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# Economic Review

## Feeling the pinch



# Foreword

## John Connolly



**John Connolly**  
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In this Review, Roger Bootle, Economic Adviser to Deloitte, turns his attention to the intense squeeze on consumers and their incomes. He thinks that the situation will get worse before it gets better. But better times do lie further ahead. And the big picture that we must not lose sight of is that consumers are still far better off than a decade ago.

Nominal pay growth is unlikely to catch up with inflation any time soon. So real earnings are likely to fall further this year. What's more, consumers face further tax rises and benefit cuts. And the labour market outlook is pretty shaky too.

Roger thinks that other commentators are wrong to expect households to run down their saving to fully offset the falls in their incomes. He expects consumer spending to fall in real terms both this year and next.

But by the middle of next year, Roger thinks that inflation will have fallen back below pay growth – allowing real incomes to start rising again. And consumers might be enjoying tax *cuts* towards the end of this Parliament. So while consumers have another tough year or two to get through first, there is light at the end of the tunnel.

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 written in a cursive, flowing style with a large loop at the end.

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# Contents

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Executive summary	2
Feeling the pinch – The squeeze on the consumer sector	3
Historical data table	12
Macro forecast table	13
Analysis: The world economy	14
Analysis: UK output and activity	20
Analysis: UK inflation	24
Analysis: UK labour market	28
Analysis: UK monetary policy	30
Analysis: UK public finances	32
Analysis: UK external sector	34
Forecast table: UK inflation	36
Forecast table: UK labour market	37
Forecast table: UK monetary	38
Forecast table: UK public finances	39
Forecast table: UK external sector	40

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# Executive summary

## Roger Bootle



**Roger Bootle**  
Economic Adviser to Deloitte

- **Households are already suffering the biggest squeeze on their incomes in decades. But the worst may be yet to come.**
- **For a start, pay growth is unlikely to catch up with inflation any time soon.** Inflation is heading towards – and possibly above – 5%. And while pay settlements have begun to increase, I doubt that they will rise much further when unemployment is still high and the public sector faces a pay freeze.
- I expect real earnings to fall by about 1.5% this year. **This will mark the fourth successive year of falling real earnings – the first time that this has occurred since the 1870s.**
- An additional reason to be pessimistic about the outlook for household incomes is the deepening fiscal squeeze.
- **Admittedly, there have been some not insignificant tax giveaways, including the rise in the personal tax allowance.** However, the net effect of this year's direct tax changes will still be to *reduce* household incomes. And it gets worse next year, when the Office for Budget Responsibility (OBR) expects receipts from income tax and national insurance contributions to rise by some 8% – compared to total earnings growth of just 3%.
- **Lastly, the labour market outlook provides further cause for concern.** I still doubt that the private sector can compensate for the cuts in public sector employment – which is already falling by 100,000 a year.
- The upshot is that I expect households' disposable incomes to fall by 2% this year in real terms – equivalent to about £780 per household. **And it will take until 2015 or so for incomes to get back to their peak in 2009.**
- Some forecasters – such as the OBR – are optimistic about the ability of households to run down their saving to support their spending. But the saving rate is historically low and, in the medium-term at least, needs to rise.
- I have been warning for some time of the difficult period that households were about to face and so already expected consumer spending to fall. **But given the additional pressure from the further rise in inflation, I have revised my forecast for this year's fall in spending from 0.5% to 1%. I now expect spending to fall further in 2012, by 0.5% or so.**
- Of course, not all households will be affected equally. Attention has focused on the "squeezed middle," but I am not convinced that middle income households will be any worse affected than the poorest or richest households. **The big picture is that pretty much all households face a further squeeze over the next year or two.**
- **At least more favourable conditions lie further ahead.** I think that inflation could be well below target by the end of 2012, allowing real incomes to start rising again. And by the end of this Parliament, taxes could be falling rather than rising. But for those households struggling to make ends meet, that may still seem an age away.

# Feeling the pinch

## The squeeze on the consumer sector

Many of us will know at first hand the severity of the squeeze on households' incomes. Indeed, Bank of England Governor Mervyn King has gone so far as to suggest it is the biggest squeeze on real pay since the 1920s. But is it really that bad? How much worse will it get? And are all households affected equally or is the so-called "squeezed middle" bearing the brunt?

In this article, I take a closer look at the outlook for households' incomes and finances, and discuss what bearing this has on the outlook for consumer spending. Can consumers start to look forward to better times? Or is the worst yet to come?

### Back to 2005

It is easier to list what has *not* been weighing on households' spending power than what has. Unchanged record low interest rates are about the only thing in households' favour (and of course even that is bad news for savers). Against that, households have been suffering from rising food and energy prices, weak pay growth, stagnant employment, the VAT increase and other fiscal tightening measures.

