



BCC UK Economic Forecast – September 2010

David Kern, Chief Economist at the BCC

The main purpose of the BCC Economic Forecast is to articulate a BCC view on economic topics that are relevant to our members, and to contribute to the wider public debate on policy issues. The Forecast also aims to complement the messages conveyed by the BCC's Quarterly Economic Survey (QES).

Main features of the September 2010 Forecast

- The UK recession ended in Q3 2009. The economic recovery started in the fourth quarter of 2009, and quarterly growth remained in positive territory in the first two quarters of 2010.
- UK GDP recorded cumulative declines of 6.4% during the 2008-09 recession. The declines in the recent recession were worse than originally estimated, and were much bigger than in the recession of the early 1990s, when UK GDP recorded cumulative declines totalling 2.5%.
- In annual average terms, we are now forecasting positive UK GDP growth of 1.7% in 2010 2.2% in 2011 and 1.8% in 2012, after a very large GDP decline in of 4.9% in 2009.
- Our new GDP growth forecasts are higher than in our June forecast for both 2010 & 2011. In June 2010, we predicted GDP increases of 1.3% in 2010 and 2.0% in 2011.
- The upward revision in our growth forecasts, which is most marked for 2010, largely reflects the unusually strong growth registered in Q2 2010, and temporary factors that will support growth in the near term. But we expect a sharp slowdown in GDP growth starting in Q1 2011, as VAT increases to 20% and tough spending cuts are implemented over the next few years.
- In spite of the relatively strong recent UK performance in Q2, the recovery is fragile and risks of a relapse are high. Over the medium term, Britain's recovery faces serious impediments.
- UK growth is likely to be modest and below the historical average in the next few years.
- Measured by the scale of GDP declines, the 2008-09 downturn was the deepest since World War II. But unemployment increased less in 2008-09 than in previous UK recessions.

- UK labour market trends have improved in recent months, with unemployment falling and employment rising. But recent improvements continue to mask worrying developments.
- Inactivity is on a rising trend, part-time workers have been the main drivers of recent increases in total employment, long-term unemployment is increasing, and the public sector has been the main source new jobs.
- On balance, our central scenario predicts further increases in UK unemployment in the next 20-24 months, but at a slower pace than at the height of the recession before mid-2009.
- Our new forecast envisages that total unemployment would rise from 2.46 million (7.8% of the workforce) in April-June 2010, to a peak of 2.65 million (8.3% of the workforce) in the first half of 2012, a net increase of just under 200,000 in the jobless total.
- We expect the same peak in unemployment as in our June report, at 2.65 million. But the new jobless peak will be reached only in H1 2012, about a year later than predicted in June.
- Our new unemployment forecast compares with a jobless peak of some 3 million (10.7% of the workforce) in the recession of the early 1990s.
- UK public sector net borrowing (PSNB) excluding financial interventions totalled £154.7bn (11.0% of GDP) in 2009-10; this is a huge figure, but is less than estimated in the Labour Government's last Budget in March 2010, which indicated that PSNB would total £166.5bn (11.8% of GDP) in 2009-10.
- Our new forecast assumes that the forceful measures announced by the new UK coalition government in the June 2010 Emergency Budget would be implemented successfully, and the deficit would decline broadly in line with the forecasts issued by the new Office for Budget Responsibility (OBR).
- Indeed, with tax receipts showing surprising buoyancy in recent months, we expect PSNB to be marginally lower than the OBR predicted, falling to £144bn (9.7% of GDP) in 2010-11, £110bn (7.1% of GDP) in 2011-12 and £83bn (5.1% of GDP) in 2012-13.
- While the new policies of greater fiscal austerity entail risks, there is now a more realistic chance that the UK will succeed in stabilising its public finances over the next few years, and the UK will be able to preserve its AAA credit rating.
- Net public sector debt is set to increase less than previously predicted, and is likely to peak in the next 4-5 years at a level of 70% of GDP, in line with the OBR forecasts.
- The forecast assumes that the MPC will persevere with its current expansionary stance for at least the next 9-12 months. The Bank of England is very probably right in its assessment that the recent surge in inflation will prove to be temporary, as spare capacity in many businesses and in the labour puts downward pressure on inflation over the next 12-18 months.
- The Bank of England cannot ignore the risk that inflationary expectations would worsen, and its own credibility would be questioned, if inflation stays for long above the 2% target.
- But threats of a setback to growth remain more serious than risks of a surge in inflation.

