

Economic Review

Will the sterling boost ever arrive?



Foreword

John Connolly



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In this Review, Roger Bootle, Economic Advisor to Deloitte, turns his attention to whether the UK's exporting sector can drive a strong and sustained recovery in the economy over the next year or two. His main points are as follows:

Signs of a boost to the UK's external sector from the lower pound have so far been conspicuous by their absence. Most worryingly, sterling's fall has not led to any increase in UK exporters' share of global exports.

Roger suggests that two main factors are to blame. First, the UK sells too many goods to the sluggish euro-zone and not enough to the roaring Asian economies. And second, exporters have preferred to use the pound's fall to boost their profit margins, rather than to cut their foreign currency prices.

Neither of these factors means that the weaker currency will do no good at all. Despite its travails, even the euro-zone should *eventually* recover. And higher profit margins give firms more of an incentive to sell abroad. The UK should not stop striving for a better-balanced economy just because it is taking a bit longer than anticipated.

But with the fiscal squeeze almost here, the economy needs help from its external sector *now*. Roger argues that only with that support, will the recovery be able to achieve reasonable strength.

Once again, I hope that this Review helps you in both your immediate and strategic thinking.

A handwritten signature in black ink that reads "John P. Connolly". The signature is fluid and cursive, with a large loop at the end of the last name.

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On the positive side, the factors that have prevented a big sterling boost so far should not prevent one emerging eventually.

Executive summary

Roger Bootle



Roger Bootle
Economic Adviser to Deloitte

- Hopes for a strong recovery in the UK economy rest on a decent boost to the external sector from the drop in the pound. **But it is looking less and less likely that the exporting sector will manage to offset the continued weakness in the domestic economy.**
- Perhaps the most pessimistic explanation for the lack of a sterling boost so far is that, given its over-valued starting point, the pound simply has not fallen far enough. **In other words, all the fall has done is to stop the trade position getting even worse.** However, both the UK's nominal and real effective exchange rates are now below their long-run averages. So we doubt that this explains why the trade deficits are actually *widening* again.
- Concerns that the UK does not produce the types of goods and services that the rest of the world wants to buy from it are also overdone. **After a long and painful transition, the bulk of the UK's exported goods are now in high-tech areas.** What's more, services (and not just financial ones) have been taking a steadily increasing share of the UK's overall exports.
- Instead, we think that two main factors are to blame for the lack of a sterling boost. The first is the fact that the UK sells to the "wrong" areas. **Over half of the UK's exports still go to Europe, yet the recovery there already seems to be flagging.** In contrast, growth remains strongest in Asia, yet exports to Asia accounted for just 11% of total exports in 2008.
- Meanwhile, the second explanation is that exporters have in the main used the fall in the pound to boost their profits margins, rather than to try to increase their market share.
- **On the positive side, the factors that have prevented a big sterling boost so far should not prevent one emerging eventually.** Even the euro-zone economy will recover in time. And in the meantime, exporters can shift towards selling more to those countries which are growing fastest. Meanwhile, higher profit margins will encourage more firms to export their goods and services.
- **However, these are not changes that can happen overnight.** Even if the share of exports that go to China and India started to rise at twice its recent pace, it would take 20 years to divert enough exports to these two countries to reduce Europe's export share from its current 57% to 50%. It also takes time to redeploy existing resources in the economy into the exporting sector. **And tight credit conditions mean that it could take even longer than usual for firms to build up their exporting capacity.**
- We still think that sterling's depreciation sets the stage for a stronger, better-balanced economy further ahead. But sterling's boost will continue to take its time to come through. **And with the UK, for now, struggling to capitalise on one of its only advantages, the recovery still looks doomed to disappoint.**
- With the fiscal squeeze looming and consumers hampered by high debt levels, we still think that the economy will grow by only 1% or so this year and about 1.5% in 2011. Against that backdrop, monetary policy should remain exceptionally loose for a long time yet.

Will the sterling boost ever arrive?

The outlook for the UK's external sector

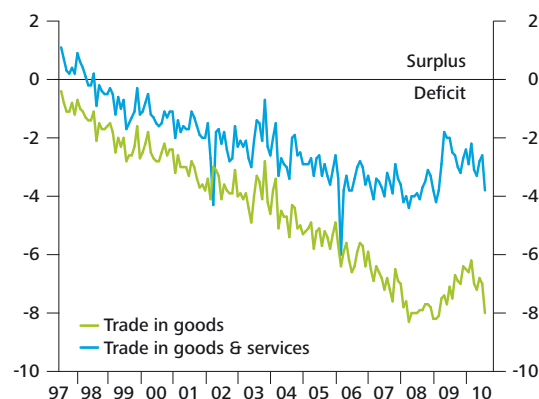
So much for the drop in the pound helping us to get out of this mess. Hopes for a strong recovery and rebalancing of the economy have long rested on the potential boost to the external sector from the pound's depreciation. And more recently, the drop in its currency has been cited as a key reason why the UK is unlikely to go the same way as Greece. **Yet the trade data just keep disappointing, with the external sector yet to start pulling its weight.**

In this article, we consider why the pound has had so little effect so far and what this means for the external sector's prospects. Is the boost simply taking its time to come through? Or are there more fundamental reasons preventing exporters from making the most of the lower pound? **One thing's for sure – without a pick-up in trade, the economy is doomed to a pretty disappointing recovery.**

Trade balances widening again

This time last year, things were actually looking up trade-wise. As Chart 1 shows, the trade deficits were finally showing some signs of narrowing in response to the 25% drop in the pound (on a trade-weighted basis) since the start of 2007.

Chart 1. Trade deficits (£bn)



Source – Thomson Datastream

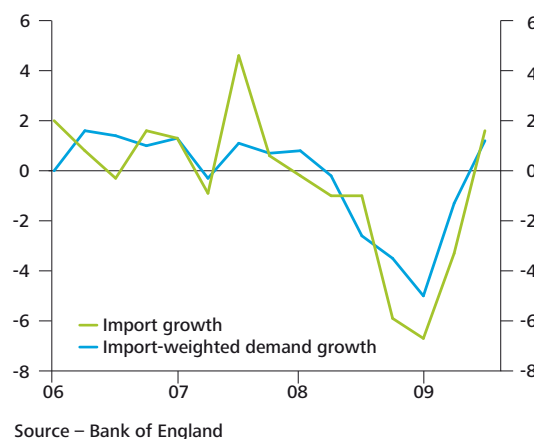
But the improvement was short-lived and the deficits have since increased to their worst levels since July 2008. As a result, far from helping the recovery to gather pace, net trade made a *negative* contribution to quarterly GDP growth in both the third and fourth quarters of last year.

Admittedly, this was partly due to strong growth of imports which, in turn, reflected both the improvement in domestic demand and the car scrappage scheme. This strength should fade now that the scrappage scheme has expired and if we are right in expecting consumer demand to be sluggish.

Nonetheless, the fact that imports have risen broadly in line with domestic demand means that there appears to have been little evidence of so-called import substitution – i.e. the lower pound encouraging firms and households to buy domestically produced goods and services instead of imports. (See Chart 2.)

And perhaps more worryingly, there has also been little evidence that the lower pound has given a significant boost to exports.

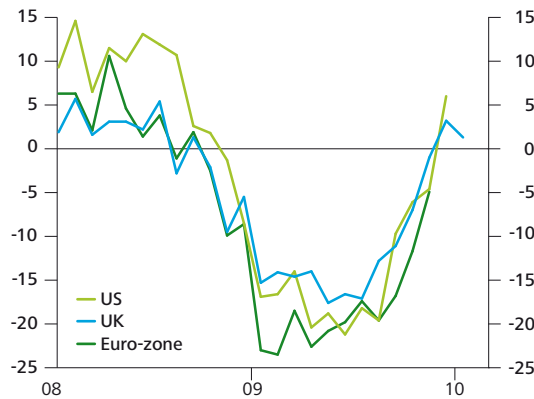
Chart 2. Import volumes & real import-weighted demand (%q/q)



Source – Bank of England

Admittedly, it looks as though the pound may have helped to cushion exports during the worst of the downturn. But in large part, this reflects the fact that services make up a relatively high share of UK exports compared to other countries – and it is trade in manufactured goods that was particularly hard hit. Chart 3 shows that the UK's goods exports fared only marginally better than elsewhere.

Chart 3. Exported goods volumes (%y/y)



Source – Thomson Datastream

What's more, even overall exports didn't out-perform for long. Since the start of last year, exports of total goods and services have been rising more slowly than overall world trade. (See Chart 4.)

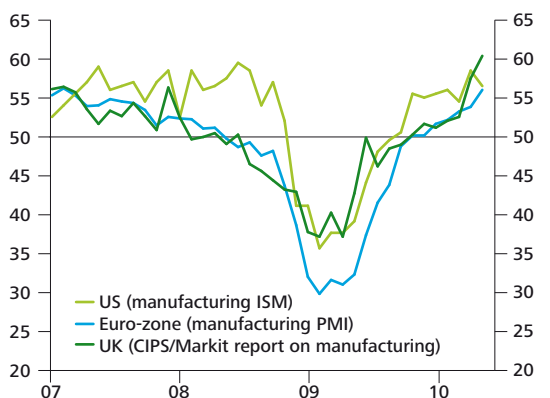
Chart 4. UK exports & world trade volumes (Jan. 2007 = 100)



Sources – Thomson Datastream, CPB

At least the more forward-looking surveys of export orders have recently picked up sharply. But again, they have risen no more quickly than similar measures in the US or euro-zone. (See Chart 5.) **Accordingly, the pick-up seems to be more a function of the general world recovery, than an indication that sterling's fall is boosting UK exporters' share of the global market.**

Chart 5. Export orders (balances)



Source – Thomson Datastream

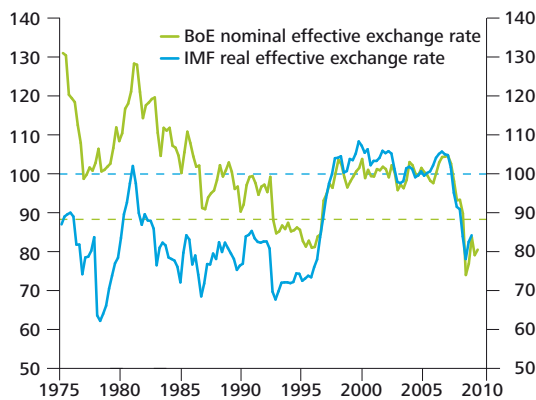
Is the pound still too high?

So far, then, the impact of the lower pound has been far from overwhelming. But does this mean that the boost is never going to arrive? Or were we simply expecting too much, too soon?

Perhaps the most pessimistic explanation for the lack of a sterling boost is that the drop in the pound simply hasn't been big enough. While the pound has fallen sharply, it was, of course, significantly over-valued to start with.

What's more, a country's competitiveness is also determined by its relative rate of inflation, meaning that a *real* effective exchange rate arguably offers more insight. Chart 6 shows the IMF's measure based on relative unit labour costs. **While the nominal effective exchange rate is 20% below its average since 1975, the real version is just 5% or so below it.**

Chart 6. Sterling effective exchange rate index



Source – Thomson Datastream

In other words, it could be argued that the lower pound has played a significant role, simply by stopping the trade position getting even worse.

A look back at Chart 1 shows that if the pre-recession trend had continued, the overall trade deficit would have reached about £6bn by now – compared to its actual £4bn.

However, none of this explains why the deficit in the past six months has started to *widen* again.

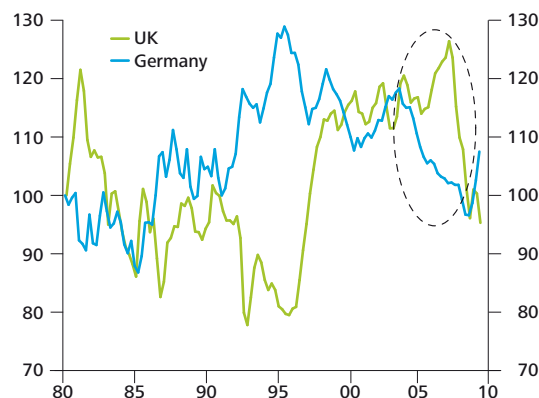
What's more, even if the real exchange rate is rather higher by historical standards than the nominal exchange rate, the fact that it is below its long-run average at all surely suggests that it should be doing more than just stabilising the trade balance.

Indeed, we continue to take rather more heart from Chart 7, showing the UK's real effective exchange rate compared to that of ultra-competitive Germany.

Unit labour costs rose sharply in the UK compared to Germany over the past few years, which lifted the UK's real effective exchange rate relative to Germany's. (See the circled period in Chart 7.) But the drop in the pound has since fully reversed this increase.

Accordingly, the UK is just as competitive against Germany as it was a decade ago – or indeed three decades ago. And it is significantly more competitive, compared to the position ten years ago, against other European countries such as France, Greece and Ireland.

Chart 7. Real effective exchange rates (using unit labour costs, 1980 = 100)



Source – Thomson Datastream

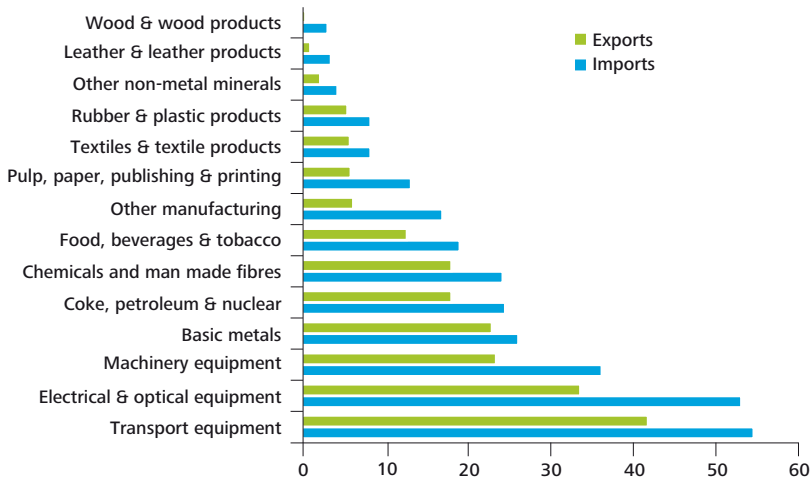
Does the UK produce what other countries want?

Pessimists also argue that the lack of a sterling boost reflects the fact that the UK simply does not produce the types of goods and services that the rest of the world wants to buy from it. For example, even a 25% drop in the pound won't make the UK competitive in the mass production of low value-added goods against countries such as China.

But we think that this concern is overdone. UK manufacturing has gone through a painful transition over the past few decades. **And the result is that the bulk of exported goods are now in high-tech areas.** Transport is the biggest export sector, a third of which is aerospace. And the second biggest sector is electrical and optical equipment, a quarter of which is medical and precision instruments. In contrast, textiles make up just 3% of exports. (See Chart 8.)

Similarly, we see no reason why the UK cannot produce many of the goods that it currently imports. The common perception is that UK imports are all cheap goods from China. But in fact Chart 8 shows that high-tech goods make up a high proportion of imports, as well as exports. Even if the UK does not start to produce entire goods from start to finish, it can play a greater role in the production process.

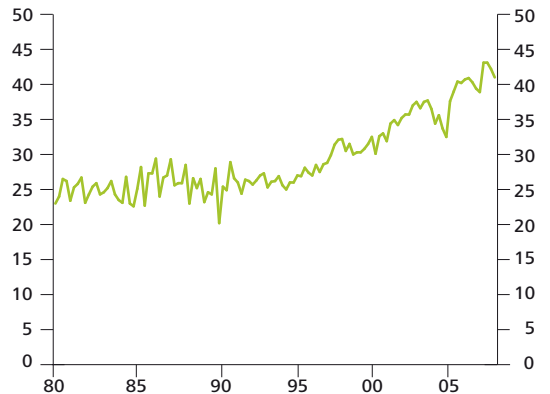
Chart 8. UK goods exports & imports (£bn in 2008)



Source – Thomson Datastream

The UK is also well-placed to serve a world that, as it gets richer, increasingly wants to buy services rather than goods. As Chart 9 shows, for the last 15 years or so, services have taken a steadily increasing share of the UK's overall exports.

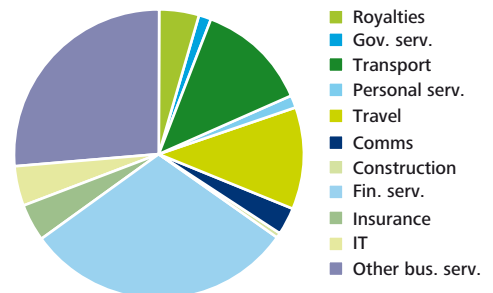
Chart 9. UK services exports as a % of all export values



Source – Thomson Datastream

Admittedly, one of the UK's main strengths is financial services and the more complex of these are not exactly going to be in hot demand any more. But for many parts of the financial sector (such as trading), it's very much business as usual. Meanwhile, the UK exports more business services than financial services and demand for these should be strong. (See Chart 10.)

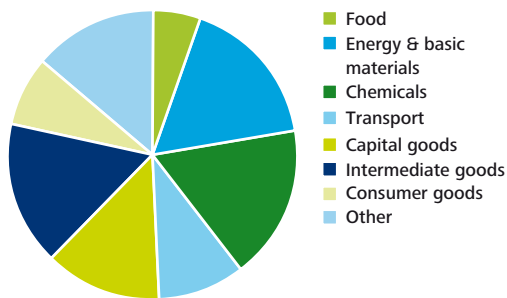
Chart 10. Breakdown of UK exports of services (% of total in 2008)



Source – Thomson Datastream

Another concern is whether the UK produces the types of goods that are most likely to be demanded during this particular recovery. With consumers in the West hamstrung by high debt levels, any pick-up in demand is more likely to be led by a rebound in business investment from the sharp falls seen during the recession. But even in this regard, the UK is not particularly badly-placed. As Chart 11 shows, exports of capital goods are bigger than those of consumer goods.

Chart 11. Breakdown of UK exports of goods (% of total in 2008)



Source – Thomson Datastream

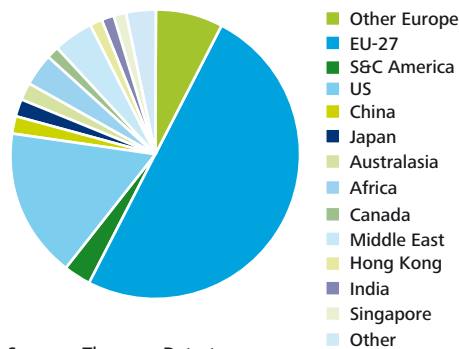
Does the UK export to the right places?

