Global & UK Macroeconomic Outlook

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World forecast

Summary of International Forecasts	2011	2012	2013	2014	2015	2016	2017
Real GDP							
North America							
United States	1.8	2.3	2.3	3.1	3.3	2.9	2.8
Canada	2.6	2.0	1.7	2.9	2.8	2.6	2.6
Europe							
Eurozone	1.5	-0.5	-0.2	1.1	1.4	1.5	1.6
Germany	3.1	0.9	0.7	1.9	1.7	1.6	1.4
France	1.7	0.0	0.0	1.1	1.2	1.3	1.4
Italy	0.6	-2.1	-1.2	0.3	1.1	1.2	1.3
EU27	1.6	-0.3	0.1	1.4	1.8	1.8	1.9
Asia							
Japan	-0.5	2.0	0.5	1.7	2.1	1.2	1.6
China	9.3	7.7	8.3	9.0	8.5	8.0	7.7
India	7.5	5.4	6.0	7.5	7.9	7.8	7.7
World	2.9	2.3	2.4	3.4	3.7	3.5	3.5

In mid 2012, risks were skewed to the downside..

- **US fiscal cliff (10%)**
  - Stalemate in the House implies much larger fiscal tightening than in baseline
  - Business and consumer confidence negatively affected
  - Additional QE and weaker US$ to provide only partial offsets
  - Trade and financial linkages cause global slowdown

- **Multiple Eurozone exits (30%)**
  - Fiscal austerity in Greece becomes unbearable; government falls and defaults
  - Financial contagion spreads
  - Run on banks in peripherals leading to credit crunch,
  - Cyprus, Portugal, Spain, Italy & Ireland also forced out of Eurozone.

- **Oxford Forecast (45%)**
  - Eurozone avoids breakup. ECB and governments take significant steps to ensure Eurozone survival
  - Risk premia fall, and consumer and business confidence gradually recover.
  - Recovery limited by high debt, weak job growth and fiscal retrenchment
  - EMs robust as policy eases and growing middle class support consumer spending and trade

- **China hard landing (15%)**
  - Commercial property crash & external weakness leads to banking sector stress
  - Flight from risk leads to falling share & property prices
  - Investment slumps in China as government recapitalises banks
  - Asian supply chain affected as domestic engine of growth stalls

…but now the risks are much more balanced

- **Middle East tensions (5%)**
  - Political tensions escalate in Egypt, Syria and Iran
  - Concerns about stability in the region push oil prices to over $200/barrel
  - Business and consumer confidence hit by energy shock
  - Political situation stabilises gradually. Oil prices return to baseline by 2015.

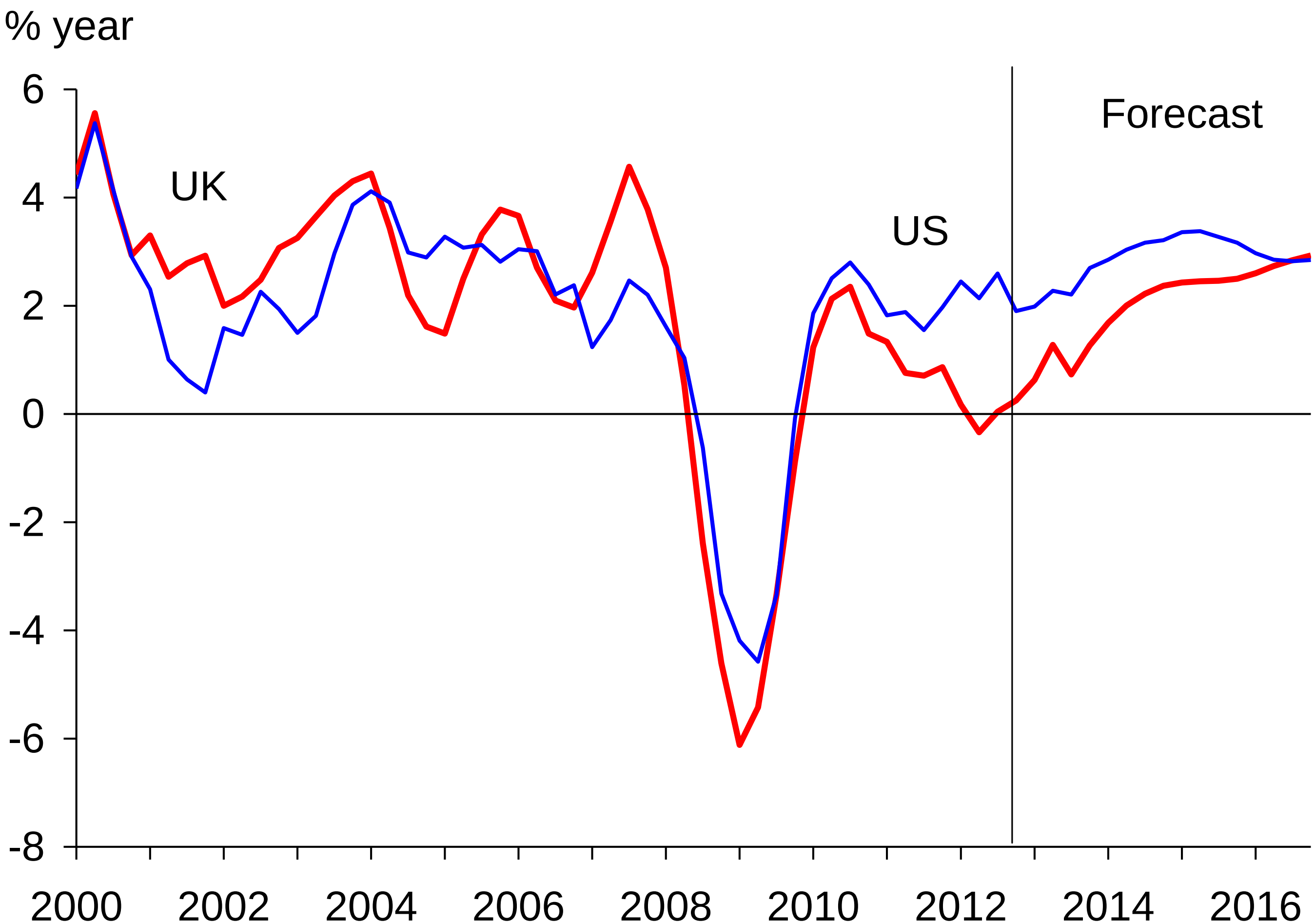
- **Eurozone exits in 2014 (15%)**
  - Fiscal austerity in peripheral countries becomes unbearable
  - No growth pushes unemployment yet higher. Pro-exit parties gain popularity.
  - No real progress on banking and fiscal union,
  - 6 countries exit Eurozone in 2014 Q1.

- **Oxford Forecast (60%)**
  - Steps to ensure Eurozone survival are taken, although they are not enough to kick start significant growth.
  - Risk premia fall, and consumer and business confidence gradually recover.
  - Recovery limited by public and private deleveraging and weak job growth
  - EMs robust as policy eases and growing middle class support consumer spending and trade

- **Faster upturns in US & EMs (15%)**
  - Resolution of outstanding fiscal issues encourages investment and hiring in the US.
  - Momentum in EMs builds as trade picks up and accommodating policy feeds through
  - Business and consumer confidence rise as conditions improve.

UK vs US – GDP growth

GDP growth



Source : Oxford Economics/ Haver Analytics

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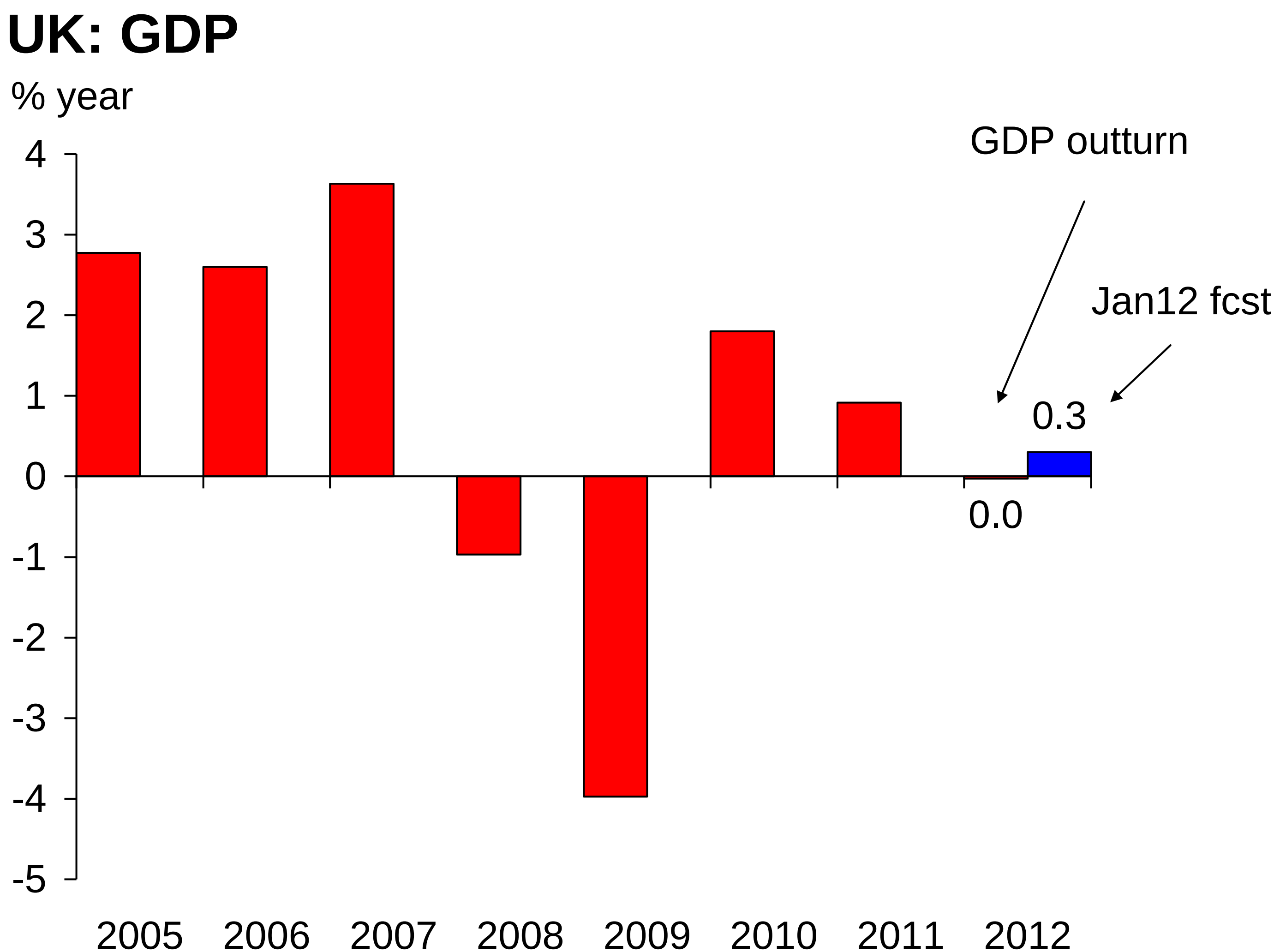
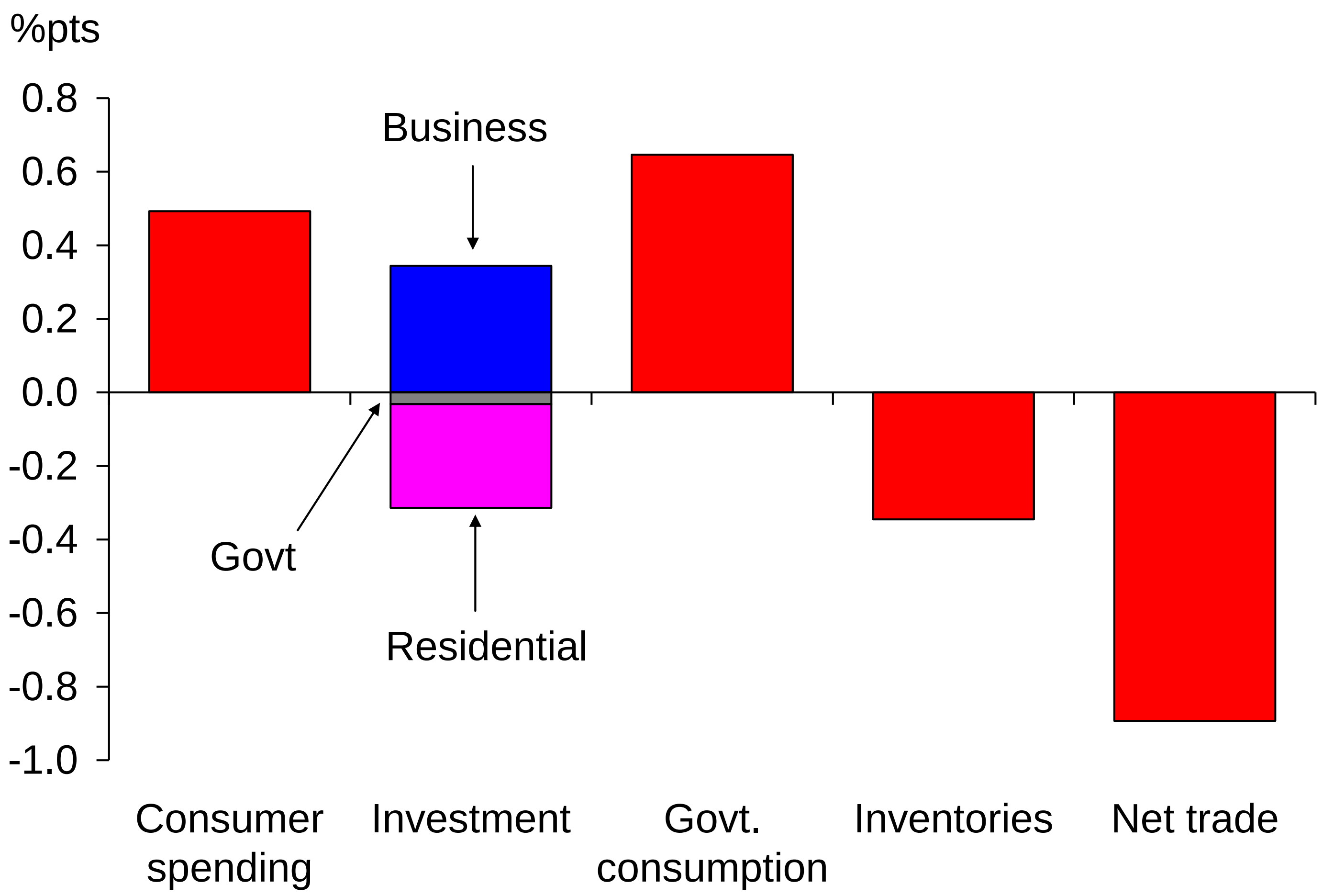
As expected, 2012 was a difficult year…