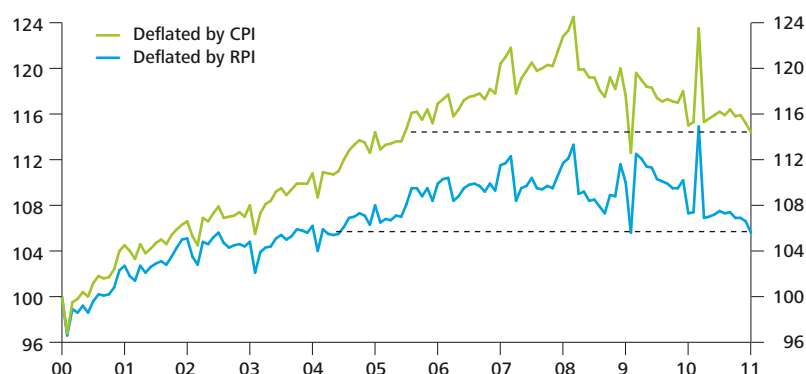
Causing particular damage at the moment is the widening gap between inflation and households' nominal pay growth. In a speech earlier this year, Governor Mervyn King said that rising inflation – driven by higher import prices, energy prices and VAT – has squeezed real pay by around 12% compared to the growth that would have "normally" been seen. **As a result, real earnings will be no higher this year than they were in 2005** – as I have illustrated in Chart 1. In fact, using the RPI, rather than CPI, measure of inflation, real earnings are no higher than they were in 2004.

Admittedly, average real earnings are arguably a rather narrow measure of households' spending power. A more comprehensive measure is households' real disposable income. Not only does this incorporate the impact of direct taxes, but by covering the household sector as a whole, it also measures the incomes of those people not in work. And it paints a slightly better picture than looking at real earnings alone (in part because employment has risen by 2% since 2005). **Nonetheless, even on this measure, real incomes are back to their 2008 level, having fallen last year for the first time since 1981.** (See Chart 2.)

### Where do we go from here?

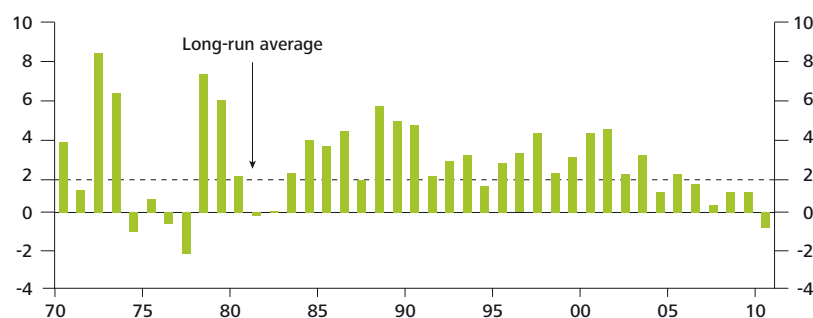
And unfortunately, the situation is likely to get worse before it gets better. I see three causes for concern – a further squeeze on real pay; the effects of further tax rises and benefit cuts; and the fairly gloomy outlook for the labour market.

Chart 1. Real average earnings (Index, 2000 = 100)



Sources – Thomson Datastream, Bootle Forecasts

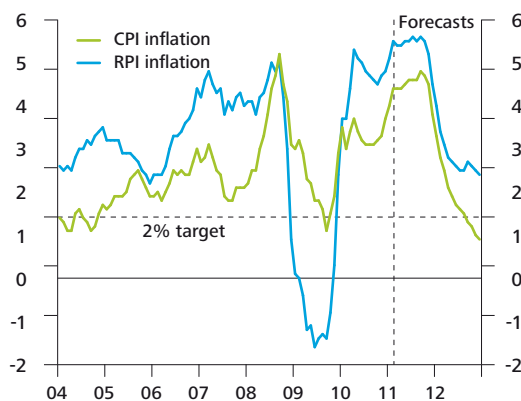
Chart 2. Households' real disposable income (%y/y)



Source – Thomson Datastream

Starting with real earnings, I think that a further fall is likely this year. Inflation is now more than twice its 2% target and is likely to remain above 4% for the rest of the year. (See Chart 3.) If oil prices keep rising, inflation could even pick up further, with the Monetary Policy Committee (MPC) now warning of a rise to above 5%. Only in 2012 do I think inflation will fall sharply.

**Chart 3. Inflation (%)**

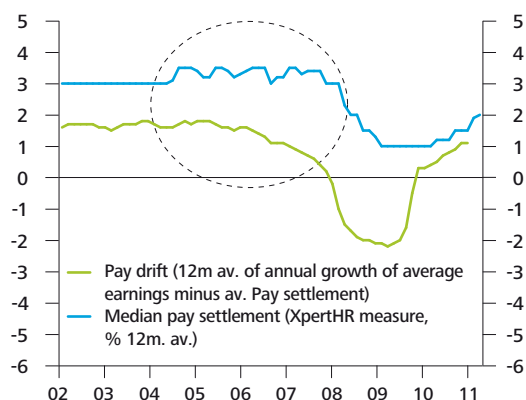


Sources – Thomson Datastream, Bootle Forecasts

Meanwhile, I think that there is little hope of nominal pay growth accelerating to “catch up” with inflation when unemployment is still so high. Note that pay growth remained subdued when inflation rose in 2007/8, even though the labour market was much healthier then.

Admittedly, the pick-up in pay settlements has been moderately encouraging (albeit not from an inflationary point of view). (See the black line in Chart 4.) But higher settlements seem largely restricted to those which are part of multi-year agreements and automatically linked to RPI inflation. What’s more, we are yet to see the public sector settlements that are concentrated later in the year – and which will be close to zero.

