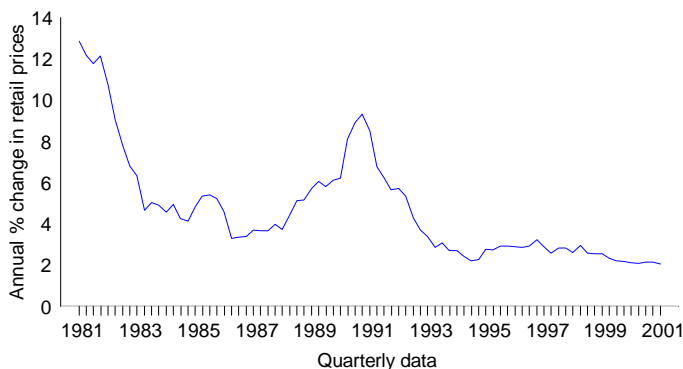


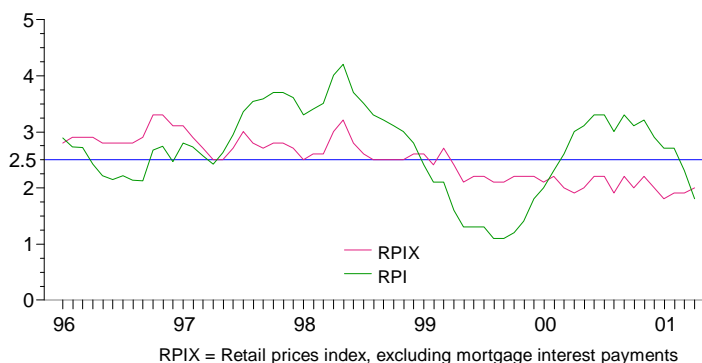
Inflation remains steady but trade gap hits new high

RETAIL PRICE INFLATION SINCE 1981



TWO YEARS OF INFLATION BELOW TARGET

Percentage increase in price on a year earlier



The annual rate of retail price inflation measured by retail prices excluding mortgage interest payments, edged higher to 2.0% in April. Much of the increase in prices last month can be traced to food.

The average price of food increased by one per cent during April—some of which is attributable to the temporary impact of foot and mouth disease.

A gentle pick up in underlying inflation reduces the chances of the Governor of the Bank of England having to hone his letter-writing skills though a letter to the Chancellor explaining the background to an inflation under-shoot.

It is worth stating that RPIX inflation has now been underneath the government's target measure for the last two years. The UK economy has experienced nearly a decade of relatively low and stable price and cost inflation.

Our relative inflation performance has improved and there is little significant risk of a return to the high and volatile inflation witnessed in the 1970s and 1980s.

WEB SITES ON INFLATION

Bank of England
www.bankofengland.co.uk

Office of National Statistics

HM Treasury Economic Databank

Tutor2u Economics www.tutor2u.net
Tutor2u Economics is a resource for students and teachers. There are hundreds of pages of revision notes, links and a Discussion Forum.

END TO DRUGS PRICE FIXING

Proprietary Association of Great Britain
www.pagb.org.uk/

Office of Fair Trading
www.offt.gov.uk

Boots
www.boots.co.uk

Alliance Unichem
www.unichem.co.uk

Inflation and Trade Data

From being the sick man of Europe, consumer price inflation in the United Kingdom has fallen to its lowest levels in over twenty years. The chart opposite shows that annual inflation (measured by the harmonised index of consumer prices) in the UK has been persistently below that of the Euro Zone average since late 1999.

HICP inflation in the UK has remained remarkably stable at around 1% for the last fifteen months. The UK's inflation performance against the average for G7 nations has also improved in recent years. This is shown in the second chart on this page.

The subdued nature of inflation in the UK has prompted some economists to argue that there has been a structural shift towards low inflation in recent years.

Inflation Report finds inflation risks are small

In its latest inflation report, the Bank of England projects that RPIX inflation will stay at around 2% throughout the rest of this year before picking up gently towards the official 2.5% target. Their report summary stated that "the risks to growth and inflation remain on the downside" allowing scope to cut nominal interest rates without the fear of a pick up in inflation.

Reasons to be cheerful:

Several factors explain the current weakness of inflation:

Severe competitive pressure in the retail sector:

Goods price inflation fell sharply in April and price deflation remains a reality in many high street retail operations. There is a basic problem of excess capacity in the retail sector reflected in big price discounts for audio visual equipment, clothing and other household items.

