

October 2018

# UK Economic Outlook

## European Economics

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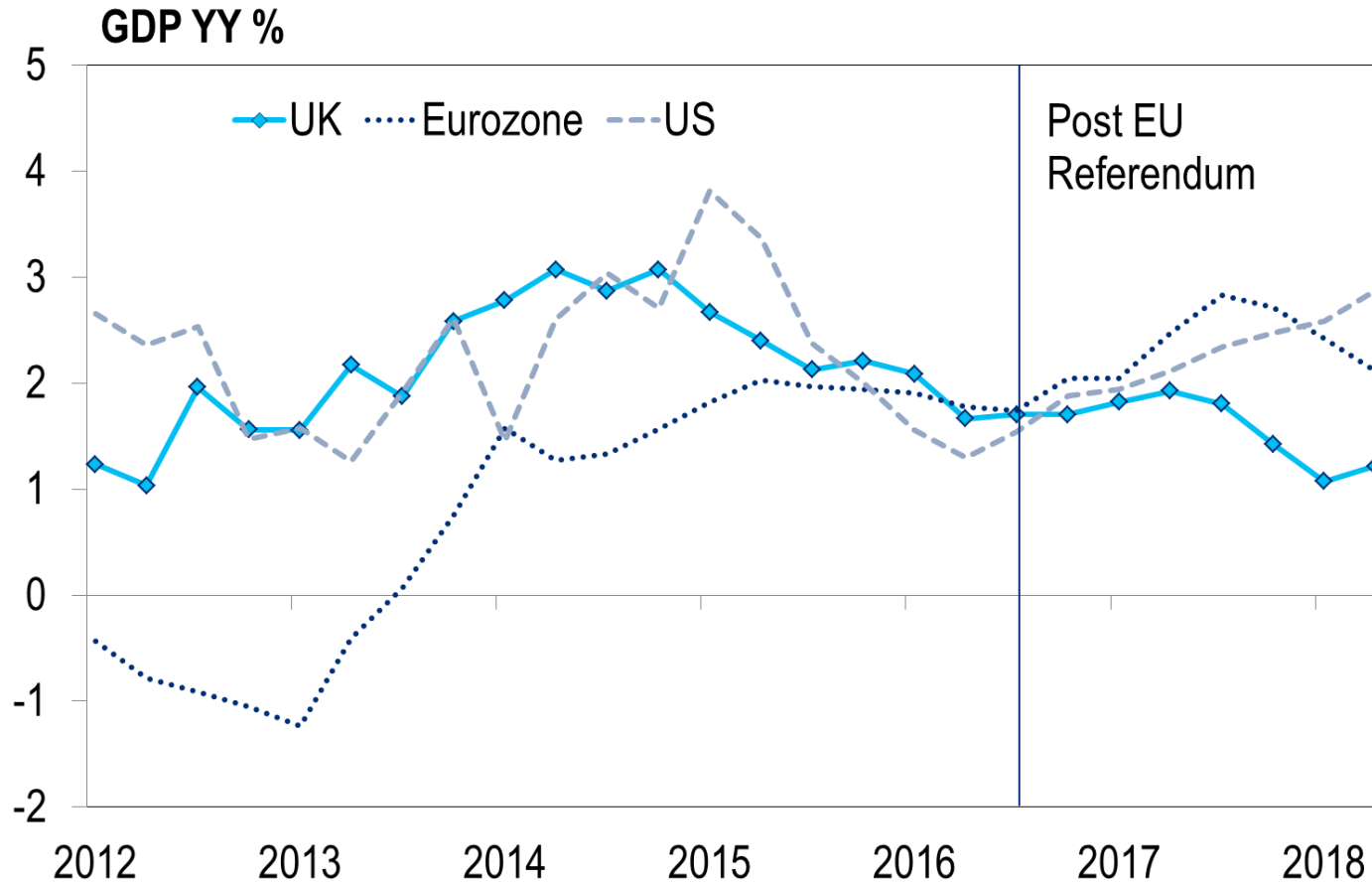
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# UK Economy: The Great Decoupling (I)

UK growth since 2016 has been modest in historical as well as international comparison.

