# How far down the road to recovery is the UK & how much more austerity is needed?

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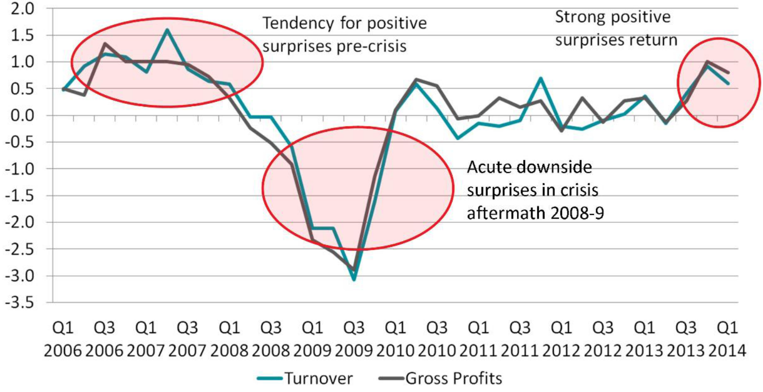
# After businesses were forced to adapt to shattered expectations in 2008-9, positive surprises have finally returned

Growth 'surprises'; number of standard deviations from mean of difference between expected and achieved turnover and gross profit growth

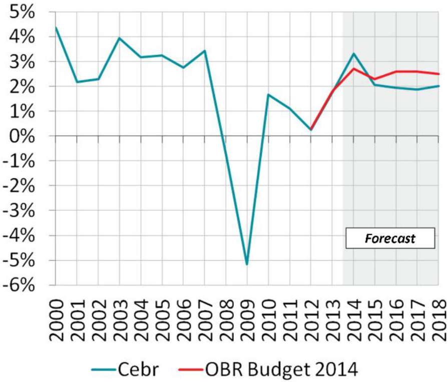



Source: ICAEW/Grant Thornton Business Confidence Monitor, Cebr analysis

# OBR comes into line with Cebr view that UK will have a mini cycle; growth at 7 year high in 2014 but falling back

- The Office for Budget Responsibility (OBR) has once again revised up its forecasts for UK economic growth, in contrast to the repeated downward revisions that marked it first few years of existence.
- The OBR is now forecasting that the UK economy will expand by 2.7% in 2014, up from 2.4% in its Autumn Statement forecast and 1.8% from its forecast a year earlier.
- While we expect growth in 2014 could be even stronger than this, we expect growth to slow in 2015 and the OBR shares this view with the UK economy's rate of expansion expected to slow to 2.3% in 2015.
- We think the slowdown could be slightly steeper and expect growth to be more constrained in the medium term due to weaker business investment forecasts, interest rate rises & fiscal austerity.

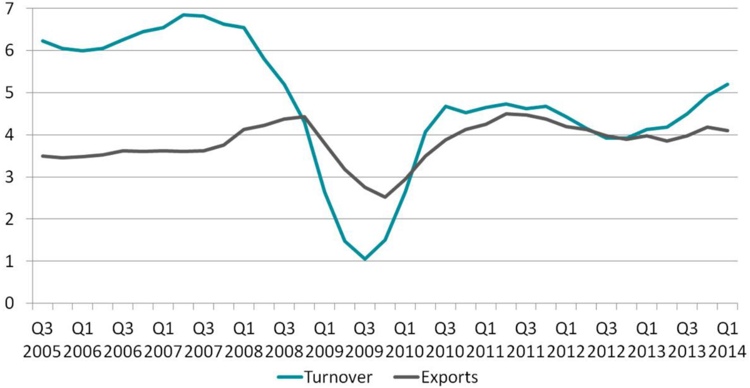
**UK gross domestic product, annual % change**




Source: Office for National Statistics, Cebr analysis

# Nagging concerns: export growth still lags behind

Expected growth in turnover and exports over the next 12 months, percentage, 4 quarter moving average




