NIESR Economists’ Briefing – NIESR February 2018

Wednesday 7th February 2018    5.30-6.30pm

Brexit: the Trade-offs Ahead

Chair: Prof. Jagjit Chadha, NIESR Director

17.30  Prof. Jagjit Chadha – Opening Remarks

17.40  Dr. Garry Young - Prospects for the Global Economy

17.50  Jason Lennard – Oil and the Macroeconomy

18.00  Amit Kara – Prospect for the UK Economy and the Brexit trade-offs

18.10  Q&A

18.30  Drinks
Opening Remarks

Jagjit S. Chadha
Director, NIESR

7th February 2018
Difference in the level of GDP by c2030 compared to remaining in the EU (% points)

- EEA
- FTA
- WTO

Legend:
- DexEU
- HMT
- NIESR

Productivity Effect
Figure 2. Maps of percentage decreases in local authority GVA.
International Risk Sharing

Income Growth

Overseas

UK

Time

Risk Sharing

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UK growth Vs OECD

Referendum

Forecast

Per cent


OECD
UK

National Institute of Economic and Social Research
The world economy

National Institute Economic Review
Issue 243, February 2018

Garry Young
Headlines

• Substantial **momentum** in global economy at start of 2018, supported by US fiscal expansion
• Material **upwards** revision to growth forecasts
• Little sign of **imminent inflationary** pressure
• Monetary policy normalisation expected to be **gradual** and **limited**
• Significant **upside** in the short term, but global growth expected to settle at 3½ per cent pa in the medium term
## Forecast summary for GDP growth

<table>
<thead>
<tr>
<th></th>
<th>World economy</th>
<th>US</th>
<th>China</th>
<th>Japan</th>
<th>Euro Area</th>
<th>Canada</th>
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</thead>
<tbody>
<tr>
<td>2016</td>
<td>3.2</td>
<td>1.5</td>
<td>6.7</td>
<td>0.9</td>
<td>1.8</td>
<td>1.4</td>
</tr>
<tr>
<td>2017</td>
<td>3.7</td>
<td>2.3</td>
<td>6.9</td>
<td>1.8</td>
<td>2.5</td>
<td>2.9</td>
</tr>
<tr>
<td>2018</td>
<td><strong>3.9</strong></td>
<td><strong>2.6</strong></td>
<td><strong>6.6</strong></td>
<td><strong>1.3</strong></td>
<td><strong>2.2</strong></td>
<td><strong>2.7</strong></td>
</tr>
<tr>
<td>2020-24</td>
<td>3.5</td>
<td>2.3</td>
<td>5.6</td>
<td>0.9</td>
<td>1.8</td>
<td>2.3</td>
</tr>
</tbody>
</table>

### Change in projected annual GDP growth since November 2017 forecast

(percentage points)

<table>
<thead>
<tr>
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<th>World economy</th>
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<th>China</th>
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<th>Euro Area</th>
<th>Canada</th>
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</thead>
<tbody>
<tr>
<td>2017</td>
<td>0.2</td>
<td>0.2</td>
<td>0.1</td>
<td>0.3</td>
<td>0.4</td>
<td>-0.2</td>
</tr>
<tr>
<td>2018</td>
<td><strong>0.3</strong></td>
<td><strong>0.4</strong></td>
<td><strong>0.1</strong></td>
<td><strong>0.3</strong></td>
<td><strong>0.3</strong></td>
<td><strong>0.5</strong></td>
</tr>
<tr>
<td>2020-24</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.0</td>
<td>-0.1</td>
</tr>
</tbody>
</table>
GDP growth consensus forecasts for 2018 being revised up.

Source: Consensus Economics, NIESR
...UK is an exception...
..though NIESR UK forecasts remain stronger
Little upwards change in consensus inflation forecasts...

Source: Consensus Economics, NIESR
..even though global labour market slack largely absorbed...

Source: NiGEM database
...with exception of much of Europe

Unemployment rate

% of labour force

1997 1999 2001 2003 2005 2007 2009 2011 2013 2015 2017

10 15 20 25 30

Source: NiGEM database

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Central forecast of smooth adjustment to slower medium-term growth:

Short-term demand
• Watchful monetary policy (especially in US)
• Strong euro impact on EA
• Higher oil prices (Box A, page F43)
• Slowing consistent with subdued monetary growth (Box C, page F54)

Medium-term supply
• Limited spare capacity and slow population growth in advanced economies
• Necessary slowing in China
Monetary policy can push against momentum

Source: NiGEM database

Euro Area (Euro short term repo)  US

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Upside risks:

• Momentum stronger than expected
• Productivity and investment pick up, helped by supportive monetary and fiscal policies and continued benign financial conditions
Productivity puzzle might have benign resolution

Note: 2007 Q4 = 100
Source: NiGEM Database and NIESR forecast

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Downside risks:

- Asset prices weaken
- High household debt levels
- Policy tightened too sharply, especially given prevailing vulnerabilities in euro area
- Protectionism
Headlines

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Oil and the Macroeconomy
Jason Lennard and Konstantinos Theodoridis
Transmission Mechanisms

- Oil revenues
- Terms of trade
- Potential output
- Inflation
The Macroeconomic Effects of an Oil Price Shock