So if the pound has fallen enough and the UK is producing the right things, what *does* explain the lack of a sterling boost? We think that two main factors are to blame.

The first is the fact that the UK is selling to the “wrong” areas.

Over half of the UK’s goods and services exports still go to Europe. (See Chart 12.) Yet the recovery there already appears to be flagging. In contrast, it is the Asian economies where growth remains strongest. Yet exports to Asia (excluding the Middle East) accounted for just 11% of total exports in 2008. Of this, China and India each accounted for just 2%. Similarly, the US recovery is so far doing quite well, yet only 17% of the UK’s exports are sold there.

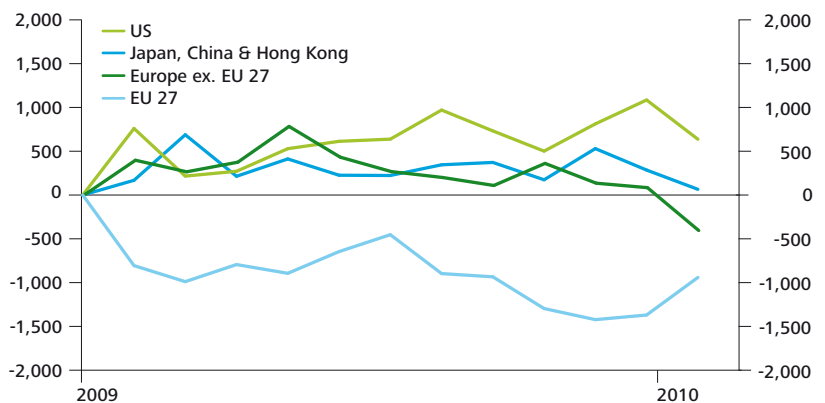
Chart 12. Breakdown of UK exports of goods & services (as a % of total, 2008)



Source – Thomson Datastream

The recent geographical split of the trade balance provides some support to this theory. Since the start of last year, the trade balance has been on an improving trend with the US. Meanwhile, the trade balance with Asia has been broadly steady. But the balance with Europe, up until the past month or two, was steadily deteriorating. (See Chart 13.)

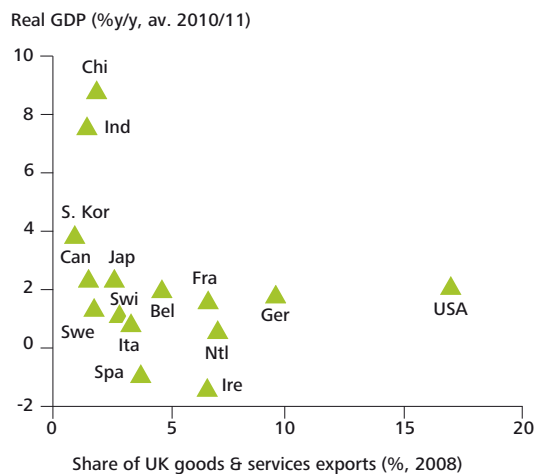
Chart 13. Cumulative change in trade deficit since January 2009 (£mn)



Source – Thomson Datastream

Looking ahead, we doubt that the geographical shape of the global recovery will become any more favourable for the UK. We recently downgraded our forecasts for growth in the euro-zone to just 1% this year and 0.5% next year. Meanwhile, we expect the recovery in the US soon to run out of steam, with growth there easing to just 1.5% next year. As Chart 14 therefore underlines, the countries which account for a large share of the UK's exports are the same countries where the prospects for growth are weakest.

Chart 14. UK exports & GDP growth forecasts



Sources – Thomson Datastream, Capital Economics

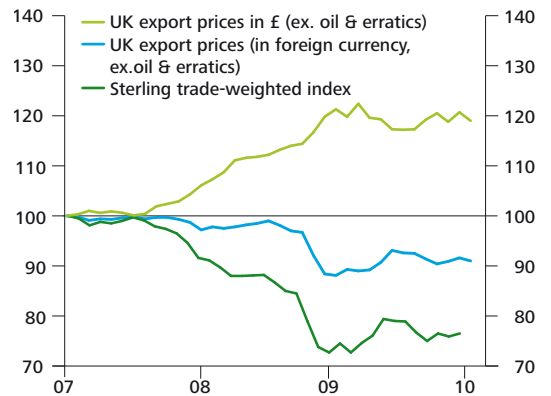
Exporters boosting margins

The second explanation for why the lower pound has had little apparent benefit lies in how exporters themselves have responded to the depreciation.

In particular, exporters have in the main used the fall in the pound to boost their profits margins, rather than to try to increase their market share.

In other words, they have kept their foreign currency prices unchanged and thus allowed the lower pound simply to translate into higher prices in sterling terms. (See Chart 15.)

Chart 15. Sterling and exporters' prices



Source – Thomson Datastream

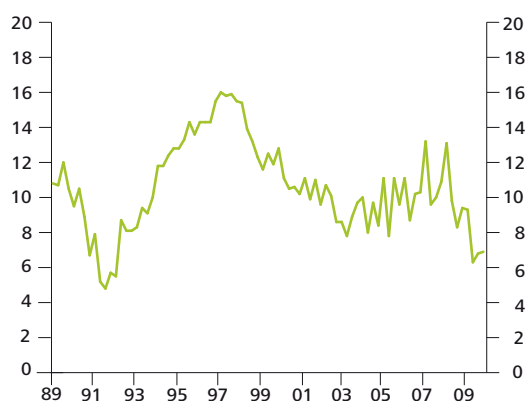
This might just reflect the fact that many firms set their prices in foreign currency, meaning that their prices do not automatically adjust to a change in the exchange rate. Accordingly, it is bound to take time for firms to set new prices and for current agreements to expire and be renegotiated. According to a report by the National Bureau of Economic Research, around 70% of UK and euro-area exporters price in foreign currency terms.

Alternatively, it might be that firms want to make sure that the low exchange rate is here to stay before altering their prices and putting themselves at risk of a squeeze in margins should the pound rise again.

However, firms have had plenty of time now to review their pricing. Similarly, a rise in the pound to its previous levels now looks like a remote prospect. **Accordingly, it would appear that many firms have deliberately taken a decision to widen their profit margins.**

Indeed, in a recent survey carried out by the Bank of England's agents, exporters gave a number of reasons why they hadn't changed their foreign currency export prices. These included a desire to rebuild cashflow and profits, a rise in imported raw material prices and the fact that inelastic demand for their products limited the benefit of cutting prices. A look at the recent profitability of the manufacturing sector shows clearly why firms are keen to use the pound to improve their bottom lines. Even with the boost from the pound, profitability this year fell to its lowest level since the early 1990s. (See Chart 16.)

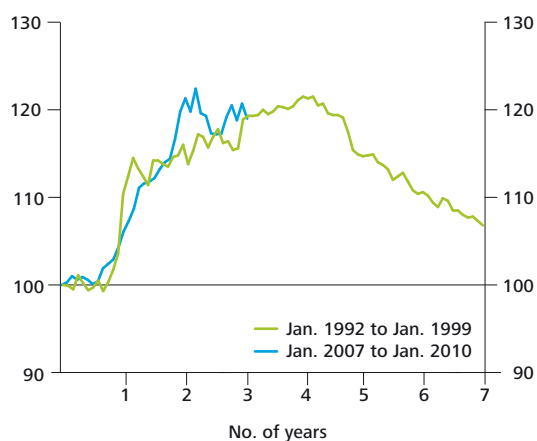
Chart 16. Manufacturing sector profitability (%)



Source – Thomson Datastream

The experience of the early 1990s also suggests that the rise in profit margins is a strategic decision by exporters, rather than a reflection of the time lags it takes to cut foreign currency prices. As Chart 17 shows, the recent rise in sterling export prices has been similar to that seen after sterling's depreciation when it left the ERM in 1992. What's more, prices then remained at this elevated level for a further couple of years. Prices started to fall eventually, in 1996. But this seemed to be more a reaction to the renewed appreciation in the pound at that time (as exporters tried to limit the resulting rise in their foreign currency prices), rather than a delayed reaction to the pound's previous fall.

Chart 17. Export prices in sterling terms (index)



Source – Thomson Datastream

Longer-term, the boost should still arrive ...

But what does this all mean for the economy's prospects? **On the positive side, the factors that have prevented a big sterling boost so far should not prevent one coming through eventually.**

For a start, the global economy – including the euro-zone – will recover in time. Indeed, given the large amounts of spare capacity still left in many economies after the recession, pretty rapid growth rates could eventually be seen.

What's more, in the meantime, exporters can shift markets and start selling more products to those countries which are growing fastest. Note that although exports to China account for just 1.8% of all UK exports, their share has increased in every year since 1996.

And lastly, higher profit margins will in time encourage more firms to export their goods and services. Admittedly, when it comes to increasing goods exports, there are concerns that the UK no longer has the skills or expertise required to build up its manufacturing base. But we see no insurmountable obstacles. (See *UK Economics Focus*, "Can the UK make the most of the lower pound?" 11th May 2009.) Workers can easily be re-deployed from other sectors, such as financial services, or imported. And note that spending on research and development in the manufacturing sector increased at an average annual rate between 2004 and 2007 of 6%.

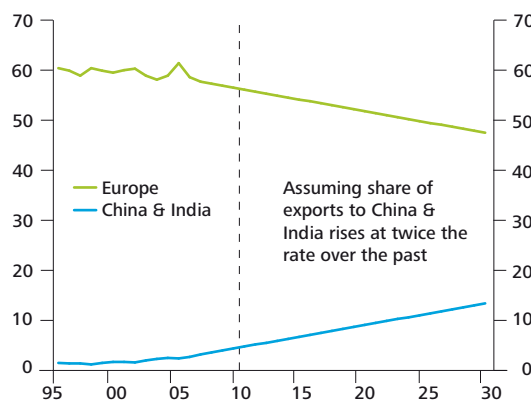
... but perhaps no time soon

However, these are not changes that can happen overnight. **For a start, the global economy could stay weak for a number of years.** Many of the UK's main export markets will be hampered by tighter fiscal policy, constrained bank lending and prolonged deleveraging in the private sector. These factors could weigh on demand for potentially several years. So we are unlikely to see a repeat of the early 1990s, when a strong global recovery meant that within a couple of years of the pound leaving the ERM, exports were rising strongly.

Meanwhile, it takes time for exporters to change which markets they export to. They need to build up relationships with new clients, set up new transport lines and investigate what their new markets will demand. What's more, in many areas, exports are starting from such a low base that even several years of rapid growth result in only a small increase in the share of overall UK exports. Over the past decade, exports to India, for example, have risen at an average annual rate of 13%. Yet in 2008 they still accounted for just 1.4% of all UK exports.

Indeed, even if the share of exports that go to China and India started to rise at twice its recent pace, it would take some 20 years to divert enough exports to these two countries to reduce Europe's share of exports from its current 57% to 50%. (See Chart 18.)

Chart 18. Share of UK goods & services exports (as a % of total)



Source – Thomson Datastream

It also takes time to redeploy existing resources in the economy into the exporting sector. Admittedly, unskilled workers can be put in different roles relatively easily and the high level of unemployment means that there is plenty of unskilled labour available. Similarly, there is a lot of unused plant and machinery or empty buildings. Indeed, the circled period in Chart 19 shows that in the early 1990s, exports picked up sharply well before business investment started to rise again.

Chart 19. Real exports & business investment (%/y)



Source – Thomson Datastream

That said, to sustain a prolonged period of export growth, investment will eventually be required – Chart 19 also shows that business investment rose strongly in the second half of the 1990s. Meanwhile, even if unskilled labour is plentiful, re-training *skilled* workers can obviously take several years.

What's more, there are good reasons to think that it could take even longer than usual for firms to build up their exporting capacity. Most importantly, credit constraints may prevent firms from accessing the finance to invest. Admittedly, the CBI industrial trends survey suggests that a relatively low net balance of manufacturers are reporting external finance to be a constraint on investment. But this may just be because few firms want to invest at the moment and so are not trying to obtain funds. The real constraints may only become apparent once firms want to spend more money – and find that they cannot get it.

Conclusions

The drop in the pound *could* eventually prove to be of significant benefit to the UK economy. Just returning the trade in goods and services balance to surplus (as it was back in 1997) would boost GDP by about 2.5%, albeit spread over perhaps a few years. What's more, it is important to remember that we can't be sure that it hasn't *already* had a significant impact – who knows how much worse the trade deficit would look had sterling remained at its previous overvalued level.

However, the evidence so far certainly has not been encouraging. Accordingly, we think that the combination of exporters wanting to rebuild their profit margins and a sluggish recovery in the UK's main export markets mean that sterling's boost will continue to take its time to come through.

Of course, at another point in time, it might not matter so much quite *when* the sterling boost came through, as long as it did eventually arrive. **But with a huge fiscal squeeze looming and consumers struggling under high debt levels, timing *does* matter.**

What the UK really needs is a strong pick-up in exports to offset a prolonged period of sluggish domestic demand. But that looks unlikely. We expect net trade to provide a positive contribution to annual GDP growth both this year and next of about 0.5%. While not insignificant, that is clearly not enough to compensate fully for the sluggish growth of domestic demand that we anticipate of just 0.5% to 1%.

Of course, every cloud has a silver lining. And at least continued weakness in the economy would result in weaker unit labour costs than otherwise, hence pushing down the real effective exchange rate further. This, in turn, would give a further boost to competitiveness. But this would be of little consolation if it meant having to endure a prolonged period of economic weakness in the meantime.

We still think that sterling's depreciation sets the stage for a stronger, better-balanced economy further ahead. But that point still looks a long way off. And with the UK, for now, struggling to capitalise on one of its only advantages, the recovery still looks doomed to disappoint.

Historical data table

	Average 1994-03	2004	2005	2006	2007	2008	2009
Demand (%y/y)							
GDP	3.2	3.0	2.2	2.9	2.6	0.5	-4.9
Consumer Spending	3.7	3.2	2.3	1.5	2.5	0.9	-3.2
Government Consumption	2.0	3.0	2.0	1.6	1.2	2.6	2.2
Fixed Investment	4.6	5.1	2.4	6.5	7.8	-3.5	-14.9
Stockbuilding (% of GDP)	0.4	0.4	0.4	0.4	0.5	0.1	-1.2
Domestic Demand	3.5	3.5	2.1	2.4	3.0	0.1	-5.3
Exports ¹	5.7	5.0	7.9	11.3	-2.8	1.1	-10.6
Total Final Expenditure	4.0	3.8	3.2	4.2	1.8	0.3	-6.4
Imports ¹	6.9	6.9	7.1	8.8	-0.7	-0.5	-11.9
Output & Profits (%y/y)							
Services Output	4.0	3.4	3.2	3.6	3.5	1.4	-3.5
Manufacturing Output	0.9	2.2	-0.2	1.6	0.6	-2.9	-10.5
Company Profits ² (nominal)	6.0	7.1	2.4	9.2	4.5	0.6	-5.1
Labour Market							
Unemployment (claimant count, millions)	1.5	0.9	0.9	0.9	0.9	0.9	1.5
Unemployment (claimant count, %)	4.7	2.6	2.9	2.9	2.5	3.6	5.0
Employment (%y/y)	0.6	1.0	1.1	0.9	0.6	0.9	0.9
Productivity (output per worker, %y/y)	2.0	2.1	2.1	2.2	1.8	-0.5	-3.3
Income & Saving (%y/y)							
Average Earnings ³	4.1	4.4	4.0	4.1	4.0	3.5	1.2
Real Household Disposable Income	3.0	1.1	2.0	0.7	0.5	1.6	3.2
Saving Ratio (%)	7.2	3.7	3.9	2.9	2.1	1.5	6.9
Prices (%y/y)							
CPI	1.7	1.3	2.0	2.3	2.3	3.6	2.1
Core CPI ⁴	n/a	1.1	1.5	1.3	1.7	1.6	1.8
RPI	2.6	3.0	2.8	3.2	4.3	4.0	-0.5
RPIX	2.5	2.2	2.2	3.0	3.2	4.3	2.0
Nationwide House Prices (end period)	10.4	13.9	3.3	9.3	6.9	-14.7	3.4
Monetary Indicators (end period unless stated)							
Base/Repo Rate (%)	5.52	4.75	4.50	5.00	5.50	2.00	0.50
10 Year Gilt Yield (%)	6.7	4.6	4.1	4.7	4.5	3.1	4.1
Sterling Trade-weighted Index	95.8	99.6	98.2	104.3	98.1	74.0	80.5
\$/£	1.61	1.91	1.72	1.96	1.99	1.47	1.62
Euro/£	1.45	1.41	1.46	1.48	1.36	1.03	1.13
M4 (%y/y, period average)	7.6	8.7	10.9	12.8	12.9	12.3	13.6
Balance of Payments & Public Finances							
Current Account (£bn)	-13.2	-24.9	-32.8	-43.8	-37.7	-22.0	-18.4
% of GDP	-1.4	-2.1	-2.6	-3.3	-2.7	-1.5	-1.3
PSNB (£bn, financial year)	13.1	39.8	37.4	30.8	34.0	87.0	167.0
% of GDP (financial year)	1.6	3.3	2.9	2.3	2.4	6.0	11.8
World Scene (%y/y)							
World GDP ⁵	3.4	4.9	4.5	5.1	5.2	3.0	-0.8
US GDP	3.3	3.6	3.1	2.7	2.1	0.5	-2.4
Euro-zone GDP	n/a	1.9	1.8	3.1	2.7	0.5	-4.0
G7 Consumer Price Inflation	1.8	2.0	2.3	2.4	2.2	3.3	-0.1
World Goods & Services Trade Volumes	6.8	10.7	7.6	9.3	7.2	2.8	-12.0
Oil Price (Brent, \$ per barrel, end period)	19.8	38.4	58.3	59.4	93.8	36.2	77.4

1 Includes VAT fraud distortion. 2 Gross trading profits of non-financial corporations. 3 Including bonuses. 4 Excluding energy, food, alcohol & tobacco. 5 PPP terms.

