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

National Institute of Economic and Social Research

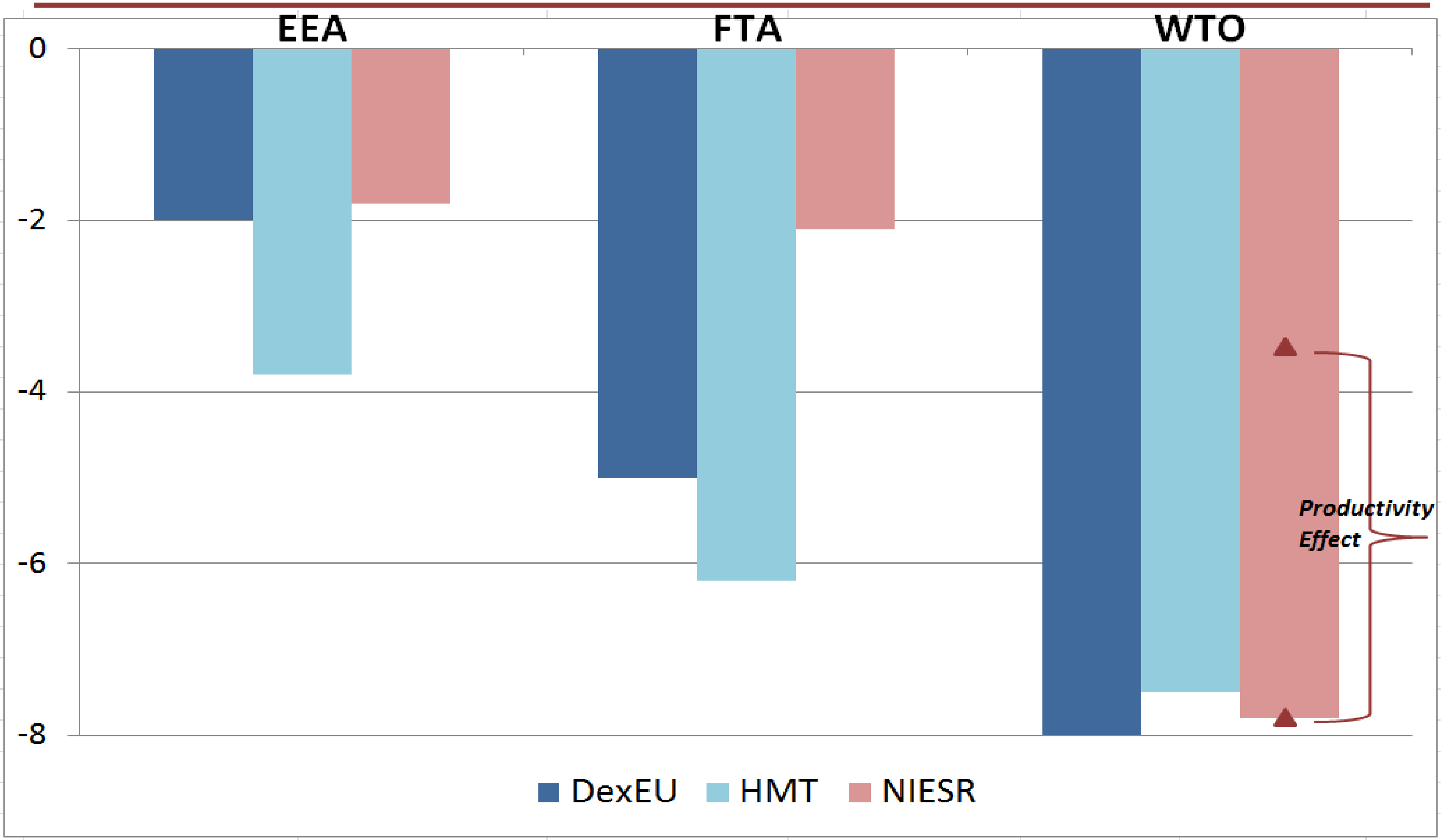
National Institute Economic Review
No. 243, February 2018

