From the London End

Pre-Budget State of the Economy

THE combined impact of the Orpington by-election, Lord Ritchie's strictures on the Government and the declining index of production seems at last to be making a dent in Mr Lloyd's restrictionist policy.

Last week's ½ per cent reduction in the Bank Hate, announced only a fortnight after the Rate was last reduced and with less than three weeks to go for the budget, is an obvious indication that with a General Election not far off. the Government is unlikely to alienate its supporters further with a tough budget.

True, when the latest Bank Rate cut was announced, the only official comment was that this cut had been made because of the continued strength of sterling No reference was made to the domestic situation, but there is little doubt that it has influenced Treasury thinking. It could even be that the latest reduction is a signal that the Government is retreating from its tight monetary policy and moving towards a slightly more expansionist policy. The downturn in the economy has gone much further than was generally expected. This is evidenced by the fall in capital investment, rising rates of unemployment, sluggish rate of industrial growth and disappointing export performance.

The comparatively high interest rates in London have continued to attract a large volume of liquid funds from other countries, and naturally this has provoked growing criticism abroad. One of the reasons for the latest Bank Rate cut is obviously to placate American and European opinion. Although most people had expected a further cut in the Bank Rate, it came much earlier than had been anticipated. Foreign investors had been hurrying to send funds to London to take advantage of the high rates which were still obtainable because they knew a cut was in the offing.

Even with this new cut, money rates in London are still higher than those in other European countries. For example in Germany the discount rate is 3 per cent, in France 3½ per cent, in Belgium 4 per cent and in the U S A 3 per cent. Compared with this, the 5 per cent discount rate in London will still prove attractive to foreign funds. Both in Europe and the U S A lack of confidence in the dollar is widespread and this has increased the comparative attractiveness of sterling at the high interest rates available.

Production at Lowest

In spite of repeated predictions from the Treasury that a rise in production was imminent, the latest figures show that far from rising, the production index has continued to decline. The seasonally adjusted industrial production index for January dropped to 111 (1958= 100). This is its lowest level in 23 months. When the December index was published and showed an apparent one point drop, the Treasury indicated that it was shortly expecting a rise. Therefore, the further one point drop in January is even more disappointing. The seasonally adjust, ed index which stood at 116 in June. July and August dropped to 113 in September and in October, November and December dropped to 112. The Treasury itself believes that the latest figures indicate "'little change"[1] from the fourth quarter level, and the Government still expects that the index will begin to rise. The index of production for manufacturing industries alone which was 112 in the three months from October to December, dropped in January to 110. (The albindus tries index, as opposed to the manufacturing index, also includes mining construction. gas electricity and water. It is known that most of the fuel and power undertakings increased production during January because of colder weather and higher demand.) Textiles were badly hit and steel production was comparatively slack, and the continuing general rundown in stocks probably also had a depressing effect on the index.

Mr Selwyn Lloyd has been predicting an imminent rise in demand and consequently in production since July, but there is still no sign of this, Perhaps he will now admit that his view of the situation was somewhat over-simplified and the problem facing the British economy was not just one of incipient inflation and potential excess demand.

Another factor which may influence the Chancellor of the Exchequer to change his policy is the forthright attack that was recently made by Lord Ritchie, Chairman of the Council of the Stock Exchange, who in an outspoken critique of Government policy said: "I believe that the City has very nearly reached the end of its tether and that its loyalty and willingness to co-operate have almost reached breaking point/' It is true that this particular attack was made with the Chancellor's proposed capital gains tax in mind, and the belief that even though the Government is committed to such a tax, violent criticism and disapproval from the City might help to relax the severity of it. But the sentiments certainly reflect the general dissatisfaction of the City with the way the Conservative Government, has been managing the economy. Many large banks have made it obvious that they too regard the Government as incapable of providing the necessary vigour and leadership that is now required. Recent speeches of City bankers have stressed this point. Barclays Chairman saying that Government policies "all add up to a record of failure in the field of leadership" and the National Provincial Bank appealing to Ministers to "avoid at all costs giving the impression of vacillation".

Before the present Government is able to commit itself to a real policy of relaxation Britain's export performance will have to make a better showing. The recent debate on the economic situation in the House of Commons gave the Opposition an excellent chance to bait the Government on the dismal failure of its policy to expand exports.

Taking all these factors into consideration, the general view appears to he that the Government is beginning to have second thoughts on its restrictionist policy, and although no dramatic changes are expected, at least the budget will not be a tough one, but a neutral one with perhaps a little bit more emphasis on expansion.