UK, US, Eurozone – Real GDP Growth (YY %), 2012-2018 (2Q)

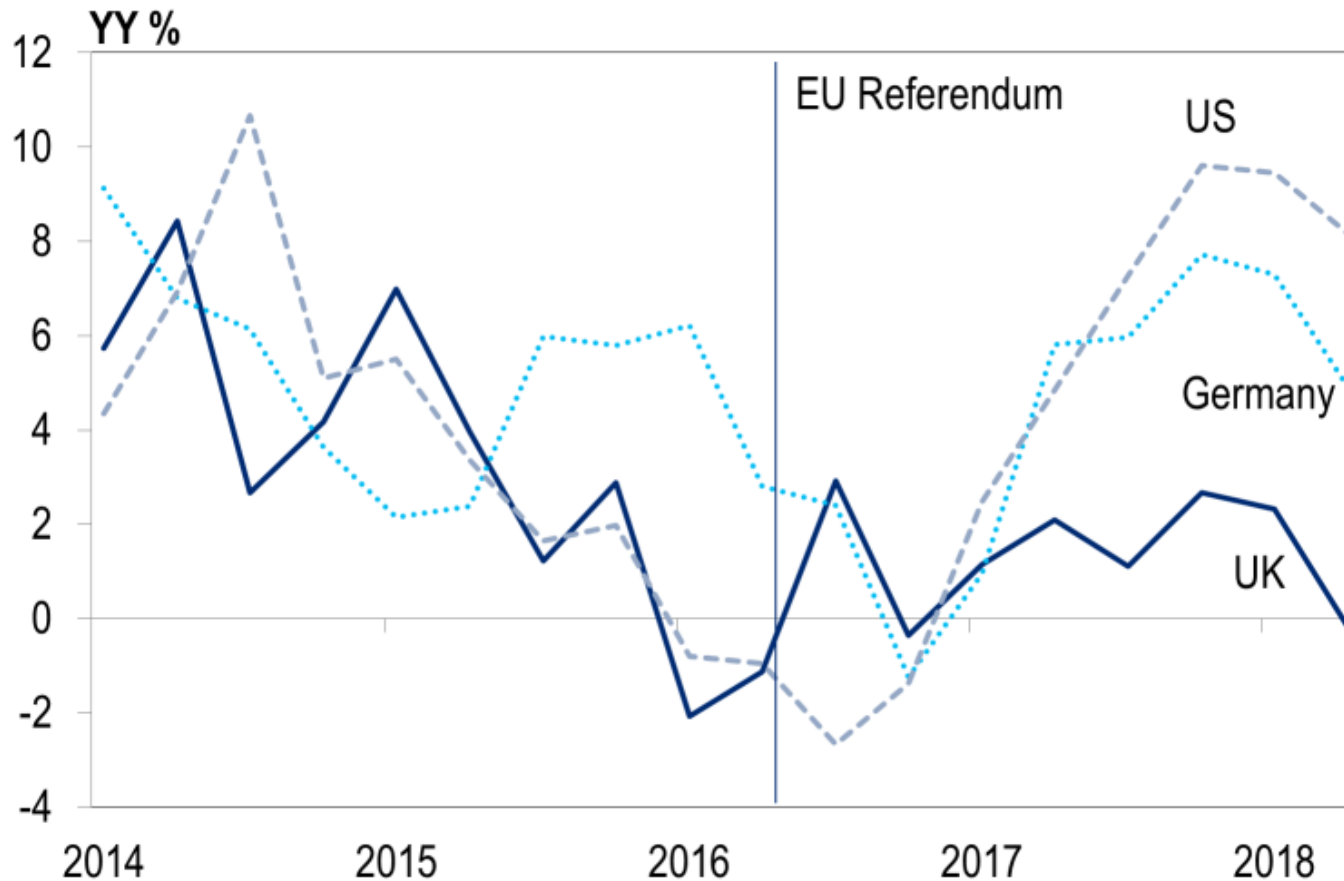


- UK was growth leader until 2016
- UK has fallen behind rivals after the EU referendum.
- Consumer spending came under pressure.

# UK Economy: The Great Decoupling (II)

Business investment in particular decoupled from the global investment cycle.

