

October 2019

# UK Economic Outlook

## European Economics

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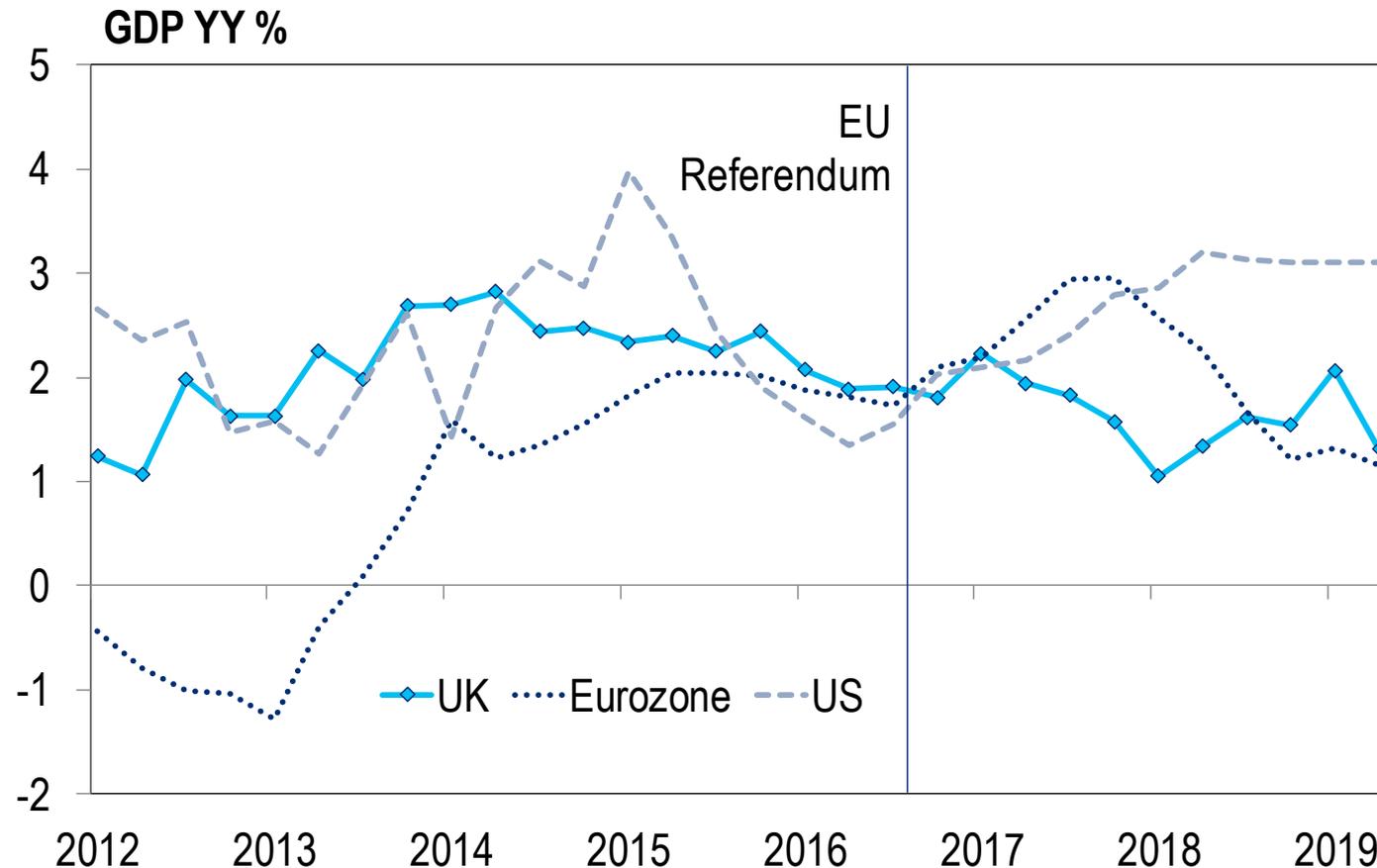
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# UK Economy: Missing Out

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

UK, US, Eurozone – Real GDP Growth (YY %), 2012-2019 (2Q)



- 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

# UK How Our Forecasts Compare to the 2018 Green Budget

2019 turned out weaker than expected owing to weaker than forecast exports and business investment. Private consumption has surprised to the upside