Opening Remarks

Jagjit S. Chadha
Director, NIESR

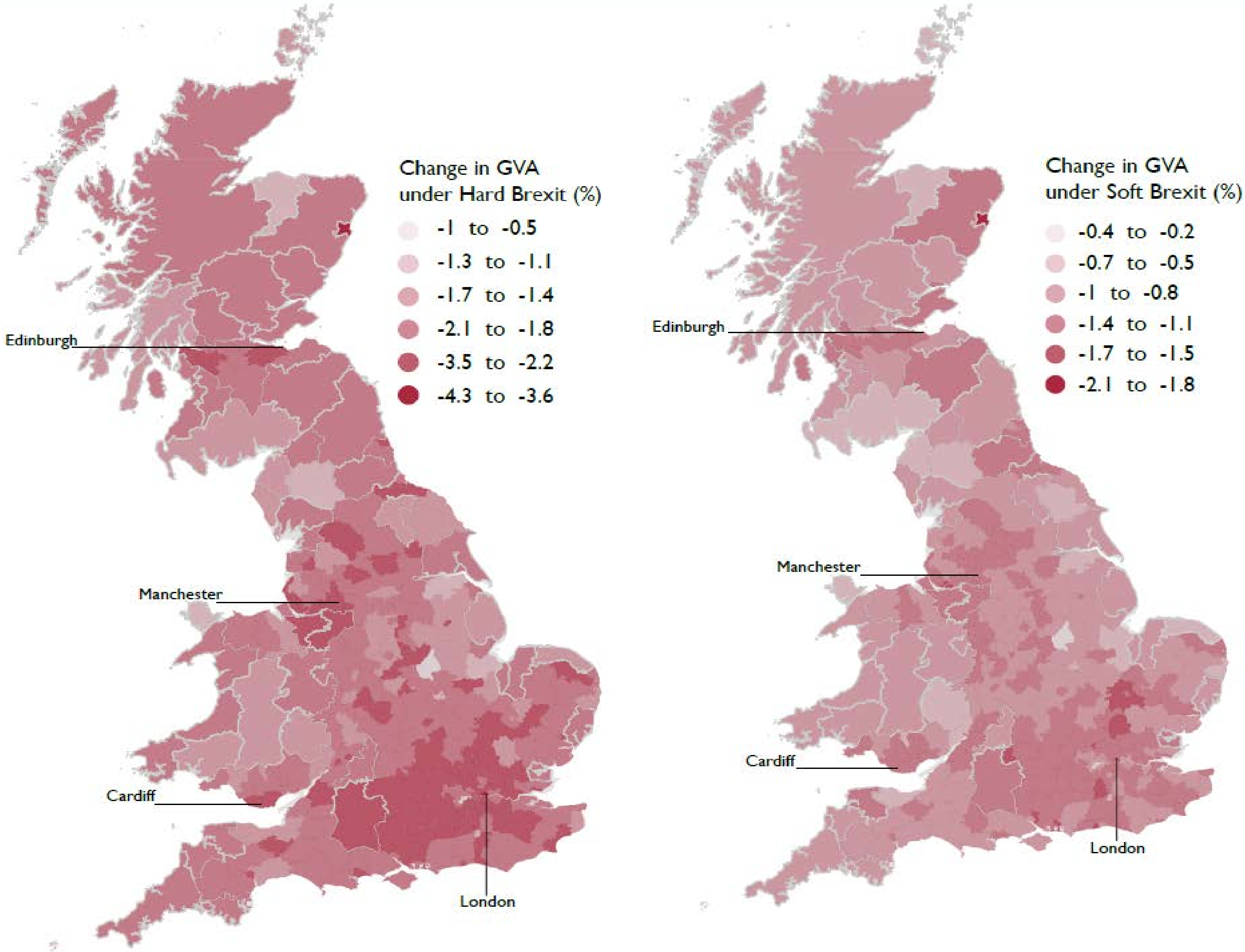
7th February 2018

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

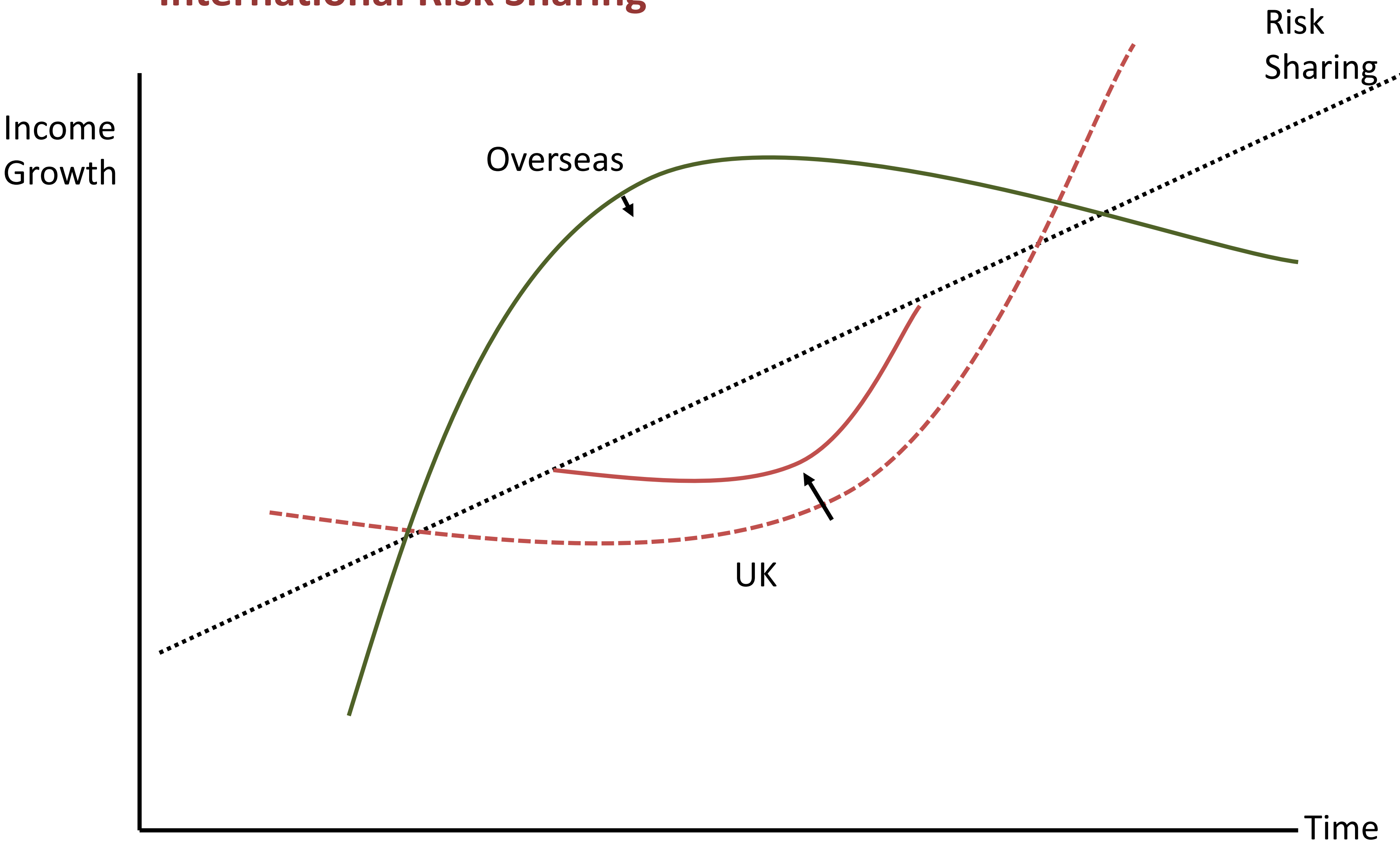


Dhingra, Machin and Overman, NIER, November 2017

Figure 2. Maps of percentage decreases in local authority GVA



International Risk Sharing



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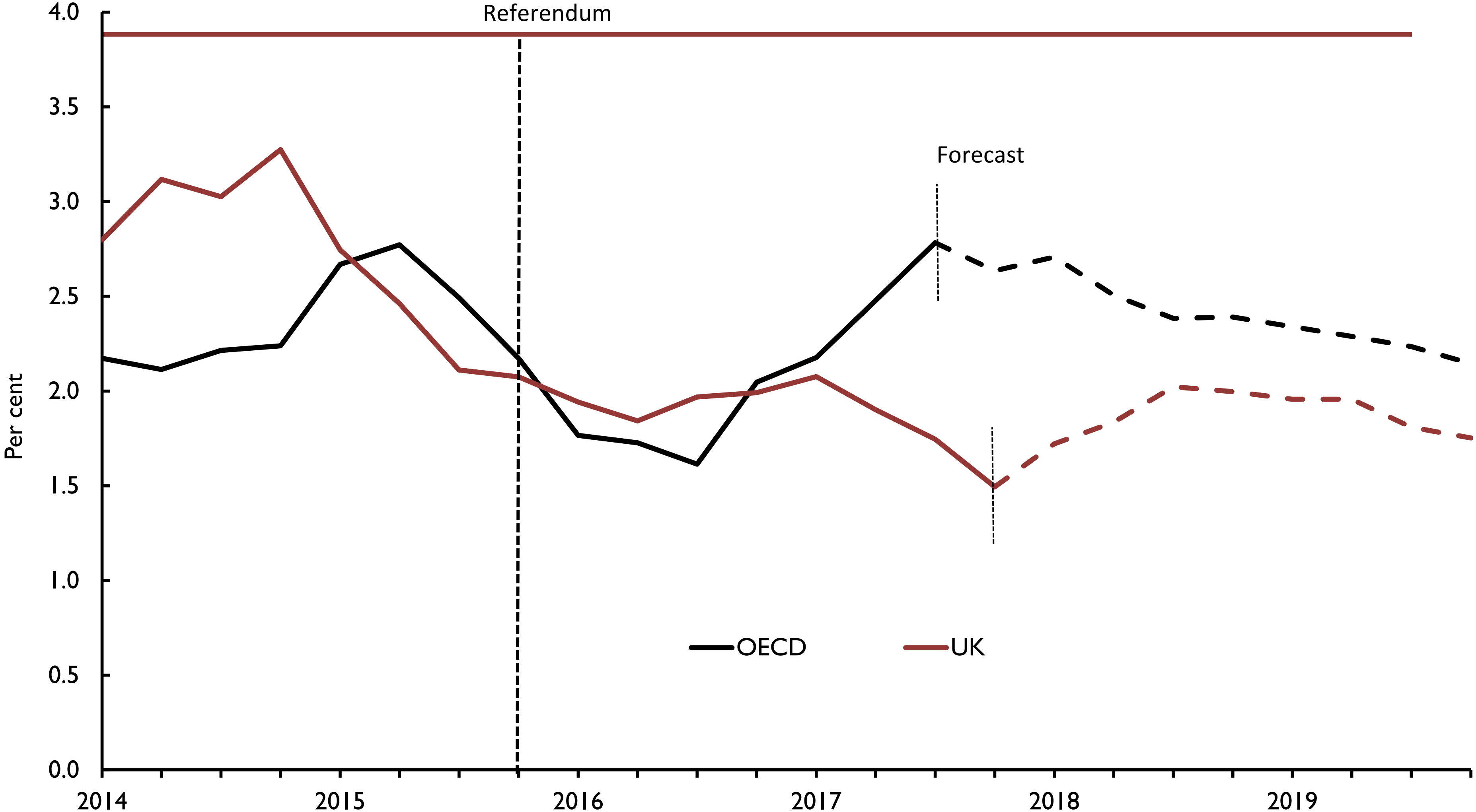
UK growth Vs OECD



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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

Annual percentage change

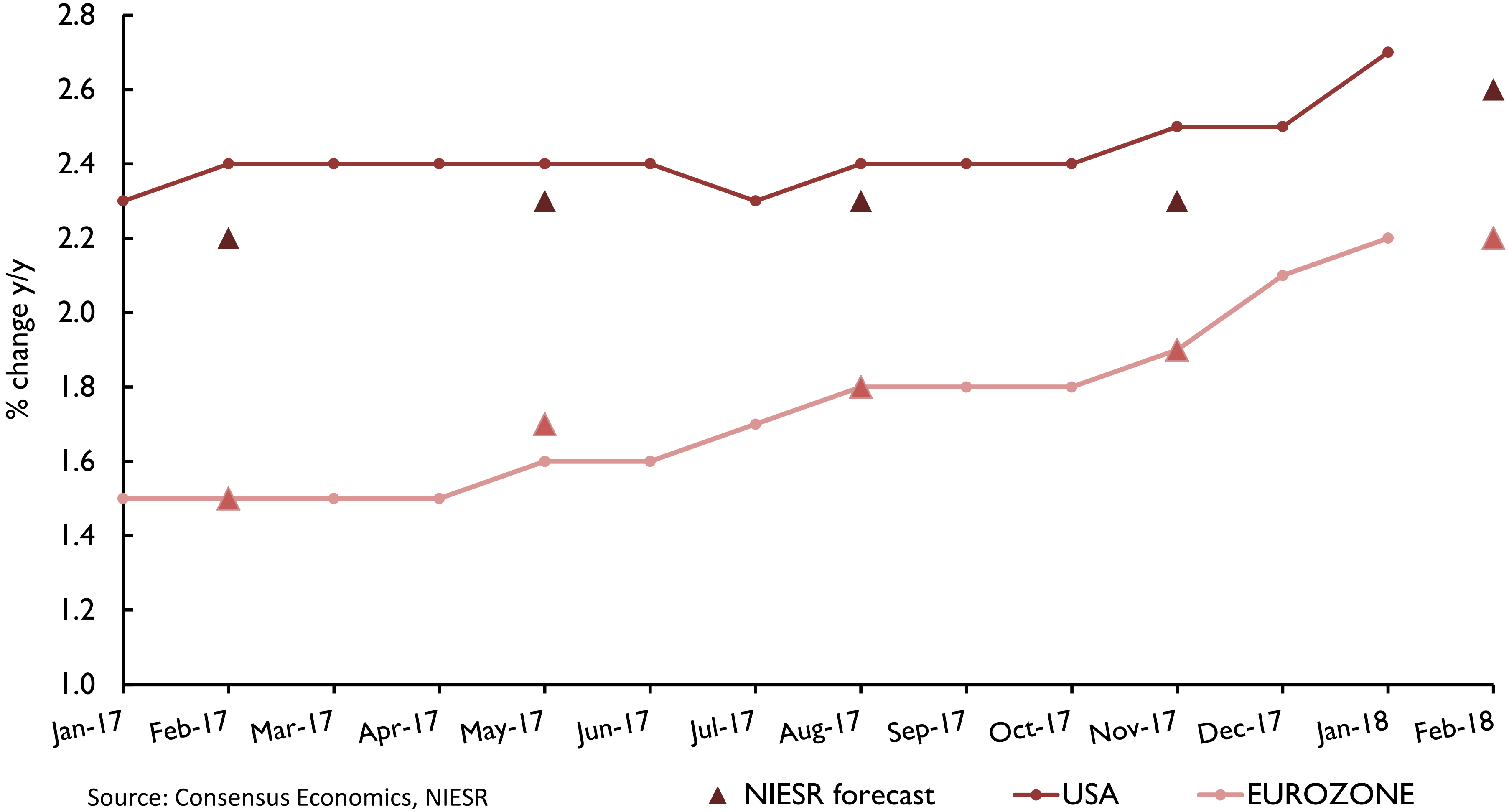
	World economy	US	China	Japan	Euro Area	Canada
2016	3.2	1.5	6.7	0.9	1.8	1.4
2017	3.7	2.3	6.9	1.8	2.5	2.9
2018	**3.9**	**2.6**	**6.6**	**1.3**	**2.2**	**2.7**
2020-24	3.5	2.3	5.6	0.9	1.8	2.3

Change in projected annual GDP growth since November 2017 forecast

(percentage points)

