

## Comment UK: Road map to recession and beyond

- *The UK slipping into recession by the end of 2016 seems almost inevitable*
- *Investment looks set to be the primary casualty, but consumption too will suffer*
- *A sterling-driven export surge looks unlikely given the weakness of world trade*
- *Monetary and fiscal largesse will be unlikely to turn things round rapidly*
- *The UK's institutional and structural challenges are of even greater concern*

There is a growing acceptance that the UK is heading for at least a technical recession – two quarters of declining real GDP – if not a protracted downturn.

The economy's performance is likely to evolve along the following lines:

FDI and domestic investment look set to take a big hit

- **Inward foreign direct investment falling sharply.** Why would anyone choose now to invest to produce goods or services for export into the EU single market? At the least a potential investor is likely to postpone a decision until matter becomes clearer. Meanwhile, FDI destined to produce output for the UK market will likely be weakened. Inflows into the financial sector may be hit first and hardest. Inflows to purchase assets – mainly houses in London, and also some companies, could hold up at least for a while, but the initial anecdotal evidence seems to be pointing in the other direction.
- **Domestic investment softening,** probably across most sectors, and across both the tangible and intangible categories, as investors postpone decisions until the outlook for the UK becomes clearer.

Consumption will also suffer, while exports may disappoint

- **Real wages and hence household consumption taking a hit** from rising import prices in the context of the weaker pound. Falling asset values – especially house prices – could compound that through the wealth effect. Reflecting increased uncertainty, there is almost certain to be some precautionary increase in the saving ratio. Consumer sentiment is already showing signs of weakening.
- **Export volumes can be expected to pick up.** Typically, however, the effects of currency depreciation take some quarters to come through. Furthermore, an export surge seems unlikely, given that world trade growth, especially trade involving the developing countries, is so sluggish by historical standards.

A key imponderable at this stage is the extent to which policy can, or will, provide offset to these forces:

Monetary and fiscal policy will be loosened ...

- **Monetary policy** remains powerful in its ability to overcome financial distress: but it may be close to the limits of its ability to do more to support aggregate demand. Bank of England Governor Carney himself has warned of this. That said, the Bank will do what it can: expect a lower Bank rate; perhaps reintroduction of QE; and perhaps even other measures to sustain the flow of credit.
- **Fiscal policy** could contribute importantly; and indeed the political way for it to do so has to some extent already been paved by George Osborne's recently-avowed willingness to postpone by several years the date by which the budget is to be balanced. This would at least allow the 'automatic stabilisers' to play out fully. At some stage however there may well be a greater willingness – as well as need – to employ discretionary stimulus too. But much will depend on the personality, philosophy, and priorities of the next Chancellor.

... but the outlook for structural reform may be less positive

- **Structural reform.** Structural adjustment is inevitable, given prospective changes in the geographic pattern and physical composition of UK trade. Hence, supply-side policies that facilitate, or at least do not discourage, the flow of capital and labour from declining to growing activities stand to be more important than perhaps at any time since the 1980s. The extent to which the May government will be able to focus on this, given the myriad issues that it will have on its policy plate, must be open to question. Early pronouncements suggest that there is a risk that it could become somewhat interventionist, if not populist. If so, that could hinder the process of resource reallocation.

## What will be known when?

The UK economy slowed conspicuously in the first quarter of 2016, and the information that has become available since suggests that, after a relatively strong April, real activity fell away sharply in the immediate run-up to the EU referendum. Moreover, information on economic activity since the vote has not been encouraging.

To gauge the evolution of the economy in the months ahead, we would recommend keeping an eye particularly on the following.

The economy is set for a serious slowdown ...