Source: Office for National Statistics, Cebr analysis

# OBR forecasts trend decline in UK share of global export market

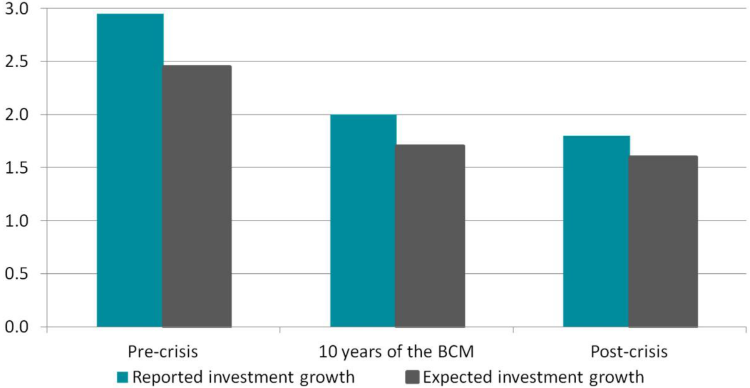
UK export market share of globe; index Q1 1998 = 100


Source: OECD, ONS, OBR. UK export share defined as exports divided by UK export markets, where exports series have been adjusted to account for the effect of VAT Missing Trader Intra Community (MTIC) fraud.

Source: Office for Budget Responsibility

# Concerns: capital investment growth has been structurally weaker after the crisis – although corporate cash piled high

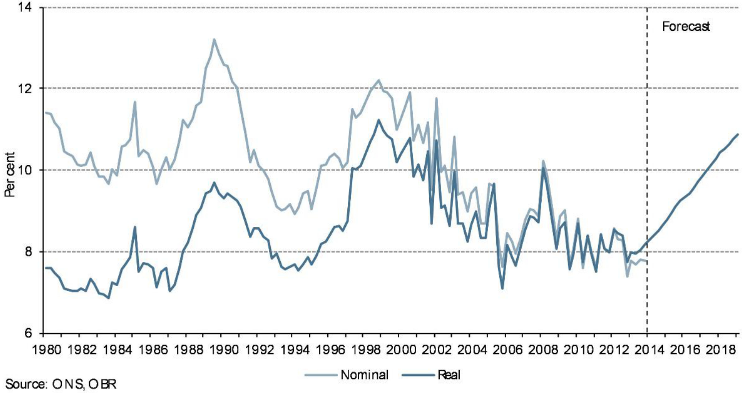
Median expected and reported annual percentage growth in capital investment, post-crisis, pre-crisis and across the whole 10 years of the BCM




Source: ICAEW/Grant Thornton Business Confidence Monitor, Cebr analysis

# The OBR is projecting quite an increase in business investment; will it be that easy?

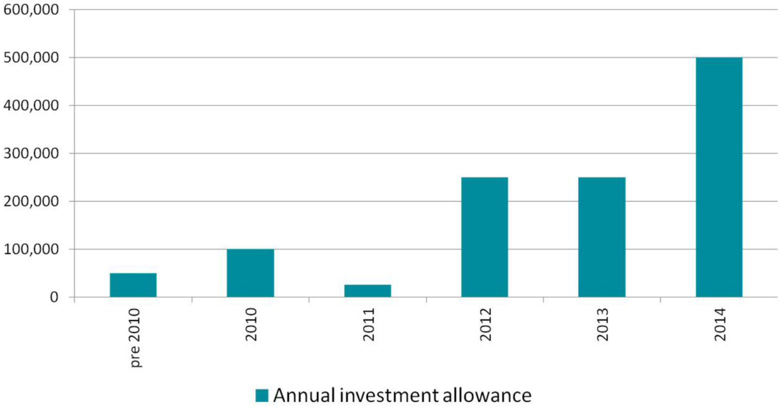
## Business investment as a share of GDP



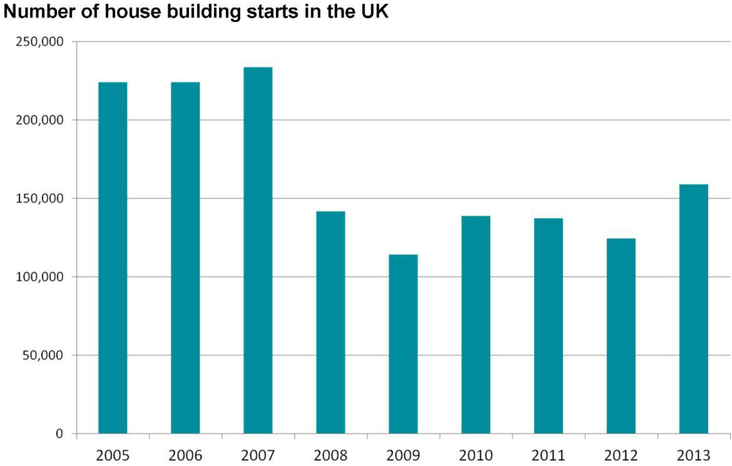

Source: Office for Budget Responsibility

# Doubling the annual investment allowance designed to help business investment but follows strange reduction earlier on!

