



Perspectives by Ruth Lea

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Keep the green shoots in perspective

Last week saw some signs that, even though the economic outlook generally remains bleak, there were some tentative “green shoots” sprouting in the British economy. The apparently positive outcome of the G20

meeting probably contributed to the general mood of rising economic confidence – though the direct impact on the world economy, in general, and on the British economy, in particular, is likely to be very modest.¹

Any “green shoots” must, however, be kept in perspective. The global backdrop is still negative as the OECD’s latest forecasts remind us. For most of the world’s major economies, GDP is continuing to fall, unemployment will continue to rise well into next year (and probably into 2011) and the fiscal balances are deteriorating fast. WTO Director-General Pascal Lamy announced recently that the WTO expects world trade to fall by 9% in 2009. This would be the biggest drop in trade since World War II.²

But, looking on the bright side, the possibility that there are green shoots suggests that, at last, the incredibly loose monetary and fiscal policies, along with the billions of public funds pumped into parts of the banking sector, are beginning to improve credit availability and help the real economy. The weak pound should also stimulate activity. And even though output is still falling in the UK and unemployment rising fast, the rate of decline in activity may now be starting to ease. Following on from a fall in GDP of 1.6% in the 4th quarter of 2008 and a likely similar fall in the 1st quarter of 2009 – there should be a smaller decrease in the current quarter.

Green shoots?

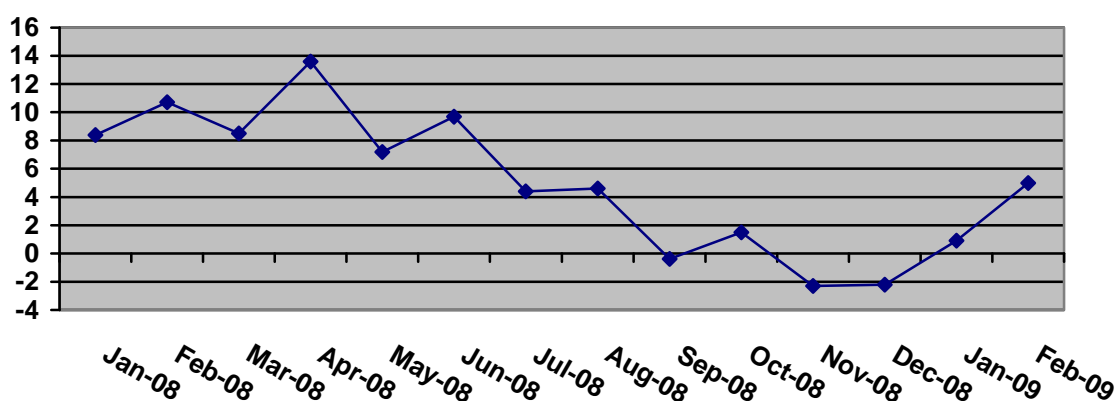
The recent green shoots fall into three broad categories: credit availability and the money supply, the housing market and the real economy: businesses and consumers.

Firstly, on credit the Bank of England’s latest Credit Conditions Survey for 2009Q1 was mildly encouraging – at least on the supply side. The demand for credit was still expected to fall. The survey suggested that the availability of secured credit to households would improve over the next 3 months. And concerning the corporate sector the survey reported that credit availability had already increased over past 3 months and, moreover, was expected to increase further over next 3 months.³

The CBI's latest credit conditions survey showed that companies were less negative about the availability of new and existing credit in March than they had been in February.⁴ The CBI was, however, at pains to point out that the credit situation was not actually getting better in absolute terms – but that “the severity of the disruption is no longer worsening as sharply as it was 3 months ago”. In other words, the rate of deterioration was decelerating. The CBI report is significant because the inability to access credit has been cited by businesses as one of the most serious obstacles since the onset of the downturn.

Turning to the Bank's own figures on money supply and credit, the latest data suggest that the growth of broad money M4,⁵ adjusted for the holdings by the financial companies, began to pick up in February – even before the effects of expansionary effects of Quantitative Easing had begun to take effect. As the chart below shows, bank lending to private non-financial corporations, having collapsed at the end of last year,⁶ may now be improving.

Chart 1 Annualised 3-month growth rates (%), bank lending to private non-financial corporations



Source: Bank of England, www.bankofengland.co. The series used relates to the monthly 3-month growth rates (annualised, %) of monetary financial institutions' (MFIs) sterling net lending (excluding securitisations etc) to private non-financial corporations (PNFCs), seasonally adjusted.