- **The various monthly surveys of business and consumer confidence**, but particularly the PMIs for both manufacturing and services.
- **The monthly indicators of credit demand and supply, and house prices, plus the FDI flow** data encompassed in the balance of payments reports published towards the end of the first month of each quarter.
- **The preliminary UK national accounts**, published towards the end of the first month of the following quarter. However, the initial releases are output-based, and often subject to considerable revision. The expenditure breakdown of GDP is only released a month later, and again the initial estimates of the investment components in particular can be less than reliable.
- **The current account** is also published towards the end of the last month of the following quarter. This is perhaps the one area that can be expected to show some improvement, and soon. The recent depreciation of sterling will exert a rapid and constructive influence on the troublesome balance of net income from abroad, which becomes automatically revalued in sterling terms as the currency weakens. The trade account, however, will take considerably longer to respond, so that the overall current account deficit is likely to remain historically large for a considerable time.
- **The summary and minutes of the monthly Bank of England MPC meetings** offer regular insights into policymakers' thinking, while the forecasts for growth and inflation published each August, November, February, and May in the Bank's Inflation Reports provide a richer assessment of the economy's recent performance and prospects. These are supplemented by the Bank's twice yearly (November and July) Financial Stability Reports, and by intermittent testimony by the Governor and senior officials to the Treasury Select Committee of parliament.
- **The Chancellor of the Exchequer's Autumn Statement**, usually delivered to parliament towards the end of November or in early December. This provides one of two regular updates on fiscal policy, on the basis of the projections provided by the independent Office for Budget Responsibility. Any discretionary changes in the fiscal stance would normally be announced either during the Statement, or as part of next April's budget.

... and its ultimate destination: recession

For more detail on what data will be available when, and what they may imply, see the table overleaf.

## Looking further ahead

Future institutional arrangements are unclear ...

The evolution of activity between now and, say, the end of the year is one thing: what will happen after that is another. Moreover, the situation does not stand to clarify for some time.

What will almost certainly not be known by year-end will be any detail on the UK's future institutional arrangements. Huge complexities and difficulties have now been thrown up, of which one of the economically most important is the UK's entire trade status and trade arrangements, with not only the EU but also with all other countries. EU Council meetings in October and December will likely only set the tone for what is likely to prove a long, laborious, and conflicted process.

... creating the risk of an extended downturn

## Watch for

A growing recognition that Brexit stands to deliver more than a 'standard' recession. ■

