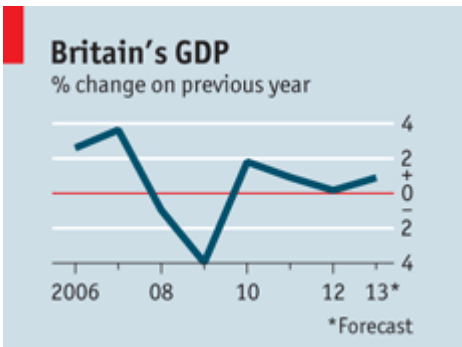
Moody blues

Britain's downgrade should refocus the chancellor and the central bank on growth



THE surprise about Britain's first-ever credit-rating downgrade—by Moody's on February 22nd—was not that it happened, but how little effect it had. That was partly because the markets were expecting it and partly because the rating agencies themselves have been downgraded: the fact that they gave their imprimatur to toxic assets in the bubble years has tarnished their reputation. Investors such as pension funds no longer blindly follow ratings in deciding what to buy and what to avoid. Together with the fact that America and France are already in the second tier Britain now occupies, that explains why the downgrade did not trigger the automatic sell-off it once would have. Sterling fell slightly—but so did gilt yields, as investors took fright from the Italian elections (see article).

Nor did the downgrade do as much damage to George Osborne, the chancellor of the exchequer, as might have been anticipated (see Bagehot). Mr Osborne was already unpopular, thanks to a budget last year that contained an unpopular tax cut for the highest earners and a series of fiddly measures on caravans and hot pies; and he has tied his reputation to an austerity programme aimed at maintaining the country's credit ratings. But he is helped by the fact that Britons still blame the opposition Labour Party for getting the country in a mess by overspending. Though they dislike the chancellor, they seem—rightly, in this newspaper's view—to accept the need to cut the deficit. Ed Balls, the shadow chancellor, therefore railed against Mr Osborne to little effect. The prime minister, David Cameron, is sticking to his chancellor, and austerity.

But the downgrade cannot lightly be brushed off. That is because growth is vital: if Britain's economy continues to flatline, Mr Osborne's plan to balance the budget by 2018 will fail. His benefits bill runs to £175 billion ($265 billion), much of it spent on income- and housing-support. Growth would cut dependency, and his outgoings. Tax receipts, weak of late, would be bolstered if the economy expands. Moody's downgrade, and its prediction of a limp expansion, justifies a rethink.

Bridge and tunnel

The lesson is not—as Mr Cameron suggested in the House of Commons on February 27th—that the government should "go further and faster on reducing the deficit". Britain is cutting about as fast as it can without seriously damaging the economy. But the cuts could be better targeted, with priority given to spending that provides the biggest economic kick. Improved railways, roads and broadband give the economy a short-term boost as they are built, and increase future productivity too. Government investment—just £29 billion in 2011-12—is a trifling part of an overall public purse of £690 billion. It is hardly impossible to find more money for infrastructure. Britain is still paying winter-fuel subsidies and free television licences to all pensioners, rich and poor alike.

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Monetary policy could be tweaked, too. Mr Osborne picks the Bank of England's target: he could call for a clear statement that the bank will not tighten until nominal GDP is up by 10%. That would calm worries about rates rising and could spur investment. The downgrade already seems to have triggered a reaction from the Bank of England: Paul Tucker, a senior official, has floated the idea of negative interest rates. Although that policy is unlikely any time soon, it is a welcome sign of radical thinking at a generally conservative institution. Credit conditions are still tight, despite quantitative easing and the Bank of England's low interest rate. Lending to British businesses has been falling since 2009, and the rates firms pay to borrow have been creeping up. Funding for lending, a scheme which lowers bank funding costs so they can pass the savings on, should be expanded. All this is worth doing anyway. If it shakes things up, Moody's might have done Britain a favour.

Fonte: The Economist, London, v. 406, n. 8825, p. 13-14, 2nd – 8th mar. 2013.