

# Prospects for the UK economy

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AICE

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# Headlines

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- Economic outlook is uncertain and **contingent on Brexit outcome**.
- Brexit has already had a lasting impact on the economy.
- We **do not expect a ‘deal dividend’** if government’s proposed Brexit deal is approved.
- **New analysis:** In the long run, the economy would be **3½ per cent smaller** with the deal compared to continued EU membership.
- On the basis of persistent uncertainty and no imminent change to trade arrangements, we forecast **economic growth of under 1½ per cent** in 2019 and 2020, an **upward revision** since August.
- There is a case for an **early cut in Bank Rate**.
- The fiscal position is deteriorating while **no Budget** is planned.
- The **general election** contributes to overall uncertainty. Its economic impact would depend on economic/fiscal policies put forward and implications for Brexit.



# Why there won't be a deal dividend

- Approval of the deal would **reduce uncertainty**.
- It would reduce the risk of a disorderly outcome but **eliminate the possibility of a closer trading relationship** with the EU.
- Leaving EU customs union + single market estimated to lower GDP by **3.5% every year** in long run.
- This corresponds today to £70 bn (£1100 per head and year).

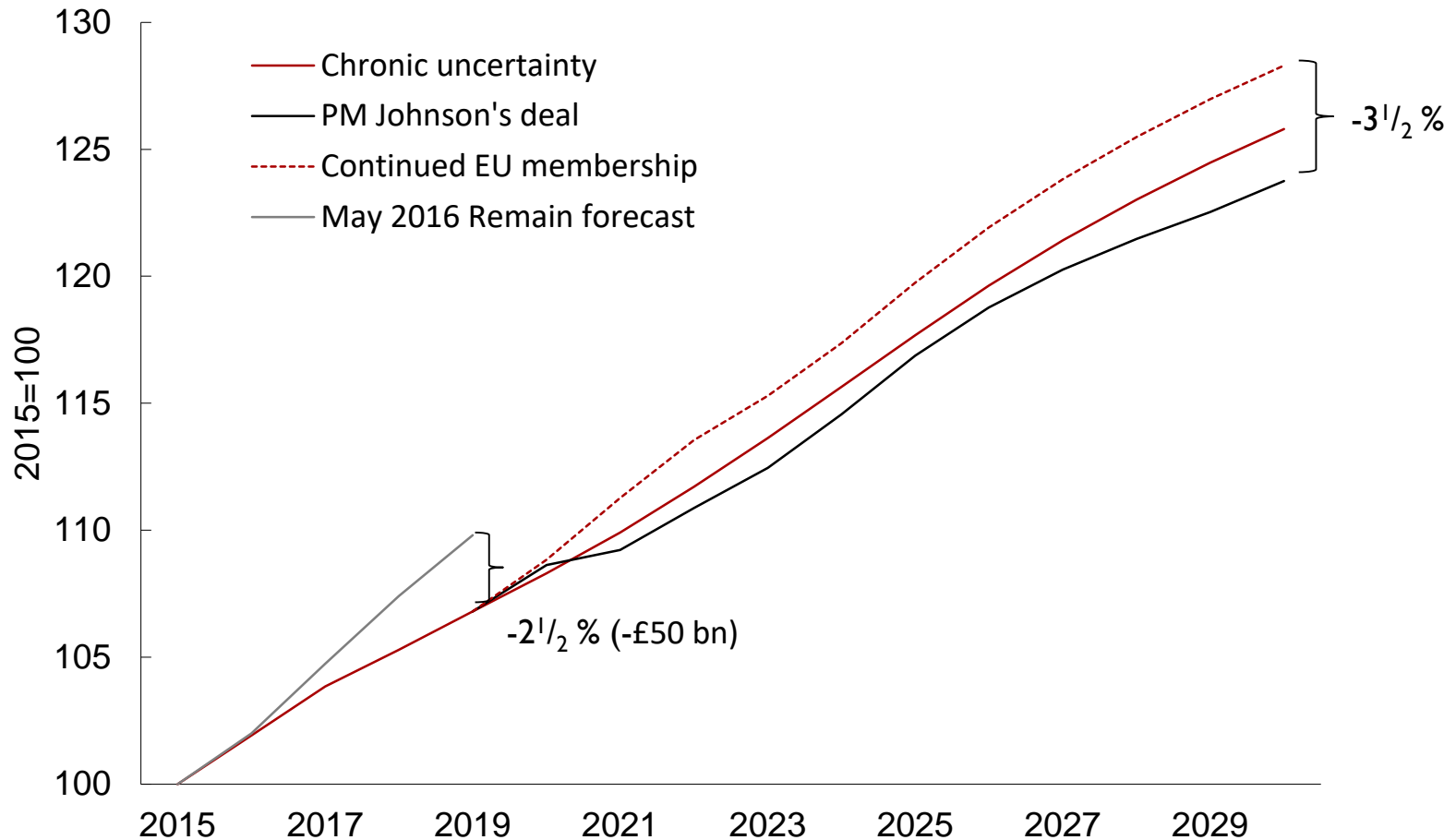
*Long-run impact relative to continued EU membership:*