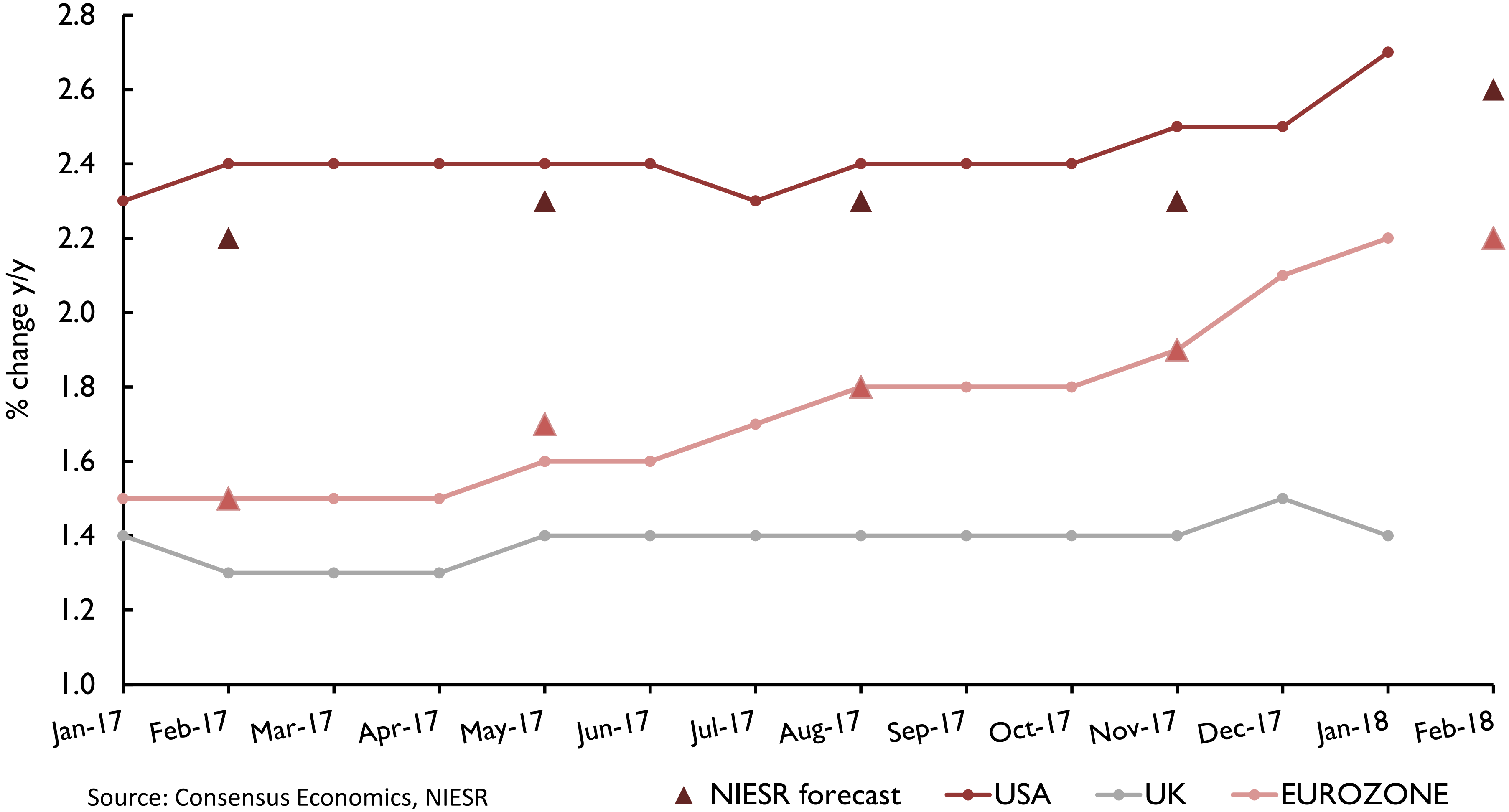
	World economy	US	China	Japan	Euro Area	Canada
2017	0.2	0.2	0.1	0.3	0.4	-0.2
2018	**0.3**	**0.4**	**0.1**	**0.3**	**0.3**	**0.5**
2020-24	0.1	0.1	0.1	0.1	0.0	-0.1

GDP growth consensus forecasts for 2018 being revised up..



