

Sterling Weekly

United Kingdom

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Forecasts	3- month Henc e	12- month Henc e
£/€	0.6 0	0.6 1
\$/£	1.4 9	1.3 9
Base Rate	5.2 5	5.5 0
10 Year Yield	5.1 5	5.5 5
Spread vs 20b Bunds	p p	35b p
2028 Yield	5.0 0	5.6 5

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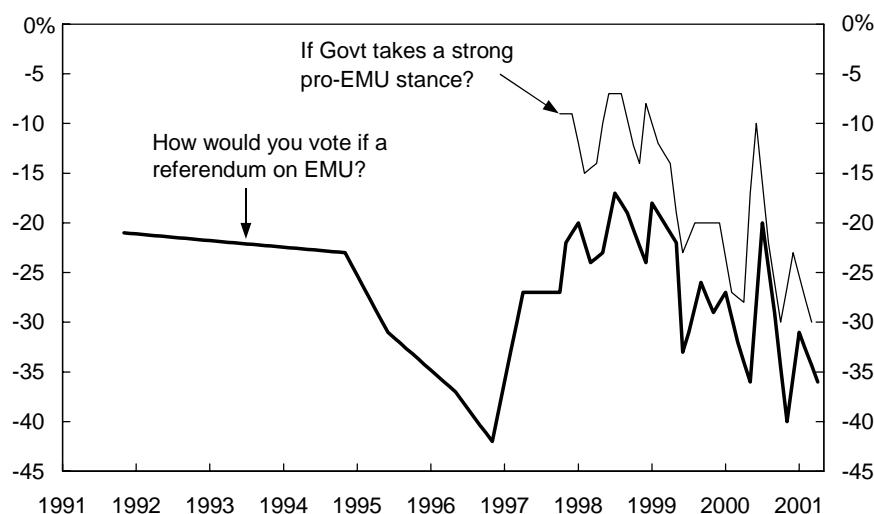
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Early EMU Referendum Looks Unwinnable

- There is rising market speculation that if the government wins the election (as seems likely) it will call an early referendum on EMU. In our view, the chances of such an early referendum are very low. Our latest MORI poll shows a rise in the balance of opinion against EMU close to the previous peaks. Even if we allow for the effect of a strong pro-EMU stance from the government, public opinion is two to one against EMU entry.
- The government has succeeded in downplaying its pro-EMU stance so much that even EMU-opponents are willing to back Labour. As a result, a Labour election victory is unlikely to be seen as a vote for EMU entry or to generate a pro-EMU swing in public opinion.
- We suspect that, if they win the general election, Labour will accept fairly quickly that they could not win an early EMU referendum and as a result they will decide not to call a referendum. In our view, the UK probably will not join EMU in the next five years.

Figure 1. UK – Balance of Opinion Over EMU, 1991-Apr 2001



Note: The chart shows the gap between the share of the sample who say that they would vote to join EMU less the share opposed, using questions 1 and 2. Details inside.
Sources: MORI Financial Services and Schroder Salomon Smith Barney.

Public Opinion is Pro Labour, Anti EMU

The high balance of public opinion against EMU entry suggests that the government is unlikely to risk an EMU referendum soon after the election.

There has been plenty of market speculation and press reports suggesting that if, as seems likely, Labour wins the upcoming general election, then Prime Minister Blair will quickly follow the election victory with a referendum to join EMU. However, our latest MORI poll suggests that public opinion is still roughly two to one against EMU entry, and that opposition to EMU entry has *risen* in recent months. Our guess is that **Labour will win the election but that the high balance of public opinion against EMU entry will (as in the past four years) oblige the government to defer EMU entry further into the future. The chances are that the UK will not join EMU in the next five years.**

Balance of opinion against EMU is close to previous peaks on first question...

