The UK Economy in 2015

Key Revision Notes on the UK Economy

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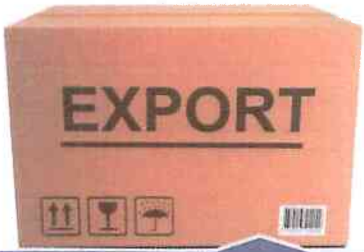
Reminder of some key Macroeconomic Objectives

Price Stability – i.e. low positive inflation, avoiding deflation

Sustainable Growth of Real GDP (National Output)

Falling Unemployment / More Jobs

Higher Average Living Standards (Income per capita)



Improved Global Competitiveness / Trade Balance

A More Equitable Distribution of Income and Wealth

Background on United Kingdom: (Population: 64.1m)

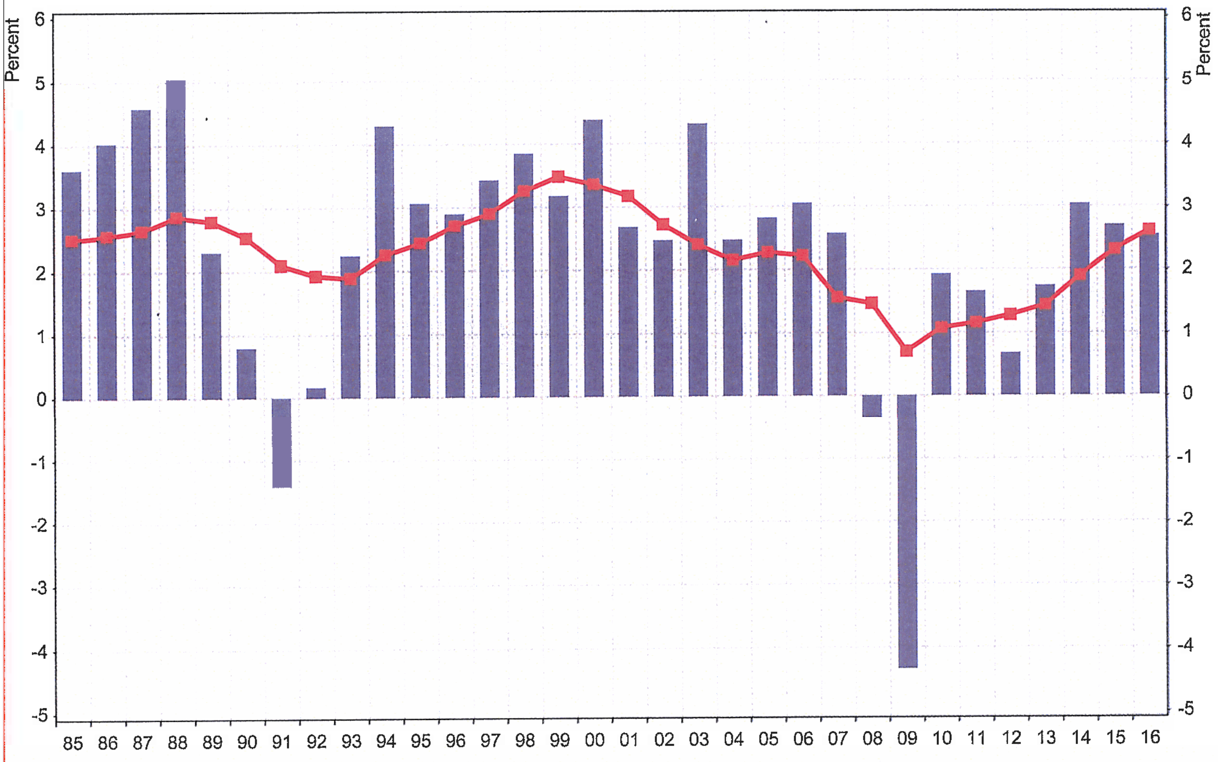
Recent Macroeconomic Data	
Latest annualised GDP Growth (%)	2.6%
GDP per capita (US $, at PPP standard)	$35013
Inflation rate (%)	0.5%
Unemployment rate (% of labour force)	5.8%
Fiscal balance (% of GDP)	-5.8%
Gross government debt (% of GDP)	91%
Yield on 10-Yr Government Bonds (%)	1.5%
Total capital investment (% of GDP) in 2012	15%

Background Information	
Currency unit	Sterling
Exchange rate system	float
Policy interest rate	0.5%
Trade in goods & services - surplus or deficit?	Deficit
Current account balance (% of GDP)	-4.4%
Main corporate tax rate (per cent)	20%
Global competitiveness ranking for 2014	9th
Economic Freedom Index Ranking	14th
Corruption Perception Ranking	14th

