean for interest rates, which have been at emergency lows of 0.5pc since March 2009? It depends on who you ask.

Michael Saunders, an economist at Citigroup, thinks they could go up as early as next month although he reckons May is more likely.

Gerard Lyons at Standard Chartered, opts for February 2012, while Jonathan Loynes at Capital Economics believes the first move will not be until early 2013.

The wide range of views highlights the dilemma facing the Bank's monetary policy committee.

Inflation is worryingly high but the economy is weak, and there is talk of a return of 1970s-style stagflation where prices are soaring but growth is muted. A premature rate rise could snub out the recovery. Waiting too long could trigger a serious inflation problem. The nine-strong MPC is at loggerheads over what to do.

'There is a great deal of uncertainty about the medium-term outlook for inflation,' said King in his letter. 'And I do not wish to conceal that there are real differences of view within the committee.'

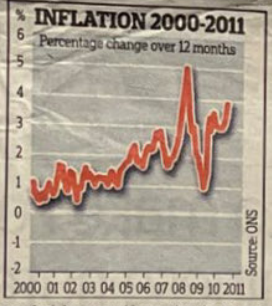
By 'real differences', he probably means 'blazing rows'.

In January, Martin Weale joined arch-hawk Andrew Sentance in voting for rates to rise to 0.75pc. On the other extreme, super-dove Adam Posen wanted to turn the printing presses back on and add to the £200bn of cash pumped into the economy through quantitative easing. Minutes of this month's meeting published next week will show which way the argument is heading, towards the hawks or the doves. King seems clearly on the side of the doves. In his letter he again blamed the inflation spike on 'temporary' factors: the rise in VAT, the drop in sterling in 2007 and 2008, and soaring commodity prices.

King said that an early rate rise 'risks generating undesirable volatility in output' and would 'increase the chances' of inflation falling dangerously low, particularly as the full force of the government's austerity measures have yet to be felt.

But pressure is mounting on the Bank to act, and not everyone on the MPC or in the City of London backs the governor.

Kathleen Brooks, a researcher at currency specialists Forex.com, said: 'The argument is fractious at the Bank. The letter highlights the fact that although King may still be dovish he may be losing the majority of the committee and rates could rise even if King is not in agreement with this course of action.' The



market is expecting rates to go up to 0.75pc in May, 1.25pc by the end of the year and 2.5pc or possibly higher at the end of 2012.

King said that if rates go up in line with market expectations, 'inflation will fall back so that it is about as likely to be above the target as below it two to three years ahead'.

The pound rallied as traders took this to mean that a rate rise was on the way. But Philip Shaw, UK economist at Investec, said: 'Whether we get an outcome that follows what the market is expecting remains to be seen.'

The Bank is likely to strike a similar tone in today's inflation report when it publishes its quarterly forecasts for prices and growth.

It will be pored over for clues as to when rates will rise with every decision between now and May – when the next inflation report is published – on a knife edge.

The May meeting happens to be Sentance's last on the MPC. If his replacement is less hawkish, it could tip the balance back in favour of the doves.

Yell shouts about the digital future

By **Rob Davies**

YELL Group is moving into the digital age.

Out has gone JR Hartley – cult hero of Yellow Pages adverts past – presumably to that great fly fishing lake in the sky.

In comes Day V Lately, the middle-aged DJ who uses his iPhone to track down the 90s dance tune he released in his halcyon days.

Just like its advert stars, Yell is desperately seeking something. Figures for the nine months to the end of 2010 illustrate the crossroads the firm has reached.

The good news is that digital revenue was up 10.4pc to £342m and contributes 25.3pc of total revenue, compared to 20pc last year.

However, its traditional Yellow Pages print edition – by far Yell's largest source of income – is suffering a rapid decline, with revenues down more than 18pc in the period to £936.6m.

