

## Allow sterling to decline *3rd Aug*

From Dr G. Lyons

Sir,—With regard to Samuel Brittan's article of July 30 I think it would be the wrong policy response to allow base rates to rise. The UK economy is not overheating. The outlook for inflation remains favourable. There is no indication that the current excessive expansion of credit or in the money supply figures will feed through into rapid growth in retail prices. Furthermore, it cannot be claimed that producer prices are set to pick up.

Yet, one major problem the UK faces is the fact that the trade deficit is set to grow. This is not, however, due to overheating per se. Rather, this appears to be a structural problem of the UK economy and it is related to the fact that British industry does not produce high quality goods that can satisfy strong consumer-led domestic demand.

As a result, it is the totally wrong policy to claim that the authorities should increase interest rates from their already high level in order, hopefully, to choke off current domestic demand. This is a very short-sighted policy response.

Instead the correct, and sensible, policy response would be to allow sterling to decline. This would provide UK exporters with an improved chance to compete. Furthermore, a background of low government borrowing and declining interest rates should feed this improved outlook for exporters by allowing investment to increase at a sufficiently high level that will improve the medium-term outlook for UK industry.

Interestingly, sterling's necessary depreciation need not be inflationary. With the US economic outlook appearing tenuous, and given the size of the US trade deficit, it is likely that a sterling depreciation would coincide with a further decline in the dollar. As a result, the UK will be able to benefit, for a second successive year, from a non-inflationary depreciation of sterling.

In 1986, sterling's depreciation coincided with a dollar decline, which helped contain imported inflationary pressures, and the benefits to UK industry were clear to see. The opportunity exists to allow such benefits to be repeated this year.

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