What would it take to bring back the "feel good" factor?

BRITAIN'S Chancellor of the Exchequer, Kenneth Clarke, says that voters won't "feel good" before the next general election. This frank assessment has created panic in the Major government, which wants a heightened sense of "feeling good" among the electorate before going to the polls.

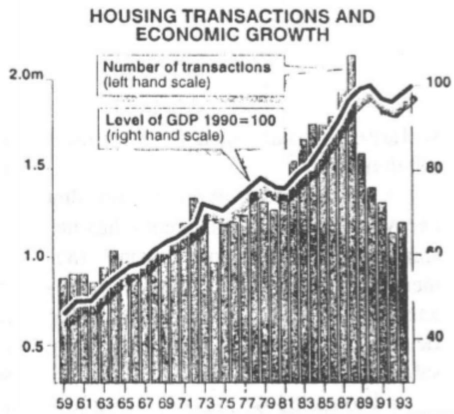
Unfortunately, no-one can agree on what it would take to make consumers feel good enough to go out into the High Streets and spend their money. The government must bear a large part of the blame, for it keeps issuing contradictory assessments of the state of health of the economy.

The government, however, is itself the victim of conventional notions of economics. This is illustrated with policy on the housing market.

* Rising house prices make owners feel richer. This encourages them to spend money. That expenditure then translates into lengthening order books for manufactured goods, which in turn stimulates investment and employment.

* Rising house prices, however, make life tougher for first-time buyers. They also encourage employees to seek higher wages.

The correlation between transactions in the housing market, and economic growth, is tracked in the graph.



Source: Midland Global Markets

THE PROBLEM for policy-makers is that, while the economy needs investment in housing, it does not need the side-effects that apparently cause "overheating".

Because of the confusion in economic debate, families are proving reluctant to borrow money to buy consumer goods. They have been led to believe that static house prices are bad. In fact, stable house prices do not necessarily mean that owners are worse off. In a period of low inflation, the real value of homes may make this asset an attractive investment. And when house prices start to rise - as they will, in some parts of Britain, within the next few years - the economy will actually be creating the conditions for the next slump. The lead will be taken by the south-east. Here are some of the reasons:

* The population of Greater London is projected to rise by about 470,000 betwen 1993 and 2011.

* Britain will receive nearly 1m immigrants over the next 20 years. And during that period, the government predicts that the number of households will grow by over 4 million.

* Speculation has already returned to some areas of the property market, starting with areas like London's Docklands.

PEOPLE ought to feel good about the low rates of inflation.

As savers, the real value of their cash-in-the-bank is not being eroded as fast as it was in the 1970s.

INSIGHT

As borrowers, they are not paying interest rates as high as they were in the 1980s.

But people intuitively distrust the official version of economic performance. Their instincts are correct. For while the Press pundits - many of whom are ready to swallow the official line presented by the government - are claiming that inflation is "licked", the underlying reality is different.

Low inflation today is not the result of a more efficient administration of monetary policy. It is the result of price-slashing by desperate retailers, and cautious wage settlements by employees who are anxious to avoid being made redundant.

Furthermore, dark clouds are gathering on the horizon.

* Pension funds, now paying out more than they are taking in, will reduce the flow of funds onto the stock market.

* Some world prices are rising, which have a serious impact on a trading economy like Britain's.

* The UK economy is about to bump up against bottlenecks in its output capacity, which will encourage a rise in wage costs.

Thus, a new round of price increases is in the offing, and the safest hedge against inflation - once again - will be land. And as speculators move into the land market, they will be magnifying the disruptive trends that lead directly to recession.

Before that happens, however, the economy is in for another round of government-induced turbulence. The illusion of happy times for some people will provoke a response from the government: more short-term "corrective" policies to "damp down" inflation. And so a new round of confused policies will be launched, designed to hold production and employment below their natural rates.