

Elusive and fragile recovery threatened by soaring deficit

Business leaders warn of potential economic relapse as Chancellor prepares report

By Sean O'Grady, Economics Editor

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As the Chancellor adds the final polish to his pre-Budget report on Wednesday, some of Britain's leading business organisations have warned that the recovery will be fragile and that soaring public borrowing threatens the UK's international credit rating. Britain runs a high risk of a "relapse" into recession next year.

The Engineering Employers' Federation says that conditions in the British manufacturing sector have continued to improve, but that signs for a strong rebound in 2010 "remain elusive."

While the EEF say that "the worst of the downturn is behind the sector and the weak pound and recovering world markets are beginning to have a positive impact", confidence across manufacturing remains fragile.

The EEF also warned that given the experience of previous recessions when investment took some three to four years to recover, the steep cutbacks seen during the current downturn present a significant threat to industry's longer term competitiveness.

Yesterday, the British Chambers of Commerce became the latest group to call on the Treasury to set out a credible plan to tackle the structural deficit, which they estimate at £90bn per year – that is the borrowing that will still be needed to keep up with public spending even if the economy recovers some of its old vigour. However, the BCC also stressed that addressing the deficit had to be done gradually.

David Kern, BCC chief economist, commented: "A relapse in activity is a real danger. Unless investment cuts are halted and reversed, industry will find it difficult to increase output once the recession ends and demand starts rising more rapidly."

He added: "Trying to cut the fiscal deficit significantly before the economy starts growing at a more normal pace would be a mistake that could unleash a new recession. Nevertheless, it is increasingly urgent to present a credible plan for curbing the deficit."

Reports over the weekend suggest that the Chancellor is ready to extend the life of special schemes to help small business, even though he is slated to reduce his growth forecast for 2009 from a contraction of 3.5 per cent to one of 4.75 per cent and will up his estimates of public borrowing as a result.

Alistair Darling is said to be ready to keep the Enterprise Finance Guarantee – state support for loans to small business – for six months longer than thought. So far it has been of assistance to 6,000 companies.

The HM Revenue and Customs' Time to Pay initiative, which defers tax payments for some firms, will be pushed into 2010. It has allowed 150,000 businesses to defer tax bills of £4bn so far.

The Chancellor is also expected to repeat the Government's support for a National Investment Corporation, previously announced in the Budget, and will say he is exploring ways for small and medium sized business to gain access to funding. One of the drawbacks of the Bank of England's £200n injection of money directly into the economy via its "quantitative easing" policy is that it has predominantly helped larger concerns with access to the capital markets, which have proved buoyant. It has been less useful to smaller enterprises reliant on bank lending, which is still proving difficult and dear.

The longer term challenges for fiscal policy as a result of demographics and a rising bill for public pensions will also be laid out by the Government this week. The National Institute for Economic and Social Research put the black hole in the public finances at £60bn per year, and called for a "consolidation through a combination of increasing retirement ages, cuts to spending plans and tax increases."

The BCC added: "Postponing unduly the presentation of a credible plan for restoring stability could threaten the UK's international credit rating, with dangerous effects for sterling and the gilt-edged market."