As always, we ask two questions on public attitudes to EMU entry. Using the first question, "If there were a referendum now on whether Britain should be part of a single European currency, how would you vote?", the share of people that favour EMU entry has edged down from 26% in January to 25% now, while the share opposed to EMU entry has risen from 57% to 61%. Thus, the balance of opinion against EMU entry has risen from 31% to 36%, well above the 25% average seen since late 1997. **The balance of opinion against EMU entry is only just below the 40% peak seen last November** and not far off the record balances seen in 1996 (37% in May 1996 and 42% in November 1996).

Figure 2. UK – Question 1: "If there were a referendum now on whether Britain should be part of a single European currency, how would you vote?" Nov 97-Apr 2001

	Nov 97- Nov 00 Average	Monthly Surveys By Survey Date							
		Jan 00	Feb/Mar 00	May 00	Jul 00	Sep 00	Nov 00	Jan 01	Apr 01
Whole Sample									
In Favour	29%	29%	26%	25%	31%	27%	22%	26%	25%
Against	54	56	58	60	51	56	62	57	61
Don't Know	16	14	15	14	17	17	16	17	14
Balance	-25%	-27%	-32%	-36%	-20%	-29%	-40%	-31%	-36%
Balances Split By Voting Intention									
• Labour	-10%	-11%	-18%	-18%	2%	3%	-25%	-10%	-14%
• Conservative	-57	-62	-64	-72	-52	-63	-69	-71	-72
• Liberal Democrat	-17	-20	-29	-26	-11	-28	-41	-17	-39
• Other/Would Not Vote/Undecided	-26	-29	-35	-34	-21	-27	-35	-31	-36
Balance Split By Social Class									
• AB	-9%	-9%	-12%	-33%	-5%	-11%	-21%	-25%	-28%
• C1	-24	-27	-28	-30	-16	-33	-43	-27	-32
• C2	-34	-37	-44	-38	-24	-38	-56	-36	-45
• DE	-32	-34	-43	-42	-31	-33	-39	-38	-37

Note: Latest polling conducted between 19 and 23 April 2001. Sample size 2,017 people for latest survey, and similar for earlier results.

Sources: MORI Financial Services and Schroder Salomon Smith Barney.

...and matches previous peaks if we allow for the effect of a pro-EMU stance from the government

The swing against EMU is even sharper using our second question, “*If the government were to strongly urge that Britain should be part of a single European currency, how would you vote?*” Using this question, which aims to allow for the effect that in a referendum, the government would take a clearly pro-EMU stance, the share of the population that favour EMU entry has fallen from 30% in January to 29% now, while the share opposed to EMU entry has risen from 53% to 58%. Thus, the balance of opinion against EMU entry has jumped from 23% to 30%. This matches the peak seen last November, and is markedly above the 16% average of the period since late 1997. **On this question, it is two to one against EMU entry. On the first, it is more than two to one against.**

Figure 3. UK – Question 2: “*If the government were to strongly urge that Britain should be part of a single European currency, how would you vote?*” Nov 1997-Apr 2001

	Nov 1997- Nov 00 Average	Monthly Surveys By Survey Date							
		Jan 00	Feb/Mar 00	May 00	Jul 00	Sep 00	Nov 00	Jan 01	Apr 01
Whole Sample									
In Favour	34%	34%	30%	29%	37%	31%	27%	30%	29%
Against	51	53	56	57	47	53	57	53	58
Don't Know	15	12	14	13	15	16	16	17	12
Balance	-16%	-20%	-27%	-28%	-10%	-22%	-30%	-23%	-30%
Balances By Voting Intentions									
• Labour	3%	0%	-12%	-5%	15%	14%	-8%	4%	-3%
• Conservative	-51	-56	-58	-66	-45	-58	-65	-65	-69
• Liberal Democrat	-10	-12	-25	-22	-1	-25	-32	-12	-32
Balances By Social Class									
• AB	0%	1%	-8%	-25%	4%	-2%	-10%	-14%	-24%
• C1	-15	-19	-23	-23	-5	-25	-29	-21	-25
• C2	-25	-30	-36	-32	-14	-32	-48	-27	-40
• DE	-23	-28	-37	-32	-22	-27	-32	-28	-30

Note: Latest survey was conducted between 19 and 23 April 2001.