Macro forecast table

			2010f		2011f	
	2010f	2011f	H1	H2	H1	H2
Demand (%y/y)						
GDP	1.0	1.5	0.3	1.6	1.6	1.3
Consumer Spending	-0.5	1.0	-0.5	-0.5	0.3	1.7
Government Consumption	2.0	-1.5	2.8	1.3	-0.7	-2.3
Fixed Investment	-2.0	2.0	-3.3	-0.5	1.7	2.4
Stockbuilding (% of GDP)	-0.4	0.0	-0.6	-0.2	0.0	0.0
Domestic Demand	0.6	0.9	0.3	0.8	0.8	1.1
Exports ¹	7.0	3.5	6.4	7.7	4.3	2.7
Total Final Expenditure	1.9	1.5	1.5	2.2	1.5	1.5
Imports ¹	5.0	1.5	5.9	4.2	1.1	1.9
Output & Profits (%y/y)						
Services Output	1.2	1.6	0.5	1.8	1.8	1.4
Manufacturing Output	2.0	3.0	1.1	2.9	3.3	2.7
Company Profits ² (nominal)	-3.5	-1.5	-2.3	-4.8	-3.3	0.3
Labour Market						
Unemployment (claimant count, millions)	1.9	2.1	1.7	2.0	2.1	2.1
Unemployment (claimant count, %)	6.0	6.6	5.6	6.5	6.6	6.6
Employment (%y/y)	-1.7	-1.0	-1.4	-2.2	-1.6	-0.3
Productivity (output per worker, %y/y)	2.8	2.5	1.8	3.9	3.3	1.7
Income & Saving (%y/y)						
Average Earnings ³	0.7	-0.2	1.8	-0.4	-0.7	0.3
Real Household Disposable Income	-1.0	1.0	0.1	-2.2	-0.1	2.1
Saving Ratio (%)	6.3	6.8	6.7	6.0	6.6	7.0
Prices (%y/y)						
CPI	2.6	0.3	3.1	2.2	0.6	-0.1
Core CPI ⁴	2.6	0.1	3.0	2.1	0.5	-0.3
RPI	3.8	1.9	4.2	3.5	2.1	1.6
RPIX	3.9	1.6	4.3	3.4	1.9	1.4
Nationwide House Prices (end period)	-5.0	-10.0	+8.2	-5.0	-12.0	-10.0
Monetary Indicators (end period unless stated)						
Base/Repo Rate (%)	0.5	0.5	0.5	0.5	0.5	0.5
10 Year Gilt Yield (%)	3.0	3.0	4.0	3.0	3.0	3.0
Sterling Trade-weighted Index	84.0	88.9	79.3	84.0	86.4	88.9
\$/£	1.50	1.50	1.45	1.50	1.50	1.50
Euro/£	1.25	1.36	1.16	1.25	1.30	1.36
M4 (%y/y, period average)	3.5	4.5	4.0	3.0	4.1	4.9
Balance of Payments & Public Finances						
Current Account (£bn)	-14.8	-7.8	-9.0	-5.8	-4.3	-3.6
% of GDP	-1.0	-0.5	-1.3	-0.8	-1.2	-1.0
PSNB (£bn, financial year)	165	130	-	-	-	-
% of GDP (financial year)	11.3	8.7	-	-	-	-
World Scene (%y/y)						
World GDP ⁵	4.0	3.0	4.2	3.8	3.3	2.7
US GDP	3.0	1.5	3.0	2.9	1.8	1.5
Euro-zone GDP	1.0	0.5	0.9	1.1	0.8	0.2
G7 Consumer Price Inflation	1.1	0.2	1.3	0.7	0.2	0.2
World Goods & Services Trade Volumes	7.0	4.0	8.5	5.5	4.0	4.0
Oil Price (Brent, \$ per barrel, end period)	60.0	60.0	60.0	60.0	60.0	60.0

1 Includes VAT fraud distortion. 2 Gross trading profits of non-financial corporations. 3 Including bonuses. 4 Excluding energy, food, alcohol & tobacco. 5 PPP terms.

Analysis: The world economy

US recovery will soon fade

- Weak growth in employment and incomes, tight credit and the prospect of a double-dip in house prices all suggest that the US economic recovery will run out of steam. We expect GDP growth of a respectable 3.0% in 2010 to be followed by a rather limp 1.5% in 2011.
- The ISM manufacturing index is pointing to annualised GDP growth of 5% or so in the first quarter. (See Chart 1.) And the recent surge in consumption growth suggests that households are starting to participate in the economic recovery. The latter, though, has been financed by households running down their saving rate. (See Chart 2.) More generally, the conditions necessary for a sustained pick-up in consumption growth are still largely absent.
- Payroll employment has started to rise. (See Chart 3.) But a third of the 162,000 gain in March was due to the hiring of temporary workers to conduct the 2010 Census. Lingering uncertainty over demand, continued tight credit and concerns over future tax rises mean that underlying jobs growth will stay subdued and the unemployment rate above 9%. Add in low wage growth, and household incomes are set to increase only modestly.
- The growing likelihood of a renewed fall in house prices will further undermine wealth and confidence. The recent rebound in excess supply is already consistent with a double-dip in prices. (See Chart 4.) By the end of next year, house prices could have fallen back by at least 5%. Consumer confidence has already dropped back to levels consistent with annual growth in spending of just 1.5%.
- Aggressive cost-cutting and rapid productivity growth mean firms have plenty of funds to invest. And the rebound in orders and shipments of capital goods has continued. (See Chart 5.) But high uncertainty and low capacity utilisation are likely to limit the strength of the investment recovery. This is especially the case for small firms, who are constrained by weak sales and tight credit.
- The fiscal stimulus will continue to support activity in the coming quarters. But the boost will fade next year. In the meantime, it is being partly offset by the pressure on state and local governments to balance their budgets. The upshot is that GDP growth will slow later this year and next year too. (See Chart 6.)
- Meanwhile, the full disinflationary pressure of the recession is only now beginning to be felt. Core inflation slowed to just 1.3% in February and it may yet drop to 0.5%. (See Chart 7.)
- Admittedly, the Fed's super-sized balance sheet is an upside risk. But this has not led to increases in the broad money supply or bank lending. In fact, bank lending *fell* by 8.2% in the year to February. (See Chart 8.) Now that the Fed has ended its asset-purchasing scheme, lending may start to fall more rapidly. Such trends are deflationary, not inflationary.
- Overall, a fading of the economic recovery and a further fall in inflation are likely to force the Fed to keep interest rates close to zero until at least 2012. The Fed may even have to start buying assets again if the broad money and credit aggregates remain weak.

Chart 1. US GDP & ISM manufacturing index

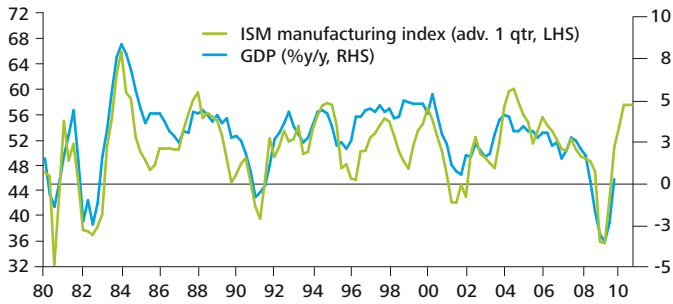


Chart 2. US real consumption & household saving rate

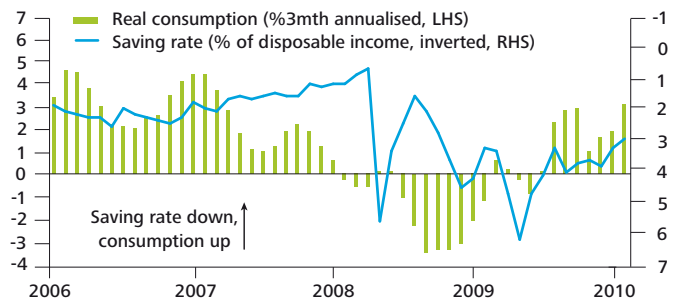


Chart 3. US non-farm payroll employment (change, 000s)

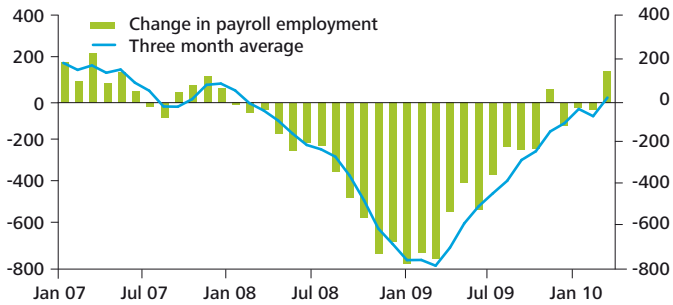


Chart 4. US excess housing supply & house price inflation

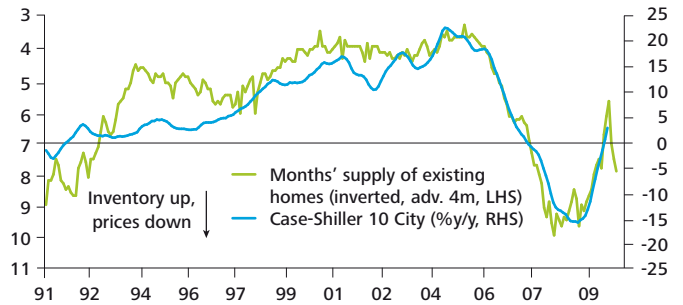


Chart 5. US non-defence, core capital goods (\$bn)

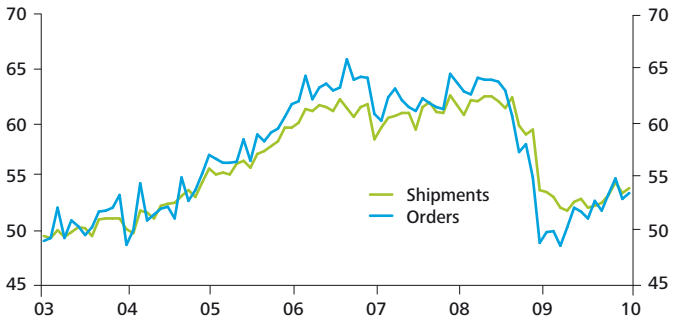


Chart 6. US GDP (%/q/q annualised)

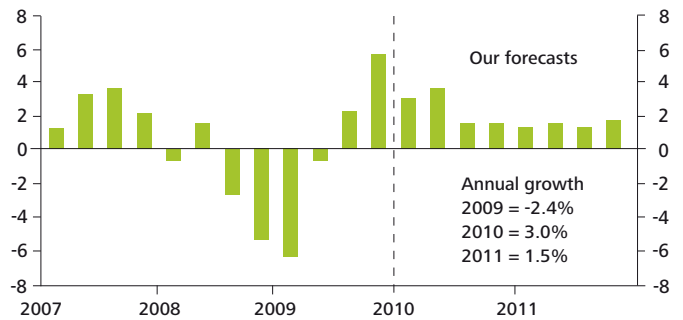


Chart 7. US CPI inflation (%/y)

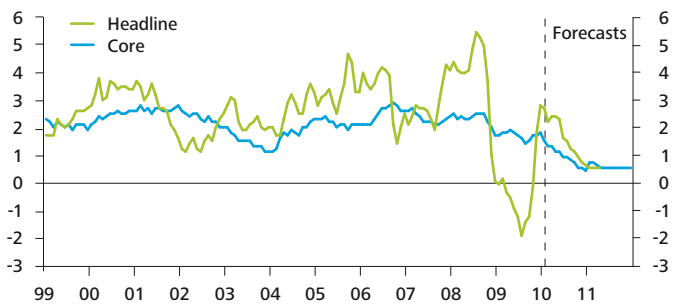
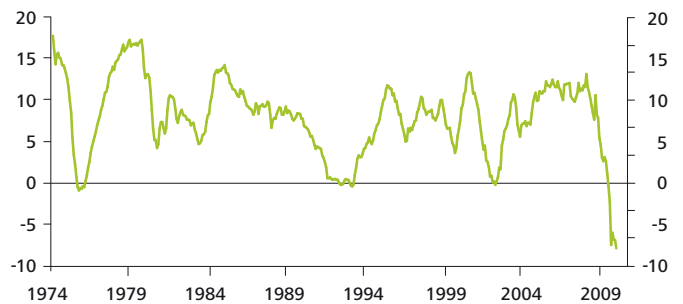


Chart 8. US bank lending (%/y)



Source – Thomson Datastream

Analysis: The world economy

European outlook darkens as fiscal worries grow

- Prospects for the euro-zone have deteriorated markedly, with the much-needed consumer recovery failing to materialise and aggressive fiscal tightening set to hit growth hard.
- Admittedly, there have been some positive signs that the recovery has some near-term momentum. After stagnating in Q4, business surveys such as the composite PMI suggest that GDP rose by around 0.5% in the first quarter. (See Chart 9.)
- The recovery remains reliant on external rather than domestic demand. (See Chart 10.) Exports should continue to recover in the near term, particularly if the euro exchange rate depreciates further as we expect. (See Chart 11.) But with global growth set to slow later this year, a sustained recovery would depend on a meaningful pick-up in domestic spending, which seems less and less likely.
- While survey measures of consumer confidence still point to a pick-up in household spending growth, it is worrying that the earlier improvement in sentiment has stalled. (See Chart 12.) Meanwhile, the continued increase in unemployment points to further downward pressure on wage growth and households' incomes to come.
- Relatively low rates of inflation should continue to support real incomes. And low official interest rates should help the domestic economy too, particularly if the ECB remains on hold throughout this year and 2011 as we expect. But weak bank lending growth still looks set to hold back both consumer spending and investment. (See Chart 13.)
- Perhaps most importantly, while the fiscal crisis in the region's periphery need not prompt the euro-zone to fall apart, it clearly points to a long period of aggressive fiscal consolidation and recession in these economies. A less dire need for fiscal tightening and a much stronger competitive position suggest that Germany will continue to perform relatively well. (See Chart 14.)
- Nonetheless, with the problems of the periphery weighing on the region as a whole, the prospect of a meaningful euro-zone recovery has all but disappeared. We now see euro-zone GDP expanding by 1.0% this year and just 0.5% in 2011.
- Developed European economies outside the single currency area are so far faring better. Exports will suffer from the euro's depreciation due to strong trade links with the region, particularly in Switzerland. But stronger public finances, especially in Norway, should ensure that their recoveries continue to be stronger than the euro-zone's. (See Chart 15.)
- Elsewhere, Emerging Europe looks set for a sluggish recovery. The outlook for Russia is closely tied to the price of oil and we expect growth to slow sharply in 2011. Meanwhile, banking sectors across much of the rest of the region remain extremely fragile and fiscal policy will tighten in almost every country over the next year or so. Turkey and Poland remain the only bright spots. (See Chart 16.)

Chart 9. Euro-zone GDP & composite PMI

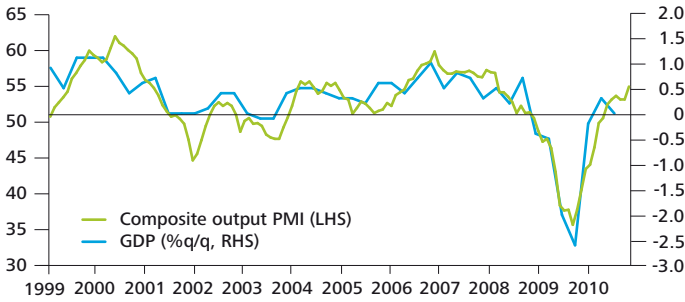


Chart 10. Euro-zone GDP, exports & H'hold spending (% y/y)

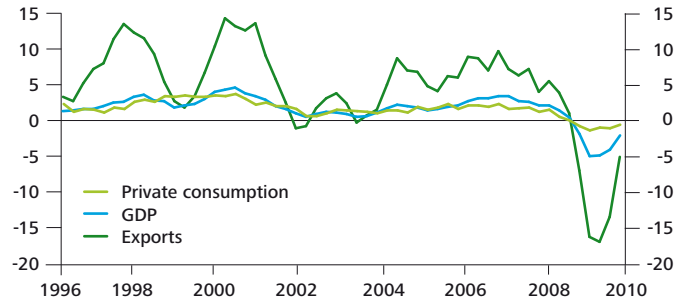


Chart 11. Euro-zone exports & euro effective exchange rate

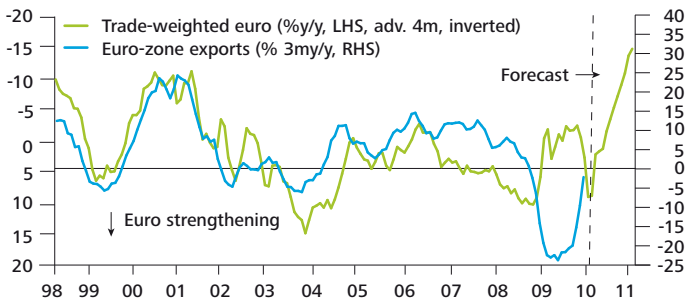


Chart 12. Euro-zone consumer confidence & spending

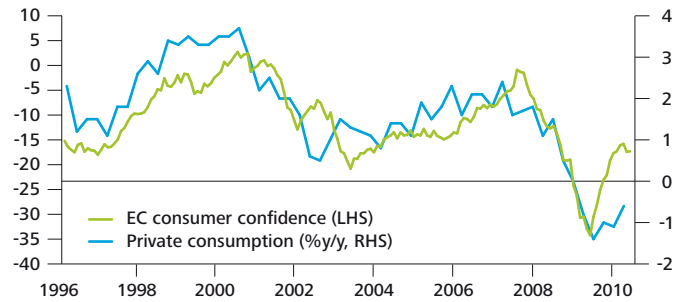


Chart 13. Euro-zone private sector lending (%/y)

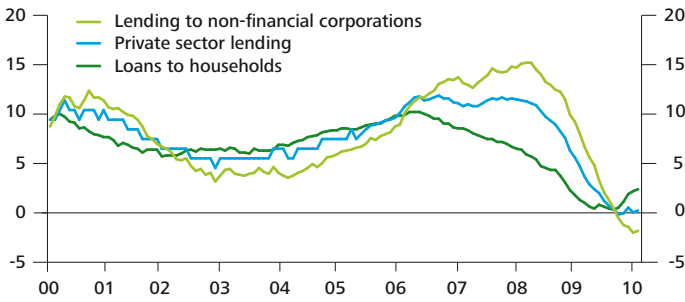


Chart 14. Euro-zone GDP (%/y)