**Chart 4. Pay drift & pay settlements**

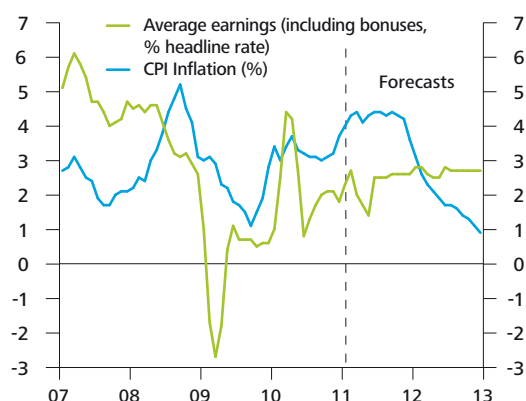


Sources – Thomson Datastream, XpertHR

Meanwhile, firms might only allow settlements to rise by squeezing the other components of pay growth – namely merit and promotion based pay rises and bonuses. In other words, the gap between settlements and earnings growth – so-called “pay drift” – could contract, as it seemed to do when settlements rose in 2007/8. (See Chart 4 again.)

Given this combination of sluggish pay growth and high (and possibly rising) inflation, I expect average earnings after CPI inflation to fall by between 1.5% and 2% this year. This will take the total drop in real earnings between 2008 and 2011 to over 5%. And I doubt that the gap between inflation and pay growth will narrow until well into next year. (See Chart 5.)

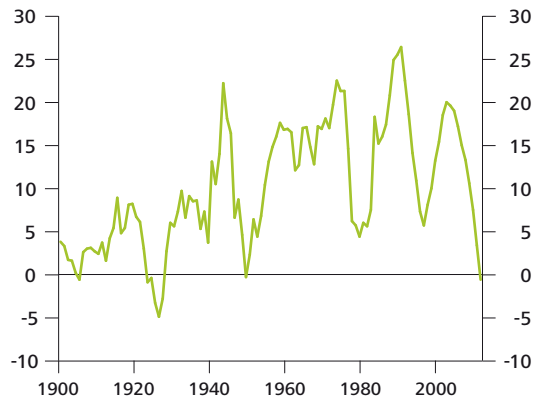
**Chart 5. Inflation & average earnings growth**



Source – Thomson Datastream

Indeed, Mervyn King has pointed out that this will be the first time since the 1920s that real earnings have fallen over a six year period. I have illustrated this in Chart 6, using long-run data on average earnings and consumer price inflation compiled by the Bank of England. On this data, there also appears to have been a period in the 1970s when real earnings fell a touch over a six year period. **But the big picture is that this is the sharpest squeeze on real pay in several decades.**

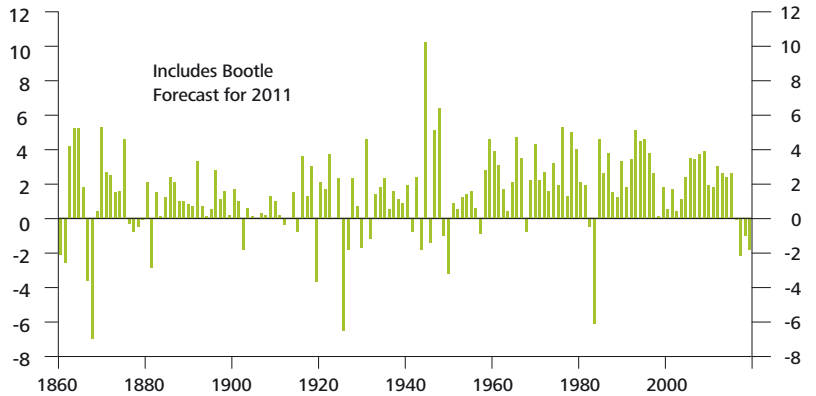
**Chart 6. % change in real av. earnings (using CPI) over rolling 6 year period**



Sources – Bank of England, Bootle Forecasts, Thomson Datastream

At least in the 1920s the squeeze on household incomes was not quite as relentless as it is now – with a year of falling real pay often offset by a year of rising pay (although obviously this might simply reflect the volatility of such historic data). **In contrast, this year will mark the fourth successive year of falling real earnings – the first time this has occurred since the 1870s.** (See Chart 7.)

**Chart 7. Real average earnings (%/y)**



Sources – Bank of England, Thomson Datastream, Bootle Forecasts

**Some tax cuts ... but some tax rises**

So a recovery in real pay is still some way off. What's more, as the fiscal squeeze continues to bite, the squeeze from higher taxes is set to deepen.

**Admittedly, there have been some not insignificant tax giveaways** – most notably the rise in the personal income tax allowance from £6,475 to £7,475. Even accounting for the accompanying reduction in the basic rate limit (to ensure that only lower rate taxpayers benefit from the move), households will receive a sizeable £3.3bn boost, equivalent to 0.3% of annual incomes.

However, this will be broadly offset by a 1% rise in employees' and self-employed national insurance contributions (NICs). This will knock £3.2bn off household incomes, even once the rise in the primary threshold (designed to cushion lower-income households from the move) is taken into account.

