Stuck in the mud

The British economy is struggling to get out of the mire.

Britain's long-awaited exit from recession has moved from thwarted prediction to firm fact. But the welcome news came with a painful sting. The economy barely crawled forward, expanding by just 0.1% between the third and the fourth quarters of 2009, according to the Office for National Statistics (ONS) on Tuesday January 26th. This was much feebler than the median forecast among City economists for an increase of 0.4%.

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The recession lasted a year and a half and was both the longest and deepest since the mid-1940s (when national output fell in the aftermath of the second world war). Indeed the slump of 4.8% in GDP last year was the steepest since 1931, when national output fell by 5.1%.

Britain's recession was the longest among the G7 economies, which typically had downturns lasting a year, although Italy's lasted for five quarters. It was not the most severe, measured from the pre-recession peak to the trough. That unfortunate accolade went to Japan (8.6%) followed by Germany (6.7%) and then Italy (6.5%). Their earlier recovery meant, however, that Britain's 6.0% fall in output between early 2008 and the third quarter of 2009 was surpassed only by Japan (7.7%)(see daily chart).

All these figures will be revised in due course. Usually this is a routine matter but in the run-up to a general election, which must be held by June 3rd at the latest, but is widely expected to be on May 6th, any changes will be politically potent. In Britain, the ONS has already moderated its initial estimate of a fall in GDP of 0.4% in the third quarter of 2009, to 0.2%. Gordon Brown, the prime minister, will be hoping that the meagre increase in national output

for the fourth quarter may be pushed up when the official number-crunchers, armed with more information, revisit the figures on February 26th and March 30th. Business surveys have suggested a more robust upturn and the labour market has been more resilient than expected.

But there is a potential pitfall for Mr Brown. The ONS will unveil its initial estimate of GDP in the first quarter on April 23rd. If this were to show a return to recession the news would torpedo Labour's already slender hopes of averting a Conservative victory. Such a relapse could happen because the main rate of VAT, a consumption tax charged on most goods and services, went up to 17.5% on January 1st, following 13 months when it had been lowered to 15% in order to combat the recession. Since consumers brought purchases forward in late 2009 to dodge the impending increase they are likely to cut back now, hindering a further expansion in national output.

Looking longer ahead, the outlook is for a pretty modest recovery this year. GDP will increase by 1.4% in 2010 according to the average of 28 independent forecasts in early January assembled by the Treasury (which itself predicted 1.25% in December). Much of the recovery will come from a turnaround in the stockbuilding cycle, as inventories are run down far less than before.

Ensuring that this fragile upturn is sustained will require some skill from policymakers. The recovery has been helped by an extraordinary stimulus, both fiscal and monetary. The budget deficit has burgeoned to a post-war record, the base rate is at a 300-year low and the policy of "quantitative easing" has been vigorously pursued. As Britain belatedly leaves recession behind, so the Treasury and the Bank of England will want to execute their own "exit strategies". Co-ordination will be vital. The tougher the fiscal tightening, the easier monetary policy can remain. But none of these crucial decisions will be made until Britain has a new government after the general election.

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