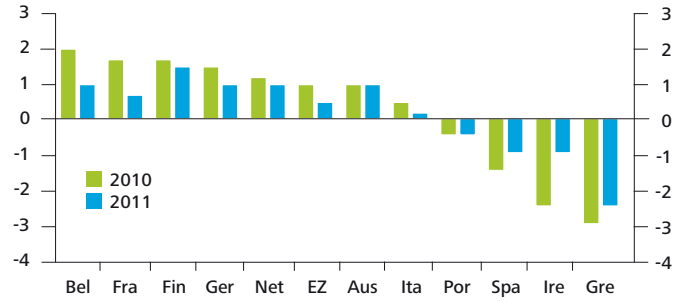


Chart 15. Developed Europe GDP (%/y)

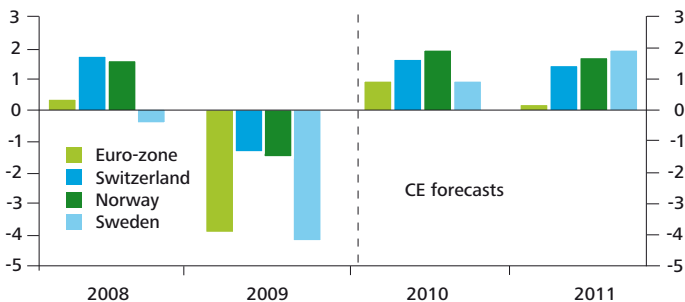
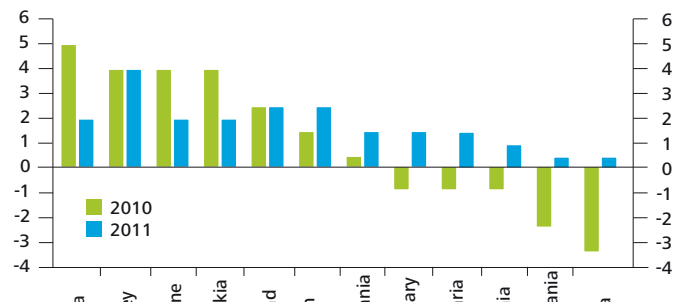


Chart 16. Emerging Europe GDP (%/y)



Sources – ECB, IMF, Markit, Thomson Datastream

Analysis: The world economy

Asia leading the global recovery

- The major economies of Asia are emerging from the global recession in relatively good shape, thanks largely to their low levels of private debt, robust banking systems and some particularly effective policy stimulus.
- Indeed, Japan has experienced the largest increase in GDP of any G7 economy since activity began to recover in Q1 2009. (See Chart 17.) Admittedly, Japan had also seen the deepest recession as exports collapsed. But the rebound is not just an export story.
- Consumer confidence and spending have recovered too, supported by government measures. The inventory cycle and investment spending are also set to make decent positive contributions to growth in the first half of the year. (See Chart 18.)
- Nonetheless, the recovery will not be strong enough to make much of a dent in the huge amount of spare capacity left by the recession. Deflation is therefore likely to persist for the foreseeable future. (See Chart 19.)
- Japan's public finances are also in a mess. In order to avoid a Greek-style crisis of confidence in the financial markets, the government's fiscal plan to be unveiled in June will have to mark the start of a multi-year programme of spending restraint and, eventually, tax increases. In the meantime, there is little prospect of the structural reforms required to offset the headwinds from Japan's adverse demographics.
- The upshot is that, after a strong 2010, Japan could be back in recession as soon as the second half of 2011. (See Chart 20.)
- China's GDP is likely to increase by around 10% this year. But while this growth rate is much higher than elsewhere, it would be nothing unusual by Chinese standards. (See Chart 21.) What's more, China's GDP growth would have to continue to accelerate in order to offset renewed weakness elsewhere, which would require a much looser policy stance than currently planned.
- The markets' fears of inflation in China are at least exaggerated. Aside from a few hotspots, property prices have barely kept pace with the growth of incomes. The headline CPI has jumped, largely reflecting the impact of winter storms on food prices and a policy decision to raise energy prices towards their would-be market levels. But core inflation remains very low and spare capacity ample. (See Chart 22.)
- Overheating is a far bigger risk in India. A surge in government spending (which shows up in "community services") kept the economy growing close to trend during the global recession, while the manufacturing sector has since rebounded strongly. (See Chart 23.) In the meantime, inflation has surged for goods as well as for commodities. (See Chart 24.)
- The Reserve Bank of India finally began to raise its key policy interest rates in March. Further increases will be needed throughout the year.

Chart 17. Change in GDP between Q1 and Q4 2009 (%)

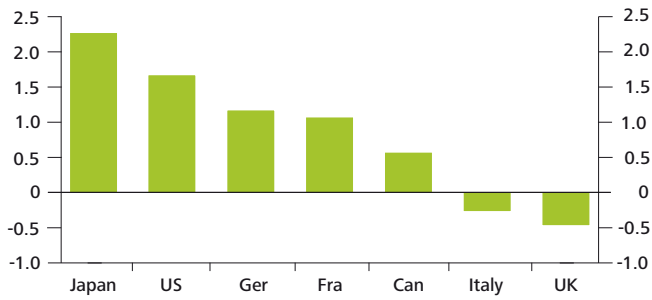


Chart 18. Japan selected contributions to quarterly GDP growth (% points)

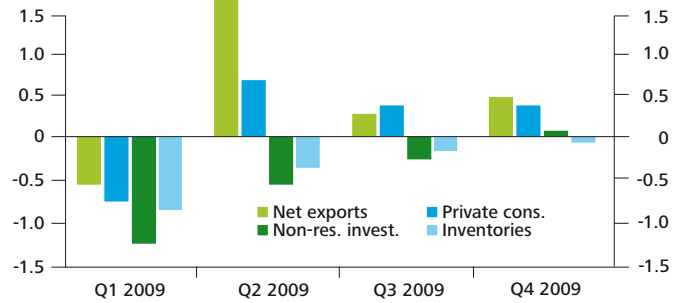


Chart 19. Japan consumer prices (Jan. 2000 = 100)

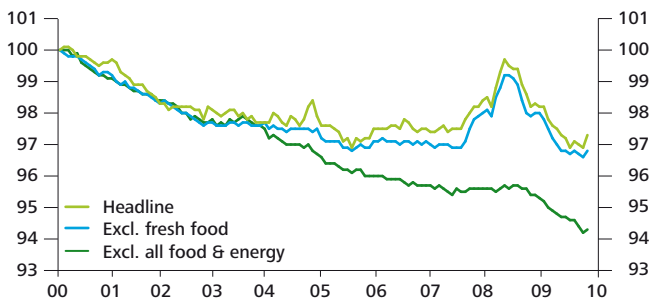


Chart 20. Japan GDP

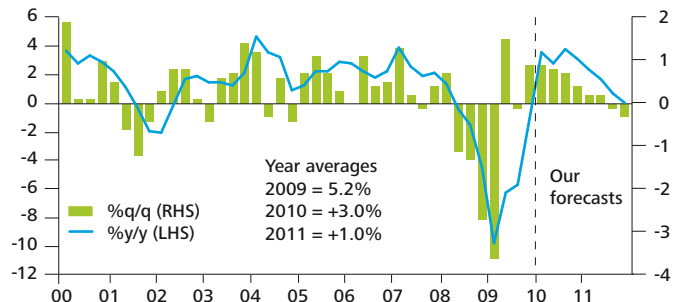


Chart 21. China GDP (%/y)

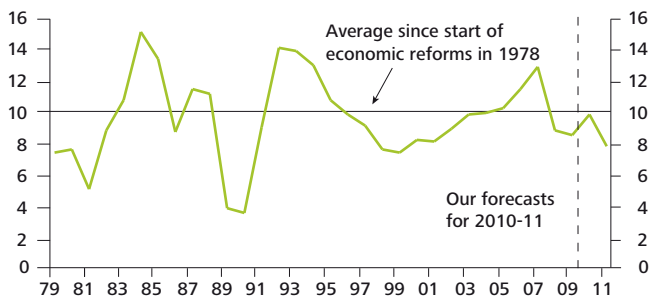


Chart 22. China consumer prices (%/y)

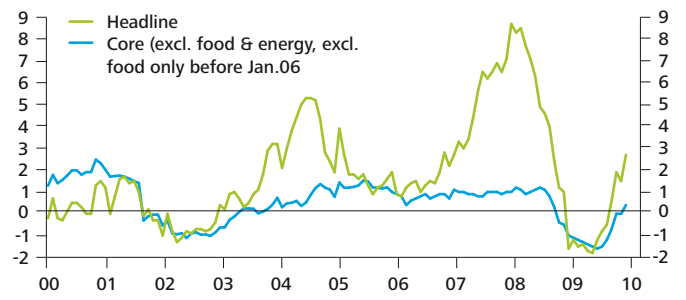


Chart 23. India GDP (%/y)

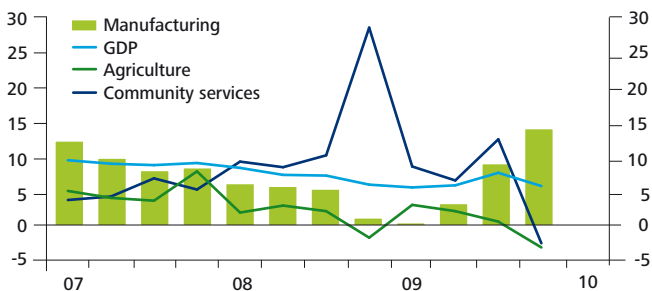
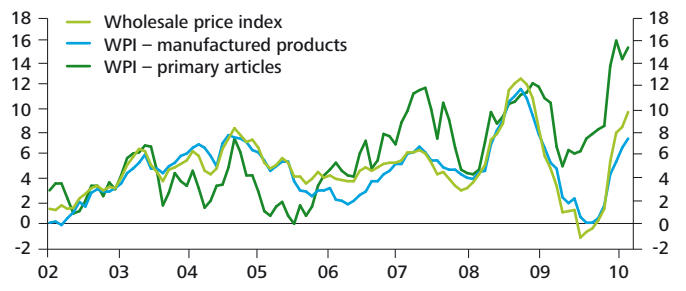


Chart 24. India wholesale prices (%/y)



Sources – CPB, CEIC, Markit, Thomson Datastream

Analysis: UK output and activity

Double-dip fears have eased ...

- The UK economy may continue to take further tentative steps towards recovery in the near term. But the prospect of sluggish credit growth, a savage fiscal squeeze and renewed weakness in the labour market – all amid a weak global recovery – looks set to ensure that the UK's recovery flags further ahead.
- Admittedly, the upward revision to quarterly GDP growth in the fourth quarter from an initial estimate of 0.1% to the 0.4% figure in the national accounts has left the UK economy lagging less far behind its competitors.
- What's more, the timelier survey data suggest that the economy has continued to expand at a decent rate early this year, despite some considerable headwinds such as the rise in VAT and the bad weather in January. (See Chart 1.)
- Meanwhile, asset prices have continued to rally, despite the decision by the Monetary Policy Committee to pause its programme of quantitative easing in February. (See Chart 2.)
- Finally, the economy also looks a bit better balanced than it did a couple of quarters ago. On the face of it, households have begun to save a far larger proportion of their income, though the saving ratio has been distorted higher by a sharp rise in additional income. (See Chart 3.) And the current account deficit has narrowed to its smallest level since 1998. (See Chart 4.)
- However, there are good reasons to think that the recovery is based on pretty fragile foundations. As Chart 5 shows, the 0.4% quarterly expansion seen in the fourth quarter was highly dependent on government spending and an easing in the rate of destocking by firms.
- In the very near term, these forces may remain in place. Indeed, after an unparalleled period of destocking by firms, the potential for a considerable boost to GDP growth over the next couple of quarters from less destocking or even restocking seems large. (See Chart 6.)
- But as these temporary boosts inevitably fade, the recovery looks set to struggle to gain further traction, for several reasons.
- First, an exceptionally severe fiscal tightening will be set in motion after the general election, regardless of its outcome. By our calculations, a credible plan to eliminate the public sector deficit by the middle of the decade could knock over 1% off annual GDP growth from next year. (See Chart 7.)
- Second, weak credit creation looks set to persist, constraining the recovery. Flows of lending to households and firms have already dried up. (See Chart 8.) Admittedly, the Chancellor has recently announced new lending targets for the partly nationalised banks RBS and Lloyds. But the fact that the banks broke the last set of targets without punishment suggests that even these unambitious targets will not be met. Instead, banks are more likely to continue to build up their capital bases than to turn on the lending taps.

Chart 1. Real GDP growth & business surveys

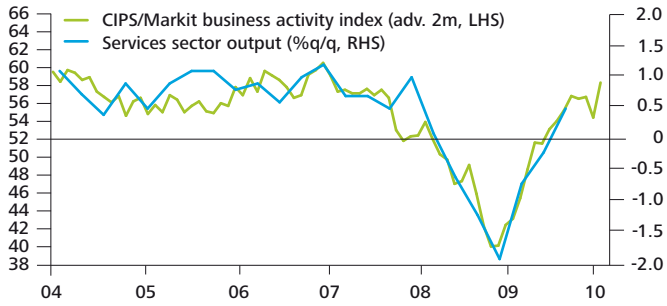


Chart 2. Asset prices (%3m/3m)

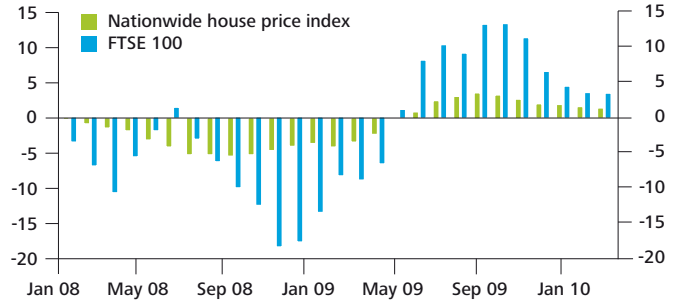


Chart 3. Household saving ratio (% of income)

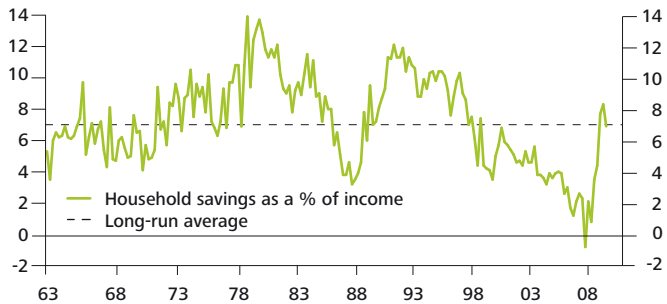


Chart 4. Current account balance

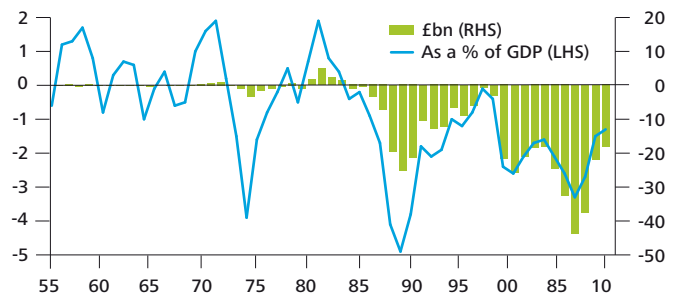


Chart 5. Contributions to GDP growth in Q4 (%)

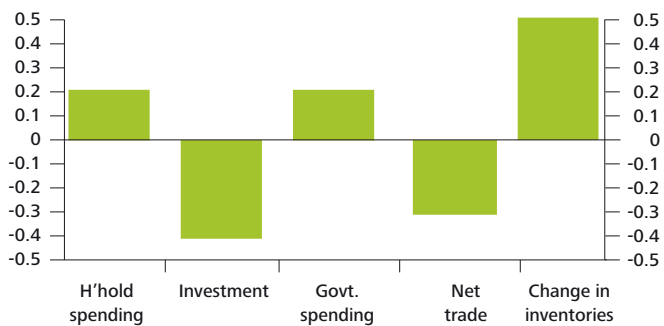


Chart 6. Change in inventories (£m)

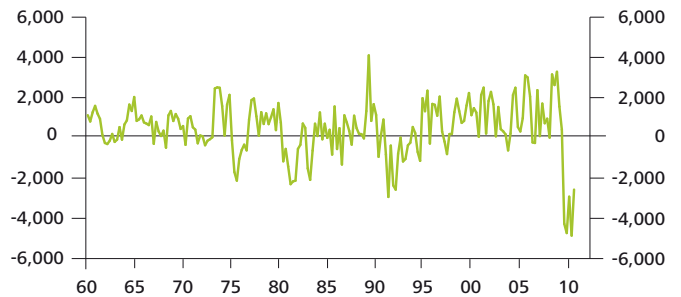


Chart 7. PSNB and fiscal impact projections

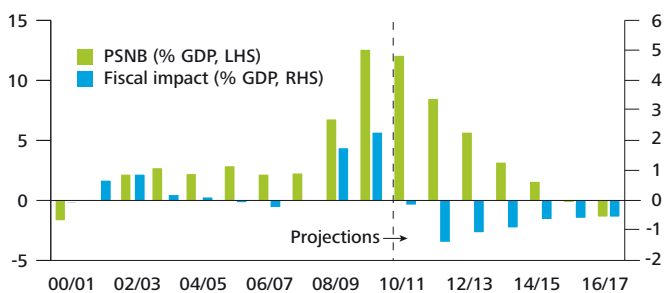
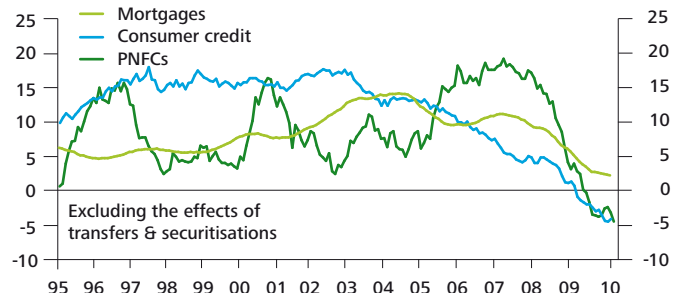


Chart 8. M4 Lending (%/y)



Sources – Thomson Datastream, BoE & Capital Economics

Analysis: UK output and activity

... but the recovery is built on fragile foundations

- But even if the supply of credit were to increase, we doubt that *demand* for it will be strong. While firms and households have begun to tackle their extraordinarily high debt levels, the deleveraging process still has many years to go if debt is to be reduced to a more sustainable level. (See Chart 9.)
- The effects of weak credit growth are likely to be widely felt. The large amount of spare capacity in the economy alone suggests that firms have little incentive to invest. (See Chart 10.) But those firms who do want to invest may struggle to find the funds.
- The third reason why we expect the recovery to disappoint stems from the fact that a renewed deterioration of the labour market seems likely. Productivity has fallen sharply during the recession, as firms have cut employment by less than output, perhaps in anticipation of a decent recovery. (See Chart 11.) But with demand picking up only slowly, firms are likely to cut jobs further to restore profitability. Meanwhile, public sector employment looks set to fall when the fiscal squeeze kicks in. Unemployment may yet top 3 million next year.
- Slack in the labour market should also lead to continued weakness in average earnings growth. As a result, we expect overall household spending to fall again, perhaps by 0.5% or so this year. (See Chart 12.)
- Furthermore, a renewed deterioration of the labour market would quickly put a halt to the recent recovery in the housing market. By most measures of affordability, the housing market is still overvalued – indeed, the house price to earnings ratio is still a long way above its peak at the height of the 1980s boom. (See Chart 13.) We think that house prices could fall by 5% this year and a further 10% next year.
- Finally, doubts remain over the extent to which the external sector will be able to take full advantage of the lower pound. (See Main Article, pages 2-11.) Indeed, the trade in goods and services deficit has *widened* recently, despite the considerable stimulus provided to exports by the lower pound. (See Chart 14.) So only a modest net trade boost to growth seems likely, insufficient to offset the broader weaknesses elsewhere in the economy.
- In light of all this, the recovery looks set to remain fragile for a considerable period. We expect real GDP growth of only 1% or so this year and about 1.5% in 2011. (See Chart 15.)
- Meanwhile, the recovery is unlikely to be strong enough to start to absorb the large amount of spare capacity in the economy. (See Chart 16.) As a result, inflationary pressures are likely to remain subdued for a considerable period. (See *Analysis: Inflation*, pages 24-27.)
- Admittedly, growth may be a little stronger than we expect if firms accept a permanent reduction in productivity or if demand for UK exports picks up at a faster rate. But there also remain significant risks to the downside of our forecast. While policymakers may have saved the economy from depression, both a premature tightening of monetary policy and too severe a tightening of fiscal policy could push the economy back into recession.