Source : Oxford Economics

…mainly due to poor export performance

UK: Contributions to GDP growth (2012)



Source : Oxford Economics/Haver Analytics

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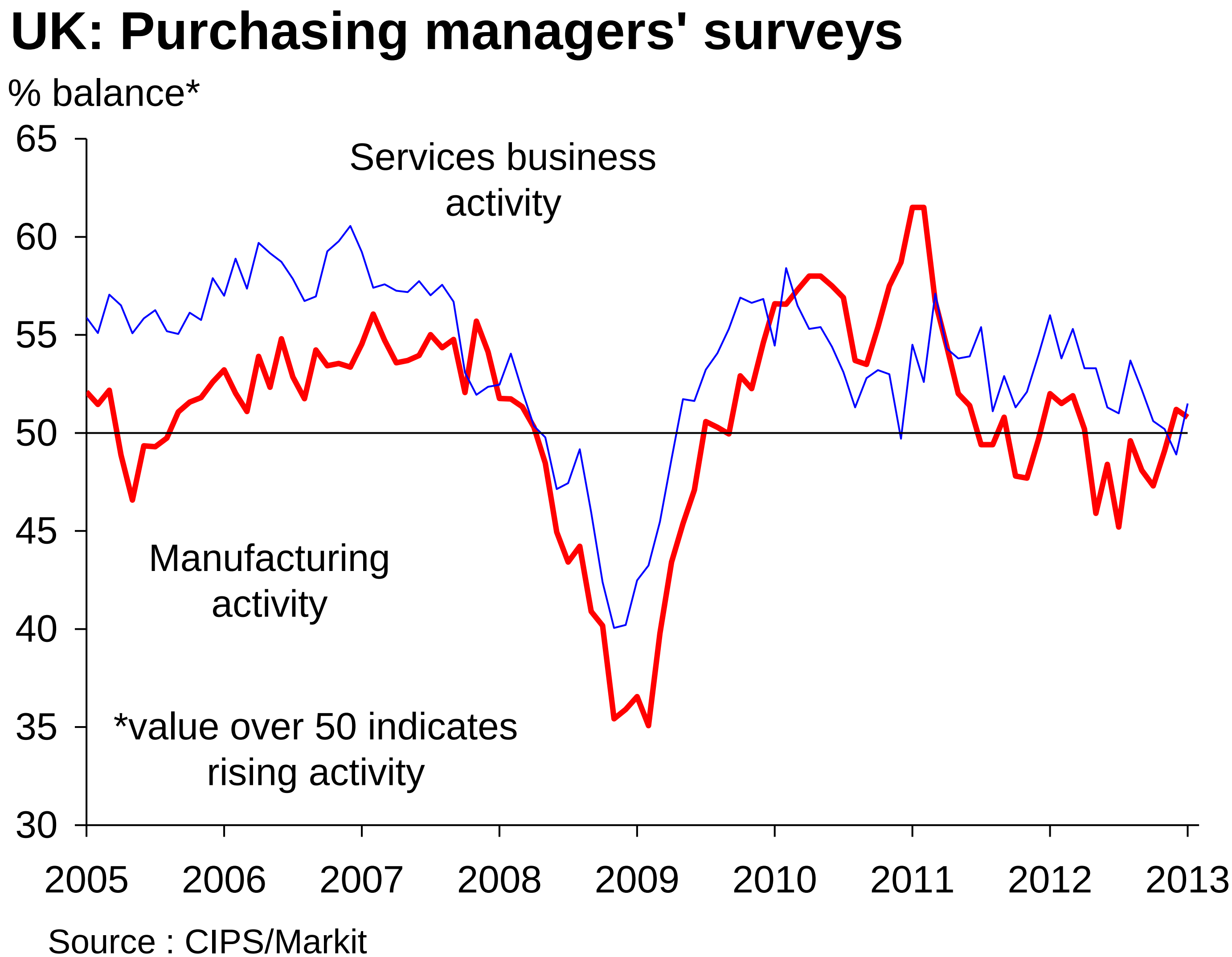
Little momentum heading into 2013

