**Tullett Prebon Research, a blog by Dr Tim Morgan**

## GDP – time travel and little green men

*by Tim Morgan on July 25, 2012*

Today's truly shocking economic numbers – which showed a 0.7% decrease in gross domestic product (GDP) in the second quarter – may have come as a surprise to the pundits, but the political response has been all too predictable.

Government spokesmen, visibly shell-shocked, have scratched around for mitigating factors. Thus far, possible culprits mentioned have included the Eurozone crisis, the stronger pound, the rain and the extra Bank Holiday, though there has been no attempt – yet, anyway – to blame it on little green men from outer space.
Labour, equally predictably, has repeated the tired mantra about cutting public spending "too far, too fast". Since spending cuts have had little impact thus far, it seems high time that Labour rationalised its economic stance – by finding more rational arguments.

The further sharp fall in construction activity highlighted (for those willing to look) an explanation that we have set out many times before. The essential problem with the British economy is structural.
Ten years of reckless private borrowing built up construction, real estate and finance just as a decade-long surge in public spending boosted health care, education and public administration. Together, these sectors – which depend on now-defunct drivers – account for 59% of the economy. Add in a retailing sector beleaguered by a combination of falling real incomes and excessive household indebtedness, and 70% of the economy is ex-growth. This cannot be fixed with minor tweaks to the system.

Thus seen, politicians' prescriptions amount to a desire for time-travel. 'Why don't we', they seem to say, 'go back in time to the days of high private borrowing, and public spending largesse?' The government wants banks to lend more to households (as well as to businesses). Labour wants to go back to high public spending. Both arguments are futile. What politicians (of all hues) don't want the public to know is that they've already tried almost every policy in the macroeconomic book – including deficit finance, devaluation, near-zero policy rates and printing money – without success. These tools, effective in destocking downturns, simply do not function in a deleveraging recession, which is what we have now.

Britain should examine some of the money-saving moves used in – for example – Spain, but with the critical difference that, instead of simply reducing the deficit, Britain could use savings in current spending to boost capital investment, of which the building of more social housing should be top of the list. Second, when macro has failed, try microeconomic reforms – free up businesses by cutting away at the thickets of excessive regulation.