	GDP	GDP per capita
Chronic uncertainty (main-case forecast)	-2.0%	-2.0%
PM May's deal + whole-UK backstop	-3.0%	-2.1%
<b>PM Johnson's deal</b>	<b>-3.5%</b>	<b>-2.6%</b>
No deal	-5.6%	-3.8%

Source: NIESR, NiGEM simulation.



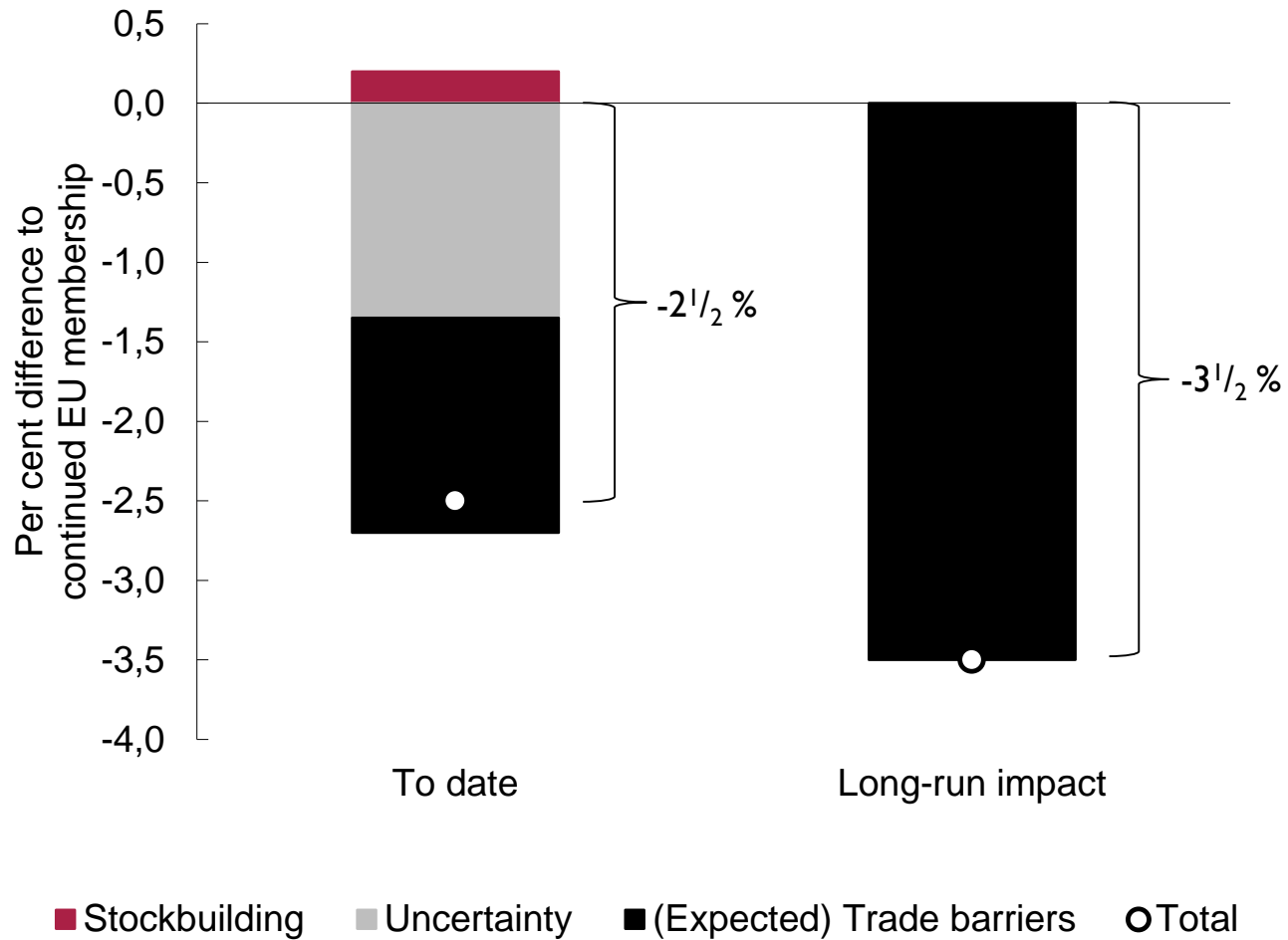
# GDP under different Brexit scenarios



Source: NIESR, NiGEM simulation.



# Has the cost of Brexit already been paid?

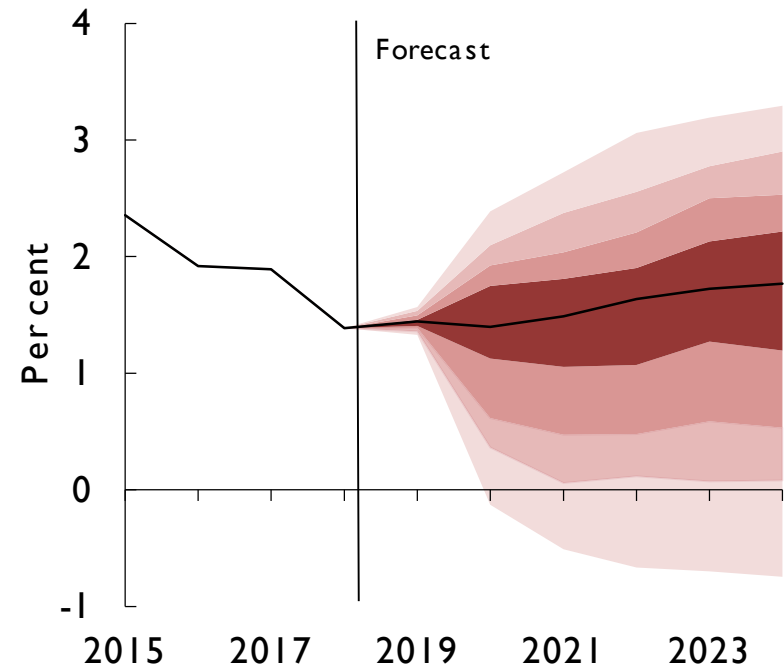


