NATIONAL INSTITUTE PRESS CONFERENCE

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Opening remarks by the Director

Good morning. Welcome to the National Institute of Economic and Social Research for the release of our quarterly Economic *Review*. It is now just over five weeks since the Referendum on the UK's future in the European Union. At the May *Review* our analysis had to encompass two distinct scenarios involving Leave or Remain: at least we now know which path we will follow - for the moment. This August *Review* thus continues our dialogue from that May *Review* and projects that the economy follows more or less the path that we indicated then under that Leave scenario. We said in May that:

- "There is likely to be a short run but persistent escalation in risk should the referendum lead to the UK seeking to leave the EU. This escalation in risk is likely to lead to a number of developments in the exchange rate, asset prices, as well as monetary and financial conditions, which will pose difficult questions for policymakers"

The fundamental point is that leaving an area of near-perfect factor mobility such as the EU is likely to have a negative long run impact on the economy. The exact magnitude of the impact depends upon the precise nature of the trading relationships adopted, the quality of the alternatives on offer and whether the countries that remain in the EU seek to change the structure of their internal trade. We do seem to have observed, though the data is noisy and incomplete, some early signs of a slowdown and there also seems to be considerable uncertainty about the state of the economy with the prospect of a reset in our external economic relations dampening activity, at least temporarily.

Last month NIESR's forecast for the preliminary estimate of the second quarter of GDP was superficially strong at 0.6% and, although our forecast turned out to be right, the headline data release masked a marked slowdown in activity in both of May and June, which if replicated in quarter three increases significantly the probability of a technical recession in the second half of 2016. Note that our central forecast for the immediate outlook is conditioned on both the depreciation in sterling (and a temporary overshoot in inflation to over 3% in late 2017) and reflects the economy's response to endemic levels of uncertainty. Obviously these levels of uncertainty may recede but if they do not the probability of a technical recession by the end of 2017 is at around evens.

Following considerable forward guidance we might expect some deployment of measures by the monetary policy committee later this week. But the lags from instrument to control of the economic system and complications related to exercising monetary control at the zero lower bound mean that it is unlikely that the reduction in growth can be prevented. A clear risk to any monetary policy response is that banks and financial intermediaries amplify the downward pressure on growth by reducing the availability of loanable funds and in conjunction with depleted levels of confidence lead to a sharp fall in the demand for funds.

The previous Chancellor's fiscal charter set a target for a fiscal surplus by the end of this Parliament. As we undertook this forecast, it appeared that the plans had been quietly shelved. But without any alteration in the published plans for government expenditure, even if we include the return of transfers to the EU from 2019 onwards, the likely economic slowdown will add some £50bn to the borrowing plans for this Parliament and the public debt-GDP ratio will nudge over 90% in 2017. One development of note is that despite the prospects of lower growth and downgrades by several credit reference agencies, the demand for UK government debt seems to have been strong with the estimated risk premia actually falling.

When there is the kind of uncertainty we are currently experiencing, the issuance of public debt can reduce overall risk in the economy. We know, for example, that the issuance of index-linked bonds can help the private sector manage inflation risk and the issuance of long term debt may play a role in developing longer term planning horizons. It may therefore now be time for the Treasury to reconsider how it manages risk through its issuance of type and quantity of public debt. Bonds of longer maturities than 50 years and also bonds that pay interest rates proportional to GDP growth may help us to deal with sharp changes in our structure of external trade. One key question is whether the government should now issue bonds and use the money to develop long-term investment projects that yield a rate of return for those parts of the country that the Referendum result tells us feel somewhat left behind by our recent path of economic growth.

Jagjit S. Chadha

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