

Economic Update: February 2010

Professor Joe Nellis

Andrew Kirchner

Welcome to the latest economic update with Professor Joe Nellis.

Now, Joe, some good news coming out last week; we are technically out of recession, a growth of 0.1 in Quarter Four. What is your reaction?

Joe Nellis

Well, Andrew, you said technically out of recession and that is correct. It is certainly good to see some positive growth. But 0.1 is an estimate, and that estimate is based on 40% of the survey data; so there is a lot more data to be analysed before we get the final estimate. And that 0.1 could be revised upwards or downwards. So it's a very, very small recovery, but it is certainly good news, absolutely.

Andrew Kirchner

What is your forecast for the rest of this year?

Joe Nellis

Well I hate to say it again, but cautious. Given how slow the recovery has been in the fourth quarter, analysts were expecting much more and have begun to downgrade their forecasts for the year as a whole.

So I think, taking a consensus view, we are going to grow somewhere between 1% and 1.25%, which is not that exciting; certainly well below our trend which is more like 2.6%. So it is not going to be a great year, but of course it is hopefully laying a foundation for more solid growth thereafter.

Andrew Kirchner

Joe, a quote that hit the headlines last week, Bill Gross of PIMCO the world's biggest bond fund, said 'the UK is a must to avoid, its gilts are resting on a bed of nitro glycerine, high debt with a potential to devalue its currency present high risks for bond investors'. So he doesn't like the UK economy at all?

Joe Nellis

Well, I wouldn't have used such emotive language, but he does make a very valid point. The level of the national debt is enormous – record level. And of course it is increasing each year by the scale of government borrowing, which this year will be 178 billion, approximately.

He is obviously flagging up the fact that the bond markets are getting nervous about whether or not the UK government could, or would, default on bonds; it won't, by the way. But nevertheless the risk profile is increasing and therefore the cost of capital is going to go up. And at the same time that drives down bond prices.

So he is flagging up a concern, as he should, but I think he is using language that is somewhat too strong given that we are nevertheless a solid economy with a few problems along the way.

Andrew Kirchner

So how should the UK tackle its budget deficit – aggressively or make the cuts much more slowly so as not to endanger the recovery?

Joe Nellis

Well this is going to be the big election issue of course; do we go for the Tories and cut quickly, or do we follow the Labour government view which is cut more gradually and halve the debt let's say over a four year period.

The truth is we are in new waters, new territory. We don't know. I would not be in favour of a quick fix. I can see the attraction of it; take the pain quickly and get over it and then move on. The problem is that the government is such a large sector of the economy that if there is any sharp reduction in government spending in order to pull back the debt levels, coupled with a sharp increase in taxation of the economy, I think that will spell – I won't say disaster, but it will put the brakes on economic recovery and could actually lead to a double dip.

Four years seems quite a long time, of course. I assume the government are thinking more or less the length of a Parliament. I see nothing wrong with that in principle, and on balance I would be a little bit more cautious than the Tories are suggesting and perhaps veer towards the Labour government view.

Andrew Kirchner

UK unemployment dipped a fraction in December – 7,000 to 2.46 million – is it likely to rise anymore?

Joe Nellis

Well, first of all, that dip was a surprise. In economic recoveries we normally expect unemployment to continue rising; it is a lagging variable. So any dip in the context of a recovery of 0.1% was not expected.

Will it rise further? Well, I hope not, but I don't think we are out of the deep waters yet. Remember we have a number of cautionary notes to make. As the year progresses, growth will be very, very modest in my opinion. Therefore unemployment will not fall sharply and if there is a double dip – as we have mentioned already – then unemployment could rise again.

On top of that, of course, the government has already announced a number of cutbacks, for example university funding and that is going to mean a number of students will not get places at university next September. That will have an impact on unemployment figures.

So I do not expect to see a significant fall; on balance I think we could see a reversal and a rise again later this year.

Andrew Kirchner Let's look at the global picture; China is growing very strongly.

Joe Nellis Yes, and of course in some ways that is not unexpected. China is a massive economy with massive spare capacity and as the G7 countries, the big industrialised countries, have recovered – particularly America – so China's exports are growing very strongly. At the same time, their own economy is growing strongly. So they are enjoying the drivers from export growth and domestic spending and they are doing very, very well, thank you.

Andrew Kirchner Is there a chance of Chinese bubble?

Joe Nellis There is; of course there is. With growth of 10% plus, it is inevitable that there is going to be some inflationary pressures. You cannot adjust to the scale of demand that quickly and inflation is probably around about 6%. But, you know, that is not a bad combination. So is it a bubble? I wouldn't regard it as a bubble, yet. There are some years to go before we start getting anxious about China because it has got – as I have said already – massive spare capacity.

Andrew Kirchner Joe, thank you very much for your time this morning.

Joe Nellis Thank you.