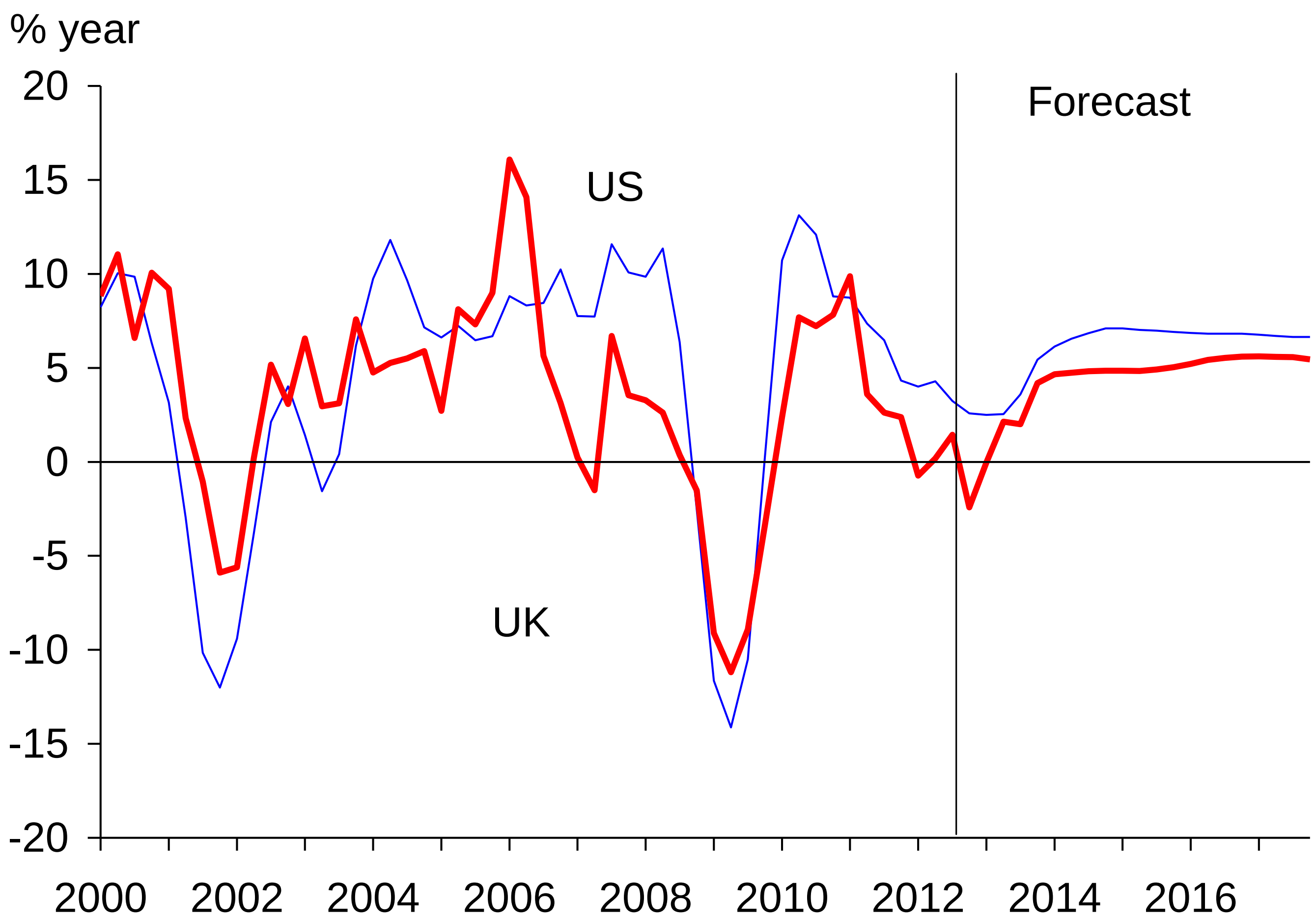


Predictions for the UK economy in 2013

- Exports to do be better in 2013

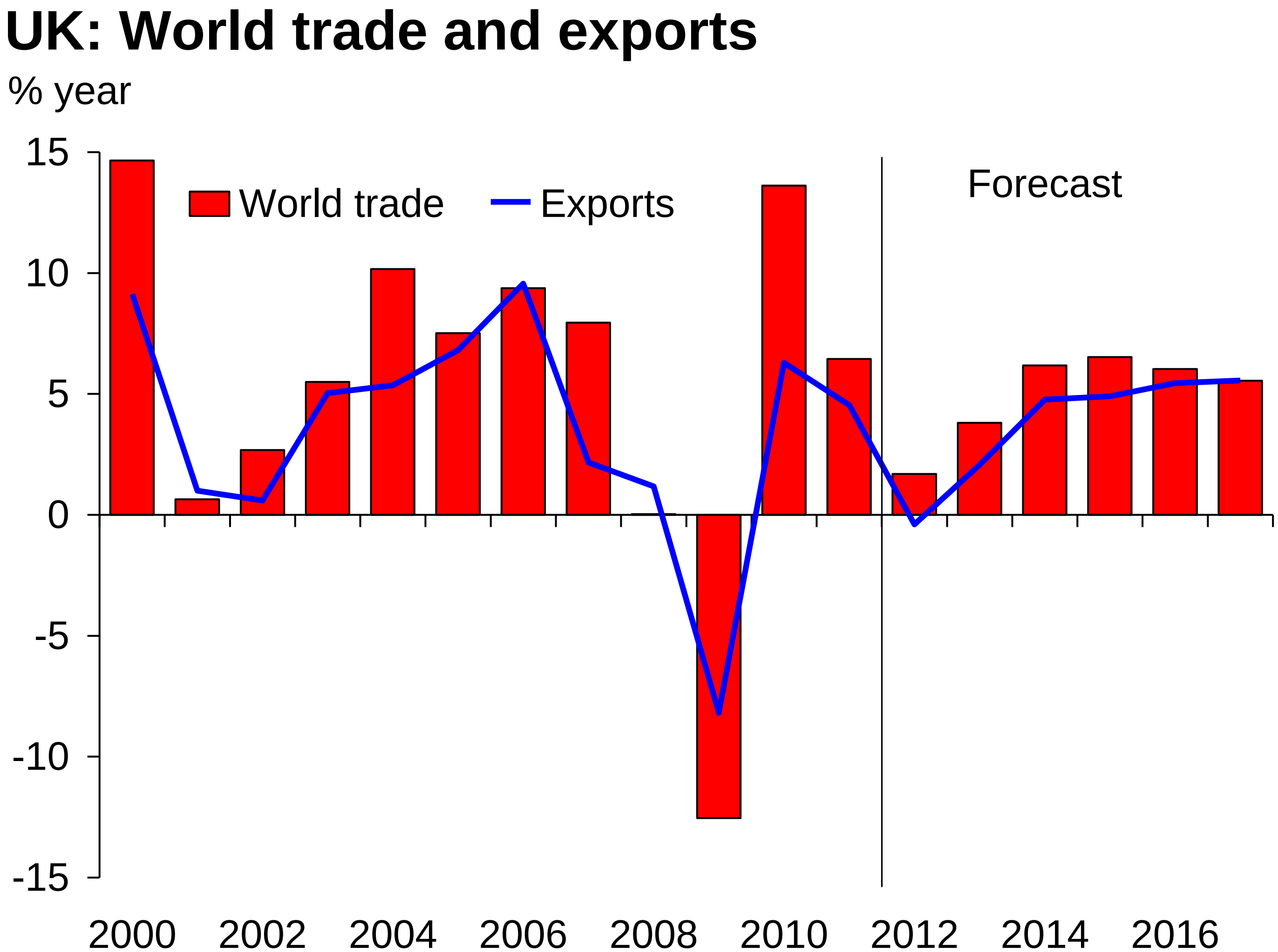
UK vs US – Exports

Export volume growth



Source : Oxford Economics/ Haver Analytics

Eurozone weakness will constrain export pickup



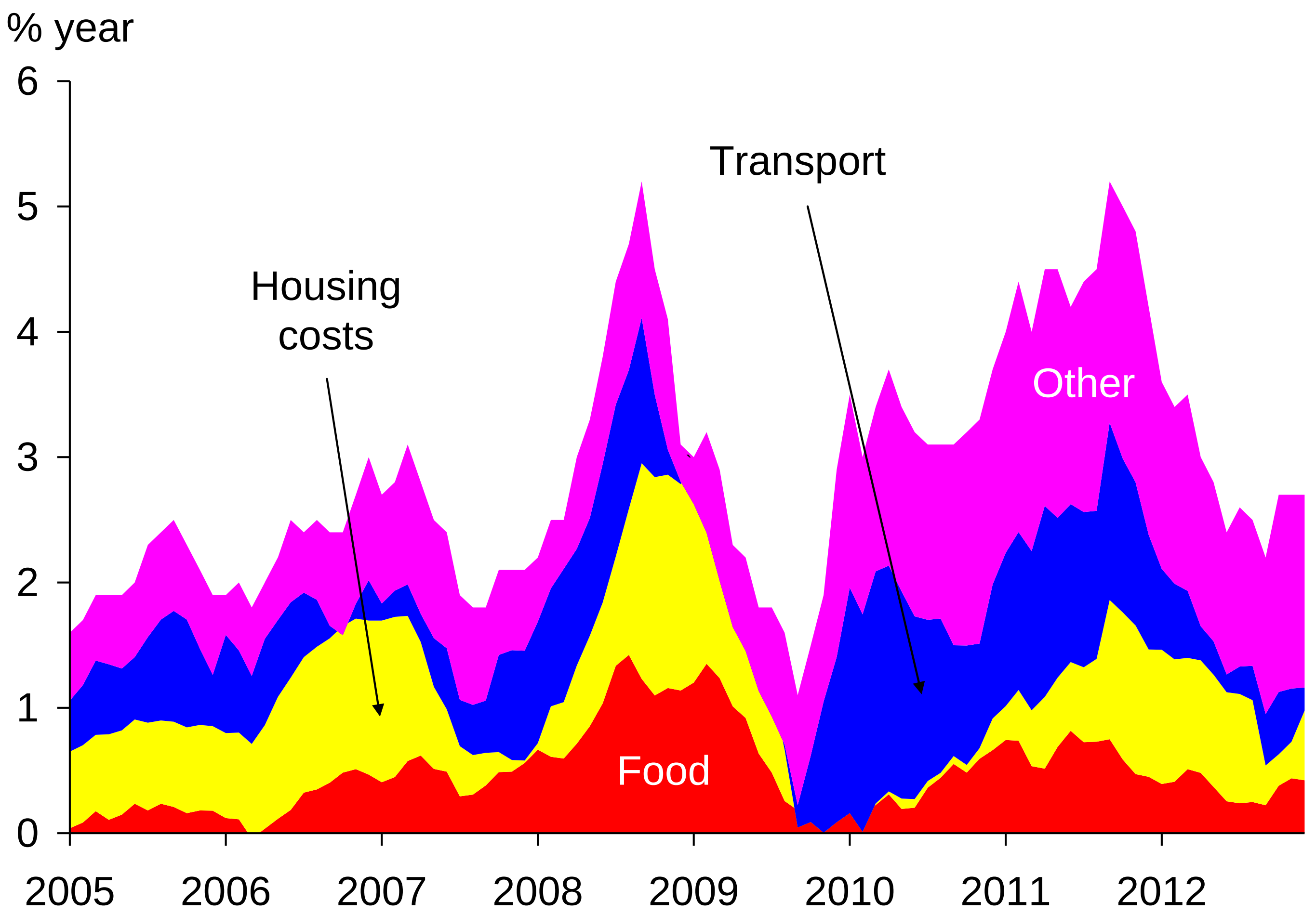
Source : Oxford Economics/Haver Analytics

Predictions for the UK economy in 2013

- Exports to do be better in 2013
- Inflation will eventually move back to target….but not until the latter part of the year

Inflation remained stubbornly high in 2012H2

UK: Contributions to CPI inflation



Source : Oxford Economics/Haver Analytics

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Stable oil prices should help reduce inflation…

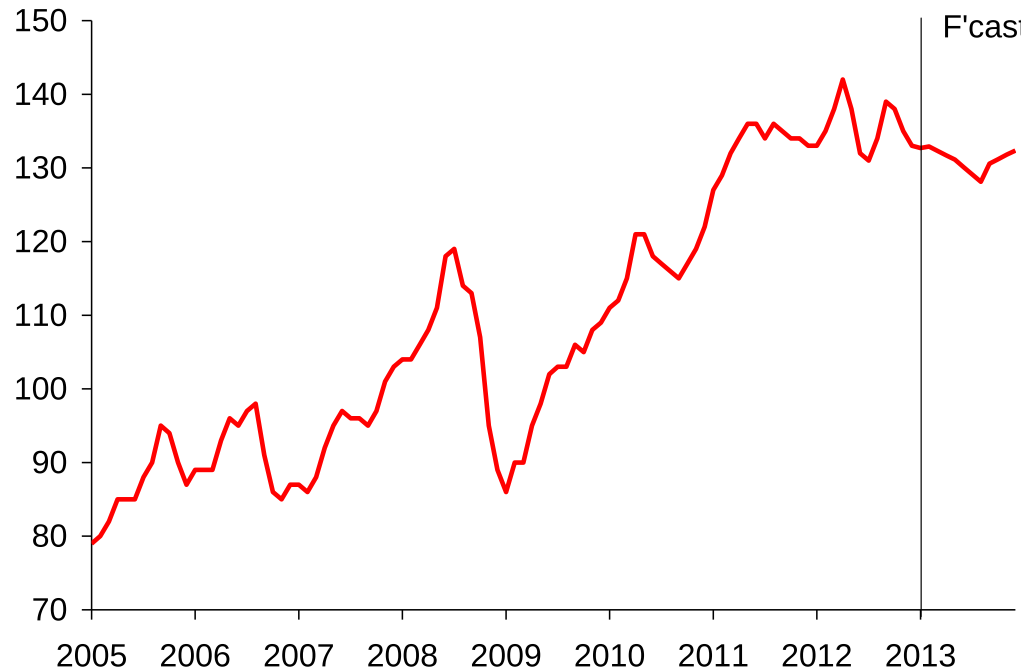
World: Oil price

$ per barrel

Source : Oxford Economics/Haver Analytics

UK: Unleaded petrol prices

pence per litre



Source : Oxford Economics/Haver Analytics

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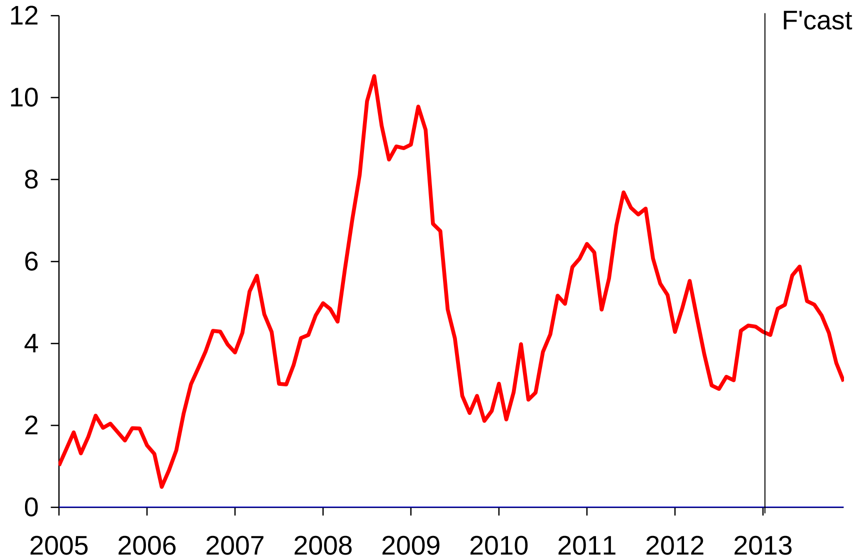
…but will initially be offset by food and utilities…

UK: Food prices

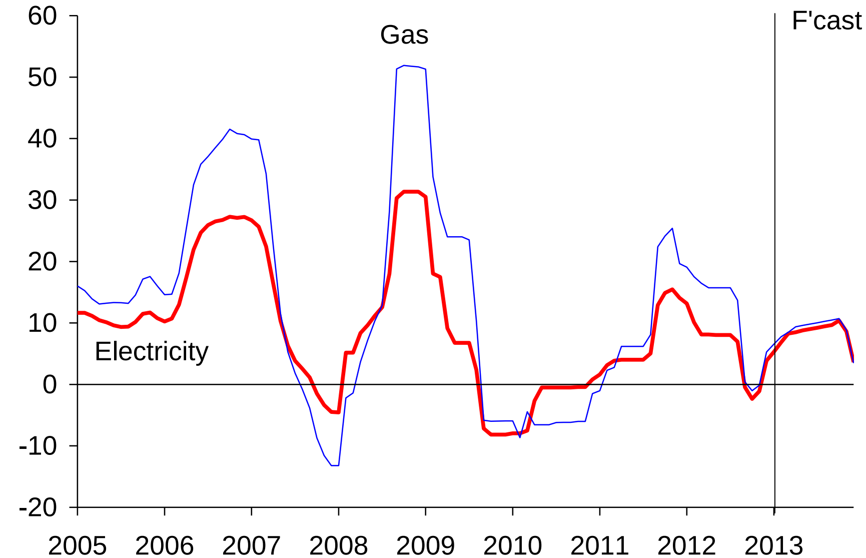
% year



Source : Oxford Economics/Haver Analytics

UK: Domestic energy prices

% year



Source : Oxford Economics/Haver Analytics

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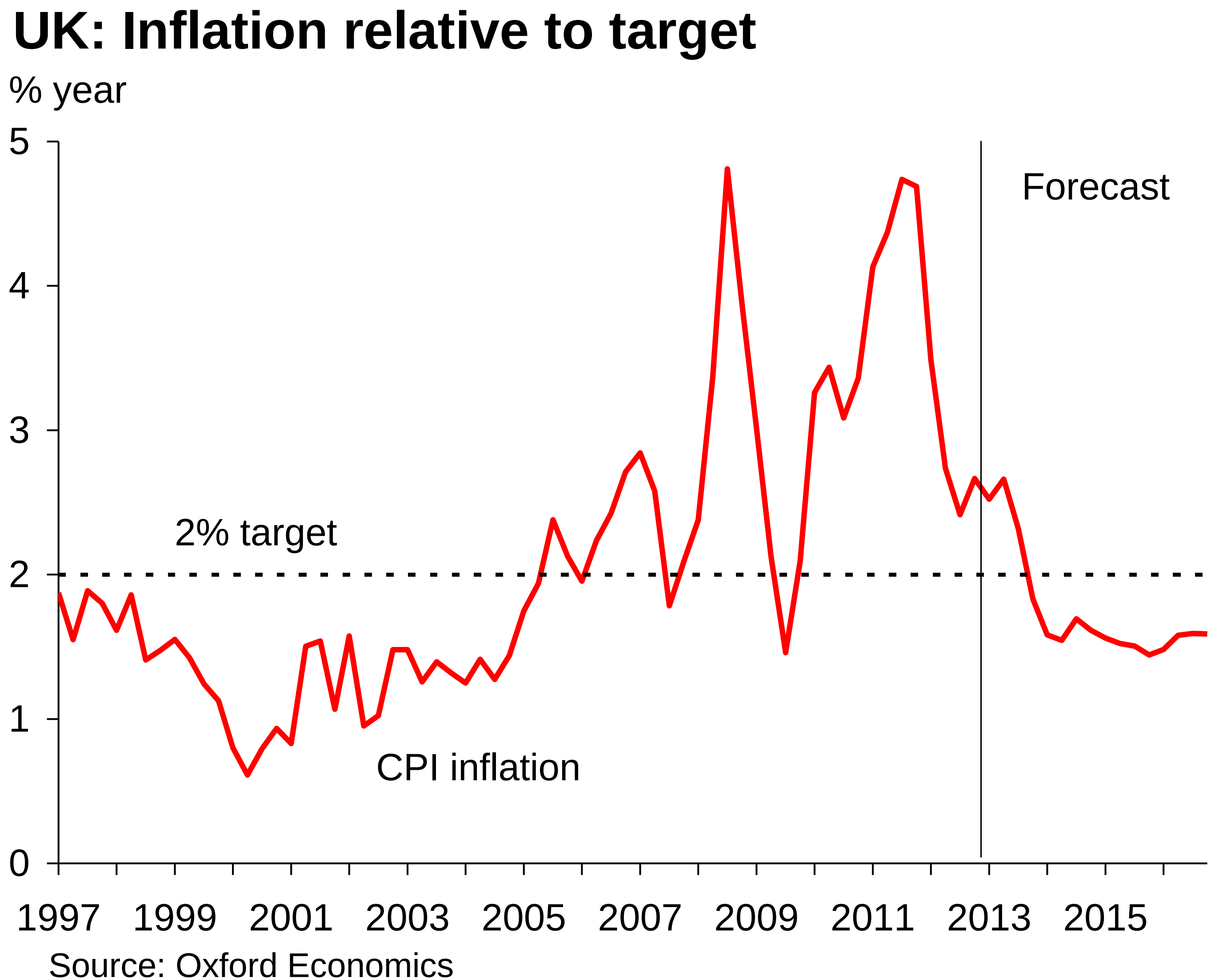
…so it will be end-13 before CPI is back at 2%



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Predictions for the UK economy in 2013