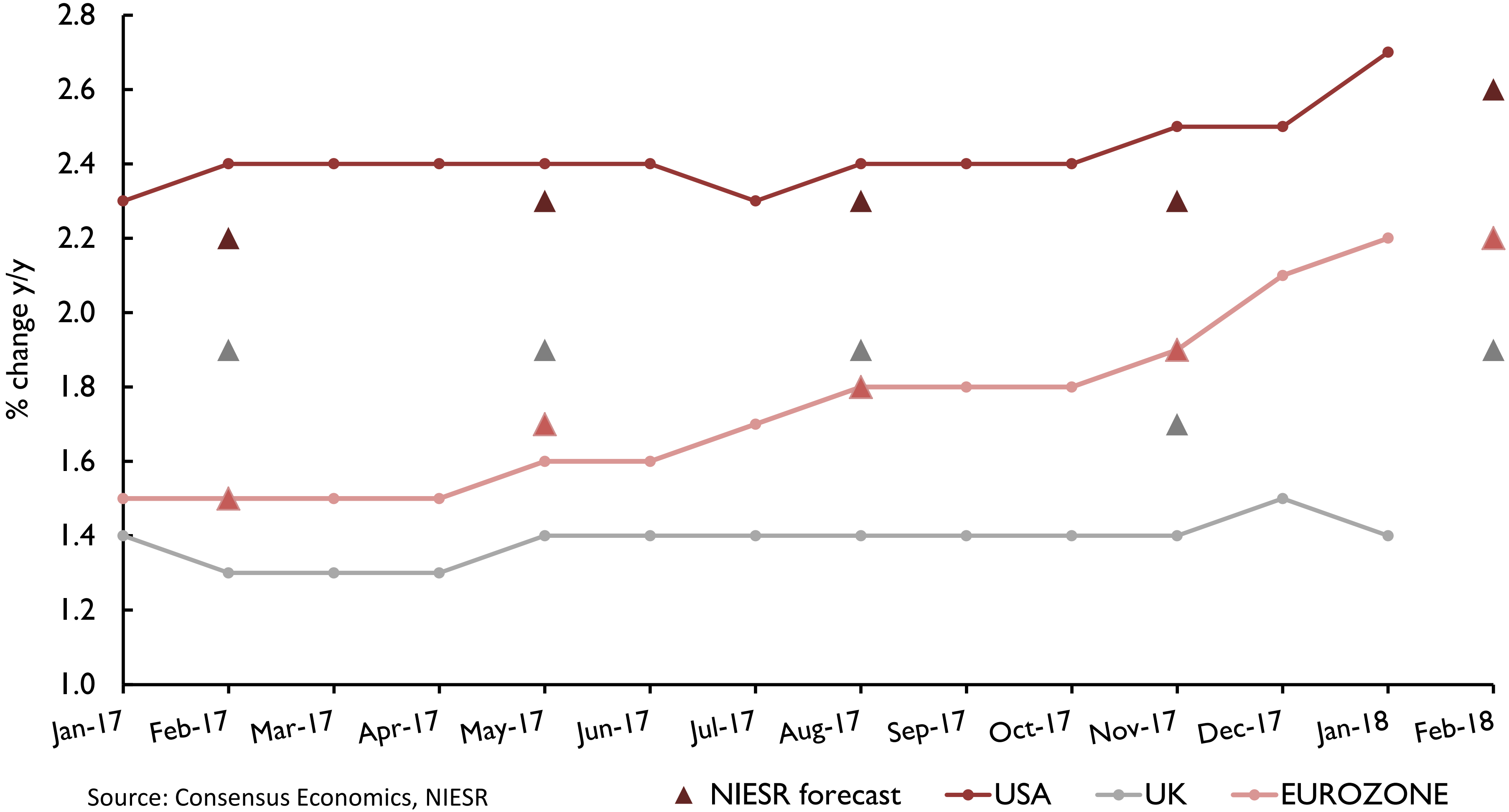
Source: Consensus Economics, NIESR

…UK is an exception…



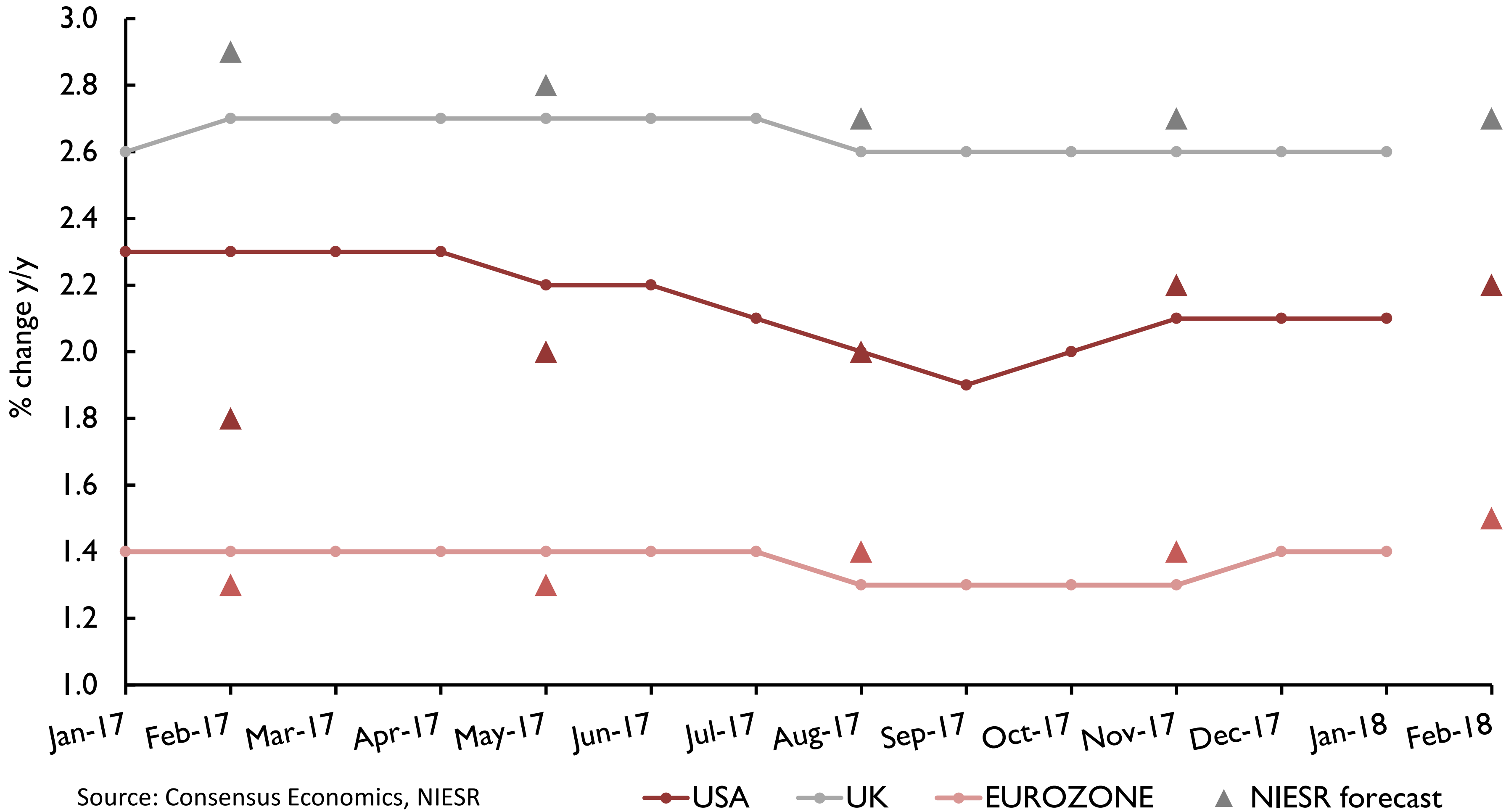
Source: Consensus Economics, NIESR

..though NIESR UK forecasts remain stronger



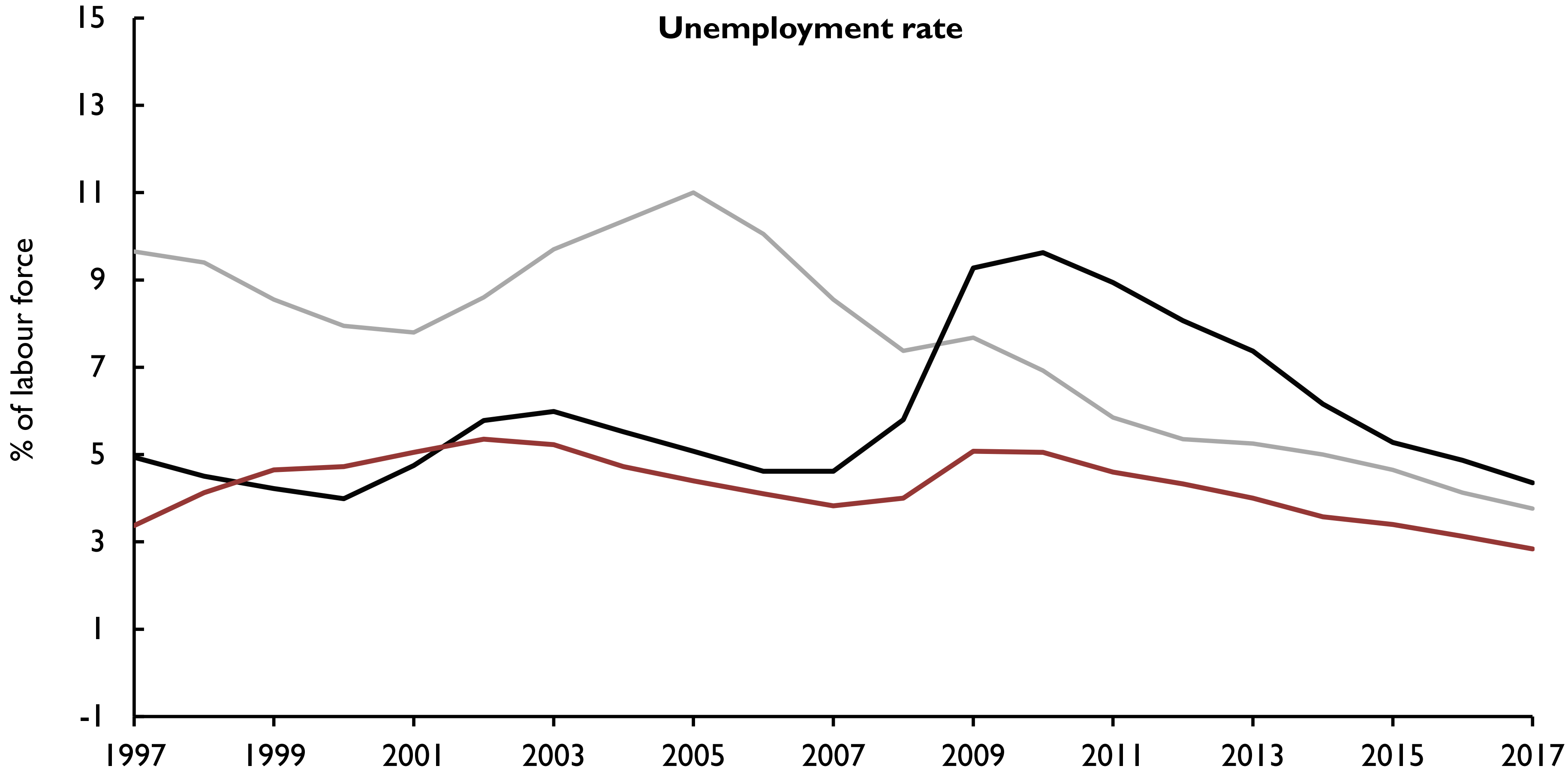
Source: Consensus Economics, NIESR

Little upwards change in consensus inflation forecasts…



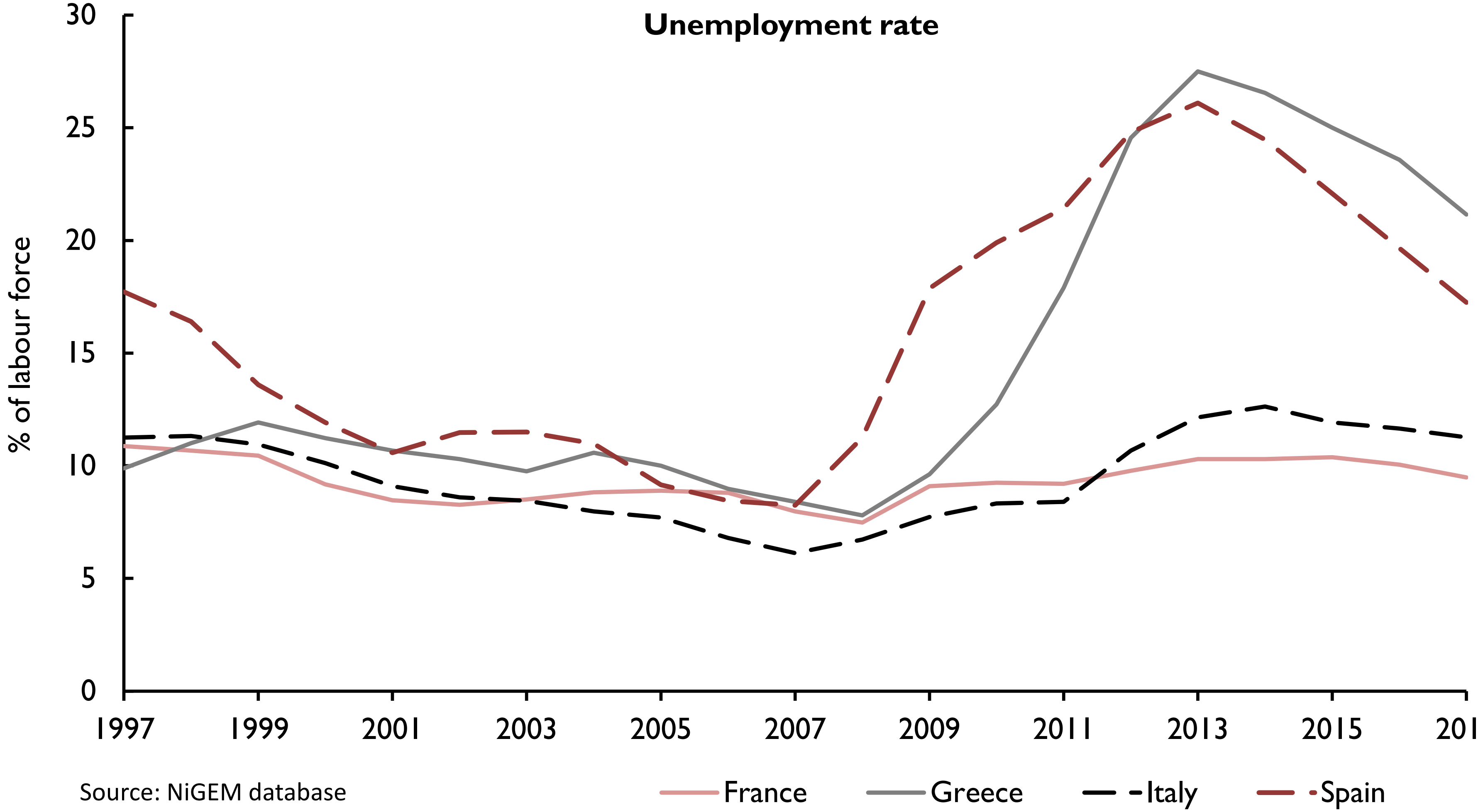
Source: Consensus Economics, NIESR

..even though global labour market slack largely absorbed...



