

Sterling Weekly

United Kingdom

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Forecasts	3- month henc e	12- month henc e
£/Euro	0.6 4	0.6 7
\$/£	1.6 4	1.6 7
Base Rate	6.2 5	7.0 0
10 Year Yield	6.1 0	6.3 0
Spread vs Bunds	50b p	50b p
2028 Yield		

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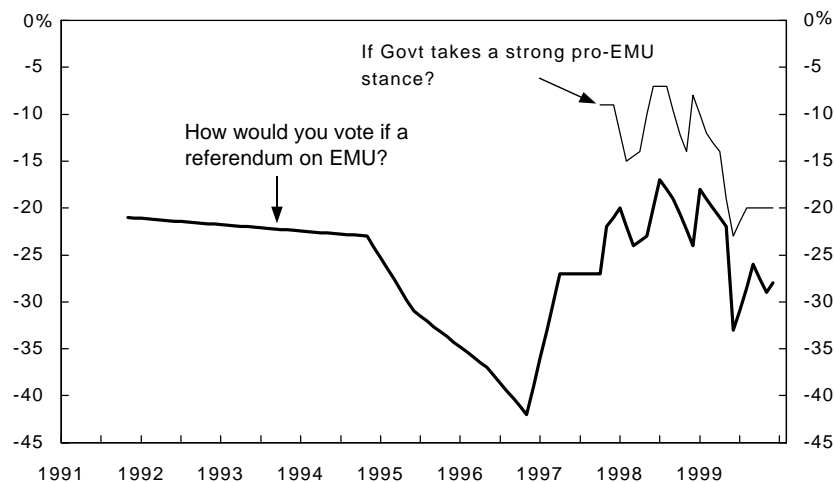
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EMU Timetable Slipping

- Our latest MORI poll suggests that public opinion remains heavily opposed to EMU entry. The balance of opinion against EMU entry is little changed from late 1999, and well above the levels seen in 1998 and early last year.
- It is not hard to see why public opinion has swung against EMU entry. The economy is doing fine outside EMU, and the Labour government is caught in a chicken-and-egg situation -- it is reluctant to give a strong pro-EMU lead while public opinion is against EMU entry, but public opinion probably will not shift unless the government gives a pro-EMU lead.
- We suspect that the government may already have accepted that the timetable for an EMU referendum will slip from "soon after the next general election" to sometime further out. As a rough guess, the chances of EMU entry in the next 6-7 years probably are about 50:50, much later than for other EU countries and on a par with say, Hungary and Estonia.

Figure 1. GB — Balance of Opinion Over EMU, 1991-Jan 00



Note: Full questions shown overleaf. The above chart also uses the results of a June survey by MORI, using the same questions, that was commissioned by the Sunday Telegraph. Sources: MORI Financial Services and Salomon Smith Barney.

It Is Still 2:1 Against

Public opinion remains heavily opposed to EMU entry...

The new year has seen no change in public opinion over EMU. Those opposed to EMU entry still outnumber those in favour of joining by about two to one. Using the question, “*If there were a referendum now on whether Britain should be part of a single European currency, how would you vote?*”, the share that favours EMU entry has risen from 27% in November to 29% now, while the share against EMU has stayed at 56%¹. Thus, the balance of opinion against EMU entry fell slightly to 27% from 29%, but is similar to September’s figure (26%). This compares with a balance against EMU of 19% in January 1998 and 18% in January 1999.

