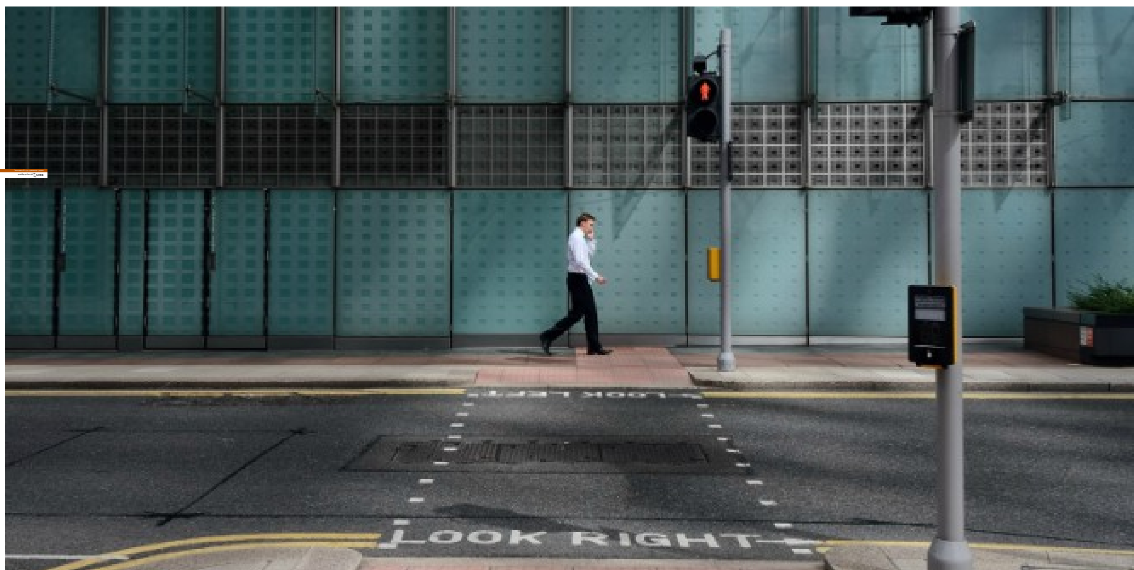
What is at stake for the UK economy



This is one of the most uncertain periods for the UK for a long time. Brexit is clouding the horizon, keeping both investment and productivity low. On the face of it, the economy has proved reasonably resilient since the referendum, which is hardly surprising given the very strong economic growth in our main trading zone of Europe as well as the US and other regions. Confidence in some sectors seems to be recovering, but despite record high employment growth, real disposable incomes have been declining and GDP growth has moved to among the lowest in the G7.

Worries on the future trade relationship with Europe and what looks like increasing signs of protectionism from the US are focussing minds on whether it is at all realistic when government ministers seem to suggest that the UK will be able to make up for any loss in UK/EU trade with trade agreements elsewhere. Most forecasters suggest that this will be difficult, with the best outcome being one that keeps us as close to where we are now. And even then, the loss to potential GDP is likely to be significant.

In the meantime 'austerity', with a severe squeeze in public spending since 2010 to reduce the 10 per cent deficit inherited by the then coalition government, has been a dampener on growth. But are things about to change? The Chancellor of the Exchequer, essentially the UK's finance minister, is due to stand in front of the parliament today and deliver what will now be known as the 'spring statement'. This is new. The current chancellor, Philip Hammond, now makes his main budgetary announcements in November each year, with the March 'statement' just giving him the chance to comment on latest growth and fiscal estimates given by the independent Office for Budget Responsibility (OBR). As such, it should in theory be a low-key affair.

And yet one year before official Brexit, there is a lot of excitement about what Hammond might say. Will a likely upgrade of growth for 2018, to 1.7 per cent from the earlier downgrade to 1.4 per cent, and the hints that 2017/18 will have finally seen a sharply reducing deficit on the government's current budget allow some room for manoeuvre?

