

UK ECONOMICS UPDATE

28th Jan. 2010

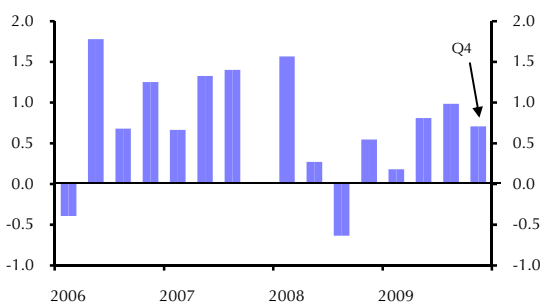


Will a “double-dip” sink Mr Brown?

- Q4's disappointing GDP figures have raised fresh questions over the possibility of a “double-dip” in the economy and the implications for the timing and outcome of the forthcoming general election.
- **Tuesday's figures revealing that the economy expanded by just 0.1% in Q4 last year were clearly bad news for Gordon Brown and the Government.** We have written on a number of occasions about the close relationship between sentiment towards the economy and the Government's opinion poll rating. (See, for example, *UK Economics Update* “Can Brown do a Major?”, 12th Oct.) Accordingly, the figures might appear to have put paid to any chances that the Prime Minister might go the polls early.
- **But while the Q4 figures were bad, there is a danger that the figures for Q1 might be even worse, perhaps revealing a “double-dip” in the economy.** We currently have little idea of how the economy has performed in Q1, but there are certainly reasons to believe that some of the forces which lifted growth in Q4 might fade.
- **Most obviously, it has been widely anticipated that the renewed rise in VAT on 1st January would bring forward some consumer spending from Q1 into Q4.** Admittedly, this has not been obvious from the retail sales figures, which recorded a smaller rise in Q4 than in the previous two quarters. (See Chart 1.) But this might reflect underlying factors. The VAT hike could still slow spending further in Q1.
- **What's more, non-retail spending may have been boosted by both the VAT hike and the car scrappage scheme.** The ONS reported that the motor sector made a strong contribution to the 0.4% expansion in the output of the distribution sector in Q4. The scheme is due to end in February so may well have a rather smaller effect in the first quarter of this year. Finally, the poor weather in January may also have a negative effect on output, though much of that may be made up in February and March.
- **Of course, these forces could be more than offset by a pick-up in the economy's underlying momentum, or by other temporary factors like a less negative contribution from inventories.** As such, our assumption is that the economy will expand a bit more strongly in Q1 – we have provisionally pencilled in a 0.4% increase in GDP followed by similar rises in the following quarters. (See Chart 2.)
- What's more, even if the economy *does* contract in Q1, that may not be quite as damaging for the Government as it might seem. After all, the Q4 figures have raised concerns in some quarters over the Conservatives' plans to tighten fiscal policy aggressively almost immediately after the election. **Further economic weakness might be seen as support for the Government's plans for a slower tightening.**
- For now, then, our assumption is that Mr Brown will hold on to the end in the hope that the economy will avoid a double-dip, or that his stance in the fiscal debate will gain more support. (May 6th has been widely touted as the most likely election date.) But it is far from clear that either will save him.

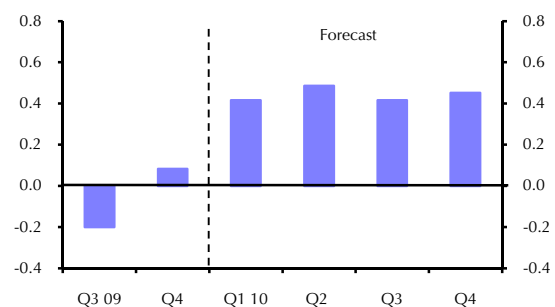
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Chart 1: Retail Sales (%q/q)



Source – Thomson Datastream

Chart 2: GDP (%q/q)



Source – Thomson Datastream, Capital Economics