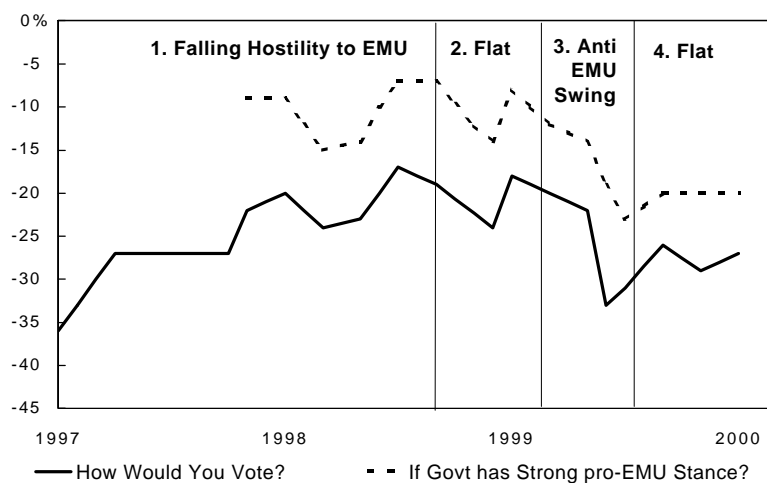
... even allowing for the effects of a pro-EMU stance from the government

The message is similar using question two, which aims to allow for the impact of a pro-EMU stance by the government. Using the question, “*If the government were to strongly urge that Britain should be part of a single European currency, how would you vote?*”, the share in favour of EMU entry rose from 31% in November to 34% now, but the share against rose from 51% to 53%. Thus, the balance of opinion against EMU entry remains at 20%. This is only just below the 23% peak seen in July, and compares with an average balance against EMU of just 13% over the past two years. The 1975 Common Market Referendum suggests that this question is likely to give a closer guide to actual voting behaviour than the “How would you vote” format in question one. But both questions give the same conclusion: public opposition to EMU entry remains high.

Lasting anti-EMU swing in mid-1999

Looking back over recent years, we can see four trends: (1) a general rise in public support for EMU from early 1997 to mid-98, with the balance of opinion against EMU entry falling to 17% (question 1) and 7% (question 2) in July 98; (2) a flattish trend in 1998 and early 1999; (3) a sharp rise in opposition to EMU entry in mid-99; (4) a flattish trend since then, with the balance of opinion against EMU staying much higher than in 1998 and early 1999. The mid-1999 anti-EMU swing initially seemed like a temporary side-effect of the EU elections, when the Conservatives took a strong anti-EMU line and won. In fact, that swing seems to have lasted.

Figure 2. GB – Turning Points in the Balance of Opinion Over EMU, 1997-2000



Sources: MORI Financial Services and Salomon Smith Barney.

¹ See “Uphill Struggle”, *Sterling Weekly*, Salomon Smith Barney, 10 September 1999.

Figure 3. Question 1: "If there were a referendum now on whether Britain should be part of a single European currency, how would you vote?", 1998-Jan 00

	Nov 97-	Monthly Surveys By Survey Date					
	Nov 99 Average	Feb/Mar 99	May 99	Jul 99	Sep 99	Nov 99	Jan 00
In Favour	30%	32%	31%	27%	30%	27%	29%
Against	53	52	53	58	56	56	56
Don't Know	16	15	15	15	14	17	14
Balance	-23%	-20%	-22%	-31%	-26%	-29%	-27%
Balances Among Selected Groups							
Men	-16%	-11	-13	-28	-20	-21	-20
Women	-29	-28	-30	-34	-31	-37	-34
Voting Intention							
Labour	-9%	-6%	-8%	-15%	-9%	-10%	-11%
Conservative	-54	-47	-59	-66	-67	-67	-62
Liberal Democrat	-13	-16	-16	-8	-16	-23	-20
Other/Would Not Vote/Undecided	-25	-24	-18	-37	-24	-30	-29
Social Class							
AB	-6%	1%	-8%	-15%	-15%	-14%	-9%
C1	-22	-16	-22	-35	-24	-29	-27
C2	-31	-34	-29	-37	-31	-32	-37
DE	-30	-29	-26	-36	-31	-38	-34
Age (Years)							
16-24	-15%	-15%	-5%	-20%	-20%	-16%	-16%
25-34	-17	-25	-15	-22	-17	-22	-16
35-44	-19	-8	-17	-28	-17	-22	-30
45-54	-22	-21	-23	-38	-23	-29	-26
55-64	-28	-19	-28	-40	-32	-41	-34
65+	-36	-30	-43	-42	-44	-47	-43
Housing Tenure							
Own With Mortgage	-18%	-12%	-18%	-28%	-24%	-22%	-24%
Own Outright, No Mortgage	-29	-25	-35	-34	-35	-38	-32
Rent	-25	-25	-18	-34	-21	-32	-30
Daily Newspaper Readership							
"Quality Press"	4%	10%	-4%	-7%	5%	-5%	4%
"Popular Press"	-34	-32	-31	-45	-40	-43	-42
None	-20	-19	-32	-26	-19	-24	-24

Note: Latest polling conducted between 13 and 18 January 2000. Sample size 2034 people for latest survey, and similar for earlier results.