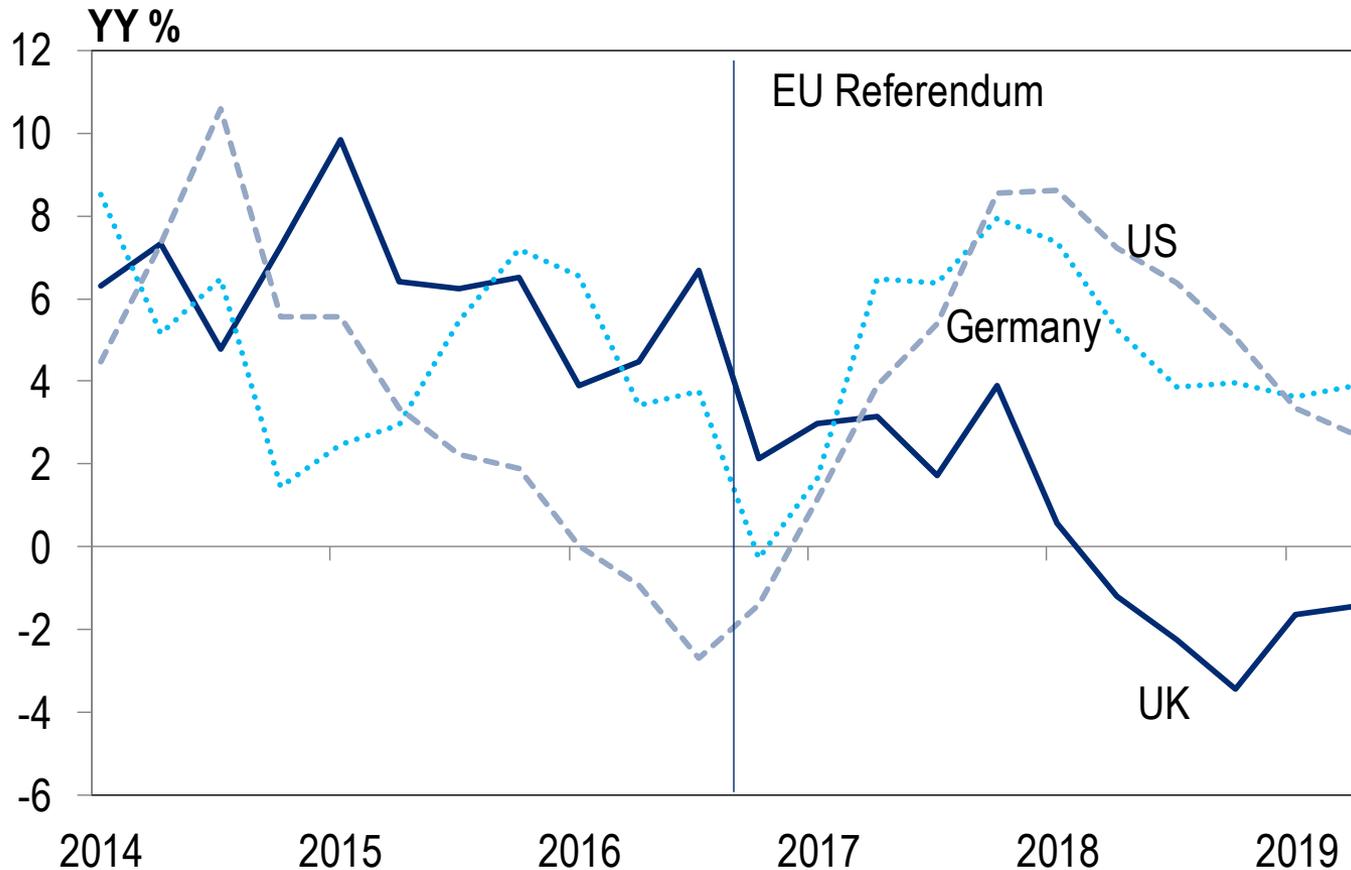
	Green Budget 2018		Latest		Deviation	
	2018	2019	2018	2019	2018	2019
<b>GDP</b>	1.3	1.5	1.4	1.1	0.1	-0.4
<b>Private Consumption</b>	1.1	1.4	1.7	1.7	0.6	0.3
<b>Public Consumption</b>	1.3	1.8	0.4	2.5	-0.9	0.7
<b>Fixed investment</b>	0.4	0.5	0.2	0.3	-0.2	-0.2
<b>Business Investment</b>	0.5	-0.2	-0.4	-1.2	-0.9	-1.0
<b>Residential Investment</b>	6.3	-0.2	7.2	0.6	0.9	0.8
<b>Exports</b>	-0.7	2	0.1	-0.4	0.8	-2.4
<b>Imports</b>	-0.2	1.8	0.7	2.6	0.9	0.8