## Annual investment allowance, £

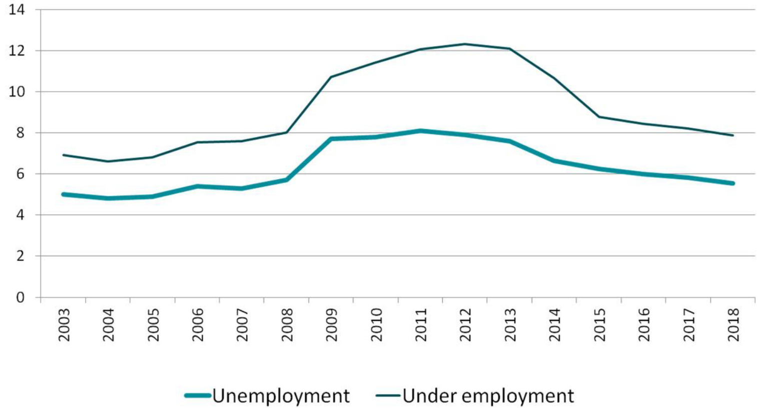


# Help to buy extended to aid UK housing shortages amid accelerating housing market recovery



# No denying the extent of the labour market recovery as unemployment rate dips to 7.2%

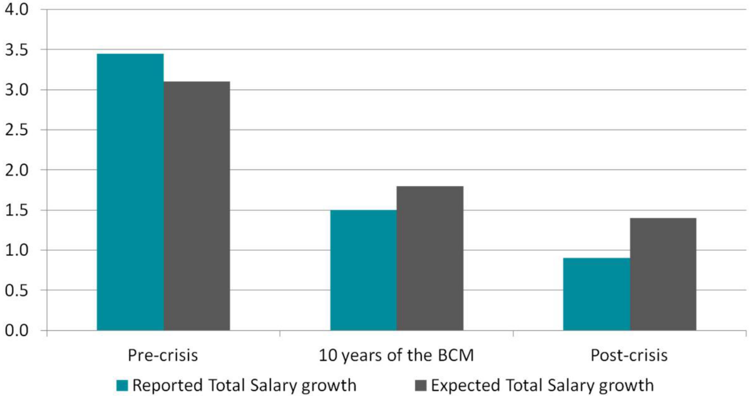
## UK unemployment and underemployment rate, %




Source: ONS, Cebr analysis

# But pay growth weaker post-crisis as large labour market spare capacity developed – any return to pre-crisis trend will take time

Median expected and reported annual percentage growth in total salary growth, post-crisis, pre-crisis and across the whole 10 years of the BCM



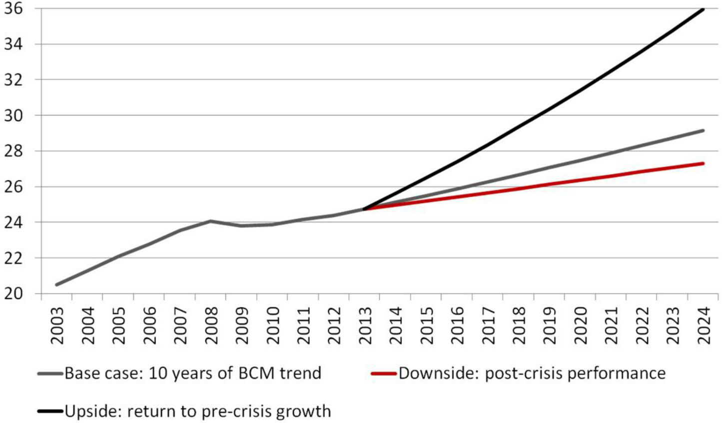

Source: ICAEW/Grant Thornton Business Confidence Monitor, Cebr analysis

# Aims

- Provide an update on the global economic outlook
- Assess UK forecast
- Review Osborne's budget
- Assess outlook for public finances and where we might end up in next five years