- In the next few years, the economy will have to cope with the effects of the very tough fiscal austerity measures that will be implemented following the recent Budget. There is a clear prospect that UK unemployment will increase, as the public sector is forced cut jobs
- Given the balance of the risks facing the economy, we expect UK Bank Rate to stay at 0.5% until Q2 in 2011 at the earliest. By end-2011, we expect Bank Rate at 1.75%.
- The Quantitative Easing (QE) programme is likely to stay at its present £200 billion level for a considerable time, and a further increase can be expected if the economy weakens.

Risks and key policy issues

- The early stages of the global recovery from the deep recession of 2008-09 have been surprisingly strong. All the major economies have returned to positive growth in 2010, and the global upturn has been stronger than expected so far.
- However, the global recovery appears to have lost some momentum, and it is widely expected that growth will slow in H2 2010 and in 2011.
- In the US, sentiment over future growth prospects has worsened considerably, in reaction to poor data on jobs, housing, consumer confidence and trade. There are also worrying signs that traditionally buoyant Asian economies such as China and India are set to slow.
- The Eurozone has performed well in Q2 2010, with Germany growing particularly strongly.
- But the Eurozone's outlook has been adversely affected by the Greek debt crisis and the risks of contagion; the euro's position as a single currency will face many challenges.
- The UK upturn from the deep recession of 2008-09 is still fragile, in spite of the stronger than expected growth performance recorded in Q2 2010.
- The UK business community and financial markets have welcomed the serious determination of the new coalition government to deal vigorously with the huge fiscal deficit.
- Although excessive and premature fiscal tightening entails serious risks, the tough measures announced in the Emergency Budget received a positive reception in the markets.
- If successful, the Budget strategy could put UK on a path of sustainable and affordable recovery, and could help create a "leaner and fitter" economy. But the policy faces obstacles.
- The scale of the fiscal retrenchment, and the decision to cut the deficit at an accelerated pace, will inevitably increase dangers of double-dip recession.
- Departmental spending cuts totalling 25% or more could cause damage, and may be difficult to implement. The decision to ring fence health & overseas aid may have to be reviewed.
- Public sector strikes and unrest are a potential risk, but are unlikely to derail policy.
- The growth forecasts of the new Office for Budget Responsibility (OBR), although more realistic than the previous Treasury forecasts, are still too optimistic.
- However, if implemented, the tough Budget measures will secure Britain's AAA credit rating.

- Our forecast predicts that the cumulative impact of huge injections of stimulus during the recession, earlier sharp falls in sterling, and the rebuilding of stocks should help support UK activity in the second half of 2010.
- But we expect a sharp slowdown in growth starting in Q1 2011, as the UK economy starts making difficult adjustments that would limit the pace of recovery in the next few years.
- In particular, the need to cut significantly the budget deficit, strengthen the banking sector, and reduce personal sector debt will inevitably limit UK growth until the middle of the decade.
- The UK labour market is now much more flexible than in previous recessions. This greater flexibility, particularly the willingness of workers to accept wage reductions, has ensured that falls in employment, and rises in unemployment, in the 2008-09 downturn have been much smaller than in the recession of the early 1990s.
- Reducing job losses in the current recession has been a positive development. However, with employment falling much less than output in 2008-09, UK productivity has recorded big falls in the recession that has now ended.
- Large numbers of people are economically inactive, and large numbers are working part-time because they are unable to find full-time employment; this situation will continue to pose serious threats to Britain's productive potential.
- Unless the UK labour market remains flexible and adaptable during the recovery, and private sector employers are encouraged to invest, export and create jobs, there is a risk that falling productivity would damage Britain's medium term growth prospects.
- Sharp falls in manufacturing output (down 10.6% in 2009), and plunging capital investment (down 15.0% in 2009), were two worrying features of the 2008-09 UK recession.
- Although capital spending and manufacturing output have recovered in recent months, previous sharp falls in investment heighten risks that, once the recession ends and demand starts rising more rapidly, UK industry would lack the capacity to increase output.
- Unless the recovery in capital investment is sustained, and the regulatory burden on business is eased, Britain's productive potential could be seriously weakened in the medium term.
- Manufacturing has the potential to continue recovering, benefiting from efforts to rebalance the UK economy and refocus activity towards exports.
- But many manufacturing viable firms risk losing their skills base.
- The manufacturing sector must be nurtured, to ensure that transitory difficulties triggered by the recession do not cause permanent and irreversible damage to our manufacturing base.
- Our central scenario envisages positive UK growth over the next few years. But the pace of expansion is likely to be relatively weak by pre-recession standards.
- Over the next 4-5 years, growth of UK GDP is likely to average just under 2% per annum, considerably less than the 3.0% average growth recorded in the 15-year period 1993-2007.

