NATIONAL INSTITUTE OF ECONOMIC AND SOCIAL RESEARCH:
PRESS CONFERENCE
Thursday 3rd May 2018
Opening remarks by the Director

Good morning. Welcome to the National Institute of Economic and Social Research for the release of our May 2018 *Review*. As we have pointed out in recent *Reviews* the UK economy is continuing to show signs of a divergence; with growth slowing here alongside growing evidence of a sustained and synchronous recovery in the rest of the World.

As we have argued the Referendum result and consequent uncertainty over the exact form of future trading relationships imparts two substantive effects. First, it tends to reduce expected trade in goods, capital, labour and services with the EU. Secondly, the uncertainty over future trading relationships will tend to lead to a delay in domestic investment or a diversion internationally to more certain destinations overseas. As such the process of exit from the EU imparts a material asymmetric shock to the UK economy.

Even though final exit from the EU remains some time away, the expectation of new future trading arrangements may have acted to reduce growth now as forward-looking households and firms start to prepare for that future. Furthermore the resultant deterioration in the terms of trade reduces real income at a given level of output. These mechanisms have been extensively explored and developed by work at the Institute since 2016. Much of this work here and elsewhere has used, as its benchmark, the Institute's Global Econometric model, NiGEM, and my colleagues Arno Hantzsche, Marta Lopresto and Garry Young have provided an updated outline of some of the key aspects of this model in this *Review*.

In this *Review* we also publish six contributions from a number of overseas policy organisations who have used NiGEM to assess country-specific and international risks. These papers assess the direct impact of various risks or policies: "A model-based analysis of the effect of increased public investment", by Nigel Pain, Elena Rusticelli, Véronique Salins and

David Turner (OECD Economics department); "The import content of expenditure components and the size of international spillovers", by Markus Jorra, Andreas Esser and Ulf D. Slopek (Deutsche Bundesbank); "The nature of the shock matters: NiGEM estimations of the macroeconomic effects of recent dollar and euro fluctuations", by Sophie Haincourt (Banque de France); "Export pricing and the macroeconomic effects of US import tariffs" by Ulf D. Slopek (Deutsche Bundesbank); "Measuring the permanent damage of Brexit", by Hugo Erken, Raphie Hayat, Carlijn Prins, Marijn Heijmerikx and Inge de Vreede (Rabobank) and "Modelling external shocks in a small open economy: the case of Ireland", by Thomas Conefrey, Gerard O'Reilly and Graeme Walsh (ESRI and the Central Bank of Ireland).

One message that emerges from this work is that we cannot understand the impact of any identified shock without specifying the policy response, which is a well-known facet of macroeconomic modelling, but also that the extent of economic interactions with the rest of the world are critical. For example, the impact of a round of public investment will have a substantially different impact on any given economy depending on the scale of spare capacity, the extent to which there is an associated monetary policy response and whether it is co-ordinated across countries. The rest of the world and its policies may thus play a critical role in affecting the success or failure of domestic policy initiatives.

The theme of global risk is explored by my colleague Jason Lennard who has pieced together evidence to suggest that the world economy is becoming more synchronised. This trend might have resulted from either or both of smaller common shocks or more trade, which tends to dissipate country-specific shocks through risk-sharing. In effect, trade matters not only in the long run for growth but might also matter in the short run for offsetting bad draws, such as those currently faced by the UK. The question facing the UK, considered by Amit Kara, then is what settings for the monetary-fiscal policy mix do we wish to adopt to offset our current set of bad draws?

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3rd May 2018