Lower petrol prices: The cuts in road fuel duty announced in the March 2001 Budget and relative stability in international oil prices has helped to keep inflation in check

Slowdown in earnings growth and rising productivity:

Despite falling unemployment, pay pressures in the labour market remain under control. And, rising labour productivity is keeping unit labour costs in check.

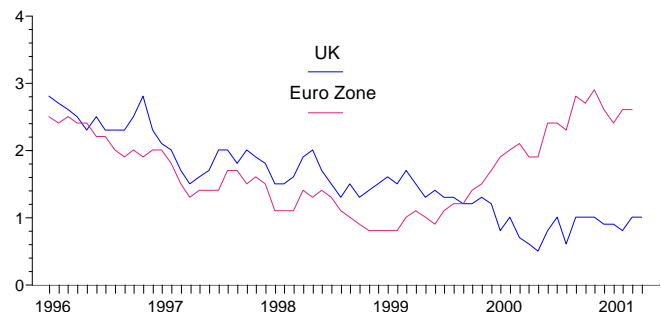
Biggest Trade Gap Since Records Began

This week the UK trade deficit in goods reached a record level. In the first three months of 2001, the balance of trade in goods and services widened to £5.2 billion (£500m higher than in the 4th quarter of 2000). The trade deficit in goods climbed to £7.7 billion in the first quarter of 2001 and if the surplus in oil is excluded, the UK was running a trade gap in goods of £8.9 billion—that is nearly one hundred million pounds per day.

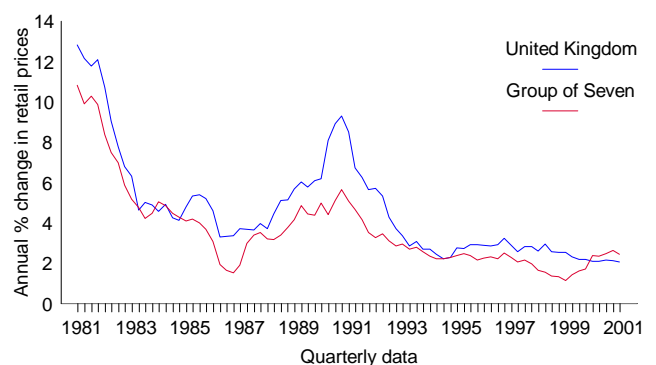
The scale of the trade gap is due in part to the strength of consumer demand and the high exchange rate—without this net outflow of spending from the circular flow, the risk of inflation in the economy would be substantially higher.

BRITISH AND EUROPEAN UNION INFLATION

Annual percentage change in prices

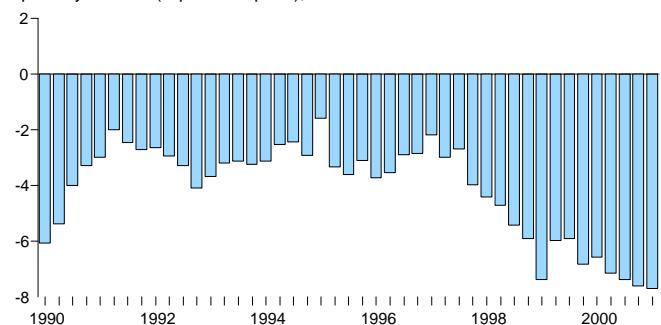


RETAIL PRICE INFLATION SINCE 1981



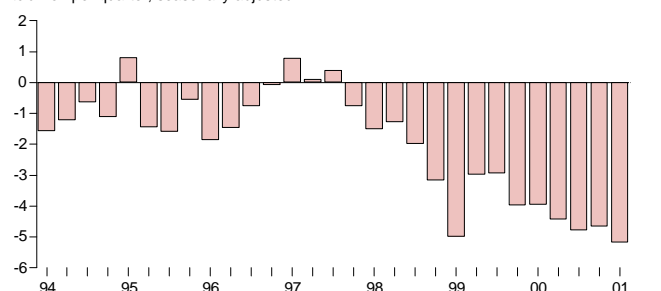
WORST TRADE DEFICIT IN GOODS SINCE 1969

quarterly balance (exports - imports), £ billion



UK TRADE BALANCE IN GOODS AND SERVICES

£ billion per quarter, seasonally adjusted



Source: Balance of Payments Statistics, May 2001

WORLD OIL PRICES STILL EXPECTED TO DECLINE

The surge in crude oil prices during the late summer and early autumn of 2000 appears to have come to an end. The average price of Brent crude oil has fallen from \$35 per barrel in September 2000 to just under \$25 in April 2001. However in the first half of May we have seen a short term rebound in oil prices because of a shortage of gasoline in the United States

Forecasting problems

There is always a degree of uncertainty about the future path of commodity prices such as oil. Consider the broad nature of the market:

Demand growth is strongly linked to the international economic cycle. When output growth in industrialised countries is strong, the demand for crude oil rises since oil is an essential input in so many production processes.