- Against this background, it is vital to ensure that wealth-creating businesses have adequate capacity to respond to higher demand when the recovery consolidates. In the face of fiscal austerity, Britain's businesses must be enabled to invest, export and create jobs.
- The Government must not deviate from its commitment to implement its deficit-reduction plan by focusing primarily on curbing public spending. But it is important to minimise cuts in vital infrastructure, so as to ensure that the economy's productive potential is not damaged.
- Given the huge challenge involved in stabilising our public finances, the Government cannot afford to ring-fence other spending categories, including health and overseas aid.
- Further steps must be taken to ensure that public sector pay and pensions remain key elements of a credible medium-term fiscal plan.
- Given the scale of the fiscal adjustment, some tax increases are unavoidable; these should mainly focus on areas least likely to damage incentives, e.g. indirect consumption taxes.
- Since the business sector will drive any sustainable recovery, it is vital to avoid new business taxes, higher NICs, and measures that damage initiative, enterprise, and innovation.
- Proposed policies that are inimical to job creation should be discarded without delay.
- Oppressive labour market regulations must be scrapped, or at least temporarily suspended.

UK economy: the main components of demand

- The UK recession ended in Q3 2009, and recovery started in Q4 2009.
- GDP has since recorded three consecutive quarters of positive growth: 0.4% in Q4 2009, 0.3% in Q1 2010, and 1.2% in Q2 2010.
- The 1.2% quarterly UK GDP growth in Q2 2010 was much stronger than expected, much stronger than in the US, and marginally higher than in the Eurozone as a whole. But UK quarterly growth in Q2 was much lower the 2.2% quarterly growth recorded by Germany.
- In year-on-year terms, UK GDP rose 1.6% in Q2 2010, after year-on-year declines of 0.2% in Q1 2010, 2.9% in Q4 2009 and 5.3% in Q3 2009.
- The most recent official figures show that UK GDP fell over six consecutive quarters in the 2008-09 recession (starting in Q2 2008 and ending in Q3 2009), and recorded cumulative declines of 6.4% during this period.
- Revised estimates show that GDP declines in the recent recession were worse than originally estimated; the cumulative falls in 2008-09 were much bigger than in the recession of the early 1990s, when UK GDP recorded cumulative declines totalling 2.5%.
- The 2008-09 recession was also worse than in 1979-81. In the 1979-81 recession, peak-to-trough falls in GDP totalled 6.0%, but quarterly GDP falls in 1979-81 were not all consecutive. If one takes into account consecutive falls only, cumulative falls in 1979-81 totalled 4.6%.

- In annual average terms, we are now forecasting positive growth UK GDP of 1.7% in 2010, 2.2% in 2011, and 1.8% in 2012, after a very large GDP decline in of 4.9% in 2009.
- Our new GDP growth forecasts are higher than in our June forecast for both 2010 & 2011. In June 2010, we predicted GDP increases of 1.3% in 2010 and 2.0% in 2011.
- We expect UK GDP growth to remain relatively robust in the second half of 2010, sustained by the rebuilding of stocks, the effects of the earlier falls in sterling, and the continued effects of the huge monetary and fiscal stimulus injected during the recession.
- However, the new forecast predicts a sharp slowdown in GDP quarterly growth starting in Q1 2011, in reaction to the VAT rise to 20% and the tough spending cuts announced in the Emergency Budget are implemented over the next few years.
- Consequently, year-on-year GDP growth, after rising to 2.9% in Q1 2011, is forecast to fall sharply to below 2% in Q4 2011, and stay below 2% during 2012.
- Our average 2010 & 2011 GDP growth forecasts are now higher than in June, mainly due to strong Q2 growth and temporary factors that will sustain growth in next few quarters.
- But the slowdown in the pace of growth envisaged during the course of 2011 & 2012 is now much steeper, because obstacles to medium-term growth now seem more severe.
- Forceful cuts in the budget deficit, and measures aimed at strengthening the enfeebled banks and at reducing personal sector debt, will limit UK growth in the next 5 years.
- Table 1 summarises our forecasts for UK GDP and its main demand components.