Turning to the housing market, there were two green shoots last week. The first was a report from the Bank of England which showed mortgage approvals had risen to nearly 38,000 in February compared with 32,000 in January and nearly 40% up on November's low point.⁷

The second was from Nationwide suggesting that house prices had increased by 0.9% in March to be just 15.7% down on March 2008.⁸ Nationwide was appropriately cautious about this finding. And, sure enough, Halifax's survey results released the next day suggested that house prices had actually fallen by 1.9% in the month.⁹ The Nationwide figure does look to be an outlier and most housing experts are still looking for another 5-10% fall in prices before they stabilise. The rate of decline in prices does, however, seem to be decelerating.

On the real economy there were three surveys of note last week which told a remarkably consistent story of continuing, but crucially decelerating, deteriorating circumstances. The first was the March GfK-NOP survey of consumer confidence which concluded that, though there were still more pessimists than optimists, the balance of opinion was improving and “consumers remain cautious but confidence is slowly increasing”.¹⁰

The other two surveys were Chartered Institute of Purchasing and Supply (CIPS)/Markit surveys on manufacturing and services. The manufacturing PMI (Purchasing Managers’ Index), which combines orders and output levels in British factories, jumped to 39.1 in March, up from 34.9 in February and the highest level since October. Even though any PMI reading below the 50 mark represents a contraction in activity, the survey does suggest that the pace of decline is easing.¹¹ Further improvements can be expected in forthcoming months as the fall in inventories, which has exacerbated the recession as firms have met demand from stocks rather than from new production, should ease off.

The services PMI rose in March to 45.5, still below the neutral 50 mark that separates expansion from contraction, but the highest since September and markedly better than the record low of 40.1 in November.¹²

There are two main conclusions to be drawn from this array of evidence:

- The credit crunch may, at last, be starting to ease. This is a prerequisite of any recovery.
- Even though economic activity is still falling, the rate of decline may be starting to ease.

These are “green shoots” of sorts.

The OECD’s latest forecasts

A timely reminder that the effects of recession are still very much with us was provided by the OECD in their latest set of economic forecasts.¹³ The three charts below provide the key data for GDP, unemployment and General Government balances for the G7 and the euro area.

The OECD has significantly downgraded its GDP forecasts since December 2008 reflecting the much sharper than expected contraction in the global economy. The worst performers in 2009 are now expected to be Japan (a fall of 6.6%) and Germany (a fall of 5.3%) as their export-led economies have been especially hit by falling world trade activity. The OECD expects the US economy to shrink by 4% this year. The UK’s drop of 3.7%, sharp though it undoubtedly is, is marginally better than the average of the G7 (-4.4%), the euro area (-4.1%) or the total OECD group (-4.3%).

The OECD is projecting that the global economy, in general, and the UK, in particular, will continue contracting throughout 2009 but flatten out at the turn of the year and begin to grow, albeit modestly, in 2010.

Even though GDP growth is forecast to pick up in 2010, the OECD expects that unemployment, a lagging indicator, will continue rising throughout 2010. It is worth remembering that in the last three British recessions, unemployment peaked at least two years later than the bottom of the recession: ¹⁴

- 1974-75 recession: unemployment peaked in 1977.
- 1980-81 recession: unemployment peaked in 1986.
- 1991 recession: unemployment peaked in 1993.

The OECD expects that UK unemployment rate will average 7.7% in 2009 (about 2.4 million unemployed on the ILO count) and average 9.5% in 2010 which is nearly 3 million, higher than in 1993.

Turning to the fiscal balances, it is a universal tale of seas of red ink. Government debt will be in plentiful supply across the OECD area and governments should increasingly be concerned about the ability to find buyers. The projected numbers for the US and the UK are horrendous.¹⁵ For the US, the OECD is forecasting deficits (as a % of GDP) of 10.2% (about \$1,430bn) for 2009 and 11.9% (about \$1,700bn) for 2010. The numbers for the UK are little better. They are 9.3% (£135bn) for 2009 and 10.5% (£155bn) for 2010.