UK, Germany, US – Business Investment  
(YY %), 2014-2018 (2Q)

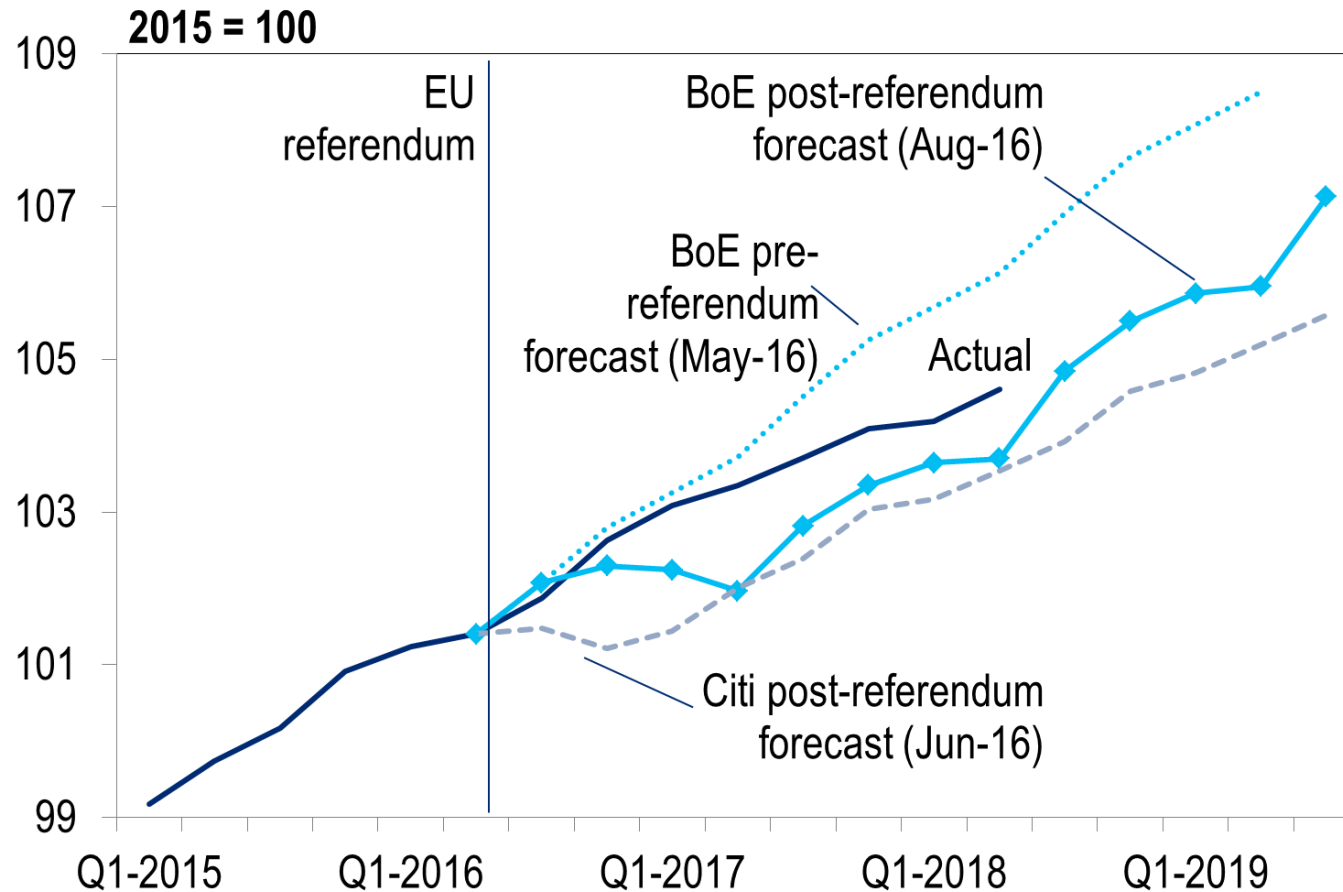


- Business investment decoupled markedly from the investment cycle elsewhere
- Exports grew nicely as weak sterling helped benefit from global trade recovery.
- But import growth was also strong, offsetting some of the benefit to growth.

# Post-EU-referendum Forecasts Weren't Far Off

After the referendum, most forecasters expected a quick hit to output and a swift recovery. The opposite happened. But 2018 GDP looks set to be almost exactly where forecasters expected.