Table 1: UK GDP & Main Demand Components, % Change Year on Year

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
<u>GDP</u>	2.8%	2.7%	-0.1%	-4.9%	1.7%	2.2%	1.8%
<u>Household Consumption</u>	1.8%	2.2%	0.6%	-3.4%	0.8%	0.9%	1.4%
<u>General Government</u>	1.4%	1.3%	1.6%	1.2%	2.5%	1.0%	0.7%
<u>Investment</u>	6.4%	7.8%	-5.0%	-15.0%	1.9%	1.7%	2.4%
<u>Exports</u>	11.1%	-2.6%	1.0%	-10.6%	3.7%	6.4%	5.0%
<u>Imports</u>	9.1%	-0.8%	-1.2%	-12.4%	5.8%	3.0%	3.7%

- Household consumption growth has dropped in annual average terms from 2.2% in 2007 to 0.6% in 2008 and a big outright decline of 3.4% in 2009; it is forecast to record positive but weak growth of 0.8% in 2010, 0.9% in 2011 and 1.4% in 2011.
- Over the next few years, growth in UK consumer spending is forecast to remain consistently weaker than the expected growth in GDP.
- Investment spending plummeted, from annual average growth of 7.8% in 2007, to -5.0% in 2008, and massive negative growth of -15.0% in 2009.
- Our new forecast predicts modest positive annual increases in capital spending, at 1.9% for 2010, 1.7% for 2011, and 2.4% for 2012.

- With world trade recovering, and the UK enjoying a competitive exchange rate, we expect positive annual growth in UK exports, of 3.7% in 2010, 6.4% in 2011, & 5.0% for 2012.
- The rebalancing in the UK economy towards net exports is expected to continue, though at a modest and patchy pace.
- UK imports are forecast to record annual average growth of 5.8% in 2010, 3.0% in 2011 and 3.7% in 2012.

UK main sectors - manufacturing, services, & construction

- All the main sectors of the UK economy – manufacturing, services, and construction – have recorded big annual average falls in 2009, and all the three sectors are now growing.
- The new forecast envisages that the three sectors are likely to register positive annual average growth in 2010, 2011 & 2012.
- Services, the largest (and traditionally the fastest growing) sector in the economy, has recorded (in annual average terms) negative growth of -3.3% in 2009, after very low growth of 0.5% in 2008.
- Looking ahead, services output is forecast to register positive growth of 1.4% in 2010, 2.3% in 2011, and 2.1% in 2012, a modest pace of expansion when compared with the increases recorded before the 2008-09 recession.
- Trends in manufacturing output have registered significant improvements in recent months.
- After recording very large quarterly falls in both Q4 2008 & Q1 2009, manufacturing output broadly stabilised, and showed modest quarterly declines only in Q2 & Q3 2009.
- Thereafter, manufacturing has recovered; while fluctuating from month to month, output recorded satisfactory quarterly growth in Q4 2009, and in the first two quarters of 2010.
- In Q2 2010, manufacturing output rose by 1.6% compared with Q1, and recorded 3.8% year-on-year growth compared with Q2 2009, which was at or near the low point of the recession.
- In recent quarters, manufacturing output has recovered more rapidly than the service sector. This partly reflects a bounce-back after very steep earlier declines; it also indicates that the manufacturing sector is benefiting from the competitive sterling exchange rate.
- Looking forward, our new forecast indicates that manufacturing output, in annual average terms, will record positive growth of 3.3% in 2010, 2.1% in 2011 and 1.6% in 2012, after declining by 10.6% in 2009.
- We believe that the manufacturing sector has the potential to recover at a satisfactory pace in the next few years, and should continue to benefit from the competitive exchange rate. But it is important to ensure that viable manufacturing firms do not lose their skills base.
- It is also important to ensure that UK manufacturing exporters are not disadvantaged in their ability to have access to trade finance on competitive terms.