Across the group, revenues fell 11.8pc to £1.35bn, while profit before tax was cut in half, from

Hitting the right note: The company's new advert 'stars' Day V Lately

£75.1m to £38.6m. Full-year profits will miss market expectations, the firm said, sparking a 10pc decline in its share price, down 1.01p to 8.89p.

But Yell's new management team, led by chief executive Mike Pocock, are working on a plan to drag the company kicking and screaming into the future. When Pocock arrived in December, he found a company whose operations in the UK, US, Spain and Latin America were split into distinct 'islands' with separate cost bases.

'That model will not work going forward, we need to be more efficient and smarter,' says the American. He wants procurement contracts, IT systems, even the famous adverts, to be coordinated in one place, creating a sleeker operation.

Smartphone users can already download Yell's smartphone app, while Pocock is looking to social networking sites such as Facebook for the next stage of development.

Pocock believes digital will be more than 50pc of Yell's business 'within the next couple of years' and a strategic review this summer will outline his blueprint for Yell's modern incarnation.

But despite the push for modernity, he insists Yell will stay close to what it knows best: local business.

The firm still has relationships with 1.4m small businesses, a network that takes the JR Hartleys of this world a level beyond the global search power of Google.

But whether customers use phones made by Apple or Bakelite, Yell's digital transition needs to outpace the decline of print revenues. Otherwise, investors may let their fingers do the walking.

Calls to fast-track travel firm probe

THOMAS Cook and the Co-op have called for a probe into their High Street travel merger to be fast-tracked to the Competition Commission.

The Office of Fair Trading is expected to send the case to the Commission after three weeks of further deliberation.

But Manny Fontenla-Novoa, chief executive of Thomas Cook (down 2.2p to 192.9p), said an immediate referral would 'provide us with the right answer most quickly'.

The firms say the deal to create a UK market leader with 1,300 shops would not hurt consumers because there is so much choice on the internet.

Tata is steeling itself for future

TATA Steel said third-quarter profit had nearly doubled to £136m.

The Indian firm – which partially mothballed Teesside's Corus plant with the loss of 1,600 jobs – said stronger demand and higher prices in Europe, coupled with rapid growth in its Indian operations, had offset the rising cost of raw materials.

Tata said it is in talks with Rio Tinto to secure supplies of key steel ingredient coking coal from Africa-focused miner Riversdale, after using its 24pc stake to back a £2.4bn bid by Rio for the company.

Micro Focus in a second warning

SHARES in technology company Micro Focus plunged by more than a third after it announced a second profit warning in six months.

Chief executive Nigel Clifford said the company, which provides software for banks, retailers and governments, had lost some large deals in the US during the last three months and it would be unable to make up for the shortfall by the year end. Shares fell 120.6p to 274.4p – much lower than the 407p chairman Kevin Loosemore and his wife pocketed when they sold 200,000 shares for £800,000 in December last year.

Gold strike for pawnbrokers

HEAVY advertising by 'cash for gold' websites has boosted business across the sector, according to pawnbroker Albemarle & Bond.

Britain's biggest pawnbroker, with 148 stores including the Cheque and Pawn and Herbert Brown brands, reported revenues at its gold-buying arm were up 22pc in the six months to the end of December.

Chief executive Barry Stevenson said: 'We have been beneficiaries of all their marketing – it increases awareness. We haven't done any.'

Although revenues at the gold-buying arm increased by 22pc in the half year, group pre-tax profits were down 1pc to £10.7m. Shares were up 7p at 297p.

Profits going stale at Premier Foods

HOVIS maker Premier Foods slipped into the red, posting a £98m annual loss after profits collapsed at ready-meal maker Brookes Avana.

The division which provides own-label posh meals to Marks & Spencer has suffered from rising ingredients costs and shrinking prices.

But the group beat forecasts on trading profits, up £311m for the year to December 31, sending shares up 16pc or 3.65p to 25.75p.

This was an improvement on £309m posted in 2009 as recent disposals brought Premier's debt to below £900m for the first time in five years.