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, Germany, US – Business Investment  
(YY %), 2014-2019 (2Q)

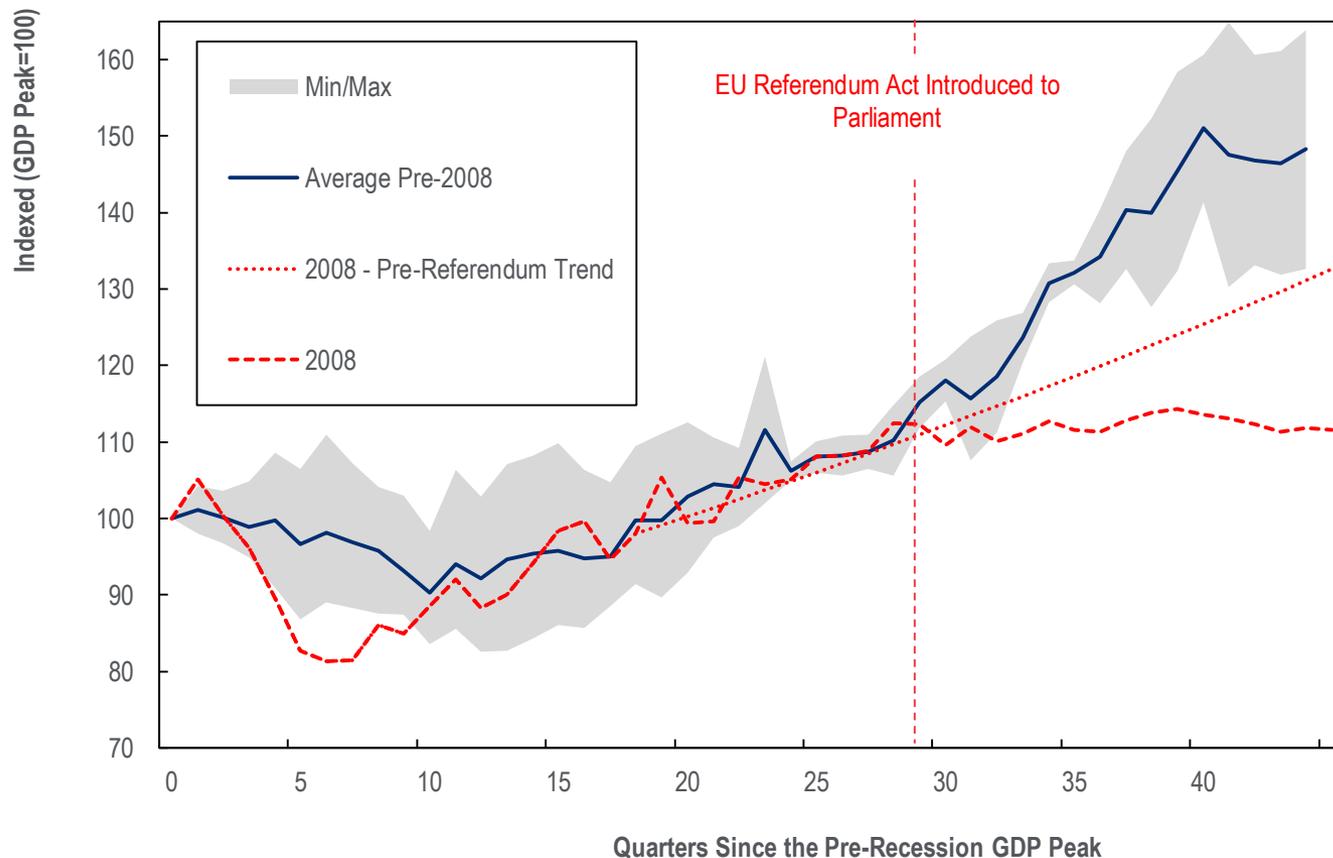


- UK business investment decoupled markedly from the investment cycle elsewhere
- Weak investment weighs on current demand and future supply.
- A lower stock of capital limits productivity growth and could erode UK competitiveness for many years.