- Construction sector output fell (in average year-on-year terms) by 1.2% in 2008, followed by a massive decline of 11.4% in 2009. In 2010, construction output fell a little further in Q1, and then recorded exceptionally strong growth in Q2.
- Our new forecast envisages a return to positive annual average growth in construction output, at 3.7% in 2010 and 1.2% in 2011, followed by a modest decline of 0.7% in 2012, mainly due to the impact of the public spending cuts.
- Table 2 summarises our specific forecasts for manufacturing, services, and construction.

Table 2: Manufacturing, Services & Construction Output, % Change Year-on-Year

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
<u>Manufacturing Output</u>	1.6%	0.5%	-2.9%	-10.6%	3.3%	2.1%	1.6%
<u>Services Output</u>	3.6%	3.5%	0.5%	-3.3%	1.4%	2.3%	2.1%
<u>Construction Output</u>	1.3%	2.4%	-1.2%	-11.4%	3.7%	1.2%	-0.7%

UK inflation and labour costs

- CPI annual inflation, the Government's target measure, remains well above the 2% target.
- The rate of CPI inflation has been above 3% in every single month this year; inflation has been generally higher than most analysts, and indeed the Bank of England, have expected.
- But, after rising to a temporary high of 3.7% in April 2010, CPI annual inflation fell in the following three months, and was 3.1% in July 2010.
- Much of the current high level of inflation is due to the increase in VAT in January 2010, past rises in oil prices, and the continued impact of higher import prices following the depreciation of sterling since mid-2007.
- However, these effects will probably prove to have a temporary impact only on inflation.
- On the other hand, spare capacity in many businesses and in the labour market, are likely to put downward pressure on inflation over the next year.
- The influence of spare capacity is one of the factors exerting downward pressure on wages.
- Growth in regular pay, excluding bonuses, has been less than 2%, markedly lower than the average growth rate of pay in the five years prior to the crisis.
- Following the announcement in the June 2010 Emergency Budget of a further increase in VAT to 20% with effect from next January, CPI annual inflation is now expected to remain above the 2% target until the end of 2011.
- But CPI annual inflation is likely to fall well below 3% over the next year.
- In line with the Bank of England's forecast, we expect that, as the effects of higher VAT, energy price rises and import price increases drop out of the twelve-month comparison, inflation will probably fall back to below the 2% target early in 2012, mainly reflecting the influence of spare capacity in the economy. But the outlook is very uncertain.

- In annual average terms we predict CPI inflation at 3.2% in 2010, 2.7% in 2011, and 1.7% in 2012. For RPI inflation we predict 4.7% in 2010, 4.1% in 2011, and 2.8% in 2012.
- Table 3 summarises our specific forecasts for various measures of UK inflation.

Table 3: UK Annual Inflation, % Change Year on Year

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
<u>CPI</u>	2.3%	2.3%	3.6%	2.2%	3.2%	2.7%	1.7%
<u>RPIX</u>	2.9%	3.2%	4.3%	2.0%	4.8%	4.0%	2.6%
<u>RPI-All Items</u>	3.2%	4.3%	4.0%	-0.5%	4.7%	4.1%	2.8%

- In April-June 2010, annual growth in total UK average earnings (including relatively volatile bonuses) was 1.3%, down from 2.7% in the three months to May 2010.
- The earnings growth for regular pay (excluding bonuses) was 1.6% for the three months to June 2010, down from 1.8% for the three months to May 2010.
- Annual growth in pay (both including and excluding bonuses) is well below inflation, on both the CPI and RPI measures.
- Recent earnings figures have shown a persistent gap between the public and private sectors, with pay in the public sector continuing to grow much faster.
- Including bonuses (total pay), annual growth in average earnings in April-June 2010 was 0.8% in the private sector, and 2.9% in the public sector.
- Excluding bonuses (regular pay), annual growth in average earnings in April 2010 was 1.0% in the private sector, and 3.1% in the public sector.
- Our forecast assumes that earnings growth for regular pay (excluding bonuses) will edge up very slowly from Q3 2010, to reach 2.0-2.5% in the final months of 2011 and 2012.