Other Indicators	
Latest HDI ranking	14th
% of population living below their national poverty line	n/a
Life Expectancy (years)	81.5
Global rank for capacity to attract skilled talent	5th
Global rank for Innovation and sophistication	8th
Gini coefficient (Latest published estimate)	36.5

Real GDP Growth and Potential Growth for the UK Economy

Real GDP, precentage change from previous period, Constant Prices



Source: OECD Economic Outlook

Key Indicators for the UK Economy: 2009-2015

GDP and Components of Aggregate Demand	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Real GDP (% change)	-4.3	1.9	1.6	0.7	1.7	3.0	2.7
Consumer spending (% change)	-3.1	0.4	0.1	1.1	1.6	2.1	2.4
Government consumption (% change)	1.2	0.0	0.0	2.3	0.7	1.0	-0.5
Gross Investment (% change)	-21.7	14.9	11.6	-2.9	12.0	8.8	6.7
Exports of goods and services (% change)	-8.7	6.7	4.5	0.7	0.5	-1.3	1.2
Imports of goods and services (% change)	-10.7	7.9	0.3	3.1	0.5	-1.6	1.2
Selection of other key indicators	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Output gap (% of potential GDP)	-3.7	-2.7	-2.0	-2.4	-1.9	-0.6	0.0
Unemployment rate (% of labour force)	7.6	7.9	8.1	8.0	7.6	6.2	5.6
Government Fiscal Balance (% of GDP)	-10.7	-9.5	-7.5	-5.9	-5.6	-5.5	-4.4
Short-term interest rate (%)	1.2	0.7	0.9	0.8	0.5	0.5	1.0
Consumer price inflation (%)	3.6	2.2	3.3	4.5	2.8	2.6	1.6
Current account balance (% of GDP)	-2.8	-2.6	-1.7	-3.7	-4.2	-4.8	-4.6
Labour productivity (% change)	-2.8	1.7	1.1	-0.4	0.6	0.7	1.3
Sterling exchange rate index (2010=100)	100.7	100.0	99.3	103.4	101.4	109.1	110.8

Source: OECD World Economic Outlook, November 2014. Data for 2015 is a forecast

Analysis: Why was UK recovery delayed and slow?

Domestic demand-side factors:

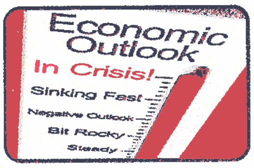
Weak consumer demand, low business capital investment, cuts in real level of government spending

Domestic supply-side factors:

Low supply of bank credit to businesses, falling labour productivity (output per worker) + high energy prices,

External demand-side factors:

Weak growth in key overseas markets, hitting UK export sales e.g. Euro Area, + too few exports to Asian region