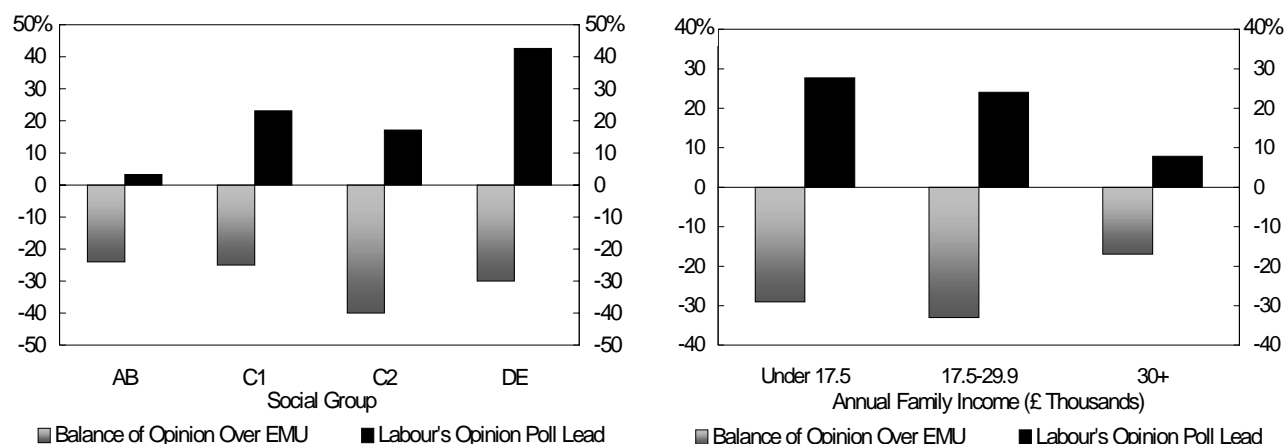
Sources: MORI Financial Services and Schroder Salomon Smith Barney.

Even among Labour voters, slightly more oppose EMU entry than support it

The split shows that opposition to EMU has risen among both Labour and Conservative voters. Our poll (in line with other surveys) also shows that Labour's ratings remain far ahead of the Conservatives. Excluding those who would not vote or are undecided who to vote for, 52% of the population intend to vote Labour (up 2% from January), against 29% for the Conservatives (down 2%)¹. But on both questions, **slightly more Labour voters are against EMU entry than in favour**. There has been a sharp swing against EMU among the relatively small number of Liberal Democrat voters, reversing the trend between November and January.

¹ Note that these figures on voting intentions are not directly comparable to MORI's regular polls, because they include the opinions of 16 and 17 year olds.

Figure 4. UK – Labour's Opinion Poll Lead and Balance of Opinion Over EMU, Split By Social Class (Left) and Annual Household Income (Right), April 2001



Note: The balance of opinion over EMU is measured using question 2. The figures for Labour's opinion poll lead exclude those who would not vote, or do not know which party they would vote for or refused to answer. Sources: MORI Financial Services and Schroder Salomon Smith Barney.