# Can pay growth get back to pre-crisis levels? ... only with sustained productivity growth

## Scenarios for UK average annual total salary over the next 10 years, £000

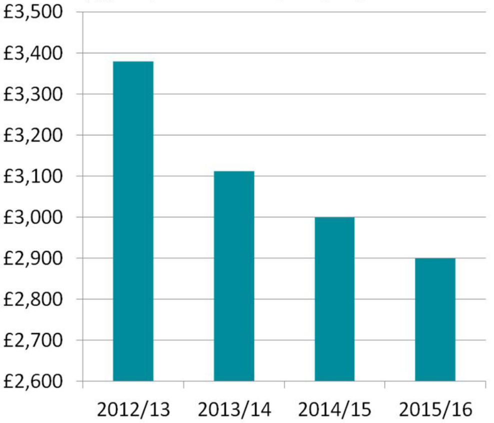



Source: ICAEW/Grant Thornton Business Confidence Monitor, Cebr analysis

# Osborne's giveaways: personal allowance rise designed to boost those in work

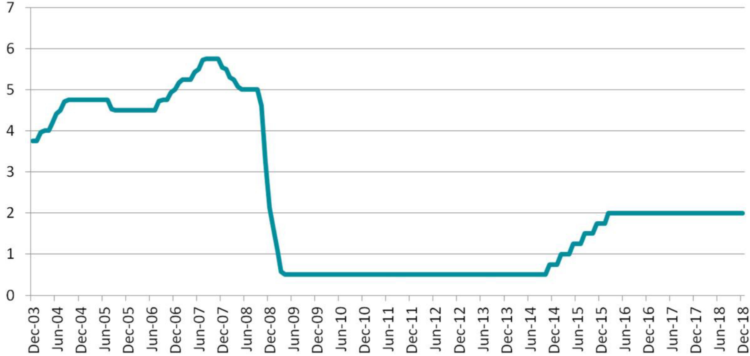
- The income tax free personal allowance will rise to £10,500 from April 2015, up the from £10,000 set for April 2014. The Chancellor expects this will take over three million of the lowest paid out of income tax altogether.
- On the other end the 40p tax threshold has been raised to £41,865 in 2014/15 to help the squeezed middle that have fallen into this band.
- Pay including bonuses for November 2013 to January 2014 was 1.4% higher than a year earlier. This is much lower than the 1.9% CPI Inflation recorded for the year to January 2014 and shows the spending power of wages are currently being eroded.
- Today's announcement means someone earning £25,000 per year will pay £212 less income tax in 2015/16 than this financial year.

**Income tax (£) paid by someone with a gross yearly income of £25,000**



# But consumers will also have to content with Bank of England rates rises over next couple of years, but pace only gradual

Bank of England Bank Rate, %




Source: Bank of England, Cebr analysis

# Public finances



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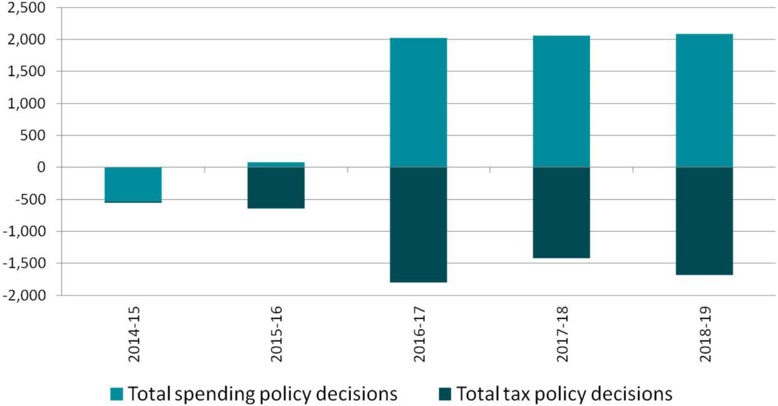
# But overall it was pretty much a neutral budget & the policy decisions are more tinkering than any significant change

