City squawk boxes resound to new scribblers' battle

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A CHEMIST, an engineer and a City economist are marooned on a desert island. They have a tin of baked beans but no can opener. The chemist suggests they heat up the can to such a temperature that it bursts. The engineer suggests they make a spear and throw it at the tin. The economist taps his calculator and says not having a tin opener is in line with market expectations.

Such is the jaundiced view sometimes taken of the City's "teenage scribblers". It is unfair of course — particularly now, when the 50 or so top pundits in the Square Mile are engaged in their liveliest debate for a while. This argument is between economists who believe the late-Nineties world is in a New Paradigm, in which inflation and boom-bust are no longer threats; and traditionalists who believe the business cycle and economic overheating remain big dangers.

A similar debate is going on in the US, but it is particularly topical in Britain where people are trying to envisage how the economy will react to the Clarke-Brown consumer boom and the £36 billion of demutualisation windfalls.

Fans of the New Paradigm in Britain include Roger Bootle at HSBC Markets, Patrick Minford of Liverpool University, Simon Briscoe of Nikko Europe, Andy Cates of UBS, Gerard Lyons of DKB International and Michael Saunders of Salomon Brothers.

They argue that the causes of inflation in the Seventies and Eighties — trade union power, commodity cartels, labour-market rigidities and irresponsible economic policies — have given way to a new world order dominated by fierce competition at home and from emerging economies, technological change, labour-market insecurity, high consumer debt levels and central banks using interest rates to pre-empt inflation.

Therefore despite the mini-boom this year, inflation is not on the march. They say that, having raised base rates to 7%, the Bank of England has done enough to cool the consumer. There should be a safe slowdown in growth to 2.5% or less next year. Interest rates are either at their peak now, or close to it.

The traditionalists include Richard Jeffrey of Charterhouse Bank, James Barty of Deutsche Morgan Grenfell, Adam Cole of HSBC James Capel, Michael Dicks of Lehman Brothers, Ian Amstad of Bankers Trust and Tim Congdon of Lombard Street Research.

They argue that the economy is already overheating, with money supply growth running at nearly 12%, house prices and share prices buoyant and growing skills shortages in the labour market. They say base rates are set to go to 8% or above and that underlying inflation excluding mortgages will rise to between 3.7% and 4% — both by late 1998.

Which is right? The New Paradigm has looked good ever since 1993, with inflation and interest rates both staying in much lower ranges than they inhabited in the Eighties. Base rates averaged 12% over that decade. Since 1993, they have never been lower than 5¼% or above 7%.

However, the business cycle is intrinsic to capitalism. There is a momentum to the confidence of consumers just as with markets. That momentum is hard to check and when the mood does change, it is usually replaced by excessive bearishness. A hard landing for Britain in 1998-99 looks likely, whether or not the Bank manages to prevent the modest inflationary blip that threatens now.