



making business sense

The fog lifts – the economic outlook is becoming much clearer

In December when we produced a forecast we looked at two scenarios. Last week we were happy just to produce a central case forecast. I am sure that we will edge our numbers up and down for the rest of the year. But at least we can now make a forecast without expecting to revise it within weeks.

In fact **there are two reasons why the economic outlook now is clearer**. First, what happened at the end of 2008 and the early months of 2009 was a **huge global inventory cycle**. Companies slashed stocks of finished goods and raw materials, particularly imported products.. This has pulled down the growth rates for the current year – world GDP will probably be down 1-2% and UK GDP by 4% or so. **But the one certain thing about an inventory cycle is that it must come to an end**. When stocks are low enough, the rate of de-stocking declines and even this is enough to boost GDP. In practice it the worldwide inventory position will probably be stable by later this year, boosting world GDP by 2-3%. So growth should restart by year end in most countries.

The other reason why the outlook is now clearer is that **of those things that could go wrong, some have and some haven't**. Notably, **the bank rescue packages around the world are now starting to work and bank lending in the UK is no longer falling** – indeed the supply of mortgages is rising slightly. The 3 monthly inter bank lending rate has fallen from a peak of 6.3% in early October to 1.58% now. This is a result of both a lower Base Rate and also a narrowing of the spread.

Of course, **we are not out of the woods yet. Job losses and squeezes on pay will almost certainly weaken consumer spending for a while yet**.

Our analysis has indicated that, while the depth of the recession will probably be fairly similar in most advanced economies, **what will separate the sheep from the goats will be the pace of the recovery**. Here one would be wrong to get too cheerful too quickly. Even globally, the cost of damaged banks, the increased barriers to risk taking, the impact of increased regulation and the effects of restoring public finances will hold back the recovery. **And in the UK the damage to some of the banks, the knock on effect of the hits to the financial service sector and the long term implications of restoring our catastrophic public finances mean that growth in the recovery phase is likely to be relatively slow by international standards**. World growth of around 3% and UK growth of between 1-2% seem likely for the next few years.

It is a complete coincidence that the G20 should have taken place as a clearer picture of the economic prospects emerges. The so called trillion dollar boost has a negligible impact in the short term and all the other measures agreed at the meeting will do little to stimulate the economy. The mood of confidence has probably helped a bit, boosting stock markets around the world. And the cost of the meeting – even allowing for the traffic disruption – is very small change either way. **President Obama deserves good marks for his flexible approach at his first big multi-lateral summit while the Chinese, who are still in their infancy as economic summit negotiators, deserve plaudits for playing their cards well and incidentally for calling President Sarkozy's bluff. Even Gordon Brown deserves applause for his handling of the summit**, though he rather spoilt the effect by building up expectations excessively in advance and by trying to spin the ultimate agreement as being worth much more than it will be in reality.

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