Tullett Prebon Research, a blog by Dr Tim Morgan

Unsteady as she goes – the back-story to flat GDP

by Tim Morgan on April 25, 2013

Today's publication of the preliminary estimate of first-quarter economic output was never going to be particularly exciting. Analysts should focus instead on the underlying picture, which remains a disturbing one. The economy is flat-lining, the living standards of the majority are continuing to deteriorate, neither the country nor the government is remotely capable of living within its means, and no-one in a position of authority really has much of a clue about how to put things right.

The structural problem is that, in the years before the 2008 crash, the British economy became dependent on two unsustainable drivers. The first of these was private borrowing, where steadily-expanding property debt was reflected in a house price bubble which, through its associated feel-good factor, spilled over into consumer spending and consumer debt. Property and consumer-related sectors prospered, but did so in a way that was always going to reverse when the property bubble met the eventual fate of all bubbles.

The second unsustainable driver was a massive increase in public spending, overseen by a government which mistook a bubble for real growth, proclaimed the abolition of "boom and bust", and ramped spending not only up to, but well beyond, the supposed revenue implications of the economy's illusory growth.

When the bubble burst, not only did the property- and consumer-related sectors plunge but the fiscal deficit reached frightening proportions, simultaneously putting an end to growth in the state-funded sectors which comprise almost a fifth of the economy.

Together with retailing, the CREF (construction, real estate and finance) and HEPA (health, education and public administration) sectors account for almost 70% of the economy, so economic stagnation, at best, was the inevitable outcome of most of these sectors becoming simultaneously ex-growth.

Britain is now walking an economic tightrope, which results from a combination of:

a) An ex-growth economy

(b) Huge individual debt

(c) Intractable fiscal shortfalls

(d) A structural (and worsening) balance-of-payments deficit

(e) Extreme vulnerability to even modest increases in interest rates.

Official expectations for a consumer-driven recovery were always fanciful, not least because, whilst nominal incomes have increased by 10% over five years, the cost of essentials has risen by 33%. An investment-led recovery is implausible, because investors need the assurance that they can sell their goods and services into an expanding economy. Over all of this looms the demographic challenge, with age-related public expenditures rising inexorably.

The only way to tackle these problems is fundamental reform. Unfortunately, flat-lining GDP is neither good enough to restore prosperity or bad enough to provoke restructuring of the economy.