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"Economic Outlook"

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Well thank you Mr Chairman for that kind introduction. Good morning ladies and gentlemen, it's a great pleasure to be here with colleagues of the Federation and for your invitation to address your annual conference.

What I propose to do is to talk about the nation's economic prospects. It seems a bit remiss to talk about anything else at the moment, but then move on to what we are looking to our government to do to help us at this time other than the blindingly obvious : just get their act together.

So, let me start with the big picture – the economic crisis had its roots as we all now know in the past decade of low inflation growth. It's worth remembering what went wrong : the availability of cheap money, the explosion in financial innovation, the mispricing of risk were all key factors in producing the asset bubble that exploded in 2007. The US sub prime mortgage market was its epicentre, its melt down prompted the collapse of the securitisation market and interbank lending and the corporate sector, our sector, felt the full force of the credit crunch with the collapse of Lehman Brothers in September which marked a severe intensification of the crisis. For me that was D-Day. I happened, unfortunately, to land at Washington Dulles on the evening that Lehman brothers collapsed and it felt like the beginning of a new world for the work of the CBI.

Over the next year I think 3 factors will determine how the banking crisis unfolds and I quite deliberately say unfolds because I still think there is a long way to go, the first is capital adequacy – will the banks, even now, have sufficient capital on their balance sheets to support their operations during the difficult months ahead. Governments pumped substantial amounts of capital into the banks at the tail end of last year, but the equity markets, over the period, not just recently, have since eroded the value of that capital. But bank leverage is the second key factor, it's worth remembering, if I keep going back in history chairman it's because I'm a historian, but I find it helpful to remember that back in 2001 outstanding customer loans in the United Kingdom roughly matched outstanding customer deposits, but in subsequent years loans came to far exceed deposits. To allow for even more conservative lending ratios the banks are going to have to undergo a continued process of deleveraging. Capacity is the third of my three forward looking constraints on the banks. At the end of 2007, about a third of UK lending to your sector, the Corporate Sector, came from foreign banks and non-bank institutions like hedge funds. The sudden retreat of that capital has removed a third of the markets total lending capacity. Now we know it will take some time for credit markets to return to normal conditions. The capital markets have opened up a little in the past 2 months enabling a select group of investment grade companies to issue bonds and raise equity, but the Bank of England's most recent survey of lending rates shows that in the past few months, in net terms, growth in lending to UK businesses has been close to zero. This is also because credit risks are growing under the pressure of recession. Rising levels of mortgage defaults in the household sector and default rates are picking up amongst our smaller medium sized companies. And all the shocks of the last year have left major UK lenders, understandably, more risk averse than they would normally be at this stage in the cycle. All of which means that the governments measures to ungun the lending market are still taking time to move through the system and to flow into the economy.

What about the global economy? Well it's at its most uncertain in decades isn't it. We are now in the midst of a synchronised global recession. The first global synchronised recession since the 70's although the OECD countries are fairing especially badly, sharp slow downs are now also under way in the emerging market economies. In 2009 we expect global GDP to fall by 1.4%, the weakest year for world economic growth since the second world war, and a sharp drop in business confidence has caused global trade to contract sharply, with manufacturing output having plummeted across many countries. And as businesses rush to preserve their cash positions, they're slashing inventories and meeting demand from existing stock rather than new production. The key question now is this, where will we find the engine for global growth in 2010? With the OECD countries, our countries, so severely under the cosh, I think it is the brick economies - Brazil, Russia, India and China – that are more likely to lead some sort of recovery. In particular China has unleashed a massive stimulus in the past year and talking to the head of CBI's Beijing office, who was in Centrepoint last week, I think this could be the spark that fires the economy back to growth.

But let's bring the story closer to home. What about UK growth? Well, the economy as we know contracted more sharply than Alasdair Darling predicted in his budget in the first quarter of the year, 1.9% contraction, the sharpest decline in 30 years. Looking ahead, we are more conservative in our growth forecast than is the Chancellor. We now expect GDP to shrink by 3.9% this year and the massive fiscal and monetary stimulus will prompt a modest recovery. We don't think that recovery will come until the Spring of 2010. And next year as a whole, we think growth will be very sluggish, something of the order of 0.1%. The Chancellor thinks it will be 1¼%, I hope he's right. The pique de trough loss of output for the economy is now going to be something of the order of 5.1% which is more severe than the early 90's recession and close to being on a par with the early 80's. As this slide shows it means 8 consecutive quarters without any economic growth in the UK economy.

Now, much of the decline in output is because businesses that I've already mentioned have responded to last autumns demand shock by slashing inventories. You know that story, I'm sure, much better than I do in your own businesses. So much so that the falling stock levels in the fourth quarter were the largest since quarterly records began in 1955. Many businesses cut back on production. This phase now seems to be drawing to an end with the steepest falls in output behind us, production is no longer plummeting despite being well below the level of 18 months ago. All in all it means the overall pace of decline is beginning to moderate. For the time being credit conditions remain constrained although our latest monthly survey suggests that the pace of deterioration in credit availability is slowing. Fewer firms are now saying that the availability of credit has got worse in the past 3 months than a couple of months ago. But that will be scant consolation for those businesses trying to arrange re-financing at this time. Lending margins have shot up, covenant negotiations cost many times more than a year ago. I think actually that the bigger problem at the moment, in spite all the media attention on credit and banks, the bigger problem I am picking up is trade credit insurance. Nearly half of the firms we survey have found that insurance to cover supply of goods to customers is a problem and nearly three quarters said it's availability had worsened in the past 3 months.