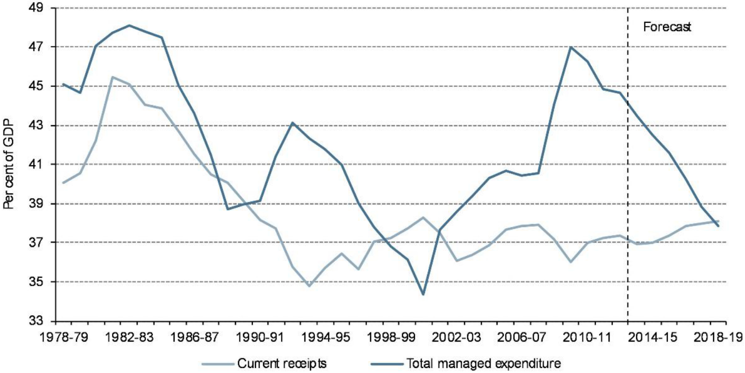
Budget policy decisions, net spend & tax by fiscal year, £m; -ve is a loss to public finances; +ve is a gain




Source: ONS, Cebr analysis

# It is easy to miss from today's spin but there is still a LOT to do to fix the UK public finances

Total public sector spending and receipts, % of GDP



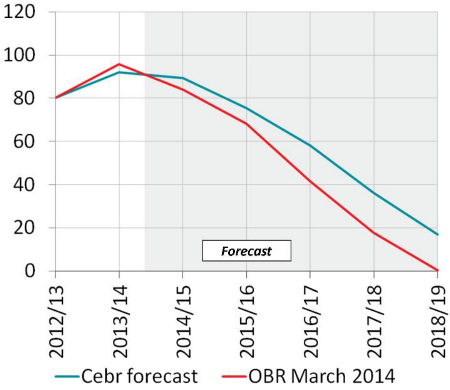

Source: ONS, OBR Excludes Royal Mail and APF transfers

Source: taken from Office for Budget Responsibility Economic and Fiscal Outlook March 2014

# OBR expect a balanced budget by 2018/19 – we expect net borrowing to still be around £17 billion at that time

- The Chancellor expects a small surplus (of £1.1 billion) to emerge by 2018/19, as net borrowing falls from the £80 billion seen in 2012/13.
- However, this reduction in net borrowing is dependent upon the rapid economic growth of around 2.5% expected by the Office for Budget Responsibility, boosted by very rapid investment growth.
- Cebr expects GDP growth of closer to 2.0% in the years to 2018/19, with business investment making a smaller contribution to expansion.
- As a result, Cebr expects the government to still be borrowing at that point, with a budget deficit of £16.9 billion projected for 2018/19.

**Public sector net borrowing, £ bn, financial year**

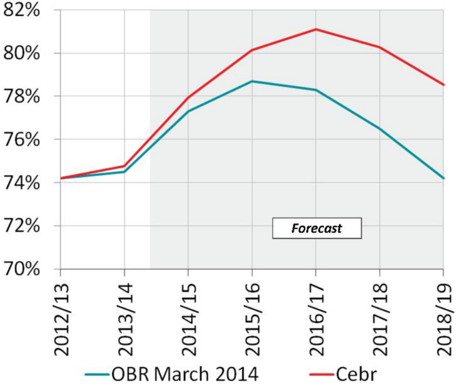



Source: Office for National Statistics, Cebr analysis

# Debt expected to continue rising as a share of GDP until 2016/17, when it begins to fall back

- In line with a narrowing of the public sector budget deficit, the Chancellor expects the debt to GDP ratio to peak in the first year of the next parliament, before falling back to 74% by 2018/19.
- However, again this is based on rapid GDP growth being sustained over the period.
- Under Cebr's central scenario of around 2.0% annual economic growth, the debt to GDP ratio is expected to continue rising until 2016/17, before falling back to 79% by 2018/19.

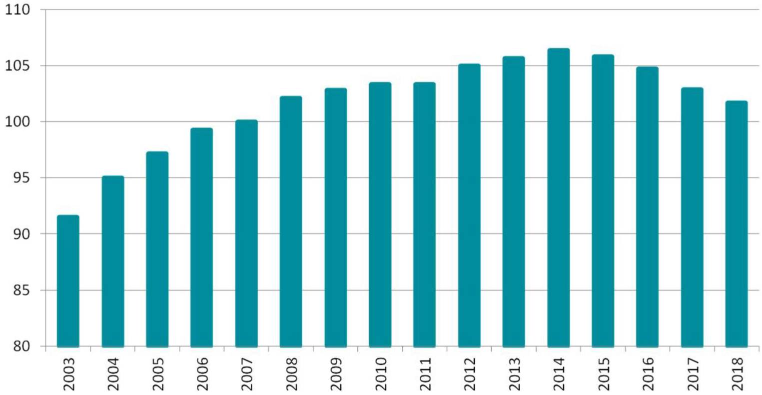
**Net debt as a percentage of GDP, financial years**




