

Economic Review – August 2004

David Kern argues that Britain's short-term economic prospects are unusually positive, but careful strategic planning is needed to exploit opportunities and cope with risks & pitfalls.

The British economy is performing unusually well at present, both by historical standards and in relation to our main European competitors. The total economic cake (GDP) recorded strong annual growth of 3.5% in the first half of 2004, and UK employment is near an all-time high. At the same time, inflation is low (the consumer price index rose a mere 1.6% in the year to June), and although interest rates are rising, they are still at historically low levels. The world environment is also positive, with global growth at its highest since 2000. Overall, the economy offers excellent opportunities for well-managed businesses.

There are, however, potential dangers. Both globally and in the UK, the recovery is maturing and the pace of growth will decelerate, with GDP growth slowing from almost 3.5% this year to some 2.5% in 2005. This is still satisfactory. But lower growth inevitably means that the competitive environment will become even fiercer. Moreover, interest rates will increase further. The Bank of England's Base rate, having risen from 3.5% to 4.5% in the final months to July, is likely to reach 5.5%-5.75% around the middle of 2005. This is not an alarming level, but it will make the business environment more difficult and more expensive. Credit risks may worsen, even if there is no housing market crash.

In contrast to our own relatively strong performance this year, the Eurozone (our largest trading



partner), will only grow at a weak pace, much lower in 2004 than in the US, Japan & the UK. Inadequate Eurozone growth will worsen global imbalances, exacerbate trade tensions, and increase the difficulties facing UK exporters. The recent upturn in Eurozone inflation, in spite of ample spare capacity, is a source of concern, because it may force the European Central Bank (ECB) to raise interest rates prematurely. This will make Eurozone growth prospects even more dismal, and preclude any serious recovery. British exporters and investors would be

wise to explore opportunities in America and in Asia.

In conclusion, the economic environment is positive overall. There are some serious pitfalls, but businesses with a sound strategy should be able to plan and invest for growth. ➔

About the author

David Kern was for more than 17 years NatWest's Group Chief Economist and Head of its Market Intelligence Department. David now works as an independent consultant specialising in global and UK macro economic trends, the various currency markets and interest rate developments.

David's clients include various UK and international businesses, professional advisors, consultancies and trade associations. 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.

Kern Consulting can be contacted on 0208 904 6293 or by email at david.kern@btinternet.com.

GDP - MAJOR ECONOMIES - % GROWTH

	2001	2002	2003	2004	2005
The US	0.5%	2.2%	3.1%	4.6%	3.6%
Japan	0.4%	-0.3%	2.7%	4.3%	2.2%
Eurozone	1.7%	0.9%	0.5%	1.7%	2.0%
Germany	1.0%	0.2%	-0.1%	1.5%	1.7%
France	2.1%	1.1%	0.5%	2.1%	2.1%
The UK	2.3%	1.8%	2.2%	3.4%	2.5%
China	7.5%	8.0%	9.1%	8.5%	7.4%
India	4.0%	4.7%	7.4%	7.0%	6.5%