Sources: MORI Financial Services and Salomon Smith Barney.

Figure 4. Question 2: "If the government were to strongly urge that Britain should be part of a single European currency, how would you vote?", 1998-Jan 00

	Nov 1997- Nov 99 Average	Monthly Surveys By Survey Date					
		Feb/Mar 99	May 99	July 99	Sep 99	Nov 99	Jan 00
In Favour	36%	37%	36%	32%	33%	31%	34%
Against	49	49	50	54	53	51	53
Don't Know	15	14	14	14	13	17	12
Balance	-13%	-12%	-14%	-23%	-20%	-20%	-20%
Balances By Voting Intentions							
• Labour	4%	7%	3%	-4%	1%	4%	0%
• Conservative	-47	-42	-52	-59	-65	-58	-56
• Liberal	-6	-10	-10	0	-15	-15	-12
Social Class							
AB	3%	7%	-3%	-8%	-13%	-6%	1%
C1	-12	-7	-14	-25	-18	-20	-19
C2	-22	-27	-22	-28	-25	-24	-30
DE	-20	-20	-18	-27	-24	-27	-28
Daily Newspaper Readership							
• "Quality Press"	12%	14%	3%	1%	8%	6%	12%
• "Popular Press"	-25	-24	-23	-37	-34	-33	-33
• None	-9	-10	-12	-17	-12	-15	-16

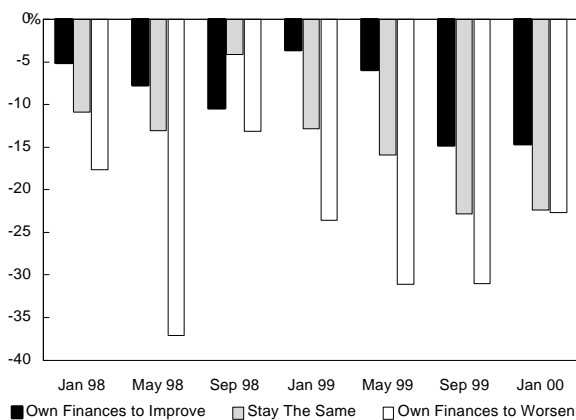
Note: Latest survey was conducted between 13 and 18 January 2000.

Sources: MORI Financial Services and Salomon Smith Barney.

Previous link between economic confidence and attitude to EMU...

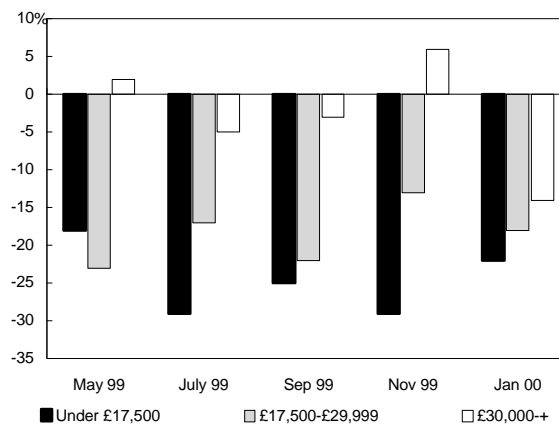
The split shows a breakdown in the prior link between EMU attitudes and optimism about one's own finances. In 1998 and early 1999, support for EMU entry was highest among those who expected their finances to improve over the year ahead. For example, in January 1999, the balance of opinion against EMU entry was 4% (using question 2) among those who expected their finances to improve and 24% among those who expected their finances to worsen. People who were prospering may have felt more comfortable with the idea of change, and the extra competition in job markets that EMU might bring, than those doing badly.

