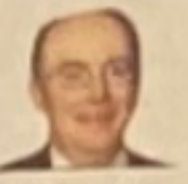
As George Osborne prepares for the crucial GDP figures this week, two of Britain's leading economists present their plans for prosperity

A BLUEPRINT FOR GROWTH

LEADERSHIP FOR
A BETTER FUTURE

Pressure point: the Chancellor, George Osborne, will face renewed scrutiny when the latest GDP figures are published

GERARD LYONS



Invest sensibly and Britain will emerge stronger from downturn

Shore thing: the Thames Gateway project typifies the type of spending Britain needs to recover

Is the UK in a triple-dip recession? This is likely to be the hot topic of conversation about the economy this week, as first-quarter growth or gross domestic product (GDP) figures are released on Thursday.

The data will follow recent disappointing economic news at home and overseas. As a result, the Chancellor's policies have come under renewed scrutiny, with the International Monetary Fund's chief economist last week being the latest to call for a shift in policy thinking.

It is now almost five years since the financial crisis hit and the UK economy has remained in the doldrums. To use the words of the incoming Bank of England Governor, Mark Carney, it has not reached "escape velocity". As a result the economy has remained fragile and vulnerable to shocks.

Indeed, last autumn another shock from the eurozone contributed to a 0.3pc fall in UK growth in the final quarter of last year. Hence the added attention to what happens to the growth figures this week. Two successive quarters of declining growth are regarded as a recession. As we have already seen this twice in recent years, this would be the third time: hence a triple dip.

Yet GDP figures are not always the best guide as to what is actually happening in the economy. Usually they are only a snapshot, based on partial data, and over time can be revised quite markedly.

The initial figure, when released, can also sometimes turn out to be very different from market expectations. The consensus is for a tiny rise in GDP. In my view, the economy is probably not as weak as the GDP figures suggest, but clearly it is not as good as it should be. The UK is still below its pre-recession peak and has been the weakest performer of any major economy during the crisis.

In recent years I have been on the pessimistic side about the UK, but I think the economy is now starting to turn, albeit very slowly.

But economic statistics are not telling the same story. Despite low interest rates, bank lending is still weak. Despite the weak pound, exports are not doing that well, even though they have picked up from a low level to economies such as China.

And despite the recession, the jobs data have defied expectations, although even they succumbed to weakness last week. Unemployment rose to 2.56m and youth unemployment remains stubbornly high at just under 1m. Admittedly, the numbers in work are high, at 29.7m.

What should we make of this? In my view, it is not the triple dip we should focus on, but that the economy is suffering from a triple whammy of a lack of demand, a lack of lending and a lack of confidence.

0.3pc
The size of the UK economy's contraction in the final quarter of last year. Another contraction would mark a return to recession

£1.4trn
The size of the UK economy in money terms - five times larger than it was in 1948, according to official statistics

2
The number of major credit rating agencies (of which there are three) that have cut the UK's prized AAA rating

Each is important and all three are inter-linked. What the economy needs for a stronger recovery is to spend, lend and change. There also needs to be more focus on how the UK will prosper in a changing global economy.

The UK cannot be seen in isolation from the world economy, and the news over the past week is unlikely to have helped confidence. As has become the norm at this time of year, the IMF revised down its global growth forecast.

Yet despite all this, we need to appreciate that the world economy is still growing at a steady pace, driven by the emerging economies.

Last week, financial markets also overreacted negatively to news that the Chinese economy grew only 7.7pc in the first quarter.

Yet practically every Chinese policymaker has hinted at this pace of growth for some time. But it was enough to hit commodity markets hard – with gold, copper and oil prices all falling sharply. This should allow UK petrol prices to fall, helping spending power here.

The legacy of high debt left the Chancellor with a no-win situation in how to get the deficit down. Policy has continued to evolve and now there is both a shock absorber for the economy and a shock amplifier. But the shock absorber is not really working that well, while the amplifier is making things harder.

Let's take the amplifier. The Government has wanted to rein in public spending. In essence there are three parts to such spending: departmental spending on areas such as health and overseas aid that is protected; annual managed expenditure, including debt interest and unemployment benefits, which is hard to control because it is heavily linked to economic performance; and non-protected departmental spending, which has become the shock amplifier.