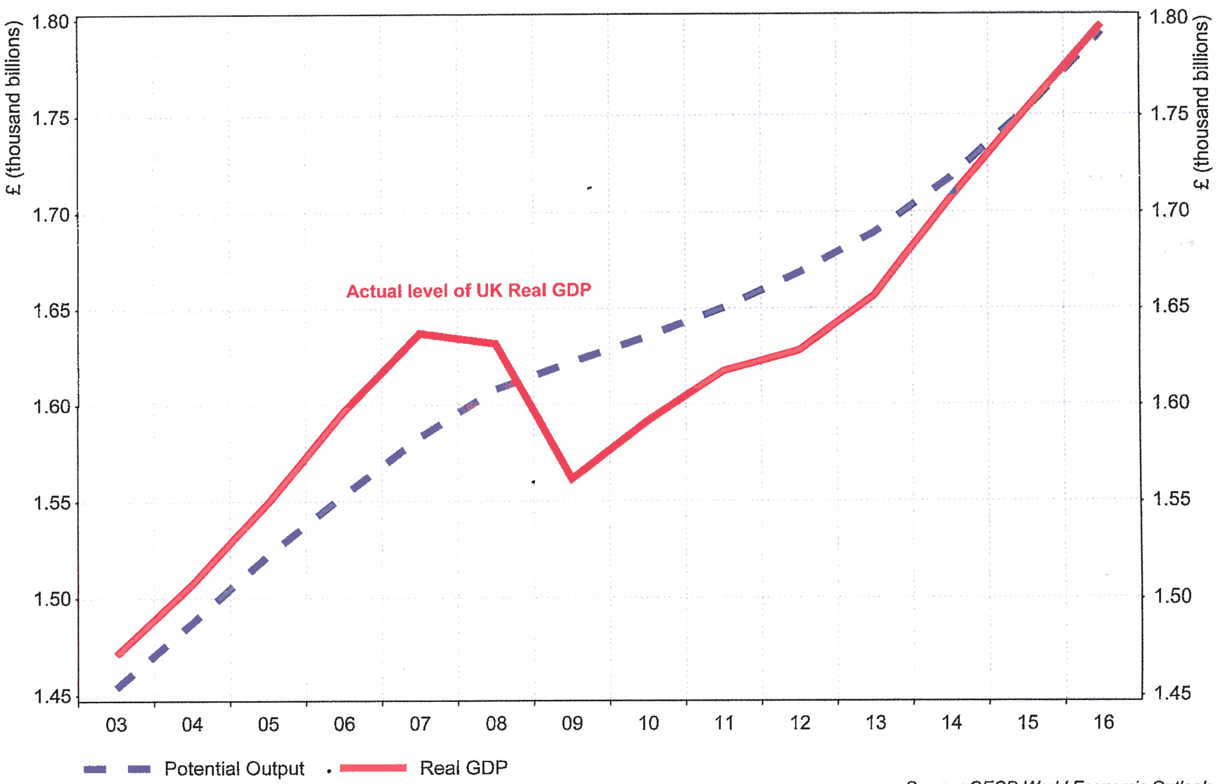


External supply-side factors:

Rising world food and energy prices, keeping UK inflation high and causing a fall in real disposable incomes

Actual and Potential GDP for the UK

£ trillion at constant prices



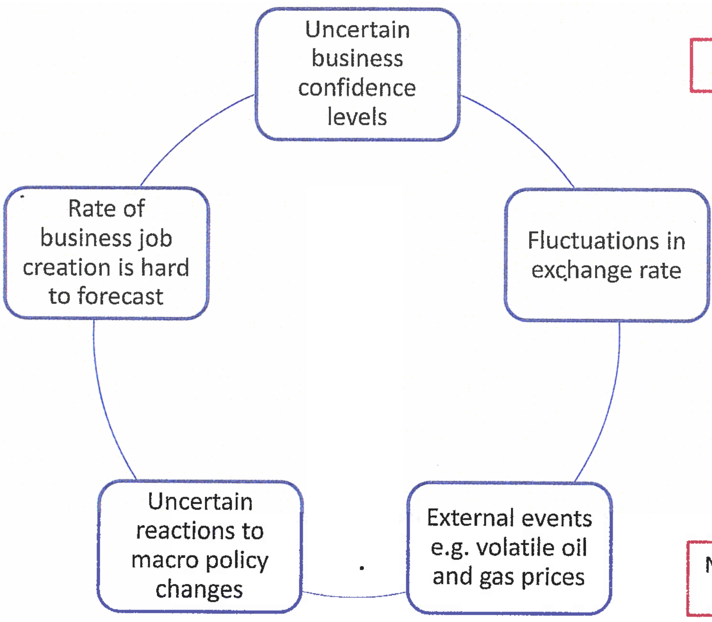
Source: OECD World Economic Outlook

Coalition's "Plan for Growth" – Policy Interventions

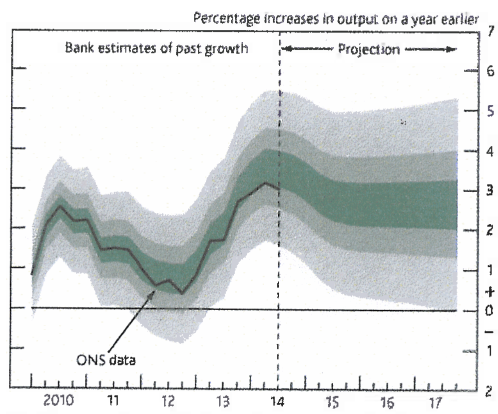
- **Business taxation**:
  - Corporation tax cut to a new level of 20% from 2015
  - Patent box (lower taxes on patented products) to stimulate innovation
  - New tax reliefs for animation, high-end television and games industries
  - Reductions in national insurance contributions for businesses employing long-term unemployed / youth unemployed
- **Business finance and red tape**:
  - Creation of Green Investment Bank for renewable energy investment
  - Funding for Lending Scheme in association with the Bank of England
  - 24 new Enterprise Zones established in areas of high unemployment
  - Qualifying period for unfair dismissal increased from one year to two
- **Education reforms**:
  - Expansion of free schools and academies
  - Large rise in the number of apprenticeships available under Youth Contract
  - 14 science and innovation capital projects