Chart 9. Private sector debt ratios

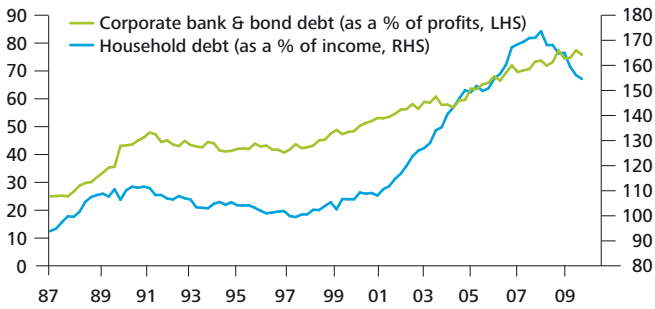


Chart 10. Investment & spare capacity

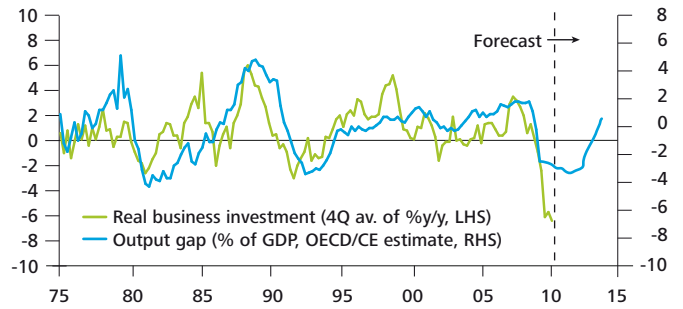


Chart 11. Unit labour costs & productivity

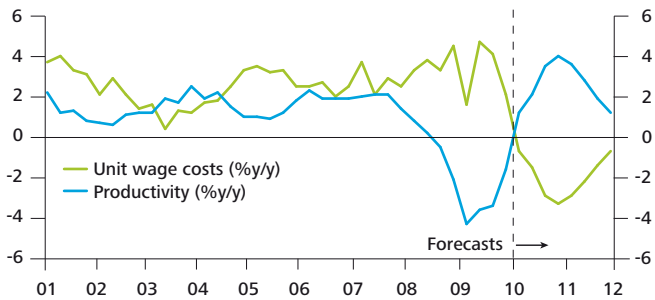


Chart 12. Household spending and disposable income

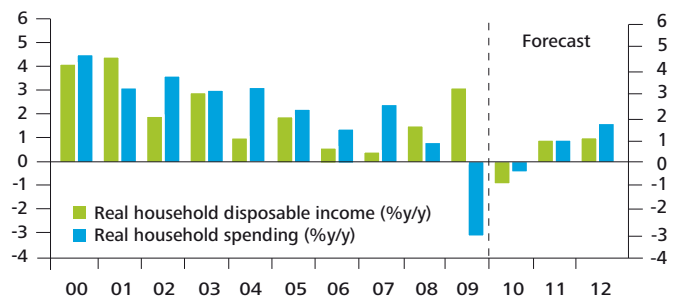


Chart 13. House prices to earnings ratio

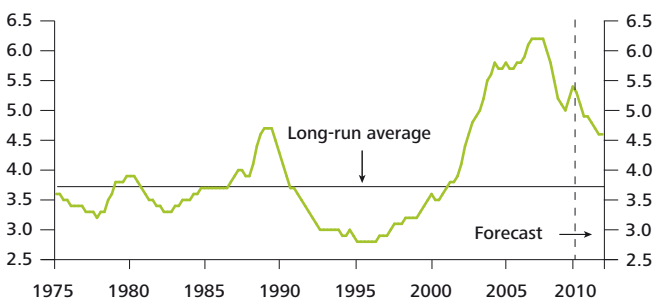


Chart 14. Trade in goods & services balance & sterling trade-weighted index

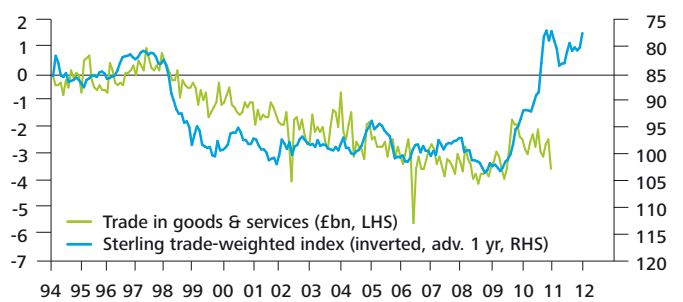


Chart 15. Real GDP growth

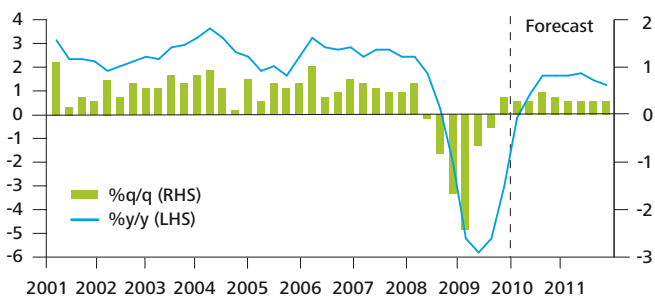
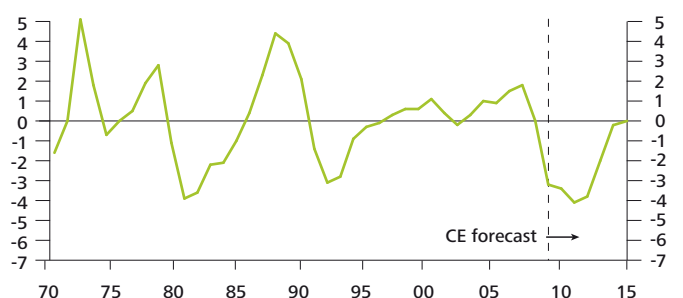


Chart 16. Output gap (as a % of GDP)



Sources – Thomson Datastream, Bank of England & Capital Economics

Analysis: UK inflation

VAT & energy to keep inflation high for a while

- Tax and energy effects will keep UK consumer price inflation above its target in the next quarter or two. But the vast amount of slack in the economy will help to bring it back down sharply later this year. Indeed, *deflation* risks have not yet evaporated altogether.
- After a long period of extraordinary stability, UK inflation has been back on something of a roller-coaster ride over the last two years. As Chart 1 shows, having risen sharply in 2008 and then dropped back in 2009, inflation has picked up strongly again in the last six months. RPI inflation, which includes housing costs, has been particularly volatile.
- Of course, inflation has risen in other parts of the world too. But UK inflation has remained above that in the US and, perhaps most surprisingly, the euro-zone. (See Chart 2.)
- This has prompted concerns amongst some members of the Monetary Policy Committee that the low inflation psychology of the last decade could be under threat. As Charts 3 and 4 show, some measures of households' inflation expectations have crept up a touch in recent months and bond markets' expectations have been elevated for a while.
- But we suspect that such concerns will prove to be relatively short-lived. Admittedly, inflation is likely to remain close to current levels for a while longer, probably triggering another explanatory letter from the Governor of the Bank of England to the Chancellor explaining why it is still more than 1% above its 2% target.
- One upward influence might be the delayed effects of the rise in VAT in January. So far, the effects of the increase have been surprisingly small, prompting inflation measures which exclude tax effects, such as CPIY, to drop sharply. (See Chart 5.) But this might partly reflect timing effects if some retailers have chosen to delay raising their prices in response. If so, further upward effects are likely.
- Meanwhile, the recent renewed rise in agricultural commodity prices suggests that the steady fall in food price inflation seen over the last year may soon start to be at least partly reversed. (See Chart 6.)
- But these effects should soon be overwhelmed by other forces working in the opposite direction. For a start, provided that the recent rise in oil prices does not go much further, the upward effect on inflation from petrol prices and other energy components should ease considerably over the next year or so. As Chart 7 shows, petrol effects alone could knock close to 1% off inflation.
- And more fundamentally, after pushing inflation sharply higher over the last year, cost pressures in the goods sector are set to work strongly in the opposite direction over the next year. As Chart 8 shows, if historical relationships hold, core (ex. food and energy) goods inflation is likely to plummet back into negative territory in response to the drop in producer price inflation already seen.

Chart 1. UK inflation measures (%/y)

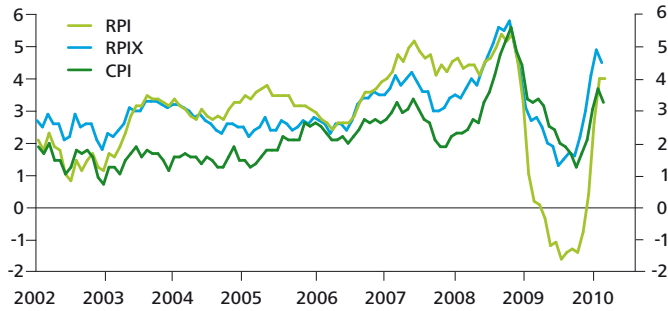


Chart 2. International consumer price inflation (%/y)

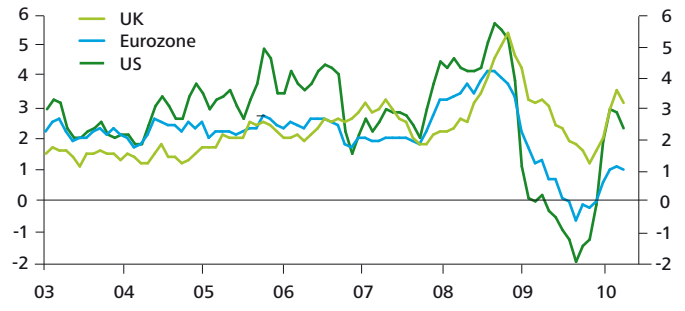


Chart 3. Household inflation expectations

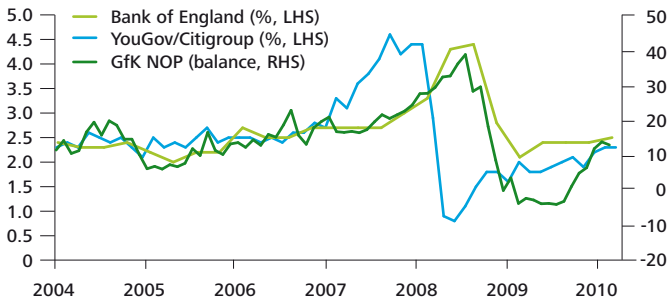


Chart 4. Bond market inflation expectations (%)

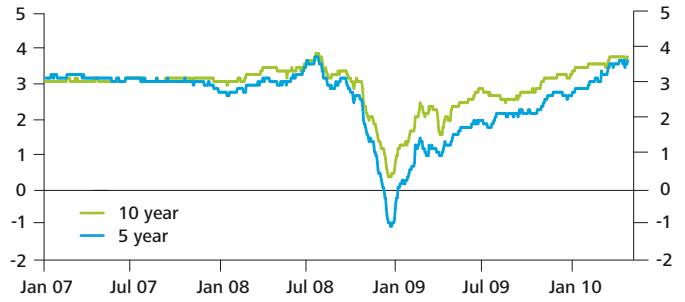


Chart 5. CPI & CPIY inflation (%)

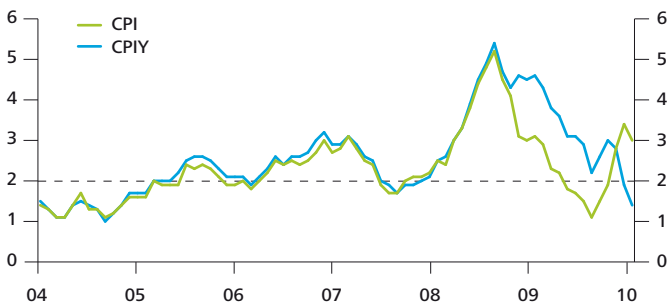


Chart 6. Agricultural commodity and food/drink prices

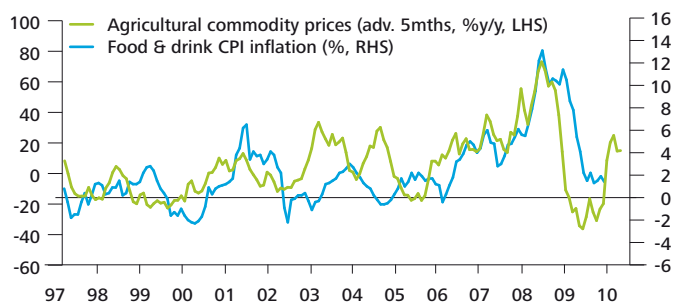


Chart 7. Oil prices & petrol contribution to inflation

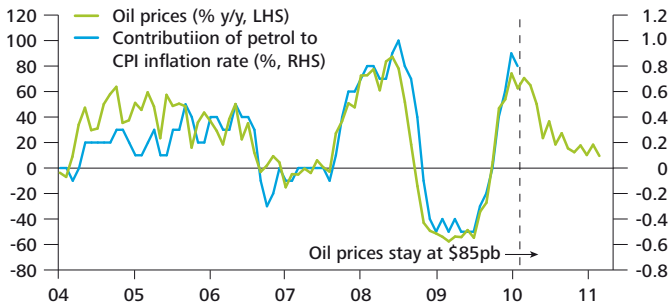
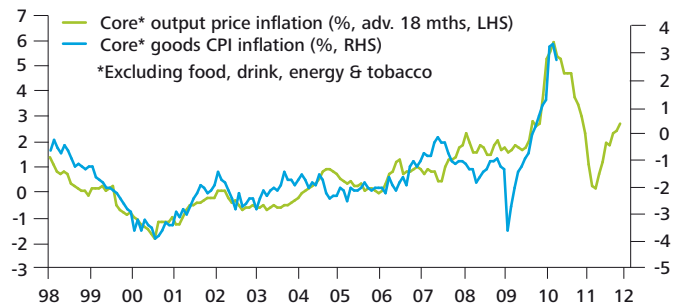


Chart 8. Core PPI inflation & core goods CPI inflation



Sources – Thomson Datastream, YouGov/Citigroup, Bloomberg

Analysis: UK inflation

But deflation still possible next year

- Admittedly, producer price inflation has picked back up again over recent months. What's more, surveys of producers' own price expectations have also strengthened. (See Chart 9.)
- Nonetheless, with the recovery in the manufacturing sector still very fragile and competition extremely intense, we doubt that producers will succeed in raising their prices too aggressively.
- The same picture applies to imported goods inflation. As Chart 10 shows, having previously risen sharply in response to the drop in the sterling exchange rate, import price inflation has since eased back considerably over the last year. Allowing for the usual lags, this will also have a downward influence on high street goods inflation.
- These various pressures should be exacerbated by the enormous degree of spare capacity in the economy. Admittedly, just what impact this will have on inflation is still highly uncertain. The lack of any obvious effect so far might suggest that the relationship has loosened somewhat.
- Nonetheless, the experience of previous episodes involving large amounts of spare capacity suggests that it could yet have a powerful downward effect on core CPI inflation. (See Chart 11.)
- A final downward influence on inflation is the recent weakness of wage growth. As Chart 12 shows, this already appears to have had at least some downward effect on inflation in the labour intensive services sector. (See Chart 12.)
- Admittedly, the picture is complicated by the recent rapid growth of *unit* wage costs, as the slowdown in average earnings growth has failed fully to offset the slump in output and productivity growth. (See Chart 13.)
- But we suspect that wage cost growth will slow before long, either as output growth recovers or as firms decide to shed more jobs. As Chart 14 shows, this process has already occurred in the manufacturing sector, strengthening the likely downward pressure on costs and prices in the goods sector.
- Overall, while worries over the inflation outlook may persist for some months yet, they are likely to ease considerably towards the end of the year as inflation itself falls back sharply. (See Chart 15.) Remember, after all, that headline inflation briefly rose above 5% in 2008, with little lasting "second-round effects" on wages growth or inflation expectations.
- One development which might keep inflation higher for longer is a post-election rise in VAT. But even this should not prevent inflation from falling back sharply in 2011, and perhaps even turning *negative*, as the disinflationary effects of the deepest recession for generations finally become evident. (See Chart 16 and *Forecast Table: Inflation* on page 36.)