Figure 5. GB -- Balance of Opinion Over EMU (Question 2) Split By Optimism Over Own Financial Position, Jan 98-Jan 00



Sources: MORI Financial Services and Salomon Smith Barney.

Figure 6. B -- Balance of Opinion Over EMU (Question 2) Split By Annual Income Level, May 99-Jan 00



... now seems to be weaker, with drop in EMU support among those who are prospering.

This has now changed. Personal economic optimism has risen a little bit, with the share of people that expects their own finances to improve up from 36% in January 1999 to 39% now. The share that expects their finances to worsen has stayed at 11%. However, the balance of opinion against EMU entry among these optimists has risen from 4% a year ago to 15% now, while that among the economic pessimists has stayed fairly stable (minus 24% a year ago, minus 22% now). People who are prospering outside EMU now see less reason to join. Similarly, support for EMU entry has fallen most sharply among people with above-average incomes (£30,000-plus), and is little changed among those with average and below-average incomes.

This highlights key factors why public opinion has swung against EMU entry.

The case for EMU entry has been weakened by economic boom ...

- The economy is doing fine outside EMU. The pro-EMU camp had argued that the economy might suffer significantly by staying out of EMU. Thus far, there is no clear evidence to support that case. Unemployment is at a 20-year low, inflation is below target, the government is in surplus, we have the longest expansion for at least 40 years, and both consumer confidence and business confidence are well above normal. This is not a question of whether the UK economy converges with the euro area or not. Rather, the issue is “why do we need to join?” Why change an economic setup that is delivering good results?

... while early entry would not bring relief to exporters ...

- Early EMU entry would not help those bits of the economy that are lagging. Some firms advocate early EMU entry as a means of weakening sterling and reviving the lagging export sector. However, if and when the UK joins EMU, the entry level will in practice be close to wherever sterling has been over the previous couple of years – and currently this would mean joining at 61p-64p/€. Other EU countries would not allow the UK government to intervene or cut rates to weaken sterling to achieve a lower entry level. Early entry would mean locking in a strong pound.

... lack of support for EU political integration ...

- The case for joining EMU on political grounds, as a stage towards closer European integration, has little support in the UK. Foreign Secretary Robin Cook has argued that there may be a political cost to staying out of EMU, but the pro-EMU argument is usually presented as one of economics. So when, as now, the economics are not compelling, the pro-EMU camp lacks other arguments to support its case. By contrast, in other EU countries, the case for joining EMU was as much political as economic.

... and weak voice of pro-EMU campaign.

- There is no strong pro-EMU campaign, either from inside or outside the government. The government is very opinion poll-conscious, and thus will not give a strong pro-EMU lead when, as now, public opinion is against joining. Rather, the government now seems to be actively trying to downplay EMU as a political issue. In particular, Blair’s backing for the “Britain in Europe” (BiE) campaign seems to be aimed at neutering the pro-EMU camp rather than promoting EMU. Blair’s offer to lead BiE initially implied that the EMU case at last would get heavyweight backing. Instead, the government has shifted BiE’s focus onto the advantages to the UK of continued EU membership, which is not really a hot political issue. Robin Cook makes the occasional pro-EMU speech. But when was the last time we heard Blair or Brown making strongly pro-EMU statements? The revised National Changeover Plan, due fairly soon, will be a key test of the government’s willingness to promote EMU entry.

*Approach of the election
will make government
more reluctant to take
pro-EMU line . . .*

With the next general election probably about 15 months away, the government probably will become more, not less, reluctant to take a clear pro-EMU line. Labour voters are evenly split between those in favour and those against EMU entry. It is unlikely that Labour can go through an election campaign without making it clear whether it believes that economic conditions will allow an EMU referendum soon after the election. And if the government leaves the door open for a post-election EMU referendum, then the election itself might develop into a vote on EMU. Such a scenario probably is the only way that Labour might lose the next election. The hike in nurses' pay, and Blair's aim of boosting health spending, offer a foretaste of the political pressures from the approach of the election.