**Table 1. Main direct tax measures facing households in 2011/12**

Measure	Benefit (+)/Cost(-) in 2011/12	As % of incomes
Rise in income tax allowance	+£3.3bn	0.3
Change in tax credits	-£0.3bn	-0.03
Restriction of pension tax relief	-£1.2bn	-0.1
Rise in employee and self-employed NICs rates	-£4.5bn	-0.5
Rise in NICs threshold	+£1.3bn	0.1
<b>Total</b>	<b>-£1.4bn</b>	<b>-0.1</b>

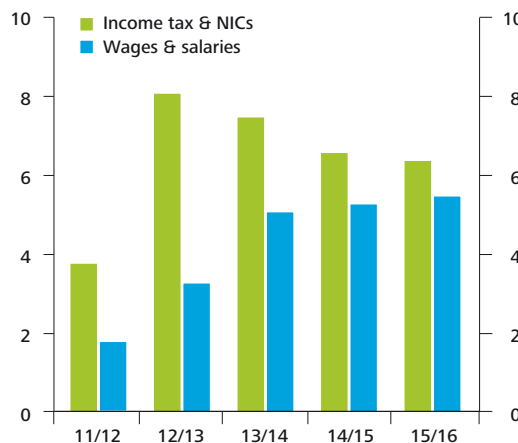
Sources – HM Treasury, Bootle Forecasts

And once other measures – such as the restriction of pension tax relief – are accounted for, the net effect of the main changes in direct taxes this fiscal year should be to reduce household incomes. (See Table 1.)

Chart 8 shows the Office for Budget Responsibility's (OBR's) estimate of total receipts from income taxes, tax credits and NICs (which includes both employees' and employers' contributions). This is set to rise by 4% this year, outpacing the sub-2% rise in total earnings.

**What's more, things are likely to get worse next year.** The OBR expects revenues from these taxes to rise by some 8% in 2012/13. Admittedly, the recent Budget announced a further rise in the personal tax allowance in 2012/13 (giving households another £1bn or so).

**Chart 8. Tax revenues & earnings (%y/y)**



Source – OBR

But also coming in that year is the freeze of the higher rate threshold (costing households £0.6bn), further restrictions on pensions tax relief (costing another £1.1bn) and the removal of various tax credits.

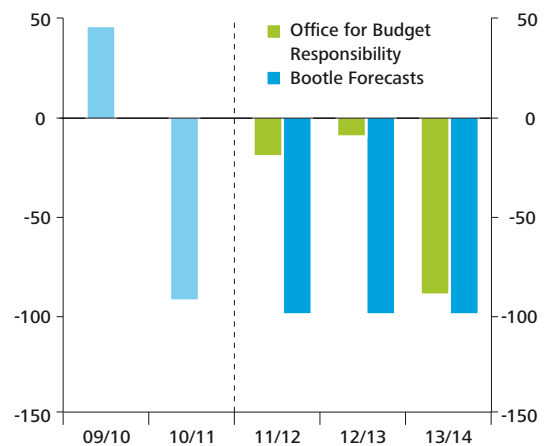
Meanwhile, benefits are being cut too. The single most important measure this fiscal year is the indexation of benefits to CPI, rather than the usually higher RPI, which will cost households about £1.5bn a year. But benefit recipients will also suffer from measures such as a reduction in housing benefit and the freezing of child benefit.

**Other measures**

The final reason to think things might yet get worse for households is the gloomy outlook for the labour market. **Not only will households be taking home lower real pay this year than last, but I think that fewer people will be working in the first place.**

For a start, public sector job cuts obviously loom. Admittedly, the OBR expect just 20,000 cuts in 2011/12. But this seems oddly optimistic when the public sector has already shed 100,000 jobs over the past year – even before the public spending cuts have really got going. Indeed, I expect the recent pace of contraction to continue for most of the current Parliament. (See Chart 9.)

**Chart 9. General gov. employment (000, y/y)**



Sources – Thomson Datastream, Bootle Forecasts, OBR

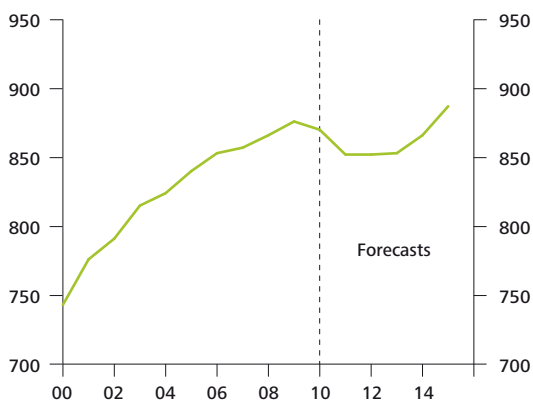
The private sector might be able to offset *some* of these losses. The employment surveys point to positive growth of the private sector workforce, in the near-term at least. But I doubt that firms will want to hire many more people when the health of the recovery is in so much doubt. Indeed, I still think that further job cuts in the private sector are possible and expect overall unemployment to keep rising for most of this Parliament.

**Real disposable income**

So where does all this leave us? **I think that households’ real disposable income will fall by 2% this year – the biggest drop since records began in 1955.** That equates to a drop of £780 per household in the UK.

And I expect real income to do little better than stagnate in 2012. **Indeed, even pencilling in a reasonable recovery in income growth from 2013 onwards, I think that it will take until 2015 for real disposable incomes to return to the level seen in 2009.** (See Chart 10.)

**Chart 10. Real household disposable income (£bn)**



Sources – Thomson Datastream, Bootle Forecasts

Of course, real incomes do not provide the definitive picture as to the health of households’ finances. Most households would probably at least include what is happening to house prices and interest rates in judging their financial health (with most, but obviously not all, viewing rising house prices as good news and rising interest rates as bad news).