# 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

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

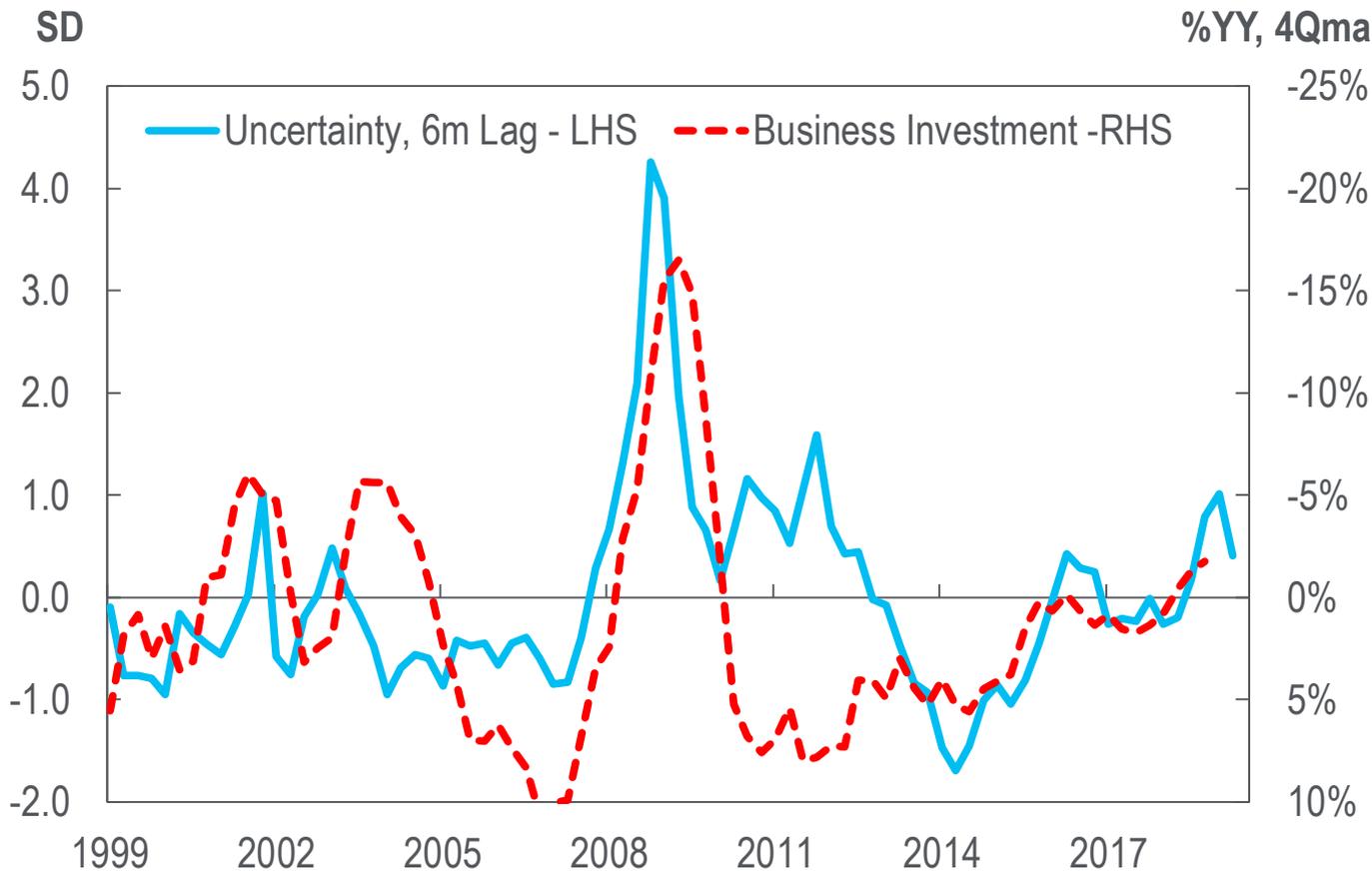


- Investment also underperforms the 2010-2016 trend (dotted line)...
- ... and trends in other GDP components