## UK – Real GDP compared to 2016 Forecasts (2015=100), 2015-2019F

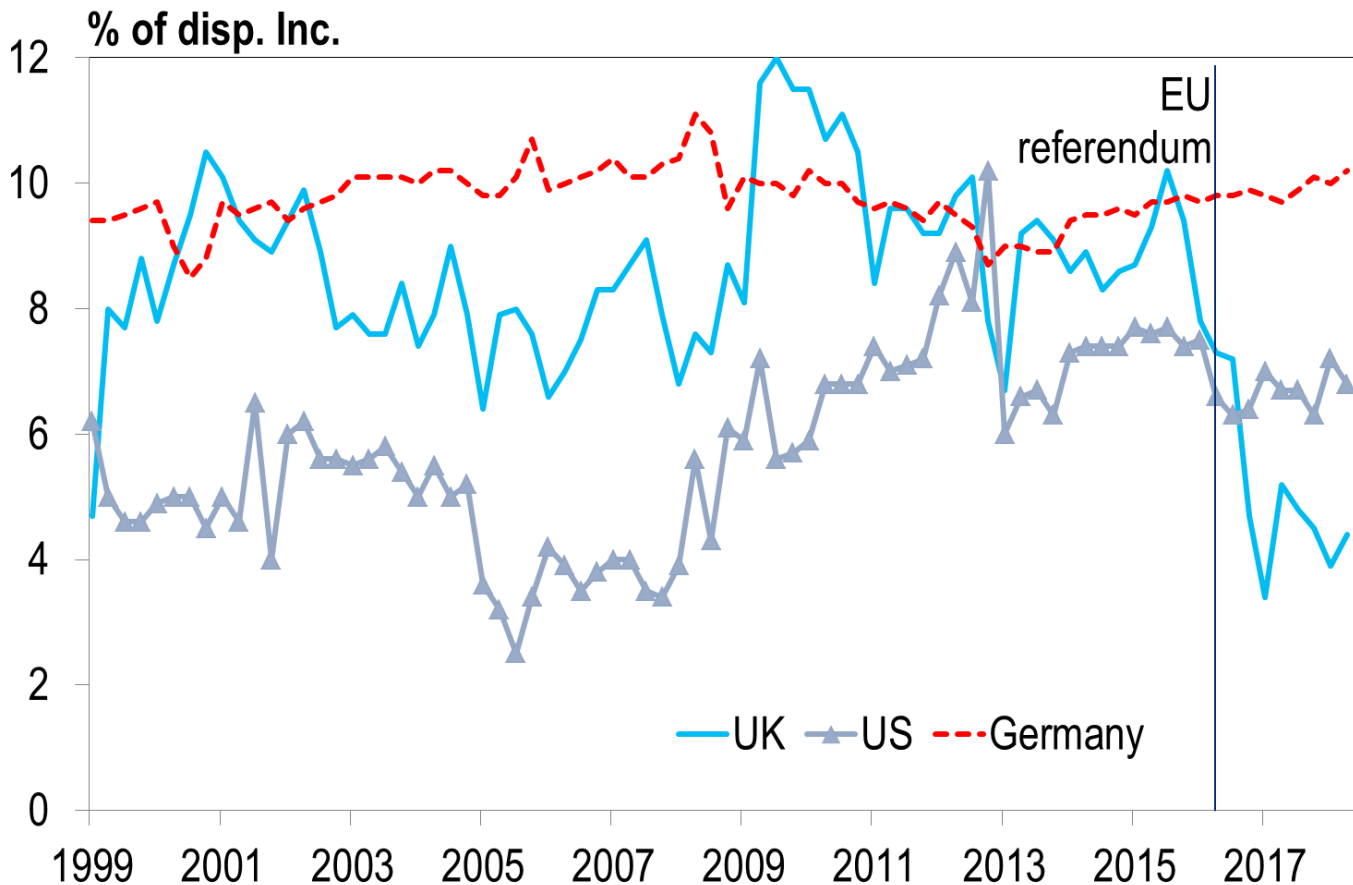


- Brexit uncertainty did not have the immediate impact we and others anticipated.
- But effects unfolded later.
- Contrary to 2016, 'no deal' Brexit in 2019 would immediately change the economy (but also end uncertainty).
- We would consider reducing forecasts by a front-loaded 5% of GDP over 2-3 years.

# UK Growth: Sustainable or Unsustainable? (I)

The sharp drop in household savings cries out for a correction...

