

**There is very little good news around at the moment and, unfortunately, this seems likely to remain the same over the coming months as the outlook for inflation over the rest of 2008 has continued to deteriorate.**

The Monetary Policy Committee left rates at 5% in July and the members probably feel quite restricted as they walk the tightrope between a sharp slowdown in the UK economy and high inflation. There is little else they could have done and it seems that the best policy at the current time is to wait and watch the varying factors which will affect the economy going forward.

During June, the financial markets had begun to believe that interest rate rises might even be on the cards with annual inflation jumping to 3.3% in May and many economists predicting that the peak will be above 4% later in the year, driven by increasing oil and energy prices, rising food prices and, as a result of both, higher pay increases. The latter even forced the Treasury to make a rare public appeal for restraint in pay negotiations. The unceasing rise in oil and other commodities is so threatening that "second tier" effects of inflation are beginning to drip through into prices and wages. A worrying indicator is the 1.3% rise in unit wage costs during the first quarter of 2008 – this is the highest rise since early 2001. All eyes will be turning towards the Bank of England's Quarterly Inflation Report which is due to be released a week after the MPC meeting on the 6<sup>th</sup> and 7<sup>th</sup> August. This will give the Bank the opportunity to reassess the outlook for the growth in prices and may provide the markets with a clue to the direction of rates.

Other economic news in the UK is just as gloomy. The Halifax house price index for June showed

a monthly drop of 2%, down 5.5% over the last quarter, 6.1% since the start of the year and 8.6% down on same time last year. This will not be helped by the continuing effects of the credit crunch with lenders withdrawing mortgage offers from the market, increasing the price of fixed rate mortgages and showing an unwillingness to lend to borrowers with small deposits. The number of mortgage approvals has slumped – approvals have more than halved since their peak at the end of 2006 – and this trend shows no signs of reversing any time soon.

Service sector activity has also weakened to its lowest level since 2001. According to the Chartered Institute of Purchasing and Supply (CIPS) and Markit, the research group, the service index fell from 49.8 in May to 47.1 in June – the worst reading since October 2001. Businesses have reported falling orders and employment. This survey is closely watched by policy makers as a guide to output growth and is now at the kind of levels where the MPC would normally be cutting rates to encourage growth. It also followed some even weaker survey evidence about the manufacturing and construction sectors.

All in all a depressing picture indeed. With the Bank of England powerless to act for the time being, the population will have to get used to feeling a little poorer and a little more miserable!

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*Interest rates valid at time of writing.*