Investment plans are also being scaled back. Businesses can't commit new money to factories and other big investments. This is a real concern for where that growth in the economy is going to come from. One of the reasons we are more cautious than the Chancellor. Overall we expect to see investment, business investment this year, 2009, fall by something of the order of 9.3% and we still think business investment will be falling in 2010 at a lower rate of about -3.4%.

You don't need me to remind you that although you are selling a staple product to the consumer market, that consumer confidence over the economy as a whole remains very fragile. Household consumption fell by 1% in the last quarter of last year. Unemployment will rise sharply throughout the year because it's a lagging indictor, peaking we believe, sadly, at something in the order of 3¼ million but not until a year from now and with companies cutting pay we expect average earnings to fall by 1.1% later this year. Household savings have increased sharply as consumers tighten their belts and pay down their debts. All of this means is that the flip side of business investment is that we're forecasting a 3.4% fall in household spending this year and a 0.4% decline next year.

Chairman, you are probably beginning to wonder if you should have invited me. The danger on these occasions is I can depress for Britain rather than bore for Britain, but since I'm in my flow I had better continue……

Let me say a word about inflation. There I think the news is rather better. As we know CPI inflation has now fallen to 2.3% and the Retail Price Index has fallen to it's lowest level of growth since 1948. We are fairly confident in this debate about the yoyo of deflation and inflation that we can get the Bank of England's inflation target on the CPI measure of 2% within the next month and it will remain around 2% throughout 2010. Clearly the cut in interest rates has helped and we'd anticipate interest rates only needing to rise very modestly. But frankly the future when we hear from the monetary policy committee every month, isn't about interest rates any more. They've almost become irrelevant, at least the base rate. The debate now is about quantitative easing and we are strong fans of quantitative easing given the government cannot do very much more to ungun the lending market we think the bank can. Its purchasing not only gilts but other private sector assets as well, commercial paper, high grade corporate bonds. It's already had an impact on gilt yields and as we know, 2 weeks ago the bank expanded its programme to £125 billion of the total £150 billion allotted to this purpose. Now in looking ahead, it's fair to say, and I'm a historian rather than an economist, but my chief economist never lets me end talks on economics without saying the risks are on the down side. And clearly that is the case, but if we'd been having this Annual Conference, Chairman, a couple of months ago we wouldn't have moved onto my next topic with such concern. I think now you can begin to see the signs of a recovery, we think it will be modest, but the bigger issue and the bigger challenge is the state of the public finances. The recent budget confirmed that public borrowing would reach £175 billion this year, or 12.4% of GDP. That's the most the UK has ever borrowed in peace time and far exceeds what the Treasury was expecting at the end of the November. It means that public sector net debt is expected to double to 79% of national income by 2013, only thereafter is it expected to stabilise. I've stopped putting up any more graphs because I think you'd go out and throw yourself onto the road.

So now I am going to talk about what the government should do about it rather than the economy, and how the CBI can help in that regard. If we don't tackle these issues of the public debt and the need for government to have a coherent plan to restore public debt we are all in difficulty. Just before that, let me tell you what you do know, which is the position in your sector. You know it better than I do but I thought it was worth touching on the fact that maybe for you things feel slightly better in the Federation and across the Federation as a whole than they do for the CBI where we've got so many of the distressed sectors. I know the last year's been tough with volatile food prices. Sharp rises in the costs of imported goods and price putting leading with profit margins under great pressure. In the year to last July, we saw a 60% increase didn't we in global food prices and the depreciation in sterling has continued to drive food inflation this year. The bakery sector as I understand your needs have got several stabilising factors. Clearly interest rate cuts and falling energy prices are boosting disposable incomes for those who've kept their jobs and lower commodity prices as a whole, although I know it's a mixed picture for your sector, are also easing some of your pressures. In this month's inflation report, the Bank of England said it expected food inflation to slow in the coming year. Moreover change in consumer habits are not necessarily reducing demand for your sectors products. We know there's a drive for value, we know that people are staying home rather than eating out and we know that overall sales have stayed stable. We also know that a number of bakery businesses have continued to report robust sales. So maybe you're in a position to ride out better in the recession than some other sectors in the CBI membership and I know Gordon when you were at the Trade Association Council on Monday at the CBI you'll have picked up the difference that some sectors are currently feeling.