If the economy disappoints, the public finances worsen. This adds to pressure for a further squeeze on spending. It is a pro-cyclical policy - or akin to being in a hole and deciding to dig deeper.

The shock absorber is monetary policy. But there is only so much it can do. Last week, central bankers in Washington expressed fears that low interest rates may encourage bad behaviour again, yet they showed few signs of wanting to tighten policy.

The UK is now locked into low interest rates. Five years ago, I said that Sir Mervyn King would not raise rates again as Governor. He hasn't. What about Mark Carney? At some stage he needs to get the economy off the drug of low rates, but not just yet.

The economy needs more lending and the Bank of England thinks the best way to achieve this is for banks to recapitalise themselves.

There is little doubt the transmission mechanism of monetary policy is not working. But small and medium-sized firms cite sluggish spending, rising business rates and tough lending conditions as reasons why they are not borrowing. In short, there is credit rationing, and thus I think the Bank of England's Funding for Lending scheme should be expanded.

The economy also needs more demand. There is a strong case for more infrastructure spending.

Some people find it hard to accept that if the aim is to reduce the deficit, then how can the Government borrow more to spend, albeit on infrastructure?

The ideal situation is that governments should run fiscal surpluses in good times, so that in bad times, such as now, they can spend.

Of course, the Chancellor did not have that luxury because of the fiscal mess he inherited.

Yet two wrongs do not make a right. Just because it was wrong for previous governments to spend too much in good times, it would be wrong now to not take advantage of low borrowing rates to invest for the long term. There is a huge difference between current consumption - which can be squeezed - and crucial infrastructure spending.

Personal disposable income has been curbed by several factors, including sluggish wage growth, the need to repay debt, stubborn inflation and too many tax rises.

Consumption did receive a windfall boost from compensation payments from banks for mis-selling, and will be aided by the large increase in personal tax allowances.

Confidence is the key. The challenge is getting firms and people who have the money available to spend to have the confidence to do so. It would, however, be wrong to think that the economy just needs a recovery in confidence. Firms will feel more confident about investing if they expect demand to recover strongly, or because they have confidence in the longer-term outlook for the UK economy.

One group displaying confidence in the UK is international investors. They continue to pour money into many areas. The most apparent is central London property but the signs are promising in many areas.

Take the London Gateway project, on the north side of the Thames Estuary, which will open this autumn and has the potential to make London a port to rival Rotterdam. DP World has invested £1.5bn, and without any UK taxpayer support. London can lead the UK recovery. It is now just under 22pc of the UK economy. Add in the South-East and surrounding regions, which are heavily dependent upon the capital, and its influence is even higher. Empowering London, and other regions, as was outlined by Lord Heseltine's review last October, makes sense.

ONLINE Join Gerard Lyons for a live webchat about the GDP figures on Thursday at 1.15pm
telegraph.co.uk/finance

A series of huge infrastructure and construction projects is already under way across London in areas such as housing, transport and retail.

Rapid population growth will add to these in the future. London's population is 8.2m, the UK's 63.2m. Official projections point to these numbers reaching 9.1m and 65.4m by 2020 and still rising. By 2060, the UK's population is expected to reach 81.5m, although the upper trajectory, which I think is more likely, could be up to 94.8m.

Little wonder, then, that international firms based overseas, who see the growing global economy first-hand, and who are confident about the UK's ability to rebound, are investing.

It raises the question why more British firms are not investing, or indeed why is the Government not taking advantage of low interest rates to renew the UK's creaking infrastructure?

In the wake of the death of Baroness Thatcher, there has been a renewed discussion on the need for supply-side reforms. In recent years the UK seems to have lost its way in this area.

Supply-side measures are hard to explain, but there was an election broadcast from before the 1979 General election that I always thought put across the message well.

It showed a race where each athlete represented a country. Britain was in the lead, and then the management started to place weights around the British runner's neck.

These weights were labelled "taxes" and "regulation". They slowed the runner down, so much so he was overtaken by other countries.

The answer, in that broadcast, was to change the management in order to remove the weights from around the Briton's neck so that he would be able to go faster, and overtake the field. He did.