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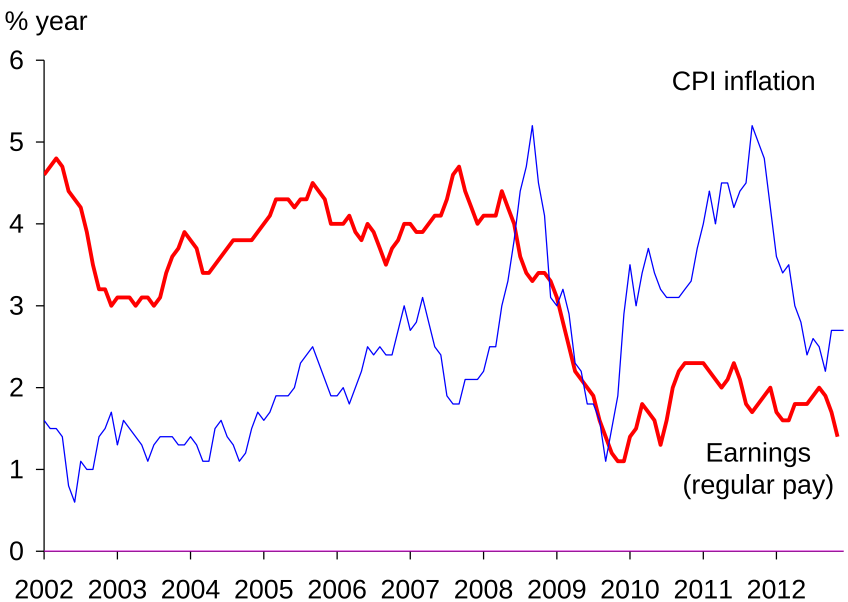
- Consumer spending to grow modestly again this year

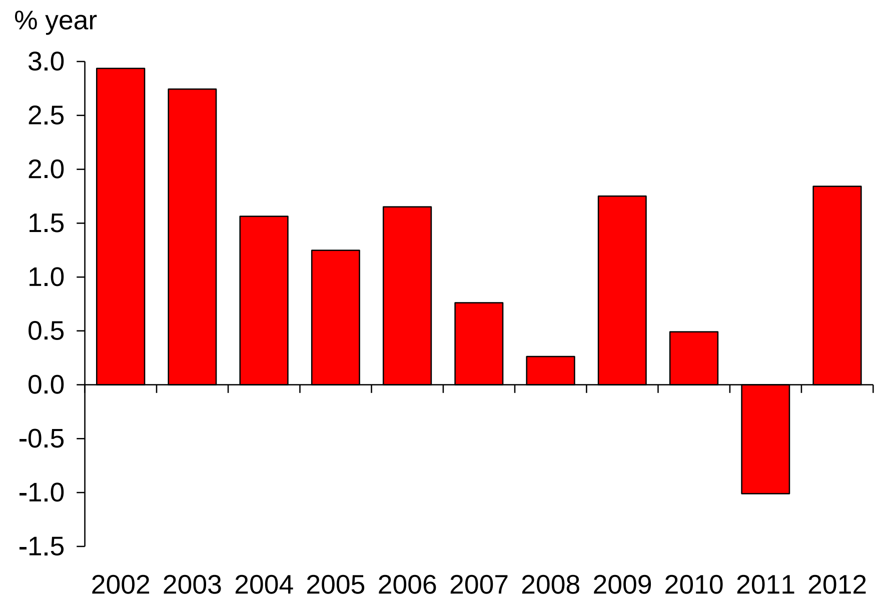
Real incomes held up surprisingly well in 2012

UK: Real wages



Source : Haver Analytics

UK: Real personal disposable income



Source : Oxford Economics/Haver Analytics

A sharp rise in employment, plus generous uprating of state benefits more than offset the impact of below-inflation earnings growth

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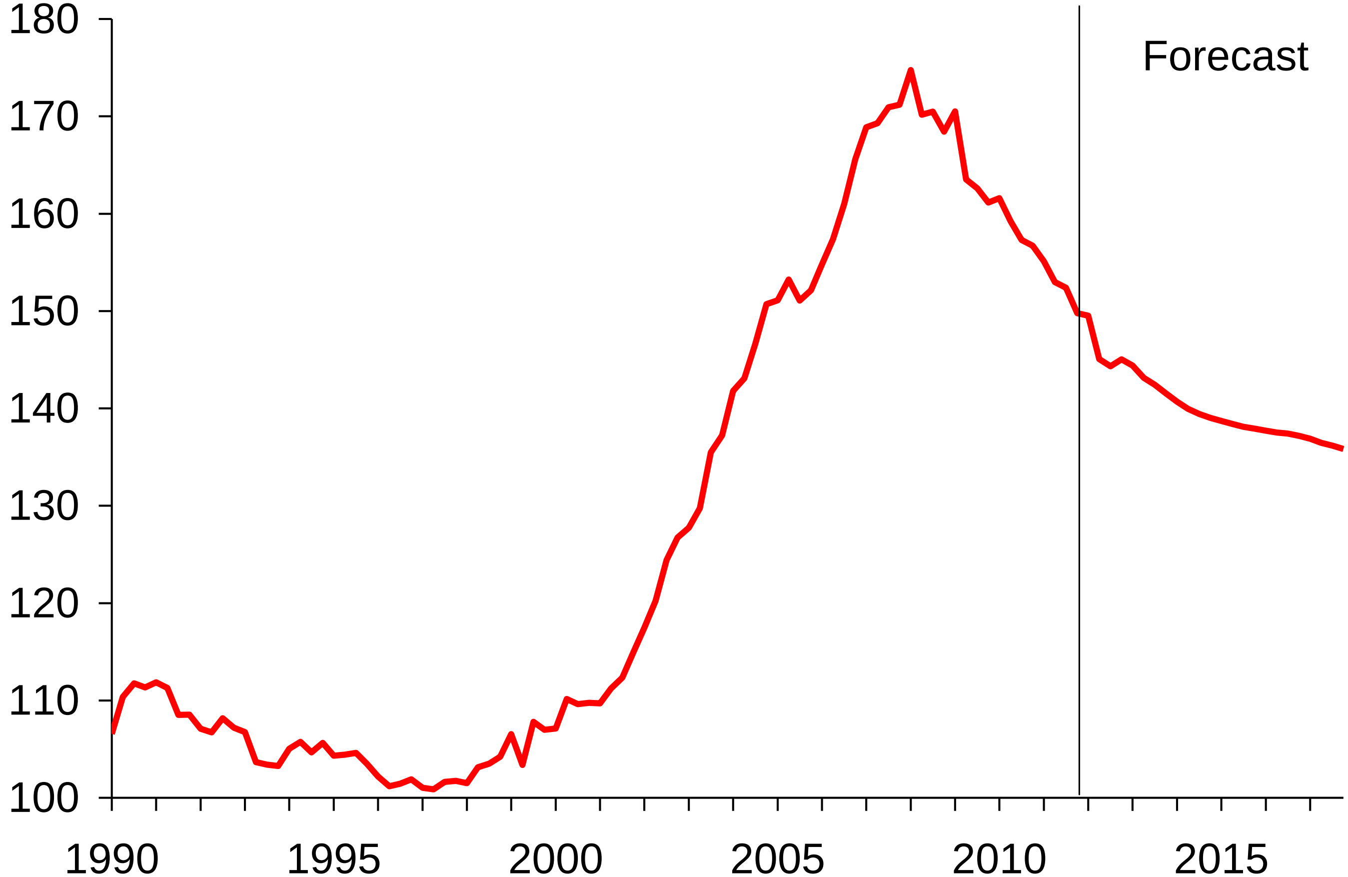
Consumers are still looking to deleverage

UK: Household debt-to-income ratio

% of household disposable income



Source : Oxford Economics/Haver Analytics

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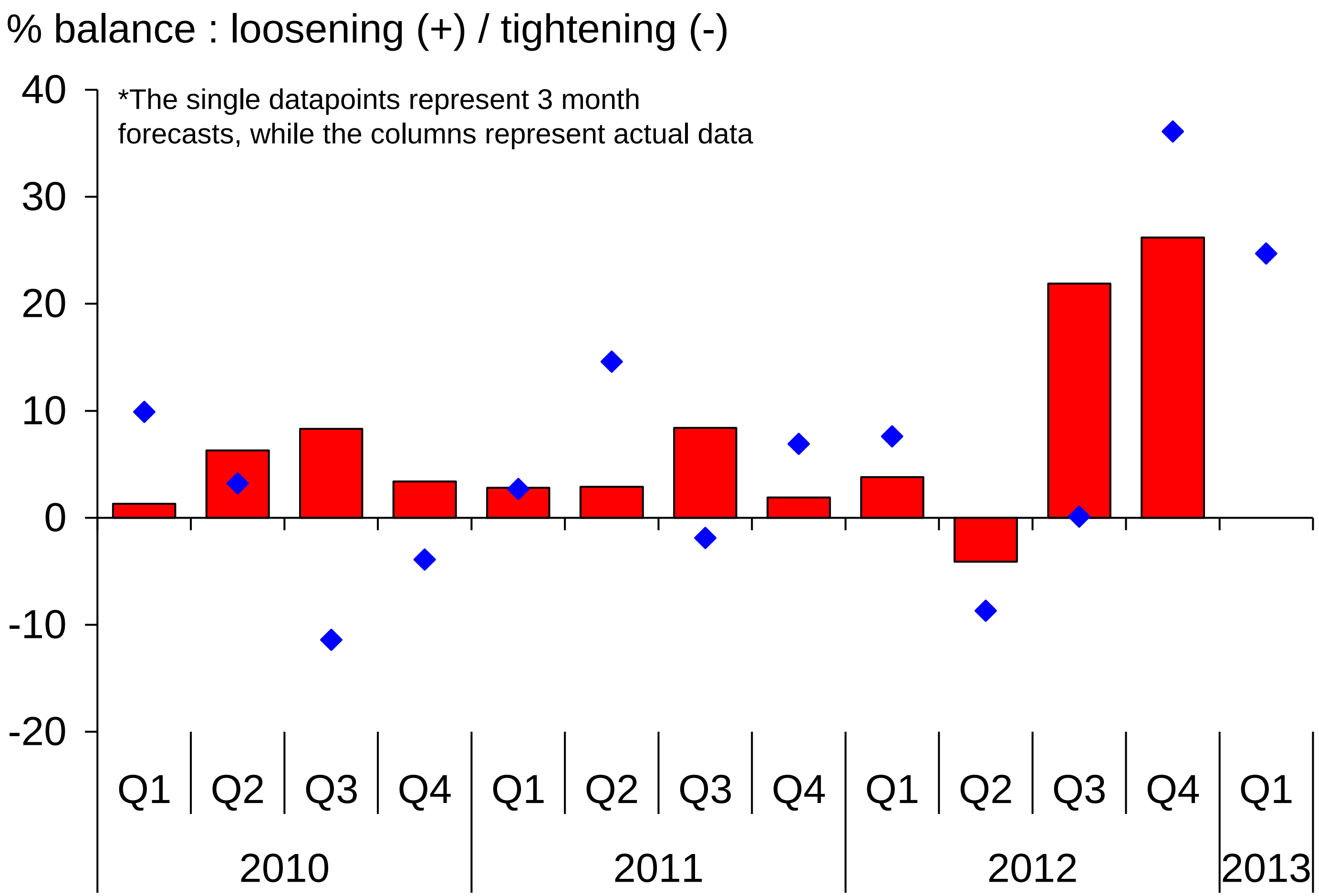
Banks are bullish about mortgage availability…

UK: Mortgage availability



Source : Bank of England Credit Conditions Survey

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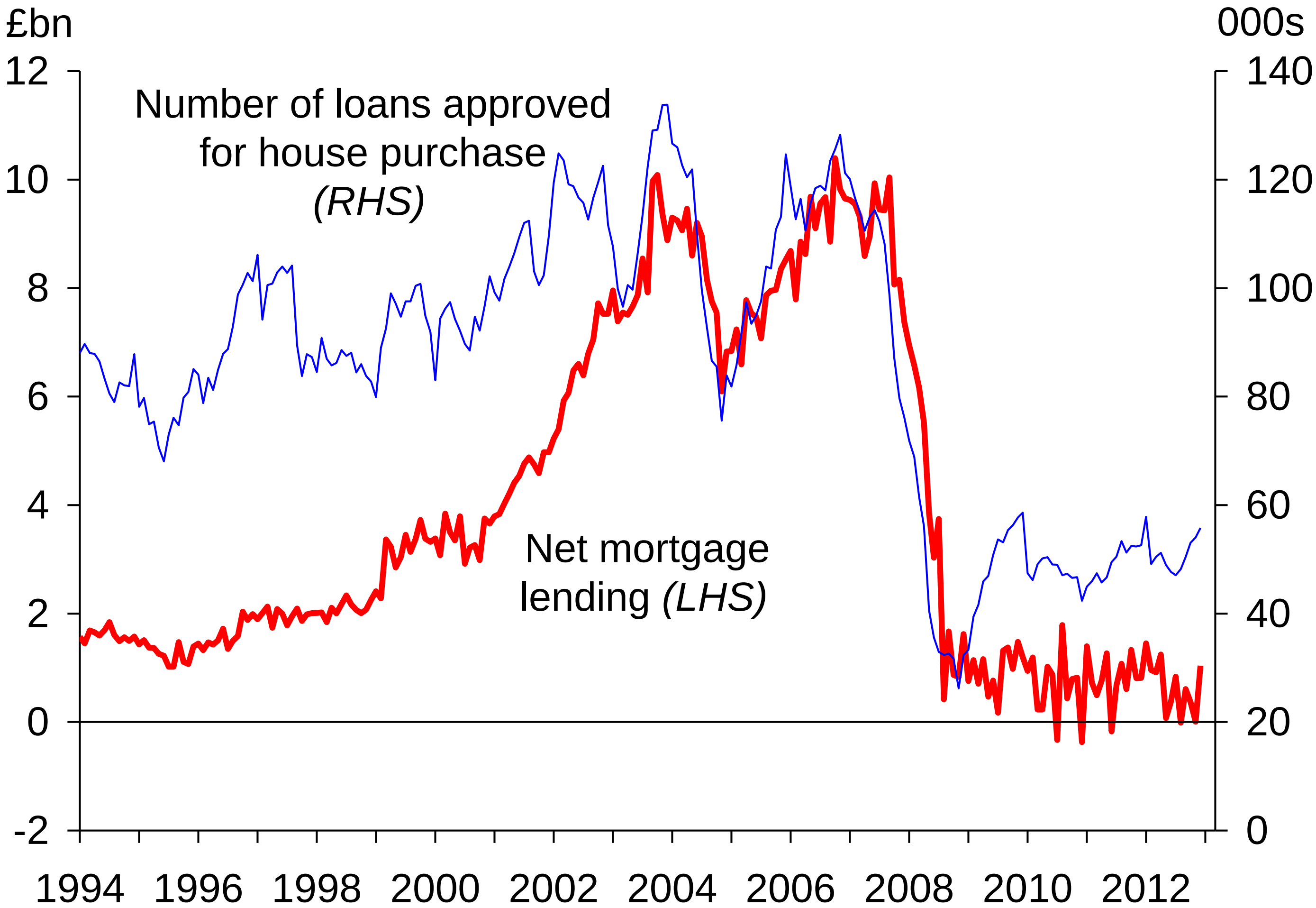
…but impact on lending has been small so far…

