UK Economic Outlook
European Economics

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UK Economy: Missing Out

UK growth since 2016 has been modest in historical and international comparison. Lately, the economy proved resilient to global headwinds.

- UK was a growth leader until 2016
- Following the EU referendum, UK growth slowed, while others accelerated
- During 2018, EA growth fell back towards UK rates. US growth has been resilient.
- Chinese rebalancing and trade wars are weighing on global manufacturing

Sources: ONS, Destatis, BEA, Eurostat and Citi Research
2019 turned out weaker than expected owing to weaker than forecast exports and business investment. Private consumption has surprised to the upside.

<table>
<thead>
<tr>
<th></th>
<th>Green Budget 2018</th>
<th>Latest</th>
<th>Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>1.3</td>
<td>1.5</td>
<td>1.4</td>
</tr>
<tr>
<td>Private Consumption</td>
<td>1.1</td>
<td>1.4</td>
<td>1.7</td>
</tr>
<tr>
<td>Public Consumption</td>
<td>1.3</td>
<td>1.8</td>
<td>0.4</td>
</tr>
<tr>
<td>Fixed investment</td>
<td>0.4</td>
<td>0.5</td>
<td>0.2</td>
</tr>
<tr>
<td>Business Investment</td>
<td>0.5</td>
<td>-0.2</td>
<td>-0.4</td>
</tr>
<tr>
<td>Residential Investment</td>
<td>6.3</td>
<td>-0.2</td>
<td>7.2</td>
</tr>
<tr>
<td>Exports</td>
<td>-0.7</td>
<td>2</td>
<td>0.1</td>
</tr>
<tr>
<td>Imports</td>
<td>-0.2</td>
<td>1.8</td>
<td>0.7</td>
</tr>
</tbody>
</table>

Sources: ONS and Citi Research (September 2019 Global Economic Outlook and Strategy)
UK Economy: Investment Decouple (I)

Business investment continues to underperform rivals with long-term consequences.

- UK business investment decoupled markedly from the investment cycle elsewhere.
- Weak investment weighs on current demand and future supply.
- A lower stock of capital limits productivity growth and could erode UK competitiveness for many years.

Sources: ONS, Destatis, BEA, Eurostat and Citi Research
UK Economy: Investment Decouple (II)

Up until the 2016 referendum, the investment recovery echoed past recoveries. Since the EU referendum, there has been a near 30% divergence from the norm.

- Investment also underperforms the 2010-2016 trend (dotted line)...
- ... and trends in other GDP components

**UK -- Real Business Investment Since the 2016 Referendum In Comparison with Historical Cyclical Recoveries, 1970-2019**

Notes: Chained volume measure used here. Previous cyclical recoveries begin in 1973, 1975, 1980, 1990 and 2008. A cyclical recovery ends when a second recession begins – this is defined as the second quarter of contracting GDP. The ‘pre referendum trend’ series is calculated over the period Q1 2011 to Q2 2015 using a Hodrick Prescott Filter with Lambda of 1600.

Sources: ONS, Bank of England and Citi Research
‘Unusual’ Uncertainty Weighs On Investment

Persistence, severity of downside risk and rolling delay of deadlines have reduced investment by up to 15-20% of what could have been.

UK – Macroeconomic Uncertainty and Business investment (YY %), 1999-2019

- Divergence between UK investment and other developed economies coincides with a sharp and sustained increase in economic uncertainty.
- This has increased the perceived risk associated with investments and reduced investment by 15-20% of what it could have been.
- Ongoing worries about the risk of a “no deal” Brexit are particularly damaging to investment.

Sources: ONS, Bank of England and Citi Research
The Cost of Brexit

2016 post-referendum forecasts were spot on, as two forecast errors offset each other. But actually, the economy should have performed better than projected in 2016, without a referendum.

- Brexit uncertainty did not have the immediate impact we and others anticipated. But effects unfolded later.
- In 2019, GDP looks set to be 2.5% (£55bn) smaller than expected before the 2016 EU referendum.
- But with global growth exceeding 2016 forecasts, the UK should have performed better, too.
- A “Doppelganger” economy of the UK would be 3% (£66bn) bigger than realised GDP.