Date	Source	Variable/event	Period	Notes
14 July	Bank of England	Policy decision and minutes	July	Well flagged first stage of easing: possible credit easing and 25 bps Policy Rate cut
14 July	RICS	Housing market survey	Post-24 June	First sign of how housing market is reacting; London a key watch for
20 July	Bank of England	Agents' summary of business conditions	July update	Key first insights post vote: consumers; business services; construction; investment; credit; housing
27 July	CBI	Retail sales	July	First survey post vote; may be indicative of official data in August
1-3 August	Markit	Manufacturing, Construction, Services PMI	July	With full month of responses given after referendum
4 Aug	Bank of England	MPC decision/minutes; Inflation report/forecasts	August	Possible second stage of easing; indication of where Bank sees economy over next 18 months
9 Aug	NIESR	Monthly GDP estimate	3 months to July	With first month post vote; as April drops out of 3-month calculation, growth could slow markedly
10 Aug	Bank of England	Agents' summary of business conditions	August	More key insights into post-vote environment across the economy
18 Aug	ONS	Retail sales	July	First sign of impact on key engine of growth post vote
21 Aug	ONS	Public sector finances	July	First sign of impact on public sector finances post vote; revenues a key watch for
26 Aug	ONS	Business investment	q2 2016	Will confirm extent of investment weakness in months before referendum
30 Aug	Bank of England	Bankstats; Money and Credit	July	Key set of financial data releases every month; first data on initial impact post vote
1-5 Sep	Markit	Manufacturing, Construction, Services PMI	August	Second month of data post vote
7 Sep	NIESR	Monthly GDP estimate	3 months to Aug	Including two months post referendum, should be suggestive of q3 growth
13 Sep	ONS	UK house price index	July	New ONS index; first month post referendum; London and the South East key watch for
15 Sep	Bank of England	MPC Announcement and Minutes	September	Limited options given likely easing already undertaken by this point
15 Sep	ONS	Retail sales	August	Second month of data post vote
21 Sep	ONS	Public sector finances	August	Second month of data post vote
21 Sep	Bank of England	Agents' summary of business conditions	q3 2016	Key insights into quarter post vote
29 Sep	Bank of England	Bankstats; Money and Credit	August	Second month of data: money and lending; balance sheets; interest rates; financial markets
30 Sep	ONS	National accounts	q2 2016	Could see some correction in current account deficit from near 7% of GDP in q1
30 Sep	ONS	Index of services	July	First sign of post-vote impact on service industries, which account for around 78% of GDP
3-5 Oct	Markit	Manufacturing, Construction, Services PMI	September	Third month of data post vote
7 Oct	NIESR	Monthly GDP estimate	3 months to Sep	First full period post vote, expected to give a good indication of Q3 GDP
14 Oct	Bank of England	Credit Conditions Survey and Review	q3 2016	First quarter post referendum; bank lending to private sector a key watch for
18 Oct	ONS	UK house price index	August	Second month of data post vote;
19 Oct	Bank of England	Agents' summary of business conditions	October	More key insights into post-vote environment across the UK
20 Oct	ONS	Retail sales	September	Third month of data post vote
20-21 Oct	-	European Council meeting	-	New Prime Minister's first meeting; could set the tone for a long, laborious, conflicted negotiation
21 Oct	ONS	Public sector finances	Sep	Third month of data post vote; if activity has turned down, impacts will increasingly be seen
27 Oct	ONS	GDP, preliminary estimate	q3 2016	First official estimate of Q3 GDP; household and corporate sector balances key watch for
27 Oct	ONS	Index of services	August	Second month of data post vote
29 Oct	Bank of England	Bankstats; Money and Credit	October	Third month of key financial data post vote
November	-	Chancellor's Autumn Budget Statement	-	Possible detail on initial response and medium-term plan; investment a key watch for
1-3 Nov	Markit	Manufacturing, Construction, Services PMI	October	Fourth month of data post vote
3 Nov	Bank of England	MPC decision/minutes; Inflation report/forecasts	November	Limited options given likely easing already undertaken; first forecasts for 2019; MPC key judgements
8 Nov	NIESR	Monthly GDP estimate	3 months to Oct	Any Q3 GDP fall will become clear, and could be a tipping point for sentiment
9 Nov	Bank of England	Agents' summary of business conditions	November	More key insights into post-vote environment across the UK
15 Nov	ONS	UK house price index	September	Third month of data post vote
17 Nov	ONS	Retail sales	October	Fourth month of data post vote
22 Nov	ONS	Public sector finances	October	4 months of data post vote
25 Nov	ONS	Business investment, provisional	q3 2016	First quarter post referendum; including spending on machinery, buildings, and intangibles
25 Nov	ONS	Index of services	September	Third month of data post vote
29 Nov	Bank of England	Bankstats; Money and Credit	October	Fourth month of data post vote; impacts could increasingly be seen
30 Nov	Bank of England	Financial Stability Report	November	Main risks to stability; resilience of banking sector, market-based finance, liquidity; policy actions
1-5 Dec	Markit	Manufacturing, Construction, Services PMI	November	Fifth month of data post vote
7 Dec	NIESR	Monthly GDP estimate	3 months to Nov	Should give a clear sign as to whether the economy is headed for technical recession
13 Dec	ONS	UK house price index	October	3 months of data post vote
15 Dec	Bank of England	MPC Announcement and Minutes	December	Final announcement of the year
15 Dec	ONS	Retail sales	November	Fifth month of data post vote
15-16 Dec	-	European Council meeting	-	Touted as possible date for triggering Article 50 but negotiations may well still be in the early stages
21 Dec	Bank of England	Agents' summary of business conditions	q4 2016	Key insights into second quarter post vote
21 Dec	ONS	Public sector finances	November	5 months of data after vote; if activity has turned down, impacts will increasingly be seen
23 Dec	ONS	Index of services	October	Fourth month of data post vote
23 Dec	ONS	National accounts	q3 2016	First data on current account post vote, may show sharper correction; sectoral balances a key watch for
Early-Jan 2017	NIESR	Monthly GDP estimate	3 months to Dec	Could hint strongly that the economy is in technical recession
Late-Jan 2017	ONS	GDP, preliminary estimate	q4 2016	Could confirm the economy has fallen into technical recession



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