The British economy: an interview with Vicky Redwood

Interview by Alistair Craven

Vicky Redwood is a UK economist at Capital Economics in London, specializing in the consumer and retail sectors.

Vicky examines the forces acting on consumer finances and spending and assesses how likely economic developments will affect the various sub-sectors of spending. She is frequently quoted in the press and appears regularly on television and radio.

Vicky joined Capital Economics in 2003 from the Bank of England, where she was a UK economist specialising in the UK corporate and household sectors. She contributed to Bank of England publications including the Financial Stability Review, as well as writing working papers on household balance sheets and business failures. Before working at the Bank, Vicky studied Economics at Oxford and Warwick.

AC: Can you tell us about Capital Economics and your day-to-day role?

Vicky Redwood:

Capital Economics is an independent consultancy, providing macro-economic analysis to companies and institutions. For example, we provide forecasts for consumer spending to retailers, forecasts for house prices to house-builders and our expectations for interest rates to banks and hedge funds.

My day will normally start with examining the latest economic data that has been released – be it the latest figures on inflation, unemployment or the public finances – and assessing how they change our view of the economic outlook. Then there might be an interest rate decision to watch out for, a speech by a Monetary Policy Committee member to read or journalists to talk to about the latest figures. We also publish longer-term research pieces – the last one I wrote involved quantifying the boost that falling inflation will give to consumers' spending power.

AC: Can you tell us about the work you did at the Bank of England on the Financial Stability Report?

Vicky Redwood:

The Financial Stability Report is published half-yearly by the Bank of England and identifies the major downside risks to the financial system, in order to help the economy prepare for these risks. I worked on the household and corporate sectors, so at that time, a key concern was obviously the rapid build-up in household debt.

AC: The economic crisis is having significant adverse effects on public finances. Can you talk us through some of these?

> **"Even at the best of times, interest rates take around 12 to 18 months to have their full effect. So they won't prevent a sharp contraction of the economy next year."**

Vicky Redwood:

When the economy slows, government spending naturally rises more quickly than usual, while tax revenues grow more slowly. Rising unemployment, for example, means less money received in income tax but more spent on jobless benefits. Meanwhile, falling house prices reduce stamp duty revenues and slower consumer spending reduces VAT receipts.

AC: The UK now accounts for a third of Europe's entire credit card debt. As a consumer and debt specialist, what is your take on this?

Vicky Redwood:

In one sense, the increase in the availability of credit card debt has been a good thing, allowing people to borrow through any temporary squeeze on their income. The problem arises where people take on more debt than they can manage. And I think we have reached that point in the UK, as evidenced by the sharp rises in personal insolvencies we have seen in recent years.

AC: You have said that you expect interest rates to fall to as low as one per cent. What effect will this have on the British economy?

Vicky Redwood:

Interest rates have already been cut sharply. However, the problems in the financial markets mean that banks are not passing on the rate cuts to customers in full, diminishing their effectiveness. That's why, with a recession taking hold, I think that interest rates will end up going to one per cent, an all-time low, or even lower. Zero is not impossible. This lower level of interest rates, by reducing the cost of borrowing and encouraging consumers and firms to spend, will bring about a recovery – eventually. The problem is that, even at the best of times, interest rates take around 12 to 18 months to have their full effect. So they won't prevent a sharp contraction of the economy next year.

AC: There has been a lot of discussion about the credibility of the monetary framework as Britain enters its most inflationary period for more than a decade. What are your thoughts?

Vicky Redwood:

The Bank of England was, like the rest of us, caught unawares by just how sharp the rise in global food and energy prices was. But I don't think that this means that credibility in the monetary framework has been lost or that people believe that inflation has got out of control. After all, people's inflation expectations have remained low, helping us to avoid a wage-price spiral like those seen in the mid 1970s and early 1980s. As such, we should now see inflation fall quickly over the coming months. In fact, we could well see negative inflation by this time next year.

AC: You are involved in the KPMG/Synovate Retail Think Tank. Can you tell us about the objectives of the Think Tank and what you have achieved so far?

Vicky Redwood:

The KMPG/Synovate Retail Think Tank was set up to try to provide an objective and unbiased view of the state of health of the retail sector. It can be difficult to cut through the swathes of numbers, so we try to provide a balanced view on the outlook for the retail sector over the next few months. We also discuss the more important longer-term issues facing the retail sector, such as internet retailing or ethical issues. Our real achievement, I think, has been bringing together nine people who specialize in different areas of retail, from economics to property and banking, meaning that we give a really wide and comprehensive view of the major issues.

AC: You have noted that it is looking unlikely that banks will raise all the capital they need, and as a result they will have to rein in their lending. Can you elaborate on this?

Vicky Redwood:

Banks need to hold a certain amount of capital, relative to their assets, in order to ensure that they can absorb future losses if necessary. This capital has been eroded due to significant write-downs on their assets, related to both sub-prime lending and the wider economic downturn. Banks have raised some capital, both privately and from the government, but this might not be enough. If it isn't, banks will need to reduce their assets – i.e. the amount of credit they extend to firms and individuals – in order to keep their so-called capital ratios high enough.

AC: Liam Halligan has said that thanks to the wisdom of Gordon Brown, "the UK has endured a decade of grossly irresponsible fiscal policy." Do you agree with him?

Vicky Redwood:

It is certainly regrettable that the government did not improve the state of the public finances while they had the chance. If they had, they would have been able to give a much bigger fiscal stimulus to the economy in the recent Pre-Budget Report than the £20bn giveaway we actually saw. So in the sense that the government is unable to support the economy during this recession as much as it perhaps should be able to, then yes, fiscal policy has been irresponsible.

AC: To repair damage there has been a lot of talk about moving away from highly geared investment banks to lower leverage and more highly regulated commercial banks. What is your take on this and the role of regulation in general?

Vicky Redwood:

I think the quid-pro-quo of the government helping out the banks by injecting capital is that they must now accept a greater degree of regulation. The key issue is to prevent this regulation going too far and hindering the growth of the UK economy in the future.

AC: In a recent article you blamed the rise in energy bills as the key factor behind the rise in both company and personal insolvencies. Can you tell us more?

Vicky Redwood:

Both company and personal insolvencies have risen in the past few months – even though it is too soon for the effects of the recession to have fed through into the insolvency figures yet. Accordingly, I think that that the rises probably reflect the sharp rises in petrol, gas and electricity prices seen over the past couple of years, which have squeezed household incomes and corporate profits. Unfortunately, insolvencies are only likely to rise further as the economy deteriorates and unemployment rises.

"In the sense that the government is unable to support the economy during this recession as much as it perhaps should be able to, then yes, fiscal policy has been irresponsible."

AC: Are there any closing comments you wish to make?

Vicky Redwood:

It's certainly an interesting time to be an economist. It's just unfortunate that I can't be the bearer of the better news. Falling energy prices, further interest rate cuts and tax cuts will bring some relief over the coming months. But I don't expect this recession to end until 2010 at the earliest.

January 2009.