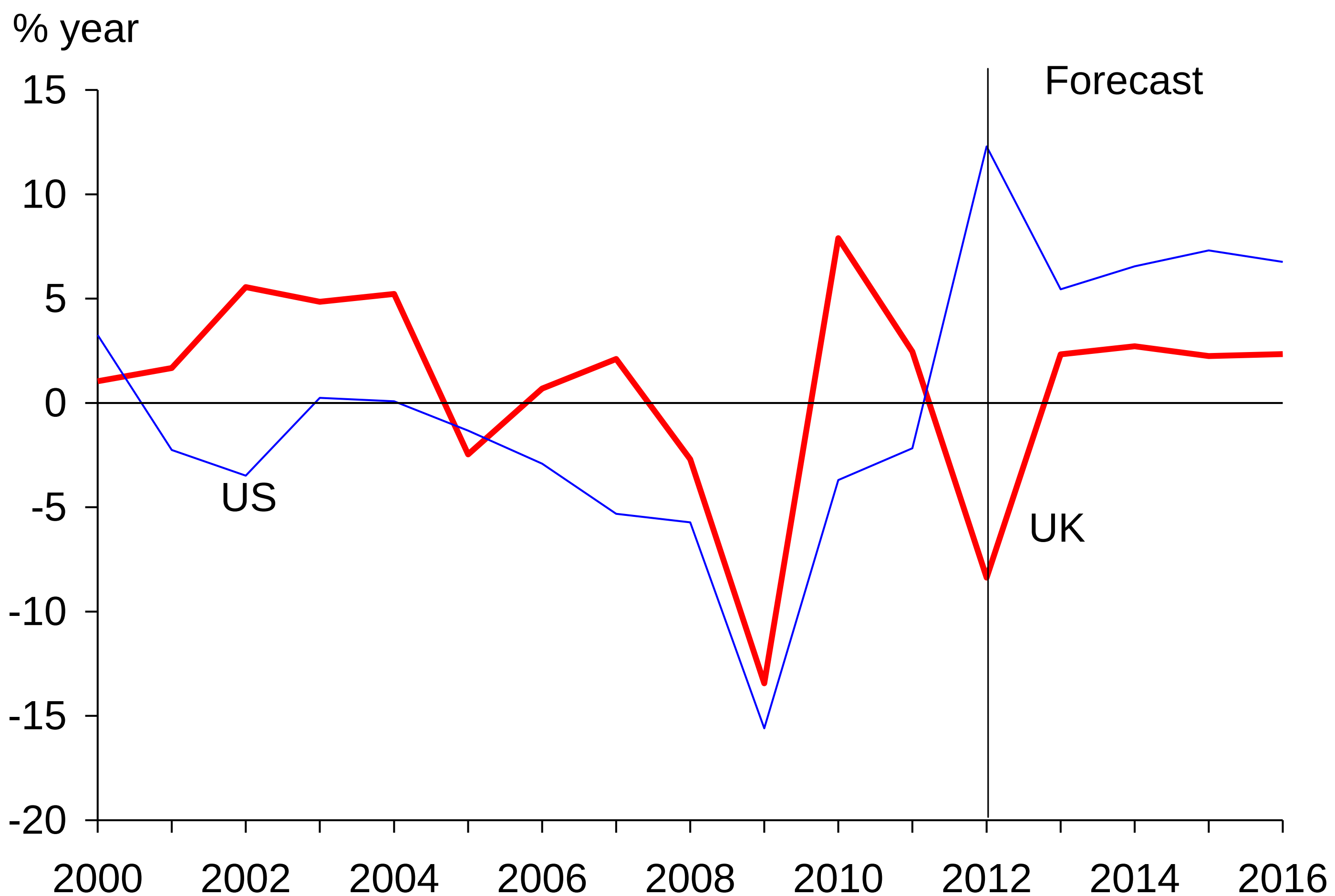
UK: Housing market activity



Source: Haver Analytics

UK vs US – Value added in construction

GVA in construction



Source : Oxford Economics/Haver Analytics

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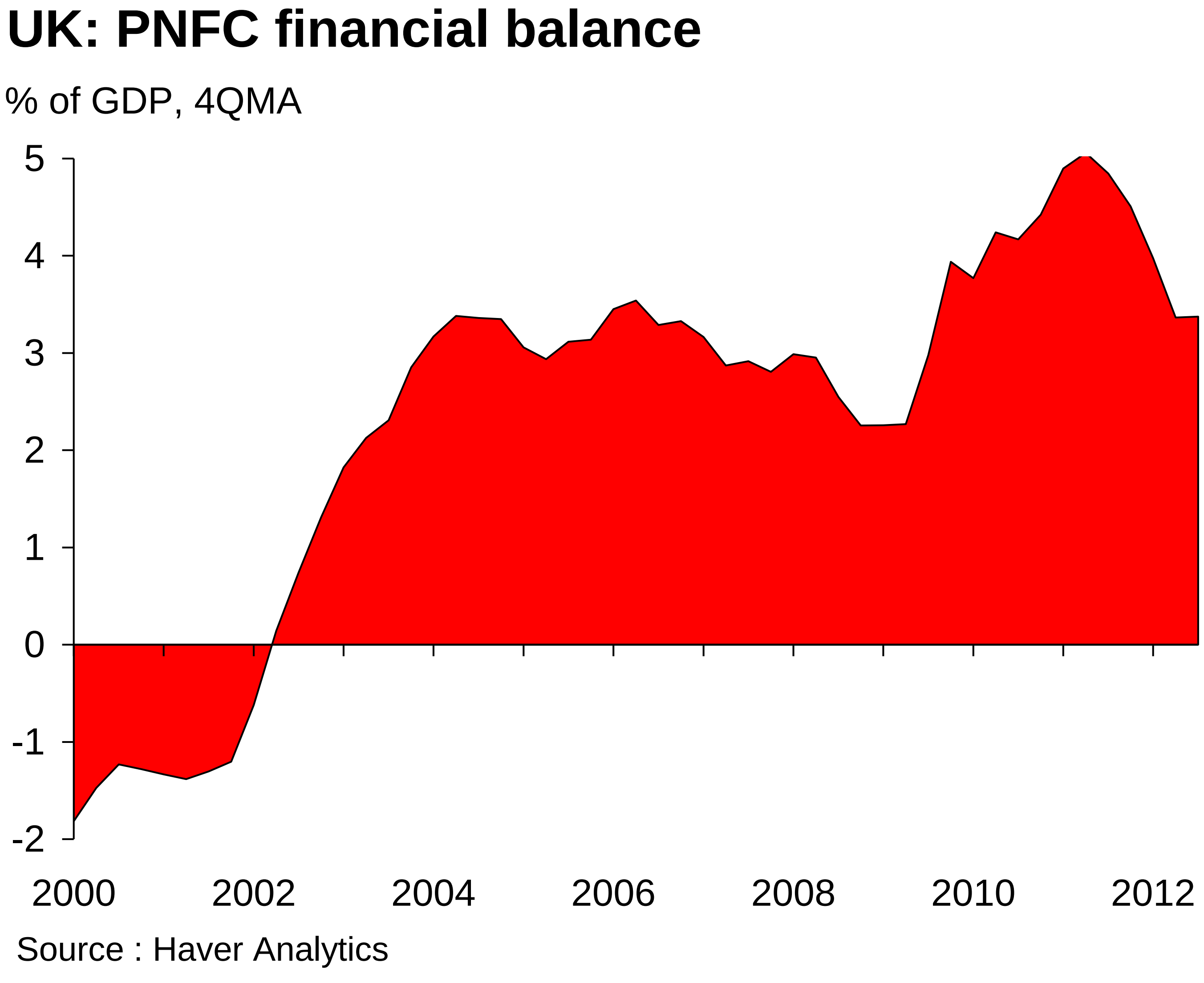
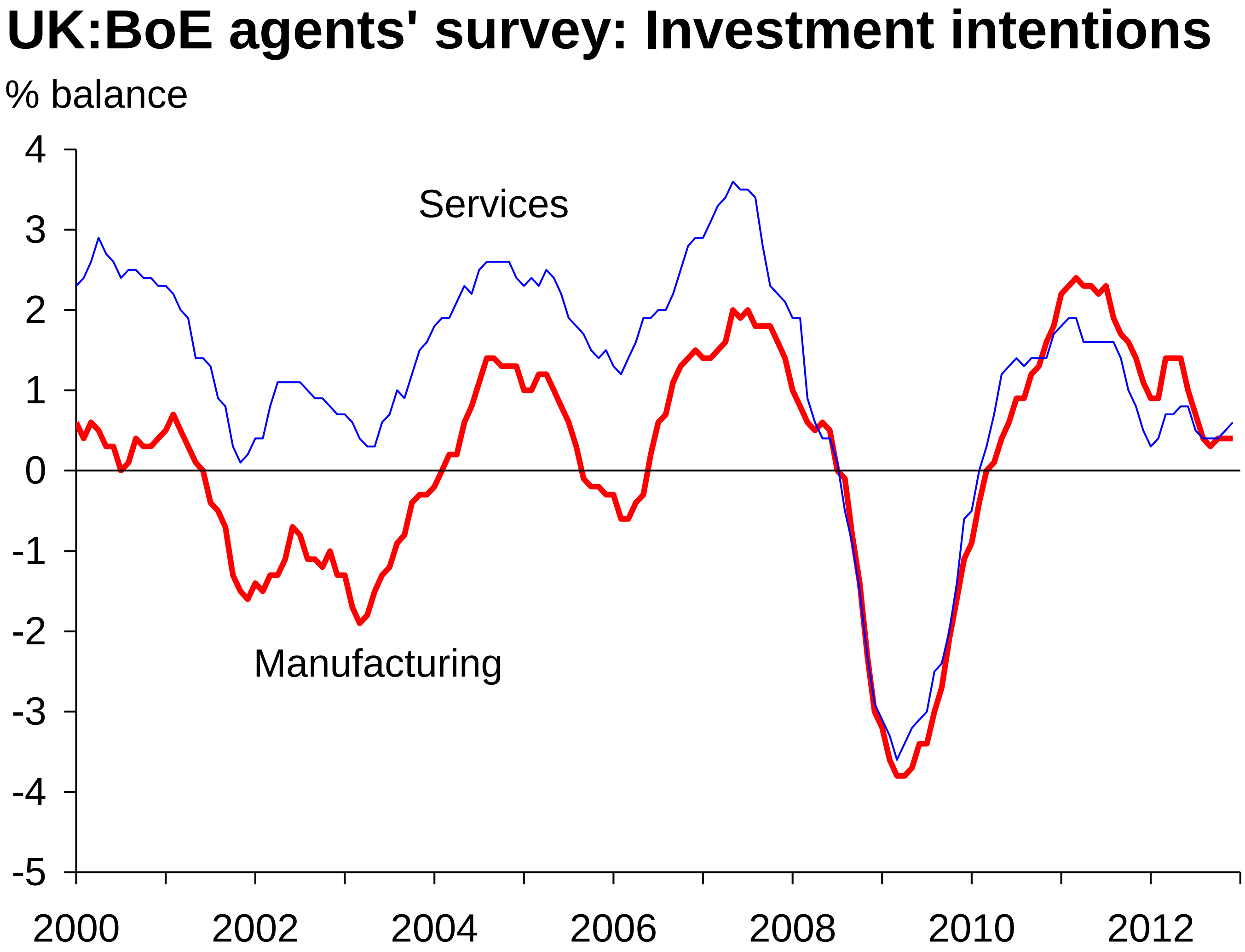
- Firms will remain reluctant to commit funds to investment because of on-going uncertainty around the outlook