Source: NiGEM database

…with exception of much of Europe



Source: NiGEM database

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

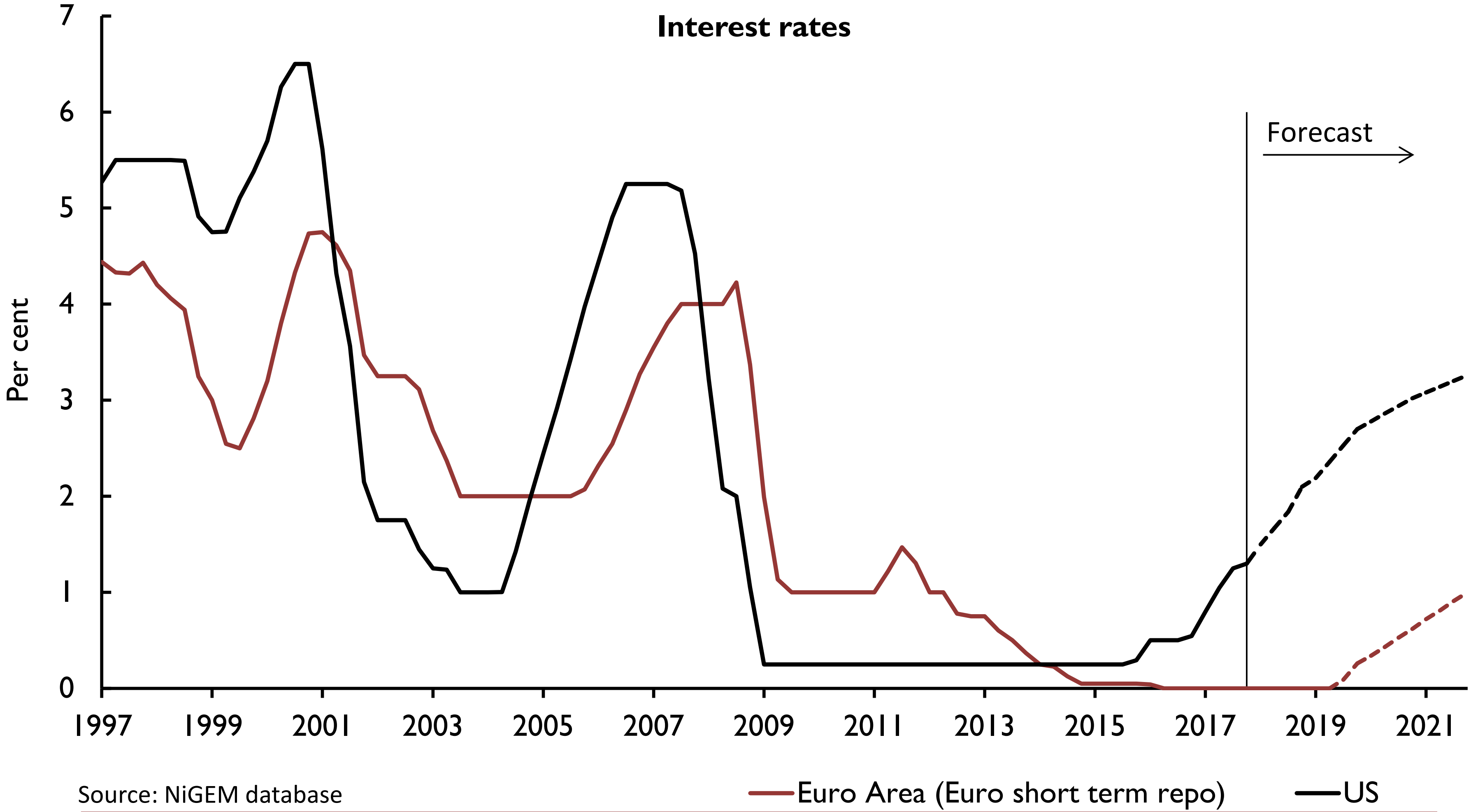
Short-term demand

- 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

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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

Downside risks:

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

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Oil and the Macroeconomy

Jason Lennard and Konstantinos Theodoridis

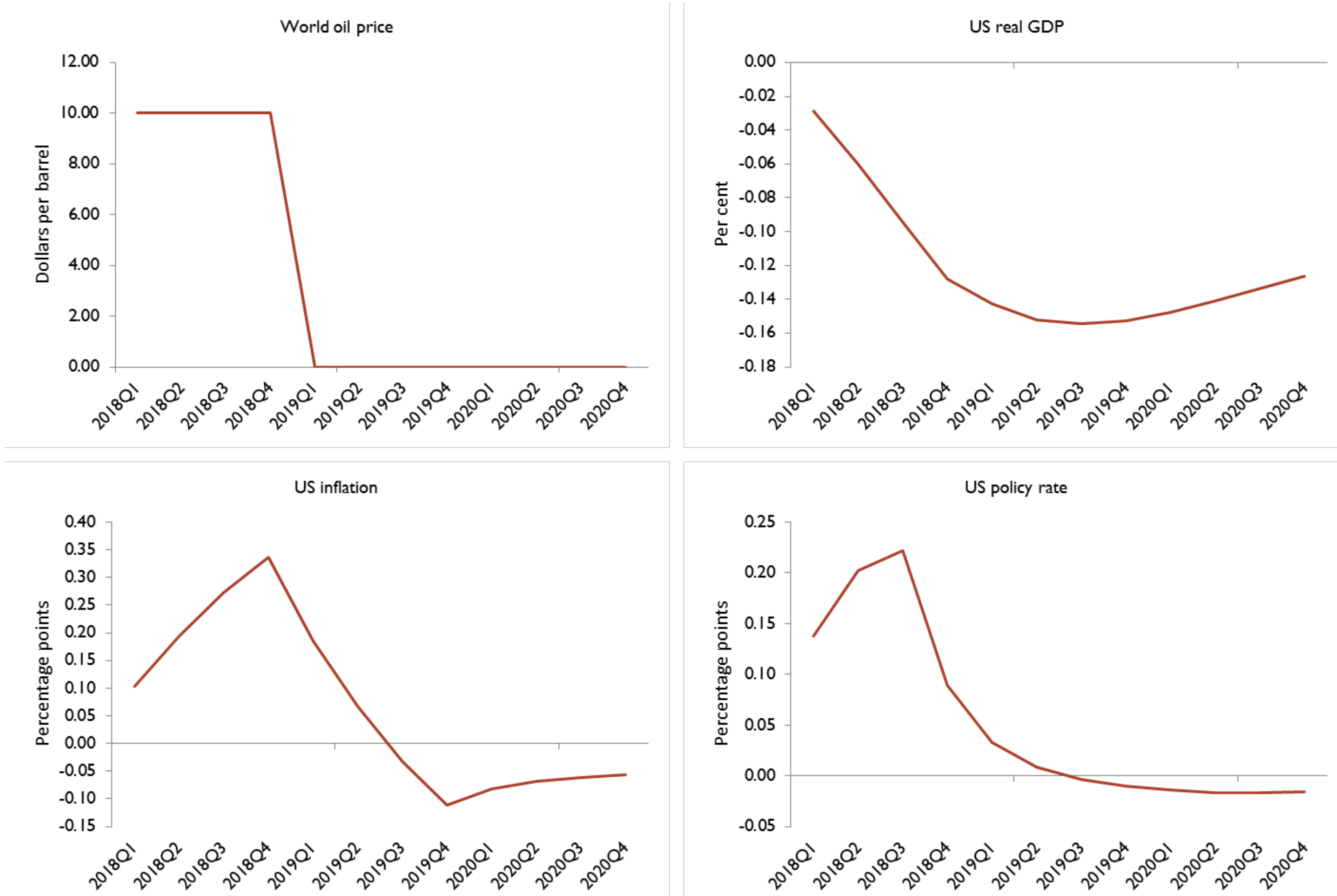
National Institute of Economic and Social Research

Europe Brent Spot Price

Transmission Mechanisms

- Oil revenues
- Terms of trade
- Potential output
- Inflation

The Macroeconomic Effects of an Oil Price Shock



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

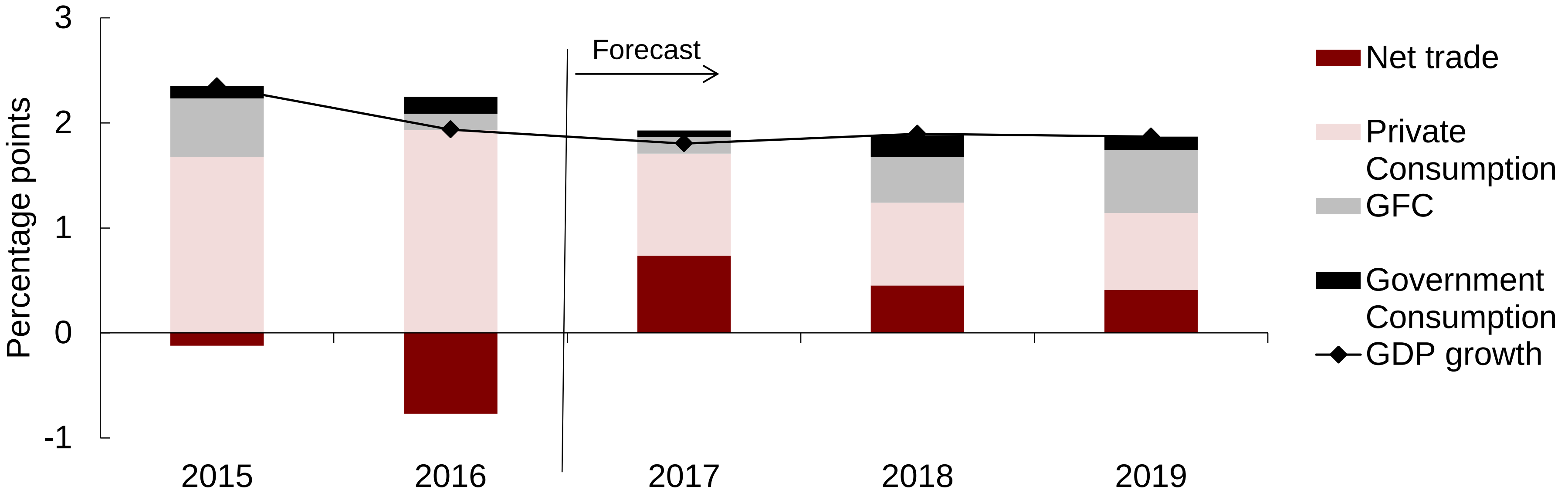
Amit Kara, with Arno Hantzsche, Jason Lennard, Cyrille Lenoel, Marta Lopresto, Rebecca Piggott, Craig Thamotheram and Garry Young

