Uncertain way forward

THE CREDIT CRISIS HAS GIVEN WAY TO A DEGREE OF RECOVERY AND A RECENT ACT MIDLANDS REGIONAL GROUP MEETING WAS GIVEN THE TENTATIVE TITLE "SEEKING THE WAY FORWARD". **STEPHEN BASEBY** REPORTS ON THE DEBATE FROM BARCLAYS' OFFICES IN BIRMINGHAM.

The meeting was opened by ACT chief executive Stuart Siddall, who pulled off some fine marketing for the ACT to an audience consisting of the home team and CIMA. Barclays closed the meeting with a review of the development of supplier-side finance, which the bank believes will have its time this side of the Channel.

Sandwiched between them was a presentation from Graham Chaplin, West Midlands agent for the Bank of England, who started by clearly articulating the Bank's role: to protect the value of the currency and to respond to financial instability. The first was met by targeting a 2% consumer price index (CPI) inflation rate; the perceived risk remains for low growth and low inflation despite the UK's current 3.1% CPI.

Keen as the assembled treasurers and accountants were to glean forecasts of interest and foreign exchange rates, Chaplin drew us back to the Bank's need to understand the drivers of inflation, both those which have resulted in the above-target current rate and those which will affect the future forecast rate. Interest rates and foreign exchange rates were put in their place as two drivers of inflation, with the Bank's base rate being a tool for modifying the future course of CPI when other factors are at work rather than being an end in itself.

A recent and novel task for the Bank has been quantitative easing. This is a task so novel that there is no benchmark to measure it against. We don't know how the UK economy would have performed without quantitative easing as we have nothing to draw on for comparison. What Chaplin did ensure we understood is that quantitative easing did not mean that the Bank was printing more banknotes: it was simply exchanging money for gilts. The open question in the future development of the UK economy remains how that money has been used.

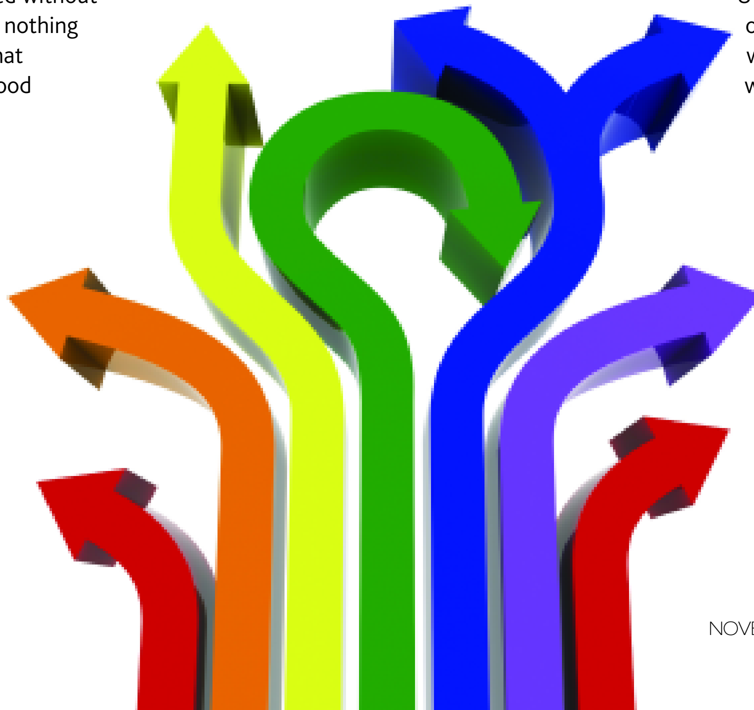
The domestic experience suggests that it is not all going into lending. The statistics show that lending is picking up, but UK corporates' net financing remains low. UK plc has developed the habit of retaining cash and investment remains low after falling more during this recession relative to the recessions of the 1980s and 1990s.

The UK risks a lower pace of recovery than was delivered after those recessions. It cannot be clear if this is a response to the depth and geographic breadth of the current recession. Corporates have fresh memories of the bank market closing; and this time growth in our predominant export market, northern Europe, remains weak.

What we do know is that the price of financial assets has risen. At nearly 4%, 30-year gilt yields are at absolute levels not seen since 2001, although the gathering noted that retail price index (RPI) derivatives show the market view to be 3%+, which locks in a miserly return for banks and pension funds required to hold gilts and has led to negative returns for savers required to hold their risk much further down the yield curve.

Parallel to the rise in bond prices has been a strong rise in equity prices. The day after the conference, the Daily Telegraph noted concerns that quantitative easing money was pushing up equity prices worldwide, supporting Chaplin's comment on the uncertainty of the Bank's forecasting when the effects of direct Bank intervention may emerge 12 months later and in unpredictable ways.

In all it was a stimulating presentation that highlighted not only the unpredictability of the UK's own economy but its reliance on the performance of others. The warning in the numbers is that while the politicians may wish to believe that low interest rates will force us personally and institutionally to spend, that very uncertainty is depressing our appetite for that risk and could emerge as the major risk to the economy.



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