Firms are still awash with cash…



…but remain reluctant to spend…

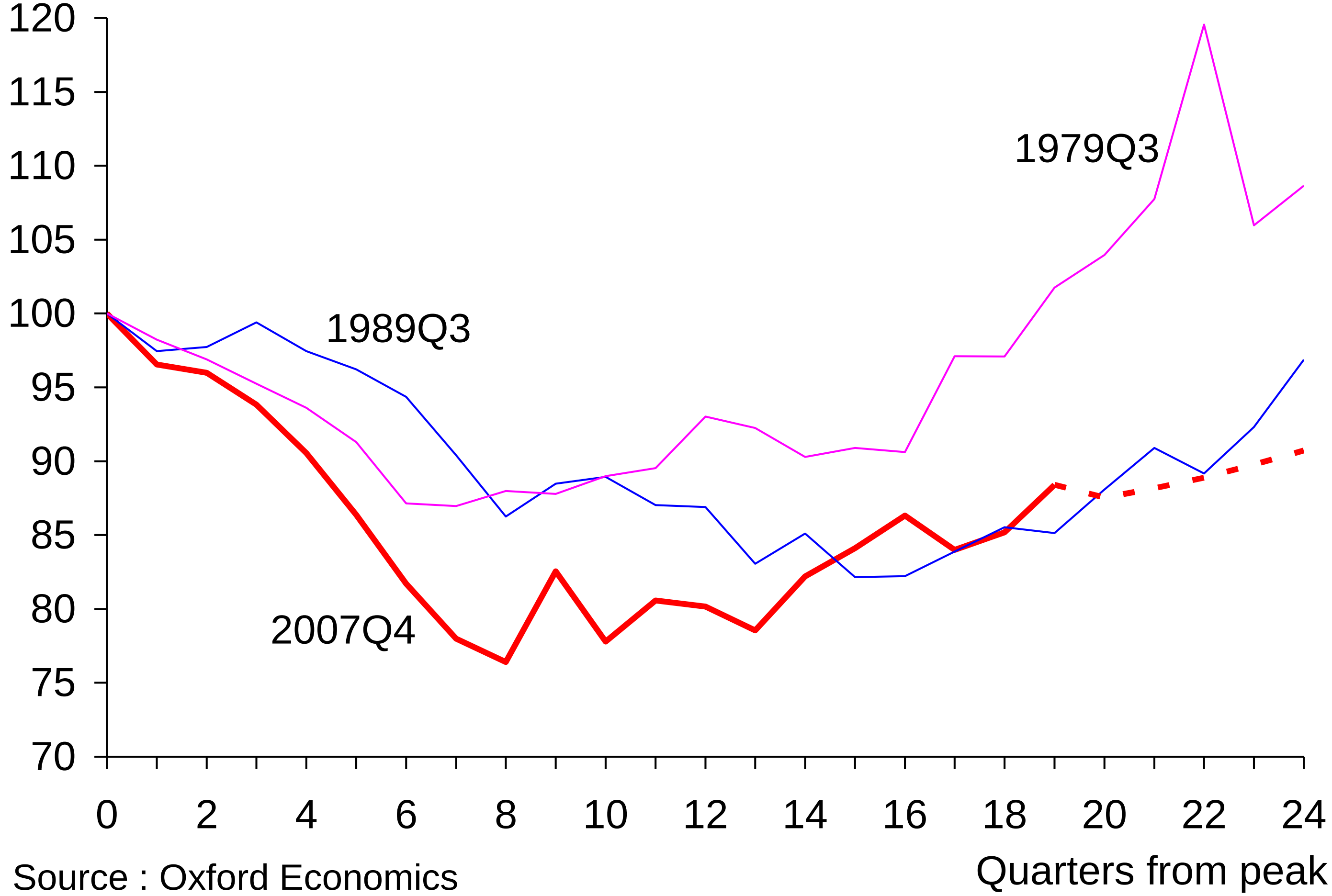


Source : Haver Analytics

…and investment is likely to continue to lag

UK: Business investment across cycles

Rebased, cyclical peak = 100



Source : Oxford Economics

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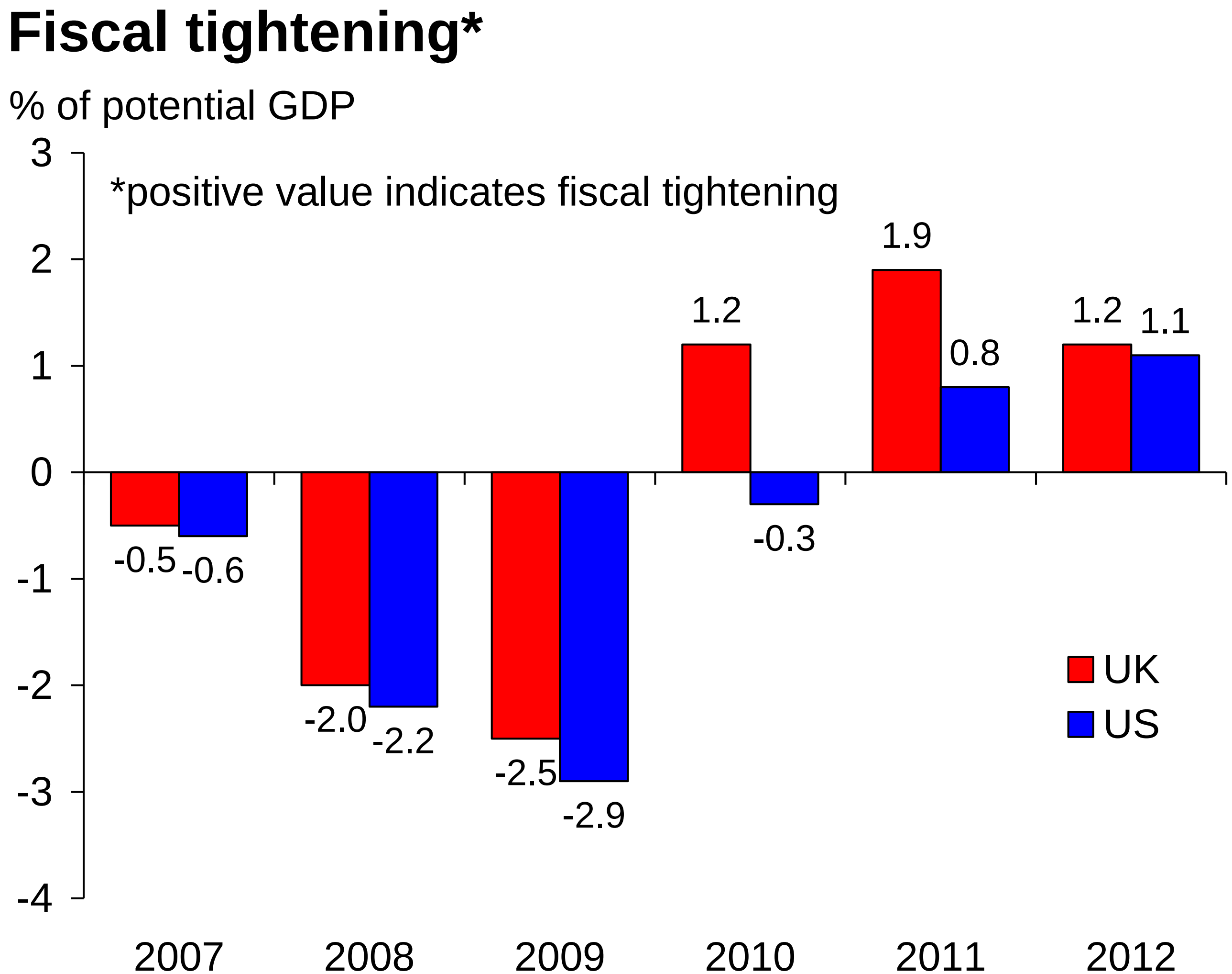
- The Chancellor will continue to follow ‘Plan A’ despite further weak growth and failing to achieve OBR’s fiscal forecasts

UK vs US – Fiscal tightening



Source : IMF

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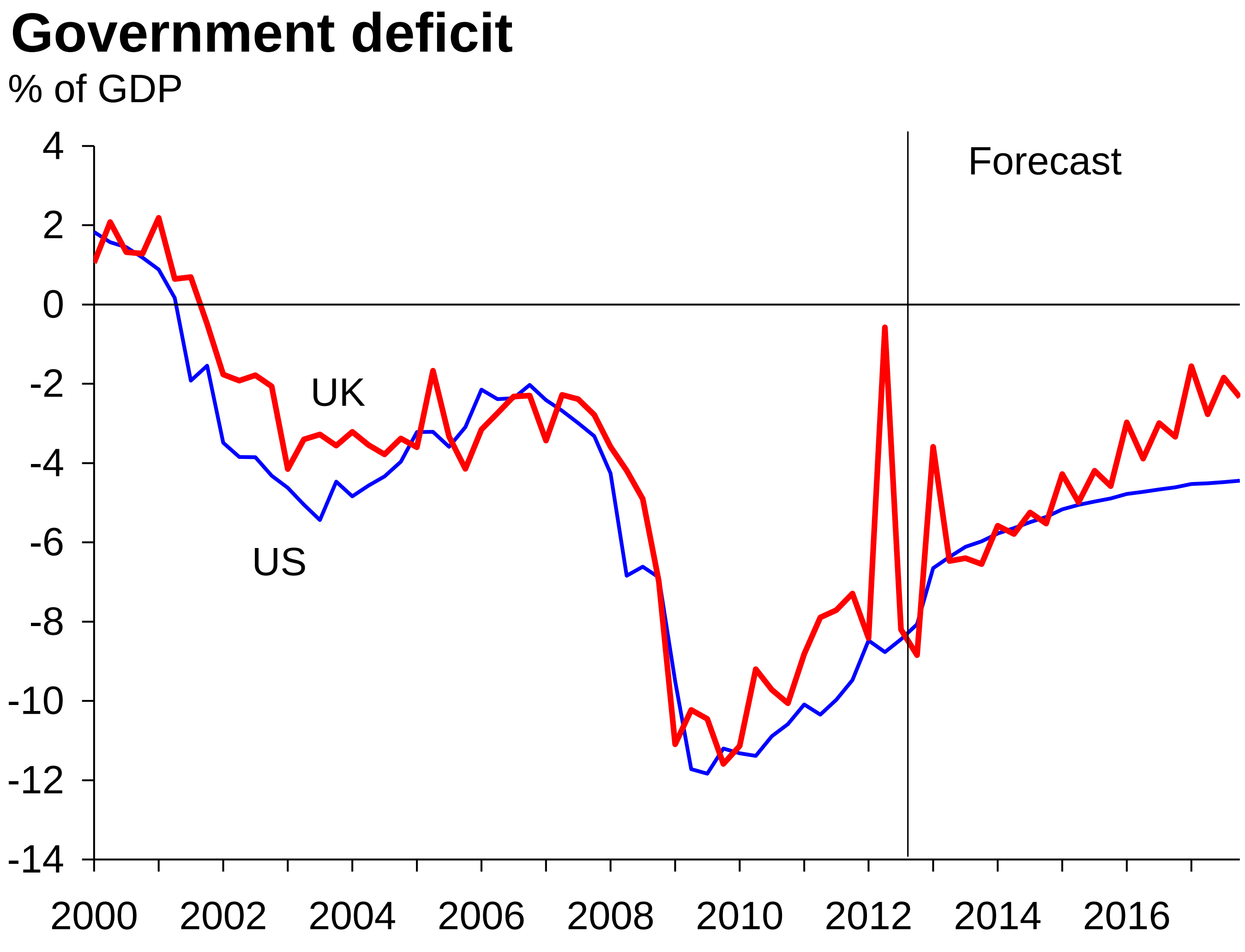
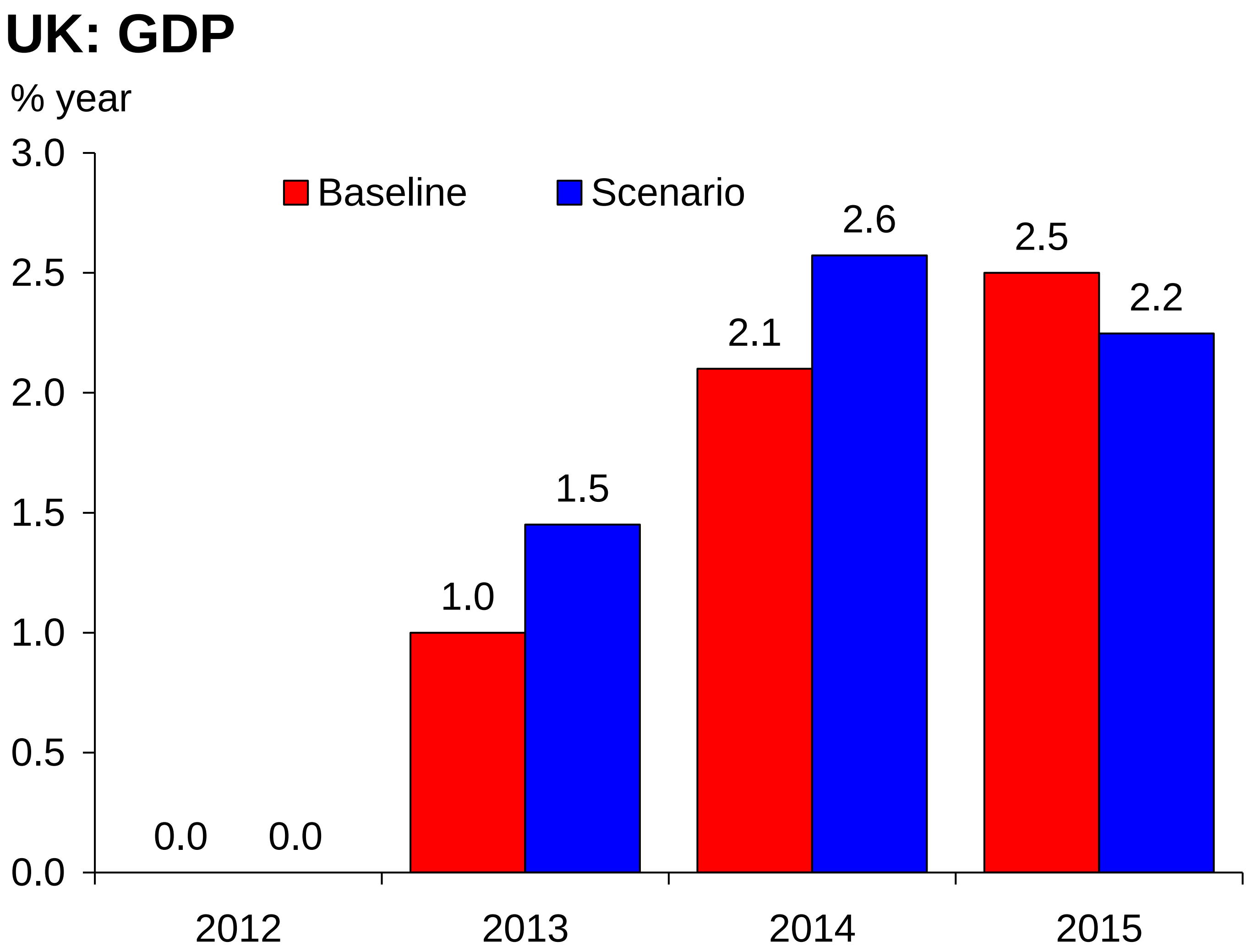
UK vs US – Government deficit



