

# Economic Review – November 2004

**David Kern argues that global economic growth has slowed markedly in recent months and the business environment has become distinctly more difficult. Fears of recession are still unwarranted but a further marked slowdown in the pace of growth is highly likely and business risks are worsening.**

The recent abrupt change in economic sentiment, both globally & in the UK, has been truly surprising. It is widely accepted that 2004 (taken as a whole) is the strongest year for global economic growth since 2000 and, on some calculations, the highest in more than two decades. But growth in the US & Japan, the world's two largest economies, slowed sharply in the 2<sup>nd</sup> quarter of 2004, at a time when the UK was still accelerating, and this has inevitably affected the UK. China, the surging Asian giant, has taken forceful action to cool a raging boom. The upsurge in oil prices has further exacerbated negative perceptions. Although in real terms, oil prices are well below previous peaks, and oil accounts for a lower share of economic activity than in earlier cycles, high oil prices will inevitably have adverse effects.

Global economic prospects remain adequate overall. But a slowdown is highly likely over the next 1-2 years. Given that serious risks persist, the main challenge facing policy makers is to maintain stability and avoid an abrupt downturn. The potential threats facing us are partly geo-political: e.g. terrorism, Iraq, & trans-Atlantic tensions between the US and parts of Europe. But persistent economic imbalances (e.g. huge budget/external deficits, trade/currency tensions & excessive debt) will remain factors likely to dampen global growth in the next few years.

In addition, short-term factors (which partly overlap with the medium-term imbalances), will limit the pace of expansion:

- High oil prices.
- Reduced fiscal & monetary stimulus (mainly in the US).
- The possible unwinding of housing price bubbles in some countries.

- The threat of a "hard landing" in China.

On balance, these problems are not likely to cause global recession. But the risks are serious and the pace of global expansion is set to slow.

In the UK, growth slowed sharply in the 3<sup>rd</sup> quarter of 2004, and there were outright falls the output of the production industries (notably manufacturing), which highlighted the problems of our two-speed economy. Equally worrying, most recent business surveys have conveyed negative messages. In particular, the Quarterly Economic Survey of the British Chamber of Commerce, one of the largest and most authoritative surveys, signalled large declines in business confidence, in both the manufacturing & service sectors. The increased concerns amongst UK businesses are due partly to adverse global developments, but they also reflect domestic worries:

- A worsening regulatory burden.
- Fears of higher taxes.
- Strikes & labour militancy.
- Concern that low Eurozone growth with will inhibit our exports.

In spite of these concerns, there is no cause for undue pessimism. Our economy still enjoys many strengths, and we are able to outperform our Eurozone competitors. UK interest rates are now expected to increase by less than previously thought, and this should help to alleviate downward pressures on our businesses. But there is no room for complacency.



Risks have increased and the fragile recovery is slowing.

The table gives my GDP growth forecasts for the major economies in 2004 and 2005. ➤

#### About the author

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He is also Economic Advisor to the British Chambers of Commerce, Economic Advisor to RSM Robson Rhodes and is a member of the DTI Panel on Monitoring the Economy and also a member of the Monetary Panel of the European League for Economic Cooperation.

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#### GDP - MAJOR ECONOMIES - % GROWTH

	2001	2002	2003	2004	2005
<b>The US</b>	0.5%	2.2%	3.1%	4.3%	3.4%
<b>Japan</b>	0.4%	-0.3%	2.7%	4.3%	2.0%
<b>Eurozone</b>	1.7%	0.9%	0.5%	1.8%	2.0%
<b>Germany</b>	1.0%	0.2%	-0.1%	1.6%	1.7%
<b>France</b>	2.1%	1.1%	0.5%	2.5%	2.3%
<b>The UK</b>	2.3%	1.8%	2.2%	3.2%	2.5%
<b>China</b>	7.5%	8.0%	9.1%	9.2%	7.7%
<b>India</b>	4.0%	4.7%	7.4%	6.6%	6.8%