Long wait for recovery in jobs and investment

• David Smith
Economics Editor

BRITAIN faces a prolonged period of high unemployment and weak investment, reports the latest forecast from the authoritative London Business School (LBS).

It says there will be no growth in real personal incomes either this year or next. Hopes of a revival in consumer spending rely on people running down their savings.

The Organisation for Economic Co-operation and Development (OECD), in its biannual assessment of the world economy, is also expected to warn this week of a big rise in Britain's unemployment, and of the risk that economic recovery will be delayed by the large debts of companies and consumers.

The new forecasts come as the Treasury, in preparing its mid-year assessment, has become more cautious. Officials are concerned that the recovery in business and consumer confidence in the spring has not been maintained. The fear is that the upturn will come later, and be more subdued, than was previously hoped.

Norman Lamont, the chancellor, was silent on the timing of the economic recovery in a speech to the Conservative women's conference last week. He faced strong pressure from delegates to cut interest rates further.

The LBS says that the background to the next election is "exceedingly unfavourable".

Analysts believe that the chancellor will delay a cut in base rates in spite of sterling's small recovery against the D-mark last week. There are fears in the government that the Bundesbank, now facing inflationary pressure and a weak D-mark, will raise interest rates at its last council meeting before its summer recess in 11 days.

Hopes of a cut centre on July 12, the day after the Bundesbank meeting — assuming German rates do not increase — and the publication date for the June Retail Prices Index.

The LBS says the economy is adjusting to the disciplines of Britain's membership of the exchange-rate mechanism (ERM) and that an inflation rate of 3.5% to 4%, which should be achieved next year, is sustainable.

The costs of ERM membership and low inflation are, however, seen as high. The forecasters say unemployment will rise to 2.8m by next summer and that there is little scope for a reduction in the total before the mid-1990s.

Service industries will be particularly hard-hit. The forecasts say 1m jobs will be lost in retailing, banking, insurance and other service industries in 1991 and 1992 combined.

The LBS is, in addition, gloomy about investment. Companies will be held back by their weak financial position, and manufacturing investment will drop by 16% this year and 3% next year. Ministers had hoped this year's investment cutbacks would precede a recovery next year.

Overall investment by the private sector is predicted to decline by nearly 10% this year and 4% next. The LBS says: "It will be some time before any pick-up in demand is likely to produce a response in the form of higher investment. On our forecast this is not until the very end of next year or even later."

This sentiment is echoed by Sudhir Janankar, deputy director of economics at the CBI, who says: "Our evidence is that the downturn is slackening. I expect the economy will bottom out by the end of the summer. But something companies and consumers can recognise as growth is not likely until 1992.

"Our surveys show there is no recovery in consumer demand at the moment. The uncertainty created by the rise in unemployment is offsetting the impact of lower interest rates on consumer demand." Janankar is predicting a 2% drop in gross domestic product (GDP) this year.

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City analysts agree there will be no break-out from recession this year. Paul Turnbull, chief economist at Smith New Court, says: "We don't feel an upturn is likely until next year. Unlike the Treasury, our view is that lower inflation alone will not spark an upturn.

"A recovery will not take place by magic and the only stimulus that works is a reduction in base rates. At 11.5%, the base rate is clearly too high."

Gerard Lyons, chief economist at DKB International, said: "We think that the recession will last for the whole of this year. GDP will only pick up in 1992. But there will be signs of a pick-up in consumer spending by the fourth quarter.

"Some people have benefited from the cut in interest rates and inflation, but have not yet had the confidence to go out and spend. We think there is scope for further rate cuts, but the effect of this will be offset by the continuing decline in investment."

The OECD is said to predict a similar rise in unemployment to that forecast by the LBS, with the total due to reach [illegible] year. OECD [illegible] the skill shortages and shortcomings in training as contributing factors.

The OECD sees no recovery in investment this year, and warns that a second-half upturn in consumer spending depends on a revival of confidence.

• The LBS says that a re-elected Conservative government would be unable to cut taxes unless it boosted public borrowing. Labour is likely to run a public-sector borrowing requirement of £20 billion a year, it adds.

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