

The Treasurer's Six Wise Men

The Treasurer's 'Six Wise Men', who provide us with the 'What Next' forecasts each month have again been asked to provide their forecasts for 2001. The statistical forecasts can be found in the table underneath. The wise men were also asked some key questions:

- In the light of the continuing poor performance of the euro and Danish referendum, what does this mean for the prospects for UK entry?
- What will the major influences be on the economic conditions in 2001?
- Which will be the best and worst performing sectors?
- Which economies will be the world's winners and losers in 2001?

Their responses are given over the next three pages. ■

		Steven Bell	Roger Bootle	Giles Keating	David Kern	Neil MacKinnon	Jeremy Peat
Forex rates at 31 Dec 2001	€ to £	1.49	1.50	0.60	1.55	1.54	1.51
	¥ to £	155	162	159	159	180	154
	\$ to €	1.00	1.09	0.87	0.96	1.02	0.99
UK annual rate of underlying inflation, by RPI(X) at 31 Dec 2001 (%)		2.3	2.1	2.0	2.2		2.4
Lending rates at 31 Dec 2001 (%)	UK base	6.0	5.5	6.0	5.75	5.50	5.0
	US Federal funds	5.5	6.0	6.5	6.0	5.50	6.25
	Euro-repo	5.25	4.5	4.75	4.75	4.25	5.25
	Japanese discount	0.5	0.5	0.5	0.75	1.00	0.75
10-year yields at 31 Dec 2001 (%)	UK gilts	5.30	4.7	5.10	5.35	5.3	6.3
	US treasury	5.60	5.4	5.55	5.60	5.3	5.6
	Germany bunds	5.0	5.0	4.80	5.40	5.2	5.0
Annual average GDP growth in 2001 (%)	UK	3.0	2.5	2.5	2.4	3.0	2.2
	US	3.5	2.0	4.2	3.0	3.7	3.5
	Germany	3.0	2.5	3.3	2.8	2.9	3.2
	Japan	2.5	1.0	2.0	1.9	2.0	2.0
Stock market forecasts for 31 Dec 2001	FTSE 100	7000	6000	6800	6800	7000	7630
	Dow	12000	8500	–	11300	11500	10400
	Nikkei Index	16800	14000	–	16800	17500	18500



Steven Bell, Global Chief Economist, Deutsche Asset Management

Prospects for UK euro entry

Had the Danes voted 'yes', the Swedes would likely have followed suit. With Greece set to join in January 2001, the UK would have been the only EU member not in Emu. The political pressure on the UK to join would then have been intense.

Nonetheless, it is UK public opinion that will determine when, and if, we join. This has been consistently and significantly opposed to the euro. Sterling entry is, in my view, at least five years away.

Major influences on economic conditions

The critical influences are the performance of the technology sector, the dollar and oil prices. We expect

tech spending to remain firm and the dollar and oil prices to fall. This would generate a very positive background for world markets.

Best and worst performing sectors

We do not believe in picking winning sectors. We focus instead on picking stocks.

World's winners and losers in 2001

2001 will see growth convergence. Japan will continue to recover in 2001 but, similar to the US 10 years ago, is facing headwinds. The US will see slower growth but no recession. Europe will continue to chug along. ■



Roger Bootle, Managing Director, Capital Economics

Prospects for UK euro entry

The prospect of the UK joining the euro in the immediate future was in any case remote, but the Danish referendum has made it more so. The reason is that with Denmark outside, and probably Sweden as well, the UK will not be isolated as the only EU member outside the single currency. Accordingly, the EU will have to make arrangements for two categories of EU membership – members and non-members of the euro. Moreover, this makes it more difficult to sell the argument to the British people that by staying out Britain risks major losses.

Major influences on economic conditions

The main influences in 2001 will be a prospective slowdown in the US economy and the effect this has on still fragile Asia and emerging markets throughout

the world.

Best and worst performing sectors

The worst performing sectors will be of those caught up in the internet frenzy of the year 2000. So-called new economy companies will be losers and many an old economy company may come back into favour.

World's winners and losers in 2001

The United States will be the world's big loser but the knock-on effect around the world may mean many other countries' absolute performance will be worse. Euroland will do relatively well and indeed will begin a period of out-performance over the US. The UK will also hold up remarkably well, helped by a lower exchange rate and lower interest rates. ■



Giles Keating, Global Head of Fixed Income Research, Credit Suisse First Boston

Prospects for UK euro entry

The structural capital outflows that have undermined the Euro now look to be subsiding. So, while there are many influences on any currency, it is not unreasonable to expect the Euro to be trading well above its recent lows by the end of 2001. By then, not only will memories of the Danish referendum have faded, but also the Euro will be about to gain physical reality for the first time as notes and coin due for issue on 1st Jan, 2002.

The impact of all this should cause some rises in public support for the Euro, while leaving it below a majority. A second-term Blair government might then be prepared to take a positive leadership role to try to create a majority in favour. So Euro entry this decade is still a very real possibility, although currently below the 50% probability mark.

Major influences on economic conditions

Oil prices remain critical. If they can settle well below

the \$28 mark, then their recent deflationary impact on the world economy will be reversed and the current economic slowdown should be shallow, and be followed by a good recovery in the second half of 2001. But if prices settle around or above \$30, then the slowdown will be prolonged and deeper.

Best and worst performing sectors

The high yield bond market, depressed in 2000 by credit market uncertainties, economic slowdown and tech sector disenchantment, is set for a strong rebound. Gradual economic recovery and the historically high rates now available will attract a major fund shift back into this market. Meanwhile the largest falls will be

seen in the energy sector, as oil price falls exceed expectations.