Source: NIESR.



# UK Forecast

- Main-case forecast assumes
  1. continued uncertainty
  2. no significant change to EU trade
- Demand being driven by household spending underpinned by rising real wages and fiscal relaxation.
- Business investment affected by Brexit uncertainty.
- Revised up 2019 growth (+0.2pp), 2020 growth (+0.3pp).

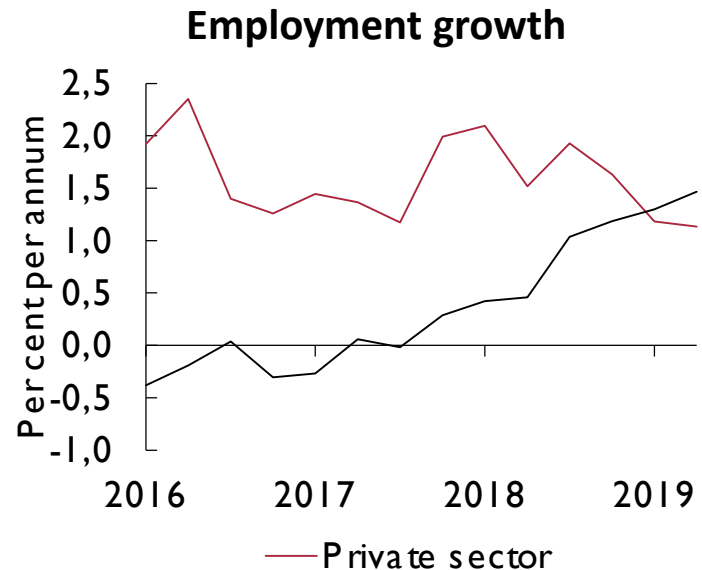


Source: NIESR.