*. . . and the government
may already have
accepted that the EMU
timetable is slipping . . .*

We suspect that the government may already have accepted that the timetable for an EMU referendum will slip from "soon after the next election" to sometime later on, and is allowing this decision gradually to emerge over several months. The aim will be to ensure that the government is not accused, either in the UK or by other EU countries, of a U-turn, if and when it formally announces that economic conditions are unlikely to allow an early referendum. The focus on the gains from being in the EU is probably aimed at reassuring inward investors and other EU countries that the UK remains committed to the EU even if it is out of EMU for a while. Last year's anti-EMU swing in public opinion may have been the decisive battle.

*. . . as indicated by
recent official comments*

Recent statements indicate the change in tone. In October 1997 the Chancellor gave a fairly clear pro-EMU line:

"We should therefore begin now to prepare ourselves so that, should we meet the economic tests, we can make a decision to join a successful single currency early in the next Parliament...it is essential that the Government and business prepare intensively during this Parliament, so that Britain will be in a position to join a single currency, should we wish to, early in the next Parliament."²

The recent tone is subtly more cautious:

"It would not be right to have a general election and then immediately on the back of it have a referendum."³

"You know the reason why people are against the single currency and us joining at the minute is probably the same reason I am, which is that the economics aren't right...If we had suddenly to join monetary union tomorrow, we would have a very difficult economic situation as a result of it, because our economy is not in the same cycle as that of France and Germany...What we don't want to do is to repeat the mistakes of the Conservatives in relation to the exchange-rate mechanism where they, in the end, went in basically for reasons of politics at the wrong rate and the wrong time. It is an economic union and what is good for British jobs and British industry and British investment is the test that I will apply."⁴

² Statement to the House of Commons By the Chancellor of the Exchequer, October 1997.

³ Prime Minister's official spokesman, quoted in press on 11 January 2000.

⁴ Excerpts from interview by the Prime Minister on the Frost Programme, 16 January 2000.

Economic Indicators

Tue 25 Jan	RPI (Dec)	Forecast: 0.1% MoM, 1.5% YoY
		Previous: 0.1% MoM, 1.4% YoY
	RPIX (Dec)	Forecast: 0.1% MoM, 2.0% YoY
		Previous: 0.2% MoM, 2.2% YoY
	RPIY (Dec)	Forecast: 0.2% MoM seas adj, 1.7% YoY
		Previous: 0.2% MoM seas adj, 1.7% YoY
	Harmonised CPI (Dec)	Forecast: 1.0% YoY
		Previous: 1.3% YoY

Base effects from a rise in tobacco taxes in December 1998 should allow underlying inflation to fall to a five-year low of 2.0%. However, other base effects – from a cut in mortgage rates a year ago – probably will ensure that the headline rate rises again to the highest rate since April. Core inflation, which excludes mortgages and tax, is likely to be roughly stable. Looking ahead, base effects and rising mortgage rates are likely to cause the headline inflation rate to rise quite sharply in coming months, with a rate of about 2% for January and about 3% in April. This probably will cause household inflation expectations to rise a bit further and, with the labour market already tight, help trigger a rise in wage deals early this year. Underlying inflation probably will stay around 2% for the next few months, perhaps even falling slightly below it for a month or two, but then is likely to head higher around midyear. Tax effects will remain helpful. RPIY inflation already seems to be past its low, having risen from 1.3% in September, and is likely to reach about 2% in March. The key figures to watch in this month's release will be the core services and core goods series. Recent months have seen services inflation worsening, offset by weakness in goods. However, the recent rise in output prices suggests that the inflation rate for goods prices will soon turn up, although perhaps not for a few more months.