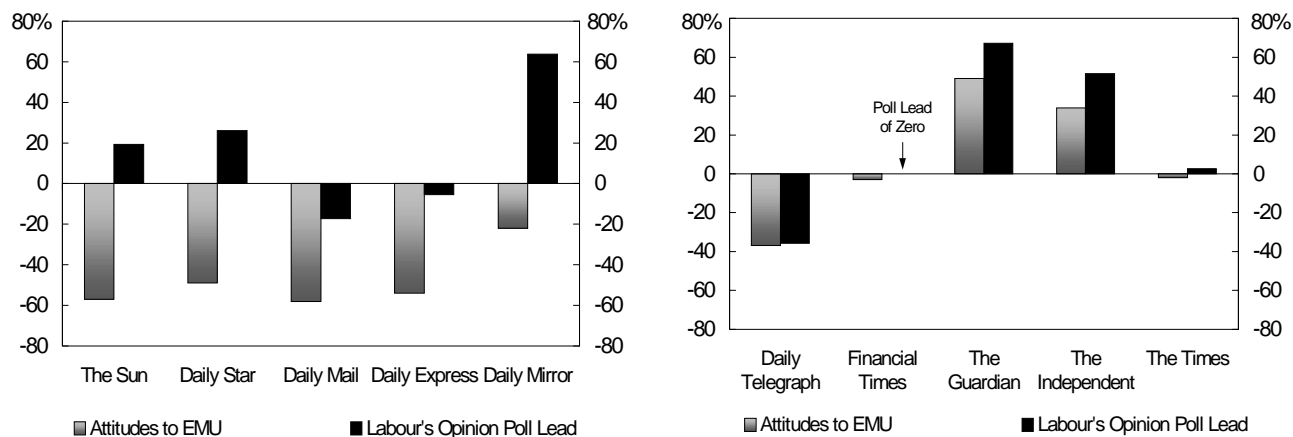
Opposition to EMU entry is high among Labour's core vote...

The split by household incomes and social class (a proxy for incomes) suggests that **Labour has to tread very gently over EMU in order to keep its core support.** There is a sizeable balance against EMU among all social groups and all broad income bands, but the highest balance against EMU is among the lower income C2 and DE groups, and in households with average or below-average incomes. These also are the groups where Labour's opinion poll lead is the highest.

...and especially among readers of the tabloid press, including papers which generally back Labour

The same point is evident looking at the split of voting intentions and attitudes to EMU by newspaper readership. There is a very high balance of opinion against EMU among readers of the top-selling *Sun* (balance is 51%), *Daily Mail* (58%), *Daily Express* (54%) and *Daily Star* (49%). Of these, the *Sun* generally backs Labour in its editorials, while the *Mail* generally backs the Conservatives. Labour has a crucial opinion poll lead among readers of the *Sun* and also the *Star*, but lags among readers of the *Mail* and (slightly) the *Express*. Among the broadsheets, there is more of a link between the paper's political stance and its readers' attitudes to EMU. There is a positive balance in favour of EMU entry among readers of the Labour-backing *Guardian* and *Independent*, but a high balance against EMU among readers of the *Daily Telegraph*, which backs the Conservatives. However, roughly three times as many people (and roughly three times as many Labour voters) read the tabloids rather than the broadsheets.

Figure 5. UK – Balances of Opinion over EMU and Labour's Opinion Poll Lead Split by Daily Newspaper Readership, April 2001



Note: The balance of opinion over EMU is measured using question 2. The figures for Labour's opinion poll lead exclude those who would not vote, or do not know which party they would vote for or refused to answer. Sources: MORI and Schroder Salomon Smith Barney.

The government has succeeded in defusing EMU as an election issue.

In practice, the government has clearly **put winning the election as its top priority rather than trying to shift public opinion in favour of EMU**. As an election winning strategy, this appears to have succeeded. Labour has downplayed its support for EMU so much that many people who oppose EMU entry also say that they will vote for Labour. However, it follows that a Labour election victory is unlikely to be seen as an endorsement to join EMU, or to generate a spontaneous pro-EMU shift in public opinion.

The case for an early referendum is put in terms of Blair's desire to achieve a lasting political legacy...