UK labour market – unemployment & employment

- Unemployment is now lower, and employment is higher, than many people have predicted.
- UK labour market trends have improved in the last three months, with employment rising & unemployment falling. But recent improvements continue to mask worrying developments.
- Although inactivity has declined in recent months, longer-term comparisons still show a clear upward trend in inactivity levels (i.e. people that have effectively left the workforce).
- Part-time workers have mainly driven recent increases in total employment; the number of part-timers has risen to the highest level since comparable records began in 1992.
- Long-term unemployment is rising. The number of people unemployed for more than twelve months has increased to the highest figure since Q1 1997.
- The public sector has been the main source new jobs. Over the 2 years to March 2010, private sector employment fell by 978,000, while public sector jobs rose by 329,000.

- With the recovery in the UK economy expected to continue, albeit at a modest pace, the private sector is likely to create eventually more jobs, particularly in those areas that will benefit from the rebalancing of the economy towards exports and investment.
- But there are also distinct risks that unemployment may increase more sharply than our central forecast indicates.
- In particular, fiscal austerity and large spending cuts will inevitably cause job losses in the public sector, and will affect adversely sectors that rely on public sector demand.
- The large number of “economically inactive” people will remain a major uncertainty for the UK jobs market. If the “economically inactive” decide to return to the workforce on a big scale, unemployment could rise sharply even if the economy recovers and employment increases.
- On balance, our central scenario predicts further increases in UK unemployment in the next 20-24 months, but at a slower pace than at the height of the recession before mid-2009.
- Our new forecast envisages that total unemployment would rise from 2.46 million (7.8% of the workforce) in April-June 2010, to a peak of 2.65 million (8.3% of the workforce) in the first half of 2012, a net increase of just under 200,000 in the jobless total.
- In our new forecast we predict the same cyclical peak in unemployment as in our June report, at 2.65 million. But we now expect the new jobless peak to be reached only in the first half of 2012, about a year later than predicted in our June forecast.
- Our new unemployment forecast compares with a jobless peak of some 3 million (10.7% of the workforce) in the recession of the early 1990s.
- The UK labour market is now much more flexible than in previous recessions.
- This greater flexibility, particularly the willingness of workers to accept wage reductions, has ensured that falls in employment, and rises in unemployment, in the 2008-09 downturn have been much smaller than in the recession of the early 1990s.
- Reducing job losses in the current recession has been a positive development.
- However, with employment falling much less than output in 2008-09, UK productivity has recorded very big falls in the recession that has now ended.
- Large numbers of people are economically inactive, and large numbers are working part-time because they are unable to find full-time employment; this situation will continue to pose serious threats to Britain’s productive potential.
- Unless the UK labour market remains flexible and adaptable during the recovery, and private sector employers are encouraged to invest and export, there is a risk that falling productivity would damage Britain’s medium term growth prospects.
- To achieve a sustainable improvement in Britain’s productive potential, recent adverse trends in the labour market must be reversed. Inactivity must decline, full-time employment must grow, and private sector employment must increase.

Unemployment in the 16-17 & 18-24 age groups

- The unemployment rate among people aged 16-17 has increased in the past two years, from 26.0% in April-June 2008, to 33.1% in April-June 2010, but the jobless rate reached 35.1% in January-March 2010.
- The unemployment total among people aged 16-17 has risen from 188,000 in April-June 2008, to 196,000 in April-June 2010, but the jobless total reached 206,000 in January-March 2010.
- The 18-24 age group continues to record very high levels, and rates of, unemployment. There have been large net increases over the past two years, from 523,000 (a jobless rate of 12.5%) in April-June 2008, to 724,000 (a jobless rate of 17.5%) in April-June 2010, but there were higher temporary peaks over the past year.
- It must be stressed that the ONS unemployment figures for these age groups include people in full-time education that are looking for part-time employment.
- With total UK unemployment forecast to peak at 2.65 million in H1 2012, or 8.3% of the workforce, in H1 2012, and with the level of inactivity in both age groups expected to rise in the next 12-18 months, our specific forecast for the 16-17 & 18-24 age groups are as follows:
 - Unemployment in the 16-17 age group is forecast to total around 200,000 (a jobless rate of 34.5%) in Q1 2011.
 - Unemployment in the 18-24 age group is forecast to total around 740,000 (a jobless rate of 18.0%) in Q3 2010.