Chart 9. PPI output price inflation CBI price expectations

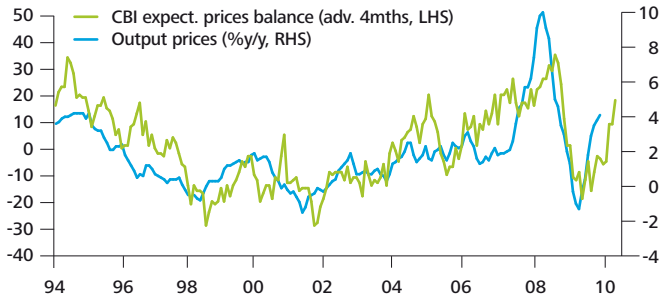


Chart 10. Import price & core goods inflation (%/y)

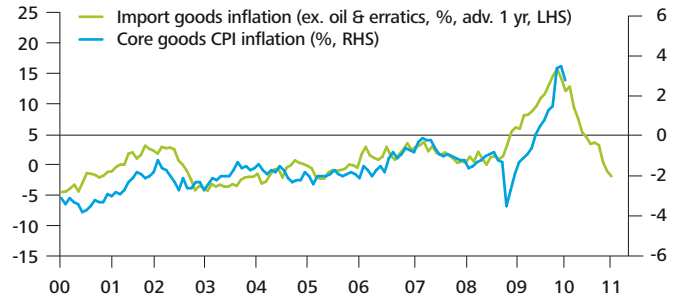


Chart 11. Output gap and core CPI inflation

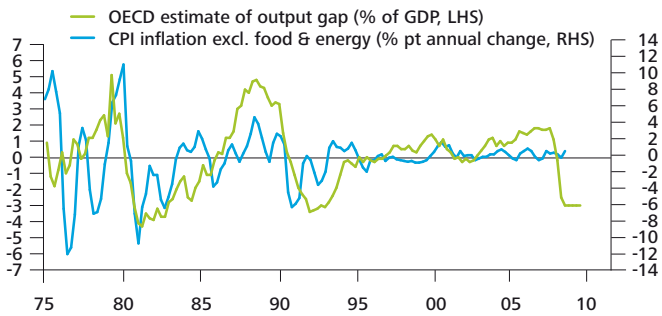


Chart 12. Average earnings and services inflation (%/y)

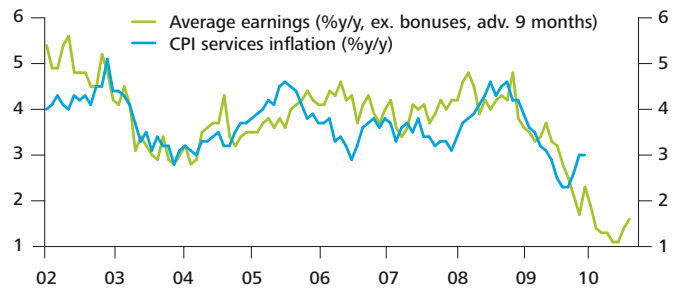


Chart 13. Average earnings & unit wage costs (%/y)

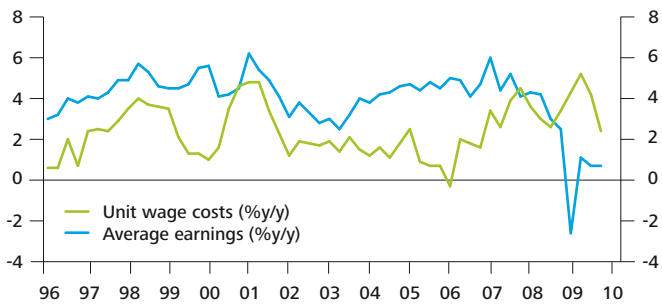


Chart 14. Manufacturing unit wage costs & goods CPI

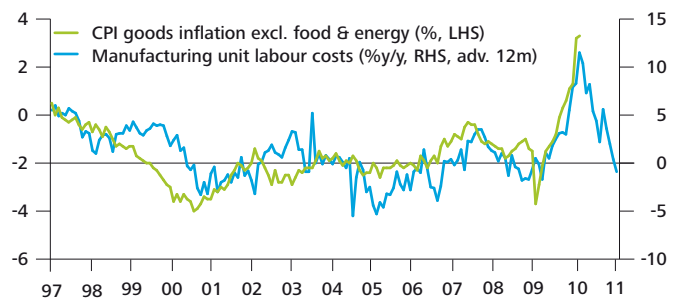


Chart 15. Headline & core CPI inflation forecasts (%/y)

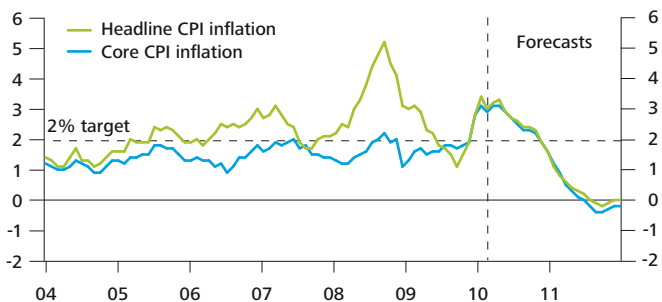
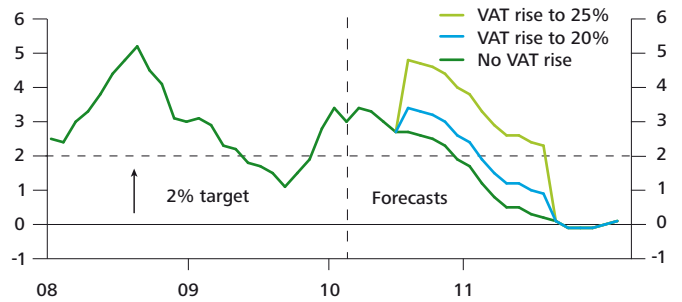


Chart 16. Inflation under different VAT rates (%/y)



Sources – Thomson Datastream, Bank of England, OECD

Analysis: UK labour market

Support from public sector soon to fade

- The labour market recovery looks fragile and we still expect unemployment to rise further. At the very least, sluggish pay growth is likely to act as a constraint on the consumer recovery and keep the threat of deflation alive.
- Unemployment on both main measures has been falling since the end of last year. (See Chart 1.) Accordingly, the labour market is still in a much better position than at the same stage of previous recoveries.
- However, the falls in unemployment have been small. What's more, *employment* is still falling, with last autumn's rise proving to be a false dawn. (See Chart 2.)
- Accordingly, the drops in unemployment have just reflected people giving up looking for work. The total number of people looking for jobs – whether unemployed or inactive – is still rising. (See Chart 3.)
- Indeed, we remain nervous about the outlook for several reasons. First, public sector employment – which was still rising at the end of last year – will soon start to fall. Public sector pay makes up one quarter of total government spending, so job cuts will be an inevitable part of attempts to cut the level of debt, whichever party wins the election.
- Second, firms have been willing to hoard labour in the hope of a quick recovery in the wider economy. But if the recovery continues to be sluggish, depressing productivity growth and boosting unit wage costs, firms may reassess their stance.
- Third, forbearance on the part of banks and the tax authorities has helped to limit the rise in business failures and hence redundancies. (See Chart 4.) However, their leniency may not last.
- Admittedly, the continued improvement in surveys of employment intentions suggests that more job cuts are not imminent. Yet the relationship between intentions and employment itself has shown tentative signs of breaking down. (See Chart 5.) In our view, it is yet possible that unemployment reaches 3m. (See *Forecast Table: Labour Market*, page 37.)
- Meanwhile, the large amount of slack in the labour market suggests that pay growth should remain at very low rates. (See Chart 6.) Note that private sector pay growth is already negative. (See Chart 7.) And although public sector pay growth has been strong, public sector pay freezes are looming.
- Admittedly, pay growth should have picked up during the start of year bonus season, given that bonuses have not been cut as sharply as they were at the start of 2009. But the rise should have been short-lived.
- And although the recent rise in inflation could put upward pressure on pay growth, inflation expectations remain low. What's more, pay settlements failed to rise following the much sharper rise in inflation in 2008. (See Chart 8.)
- Overall, then, the combination of a jobless recovery and sluggish pay growth is set to weigh heavily on households' incomes.

Chart 1. Unemployment (000s)

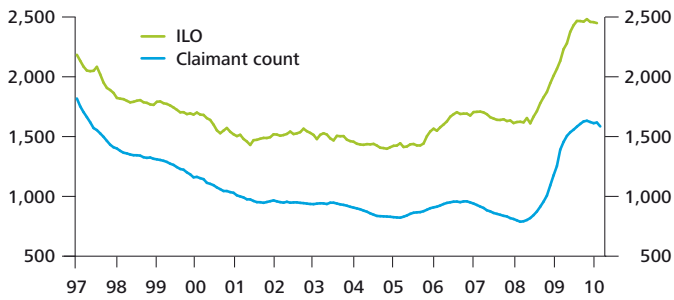


Chart 2. Breakdown of employment growth (000s, q/q)

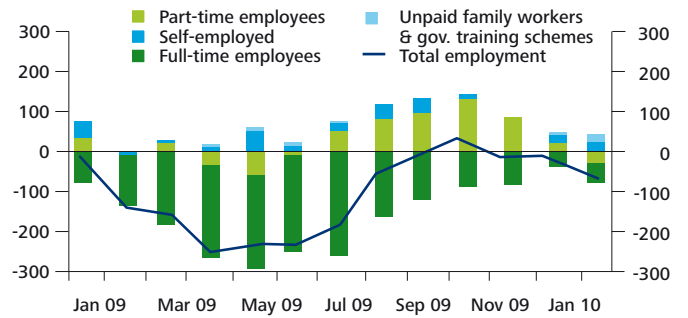


Chart 3. No. of people wanting a job (000s, 3m/3m)

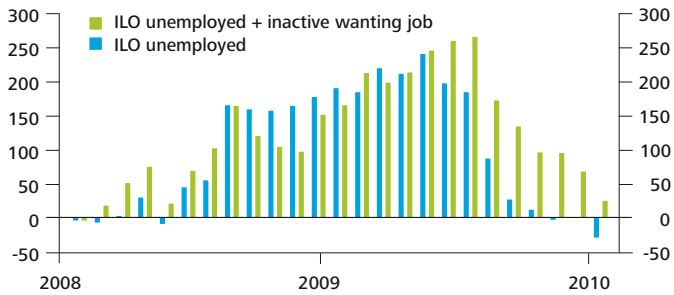


Chart 4. Company insolvencies & redundancies

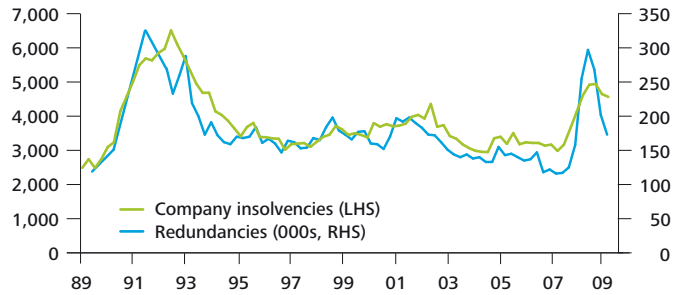


Chart 5. Employment & employment intentions

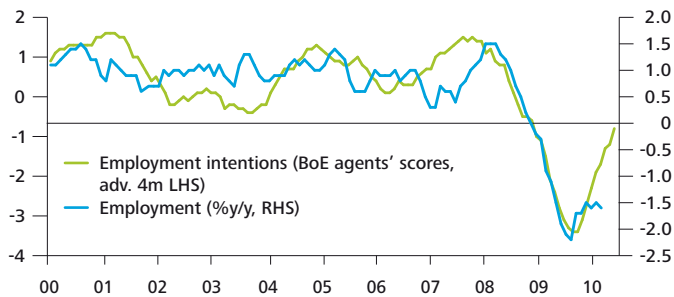


Chart 6. Average earnings & recruitment difficulties

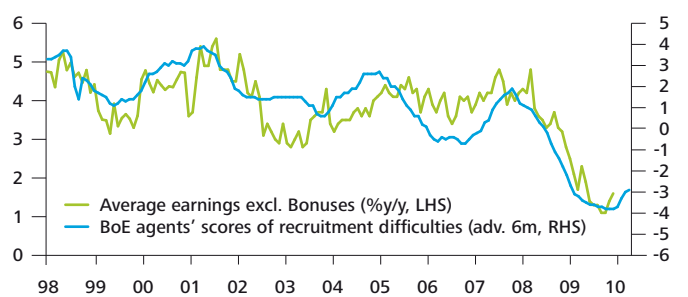


Chart 7. Average earnings (%/y)

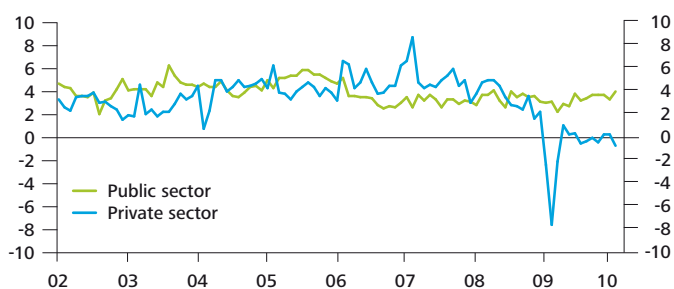
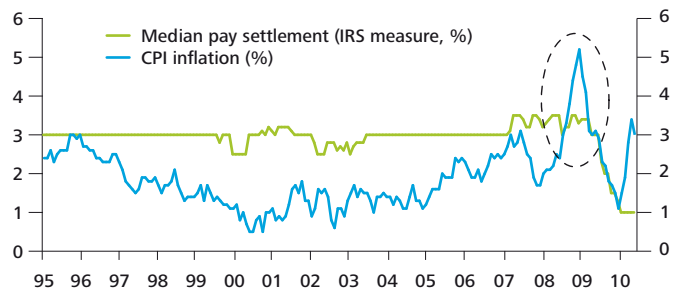


Chart 8. Median pay settlement & CPI inflation



Source – Thomson Datastream

Analysis: UK monetary policy

Further policy loosening yet possible

- With a major fiscal tightening almost upon us and inflation soon set to fall sharply, we continue to think that monetary policy will be kept loose for an exceptionally long period.
- In fact, the Monetary Policy Committee (MPC) has left the door open to a further policy *loosening*. February's Inflation Report showed that the Committee expects inflation to be below target in two years' time, even if interest rates stay at 0.5%. (See Chart 1.) Mervyn King emphasised that "it is far too soon to conclude that no more purchases will be needed."
- The Committee nonetheless left interest rates and its quantitative easing (QE) programme of asset purchases unchanged in February and March. However, this seemed to reflect the MPC's fear that the current above-target rate of inflation could boost inflation expectations. But these have so far remained low. (See Chart 2.) And inflation should now have peaked.
- The Committee also wants to wait and see how the impact of its past asset purchases pan out. It has been keen to stress that it is the stock, rather than flow, of purchases that matter most for the economy. Indeed, the monetary base remains almost three times as high as a year ago. (See Chart 3.) So far, however, the impact on *broad* money growth has been disappointing. (See Chart 4.)
- We therefore expect a further loosening of policy later this year. The MPC has indicated that this will initially take the form of more QE. Given the large amount of issuance due this year, the Committee could buy £50bn more gilts without raising its share of the outstanding stock. The MPC could also buy more corporate assets which have accounted for a tiny fraction of its purchases so far. (See Chart 5.)
- Alternatively the MPC could use other policy tools. After all, some members have expressed concern about how much use extra QE will be, while others are concerned that it will cause another asset price bubble. And if the economy heads for a double-dip, pressure will build for the MPC to take any action it can.
- One possibility is to cut Bank Rate further. Other central banks have cut official interest rates to below 0.5%, despite sharing the MPC's concerns about the adverse impact on money markets or banks' margins. (See Chart 6.)
- Alternatively, the Committee could cut the rate paid on banks' deposits with the central bank. At November's meeting, the MPC agreed that "it might be a useful policy too in the future."
- Even if the MPC shies away from loosening policy further, any *tightening* still looks a long way off. Markets have recently scaled back their expectations of how quickly interest rates will rise. But they still think that rates will rise in the second half of the year. (See Chart 7.)
- Yet this will be just when the fiscal squeeze is starting to take effect and inflation is starting to plummet. We still expect interest rates to remain close to their record lows during 2010 and probably 2011 too. Longer-term interest rates should therefore fall further. (See Chart 8 and *Forecast Table: Monetary*, page 38.)