The view that Blair will go for an early referendum is sometimes put in terms of his apparent desire to achieve a lasting political legacy, before opting to retire midway through the next parliament and make way for Gordon Brown to become Prime Minister. Some people argue that Blair has little personal political achievement to his name. He has not put the UK at the heart of Europe, and peace in Northern Ireland is fragile. The government's economic and social achievements — low inflation, low unemployment, a budget surplus, the "New Deal" for youth unemployed, the minimum wage, and plans to boost spending on health, pensions and education — are (it is argued) more the responsibility of Chancellor Gordon Brown than Blair. Hence, the argument goes, Blair will join EMU to ensure his place in history.

...but Blair's legacy has been to make Labour electable

In our view, this argument both understates Blair's political achievements, and overstates his political magic. Blair's main political achievement is to show that a moderate left-of-centre government can be politically popular in the UK. Previous Labour leaders had plenty of policies, but were unable to gain or retain power. None of the four previous Labour governments was in power for more than six

consecutive years. Labour was in power for just 19 of its first 97 years, between its creation in 1900 and Blair's first election victory in 1997. Blair is now on the verge of securing a second election victory that, all opinion polls suggest, will be easily big enough to allow a full second four- to five-year term in government. That alone is enough to give Blair a high place in Labour's pantheon of political stars.

The government probably would be unable to shift public opinion enough to allow the government to win an early referendum...

Moreover, in our view, it is simply unrealistic to think that Blair could change public opinion over EMU fairly quickly. Blair's political success has come from ensuring that Labour is close to public opinion, rather than trying to shift public opinion to Labour's views. A strong pro-EMU stance from the government would sway some people, but (as indicated by our second question) probably would not be enough to win a referendum on its own. The Danes voted against EMU entry even though all main political parties and business groups favoured entry. The UK is unlikely to have such a political consensus in favour of entry, and has a much higher hurdle to overcome in terms of public hostility to the general aim of European integration. There has never been a poll showing a balance of opinion in favour of the UK joining EMU, and the share of people that are undecided is fairly low and stable (around 15% of the population). This suggests that opposition to EMU has considerable depth, and is not hugely volatile.

...and an early referendum would be very costly in political terms

A defeat in an EMU referendum — with the Conservatives leading the 'No' campaign — would damage the government severely. The government's reputation for economic competence might be lost, in the same way that sterling's ERM exit inflicted a lasting wound on the 1992-97 Conservative government. If Blair calls an EMU referendum and loses it, then his legacy may be as the person who gave the Conservatives a political lifeline and threw away Labour's best ever chance of staying in power for a long period of time.

The government's success at managing the economy outside EMU makes it harder to find reasons to join

In our view, public opinion is unlikely to favour EMU entry unless there is: (1) a strong pro-EMU lead from the government over several years; (2) clear signs that the euro-area economies are outperforming the UK; and (3) reason to think that the UK could share those gains by joining EMU. In a general sense, the UK economy is doing fine outside EMU, with low unemployment, low inflation, budget surplus and high consumer confidence. Some sectors are suffering (manufacturing, farming), but these sectors also are not doing very well in euro-area countries. The government's success in achieving reasonable economic stability outside EMU makes it hard to argue that the UK is losing out by staying outside EMU. **We doubt that the UK economy will underperform its euro-area neighbours in a general sense in the next few years. With this backdrop, it will be very hard to win an EMU vote.**

We suspect that Labour will conclude that an early referendum could not be won...

Thus, our guess is that Labour will win the election but conclude fairly soon post-election that an EMU referendum cannot be won, and thus will not call one. Of course, the government will not put it like that. Rather, they will probably delay their assessment of the five, rather vague, economic tests, and eventually

conclude that the tests are not met. The government may try to signal that its commitment to the long-term aim of joining EMU by concluding that the UK is becoming more convergent with the euro area, but is not yet convergent enough. Nevertheless, the effect will be to put off EMU entry again.

