Tullett Prebon Research, a blog by Dr Tim Morgan

Back to black

by Tim Morgan on October 25, 2012

The return to growth in the third quarter (when GDP expanded by 1.0%) will be particularly welcome to the government. Ministers will breathe a sigh of relief at the ending of the "double dip" recession, and are entitled to enjoy the discomfiture which today's figures will cause to Ed Balls and his fellow 'borrow and spend' merchants. They should not, however, allow this modest up-tick to obscure the need both for supply-side reform and for capital investment.

Following recent good news on inflation, employment and public borrowing, these latest figures should contribute to positive momentum where economic sentiment is concerned. Economists discount sentiment at their peril, since a 'feel-good factor' (or, for that matter, a 'feel-bad' one) can have important behavioural implications both for consumption and for investment.

The discordant note here seems to be the contrast between today's GDP upturn and the cautionary tone adopted recently by, amongst others, Mervyn King and Adair Turner. Both noted that banks' reserve cushions are far too small. Turner's comments about the need for "unconventional" measures were interpreted by some as a call for the outright printing of money and, though King is an emphatic opponent of "helicopter money", he too seems to recognise that the road recovery will be a long and arduous one.

What are we to make of this overall picture? My view is that the British economy is 'oscillating around zero'. The preliminary ONS year-on-year comparison – which says that GDP is at roughly the same level now as it was at this point in 2011 – is probably about right. In other words, we are still a long way away from the kind of growth which has been forecast, time and again, by the OBR, and which has informed government projections for debt and the deficit. The deficit overshoot in 2012-13 might now be rather smaller than seemed likely a couple of months ago, but it would be unrealistic to expect any further reduction in the gap between revenues and spending in the current fiscal year. The government should assume that it will be going into the 2015 general election with a scorecard that reads 'work in progress' rather than 'job done'.

All of which raises the question of quite how much useful work really is in progress. Recent increases in electricity and gas prices – and the implication that inflation is likely to start moving up again – should remind us that the "middle" is still very "squeezed". Public borrowing remains far too high, and individual indebtedness remains a major obstacle to growth.

In this situation, two things are needed from government. The first is genuine supply-side reform, and the second is a capital investment programme. Specifically, employment legislation needs reform which, as I may explain at a later date, need not impair the levels of protection enjoyed by working people. On the capital side, the requirement for a national council-house-building programme is as imperative as ever.