

# Biggest fall in GDP since 1931 but a dead cat bounce could be seen by the end of the year



making business sense

Leading economics forecaster's projections remain unchanged – UK GDP will contract by around 4.5 per cent this year

cebr's most recent United Kingdom prospects report gave a gloomy assessment of the prospects for the UK economy this year, **predicting that output would decline by around 4.5 per cent in 2009** – the largest single year fall since 1931 when the consequences of the Great Depression were reverberating through the economy. **Today's GDP release showing a 1.9 per cent contraction for the first quarter of this year, along with the plethora of economic data released this week, has not changed this view.**

A particularly steep inventory cycle is evolving – with firms having reduced inventory levels by £4.1 billion in the final quarter of 2008. Firms will continue to run down stocks in 2009 – a key force behind the large decline in gross domestic product. **One potential impact of this is that there may be a 'dead cat bounce' in the fourth quarter of this year, as the inventory cycle turns – one area that the Chancellor may have got right in his forecasts on Wednesday, but almost certainly for the wrong reasons.**

This is a business-led recession; firms have slashed their inventories and are cutting their investment sharply. Weak prospects and difficulty accessing finance from the beleaguered domestic banks and reticent foreign lenders will cause business investment to fall by almost a fifth (19.4 per cent) in 2009. Private sector housing investment is also plummeting, meaning that overall investment will fall by 18.9 per cent in 2009.

Firms are carefully scrutinising their cost base – in February we saw claimant count unemployment increase at the fastest monthly rate since records began in 1971, and March's data, whilst showing a smaller increase in claimant count than expected, confirms the continued weakness of the labour market. We think that overall employment will fall by 3.6 per cent in 2009 and a further 1.9 per cent in 2010. By the time employment starts rising again in 2012, employment could have dropped by 1.8 million.

The other main contribution to the slowdown will be a **fall in real consumer spending through the summer** as unemployment reaches ten per cent by the end of 2009, nominal earnings growth falls to the lowest on record and households rebuild balance sheets through precautionary saving.

**Today's GDP numbers and our forecasts will make grim reading for Chancellor Darling and his Treasury bean-counters.** Their borrowing forecasts of £175 billion for this financial year were based upon a 3.5 per cent contraction for 2009. We think that the real figure will be **at least £190 billion** which will put even more pressure on the public finances over the medium term. Whilst it is perfectly possible that we will see an inventory-led bounce towards the end of this year, **the medium term prospects are surely for an incredibly sluggish recovery, as a combination of fiscal drag, continued major structural problems in the finance sector, a sluggish housing market and more prudent household spending and saving put an incredibly heavy anchor on growth.**

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