*...and hence EMU entry
will be deferred for
another five years at
least*

If EMU entry is postponed beyond the first couple of years of the next government, then it probably will be postponed for the full four- or five-year term. The government's National Changeover Plan estimated that the full process from a decision to join EMU to the final introduction of notes and coin would probably take about three years. If the balance of opinion over EMU is small, then the government would not want to join in the second half of the next parliament (ie after 2003) because of the risk that EMU entry would be incomplete at the subsequent election (probably in 2005 or 2006). Otherwise, the Conservatives would try to turn the 2005/06 election into a second EMU referendum which, if the Conservatives win, would result in the UK reversing its unfinished decision to join EMU. Either way, we shall continue to report the swings in public opinion.

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Economic Indicators

Mon **M0 (Apr)** **Forecast: 0.3% MoM, 8.1% YoY**
 30 Apr **Previous: 0.3% MoM, 8.3% YoY**

Partial data suggest that narrow money growth slowed slightly in April, with the lowest monthly gains since last November (also 0.3%). Nevertheless, with the annual rate likely to remain around 8%, we would not regard narrow money growth as weak in a major way, and such a pace of narrow money growth still is consistent with fairly strong growth in consumer spending.

Tue **Purchasing Managers' Index (Apr)** **Forecast: 49.0**
 1 May **Previous: 49.7**

The March survey showed a sharp drop in new orders, which dragged down the overall index very sharply. We expect a further drop in April, albeit less sharp than that seen in March. The external environment continued to worsen, while the disruption from the foot-and-mouth crisis probably also worsened. The prices component slipped sharply in March and, at 52.0, was the lowest for 20 months. However, with gains in food prices and oil prices, the prices index probably will not weaken further in April and may actually pick up slightly.

Wed **Personal Borrowing (Mar)** **Forecast: £4.7 billion MoM, 8.8% YoY**
 2 May **Previous: £4.7 billion MoM, 9.0% YoY**
Mortgage Lending (Mar) **Forecast: £3.7 billion MoM, 8.2% YoY**
Previous: £3.7 billion MoM, 8.3% YoY
Consumer Credit (Mar) **Forecast: £1.0 billion MoM, 11.4% YoY**
Previous: £1.1 billion MoM, 11.8% YoY
Mortgage Commitments (Mar) **Forecast: £11.0 billion MoM, 6.5% YoY**
Previous: £11.0 billion MoM, 14.5% YoY

Personal borrowing growth has levelled off at a high pace recently and base effects from the exceptionally strong March 2000 reading may cause the annual rate to edge lower in March this year. Nevertheless, we would not regard this as a genuine sign of weakness in consumer spending. Personal borrowing growth of 8%-9% year on year, at a time when inflation is about 2%, amounts to very strong real-term gains that are enough to support robust consumer spending. Moreover, personal after-tax incomes are accelerating, which should allow consumer spending to remain strong even if the savings rate edges up a bit. Mortgage commitments recently have risen well above year-ago levels and, with the RICS survey suggesting that housing activity is picking up, we expect that commitments will remain higher than a year ago. This would add to the general message from economic data that consumer spending will stay fairly strong.

Wed **CBI Retail Survey – Balance Reporting Sales** **Forecast: 25%**
 2 May **Up Year on Year (Apr)** **Previous: 30%**

Partial data from retailer John Lewis, plus the slowdown in notes and coin in circulation in recent weeks, suggest that retail sales growth slowed a bit in April, and hence we expect the balance of retailers reporting sales up on a year ago to slip to its lowest since last December. The poor weather may have been a factor, with unusually cold temperatures hitting sales of spring and summer clothing, while retailers also may have suffered from the disruption to tourism caused by the foot-and-mouth crisis. Nevertheless, such a reading would not be weak in a major way, but would be similar to the average of the past five years. Over that period, retail sales volumes have risen at an average of 3.8% year on year and real consumer spending has risen at an average of 4.0% year on year. The MPC has been expecting spending to slow to well below that recent pace this year, and thus the survey would have to weaken by much more than we expect in order to be consistent with their view.

