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BUSINESS

Inflation: Lawson sweats it out

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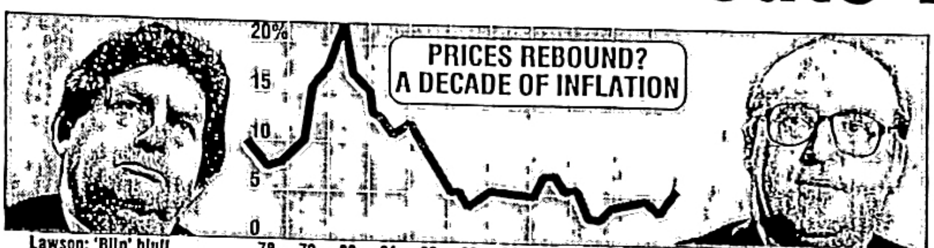

Lawson: 'Blip' bluff

Smith: Tax attack

CHANCELLOR Nigel Lawson faces another tough period in the next 10 days trying to ward off upward pressures on interest rates.

Money supply figures to be published on Tuesday will confirm that the Chancellor's principal monetary indicator, M0, did not peak earlier in the summer as the Treasury had claimed. It is continuing to expand at around 7½ per cent a year — more than double the central rate of the official target range of 1 to 5 per cent.

Overseas trade statistics for Tuesday week are expected to show that the balance of payments deficit for this year on current account is heading for something like four times the £4 billion forecast in the Budget.

Lawson is considered to have scored a tactical victory last week with his pre-emptive strike alerting financial markets to bad inflation figures. When the 5.7 per cent figure for August was announced the market had been well prepared.

But the key three-month interbank interest rate is still pointing to a rise in bank base rates, and announcements by some banks of 13 per cent mortgage rates have already raised fears that base rates will also go up further. Typical of fears in the market was the comment by Dr Gerard Lyons, chief UK economist of SBCI Savory Milln: 'We expect money market rates to continue to firm, with a base rate rise likely following the next appalling set of trade figures on Tuesday week.'

City sources point out that, although Junior Treasury minister Peter Lilley claims the Government has already moved via earlier interest rate rises to contain the deterioration in the inflation prospect, these steps were taken before the latest news of an acceleration in the movement of the retail price index and the index of average earnings.

The Treasury maintains that the mortgage element in the RPI distorts the change and that other countries do not have the same problem. But comparable statistics both for average earnings and consumer prices, excluding mortgage rates, show that the UK inflation rate is now significantly above those of other major industrial nations.

Officials behind the scenes are concerned that Lawson's chosen policy of maintaining that the latest inflation statistics are only a 'blip' may stretch the public's interpretation of the word. Tuesday's monetary statistics will not be distorted by the effects of the postal strike, but the batch to be unveiled in a month's time certainly will. Neither set of figures is likely to help the Government's claim that the market's fears are exaggerated and that the economy is slowing down.

Meanwhile, the Government faces the prospect, even on its own forecasts, of having to unveil 'blippish' inflation figures at least until the new year, when it expects the RPI to turn down.

One City analyst said yesterday: 'The Chancellor is out on a blip. There is going to be lots of bad financial news for quite a long time.'

Lawson will be attending meetings of the top Group of Five and Seven finance ministers in Berlin on Saturday, before the opening of the annual meeting of the World Bank and International Monetary Fund. The general aim of G5-G7 will be to try to have low-key meetings which do not upset the markets, it being acknowledged that nothing substantive can be expected from US economic policy this side of the November presidential election.

■ Shadow Chancellor John Smith said interest rate rises had more than offset the benefit of Budget tax cuts for most people. 'The Government has caused most of the price increases,' he said. 'Constantly rising interest rates have pushed up mortgage rates to a level which exceeds by two or three times any tax cuts ordinary families got in the Budget.'

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