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

The Great British Trade-Off

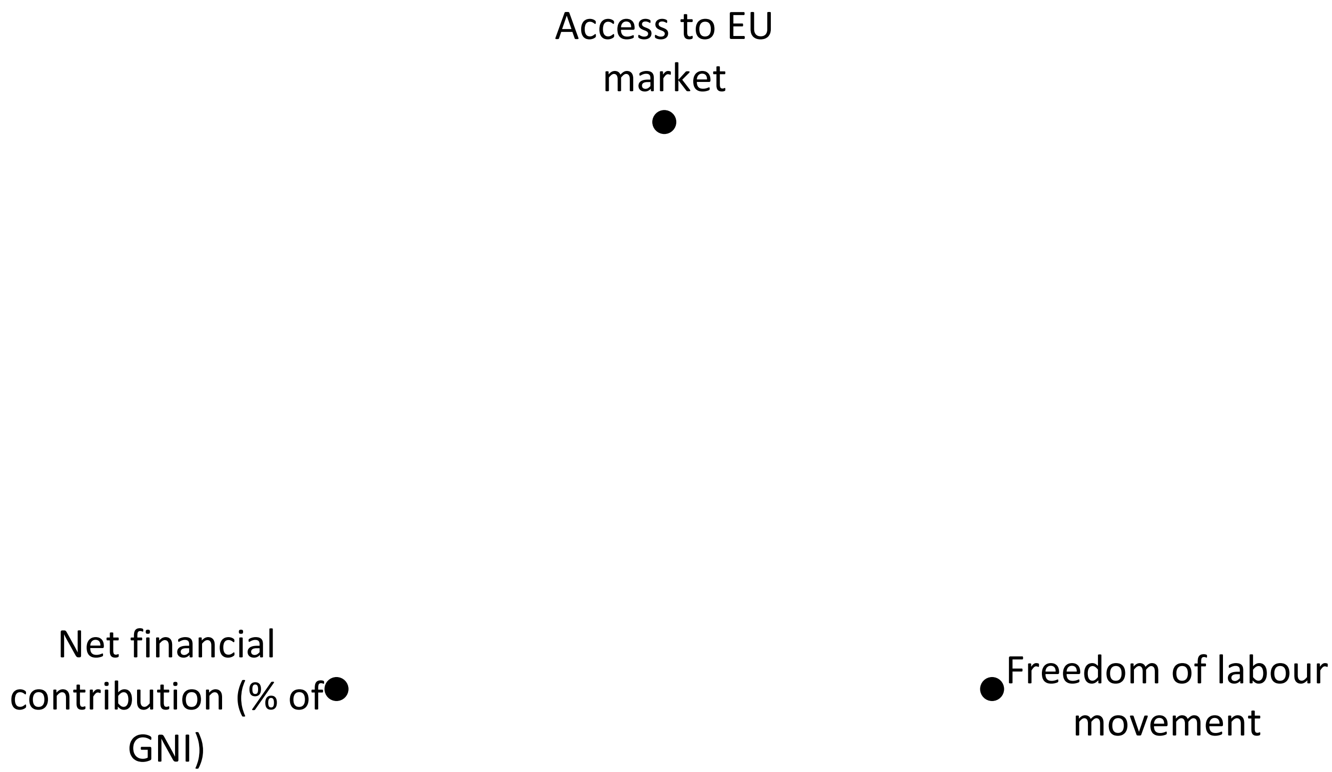
Ready

Steady

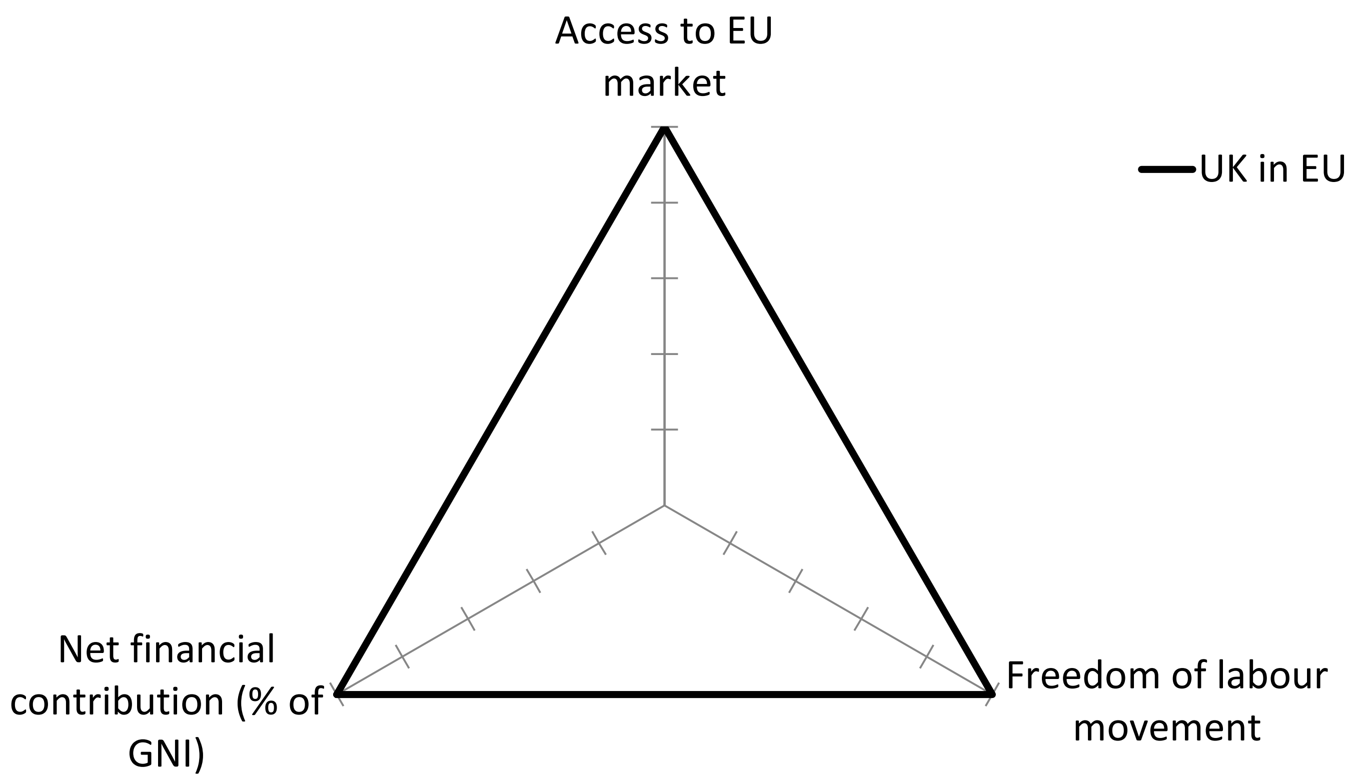
Trade (Deal)

Trade (WTO)