**But taking a broader look at households’ finances arguably leaves the position looking even worse.**

Table 2 lists all the years since the Second World War when households have experienced a fall in real earnings (I have used real earnings rather than disposable income because of its longer history). I have also added some indicators of the broader condition of household finances – in particular whether real house prices, unemployment and interest rates were rising in each of those years.

I think that this year will see falling real earnings, falling real house prices and rising unemployment. **The depths of the recent recession aside, that would make 2011 the worst year for households since 1977.** What’s more, while not my central forecast, there is clearly a significant risk that interest rates rise this year too. **Were that to happen, conditions would arguably be the worst for households since 1952.**

**Table 2. Years of falling real earnings**

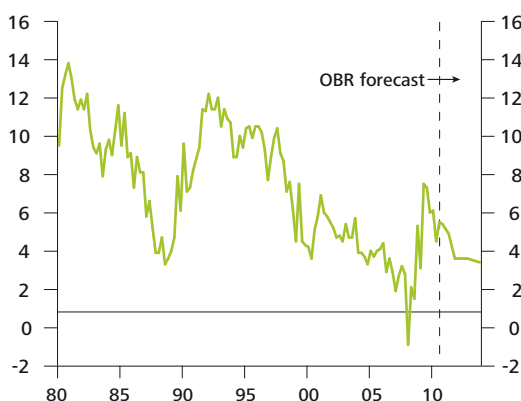
	%y/y real earnings	Real house prices falling?	Unemployment rising?	Interest rates rising?
1941	-1.4	Yes	No	No
1944	-1	No	No	No
1945	-3.2	No	Yes	No
1952	-0.9	Yes	Yes	Yes
1962	-0.8	Yes	Yes	No
1976	-0.5	Yes	No	Yes
1977	-6.1	Yes	Yes	No
2009	-2.2	Yes	Yes	No
2010	-1.0	No	No	No
2011	-1.8?	Yes?	Yes?	Possibly?

Source – Various

Against this backdrop, I think that the outlook for consumer spending is pretty dismal. Admittedly, some commentators see scope for households to run down their saving rate in order to sustain their spending even as their incomes fall.

The OBR, for example, expects the saving rate to drop a bit this year and then stay low at just 3.5%. (See Chart 11.)

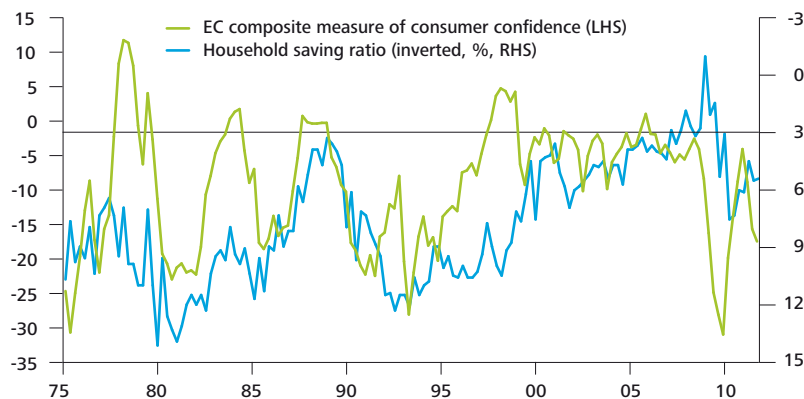
**Chart 11. Household saving ratio (%)**



Sources – Thomson Datastream, OBR

I have said before that I think that this is unlikely to happen. Borrowing will remain weak as credit conditions remain tight and households seek to repay debt. Meanwhile, a lack of confidence will surely mean that households want to save more, rather than less, of their income. The relationship between consumer sentiment and household saving is not perfect. But on the face of it, the current weakness of sentiment suggests that saving should be rising. (See Chart 12.)

**Chart 12. Household saving and consumer confidence**

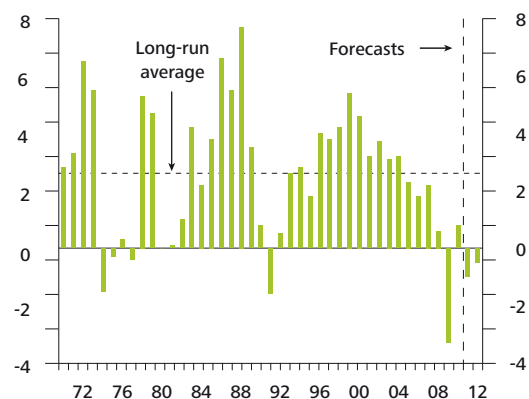


Source – Thomson Datastream

Admittedly, I would not rule out *any* drop in saving, at least in the short-term when falling household incomes will leave some households with little choice *but* to run down their savings. Nonetheless, I doubt that saving will fall enough to counteract fully the drop in income that I expect this year. **And the big picture is that the saving rate is historically low and, in the medium-term, needs to rise.** So as income recovers, I think it more likely that households use this to raise their saving back to more sustainable rates, rather than using it to fund spending.

I have been warning for some time of the difficult period that households were about to face and so already expected consumer spending to fall. **But given the additional squeeze from rising inflation, I have revised my forecast for this year's fall in spending from 0.5% to 1%.** And I now expect spending to fall further next year – by perhaps another 0.5% or so – rather than stagnating as I previously thought. (See Chart 13.) If this happened, it would be the first time that spending has fallen in two consecutive years since the mid-1970s.