Chart 2 Real GDP growth rates (%), G7 international comparisons

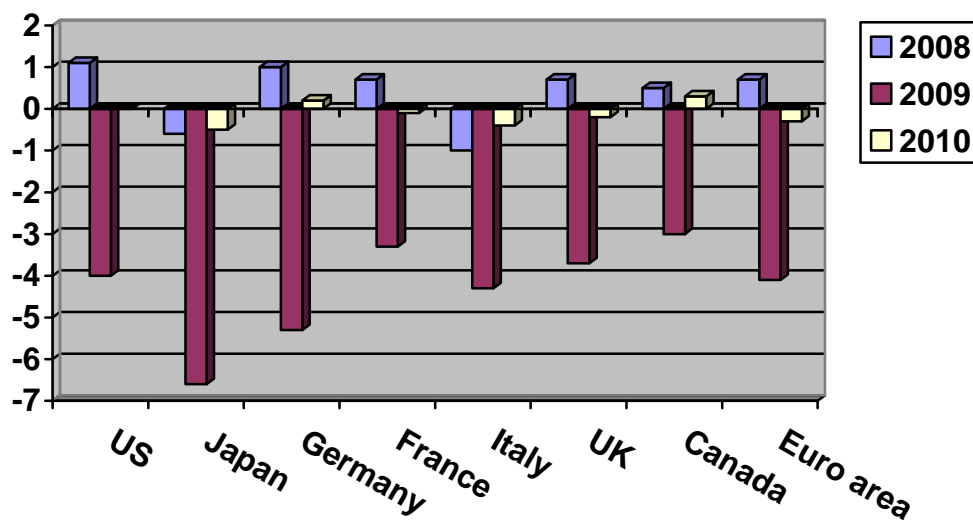


Chart 3 Unemployment rates (%), G7 international comparisons

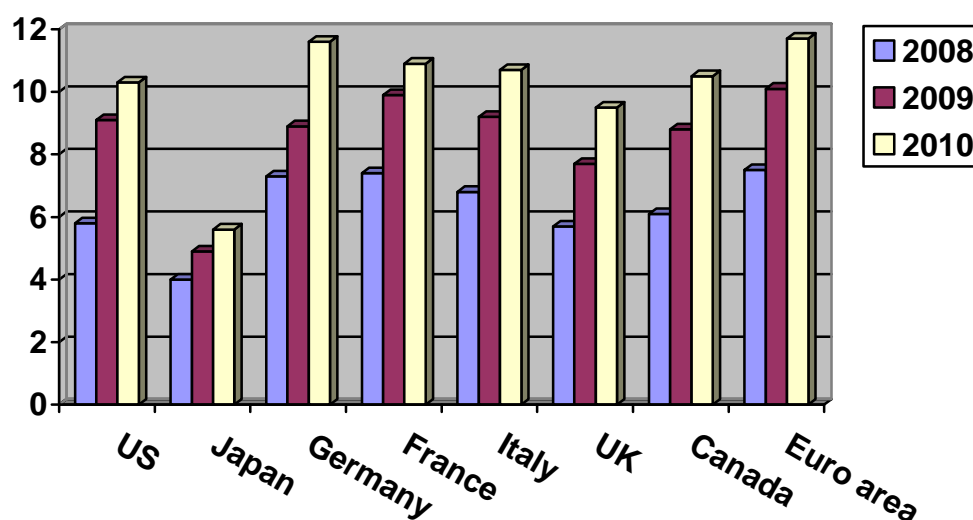
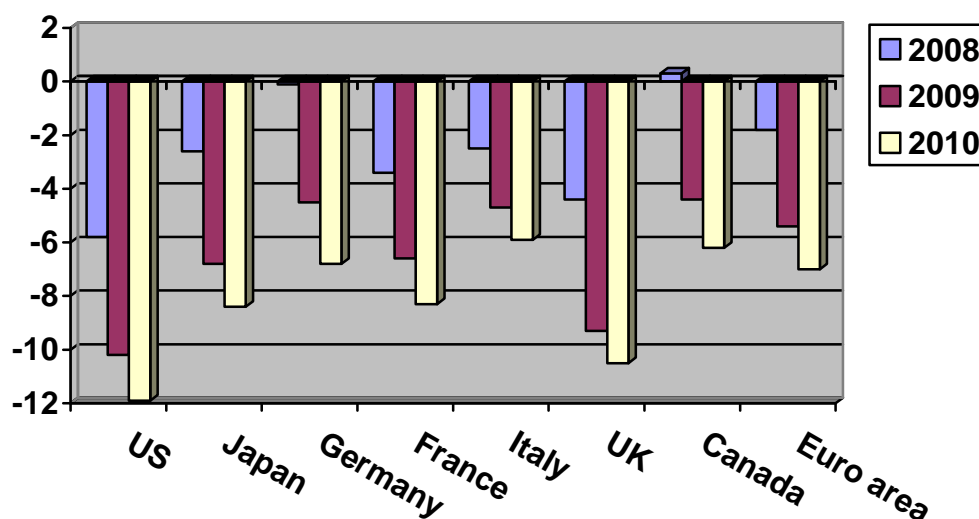


Chart 4 General Government fiscal balances (% of nominal GDP)



Source: OECD, *Economic Outlook, Interim Report*, March 2009, www.oecd.org

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