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Base rate worries remain

by David Smith, Economics Editor

INDUSTRIAL unrest and the government's mid-term blues will weigh down on sterling this week, maintaining the risk of higher base rates. Initial market relief over the March trade figures has been replaced by other worries.

The prospect of a heavy defeat for the government in Thursday's Vale of Glamorgan by-election and the threat of strikes by dockers, railwaymen, tube workers, engineers, BBC staff and busmen have unsettled foreign holders of sterling. The pound closed at \$1.687 against a strong dollar in New York on Friday, a three-cent fall on the week.

"People are worried that the forthcoming elections are not going to be good for the Conservatives", says Neil MacKinnon, economist at Chase Investment Bank.

Although money-market interest rates have eased, base-rate worries remain. Among big investment houses surveyed by IDEA, the money-market consultants, at the end of last week, 66% expected a rise in base rates by August, while 34% thought the next base rate move would be downwards.

Part of the pound's interest-rate prop has been removed by higher rates overseas, together with signs of slowdown in the economy, which have weakened the domestic arguments for higher base rates.

Gerard Lyons, economist at the Japanese bank DKB, says Japan's discount rate will rise from 2.5% to 3% before the end of May. Strong American employment data on Friday could push US rates higher.

Provisional calculations for M0, Britain's target money measure, suggest it has been within its 1%-5% target range this month, for the first time since early last year.

The Treasury and Bank of England played down the M0 slowdown, saying the seasonally adjusted figures will show faster growth, and stressing that lower interest rates are not on the agenda. Even without the need to keep base rates high because of the pound, the chancellor would want M0 growth to be well within its target range for some time before contemplating rate cuts.

This week's return of Alan Walters as the prime minister's personal economic adviser could, however, make it more difficult for the chancellor to raise rates to protect sterling when the monetary evidence points in the opposite direction. Walters has been dismissive of exchange-rate management in the past, and his views are shared by the prime minister.

Figures from the Treasury this week are expected to show that substantial intervention in support of the pound has continued. The reserves may show an April fall on the scale of the \$1.2 billion drop in March.

A detailed analysis of Britain's trade deficit during the 1980s, published by Greenwell-Montagu today, challenges the Treasury view that the deterioration has been due to a boom in investment.

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