Dr Gerard Lyons is chief economic adviser to Boris Johnson, the Mayor of London. He was formerly chief economist at Standard Chartered

Allow the private sector to truly flourish

ANDREW SENTANCE

Devaluing the pound will only lead to the pain of high inflation

OFFICIAL UK economic policy statements repeatedly emphasise the need to rebalance our economy.

The idea is that growth before the financial crisis was too dependent on financial services and consumer spending.

During the recovery, ministers and senior Bank officials have argued that we need a bigger contribution to growth from non-financial businesses and from investment and exports.

But four years into the recovery, there are few signs of this shift. Financial services have contracted – with banking and insurance activity down 8pc since 2007. But manufacturing output has fallen by 8pc over the past five years – almost as much.

Investment spending has been sluggish. UK capital spending was just over 14pc of GDP in 2011 and 2012 – the lowest ratios for 60 years – compared with 17pc-18pc before the financial crisis.

And though exports have grown, imports have risen even faster. That has pushed up our deficit with the rest of the world – to nearly £60bn last year.

In 2012 we recorded the fourth highest UK balance of payments deficit as a share of GDP (3.7pc) since 1948. Only in 1974 and 1988-89, when our economy was overheating, were the figures higher.

The economy remains dependent on spending by consumers and government. Instead of falling, the share of public and private consumption in UK GDP reached a post-war high in 2012 – at 88pc of GDP.

The official response to this lack of rebalancing is to argue that it is a matter of time. I take a different view.

First, ministers and central bankers are not best placed to judge which parts in the economy need to grow and which should reduce in size. Their policies should support growth across the economy and not favour specific sectors.

Bank officials want exports and investment to drive growth

The bulk of our economy is made up of services industries, whereas manufacturing contributes just over 10pc to GDP. And it is services that have led the UK recovery – with output now back above the pre-recession peak in 2008.

Second, a weak pound is not helping to rebalance the economy. Though sterling has fallen 20pc-25pc since mid-2007, it has pushed up import prices and inflation. Third, we need a stronger emphasis on supply-side policies – measures that help make the UK a more attractive location for investment and wealth creation, encourage new firms to start up and incentivise businesses to expand.

That means cutting back the burden of regulation, rewarding firms investing in skills, accelerating the development of new transport infrastructure and simplifying our tax system.

The main way in which the Government should be seeking to rebalance the economy is through reducing the burden of public spending, allowing the private sector more scope to develop new business opportunities. Many of these will be in the services sector, not just manufacturing. And we won't help ourselves by devaluing the pound, which is a surefire recipe for higher inflation.

Andrew Sentance, senior economic adviser, PwC, was formerly a member of the Monetary Policy Committee

Telegraph money

Free Guide to Equity Release

Take control of your future using the equity in your home

Guide to Equity Release
Telegraph
Key

We all have dreams and aspirations, whether it's home improvements, to visit the world famous landmark you've always wanted to see or perhaps you'd like to help a family member get on the property ladder.

If you're a homeowner and aged 55 or over, releasing the equity locked inside your home could make these dreams and more a reality. The free 'Telegraph Guide to Equity Release' has been produced in association with Key Retirement Solutions, the UK's leading equity release specialists.

The 'Telegraph Guide to Equity Release' is a helpful first step for anyone considering releasing the cash locked away in their property. It will explain how equity release will reduce the value of your estate and may affect your entitlement to state benefits.

provided by Key RETIREMENT SOLUTIONS Equity Release

To request a guide or to book a free no-obligation consultation call 0808 252 9094 or visit www.telegraph.co.uk/er where you can also find out how much you could release

Lines are open 7 days a week, 7am-7pm

This is an equity release plan. To understand the features and risks ask for a personalised illustration.

Telegraph Equity Release Service is provided by Key Retirement Solutions Limited, which is authorised and regulated by the Financial Services Authority (FSA) under registration number 2457440. Registered office: Harbour House, Portway, Preston, Lancs, PR2 2PR. Registered in England No. 2457440. Telegraph Media Group Limited is an Introducer Appointed Representative of Key Retirement Solutions.