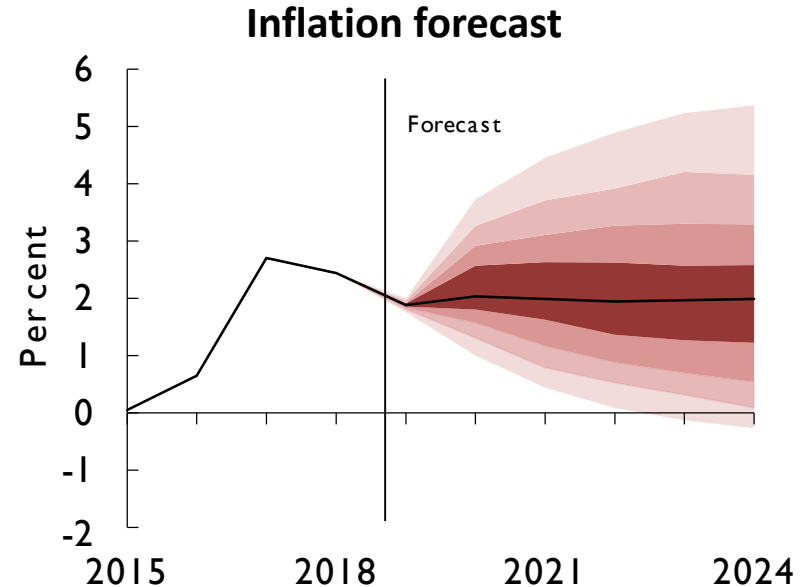
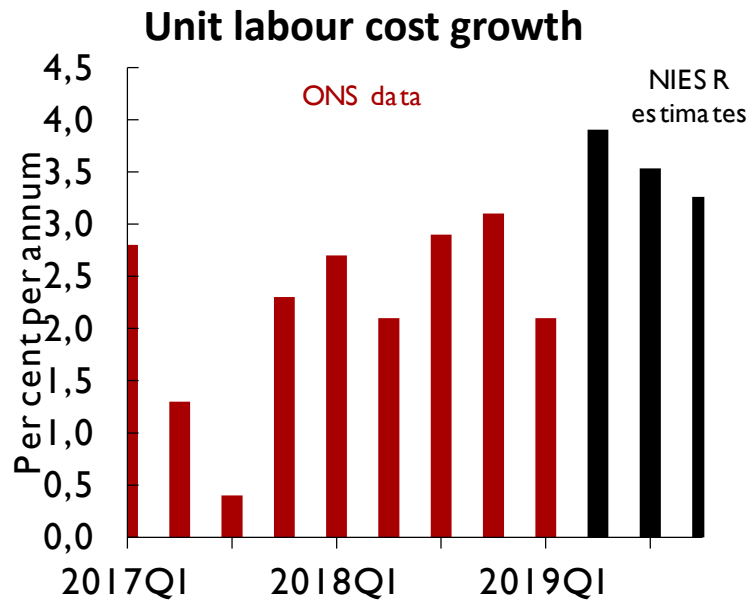
# Labour market outlook

- Private sector labour demand is weakening amidst global and domestic uncertainties.
- This is increasingly being offset by stronger public sector employment and wage growth.



# Inflation outlook

- After having risen to a 10y high, unit labour cost growth is expected to ease as productivity growth slowly picks up.
- Inflationary pressure is contained and offset by weaker import prices.



Source: NIESR, ONS.







# Monetary policy

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- MPC will be concerned about unit labour cost growth, but they think there is spare capacity.
- There is a **case for a 25 bps cut in Bank Rate** next week:
  - CPI inflation below target,
  - global downside risks apparent,
  - other central banks are easing,
  - no-deal risks receding and
  - sterling higher.
- Forecast assumes MPC delay until March meeting.





