

CBI Economic Forecast

- **Credit shock and the real economy**

The intensification of the banking crisis in September and October has had a severe impact on the flow and availability of credit and this has significantly dampened prospects for economic growth. Even before the height of the crisis, lending growth to the non-financial private sector had slowed very sharply. Since September we have increasing anecdotal and survey evidence that credit is being rationed very tightly and this is now materially impacting firms' output, employment and capital spending decisions. Indicators of activity and employment have weakened rapidly as a result.

Although the government financial assistance plan should help ensure banks' funding needs are met, money markets are still not functioning properly. Until they do, credit conditions will remain extremely tight. Despite the rapid policy intervention we have seen so far, a deeper and longer lasting recession is now expected, representing a sizeable downgrade to our last forecast.
- **Firms**

Firms are being hit hard by the combination of slowing demand and credit rationing. Whereas in normal downturns, firms are able to cushion temporary falls in revenues with borrowing, for many firms this option is now much costlier or not open at all. The resulting pressure to cut costs is clearly visible, with more significant job losses and a sharp scaling back of investment anticipated. Our central forecast is for unemployment to reach a peak of 2.88 million in 2010 and for a further cumulative fall of 12% in business investment.
- **Households**

Our forecast for consumption has also fallen as a result of the deterioration in job prospects and the sharp fall in asset prices since September. The rapidly weakening labour market will hold back any recovery in real income growth which could have been expected given falling commodity prices. At the same time, households' saving needs have increased as a result of the fall in wealth and the increased risk of unemployment. We now envisage a fall in consumer spending of 1.8% in 2009.
- **UK trade**

With the sudden change in credit conditions affecting most of the developed world and increasing signs of contagion into emerging economies, the prospects for UK exports have also deteriorated. However, continued sterling depreciation will cushion the fall in exports and decrease import penetration, leading to a positive net trade contribution throughout the forecast period.
- **GDP**

Our new 2009 GDP forecast is -1.7%, compared to 0.3% in September. The quarterly profile shows five consecutive falls in output, from mid-2008 until Q3 next year and a cumulative fall in output of 2.4%, similar in magnitude to the early 1990s recession. In 2010 we envisage a muted recovery in output growth, as macroeconomic policies have their desired effects and lending growth resumes.
- **Inflation and monetary policy**

Since our September forecast, the oil price has fallen almost 50%, while the outlook for GDP has weakened dramatically. As a result, CPI inflation is expected to fall back below target sooner and stay well below 2% for the whole of 2010. The MPC has already responded to the changed inflation outlook by cutting Bank Rate to 3% from 5% in September. We envisage at least a further percentage point reduction by 2009 Q2.

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12mth% unless otherwise stated				2009				2010			
	2008	2009	2010	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GROWTH & CONSUMPTION											
Real GDP	0.8	-1.7	1.2	-1.8	-2.2	-1.9	-1.0	0.0	0.9	1.7	2.3
Manufacturing output	-1.2	-4.0	0.1	-4.7	-4.6	-4.1	-2.5	-1.2	-0.2	0.8	1.2
Household consumption	1.6	-1.8	0.2	-1.9	-2.2	-1.8	-1.0	-0.3	0.2	0.4	0.6
Government consumption	2.2	2.0	2.2	2.0	2.0	2.0	2.0	2.0	2.1	2.2	2.3
Household savings ratio	0.1	1.1	2.7	0.8	0.9	1.2	1.4	1.8	2.3	3.2	3.6
INVESTMENT											
Fixed investment	-3.8	-10.5	-0.3	-10.6	-10.9	-11.0	-9.5	-5.2	-1.3	1.8	3.7
of which:											
Total business*	-0.6	-9.1	-0.2	-7.6	-9.5	-9.9	-9.5	-4.9	-1.2	1.9	3.8
General government*	8.7	3.6	6.5	-3.4	3.3	6.1	8.8	7.4	6.4	6.2	6.2
Manufacturing*	-5.1	-9.1	0.1	-10.1	-8.3	-9.3	-8.5	-4.3	-1.0	2.1	3.9
* Exc. BNFL transfer											
EXTERNAL TRADE											
Exports**	1.3	-0.1	2.3	-0.4	-0.3	-0.3	0.6	1.1	1.8	2.7	3.6
Imports**	0.6	-3.6	0.2	-3.6	-4.0	-4.3	-2.5	-1.2	0.0	0.6	1.3
Current account (£bn)	-35.1	-31.2	-27.8	-8.6	-8.1	-7.2	-7.4	-7.8	-6.6	-6.5	-6.8
% of GDP	-2.4	-2.1	-1.8	-2.3	-2.2	-2.0	-2.0	-2.1	-1.8	-1.7	-1.8
** Inc. MTIC fraud											
PRICES											
CPI	3.7	2.8	1.2	4.0	3.3	2.1	1.7	1.4	1.1	1.1	1.2
RPI	4.3	1.2	2.0	2.3	1.2	0.9	0.6	1.4	2.1	2.2	2.2
RPIX	4.5	3.2	2.0	4.2	3.7	2.8	2.2	2.0	2.0	2.0	2.1
Producer output prices	7.5	3.1	2.5	5.0	2.8	1.6	3.0	2.6	2.2	2.4	2.7
LABOUR MARKET											
Unemployment (ILO, mn)	1.82	2.52	2.86	2.23	2.44	2.63	2.77	2.85	2.87	2.88	2.85
Unemployment rate (%)	5.8	7.9	9.0	7.1	7.7	8.3	8.7	8.9	9.0	9.0	8.9
Unemployment (CC, mn)	0.93	1.59	1.92	1.32	1.52	1.70	1.83	1.90	1.93	1.93	1.90
Claimant count rate (%)	2.5	4.9	5.9	4.1	4.7	5.2	5.6	5.9	6.0	6.0	5.9
Employment (mn):	27.30	26.69	26.37	26.93	26.76	26.63	26.46	26.36	26.34	26.37	26.42
Average earnings inc. bonus	3.5	3.2	3.1	3.3	3.2	3.1	3.0	2.9	3.0	3.2	3.4
PUBLIC SECTOR											
Net borrowing (£bn)***	69.9	93.8	97.8								
% of GDP	4.8	6.4	6.4								
*** 2008/09, 2009/10, 2010/11											
FORECAST ASSUMPTIONS											
	2008	2009	2010	2009	2009	2009	2009	2010	2010	2010	2010
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
OECD GDP	1.5	0.1	1.9	-0.1	-0.2	0.1	0.7	1.3	1.7	2.1	2.4
UK Bank Rate	4.69	1.65	2.53	2.10	1.50	1.50	1.50	1.80	2.25	2.80	3.25
Oil prices \$ per barrel	100.0	65.1	68.8	64.2	64.6	65.1	66.3	66.5	68.6	70.0	70.0
GBP Trade-weighted index	91.9	80.7	82.1	81.2	80.7	80.6	80.5	80.8	81.7	82.7	83.2
USD/GBP	1.88	1.46	1.49	1.45	1.45	1.46	1.47	1.48	1.49	1.50	1.50
GBP/EUR	0.79	0.87	0.85	0.86	0.87	0.88	0.88	0.88	0.86	0.84	0.83