The Great British Trade-Off

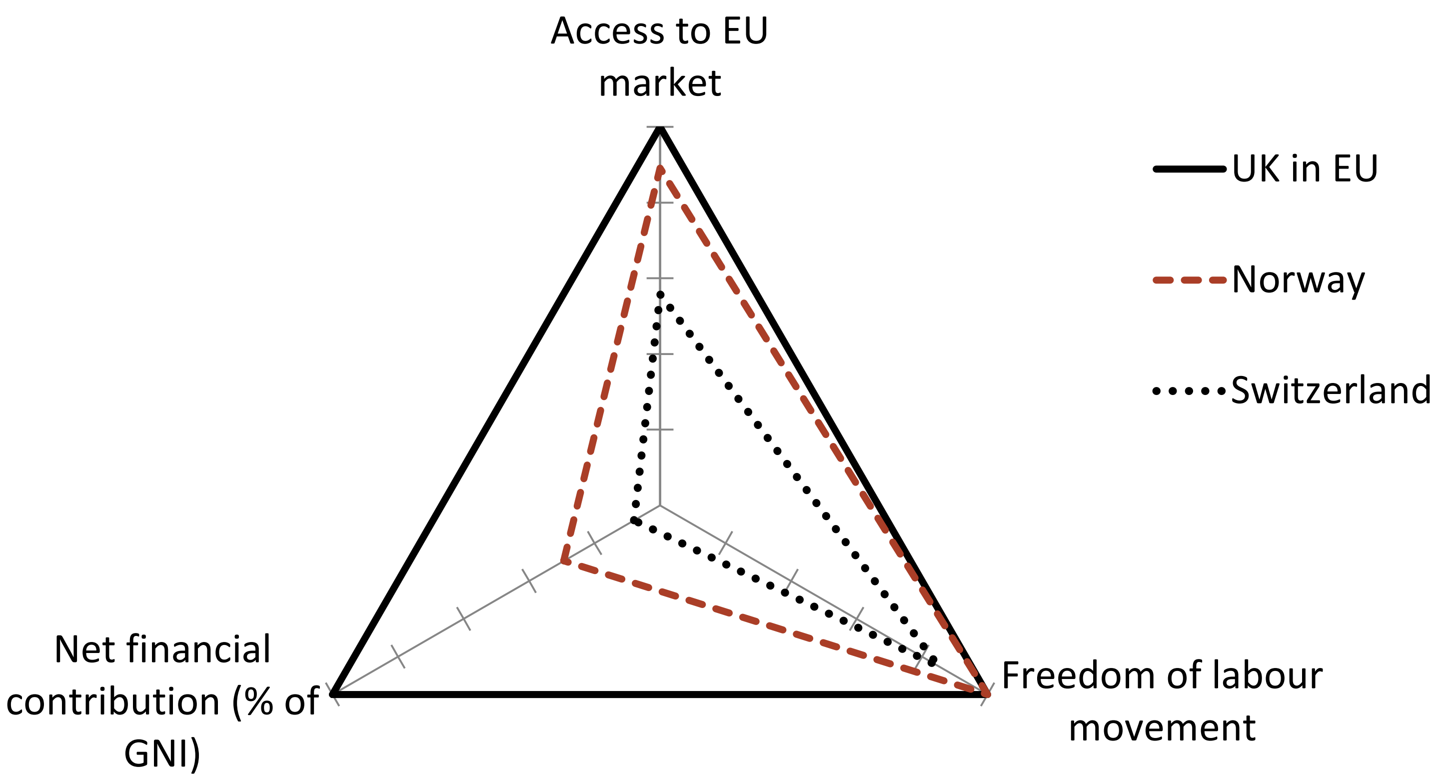


The Great British Trade-Off



Source: NIER February 2018

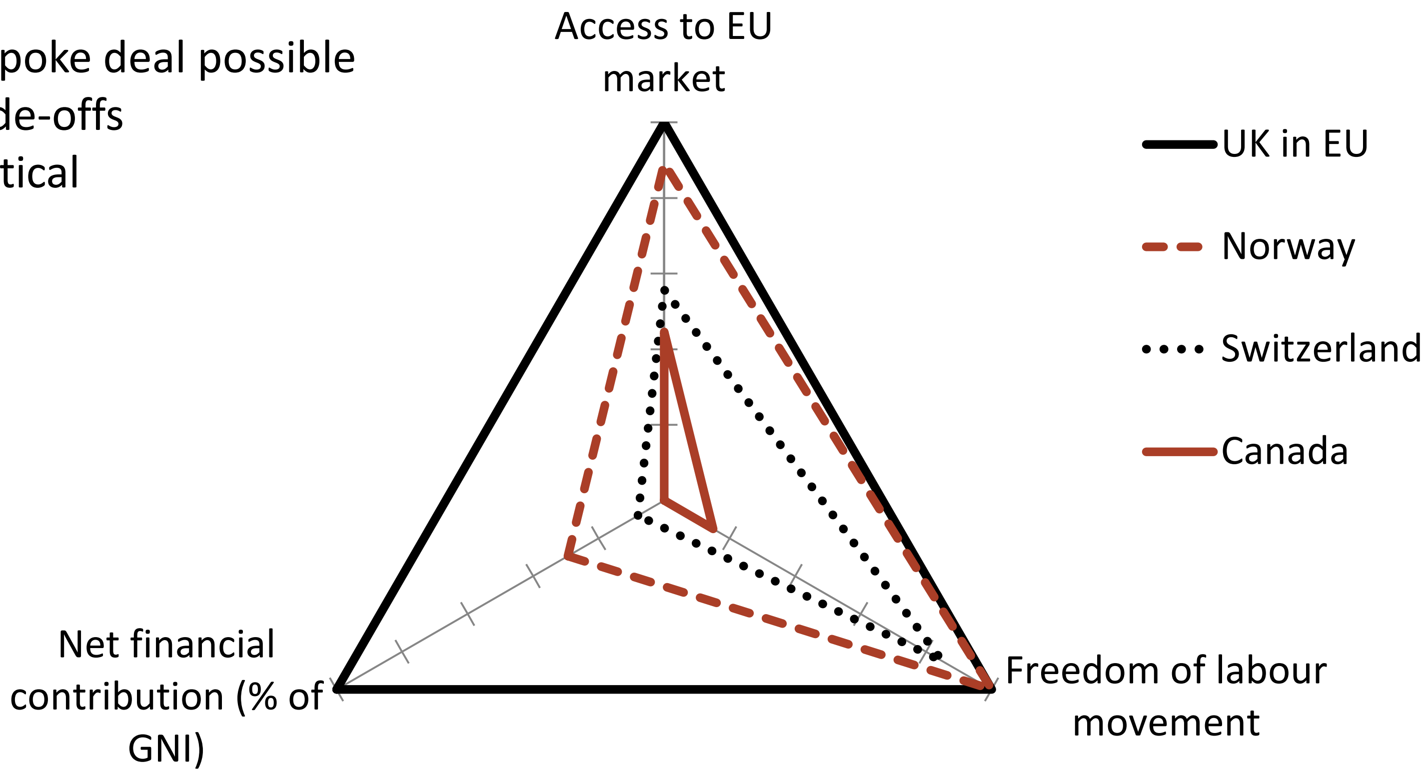
The Great British Trade-Off



Source: NIER February 2018

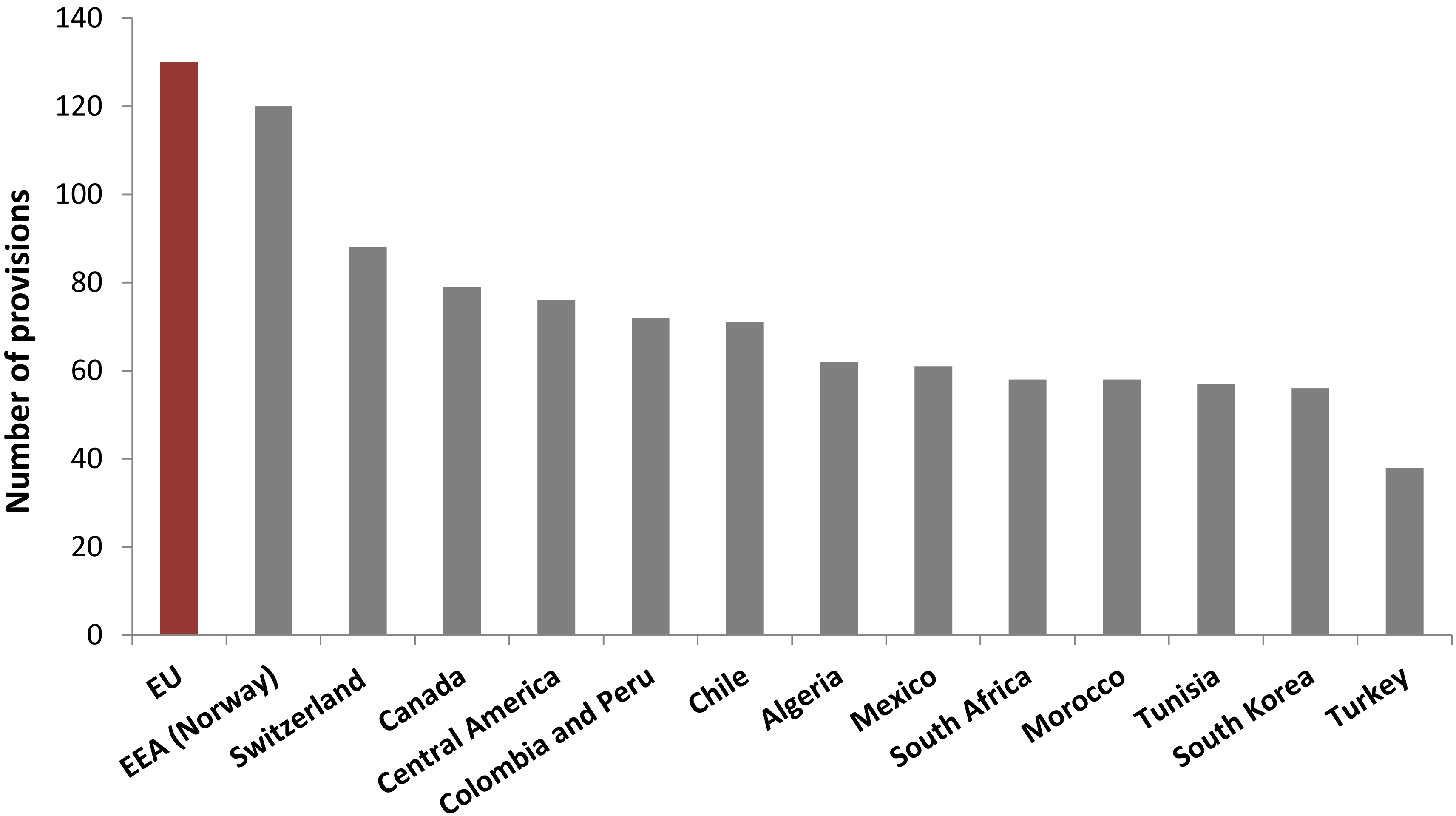
The Great British Trade-Off

- Bespoke deal possible
- Trade-offs
- Political



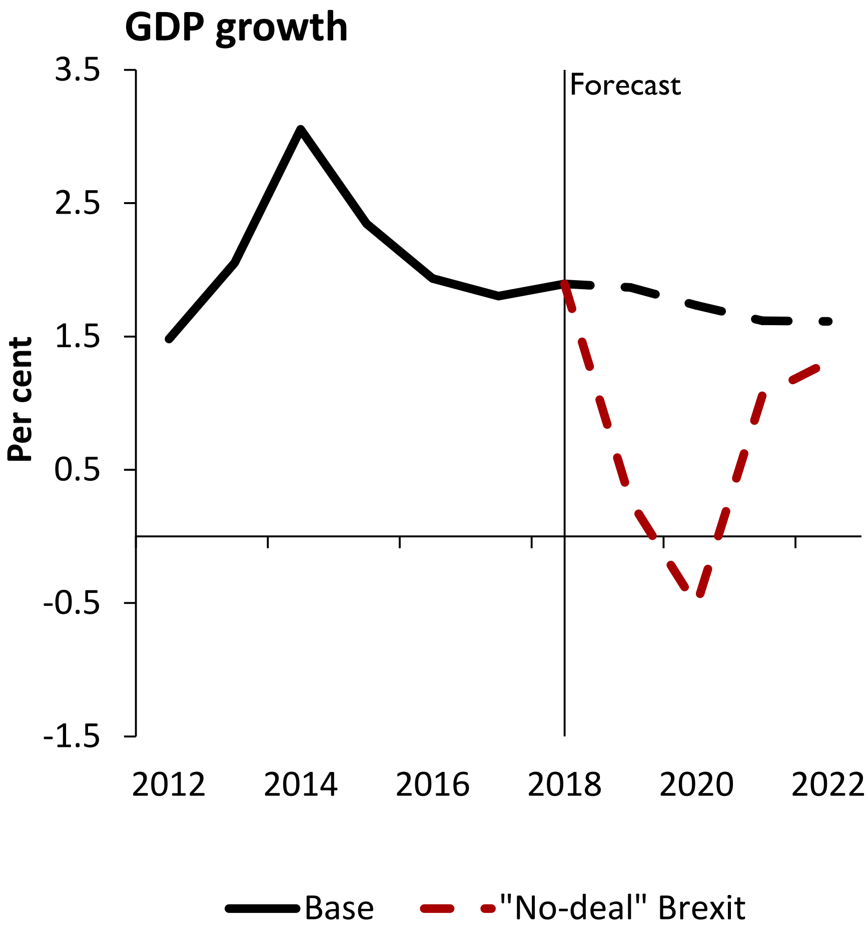
Source: NIER February 2018

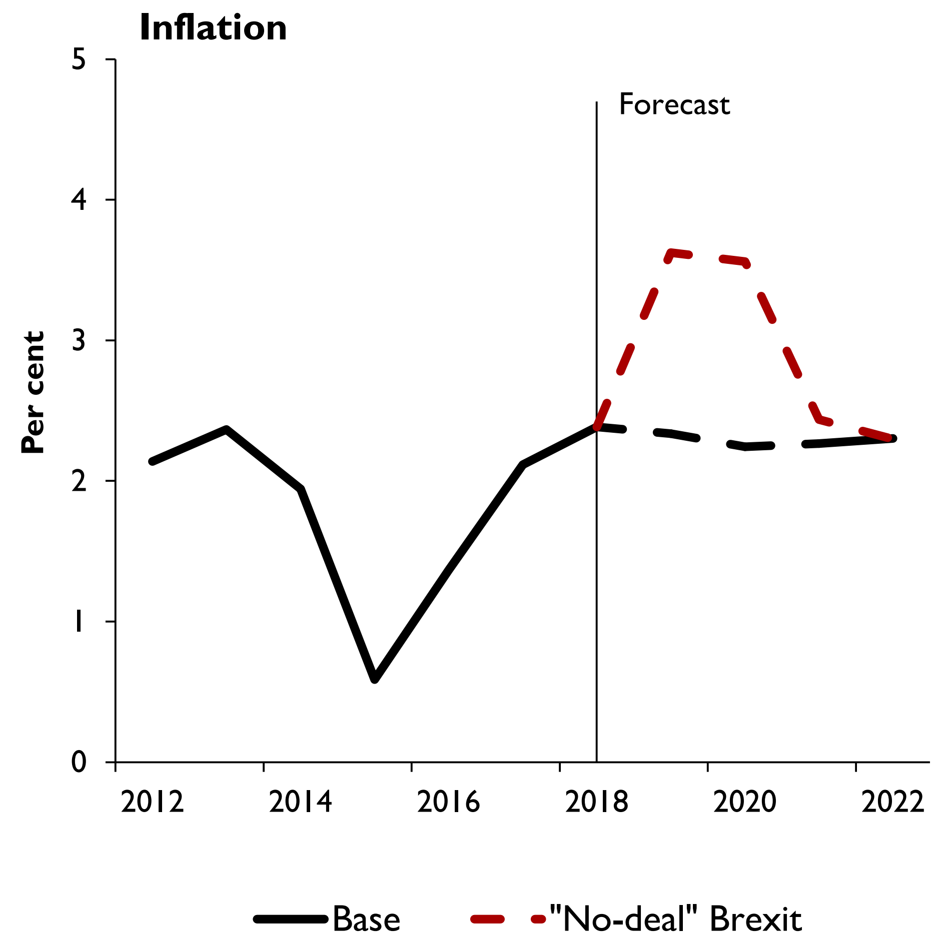
Market access to the EU



Source: World Bank, NIESR

What if talks fail? WTO-scenario





Source: NiGEM database, NIESR forecast

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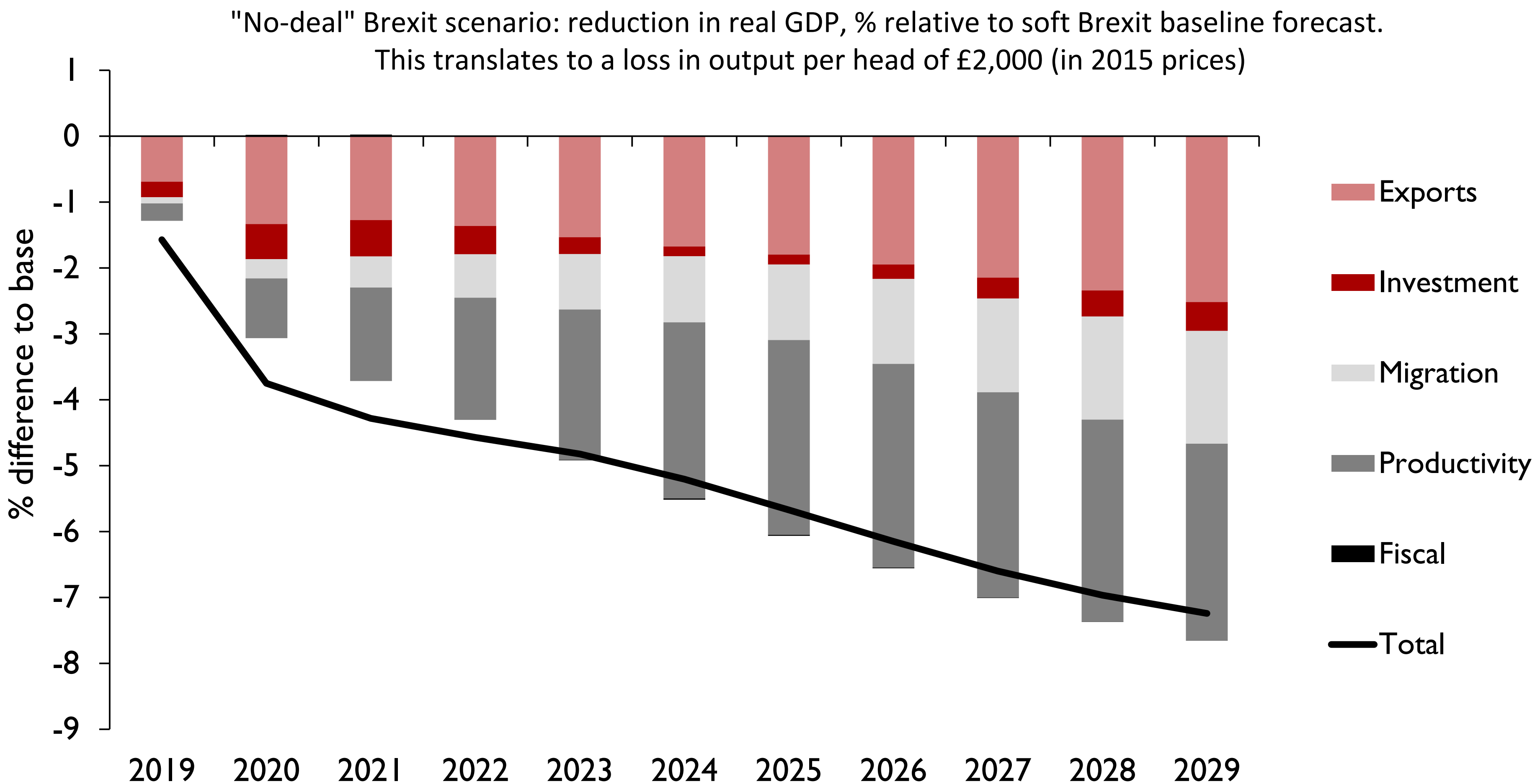
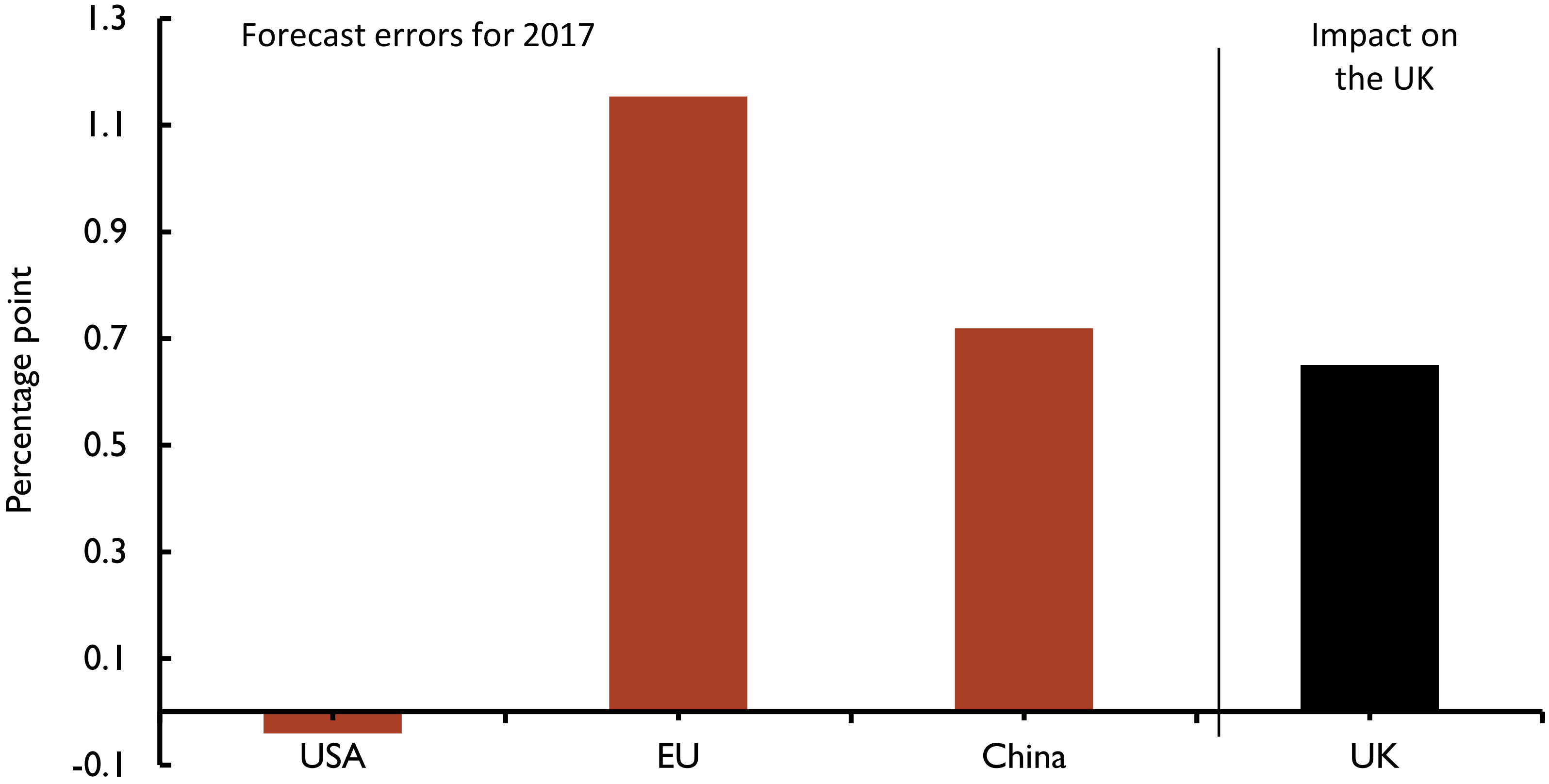


Source: NiGEM database, NIESR forecast

Why did GDP growth surprise to the upside in 2017?

Was UK GDP growth in 2017 made in the EA?