The rate of growth of world output is expected to slow-down during 2001 (not least because of the softer pace of expansion in the United States) - but there are inevitable disagreements between economists as to the scale and duration of a US economic downturn. If the American economy slides into outright recession, this will impact negatively on Asian economies, most of whom are heavy users of crude oil.

Supply Fluctuations

Crude oil supply is also difficult to forecast with accuracy. OPEC controls just over 40% of the world supply (see the pie chart below) and OPEC has put in place stricter production quotas in a bid to stabilise the market price. OPEC decided to cut total production by 1 million barrels per day from the 1st of April on top of a 1.5m barrels per day reduction in February 2001. Total OPEC production now stands at 24.2 million barrels per day. But there are indications that OPEC members have not yet achieved the production cut-backs intended.

Furthermore, the supply of non-OPEC crude oil has grown faster than forecast—partly a supply response to the high prices seen last year which has made it more profitable to extract oil from existing rigs and has also stimulated an increase in investment spending on exploiting new supplies of oil.

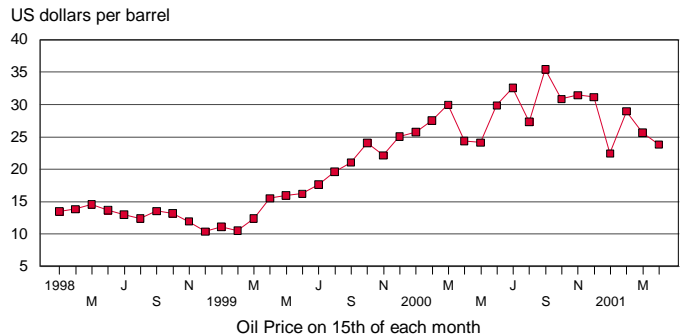
Having fallen by 2.2% in 1999, world crude oil supply expanded by 3.5% in 2000 and is expected to increase by 4.4% during 2001. In contrast, the final demand for oil in the world economy has grown more slowly.

Taken together, a slowdown in the growth of oil demand and a rise in crude oil supply has brought down the market equilibrium price. This is good news for manufacturing industry in the UK - a period of oil price stability will help subdue cost pressures in industry.

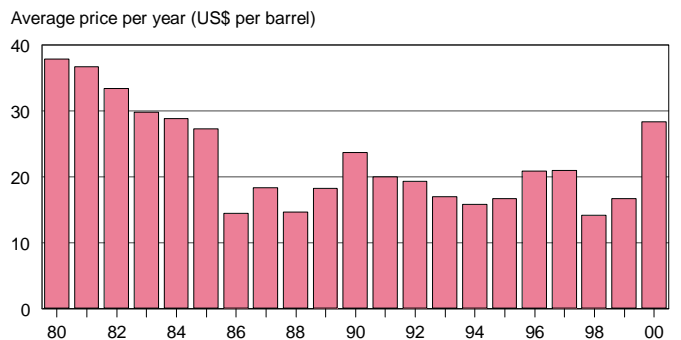
The Bank of England estimates that the prices of basic materials and fuels accounts for around 30% of UK manufacturers' production costs.