Chart 1. MPC's CPI inflation forecast in Feb. infl. report (%)

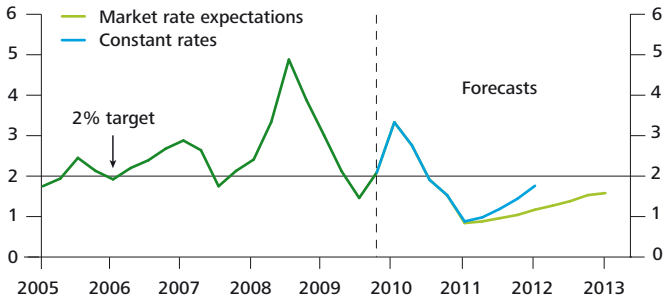


Chart 2. Households' inflation expectations (%)

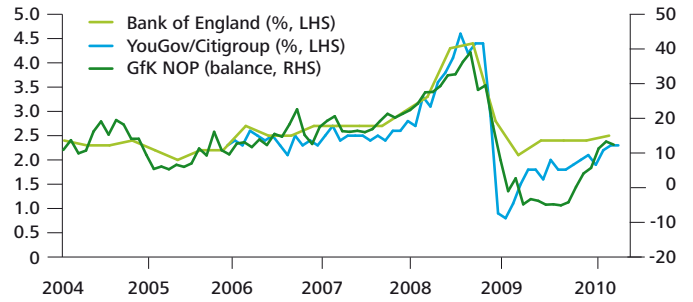


Chart 3. Monetary base & banks' reserves (£bn)

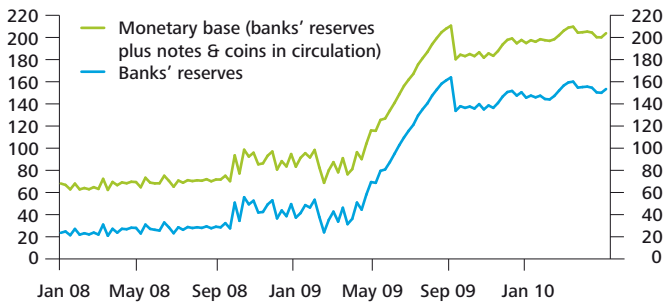


Chart 4. M4 excl. intermediate OFCs

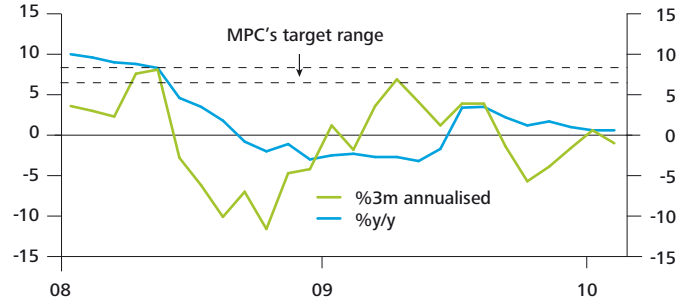


Chart 5. BoE asset purchases (£bn)

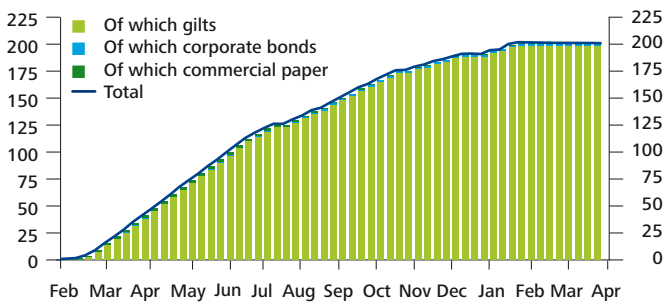


Chart 6. International official interest rates (%)

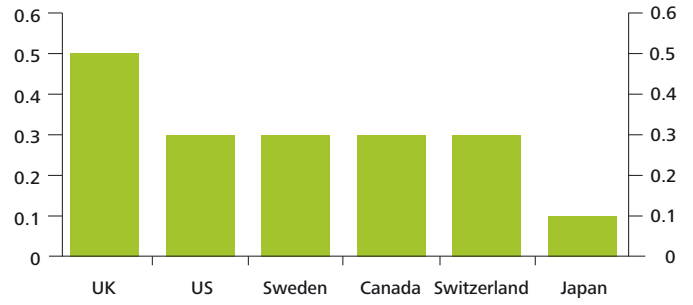


Chart 7. Interest rate expectations (%)

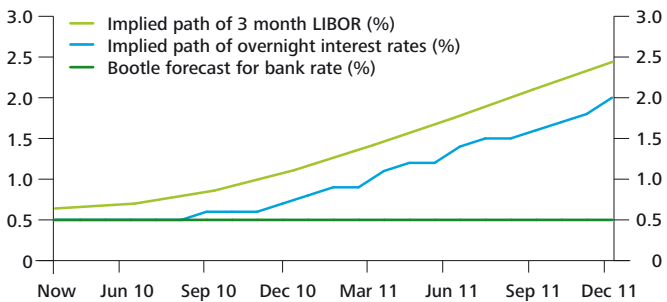
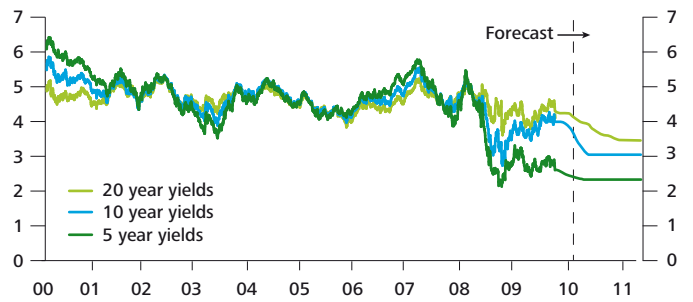


Chart 8. Bond yields (%)



Sources – Thomson Datastream, Bloomberg, Bank of England

Analysis: UK public finances

Painful fiscal squeeze ahead

- Whatever the outcome of the general election, a prolonged and painful fiscal squeeze lies ahead which will act as a major constraint on the growth of the economy.
- Alistair Darling resisted the pressure for a pre-election giveaway in March's Budget. Instead he used the proceeds from a recent pick-up in the growth of tax receipts, which he assumed will last into future years, to bring his projections for the future path of public borrowing down a touch. (See Charts 1 & 2.)
- But the changes did little to address the gaping hole in the public finances. After all, at almost 12% of GDP, the budget deficit is still very similar to that of Greece. (See Chart 3.) Meanwhile, the level of public sector net debt is expected to rise to close to 80% of GDP and not return to previous levels of around 40% for around a quarter of a century. (See Chart 4.)
- What's more, the Chancellor's plans to halve the budget deficit over the next four years continue to rest on some very optimistic assumptions for the economy. If our own rather weaker forecasts are correct, borrowing will fall much more modestly without a further fiscal tightening. (See Chart 5.)
- Admittedly, Mr Darling predicted that the *structural* (i.e. cyclically adjusted) budget deficit would fall from 8.4% of GDP to 2.5% of GDP by 2014-15, apparently answering calls from Mervyn King and others for the "bulk" of the deficit to be eliminated over the next parliament. (See Chart 6.)
- What's more, the current plans already incorporate a pretty aggressive squeeze on public expenditure over the coming few years. As Chart 7 shows, total spending is projected to be broadly flat in real terms from 2011 onwards – tough, but not unprecedented.
- But once unavoidable increases in areas like debt interest are accounted for, along with protected areas like health and education, some departments could see spending fall by up to 25% over four years – a bigger squeeze than seen under the Thatcher government.
- Despite this, it seems clear that further action is needed to put the public finances on a more concrete path back towards health. The timing and size of any additional fiscal tightening may depend in part on the outcome of the general election. The Conservative Party, supported by some economists, has argued for a faster pace of consolidation than the existing plans.
- But whatever the election outcome, the UK faces a long and painful period of fiscal consolidation which will act as a major constraint on the strength of the economic recovery over the coming years.
- Worries about the UK's sovereign credit rating and the prospective flood of supply over the next few years may continue to weigh on the gilt market over the coming months. (See Chart 8.) However, the emergence of more credible fiscal plans after the election should allow long-term interest rates to remain at low levels. (See Forecast Table: Public Finances, page 39.)

Chart 1. Tax receipts (%/y)

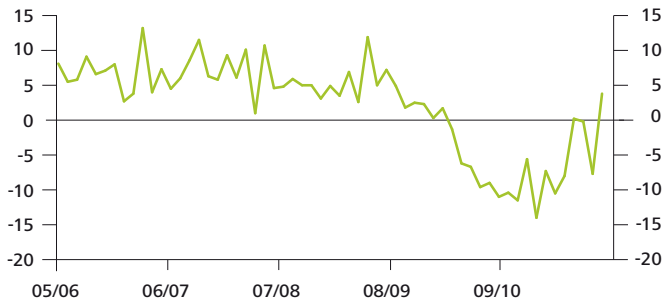


Chart 2. Public sector net borrowing (£bn)

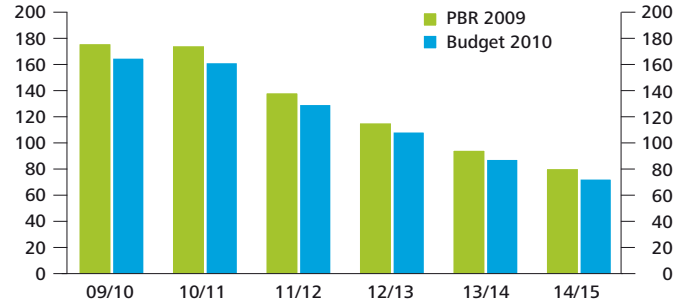


Chart 3. Public sector net borrowing (% of GDP)

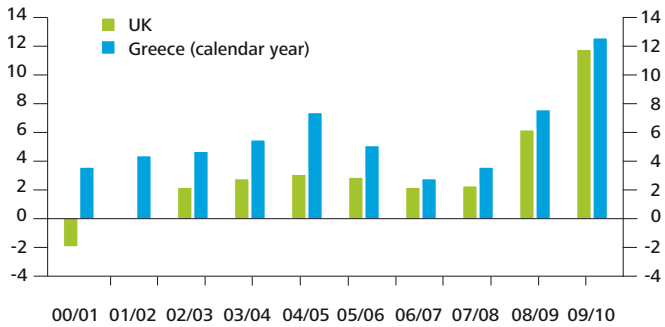


Chart 4. Public sector net debt (as % of GDP)

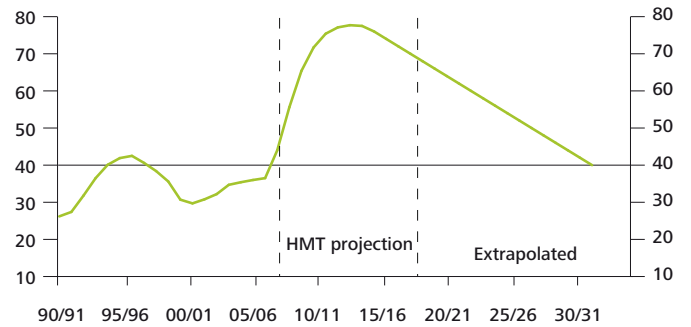


Chart 5. Public sector net borrowing (£bn)

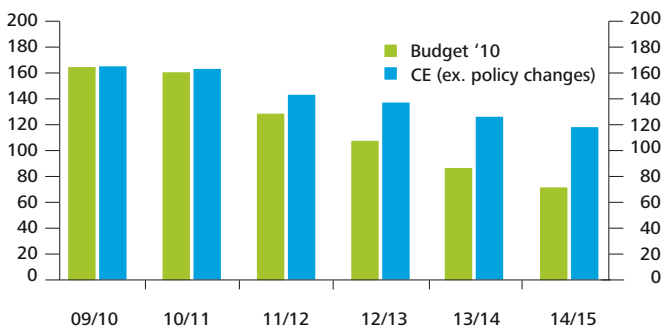


Chart 6. PSNB & cyclically adjusted PSNB (% of GDP)

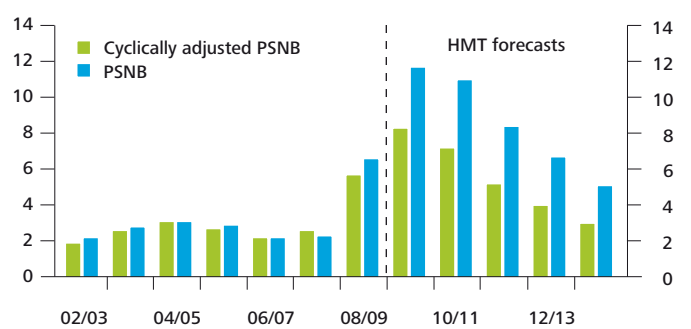


Chart 7. Real public spending (%/y)

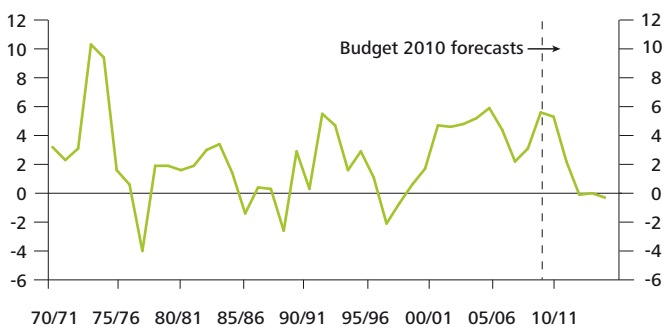
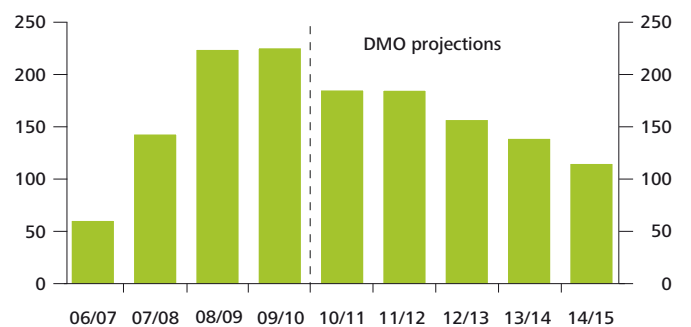


Chart 8. Gross gilt issuance (£bn)



Sources – Thomson Datastream, HM Treasury

Analysis: External sector

A slow rebalancing in prospect

- The weak pound should enable the UK economy to rebalance towards the external sector. But progress is likely to be very slow.
- There are three factors which should help the external sector to make a contribution to the UK's recovery. First, the pound looks set to stay weak, in part reflecting the UK's lacklustre recovery itself. For example, forecasts for growth differentials between the UK and the euro-zone support the current low exchange rate. (See Chart 1.)
- Second, the global economy has begun to recover, boosting demand for UK exports. Chart 2 shows that global trade volumes have now rebounded strongly. And third, UK consumers and firms are still highly indebted relative to their foreign counterparts. This may put a lid on any further recovery in imports. (See Chart 3.)
- The combination of the weak pound and the tentative global recovery has fostered hopes that the UK may experience another export-led recovery similar to that in the mid-1990s when these same conditions prevailed. (See Chart 4.)
- In this context, therefore, the external sector's recent performance is deeply concerning. The trade in goods and services deficit *widened* from £8.3bn to £8.7bn in Q4, while net trade continued to drag on the recovery in Q4. (See Chart 5.) And, despite the pound's weakness, UK exporters' share of world trade has fallen.
- Temporary factors – such as the car scrappage scheme – account for only a small part of the trade deficit's recent deterioration. The deterioration in the trade in cars balance has added only £0.4bn or so to the overall trade deficit. (See Chart 6.) So the scheme's end in March will have only a small positive effect.
- Moreover, structural weakness look set to constrain export demand. UK exports remain over-weight in financial services and oil – and the outlook for both appears weak. In addition, UK exporters have a high market share in economies which we expect to grow relatively slowly in the near future. And, because UK exporters tend to set prices in local currency rather than in sterling, the lower pound has largely boosted exporters' margins, rather than their volumes. (See Main Article, pages 2-11.)
- In light of all this, we have pencilled in only a modest narrowing of the trade deficit from £33bn in 2009 to around £25bn in 2011.
- The outlook for investment income, however, appears brighter. While the surplus can be volatile, a large surplus may be maintained. (See Chart 7.) The relative weakness of the UK's recovery should dampen the flow of income out of the UK. The weak pound may also boost the sterling value of income flowing from the UK's large stock of overseas assets.
- But overall, a slow rebalancing is likely to be the best the external sector can achieve. As a result, we have pencilled in a narrowing in the current account deficit from 1.3% of GDP in 2009 to around 0.5% in 2011. (See Chart 8 and *Forecast Table: External Sector*, page 40.)

Chart 1. €/\$ exchange rate & expected GDP differentials

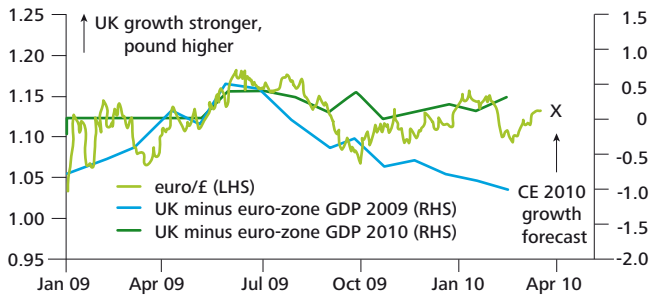


Chart 2: World trade volumes (%3m/3m ann.)

