Forecasts

Cuts and rise in prices mean recovery will be slow, says OBR

Heather Stewart

George Osborne billed his budget as a "budget for growth" but he was forced to concede that bouncing back from Britain's deepest recession in a generation will take longer than he had hoped.

The independent Office for Budget Responsibility (OBR), which published its latest health-check of the economy with the budget, warned: "We expect this recovery to be weaker than the recoveries of the 1980s and 1990s," with GDP growth of below 3% each year throughout the rest of the parliament.

"This reflects the effects of the fiscal consolidation, the relatively slow easing of tight credit conditions and ongoing private sector deleveraging," the OBR said. In other words, Osborne's spending cuts, together with belt-tightening by debt-burdened consumers, will keep the brakes on growth for years to come.

The OBR cut its growth forecast for 2010 from 2.1% to 1.7%, reflecting the surprise contraction in GDP at the end of last year, which Osborne at the time blamed on December's snow.

The OBR also shaved its expectations for growth in 2012, from 2.6% to 2.5%. The downgrade confirmed that, as the Organisation for Economic Co-operation and Development warned earlier this month, the UK's recovery will be "subdued".

Ed Miliband seized on the deterioration in the OBR's projections in his response to the chancellor's speech, saying: "Growth down, last year, this year and next year. It's the same old Tories: it's hurting, but it isn't working."

The detail of the OBR's forecasts suggests that there will be little early relief for households already suffering from job insecurity, weak growth in wages and high inflation.

The OBR expects the unemployment rate to continue rising, from the 8% hit in April 2010, to 8.2% this year, remaining at 8.1% in 2012. The number of people claiming unemployment benefit will be stuck above 1.5 million until 2013, it believes.

Meanwhile, house prices will continue falling, delivering another blow to homeowners' confidence. The OBR is expecting house prices to decline by 2.3% this year, rising by 0.1%, in 2012.

Despite Osborne's headline-grabbing cut in petrol duty, the OBR expects the intense cost-of-living squeeze for British households to continue.

Average earnings will increase by a paltry 2% in 2011, it predicts, while tax rises and the rocketing price of oil mean that the cost of living will rise more than twice as fast, with CPI (consumer prices index) inflation running at 4.2%.

Mervyn King, the governor of the Bank of England, has already called this the most sustained attack on living standards since the 1920s, and a recent Nationwide survey showed consumer confidence at lower levels than during the credit crunch.

Gerard Lyons, chief economist at Standard Chartered, said the fragility of the economic recovery, revealed in the forecasts, showed that King and his colleagues will have to keep interest rates close to rock bottom levels for a long time.

"What we know about tightening fiscal policy is that there needs to be a credible medium-term plan to reduce the deficit and that whilst fiscal policy is being tightened, interest rates have to stay low," Lyons said.

The OBR's report is also sceptical about the effects of the measures in the government's "plan for growth" in the short term. "In the event that these measures have an impact on growth, there is likely to be some lag before the effects are realised; the effects will also depend on how the measures are implemented," it said.

City economists said the 1.7% forecast for 2011 looked realistic but warned that the chancellor is relying on a sharp pick-up in growth in future years to bring the public finances into balance. In 2013 and 2014, the OBR is expecting growth of 2.9%.

Howard Archer, of Global Insight, said that could mean more tax rises or spending cuts in future years if the economy underperforms.

"If the OBR's longer-term growth forecasts prove modestly optimistic, as we suspect, this suggests that the chancellor will either eventually have to take additional fiscal corrective measures to achieve his long-term budgetary targets or accept some slippage," he said.