**Chart 13. Real consumer spending (%y/y)**



Sources – Thomson Datastream, Bootele Forecasts

**Who's worse hit?**

Without doubt, then, the consumer sector is in for another tough year or two. But of course, not all consumers are hit equally badly. **Attention has focused recently on the "squeezed middle."** But I am not sure this term is particularly helpful.

For a start, it encompasses such a large number of people that it would be hard to see a drop in overall household income without this group being affected. The Labour Party has defined the squeezed middle as everyone on an income of between £16,000 and £50,000. But Table 3 shows the distribution of income in the UK and suggests that this definition includes more than half of all households i.e. pretty much all those except in the bottom two and top two income deciles.

**Table 3. Distribution of household incomes**

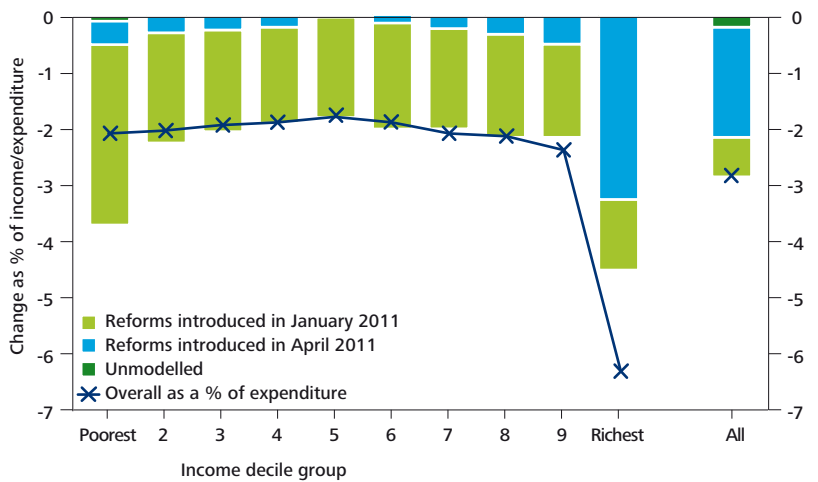
Income decile	Range of income (£)	
Lowest	0	10,556
2	10,556	13,988
3	13,988	17,680
4	17,680	21,892
5	21,892	26,260
6	26,260	31,096
7	31,096	37,024
8	37,024	45,968
9	45,968	61,360
Highest	61,360	-

**Bold** shows "squeezed middle"

Source – HM Treasury

In addition, it is not clear that the "squeezed middle" is in fact any more squeezed than other groups of households. Research by the Institute of Fiscal Studies (IFS) shows that it is the highest income households which will be made worst off from the fiscal measures introduced this year – followed by the lowest income households. (See Chart 14.) The rich lose out from the changes to direct taxes – as they suffer from the rise in NICs but, because they are higher rate taxpayers, do not benefit from the rise in the personal allowance. The very rich also suffer from the restriction on pension tax relief and higher rate of stamp duty.

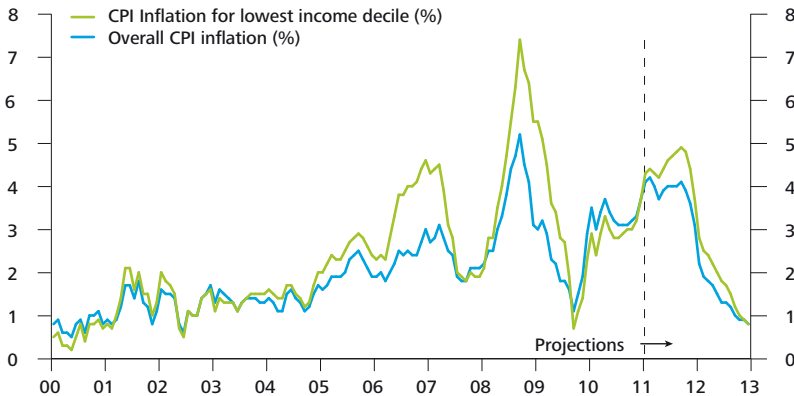
**Chart 14. Distributional effects of tax/benefit measures introduced this year (as a % of income)**



Source – IFS

Meanwhile, many households in the poorest income decile are not working and/or are claiming benefits. Accordingly, they get little benefit from the rise in the income tax personal allowance and NICs primary threshold. But they suffer from the switch to indexing benefit payments to CPI rather than RPI and other reductions in benefit payments. What's more, the poorest households devote a particularly high proportion of their expenditure to spending on food and utilities and have therefore been experiencing a higher than average inflation rate. (See Chart 15.)

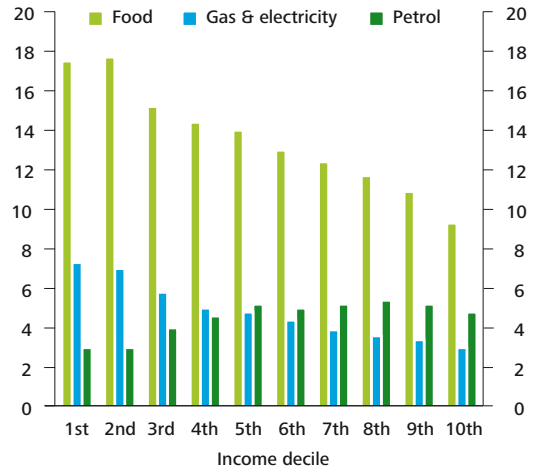
**Chart 15. Inflation rates for low income households**



Sources – ONS, Thomson Datastream, Bootle Forecasts

**Nonetheless, there are some other ways in which middle-income households will be hit worse than other groups.** For a start, low to middle earners are disproportionately concentrated in the public sector. Accordingly, they are most likely to be affected by the public sector job cuts, public sector pay freeze and rise in pension contributions by public sector employees. Meanwhile, middle-income households are those set to lose the most from cuts in tax credits for children. And Chart 16 shows that middle income households devote the greatest proportion of their spending to petrol – meaning that they will suffer most from the rise in petrol prices.