Source: Office for National Statistics, Cebr analysis

## Hence we expect there to be spending cuts throughout the next Parliament, whoever wins, although the shape will vary

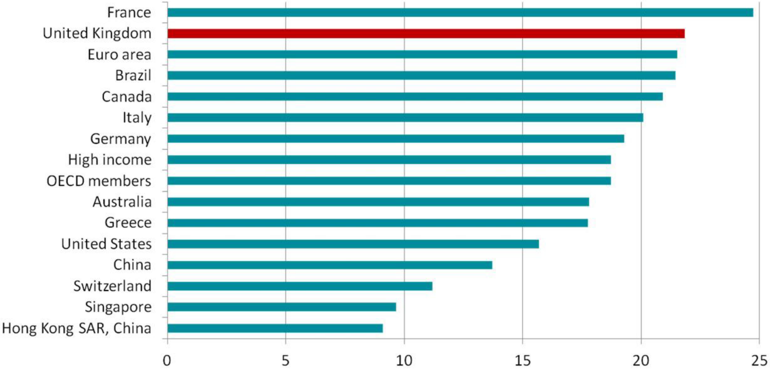
### Index of real government spending (2007 = 100)




Source: ONS, Cebr analysis

# Hence we expect there to be spending cuts throughout the next Parliament, whoever wins, although the shape will vary

## Central government spending as a % share of GDP




Source: World Ban k Development Indicators

# Global backdrop



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## Conclusions

- The global economic backdrop is favourable for the UK – inflationary pressures are easing and economic growth in the US and Eurozone is picking up.
- Osborne tinkered but didn't do that much of substance
- There is another five years or so of difficult decisions to bring the public finances back to surplus
- We are seeing strong growth this year but it will slow
- Risks from Eurozone, Ukraine & monetary tightening
- Strong growth has brought with it a productivity puzzle – unclear if sustained real wage rises can be sustained.
- Economic growth likely to peak this year, falling back in 2015.
- Interest rates likely to rise over the next couple of years, but rates will remain very low by historic standards.

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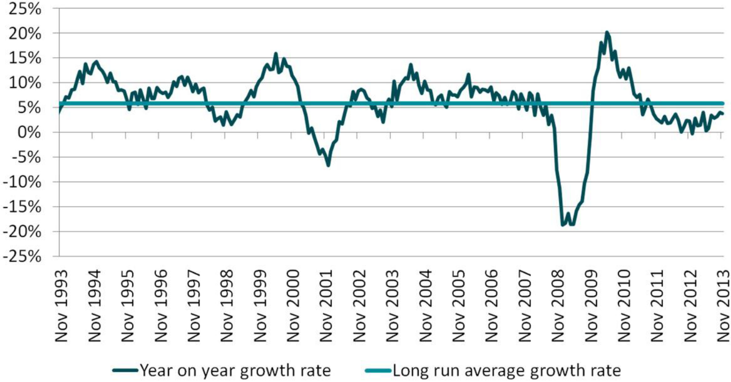
# World trade picks up as advanced economies recover but slowdown in emerging markets keeps it below long-run average

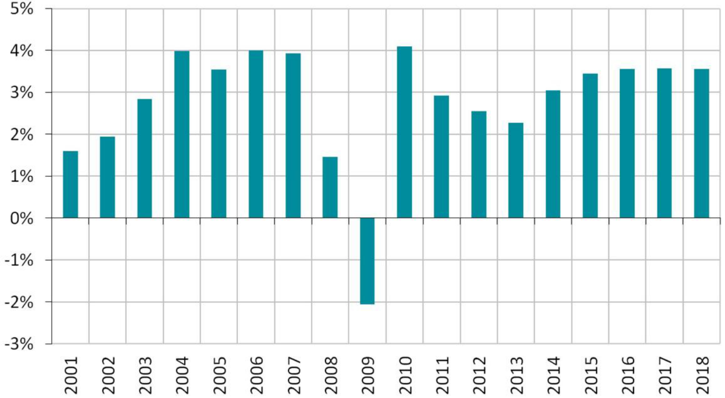
## Year to date annual percentage change in global trade growth