Note: Doppelganger has the following weights: Canada – 15.5%; United States – 24.0%; Ireland – 4.2%; Hungary – 23.1%; Japan – 20.3%; Norway -6.7%; Denmark – 3.7%. Selection is based on the use of a synthetic control unit on quarterly national accounts data. Sources: ONS, Bank of England and Citi Research.
### Brexit: Four Scenarios

Brexit outcomes depend on political scenarios. Conservative tax cuts & spending hikes could cushion “No-Deal” downside. Labour’s regulation, taxation & nationalisation cap “No-Brexit” upside.

<table>
<thead>
<tr>
<th>Base Case: More Delays</th>
<th>Deal</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Deal impossible or rejected, no-deal ruled out, elections inconclusive</td>
<td>• EU and UK agree on withdrawal terms, followed by 1-3 year transition, negotiations on future relationship</td>
</tr>
<tr>
<td>• 1-2% of GDP fiscal loosening, given that all parties have such commitments</td>
<td>• 1-2% fiscal loosening, one 25bp Bank Rate hike per year</td>
</tr>
<tr>
<td>• Steady monetary policy (risk of cut)</td>
<td></td>
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</table>

<table>
<thead>
<tr>
<th>No-deal</th>
<th>Revocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Conservative election victory leads to no-deal Brexit</td>
<td>• Remain alliance around Labour, Liberal Democrats and SNP leads to second referendum and vote to remain in EU</td>
</tr>
<tr>
<td>• Some preparations in place, reduced risk of financial turmoil</td>
<td>• Significant fiscal loosening partly offset by higher taxes</td>
</tr>
<tr>
<td>• &gt;2% fiscal loosening</td>
<td>• Labour programme of nationalisation, labour regulation watered down</td>
</tr>
<tr>
<td>• Bank Rate cut to zero, Bank QE restarted</td>
<td>• Bank Rate rises faster</td>
</tr>
</tbody>
</table>

Sources: ONS and Citi Research
Brexit: Economic Paths

In our base case of continued Brexit uncertainty and delays, GDP would rise by 4.8% in 2019-2022. From no-deal to no-Brexit, a downward-skewed span of 4.3% around that opens up.

- **Deal** (+0.8% by 2022 compared to base line): negotiations about the Brexit endstate continue and potential upside of never-Brexit gone

- **No-deal** (-2.6%) – still expect no-deal Brexit to subtract from GDP but half what we projected in 2018.

- **No Brexit** (+1.7%) – relief is partly offset by Labour’s economic policies and uncertainty as third referendum remains possible.

Sources: ONS and Citi Research
Forecast overview: Low Growth For Longer

Amid global headwinds and Brexit uncertainty, we project growth to remain subdued (and somewhat below other forecasters’ projections) throughout the forecasting horizon

<table>
<thead>
<tr>
<th>YY %</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
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<tr>
<td>GDP</td>
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<td>1.1</td>
<td>1.0</td>
<td>1.3</td>
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<td>1.4</td>
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<tr>
<td>Private Consumption</td>
<td>1.7</td>
<td>1.7</td>
<td>1.3</td>
<td>1.4</td>
<td>1.6</td>
<td>1.6</td>
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<tr>
<td>Business Investment</td>
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<td>0.3</td>
<td>0.8</td>
<td>1.3</td>
<td>1.6</td>
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<tr>
<td>Construction Dwellings</td>
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<td>2.8</td>
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<tr>
<td>Exports</td>
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<td>1.0</td>
<td>2.7</td>
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<td>2.0</td>
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<tr>
<td>Imports</td>
<td>0.7</td>
<td>2.6</td>
<td>-1.0</td>
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<td>2.1</td>
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Other Forecasters (GDP only)

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<th></th>
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<th>2020</th>
<th>2021</th>
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<td>Consensus (Bloomberg)</td>
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<td>IMF</td>
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<td>Bank of England</td>
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Sources: ONS, BoE, IMF, Bloomberg and Citi Research (Latest Forecasts September 2019)
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