The world's winners and losers in 2001

Japan will be the big winner in 2001. Gloom still surrounds this economy and its equity markets, but in reality, although structural problems are not being addressed as fast as is desirable and debt overhang remains, nevertheless there is a gathering recovery and a vibrant tech sector. Lower oil prices would also help. By contrast, the worst performers are likely to be those oil-exporting emerging nations in Latin America, Asia and Africa that have failed to grasp the nettle of reform. ■



David Kern, Consultant Economist

Prospects for UK euro entry

The weak euro and the Danish referendum on 28 September 2000 reinforce hostile UK attitudes towards joining, reduce the prospects of UK entry, and delay further the date of a future referendum. However, the issue will remain at the centre of the economic and political debate. The apparent success of the UK economy outside the euro-zone, in spite of the problems facing manufacturing, strengthen the arguments for delay.

However, remaining permanently outside the euro may make the UK less attractive to international investment, damage the City of London and diminish Britain's political influence. But, if euro-denominated notes and coins can be successfully introduced by mid-2002, euro usage in the UK will inevitably increase.

Major influences on economic conditions

The key influence will be the marked slowdown in economic activity, both global and domestic, which is highly likely next year. This will be driven by a deceleration in US growth (from 5% in 2000 to some 3% in 2001), by the adverse effects of the sharp rise in oil prices, and by the delayed effect of earlier in interest rates. However,

the slowdown in growth will be less pronounced in the UK (from 3% in 2000 to 2.4% in 2001) than in the US, and the adverse effects on UK credit quality will therefore be milder.

Best and worst performing sectors

New economy sectors, particularly those focusing on business-to-business (B2B) e-commerce (computer and related activities, business support services, office equipment, and post and telecommunications) will do well, although volatility and pressure for restructuring will persist.

The worst performing sectors will be in traditional manufacturing – for example, metal and textiles.

The world's winners and losers in 2001

Against the background of a general global slowdown in 2001, the US will be a relative loser, while the euro-zone (although also slowing) and Japan will be relative winners. In the longer term, however, the US will remain more successful than both Japan and the euro-zone. China will be a winner in 2001 and a star performer over the medium term. ■



Neil MacKinnon, Senior Currency Strategist, Merrill Lynch

Prospects for UK euro entry

The UK government's decision on UK membership is clearly political, despite the treasury's attempt to make the decision appear a purely economic/technical decision based on their convergence tests. However, the tests are mainly qualitative in nature and are of little practical use.

As far as the politics are concerned, it looks like it will be a tough, uphill struggle to convince the UK electorate that signing up is a 'good thing', even in the

event of a recovery in the euro. It would probably have to take a recession in the UK economy combined with an obvious sustained recovery in the euroland economies (and in particular a clear reduction in unemployment) to convince the UK electorate that they would be better off joining Emu. But, again, economics might not be enough. As the Danish referendum made clear, there is an inherent suspicion that euroland is simply an undemocratic 'super state' which does not have the UK's interests at heart.

Major influences on economic conditions

Global economic growth has peaked this year in response to previous monetary tightening and the impact of higher oil prices. For 2001, I would expect some relaxation in G7 monetary tightening as well as a move back to lower oil prices (I will be looking for an average oil price of \$25 in 2001). For the US economy, a 'soft landing' is a prospect, with GDP growth proving fairly resilient. A sustained dip below 2% yearly growth rates is unlikely. The Federal Reserve has a good track record of 'fine-tuning' interest rates, therefore ensuring that previous downturns in the US economy are both mild and brief.

Best and worst performing sectors

Equity investors can begin to move away from defen-

sive sectors such as utilities, pharmaceuticals and financials during the early stages of an economic slowdown. During 2001, I expect equity investors to respond positively to a lower interest rate environment and to the prospect of a pick-up in earnings growth later in 2001. In this regard, an increase in risk appetite will possibly lead to increased weightings in the TMT sector.

World's winners and losers in 2001

The first half of 2001 will see all the major economies experience a cyclical slowdown but I again expect the US to lead the way because of its advantage in IT and much more flexible economy. A pick-up in US growth will help Japan (and Asia) where further restructuring is required. ■



Jeremy Peat, Chief Economist, Royal Bank of Scotland

Prospects for UK euro entry

Before the Danish referendum placed a 60% probability on the UK's entry to Emu at about 2003.

But that must now be reduced markedly, given the difficulties a new Labour government would perceive in 'winning' a referendum early after the next election.

Even a delay of, say, two years would make it difficult to complete the process of UK entry, right through to circulation of notes and coins, before the subsequent election.

The euro's continuing weakness has been yet another blow to public perceptions, but it is still feasible to conceive a convergence path for interest and exchange rates.

Influences on economic conditions

The key driver for the global economy in 2001 will be the performance of the US economy.

If, as I expect, a 'soft landing' is achieved, with growth returning to a sustainable rate of about 3% without either accelerating inflation or equity market trauma, then the climate will be set fair for another couple of good years.

In addition, a steady decline in the oil price, towards an equilibrium price about \$15-\$20 per barrel, would aid stability and continuing low interest rates in UK and elsewhere.

Best and worst performing sectors

This could be the year for old faithfuls, rather than exciting new prospects. A re-balancing of exchange rates, with the dollar and sterling falling against the euro and sterling rising slightly against the dollar, could bring some relief for the UK traded sectors. In Europe, anticipation of the arrival of notes and coins on 1 January 2002 should lead to structural shifts and generally strongly performance in a number of sectors – with a variety of winners and losers.

Winners and losers in 2001

Given that US soft landing, most countries, developed and emerging, could be deemed winners next year. The euro-zone should maintain decent growth rates, and even in Japan there are hopes for at least positive trends in GDP. ■