Source: CPB World Trade Monitor, Cebr analysis

# Global growth to pick up in 2014 as recovery gains foothold in advanced economies

## Real global GDP growth weighted at market exchange rates, annual percentage change

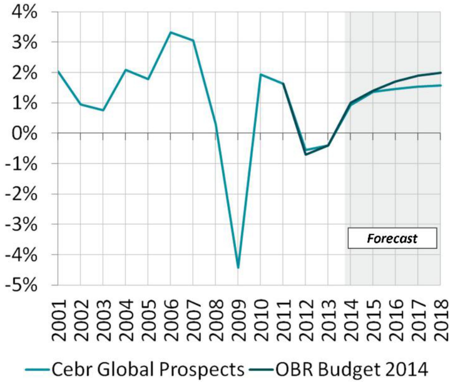



Source: IMF World Economic Outlook October 2013; Cebr Global Prospects January 2014

# Osborne benefits from increasingly benign external economic environment as Eurozone returns to growth

- The backdrop for the UK economy has been becoming increasingly helpful.
- The UK's largest single export market, the Eurozone, is growing again after successive annual declines in output.
- The Office for Budget Responsibility assumes that Eurozone growth will pick up from around 1% in 2014 to just short of 2% by 2017.
- These forecasts are broadly in-line with Cebr's global economic forecasts, although the OBR is slightly optimistic about the medium term growth trajectory of the Eurozone.
- This creates an improving economic environment for UK exporters meanwhile softer growth in emerging markets reduces inflationary pressures on the UK economy, contributing to a reduced squeeze on household spending power.

**Eurozone gross domestic product, annual % change**

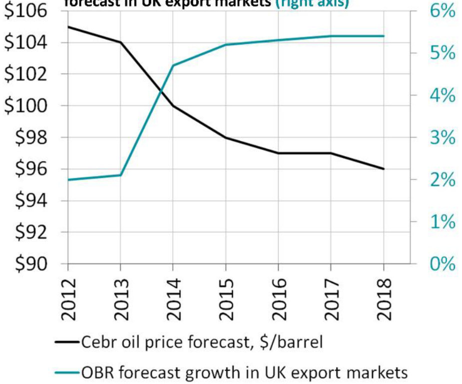



Source: Office for National Statistics, Cebr analysis

# Easing inflationary pressures alongside accelerating growth in UK export markets make a helpful backdrop

- With oil supply increasing and emerging market growth cooling as the US Federal Reserve scales back its programme of monetary easing, oil prices have fallen back.
- Oil prices are expected to ease further and global inflationary pressures are contained.
- This contrasts with years in which surging emerging market growth and supply constraints caused oil prices to surge.
- The easing in commodity price inflation has helped to reduce inflationary pressures in the UK economy & has seen the gap between earnings growth & inflation close considerably.

**Oil price forecast ($/barrel, left axis); growth forecast in UK export markets (right axis)**




Source: Office for National Statistics, Cebr analysis

# Outlook for UK Economy



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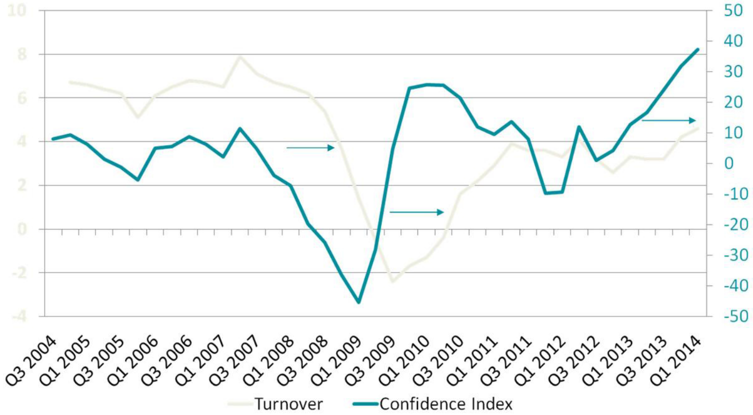
# Leading indicators show sustained pick up business confidence – implying accelerating UK recovery

**Reported quarterly annual % change in turnover; quarterly BCM Confidence Index (RHS)**




Source: ICAEW/Grant Thornton Business Confidence Monitor, Cebr analysis