

**Neptune's Response to the 2009 Budget**  
**By James Dowey, Economist**

**24th April 2009**

Alastair Darling faced a big dilemma on the budget yesterday. Private spending – household consumption, business investment and exports – is shrinking fast so should he a) shrink public spending too, in order to balance the books in response to falling tax revenues; or should he b) expand public spending in order to offset everything else that is shrinking – in other words balance the economy rather than the books?

Not ignobly, he tried to do both. He presented a path for borrowing which, though very high in both historical terms and in comparison to other countries at the moment, gives the impression of sustainability. He projected the national debt to peak in 2013/14 at just under 80% of GDP, and annual borrowing to peak at 12% of GDP next year, before halving over the next three years. Yet, at the same time, he failed to announce a commensurate tightening of government spending over that period (when judged, for instance, against what the Institute for Fiscal Studies believes is required).

Instead his strategy was to make blissfully optimistic GDP growth forecasts for the next few years, which in turn imply blissfully optimistic tax revenue growth, which have the nice property of automatically putting the books back in order in the medium term. He forecasted -3.5% GDP growth this year, which is bang on consensus. But from there his projections quickly departed from the mainstream. He forecasted 1.25% growth in 2010 against the current consensus of 0.3%; and then, and this is where his optimism shone, he forecasted 3.5% in 2011 and 2012.

Most economists do not see it this way and the market does not see it this way, and that is why the market did not like this budget – it did not share his optimism. As a result, sterling sold off.

This is not an ordinary recession. The private sector debt burden has reached much higher proportions than during an ordinary recession. As a result the recovery is likely to be a slow climb, not a bounce like the Chancellor predicts. Moreover, the main indebted sector is the household sector, which is the bulk of the UK economy at 65% of GDP. With households on the sidelines for the next few years, paying down debt, you just cannot get the Chancellor's sustained burst of 3.5% GDP growth. From an investor's point of view, exports will buck the trend owing to sterling's big depreciation during the crisis and that is where the growth will be.

To hear more from James Dowey on Wednesday's budget, you can watch his [Budget Response Video](#) on our website, filmed by Citywire on Budget day.

Kind regards

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