BCC Quarterly Economic Survey (Q4)Tue
25 Jan

New Domestic Orders	Forecast: 24/35
(Manufacturing/Services)	Previous: 19/29
New Export Orders (Manufacturing/Services)	Forecast: 18/20
	Previous: 13/15

This survey is likely to show a further broad-based acceleration in economic growth, with improvements in orders for both services and manufacturing industry. Readings in line with our forecast would put service sector orders (both for domestic and export business) back to the peaks seen in 1996-97, with manufacturing export orders at the highest since 1997 and manufacturers' domestic orders at the highest since 1995. This would be consistent with other recent surveys (Dun and Bradstreet, purchasing managers) which have shown a steady strengthening in activity over recent months. Other key readings to watch are those for the share of firms experiencing recruitment difficulties, which probably will rise a bit, and is a useful qualitative guide to labour market strains.

Wed
26 Jan

Retail Sales (Dec)	Forecast: 0.9% MoM, 5.8% YoY
	Previous: 0.3% MoM, 4.1% YoY

Surveys from the CBI and BRC point to strong December retail sales, as does the pickup in narrow money (although distorted by Y2K effects) and reports from a series of individual retailers. We expect retail sales volumes to rise by nearly 1% MoM, which would put the annual gain in volumes at the highest since January 1998. Such a figure would put Q4 volumes up by 1.4% from Q3, similar to the 1.3% QoQ gain in Q3, and consistent with the view that overall Q4 GDP growth remained close to 1% QoQ.

Economic Indicators

Thu 27 Jan	Overall Trade Balance (Nov)	Forecast: £-2.3 bn
		Previous: £-2.3 bn
	Non EU Trade (Dec)	Forecast: £-1.8 bn
		Previous: £-1.9 bn

Figures already have been released showing a drop in the UK's trade deficit with non-EU countries to £1.9 billion in November from £2.1 billion in October. However, we suspect that this will be offset by a slight rise in the deficit with EU countries, after the relatively low £0.2 billion figure recorded for October. Such a figure would suggest that the Q4 trade deficit is on course to total about £7 billion, well up from the £5.9 billion deficit seen for Q3. The deficit is likely to worsen further in coming months due to the mix of the high pound and buoyant domestic demand. Although exports are picking up, helped by the upturn in world trade, imports also are very strong due to the strength of domestic demand.

Thu 27 Jan	CBI Monthly Industrial Trends Survey (Jan)	
	Business Confidence (Jan)	Forecast: 18% Previous (October): 13%
	Pct of Firms With Skilled Labour Shortages (Jan)	Forecast: 12% Previous (October): 11%
	Output Expectations (Jan)	Forecast: 16% Previous (Dec): 14%
	Order Books (Jan)	Forecast: -17% Previous (Dec): -15%
	Price Expectations (Jan)	Forecast: -2% Previous (Dec): -8%
	<p>This survey is likely to show the highest reading for business confidence since early 1994, reflecting both seasonal factors and the underlying improvement in the real economy. Business confidence is quite seasonal, and on average improves by about 5 percentage points between the October and January surveys. We do not expect any further gain on top of that seasonal trend, because the October figure in seasonally adjusted terms already was very strong - and close to the peak seen in 1994. Other recent surveys, such as the purchasing managers' survey and the Dun and Bradstreet reading, suggest that manufacturing remains strong, hence suggesting that the seasonally adjusted confidence figure will remain high. As a result, the share of firms with skilled labour shortages probably will edge up again, to stand in line with its longrun average. Seasonal factors also tend to affect the monthly readings on output, orders and prices, and probably will produce gains in price expectations and output expectations but a slight dip in order books.</p>	
Fri 28 Jan	GDP (Q4, Preliminary)	Forecast: 0.8% QoQ, 2.9% YoY Previous: 0.8% QoQ; 1.9% YoY
	<p>The signs are that the economy continued to grow strongly in Q4, with the annual gain in GDP rising to the highest since end-1997. Partial data suggest that retail sales continued to rise strongly, by more than 1% QoQ, and that industrial production also remained strong. The sharp rise in private housing starts suggests that construction output also was buoyant. The continued drop in unemployment supports the view that growth remained above trend. Such a figure would put growth for 1999 as a whole at 2.0%, and suggest that the consensus view for 2000 (growth of about 3%) looks a bit low.</p>	

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