UK public finances and the balance of payments

- UK public sector net borrowing (PSNB) excluding financial interventions totalled £154.7bn (11.0% of GDP) in 2009-10; this is a huge figure, but is less than estimated in the Labour Government's last Budget in March 2010, which indicated that PSNB would total £166.5bn (11.8% of GDP) in 2009-10.
- Our new forecast assumes that forceful measures announced by the new UK coalition government in the June 2010 Emergency Budget would be implemented successfully, and the deficit would decline broadly in line with the new forecasts issued by the new Office for Budget Responsibility (OBR).
- Indeed, with tax receipts showing surprising buoyancy in recent months, we expect PSNB to be very slightly lower than the OBR predicted, falling to £144bn (9.7% of GDP) in 2010-11, £110bn (7.1% of GDP) in 2011-12, and £83bn (5.1% of GDP) in 2012-13.
- While the new policies of greater fiscal austerity entail risks, there is now a more realistic chance that the UK will succeed in stabilising its public finances over the next few years.

- If implemented, the tough Budget measures will help secure Britain's AAA credit rating.
- Net public sector debt is set to increase less than previously predicted, and is likely to peak in the next 3-4 years at a level of 70% of GDP.
- The UK business community and financial markets welcomed the serious determination on the part of the new Government to deal vigorously with the huge fiscal deficit.
- Although excessive and premature fiscal tightening entails serious risks, the tough measures announced in the Emergency Budget received a positive reception in the markets.
- If successful, the Budget strategy could put UK on a path of sustainable and affordable recovery, and could help create a "leaner and fitter" economy.
- But the policy faces big challenges. The huge scale of the retrenchment that the Government wants to implement, and the decision to cut the fiscal deficit at an accelerated pace, will inevitably increase dangers of double-dip recession.
- Departmental spending cuts totalling 25% or more could cause serious damage, and may be difficult to implement.
- The decision to ring fence health and overseas aid may have to be reviewed.
- Public sector strikes and unrest are a potential risk, but are unlikely to derail policy.
- The UK current account deficit fell from 2.6% of GDP in 2007, to 1.6% of GDP in 2008, and 1.1% of GDP. But figures for Q1 2010 point to a larger deficit this year
- Our new forecast suggests that the UK current account deficit is likely to total 1.8% of GDP in 2010, before falling to 1.6% of GDP in 2011 and 1.4% of GDP in 2012.
- We expect the UK current account deficit to remain low by historical standards.
- Table 4 below summarise our new forecasts for UK public borrowing and for the balance of payments on current account.

Table 4: Balance of Payments Current Account & Public Sector Borrowing

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
<u>BofP-CurrentAccount-%GDP</u>	-3.4%	-2.6%	-1.6%	-1.1%	-1.8%	-1.6%	-1.4%
<u>PSNB-FinYears-%GDP</u>	2.3%	2.3%	6.7%	11.0%	9.7%	7.1%	5.1%
<u>BofP-CurrentAccount-£bn</u>	-44.9	-36.5	-23.8	-15.5	-26.0	-24.0	-22.0
<u>PSNB-FinYears-£bn</u>	30.9	33.3	96.1	154.7	144.0	109.9	82.8
<i>*Positive PSNB figure indicates deficit; negative PSNB figure indicates surplus</i>							

UK interest rates and monetary policy

- The forecast assumes that the MPC will persevere with its current expansionary stance for the next 9-12 months. The Bank of England is very probably right in its assessment that the

recent surge in inflation will prove temporary, as spare capacity in many businesses and in the labour market puts downward pressure on inflation over the next 12-18 months.

- The Bank of England cannot ignore the risk that inflationary expectations would worsen, and its own credibility would be questioned, if inflation stays for long above the 2% target.
- But threats of a setback to growth remain more serious than risks of a surge in inflation.
- In the next few years, the economy will have to cope with the effects of the very tough fiscal austerity measures that will be implemented following the recent Budget. There is a clear prospect that UK unemployment will increase, as the public sector is forced cut jobs
- Given the balance of the risks facing the economy we expect UK Bank Rate to stay at 0.5% until Q2 in 2011 at the earliest. By end-2011 we expect Bank Rate at 1.75%.
- The Quantitative Easing (QE) programme is likely to stay at its present £200 billion level for a considerable time, and a further increase may be considered if the economy weakens.

Contact details:

David Kern, Chief Economist at the BCC,

Telephone: 020 8904 6293; E-mail: david.kern@btinternet.com