

# DON'T BE BOLD, BE CAUTIOUS

**Roger Bootle**, managing director of Capital Economics and economic advisor to Deloitte, predicts that Europe will be 'hit very badly' this year, warning that this is not a time for expansion. He shares a stark message with Christopher Kanal.

## **Christopher Kanal: What is the financial outlook for Europe for 2009? Do you foresee any recovery?**

Roger Bootle: No one can say for certain what the outlook will be. There will be more declines in Europe. If the world economy were in a reasonable state then I think it is possible that you might find Germany showing signs of recovery but I wouldn't be confident about that. I am pencilling things in as flat.

## **Which European countries will be hardest hit?**

The UK, Ireland, Spain and Italy, where there have been financial excesses unlike in France and Germany. I think the Italian position is very serious. It could end up worse off than Britain.

## **The European Commission's forecast for 2009 says the eurozone economy will shrink 1.9% in 2009 and grow by 0.4% in 2010. Was this a fair assessment?**

I think it's a reasonable assessment but I think the 1.9% is a joke. Why can't they call it 2%?

## **The European Central Bank recently cut eurozone interest rates to 2%. Will this be effective in bolstering eurozone economies or are further cuts needed?**

Do I think it will solve the problem? No. Do I think it was the right

thing to do? Yes. We are in a position where the traditional tools of monetary policy aren't that effective. That doesn't mean you shouldn't use them. If anything, it's the opposite. But I wouldn't be confident that this will deliver a massive response.

## **Will there be future interest rate cuts?**

Yes, I think they will be forced to reduce rates to zero.

## **Will the devaluation of the pound give Britain its best chance of avoiding a depression?**

There is not much that can be done to avoid Britain passing through a very weak phase, whatever word you care to use. I've got -3% for GDP this year and a positive number next year, but the weak phase could drag on for a few years after that.

The exchange rate mitigates the extent of the downturn marginally, but when there is an upturn in the world economy, it will make it likely that Britain will fare pretty well.

## **How far do you expect UK company profits to fall and how will this compare to their European counterparts?**

I think we are going to see a fall of about 15% this year and 10% in 2010. There will be a divergence in the UK between those companies that are heavily reliant on exports and those that aren't. Some of those that have

a good export percentage will actually find their profits going up because of the exchange rate, whereas domestic-facing industries could get absolutely clobbered. Within the eurozone there won't be that factor.

### **Are any industries recession resistant?**

Basic utilities will be fairly resistant but even in the food and drink industry we have seen people trading down, not necessarily in quantity but in price, which hits profit margins.

### **What impact will the slowdown of Brazil, Russia, India, and China have on the world economy?**

China is going to experience a very sharp slowdown, with growth of about 5% this year. This sounds pretty good but, compared to previous growth of 10% and 12%, it is not. It is potentially devastating inside China, bringing with it a risk of social unrest, but good things could emerge from it as Chinese authorities take steps to bolster demand. The worst thing that could happen is that they react by keeping export surpluses up or increasing them. India will suffer but it is not as exposed to the world economy in terms of export share as China. Russia is hugely problematic. It will be back in budget deficit and current account deficit this year and in 2010 at these oil prices, let alone if prices fall to \$20 a barrel, which they could easily do. Brazil's position is less serious. Of the Latin American countries it will probably do the best but as a commodity exporter it will be hit.

### **In January 2009, the *Guardian* newspaper put together a guide to the people who it claims got us into this mess, including Alan Greenspan and George W Bush. What are your thoughts on the choices?**

I largely agree. They were a bit hard on Mervyn King (Bank of England chief), who warned about the bubble from some way off. There is no mention of the Chinese, who I think are the root cause of all this, nor is there any real mention of the academics who argued that the markets are always right.

### **Has the crisis exposed an inherent fault in the construct of capitalism?**

No, I don't think that. It has exposed the peculiarity of financing and the need for it to be treated differently. There is nothing much wrong with capitalism but there is something wrong with financial markets and the supply of credit.

Also at an international level, the system seems to generate a situation in which a large number of countries think the right thing to do is to run huge surpluses. If there are surplus countries, there have got to be deficit countries.

### **Are there investment opportunities at this time?**

There are lots of opportunities if the world economy is going to bounce back. We don't know. It's possible that we are entering the great depression mark two, in which case I don't suppose there are many opportunities apart from western economies substituting for eastern supply. If there was a real breakdown in trade relations and trade agreements imploded, then there are all sorts of old-fashioned industries in the west that would have to be re-invented, particularly the ones we have parcelled out to China and India. Parts of Africa would benefit if we couldn't trade with China. But assuming the world economy recovers, the big opportunities will lie in western industries supplying to China and the emerging markets. I also think that, going forward a fair way, there has to be a boom in eastern tourism into the west. ■

'PEOPLE ARE GOING TO FEEL INSECURE AND CAUTIOUS, SO THEY WILL CUT BACK ON DISCRETIONARY SPENDING.'

Roger Bootle