Source: NiGEM database, NIESR forecast

Forecast summary

Percentage change

	2014	2015	2016	2017	2018	2019	2020	2021	2022
GDP	3.1	2.3	1.9	1.8	1.9	1.9	1.7	1.6	1.6
Per capita GDP	2.3	1.6	1.1	1.2	1.3	1.2	1.1	1.1	1.1
CPI Inflation	1.4	0.1	0.7	2.7	2.7	2.1	2.0	2.0	2.1
RPIX Inflation	2.4	1.0	1.9	3.8	3.4	2.7	2.6	2.7	2.7
RPDI	1.0	5.3	0.2	0.2	1.5	1.9	1.9	1.7	1.6
Unemployment, %	6.2	5.4	4.9	4.4	4.3	4.3	4.5	4.5	4.6
Bank Rate, %	0.5	0.5	0.4	0.3	0.7	1.2	1.6	2.0	2.4
Long Rates, %	2.5	1.8	1.3	1.2	1.6	2.3	2.9	3.3	3.6
Effective exchange rate	7.6	5.5	–9.7	–5.1	1.9	0.2	0.0	0.0	0.0
Current account as % of GDP	–5.3	–5.2	–5.8	–4.6	–4.2	–3.5	–3.2	–2.8	–2.5
PSNB as % of GDP[a]	5.3	4.2	2.8	2.5	1.8	1.2	0.9	0.4	0.0
PSND as % of GDP[a]	83.3	83.1	85.7	89.0	86.3	83.6	79.2	73.5	71.1

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Brexit: the Trade-offs Ahead

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