UK, Germany, US – Household Saving Rate  
(% of disposable income), 1999-2018

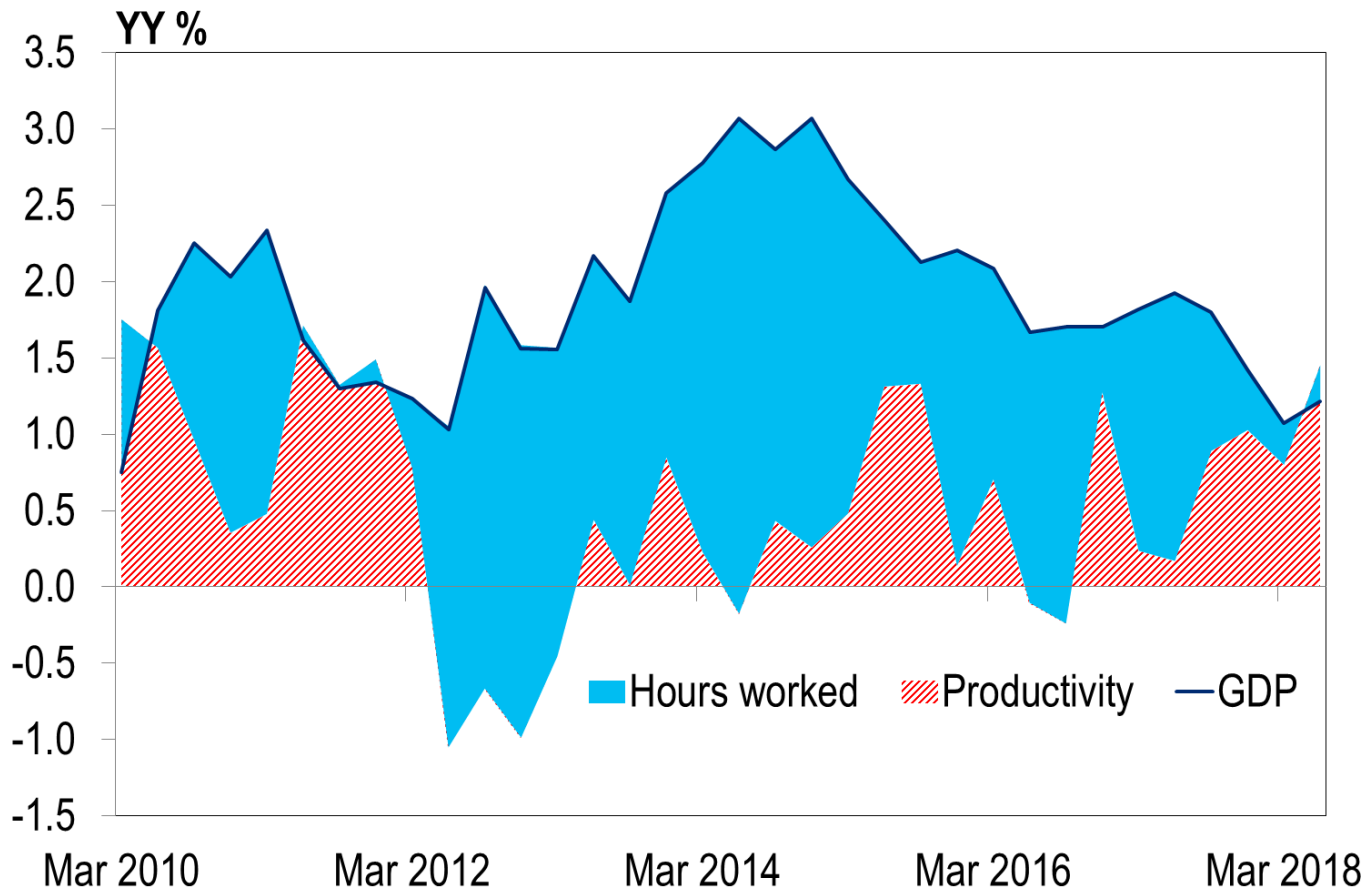


- Resilience in UK consumer spending was helped by plunging household saving ratio.
- With saving rates at historic lows, the consumer might find it harder to ride to the rescue again in the event of a no deal Brexit.

# UK Growth: Sustainable or Unsustainable? (II)

... but tentative signs of a productivity growth rebound could signal untapped potential.