# '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

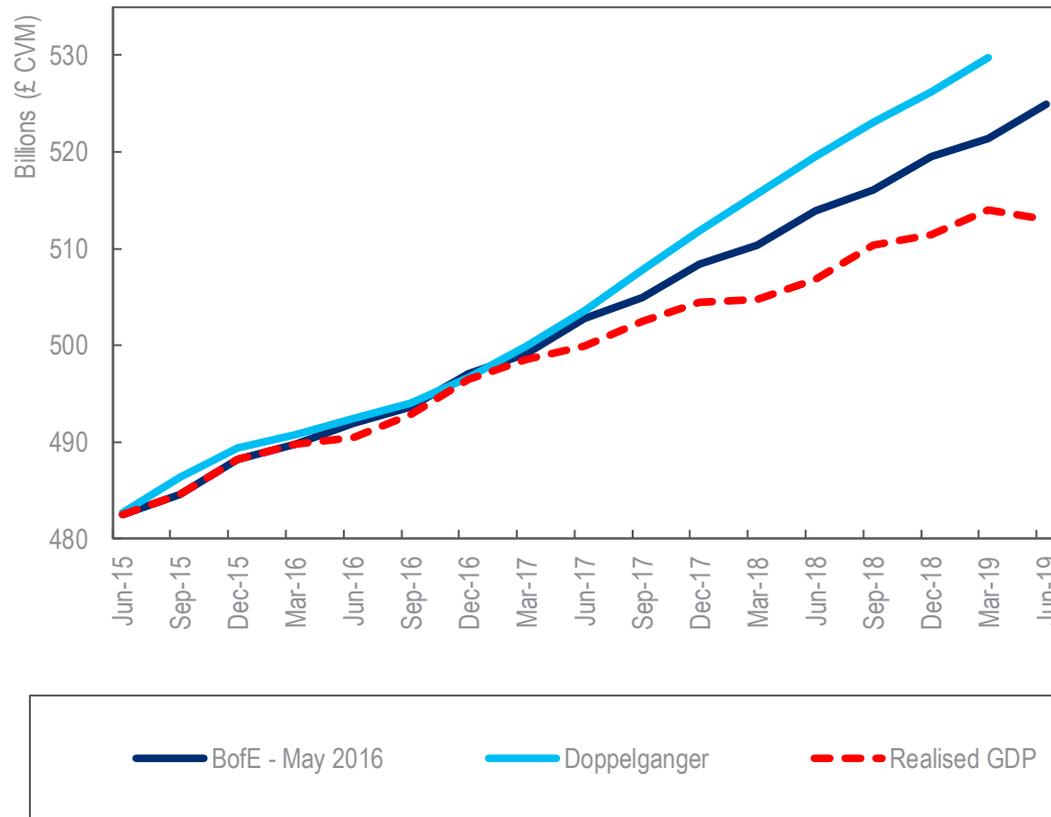


- Divergence between UK investment and other developed economies coincides with a sharp and sustained increase in economic uncertainty.
- This has increased the perceived risk associated with investments and reduced investment by 15-20% of what it could have been.
- Ongoing worries about the risk of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

# 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.

## UK -- Real GDP and Doppelganger (2016 GBP billion), 2Q 2015 – 2Q 2019



- 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.

## Base Case: More Delays

- Deal impossible or rejected, no-deal ruled out, elections inconclusive
- 1-2% of GDP fiscal loosening, given that all parties have such commitments
- Steady monetary policy (risk of cut)

## Deal

- EU and UK agree on withdrawal terms, followed by 1-3 year transition, negotiations on future relationship
- 1-2% fiscal loosening, one 25bp Bank Rate hike per year

## No-deal

- Conservative election victory leads to no-deal Brexit
- Some preparations in place, reduced risk of financial turmoil
- >2% fiscal loosening
- Bank Rate cut to zero, Bank QE restarted