Source : Oxford Economics/ Haver Analytics

Boost to capital spending was too timid



Source : Oxford Economics

Baseline includes £5bn of extra capital spending between 2013-15, paid for by deeper current spending cuts

Scenario shows impact of £10bn of additional capital spending in both 2013/14 and 2014/15, paid for through additional borrowing

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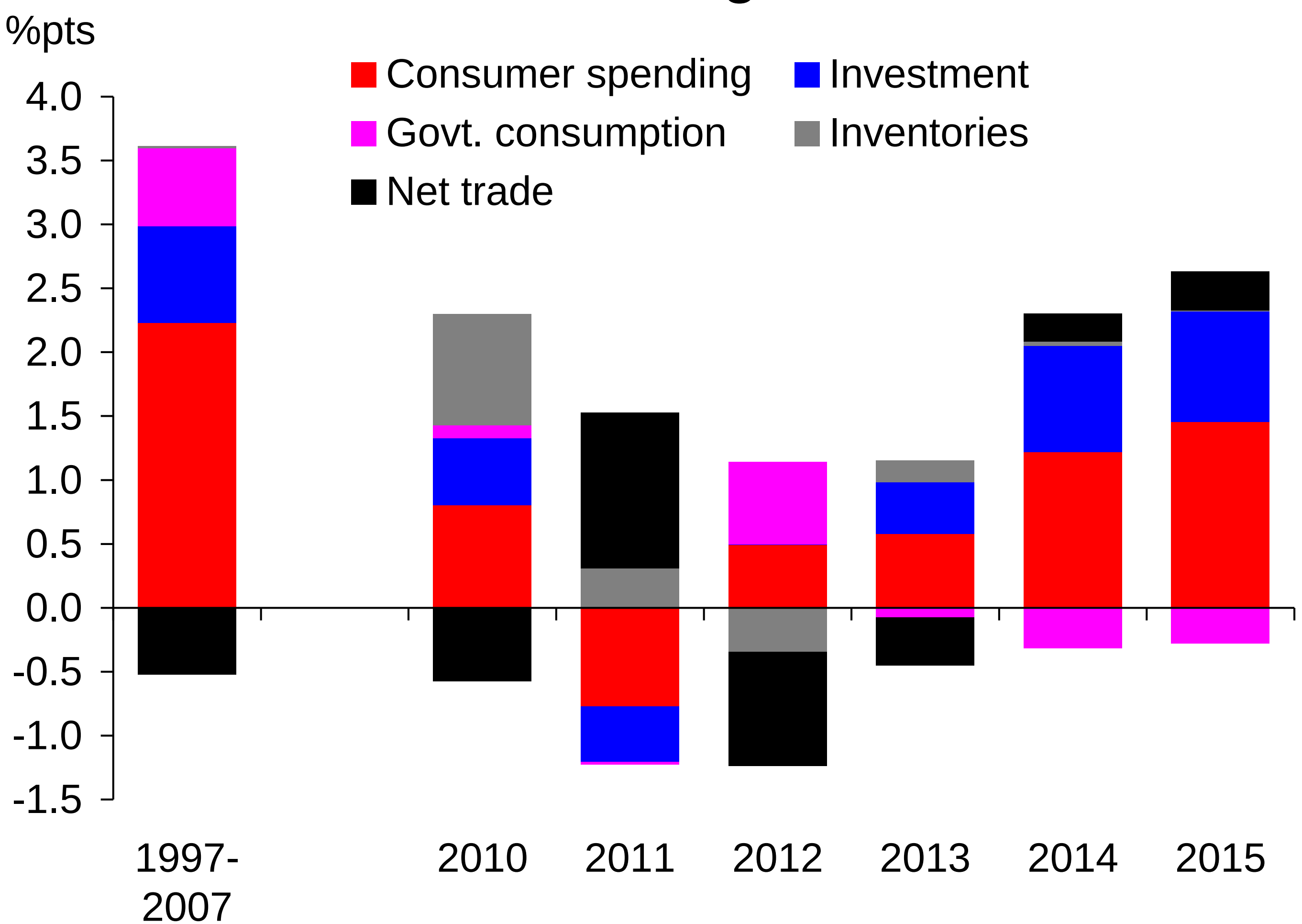
- Firms will remain reluctant to commit funds to investment because of on-going uncertainty around the outlook
- The Chancellor will continue to follow ‘Plan A’ despite further weak growth and failing to achieve OBR’s fiscal forecasts
- The MPC appears to have lost faith in QE and looks likely to sit on its hands…at least until the change of Governor

Growth will struggle to get above 1% in 2013

UK: Contributions to GDP growth



Source : Oxford Economics

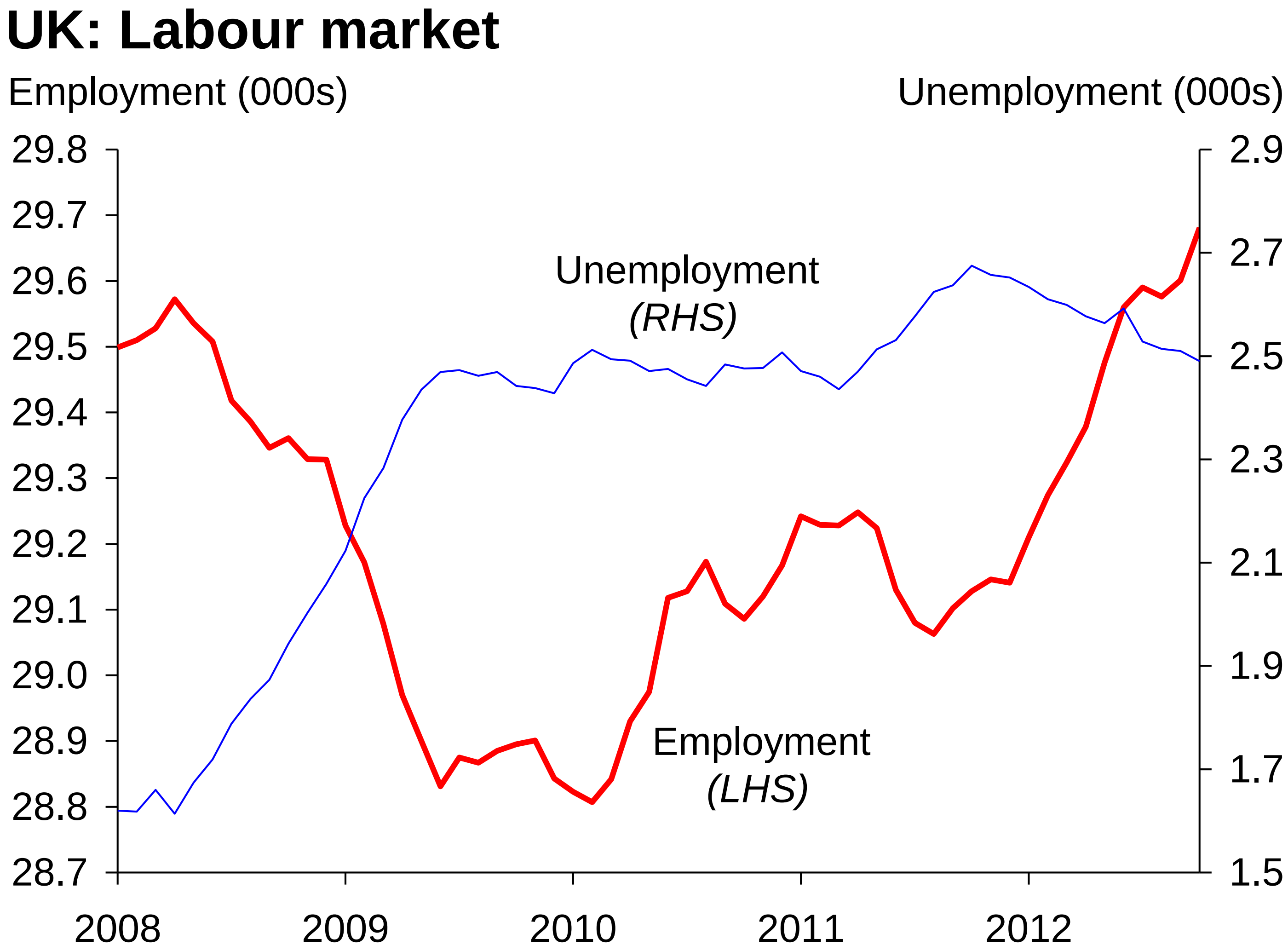
UK forecast

Forecast for UK

(Annual percentage changes unless specified)

	2011	2012	2013	2014	2015	2016	2017
Domestic Demand	-0.6	1.0	1.3	1.8	2.1	2.3	2.4
Private Consumption	-1.3	0.9	1.2	2.0	2.4	2.8	3.0
Fixed Investment	-2.9	0.0	2.8	5.6	5.6	5.8	5.8
Stockbuilding (% of GDP)	0.4	0.1	0.3	0.3	0.3	0.3	0.3
Government Consumption	-0.1	2.8	-0.3	-1.4	-1.3	-1.6	-2.2
Exports of Goods and Services	4.5	-0.4	2.1	4.8	4.9	5.4	5.6
Imports of Goods and Services	0.5	2.3	3.0	3.8	3.7	4.0	4.0
GDP	0.9	0.0	1.0	2.1	2.5	2.8	2.9
Industrial Production	-0.8	-2.4	-1.0	1.2	1.1	1.3	1.4
CPI	4.5	2.8	2.4	1.6	1.5	1.6	1.7
Current Balance (% of GDP)	-1.3	-3.6	-3.3	-3.1	-2.9	-2.4	-1.9
Short-Term Interest Rates (%)	0.9	0.8	0.5	0.5	0.5	0.7	1.6
Long-Term Interest Rates (%)	3.1	1.9	2.1	2.4	2.6	3.0	3.6
Exchange Rate (vs US$)	1.60	1.59	1.58	1.53	1.53	1.54	1.54
Exchange Rate (Euro per £)	1.15	1.23	1.24	1.27	1.31	1.31	1.32
Output gap (% of potential GDP)	-2.9	-5.0	-5.4	-5.2	-4.6	-4.0	-3.2

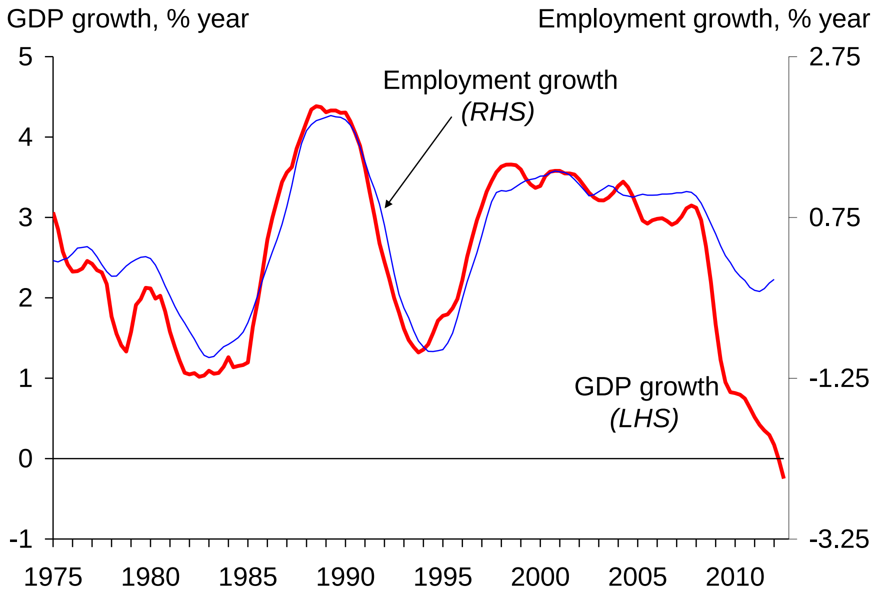
Flat GDP and strong employment growth…



Source : Haver Analytics

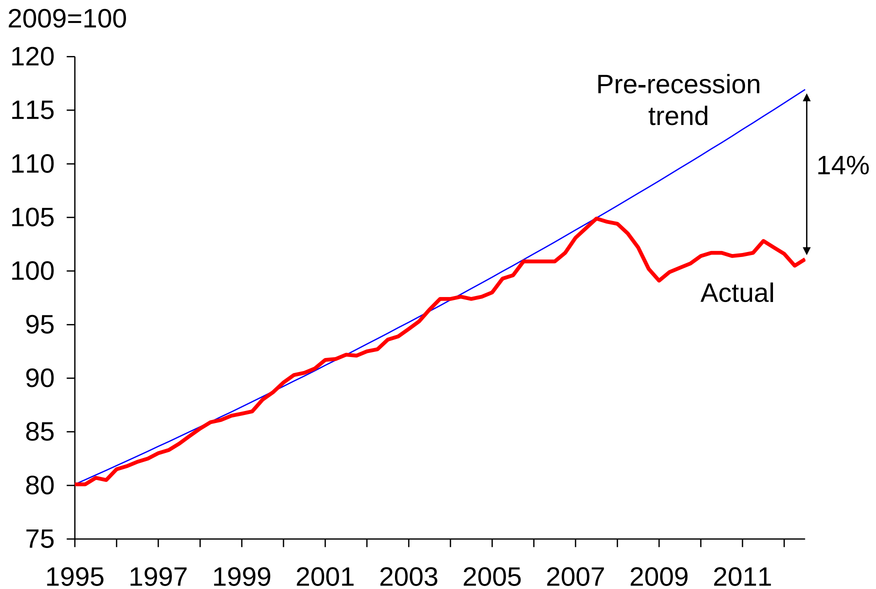
…have left us with a productivity puzzle

UK: GDP and employment growth (5yr MA)



Source : Haver Analytics / Oxford Economics

UK: Output per worker



Source : Haver Analytics

Why could productivity have been so weak?