Recent Trends in Oil Prices

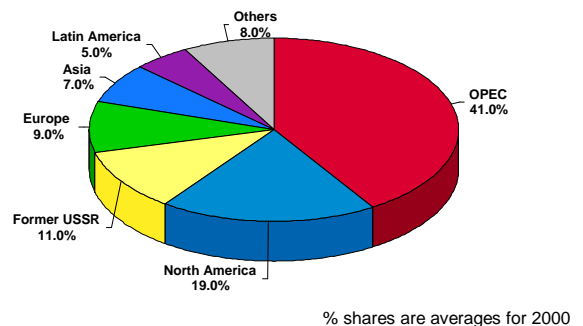
BRENT CRUDE OIL PRICE



AVERAGE PRICE FOR BRENT CRUDE OIL SINCE 1980



SOURCES OF WORLD CRUDE OIL SUPPLY

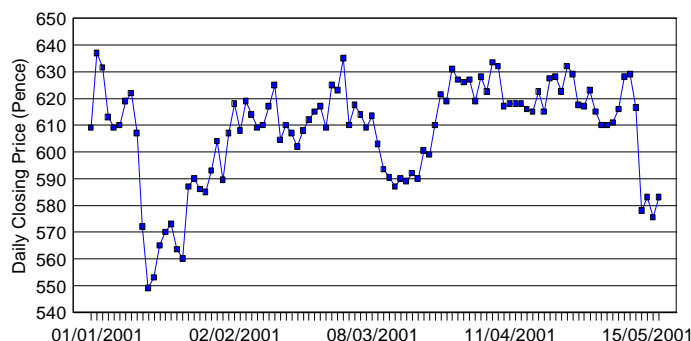


RECENT TRENDS IN WORLD OIL PRICES

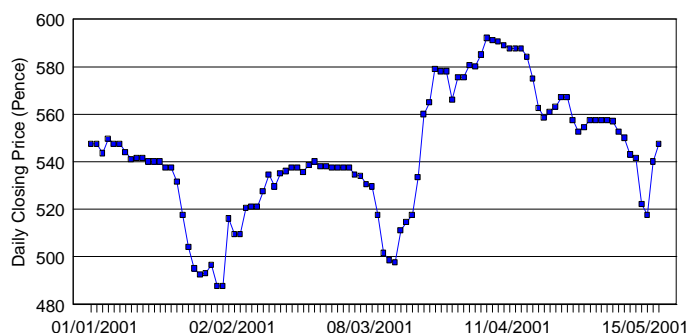
(\$ per barrel)	UK Brent	West Texas Intermediate
1998	14.21	15.74
1999	16.70	18.15
2000	28.33	29.18
April 2001 Latest	23.80	25.60

Over The Counter Pharmaceuticals

BOOT SHARE PRICE DURING 2001



ALLIANCE UNCIHEM SHARE PRICE DURING 2001



PROFITS AND TURNOVER FOR LEADING CHEMISTS

Figures for 2000 £ million unless stated	BOOTS	UNICHEM
Turnover	5,187	6,191
Pre Tax Profits	562	120
Dividend per share (pence)	25.2p	12.8
Market Capitalisation (£ million)	4,851	1,744

Source: Hemscott Corporate Information

RESALE PRICE MAINTENANCE EXPLAINED

In 1964, the Resale Prices Act was introduced to prevent manufacturers deciding the retail prices of their goods. However, due to their special status, medicines were exempted under a mechanism known as Resale Price Maintenance.

This meant that suppliers of over-the-counter medicines may maintain, through their agreements with wholesalers and retailers, minimum prices at which their goods must be sold.

The challenge to Resale Price Maintenance has now been successful—leading to sharp falls in the prices of many branded pharmaceutical products

A decision by the **Restrictive Practices Court** has brought an end to the last legal price fixing agreement in the UK economy - covering the prices of non-prescription medicines by chemists. Resale Price Maintenance is now officially at an end.

The main supermarkets have already acted by slashing the prices of many popular brands including Anadin, Lemsip and Calpol paracetamol. Price discounts have reached 50% on some products and there is every prospect of an aggressive price war in the months to come.

Monopsony Power

Asda, Tesco, Sainsburys and other leading retailers have undoubted monopsony power - they can force down the cost of supplies from manufacturers and then pass some of these gains onto consumers without suffering a sharp fall in profit margins. Indeed the national supermarkets have been at the forefront of the campaign to end the price fixing agreement.

Community Charge?

Will consumers benefit from this decision? The end to over the counter pharmaceutical price fixing inevitably raises the prospect that smaller independent retailers will lose market share and lose financial viability, The Community Pharmacy Action Group has estimated that up to 12,000 independent pharmacies might close down with a particular impact on rural consumers.

Approximately 6% of pharmacists' total sales come from the products covered by the price fixing agreement. 70% of sales come from NHS prescriptions.

The **Office for Fair Trading** has hailed the decision as good news for consumers.

John Vickers, the Director General of Fair Trading, said: "This is excellent news for consumers, who will benefit from lower and more competitive prices for common household medicines. Consumers will save millions of pounds a year."

Boot On The Other Foot?

Shares in Boots, which runs 1,400 chemists fell sharply in the wake of the announcement. Profits are likely to fall if prices are cut and Boots loses market share to the supermarkets - but Boots will probably respond to the introduction of price competition by shifting to retail products with higher profit margins. Share prices in Boots and Alliance Unichem fell heavily in the immediate aftermath of the ruling—although Unichem's share valuation has subsequently improved.

Non-price competition is also important in this market - for example the quality of customer service / advice when dispensing medical products.

The market for over-the-counter drugs and food supplements is worth more than £1.5 billion a year.