But I want to come back to this credible and robust plan that we are looking to the Chancellor of the Exchequer to put in place to restore the public finances on a sustainable footing. Our verdict is sadly that the budget failed to deliver this. We think the governments economic forecast was shaky, the Chancellor assumes that the recovery, as I've already mentioned, will start later this year and then he sees, more tellingly, 3 consecutive years of above trend rate growth. More than 3% GDP growth 3 years in a row from 2011. I think that's going it a bit. Even so, the government said it's books would only be balanced by 2018, 2 years later than what it had forecast in November. And as I've already mentioned with public sector debt due to double by 2013 we think the government is running too much of a risk with the willingness of international investors to finance UK government debt. Moreover, the Chancellors plans rely on some new discretionary tax increases as well as cuts in the wrong place in public spending, cuts in public capital spending, both of which we think are misguided. For the government to meet it's targets it'll have to deliver on it's plans for reducing public current spending, that in turn raises fundamental questions which the CBI's grappling with at the moment, on the size and the role of the public sector, about the way we deliver public services and about tricky and delicate issues for the CBI to address like public sector pay and dare I say public sector pensions. Progress on all these fronts is needed to return the UK's fiscal balance without you and us as citizens being hit by a prolonged serious of hefty tax rises.

Where do we go from here? In the coming months I think the restoration of credit flows to viable businesses will remain the most urgent task, the governments measures need to have effect and we are only beginning to see that and they certainly need to do more on trade credit insurance where their limited scheme in the budget simply didn't go far enough and we're busy this week talking to government about widening it. But I think some of the hardy perennials for the CBI on your behalf remain very very vital. You were generous enough, chairman, to mention our work on labour market flexibility and working time. We need an employment sector which is there for you when you do have the sunny uplands and if the flexibilities that we have, and some of our continental competitors lack, are eroded then we're in trouble which is why we were pleased with last week's announcement restricting the increase in the national minimum wage from October to 7p an hour, 1.1%. The CBI is the only employers voice that's represented in that negotiation on the low pay commission. We felt this was not the year, the first year that the minimum wage had been increased in recession, to have a significant increase given the scarring effects of unemployment on the people that the minimum wage is meant to protect. Women returners doing part time work and often several part time jobs at the same time and young people, often with few qualifications, trying to find their way into the labour market. As you mentioned that followed a signification victory for british business in the retention of the 48 hour working time opt out. Something that many of our international competitors would love to see us lose.

But there is still, as ever, challenges to our labour market competitiveness. A couple of weeks ago government released it's consultation on regulations that will give effect to the agency workers directive. This is one that should be on all of your radar screens as you need to flex your labour force to deal with peaks and troughs in demand. Under this directive agency workers would be given the same, specifically the same basic pay and conditions as permanent staff after 12 weeks in a job. And the reality is that where you do make use of agency workers you're gonna send them back to the agency after 11 weeks and ask for another one. We need a set of regulations that are straight forward and inexpensive for business and we need government to implement this directive as late as it possibly can. 2011, October that year, not currently in the middle of a recession.

More broadly, we know that our politics are even more volatile than the state of the economy. Our challenge in these difficult times is how do we do current business. It's on the technical issues that you need us, as with the Federation, to work with government on. We've also got to extend out debates about the future of business policy with whoever's in power after the election. Frankly, manifesto's for all the major political parties are already pretty well firmed up and to the extent they've got flexibility, it'll be gone by the autumn party conferences. Studiously non party political as the CBI is, you would expect us to be intensifying our links with the Conservative party. In the last couple of weeks, we've had meetings with George Osbourne, Ken Clarke, Oliver Letwing the Chairman of the party's policy review. And we are also thinking beyond the next year about the issues that will shape our future competitiveness. About the governments developing plans for what Peter Mandelson calls industrial activism, is effectively a new style of industrial policy to promote british manufacturing and part of that is actually an even broader issue, what we can do to get business advantage out of the transition to a low carbon economy. What we need to do to improve our transport network, one of the continuing cinderellas of our industrial competitiveness. And for our part in all of these debates we are seeking to put the food industry , the wider food industry, at the heart of the debate. The food and drink sector has an important story to tell with your other colleagues in the wider industry, you've got a turnover of 74billion. How many people realise that that is now the largest manufacturing sector in the UK economy. Employing more than 400,000 people and purchasing two thirds of all of UK's agricultural produce. One of the issues that we can help you on with that. I do think it's a question of how far the food industry is really understood and reflected in Whitehall. Who in government speaks up for you? Do government departments trip over each other? It's an issue for you not an issue for the CBI to decide on. We have actually worked very successfully with the new department of business since it was created after the last election. With John Hutton and more recently with Peter Mandelson and I do wonder whether your interests wouldn't be better looked after if BERR rather than DEFRA and sometimes the Department of Health was dealing with you. We are also constantly on the job of making sure that regulations that affect your industry are appropriate and proportionate and I would be very interested to hear what you think of the Chief Executive of the Food Standards Agency at your annual lunch.

These, ladies and gentlemen, are some of the battles that the CBI is fighting and committed to winning. At a considerable time of uncertainty I think the CBI's job, like the Federations job, is more vital than ever. We're enormously grateful to all of you in the room, in the bakery sector who helps support both the Federation and the CBI. We couldn't do our respective jobs without your help. The Federations' role in the CBI is vital.

Thanks again for the invitation and I'd be very happy to take any questions.

Thank you very much

[applause]