- Factor substitution – preference of labour for capital?

  Not large – little substitutability between labour and capital in most industries

- Labour hoarding, made possible by low earnings growth?

  Maybe at the start of the recession, but why would firms be taking new staff on now?

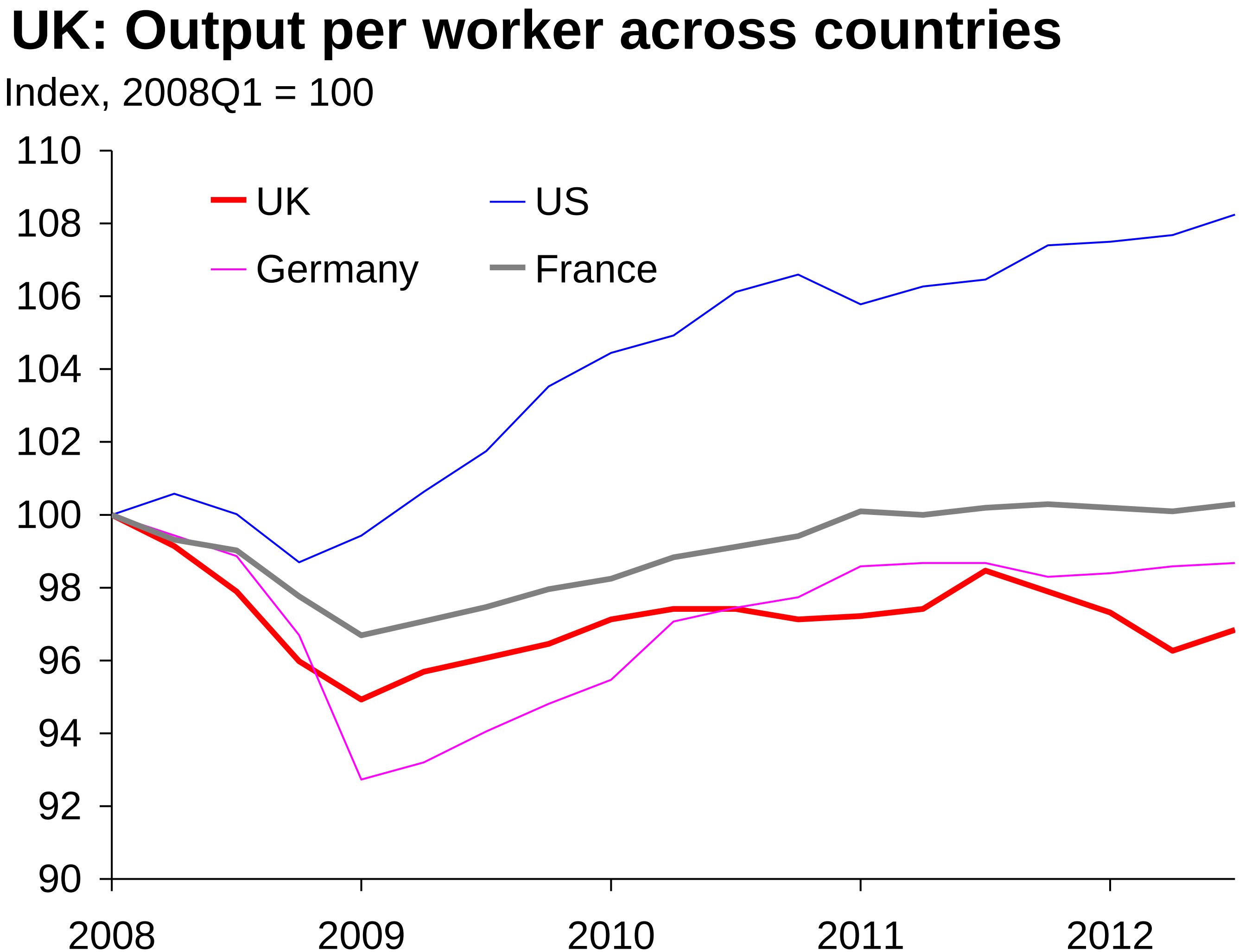
- Zombie companies tying up capital and employing staff?

  Again may contribute to some labour hoarding but can’t explain new jobs

- Given the above and comparing UK with other countries suggest that there may well be some under-reporting of GDP

  Deflators are probably too high, particularly for services activity

Is the drop in UK productivity plausible?



Source : Haver Analytics

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Why has the UK recovery been so weak?

Decomposing UK GDP in 2012 per cent	
Degree to which GDP is below the long-term trend	14
Impact of the financial crisis on potential output	
Impact on capital stock	1
Impact on growth in the labour supply	0
Impact on total factor productivity	3-5
Under recording of the current level of GDP	3
Spare capacity	5-7
Why are we below capacity?	
Fiscal tightening	3
Tight credit conditions	1
Weak Eurozone demand	1
Slow adjustment	1-2

Note: Figures may not sum due to rounding

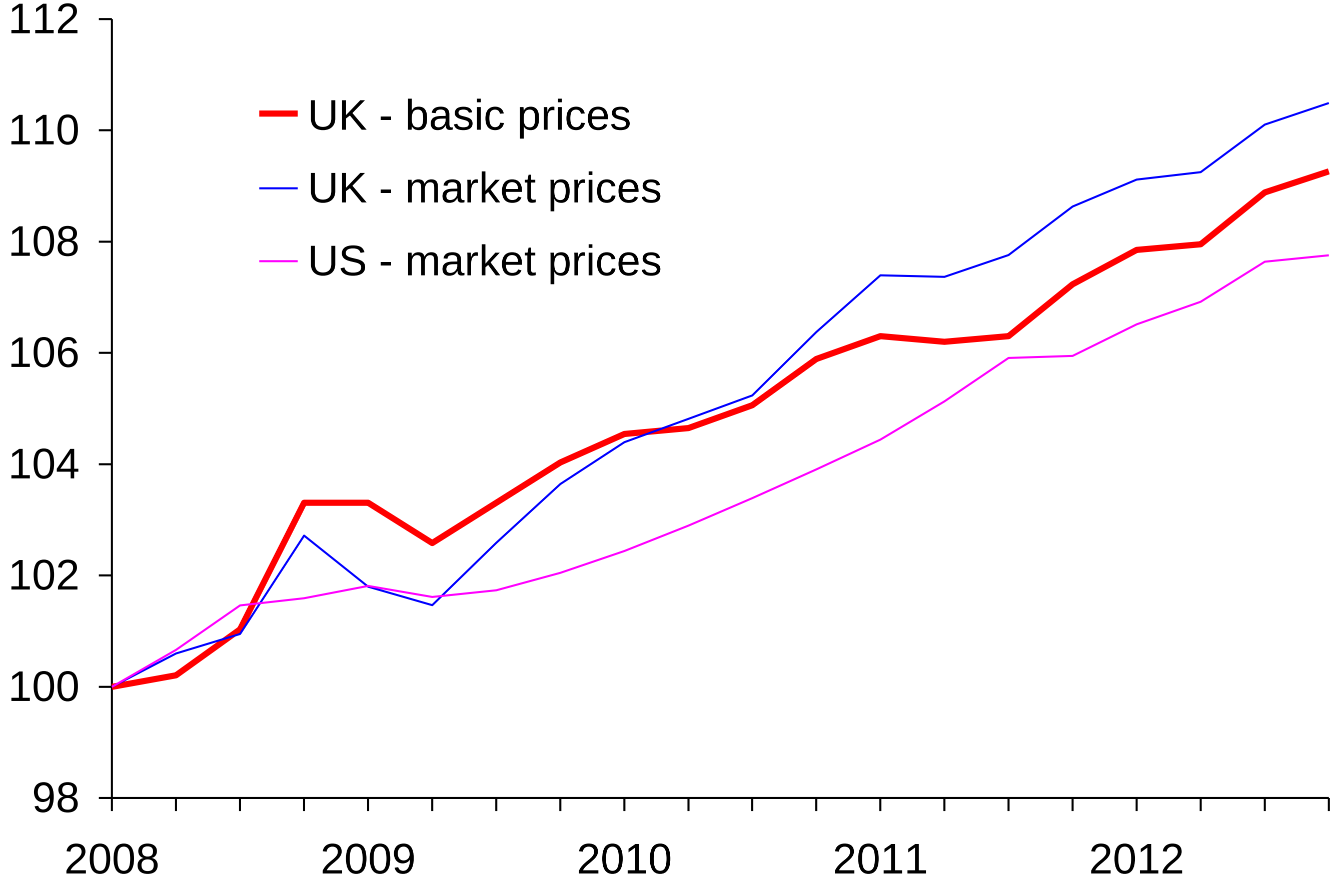
Source: Oxford Economics

Thank you

The UK deflators look high

GDP deflator

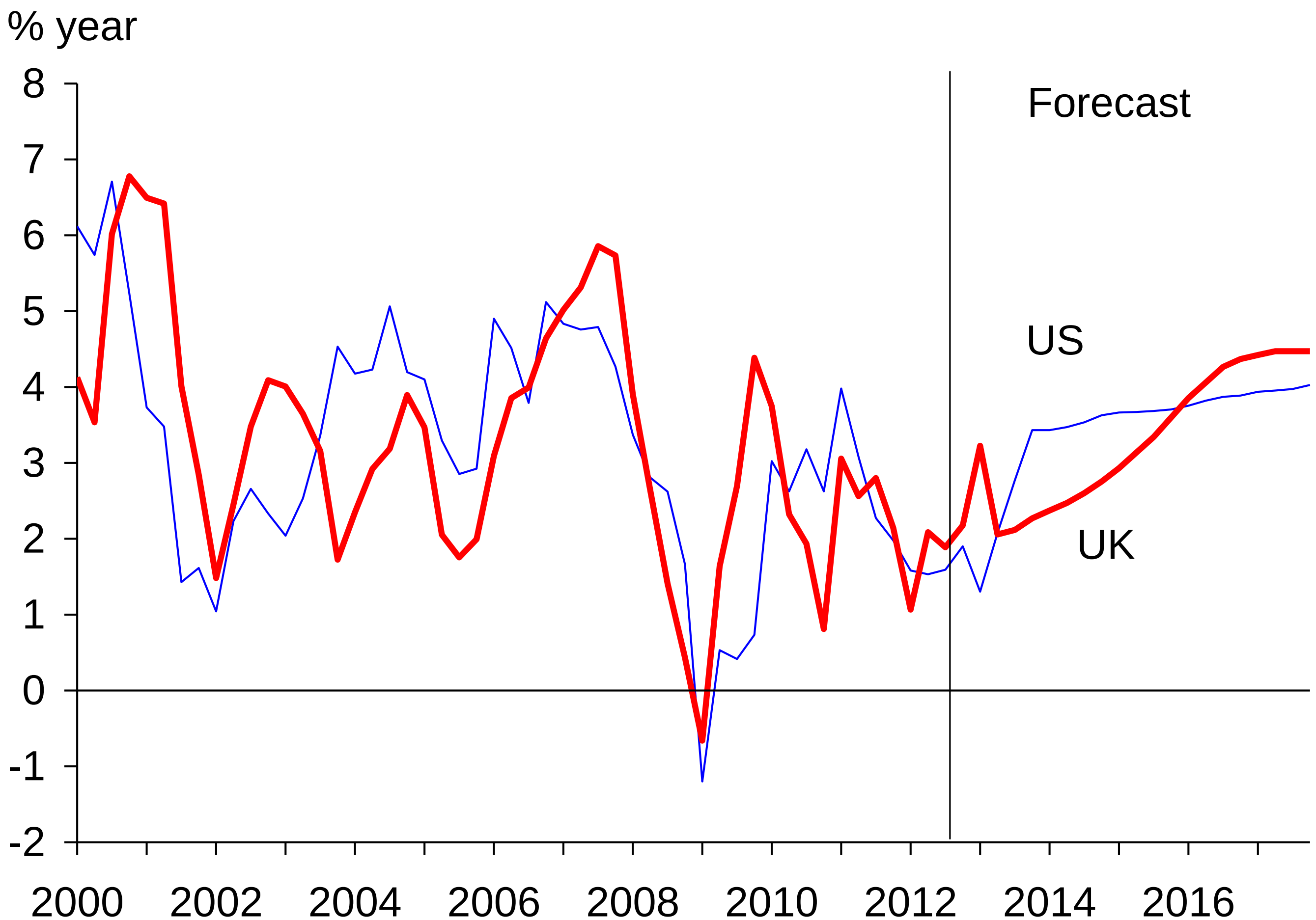
2008Q1 = 100



Source : Haver Analytics

UK vs US – Wage inflation

Wage inflation



Source : Oxford Economics/ Haver Analytics