Problems in Forecasting Real GDP Growth

No macroeconomic model can hope to cope with the volatility of indicators such as inflation, exchange rates and global commodity prices such as oil. This makes forecasting GDP growth difficult



Forecast Growth for UK (source: BoE)



Note here that Nov 2014 BoE fan chart projection forecasts no recession risk for the UK until 2017

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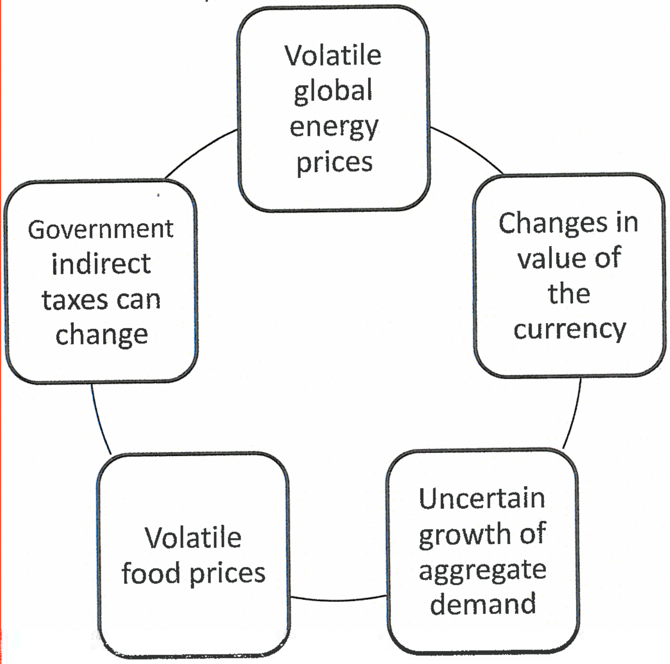
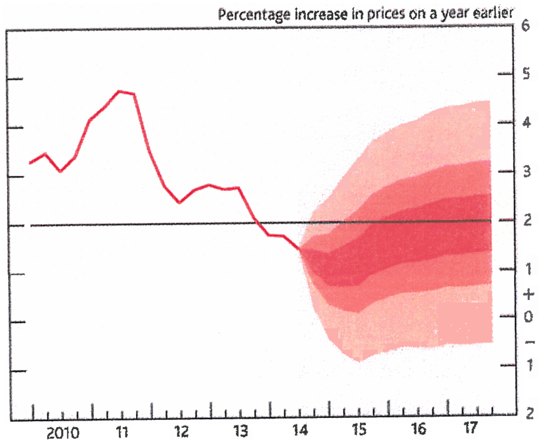
Why is CPI inflation difficult to forecast accurately?



Forecast inflation for UK (source: BoE)



The chart shows the UK CPI inflation forecast published by the Bank of England. The probability fan chart for inflation indicates the range of probabilities for inflation in the forecast period.

Consumer Price Inflation – A Cross Country Comparison

Country	Latest annual rate of consumer price inflation (%)
Australia	2.3%
Chile	4.6%
China	1.5%
France	0.1%
Greece	-2.6%
India	5.0%
Italy	0.0%
Japan	2.4%
Mexico	4.1%
Poland	-1.0%
Singapore	-0.2%
South Korea	0.8%
Spain	-1.0%
Turkey	8.2%
United Kingdom	0.5%
United States	0.8%

Recent Changes to UK Monetary Policy

There have been a number of important changes in the handling of monetary policy by the Bank of England in recent years

- **Quantitative Easing (QE) (2009-15)** – buying bonds to increase deposits and lending by the banking industry – worth £375bn
- **Project Merlin (2011)** - agreement between banks & Government to increase lending to small/medium-sized businesses
- **Funding for Lending Scheme (2012)** – a joint policy between the Treasury and the BoE that provides cheaper funding to banks that increase loans to households and businesses (extended to 2016)
- **Forward Guidance (2013-15)** - under forward guidance, the Bank's policy interest rate will remain at 0.5% at least until unemployment falls to 7% or until there are clear signs that the amount of spare capacity in the economy has reached normal levels

Forward Guidance when Setting Interest Rates

- This was introduced by Mark Carney in August 2013
- It has been signalled that the Bank of England will leave **their policy interest rates unchanged** as long as the unemployment rate is above 7.0% and inflation is under control
- The main aim is to **build consumer / business confidence** by signalling that policy interest rates would stay at low levels for some time
- In February 2014, Mark Carney signalled that forward guidance would evolve – LFS unemployment is not the sole data measure to be used – they look at indicators such as the output gap