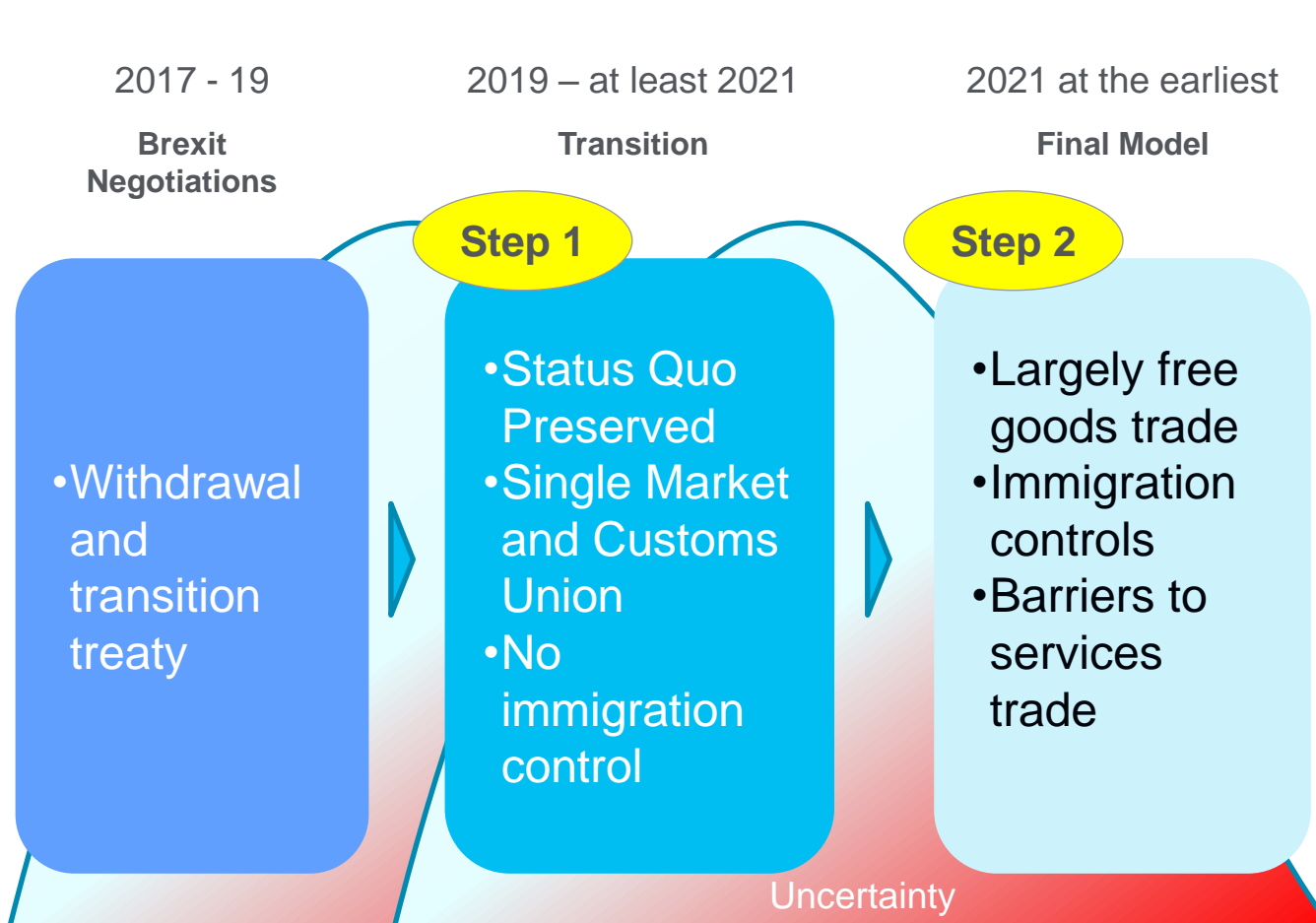
UK – Productivity and Labour Input  
(YY %), 2010-2018



- Most of UK output growth 2012-2017 came from more labour input.
- The lack of investment restricts labour productivity growth.
- But productivity growth has picked up. Are companies improving production processes?
- Sustained higher productivity growth would be important, e. g. for inflation and fiscal forecasts.

# Outlook: “Smooth-but-hard” Brexit assumption

Key assumption is that the UK and the EU agree on a transition period preserving essentially the same relationship they have today.