- World oil price
- US real GDP
- US inflation
- US policy rate
Summary

• A further increase in oil prices would raise inflation and mildly depress output in the US and UK
• In general, the economic impact would be conditional on a number of factors
  – Domestic oil reserves
  – Oil intensity of output
  – Monetary policy response
  – Source of the shock
Prospects for the UK economy

National Institute Economic Review

Issue 243, February 2018

Amit Kara, with Arno Hantzsche, Jason Lennard, Cyrille Lenoel, Marta Lopresto, Rebecca Piggott, Craig Thamotheram and Garry Young
Big picture

- Economic forecast: revised higher
- Rebalances: towards net trade
- Monetary policy normalisation: 25bp every 6-months
- Central forecast = Soft Brexit: close to full access to the EU market
- Great British Trade-off: bespoke deal is possible
- Brexit uncertainty: political turmoil
- ‘No agreement’ or ‘orderly’ cliff edge: GDP will be 7 per cent smaller relative to baseline
- Other risks: Productivity & wages
- GDP growth surprise in 2017: Surprise strength in global growth
Economic forecast

- GDP growth steady at just under 2 per cent. Well above market consensus
- Small upward revision: Why? Global growth + Phase 1 Brexit agreement
- Growth eases back to potential over the next 3 years
- Net trade makes large positive contribution, driven by exports

Source: NiGEM database, NIESR forecast

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THE GREAT BRITISH TRADE-OFF

READY

STEADY

TRADE (DEAL)

TRADE (WTO)

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The Great British Trade-Off

Access to EU market

Net financial contribution (% of GNI)

Freedom of labour movement
The Great British Trade-Off

Access to EU market

Net financial contribution (% of GNI)

Freedom of labour movement

Source: NIER February 2018
The Great British Trade-Off

Source: NIER February 2018
The Great British Trade-Off

- Bespoke deal possible
- Trade-offs
- Political

Source: NIER February 2018
Market access to the EU

Source: World Bank, NIESR

Number of provisions

EU
EEA (Norway)
Switzerland
Canada
Central America
Colombia and Peru
Chile
Algeria
Mexico
South Africa
Morocco
Tunisia
South Korea
Turkey

Source: World Bank, NIESR
What if talks fail? WTO-scenario

Source: NiGEM database, NIESR forecast

GDP growth

Inflation

Base  "No-deal" Brexit

Base  "No-deal" Brexit

Source: NiGEM database, NIESR forecast
"No-deal" Brexit scenario: reduction in real GDP, % relative to soft Brexit baseline forecast. This translates to a loss in output per head of £2,000 (in 2015 prices).
Why did GDP growth surprise to the upside in 2017?
Was UK GDP growth in 2017 made in the EA?

Forecast errors for 2017

Impact on the UK

Source: NiGEM database, NIESR forecast
## Forecast summary

<table>
<thead>
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<tbody>
<tr>
<td><strong>GDP</strong></td>
<td>3.1</td>
<td>2.3</td>
<td>1.9</td>
<td>1.8</td>
<td>1.9</td>
<td>1.9</td>
<td>1.7</td>
<td>1.6</td>
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<tr>
<td>Per capita GDP</td>
<td>2.3</td>
<td>1.6</td>
<td>1.1</td>
<td>1.2</td>
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<td>1.2</td>
<td>1.1</td>
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<tr>
<td><strong>CPI Inflation</strong></td>
<td>1.4</td>
<td>0.1</td>
<td>0.7</td>
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<td>RPIX Inflation</td>
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<td>2.6</td>
<td>2.7</td>
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<td><strong>RPDI</strong></td>
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<td>0.2</td>
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<td>1.9</td>
<td>1.9</td>
<td>1.7</td>
<td>1.6</td>
</tr>
<tr>
<td>Unemployment, %</td>
<td>6.2</td>
<td>5.4</td>
<td>4.9</td>
<td>4.4</td>
<td>4.3</td>
<td>4.3</td>
<td>4.5</td>
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<td>4.6</td>
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<tr>
<td>Bank Rate, %</td>
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<td>0.5</td>
<td>0.4</td>
<td>0.3</td>
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<td>1.2</td>
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<td>2.0</td>
<td>2.4</td>
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<tr>
<td>Long Rates, %</td>
<td>2.5</td>
<td>1.8</td>
<td>1.3</td>
<td>1.2</td>
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<td>2.3</td>
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<td>3.3</td>
<td>3.6</td>
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<td>Effective exchange rate</td>
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<td>-9.7</td>
<td>-5.1</td>
<td>1.9</td>
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<td>Current account as % of GDP</td>
<td>-5.3</td>
<td>-5.2</td>
<td>-5.8</td>
<td>-4.6</td>
<td>-4.2</td>
<td>-3.5</td>
<td>-3.2</td>
<td>-2.8</td>
<td>-2.5</td>
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<tr>
<td>PSNB as % of GDP(a)</td>
<td>5.3</td>
<td>4.2</td>
<td>2.8</td>
<td>2.5</td>
<td>1.8</td>
<td>1.2</td>
<td>0.9</td>
<td>0.4</td>
<td>0.0</td>
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<td>PSND as % of GDP(a)</td>
<td>83.3</td>
<td>83.1</td>
<td>85.7</td>
<td>89.0</td>
<td>86.3</td>
<td>83.6</td>
<td>79.2</td>
<td>73.5</td>
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