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MONDAY VIEW

By **Gerard Lyons**

How to answer the big question of the new year

WHERE is demand going to come from? That is the big question for the economy in 2013.

The signs at the start of the year are not good.

The economy weakened at the end of 2012 and there is a genuine risk of a further contraction in the next few months, hence talk of a triple dip recession.

The economy is still smaller in size than it was before the crisis hit.

This is an incredibly weak performance and helps explain the pessimistic mood that continues to prevail.

Yet despite all this, 2013 should be a better year for the economy than last. After a poor start it would not be a surprise if growth picked up during the year, reaching 1.5pc or so, helped by an improving global economy. Not great, but in the right direction.

Trouble is, even if we reached this, it might feel like an 'invisible recovery' with the pace of growth still too slow so that many people may not see it.

Because the economy has been so weak it really needs to start motoring to make an impact.

This year, to help, we need to see both a policy that succeeds in getting more lending into the economy and a recovery in confidence that encourages people and firms who have the ability to spend to do so.

Throughout this whole crisis the outlook for the economy has depended upon the interaction between the fundamentals: the policy stance of both the Government and the Bank of England, and confidence.

A lack of demand has been the biggest problem largely because the public have continued to repay debt and have been hit by a combination of tax increases and higher costs for food, rent, petrol and utilities.

In short, spending power has been squeezed.

The picture varies greatly. Savers continue to suffer, while at the other end of the spectrum there has been a surge in pay-day loans.

In contrast, for some, the present situation is good: their jobs are secure and low interest rates make mortgage payments affordable. This makes it hard to predict consumer spending.

I think there will be a pick-up as income tax allowances rise this spring.

But it also needs inflation to ease, and much will depend on food and energy costs.

In addition, faced with a combination of weak demand and tough lending conditions, firms have been cautious to invest and spend. The continued language of austerity probably does not help.

But the good news is that employment is at an all-time high.

This makes some wonder whether the economy is stronger than the data is showing.

I don't think it is.

Many jobs are part-time, wages are being squeezed and firms are holding onto staff in the hope of a recovery and because of the high cost of finding and rehiring skilled workers.

HOWEVER, this year it may be the continued squeeze on public sector jobs that attracts attention.

This will lead to renewed focus on the policy stance. There is a strong case to do more to help the economy. There is a need to reduce taxes to get more money into peoples' pockets.

Expect to see a repeat of last year's debate, namely that the Government should take advantage of low interest rates to borrow for increased infrastructure spending and stimulate the construction sector.

This makes a lot of sense.

Also I think there should be more focus on where the Government spends, not just how much it spends. The welfare bill is too high and needs to be targeted better to those in need.

It is hard to see interest rates rising this year.

Instead I would expect the focus to be on boosting bank lending, and in ensuring that the Funding for Lending scheme works.

In 2013, as last year, monetary policy remains the shock absorber for the economy.

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