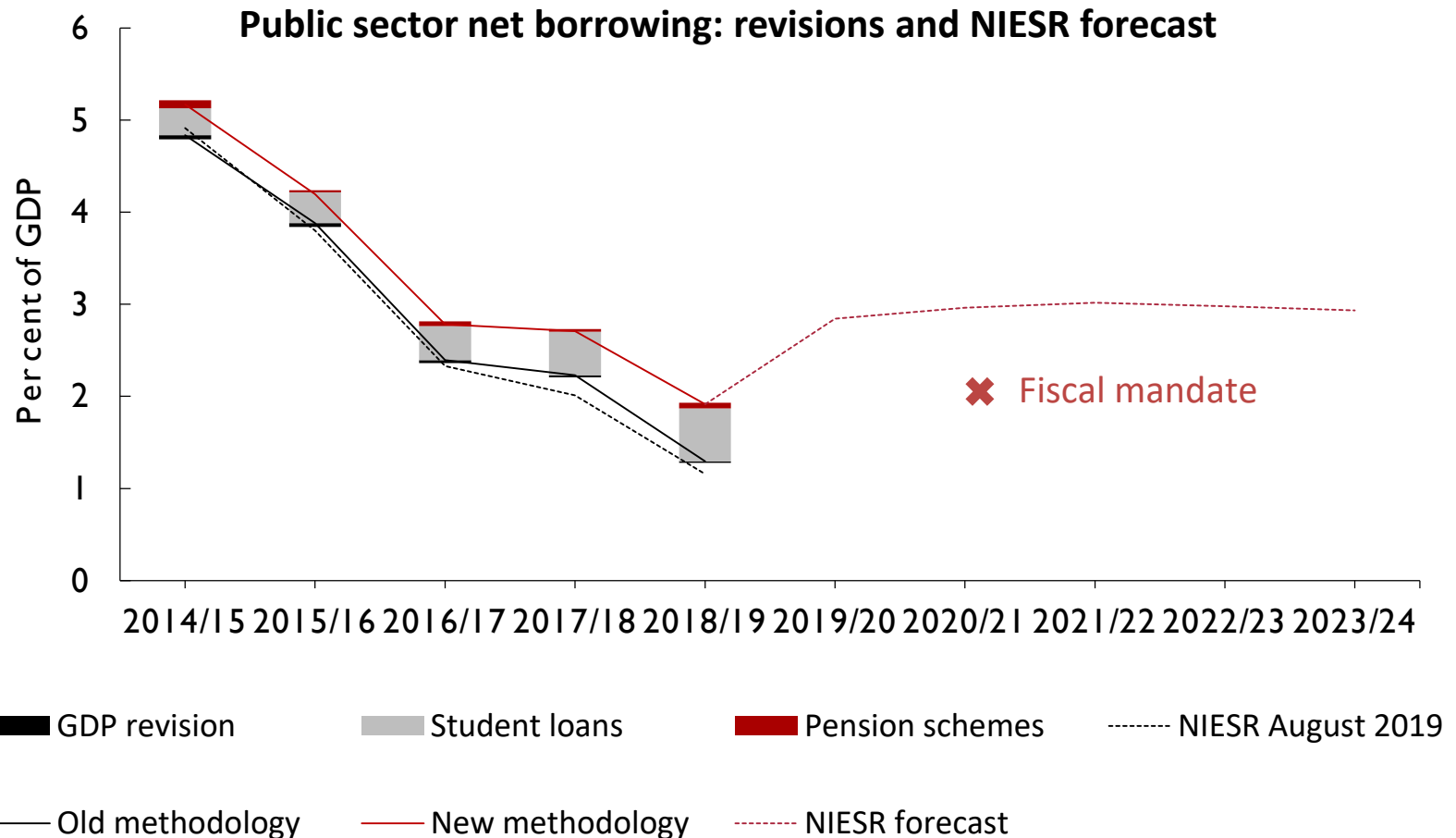
# Fiscal policy

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- Fiscal policy is in disarray:
  - 2019 Spending Round done without OBR forecast
  - Budget cancelled
  - Post-2019 Spending Round forecast is for deficit of 3% of GDP
- Concern about lack of fiscal strategy, and contribution to political uncertainty.
- Extra spending is in line with our previous forecasts and supporting economy at time of private sector weakness:
  - 4% increase in real spending adds 0.3pp to 2020 growth.
- Together with data revisions, previous Chancellor's fiscal mandate will be broken.



# Fiscal policy



Source: NIESR, ONS.



# UK forecast overview

	Real GDP growth (%)	CPI inflation (%)	Unemployment (%)	Bank Rate (%)	External current balance (% GDP)	Public sector borrowing (% GDP)
2018	1.4	2.2	4.0	0.75	-4.3	1.9
2019	1.4	1.8	4.0	0.75	-3.9	2.8
2020	1.4	2.0	4.0	0.50	-2.8	3.0
2021	1.5	1.9	3.9	0.50	-2.6	3.0

See also Box A in the *Review* which analyses NIESR's forecasting performance since the EU referendum.





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