Thu **Services PMI (Apr)** **Forecast: 55.5**
 3 May **Previous: 56.3**

The March survey showed a modest dip in service sector activity, with some damage from the external slowdown and the foot-and-mouth crisis. We expect those pressures to cause a further modest drop in activity in the April survey, although this would still be well above the levels seen in the 1998/9 slowdown, when this index troughed at 47.4. Prices

have weakened markedly in recent months, but probably will not slow much further in coming months because of cost pressures from pay and oil.

Thu
10 May

Industrial Production (Mar)

Forecast: 0.4% MoM, 0.9% Three Months YoY

Previous: -0.3% MoM, 0.9% Three Months YoY

Manufacturing Output (Mar)

Forecast: 0.1% MoM, 1.4% Three Months YoY

Previous: 0.1% MoM, 1.6% Three Months YoY

The February data showed a sharp drop in industrial production, because of another sharp drop in output of the energy sector. Output of the mining and quarrying sector (which includes oil and gas production) has fallen sharply in recent months, dragging down overall industrial production. Swings in energy output are volatile, but at some point output is likely to rebound again. Our forecast allows for output of the mining and quarrying sector to regain between a third and a half of the ground lost since Q3 last year, hence lifting industrial production ahead of the sluggish trend in manufacturing output. It must be stressed, however, that the forecast for the energy-producing sector is a very rough estimate, and there is scope for surprises on either side. Even with such a rebound, however, our forecast would leave first-quarter industrial production down by 0.4% quarter on quarter after a 0.6% drop in Q4.

Economic Calendar, 23 Apr - 11 May 2001

Monday	Tuesday	Wednesday	Thursday	Friday
23 M4 (Mar) Mar 0.7% (8.4%) M4 Lending (Mar) Mar £8.9B (10.5%) Public Sector Net Requirement (Mar) Mar01 £6.7B (£-) Public Sector Net Borrowing (Mar) Mar01 £3.1B (£-) Overall Trade Feb £-2.3B Non-EU Trade Mar £-2.6B	24	25 CBI Qrtly Industrial (Apr, 11:00) Industrial Jan -3% Apr -29% Output Expectations Mar 3% Apr -2% Order Books (Apr) Mar -23% Apr -26% Price Expectations Mar -14% Apr -13%	26 ECB Council Meeting IMF/World Bank Spring Meetings (Washington, Apr)	27 GDP (Q1, Q4-00 0.4% QoQ Q1-01 0.3% QoQ) <i>This Weekend:</i> G7 Finance Central Bankers' (Washington, Apr)
30 M0 (Apr) Mar 0.3% (8.3%) AprE 0.3% (8.1%)	1 Purchasing Index (Apr) Mar 49.7 AprE 49.0 Holiday in many European Countries	2 Personal Borrowing Feb £4.7B (9.0%) MarE £4.7B (8.8%) Mortgage Lending Feb £3.7B (8.3%) MarE £3.7B (8.2%) Consumer Credit Feb £1.1B (11.8%) MarE £1.0B (11.4%) Mortgage Commitments Feb £11.0B (14.5%) MarE £11.0B (6.5%) CBI Retail Survey: Sales (Apr, 11:00) Mar 30% YoY AprE 25% YoY	3 Services PMI (Apr) Mar 56.3 AprE 55.5 OECD releases Economic Outlook	4
7 Bank Holiday ECOFIN Meeting	8	9 BoE MPC Meeting	10 Industrial Feb -0.3% (0.9% 3M) MarE 0.4% (0.9% 3M) Manufacturing Feb 0.1% (1.6% 3M) MarE 0.1% (1.4% 3M) BoE MPC Meeting Outcome at Noon ECB Council Meeting (Press Conference)	11

E Schroder Salomon Smith Barney estimate. P Provisional. R Revised.

Note: All data are month-to-month percentage changes, except those in parentheses, which are year-to-year changes.
All data are released at 9.30 a.m., except those marked otherwise.