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Britain's stuttering economy

Double-dip trouble

Real growth looks a distant prospect, but the news that Britain has fallen back into recession is more dispiriting than alarming

AN APPALLING month for David Cameron's gaffe-prone government took a turn for the worse this week with the revelation that the economy has not, after all, clawed its way clear of recession. Preliminary figures released on April 25th showed that **GDP** shrank by 0.2% in the first three months of 2012 (at an annualised rate of 0.8%), following a drop of 0.3% in the last quarter of 2011. When Britain emerged in 2009 from the deep recession that followed the financial crisis, the hope was that the economy had enough momentum to maintain a modest recovery, even while the fiscal deficit was being dealt with. But growth, never robust, has stuttered since the fourth quarter of 2010 (see first chart). Now it has stalled, leaving output lower than it was in late 2010.

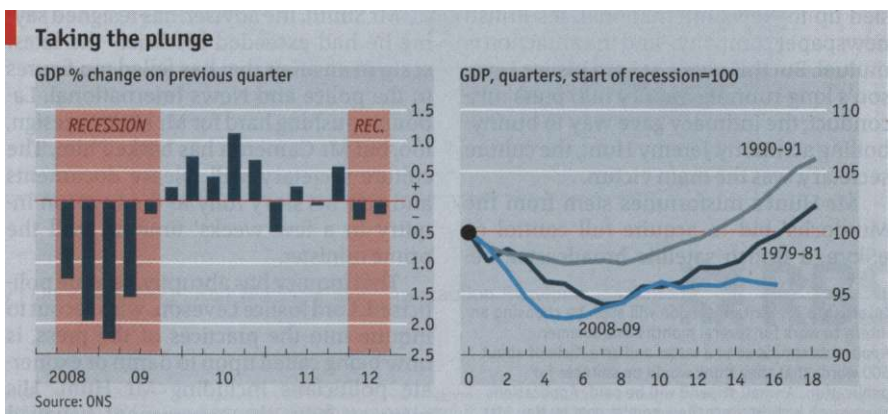
Nobody expected miracles, but the figures were surprisingly poor. On the basis of earlier surveys, most analysts thought stronger performance by the services sector, which produces three-quarters of total output, would keep overall **GDP** in positive territory. They were wrong. Services grew by a measly 0.1%, quarter on quarter. Manufacturing fell by the same amount, and construction by 3%. The numbers will be revised, but they could go down as well as up. The outlook for the second quarter, studded with holidays, is hardly brighter.

Mr Cameron called the figures "very, very disappointing"; Ed Miliband, the leader of the opposition, retorted that the government's "catastrophic" policies were to blame. That is excessive. The economy is essentially still bumping along the bottom. But technically Britain has fallen into a double-dip recession, and for the first time since the 1970s. The economy is rebounding less quickly than it did from previous downturns (see second chart), and less strongly than America, say. Why?

Four main types of spending drive **GDP**, and each of the four is being held back. Household consumption, which accounts for half of spending, fell by 1.2% during 2011. Meagre wage increases (for those lucky enough to be in work) mean shoppers have little extra to spend. Inflation is stubbornly high at 3.5%, thanks partly to higher fuel prices. Previous price rises, caused by weaker sterling and an increase in value-added tax, continue to chill consumption. To top it off, heavily indebted consumers seem more interested in paying down what they owe than splashing out on flat-screen televisions. Adam Posen, a member of the Bank of England's Monetary Policy Committee, reckons that households holding back spending is one of the main reasons why Britain has done worse than America since 2009.

Government consumption normally accounts for around a fifth of spending. It can pack a bigger punch than its share implies because when the state buys things, cash flows to firms and their workers, boosting consumption. But this part of the pie is shrinking too: fiscal-austerity measures took 0.7% off output over the past year. Planned changes will have broadly the same impact over the next 12 months, according to estimates by Morgan Stanley, an investment bank.

Nor has stronger trade managed to drag **GDP** out of the trough, despite sterling's 20% trade-weighted depreciation since before the crash. The euro crisis has been supremely bad for business. Britain sells around half of its exports to the euro area, more than to newly buoyant America or fast-growing emerging markets. Prospects ••



• for boosting sales to the continent are not exhilarating: recent indicators of manufacturing activity point to a slowdown there.

Business investment is the final source of output, and Mr Posen's other main explanation for why Britain is recovering so slowly. Investment picked up a bit for most of 2011, though it never regained its 2008 level. But it turned down again in the last quarter of 2011, as domestic demand failed to take off and Europe's prospects worsened. The prospects for investment look bleak, as the economy is entering a disturbing new phase of the credit crunch.

Some big firms are sitting on piles of cash. But bank lending matters too, and it is drying up. Banks' own funding costs have risen as concern mounts in the markets over their exposure to the euro crisis; the biggest British lenders have seen a 40% increase since early February. Now they are starting to pass their funding costs on to their customers in the form of higher borrowing rates. Before the credit crunch bank lending to businesses grew by about 15% a year. Based on the trends of the past three months, it could fall by 8% this year.

This is especially worrying because it means that, despite holding its own rates to record lows and feeding money into the economy through quantitative easing, the Bank of England is ever less able to offset tight fiscal policy with loose money. Britain's pursuit of austerity, led by George Osborne, the chancellor of the exchequer, is going fairly well. Stimulating growth is going to prove a lot harder. •

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