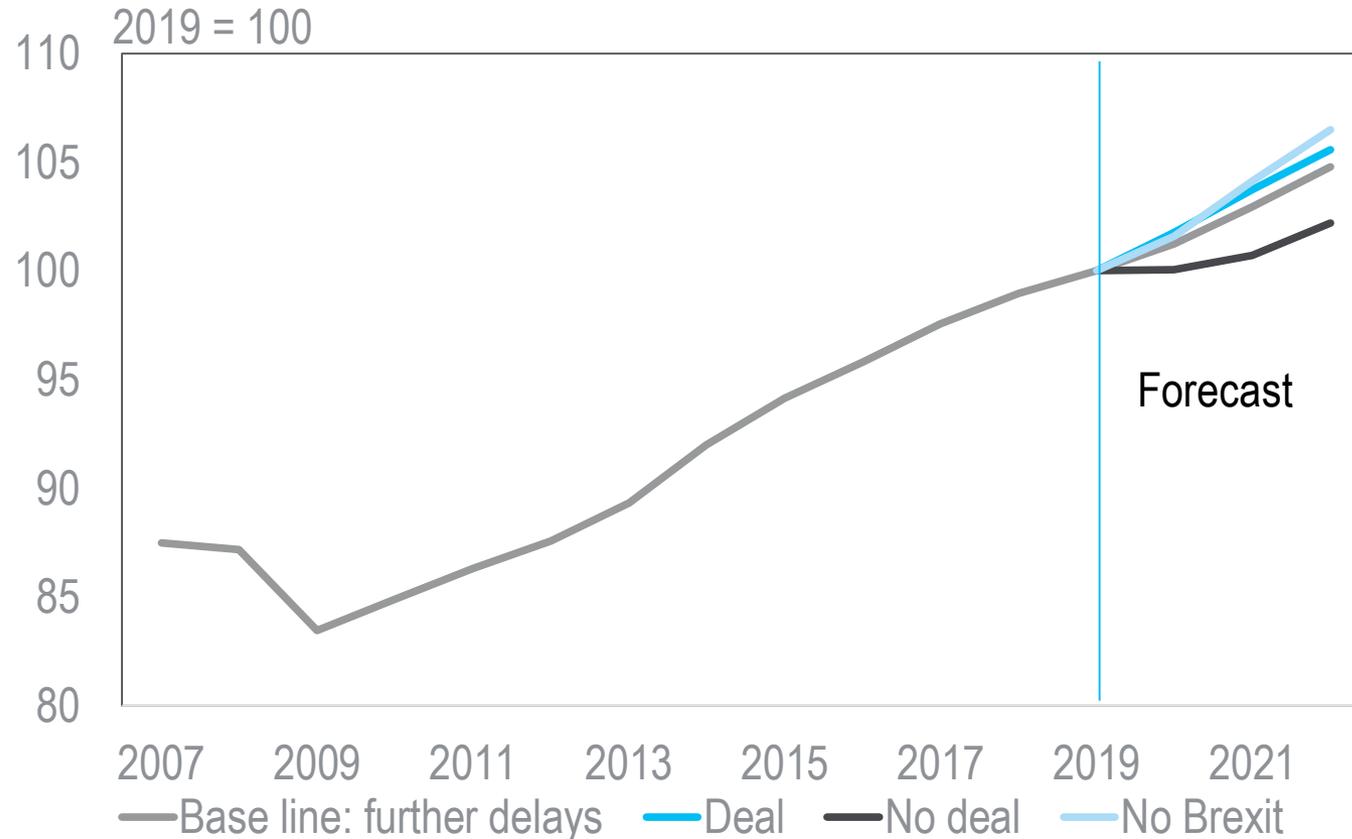
## Revocation

- Remain alliance around Labour, Liberal Democrats and SNP leads to second referendum and vote to remain in EU
- Significant fiscal loosening partly offset by higher taxes
- Labour programme of nationalisation, labour regulation watered down
- Bank Rate rises faster

# 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.

## UK – Real GDP (2019 = 100) Under Different Brexit Scenarios



- 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.

# 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

YY %	2018	2019	2020	2021	2022	2023
<b>GDP</b>	1.4	1.1	1.0	1.3	1.5	1.4
<b>Private Consumption</b>	1.7	1.7	1.3	1.4	1.6	1.6
<b>Public Consumption</b>	0.4	2.5	2.2	1.2	0.9	0.9
<b>Fixed Investment</b>	0.2	0.3	0.5	1.2	1.5	1.7
<b>Business Investment</b>	-0.4	-1.2	0.3	0.8	1.3	1.6
<b>Construction Dwellings</b>	7.2	0.6	2.9	2.8	2.8	2.8
<b>Exports</b>	0.1	-0.4	1.0	2.7	2.7	2.0
<b>Imports</b>	0.7	2.6	-1.0	2.6	2.4	2.1
<b>Other Forecasters (GDP only)</b>						
<b>Consensus (Bloomberg)</b>	1.4	1.2	1.1	1.5		
<b>IMF</b>	1.4	1.3	1.4	1.5	1.6	1.6
<b>Bank of England</b>	1.4	1.3	1.3	2.3		

Sources: ONS, BoE, IMF, Bloomberg and Citi Research (Latest Forecasts September 2019)

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