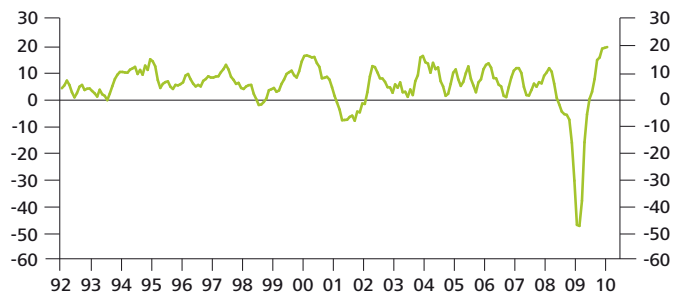


Chart 3. Domestic demand and imported goods vols (%/y)

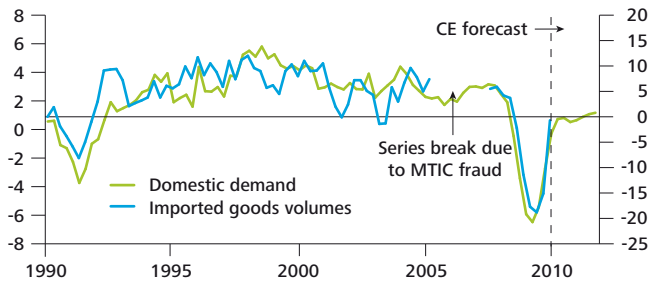


Chart 4. Sterling exchange rate and export volumes

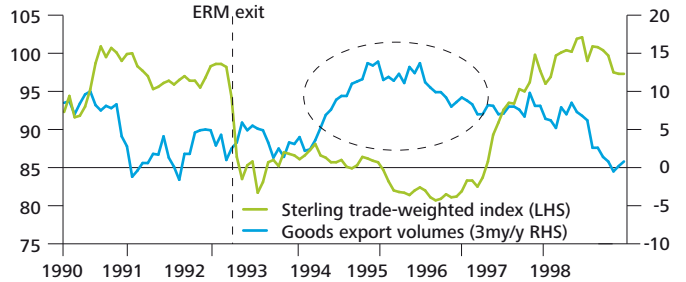


Chart 5. Net trade contrib. to quarterly GDP growth (%)

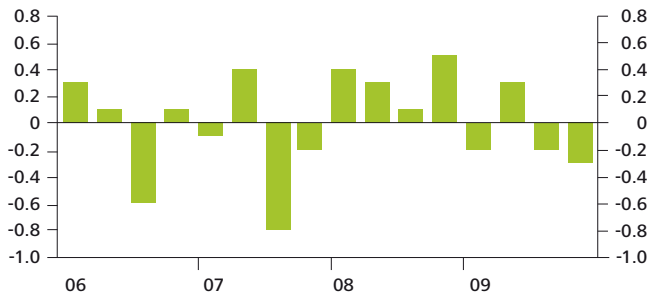


Chart 6. Trade in cars balance (£bn)

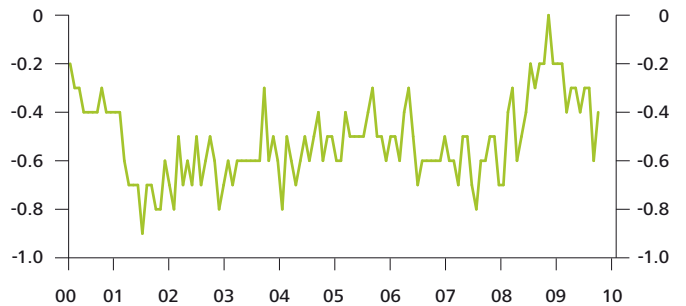


Chart 7. UK investment income balance

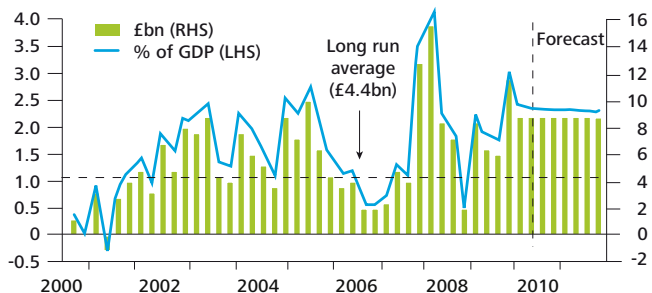
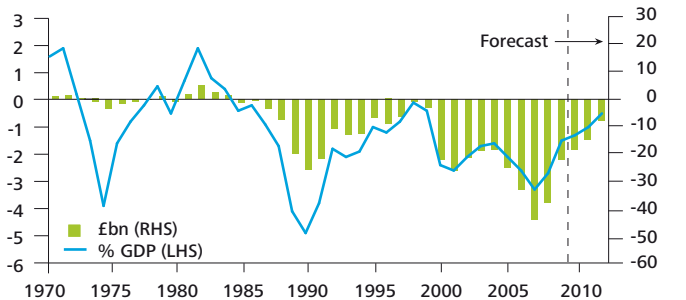


Chart 8. Current account balance



Source – Thomson Datastream

Forecast table: Inflation

	Monthly Effect on Index							Annual Rate				
	s.a. Core	Other Items					Total Change	Level of the CPI Index	All CPI	CPI Core ²	RPI ³	RPIX
		Rent	Alc & Tobac.	Energy	Seas Food ¹	Seas Eff.						
2009												
Jan	0.1			-0.1		-0.7	-0.7	108.7	3.0	1.3	0.1	2.4
Feb	0.6			0.1	0.2	0.0	0.8	109.6	3.1	1.6		2.5
Mar	0.2			-0.1		0.2	0.2	109.8	2.9	1.7	-0.4	2.2
Apr	0.2					0.1	0.3	110.1	2.3	1.5	-1.2	1.7
May	0.3				0.1	0.1	0.5	110.7	2.2	1.6	-1.1	1.6
Jun	0.3			0.1			0.3	111.0	1.8	1.6	-1.6	1.0
Jul	0.2				0.0	-0.3	-0.1	110.9	1.7	1.8	-1.4	1.2
Aug	0.3					0.3	0.5	111.4	1.5	1.8	-1.3	1.4
Sep	0.1			0.1	-0.1		0.1	111.5	1.1	1.7	-1.4	1.3
Oct					0.1		0.2	111.7	1.5	1.8	-0.8	1.9
Nov	0.1			0.1	0.1		0.3	112.0	1.9	1.9	0.3	2.7
Dec	-0.1			0.0	0.1	0.5	0.5	112.6	2.8	2.8	2.4	3.8
2010												
Jan	0.4			0.1	0.0	-0.7	-0.2	112.4	3.4	3.1	3.7	4.6
Feb	0.4			0.0	0.1	0.1	0.4	112.9	3.0	2.9	3.7	4.2
Mar	0.3			0.0		0.2	0.4	113.3	3.2	3.1	4.3	4.4
Apr	0.1					0.1	0.4	113.7	3.3	3.1	4.8	4.6
May						0.2	0.2	114.0	2.9	2.9	4.5	4.3
Jun								114.0	2.7	2.7	4.1	4.1
Jul						-0.2	-0.2	113.7	2.6	2.5	3.6	3.8
Aug	0.1					0.3	0.3	114.1	2.4	2.3	3.8	3.7
Sep							0.1	114.2	2.4	2.3	3.8	3.7
Oct	-0.2							114.2	2.3	2.2	3.7	3.5
Nov	-0.2						-0.1	114.1	1.9	1.9	3.3	3.1
Dec	-0.1					0.3	0.2	114.3	1.6	1.6	3.0	2.8
2011												
Jan	-0.1					-0.7	-0.6	113.7	1.1	1.2	2.6	2.4
Feb						0.1	0.1	113.8	0.8	0.9	2.4	2.1
Mar	-0.1					0.2	0.2	114.0	0.6	0.5	2.2	1.9
Apr	-0.1					0.1	0.2	114.2	0.4	0.3	2.0	1.8
May	-0.2					0.2	0.1	114.3	0.3	0.1	1.9	1.7
Jun	-0.2					0.0	-0.1	114.1	0.2	0.0	1.8	1.5
Jul	-0.2					-0.2	-0.3	113.8	0.0	-0.2	1.7	1.4
Aug	-0.1					0.3	0.2	114.0	-0.1	-0.4	1.6	1.3
Sep	-0.1							114.0	-0.2	-0.4	1.5	1.3
Oct	-0.1						0.1	114.1	-0.1	-0.3	1.6	1.3
Nov	-0.1						-0.1	114.1	0.0	-0.2	1.7	1.4
Dec	-0.1					0.3	0.2	114.4	0.0	-0.2	1.7	1.4

1 Fresh fruit and vegetables, fresh fish, eggs and home-killed lamb.

2 Excludes energy, food, alcohol & tobacco.

3 Assumes repo rate remains at 0.5% throughout forecast period.

Forecast table: Labour market

Activity	Workforce		ILO/Labour Force Survey Employment		ILO Unemployment		Claimant Count Unemployment	
	Millions	%y/y	Millions	%y/y	Millions	%	Millions	%
	2008	31.2	1.1	29.5	0.9	1.7	5.6	0.9
2009f	31.4	0.6	29.0	-1.6	2.4	7.6	1.5	4.9
2010f	31.3	-0.3	28.5	-1.7	2.8	9.1	1.9	6.0
2011f	31.2	-0.2	28.2	-1.0	3.1	9.8	2.1	6.6
Q1 2009	31.4	1.0	29.2	-0.8	2.1	6.8	1.4	4.4
Q2	31.4	0.6	29.0	-1.8	2.4	7.5	1.5	4.9
Q3	31.4	0.5	28.9	-1.9	2.5	7.9	1.6	5.1
Q4	31.4	0.3	28.9	-1.5	2.5	7.9	1.6	5.2
Q1 2010	31.3	-0.2	28.8	-1.5	2.5	8.0	1.6	5.2
Q2	31.3	0.0	28.5	-1.4	2.8	8.8	1.8	5.9
Q3	31.3	0.0	28.4	-1.9	2.9	9.4	2.0	6.3
Q4	31.3	0.0	28.2	-2.4	3.1	9.8	2.1	6.7
Q1 2011	31.3	-0.1	28.2	-2.0	3.1	9.8	2.1	6.7
Q2	31.2	-0.1	28.2	-1.2	3.0	9.8	2.1	6.6
Q3	31.2	0.0	28.2	-0.6	3.0	9.8	2.1	6.6
Q4	31.2	0.0	28.2	-0.1	3.0	9.8	2.1	6.6

Earnings & costs	Average earnings		Real av. earnings (Incl. bonuses, %y/y)		Productivity	Unit labour costs
	Incl. bonuses	Excl. bonuses	Deflated by RPI	Deflated by CPI		
	%y/y	%y/y	inflation	inflation		
2008	3.5	3.8	-0.5	-0.1	-0.3	3.1
2009f	0.0	1.7	0.5	-2.2	-3.1	4.0
2010f	0.7	0.5	-3.2	-1.9	2.8	-2.1
2011f	-0.2	-0.5	-2.1	-0.5	2.5	-2.6
Q1 2009	-2.6	2.5	-2.5	-5.6	-4.2	4.3
Q2	1.1	2.0	2.4	-1.0	-3.5	5.2
Q3	0.7	1.3	2.1	-0.8	-3.3	4.2
Q4	0.7	1.2	0.0	-1.4	-1.5	2.2
Q1 2010	3.3	1.5	-0.6	0.1	1.3	1.9
Q2	0.4	0.8	-4.0	-2.6	2.2	-1.8
Q3	-0.1	0.4	-3.9	-2.6	3.6	-3.6
Q4	-0.8	-0.7	-4.1	-2.7	4.1	-4.7
Q1 2011	-0.4	-1.5	-2.8	-1.2	3.7	-4.0
Q2	-1.1	-1.1	-3.0	-1.3	2.9	-3.8
Q3	-0.3	-0.3	-1.9	-0.2	2.0	-2.3
Q4	0.9	0.9	-0.8	0.9	1.3	-0.5

Forecast table: Monetary

Interest rates & bond yields (end period)							
	Repo rate	10-year gilts	20-year gilts	US Fed Funds rate		Euro-zone Refi rate	
	%	%	%	%	UK-US	%	UK-Euro-zone
2008	2.00	3.1	4.0	0.25	1.8	2.50	-0.5
2009f	0.50	4.1	4.4	0.25	0.3	1.00	-0.5
2010f	0.50	3.0	3.8	0.25	0.3	1.00	-0.5
2011f	0.50	3.0	3.5	0.25	0.3	1.00	-0.5
Q1 2009	0.50	3.0	3.9	0.25	0.3	1.50	-1.0
Q2	0.50	3.7	4.2	0.25	0.3	1.00	-0.5
Q3	0.50	3.6	3.9	0.25	0.3	1.00	-0.5
Q4	0.50	4.1	4.4	0.25	0.3	1.00	-0.5
Q1 2010	0.50	4.3	4.6	0.25	0.3	1.00	-0.5
Q2	0.50	4.0	4.5	0.25	0.3	1.00	-0.5
Q3	0.50	3.5	4.2	0.25	0.3	1.00	-0.5
Q4	0.50	3.0	3.8	0.25	0.3	1.00	-0.5
Q1 2011	0.50	3.0	3.7	0.25	0.3	1.00	-0.5
Q2	0.50	3.0	3.5	0.25	0.3	1.00	-0.5
Q3	0.50	3.0	3.5	0.25	0.3	1.00	-0.5
Q4	0.50	3.0	3.5	0.25	0.3	1.00	-0.5

Sterling exchange rates (end period)					
Sterling versus...	\$	¥	Euro	Euro ¹	ERI ²
2008	1.46	132	0.97	1.03	74.0
2009f	1.62	147	0.89	1.13	80.5
2010f	1.50	150	0.80	1.25	84.0
2011f	1.50	165	0.73	1.36	88.9
Q1 2009	1.43	140	0.93	1.08	76.6
Q2	1.65	160	0.85	1.17	84.1
Q3	1.60	144	0.91	1.09	78.9
Q4	1.62	147	0.89	1.13	80.5
Q1 2010	1.50	135	0.90	1.11	77.9
Q2	1.45	131	0.86	1.16	79.3
Q3	1.50	143	0.80	1.25	84.0
Q4	1.50	150	0.80	1.25	84.0
Q1 2011	1.50	158	0.80	1.25	84.0
Q2	1.50	165	0.77	1.30	86.4
Q3	1.50	165	0.77	1.30	86.4
Q4	1.50	165	0.73	1.36	88.9

1 Pound per euro. 2 Effective exchange rate index.

Forecast table: Public finances¹

Government spending & receipts (£bn)							
	(1) Current receipts (excluding tax changes)	(2) Revenue effect of tax changes	(3) Current receipts (including tax changes)	(4) Current spending ²	(5) Current balance	(6) Net investment	(7) = (4) + (6) Total expenditure
Recent history							
05-06	487	n/a	487	501	-14	23	524
06-07	520	n/a	520	524	-4	26	550
07-08	548	n/a	548	553	-5	29	583
08-09	534	n/a	534	582	-49	47	630
HM Treasury forecast							
09-10	508	n/a	508	624	-117	50	674
10-11	541	n/a	541	664	-123	40	704
11-12	582	n/a	582	683	-101	29	712
12-13	621	n/a	621	704	-83	26	730
13-14	660	n/a	660	726	-66	22	748
Capital Economics forecast							
09-10	507	0	507	624	-117	50	674
10-11	539	5	544	664	-120	45	709
11-12	568	10	578	678	-101	29	707
12-13	596	15	611	701	-90	20	721
13-14	627	15	642	722	-80	20	742

Government borrowing & debt							
	PSNB		Public sector net cash requirement (PSNCR) £bn	General government gross debt % GDP ³	Public sector net debt % GDP	Gross gilt sales £bn	
	£bn	% GDP					
Recent history							
05-06	36.8	3.0	33.4	43.7	35.4		52.3
06-07	30.0	2.3	35.4	43.3	36.0		62.5
07-08	34.7	2.4	34.7	43.2	36.5		58.4
08-09	96.1	6.7	96.1	55.5	44.0		147.0
HM Treasury forecast							
09-10	167	11.8	144	72.9	55.6		228
10-11	163	11.1	164	82.1	65.4		185
11-12	131	8.5	131	88.0	71.7		187
12-13	110	6.8	110	90.9	75.4		159
13-14	89	5.2	89	91.6	77.1		141
Capital Economics forecast							
09-10	167	11.9	169	73.2	55.9		228
10-11	165	11.3	167	82.1	65.4		230
11-12	130	8.7	132	88.7	72.4		200
12-13	110	7.0	112	91.6	76.1		140
13-14	100	6.0	102	92.8	78.3		110

1 Some figures in this table may not add due to rounding. 2 Includes depreciation. 3 Maastricht definition.

Forecast table: External sector

Current account										
	Goods		Services		Investment income		Current transfers		Current account	
	£bn	% of GDP	£bn	% of GDP	£bn	% of GDP	£bn	% of GDP	£bn	% of GDP
2008	-93.4	-6.4	55.1	3.8	30.3	2.1	-14.0	-1.0	-22.0	-1.5
2009f	-81.8	-5.9	49.3	3.5	28.7	2.0	-14.6	-1.0	-18.4	-1.3
2010f	-85.6	-5.9	52.8	3.6	32.0	2.2	-14.0	-1.0	-14.8	-1.0
2011f	-83.3	-5.6	57.5	3.9	32.0	2.2	-14.0	-0.9	-7.8	-0.5
Q1 2009	-21.1	-6.0	13.2	3.8	7.5	2.1	-3.8	-1.1	-4.3	-1.2
Q2	-19.8	-5.7	11.7	3.4	5.6	1.6	-4.0	-1.2	-6.8	-2.0
Q3	-19.8	-5.7	12.1	3.5	5.3	1.5	-3.5	-1.0	-6.5	-1.9
Q4	-21.0	-6.0	12.4	3.5	10.3	2.9	-3.3	-0.9	-1.7	-0.5
Q1 2010	-22.5	-6.3	12.8	3.6	8.0	2.2	-3.5	-1.0	-5.2	-1.5
Q2	-21.3	-6.0	13.1	3.6	8.0	2.2	-3.5	-1.0	-3.8	-1.1
Q3	-21.0	-5.8	13.4	3.7	8.0	2.2	-3.5	-1.0	-3.2	-0.9
Q4	-20.8	-5.7	13.7	3.7	8.0	2.2	-3.5	-1.0	-2.6	-0.7
Q1 2011	-20.7	-5.6	14.0	3.8	8.0	2.2	-3.5	-0.9	-2.2	-0.6
Q2	-20.8	-5.7	14.3	3.9	8.0	2.2	-3.5	-1.0	-2.0	-0.6
Q3	-20.9	-5.6	14.5	3.9	8.0	2.2	-3.5	-0.9	-1.9	-0.5
Q4	-20.9	-5.6	14.8	3.9	8.0	2.1	-3.5	-0.9	-1.7	-0.5

Exports, imports & prices (£bn)								
	Goods		Services		Goods & services		Prices ¹	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports %y/y	Imports %y/y
2008	251.6	345.0	170.8	115.6	422.4	460.6	10.8	9.8
2009f	227.7	309.5	161.2	111.9	388.8	421.3	6.4	6.1
2010f	249.0	334.6	160.7	107.9	409.7	442.5	2.0	2.5
2011f	259.2	342.5	166.7	109.1	425.8	451.6	3.0	2.5
Q1 2009	55.8	76.9	42.2	29.1	98.0	105.9	12.8	13.0
Q2	54.7	74.5	39.9	28.2	94.5	102.7	6.4	7.4
Q3	56.4	76.2	39.2	27.1	95.6	103.3	4.2	3.9
Q4	60.8	81.8	39.9	27.5	100.7	109.3	2.6	0.8
Q1 2010	60.4	82.9	39.5	26.8	100.0	109.7	-1.3	-1.4
Q2	62.2	83.5	40.0	26.9	102.1	110.4	2.0	2.3
Q3	62.9	83.9	40.4	27.0	103.2	110.9	4.0	5.1
Q4	63.5	84.3	40.8	27.2	104.3	111.4	3.4	4.2
Q1 2011	64.1	84.8	41.2	27.2	105.3	112.0	4.5	3.9
Q2	64.5	85.3	41.5	27.3	106.1	112.6	3.5	2.7
Q3	65.0	85.9	41.8	27.3	106.9	113.2	2.5	1.9
Q4	65.5	86.5	42.1	27.4	107.7	113.8	1.6	1.5

¹ Excludes prices of oil and other erratic items.

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