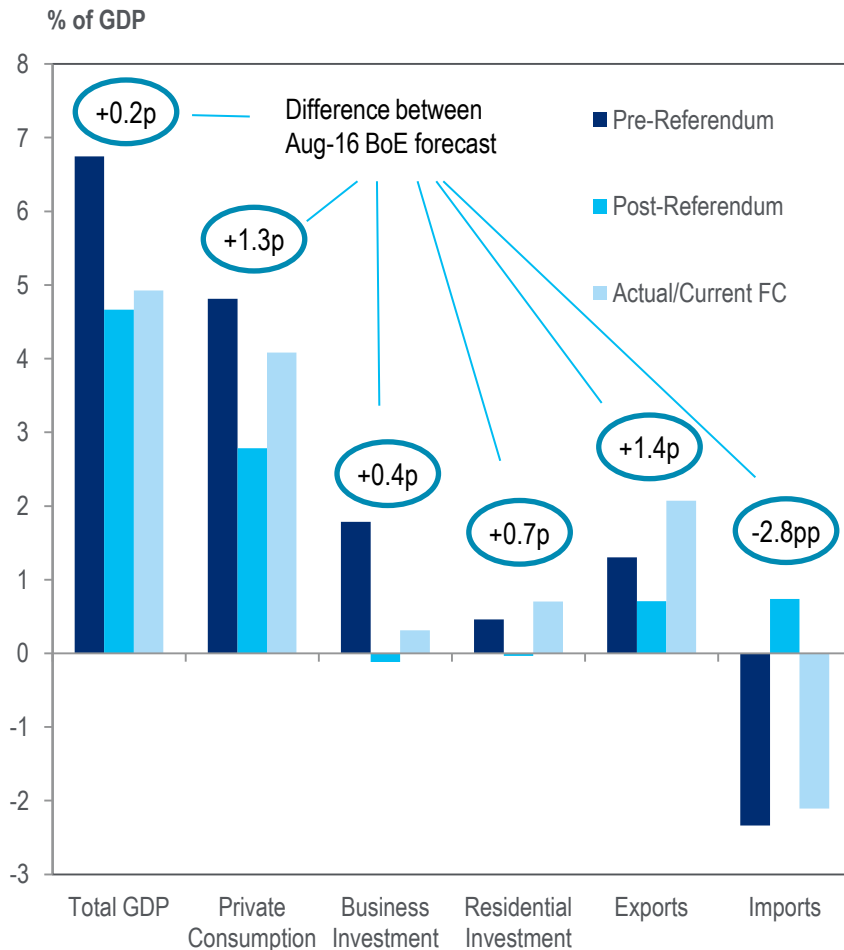


- Brexit uncertainty and adjustment is likely to weigh on growth for the foreseeable future.
- In addition, most scenarios will see less free trade with Europe and lower immigration.
- No deal would likely to cause major disruption in the short-term.
- Long-term consequences of Brexit are difficult to predict as UK choices matter as well.
- “Global Brexit” vs. “Drawbridge Brexit”

# Lessons From and For Brexit Forecasting

As 'no deal' remains a risk less than 6 months before the Article 50 TEU deadline, the post-referendum forecasts provide some lessons for risk analysis.

## UK components of GDP growth, 2016 –18: BoE forecast and actual



- Business investment is key weak spot so far
- Consumers just kept spending
- Import substitution takes a lot of time
- Brexit has had virtually no impact on the rest of the world
- Long lags and policy supported residential construction investment
- The housing market is (partly) a Brexit victim
- If policy makers avoid errors, financial conditions can loosen
- Sterling's pass-through to inflation was faster than expected
- This time would be different: no deal brings actual changes, not just uncertainty.

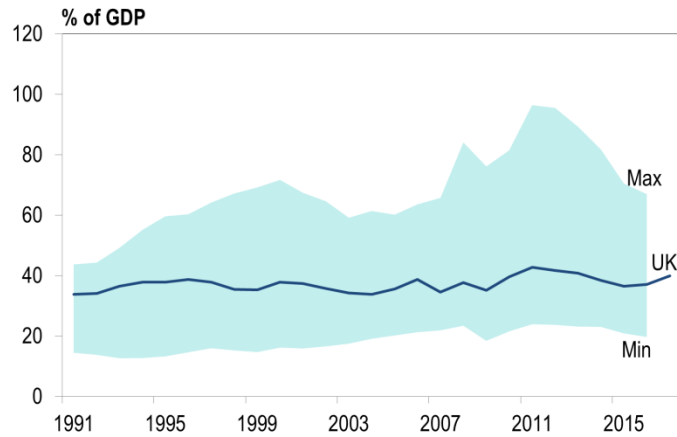


# UK's Global Success Story Challenged

The UK successfully specialised in Advanced Economy service provision, benefitting from immigration and capital inflows. Not just Brexit, but peak globalisation and a backlash against free trade and migration could keep the UK's position in the global economy in suspense for years.