**Chart 16. Spending on essentials (as a % of all spending)**



Source – ONS

Perhaps the key point, then, is that few households will escape a further squeeze over the next couple of years. Indeed, it might be easier to think of who *won't* be affected much. Perhaps one of the most insulated groups is low earners. These people earn a small enough amount to be beneficiaries of the rise in the personal allowance and NICs threshold. They will also be protected from the public sector pay freeze (which exempts workers earning less than £21,000). Nonetheless, even they will be affected by the squeeze on their real pay from rising inflation, as well as a reduction in tax credits.

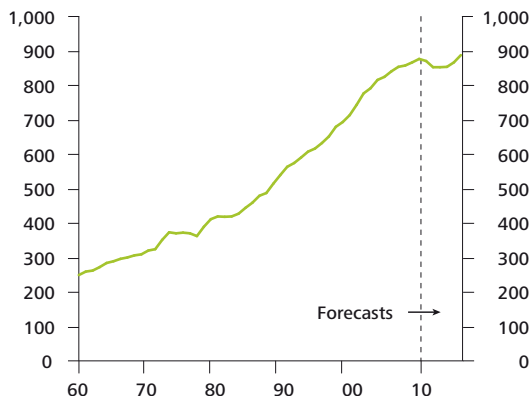
### Conclusions

The recession may be over – but for many households, the next year or two will be even more painful than the past couple of years.

Admittedly, the current squeeze needs to be kept in perspective. **The big picture is that the recent and looming falls in real incomes will reverse only a small part of the gains in both real incomes and living standards achieved over the past few decades.**

(See Chart 17.)

Chart 17. Real household disposable income (£bn)



Sources – Thomson Datastream, Bootle Forecasts

By the end of this year, real disposable incomes will still be about 15% higher than in 2000 – and even in per household terms, about 5% higher. Indeed, claims that British households are the “worst off since 1981” are obviously not true when looking at the *level* of household income.

#### And more favourable conditions lie further ahead.

I think that inflation could be well below target by the end of 2012, allowing real earnings to rise again. And by the end of this Parliament, taxes could be falling rather than rising. The Government tentatively indicated in its latest Budget that the 50% income tax will be only temporary, but hopefully households will have more to look forward to as the next election approaches.

**But for those households struggling to make ends meet, that might still seem like an age away. In the meantime, the continuing squeeze on households’ finances looks likely to be the most defining influence on the economy over the next year or so.**

# Historical data table

	Average 1995-04	2005	2006	2007	2008	2009	2010
<b>Demand (%y/y)</b>							
GDP	3.1	2.2	2.8	2.7	-0.1	-4.9	1.3
Consumer Spending	3.7	2.3	1.8	2.2	0.6	-3.3	0.8
Government Consumption	2.2	2.0	1.4	1.3	1.6	1.0	0.8
Fixed Investment	4.7	2.4	6.4	7.8	-5.0	-15.4	3.0
Stockbuilding (% of GDP)	0.4	0.4	0.4	0.5	0.0	-1.2	0.2
Domestic Demand	3.5	2.1	2.5	3.1	-0.7	-5.5	2.4
Exports <sup>1</sup>	5.3	7.9	11.1	-2.6	1.0	-10.1	5.3
Total Final Expenditure	3.9	3.2	4.2	1.9	-0.3	-6.4	2.9
Imports <sup>1</sup>	7.0	7.1	9.1	-0.8	-1.2	-11.9	8.5
<b>Output &amp; Profits (%y/y)</b>							
Services Output	3.9	3.1	4.1	3.5	0.5	-3.2	1.1
Manufacturing Output	0.6	-0.2	1.6	0.5	-2.9	-10.7	3.6
Company Profits <sup>2</sup> (nominal)	4.9	2.4	7.8	6.3	-0.5	-7.5	4.3
<b>Labour Market</b>							
Unemployment (claimant count, millions)	1.3	0.9	0.9	0.9	0.9	1.5	1.5
Unemployment (claimant count, %)	4.2	2.9	2.9	2.5	3.6	4.9	4.5
Employment (%y/y)	1.1	1.1	0.9	0.7	0.9	-1.5	0.0
Productivity (output per worker, %y/y)	1.9	1.4	2.0	2.0	-0.9	-3.3	1.2
<b>Income &amp; Saving (%y/y)</b>							
Average Earnings <sup>3</sup>	4.1	4.6	4.9	4.7	3.5	0.0	2.3
Real Household Disposable Income	3.0	2.0	1.5	0.4	1.1	1.1	-0.8
Saving Ratio (%)	6.6	3.9	3.4	2.6	2.0	6.0	5.4
<b>Prices (%y/y)</b>							
CPI	1.6	2.0	2.3	2.3	3.6	2.1	3.3
Core CPI <sup>4</sup>	n/a	1.5	1.3	1.7	1.6	1.8	2.9
RPI	2.6	2.8	3.2	4.3	4.0	-0.5	4.6
RPIX	2.5	2.2	3.0	3.2	4.3	2.0	4.8
Nationwide House Prices (end period)	11.5	3.3	9.3	6.9	-14.7	3.4	0.0
<b>Monetary Indicators (end period unless stated)</b>							
Base/Repo Rate (%)	5.38	4.50	5.00	5.50	2.00	0.50	0.50
10 Year Gilt Yield (%)	6.7	4.1	4.7	4.5	3.1	4.1	3.5
Sterling Trade-weighted Index	97.2	98.2	104.3	98.1	74.0	80.8	79.8
\$/£	1.65	1.72	1.96	1.99	1.47	1.62	1.55
Euro/£	1.46	1.46	1.48	1.36	1.03	1.13	1.16
M4 (%y/y, period average)	8.0	10.9	12.8	12.9	12.3	13.4	2.0
<b>Balance of Payments &amp; Public Finances</b>							
Current Account (£bn)	-15.0	-32.8	-44.9	-36.5	-23.8	-23.9	-36.2
% of GDP	-1.5	-2.6	-3.4	-2.6	-1.6	-1.7	-2.5
PSNB (£bn, financial year)	12.7	37.4	30.9	33.3	96.1	156.4	145.9
% of GDP (financial year)	1.3	2.9	2.3	2.4	6.7	11.1	9.9
<b>World Scene (%y/y)</b>							
World GDP <sup>5</sup>	3.5	4.5	5.1	5.2	3.0	-0.8	4.5
US GDP	3.3	3.1	2.7	1.9	0.0	-2.6	2.9
Euro-zone GDP	n/a	1.7	3.1	2.8	0.3	-4.0	1.7
G7 Consumer Price Inflation	1.8	2.3	2.4	2.2	3.3	-0.1	1.6
World Goods & Services Trade Volumes	7.0	7.6	9.3	7.2	2.8	-12.0	16.0
Oil Price (Brent, \$ per barrel, end period)	21.4	58.3	59.4	93.8	36.2	70	90