Sadly not. The truth is that the UK has managed to achieve reasonable growth and near full employment thanks largely to huge monetary easing by the Bank of England following the referendum, while also benefiting from the sharp fall in the pound that accompanied the vote to leave the EU. There has also been a synchronised recovery in world trade which has helped manufacturing. The Brexit uncertainty has nevertheless weighed on growth. Mark Carney, the Governor of the Bank of England, has estimated that from the referendum to the end of 2018 the economy will have grown by 2 per cent less than it would otherwise have done. This is some £40 billion, enough to fund eight £5-billion yearly increases to the health budget asked for by the NHS. And although this year's deficit, at some £40 billion, is likely to be some £10 billion below what was forecast a year ago, it is some £40 billion higher than forecast two years ago, when a balanced budget had been promised. Debt has increased sharply to some £1.8 billion, or 85 per cent of GDP. The government's own impact assessments suggest that the UK will have to borrow an extra £20-80 billion by 2030 depending on what Brexit we finally get.

So the Chancellor will play it safe and austerity will continue. There will be further squeezes across spending departments and councils, while benefit freezes continue. The cap in public sector pay is being lifted for some workers but a devaluation-induced pickup in inflation is reducing real wages, affecting retail sales and margins, and bringing a slowdown in the housing market. In the car industry, the UK's great success story of recent times, capital expenditure was halved in the last two years. With the Bank of England already starting to raise interest rates, the stakes are high. UK productivity growth, though finally picking up, has been severely lagging behind most of our competitors since the financial crisis.

So where do we go from here? It is becoming increasingly obvious that altering the relationship with a market which we have helped develop over a period of more than 40 years, and to which we sell 45 per cent of our goods and services is both difficult and precarious. The impact assessments warn of the serious consequences for regions and sectors. The debate over staying in the, or a, customs union are now increasingly reflecting pressure from business, which wants to keep buying and selling with Europe without customs and other non-tariff regulatory barriers. In Ireland, whose economy is almost fused with mainland Britain, there are serious worries about not endangering the Northern Ireland peace process agreement by reintroducing a border when Britain leaves the EU.

The rest of the EU sell only 7 per cent of their products to us, although clearly some countries like Germany export more to us than others. So far, the lack of sufficient cards in UK hands has resulted in the British government making numerous concessions to get to a Phase 1 agreement before trade talks start in earnest later this month, and a request of a two-year transition deal. More concessions will need to be made to at least secure tariff-free trade in goods but including financial services in any Free Trade Agreement is likely to prove harder. A summit in mid-March might propel us forward. But time is running out. The Brexit withdrawal treaty must be drafted by October for 27 EU governments, the European Parliament and the House of Commons to accept it for 29 March 2019, when the UK quits the EU. Parliament is flexing its muscles to frustrate the withdrawal process and very little legislation affecting the economy can get through the House of Commons because of divisions over Brexit. Not a comfortable position to be in.

Notes:

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Vicky Pryce is an economist, author and commentator and on the board of the Centre for Economics and Business Research (CEBR). Vicky was previously Senior Managing Director at FTI Consulting, Director General for Economics at the Department for Business, Innovation and Skills (BIS) and Joint Head of the UK Government Economic Service. Before that she was Partner at the accounting and consulting firm KPMG and at London Economics after senior economic positions in banking and the oil sector. She holds a number of academic posts and is a Fellow of the UK Academy for Social Sciences and of the Society of Professional Economists. She sits on the Council of the Institute for Fiscal Studies, on the cross-party/cross-House Design Commission, on the Advisory Board of the central banking think-tank OMFIF and on the Economic Advisory Group of the British Chambers of Commerce. Her books include: ‘Greekonomics: The Euro crisis and Why Politicians Don’t Get It’, Biteback Publishing (2013)’; ‘It’s the Economy, Stupid- Economics for Voters’, with Ross and Urwin, Biteback (2015); ‘Redesigning Manufacturing’, with Nielsen and Beverland, Palgrave Macmillan (2015); and “Why Women Need Quotas”, Biteback (2015). She is also co-founder of GoodCorporation, a company set up to promote Corporate Social Responsibility.

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