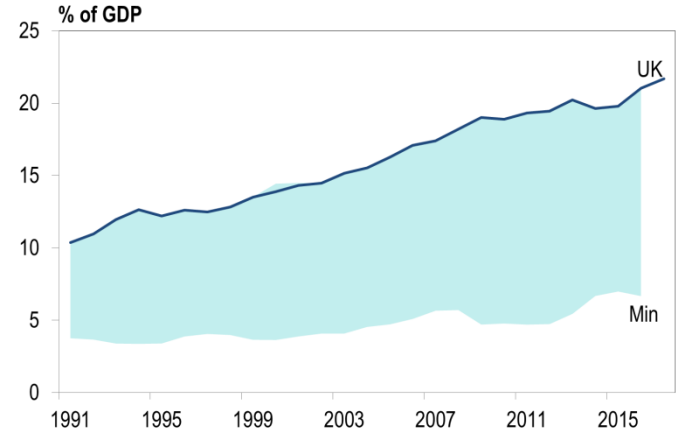
## Also-ran in manufacturing generally

Large OECD Economies – Goods Trade Intensity (% of GDP), 1991-2017



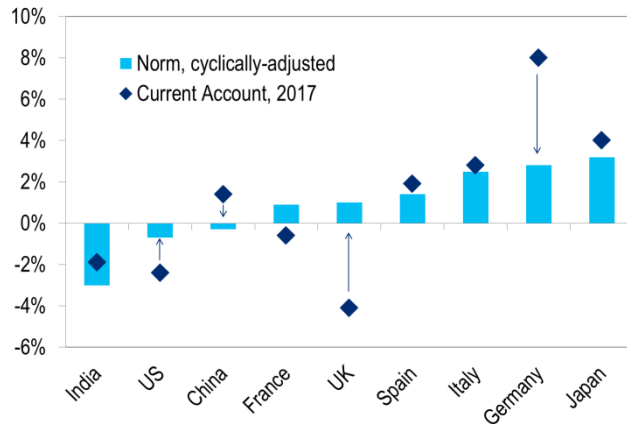
## World leader in AE services

Large OECD Economies – Goods Trade Intensity (% of GDP), 1991-2017



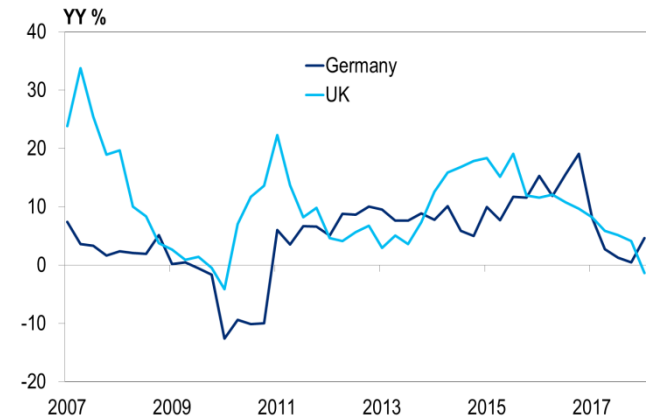
## Unsustainable external imbalance

Selected Economies – Cyclically-adjusted Norm and Actual Current Account Balance (% of GDP), 2017



## Economic Recovery Reduces EU Mobility

UK, Germany – Employment of Foreign EU Citizens (YY %), 2007-2018Q1



# Forecast overview: Medium-term Optimism

We expect growth to remain weak through the winter as Brexit uncertainty continues, but – assuming a long Brexit transition period – a growth rebound thereafter. Key risks are ‘no deal’ short transition and external risks.

YY %	2017	2018	2019	2020	2021	2022
<b>GDP</b>	1.7	1.3	1.5	1.9	2.0	1.9
<b>Private Consumption</b>	1.8	1.1	1.4	1.5	1.6	1.6
<b>Public Consumption</b>	-0.1	1.3	1.8	1.2	0.9	0.9
<b>Fixed Investment</b>	3.4	0.4	0.5	3.2	2.6	2.6
<b>Business Investment</b>	1.6	0.5	-0.2	3.2	2.4	2.4
<b>Construction Dwellings</b>	9.6	6.3	-0.2	3.8	2.8	2.8
<b>Exports</b>	5.4	-0.7	2.0	2.8	3.1	2.6
<b>Imports</b>	3.2	-0.2	1.8	2.1	1.6	1.6
<b>Other Forecasters (GDP only)</b>						
<b>Consensus (Bloomberg)</b>	1.7	1.3	1.5	1.6		
<b>IMF</b>	1.7	1.4	1.5	1.5	1.6	1.6
<b>Bank of England</b>	1.7	1.5	1.75	1.7	1.7	

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