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

			2011f		2012f	
	2011f	2012f	H1	H2	H1	H2
<b>Demand (%y/y)</b>						
GDP	1.5	1.5	1.9	1.2	1.1	1.9
Consumer Spending	-1.0	-0.5	-0.1	-1.8	-1.6	0.7
Government Consumption	-0.5	-1.5	-0.2	-0.8	-1.6	-1.4
Fixed Investment	7.0	6.0	6.4	7.6	6.7	5.4
Stockbuilding (% of GDP)	0.8	0.7	0.8	0.7	0.7	0.7
Domestic Demand	0.9	0.4	1.8	0.0	-0.3	1.0
Exports <sup>1</sup>	8.0	5.0	8.1	7.8	6.1	4.1
Total Final Expenditure	2.3	1.4	3.1	1.6	1.1	1.7
Imports <sup>1</sup>	4.0	1.0	5.8	2.3	1.1	1.0
<b>Output &amp; Profits (%y/y)</b>						
Services Output	1.0	1.5	1.2	0.8	1.0	2.1
Manufacturing Output	5.0	2.0	5.3	4.6	2.5	1.5
Company Profits <sup>2</sup> (nominal)	8.0	2.0	11.5	4.6	2.0	2.0
<b>Labour Market</b>						
Unemployment (claimant count, millions)	1.7	1.8	1.6	1.7	1.8	1.9
Unemployment (claimant count, %)	5.2	5.8	5.0	5.4	5.7	5.9
Employment (%y/y)	0.0	-0.8	0.4	-0.8	-0.8	-0.7
Productivity (output per worker, %y/y)	1.7	2.3	1.4	2.0	1.9	2.6
<b>Income &amp; Saving (%y/y)</b>						
Average Earnings <sup>3</sup>	2.4	2.7	2.2	2.6	2.7	2.7
Real Household Disposable Income	-2.0	0.0	-1.8	-2.2	-0.5	0.4
Saving Ratio (%)	4.7	5.1	4.3	5.0	5.4	4.7
<b>Prices (%y/y)</b>						
CPI	4.4	1.8	4.4	4.5	2.4	1.3
Core CPI <sup>4</sup>	2.6	0.5	3.1	2.2	0.6	0.5
RPI	5.2	2.8	5.3	5.0	3.0	2.6
RPIX	5.1	2.8	5.3	4.9	3.0	2.6
Nationwide House Prices (end period)	-5.0	-7.0	-3.0	-5.0	-7.5	-7.0
<b>Monetary Indicators (end period unless stated)</b>						
Base/Repo Rate (%)	0.50	0.50	0.50	0.50	0.50	0.50
10 Year Gilt Yield (%)	2.75	2.75	3.75	2.75	2.75	2.75
Sterling Trade-weighted Index	78.4	86.8	80.1	78.4	81.6	86.8
\$/£	1.50	1.40	1.65	1.50	1.40	1.40
Euro/£	1.15	1.40	1.14	1.15	1.27	1.40
M4 (%y/y, period average)	-0.5	2.0	-1.1	0.0	1.5	2.5
<b>Balance of Payments &amp; Public Finances</b>						
Current Account (£bn)	-30.0	-25.0	-14.9	-15.1	-14.0	-11.0
% of GDP	-2.0	-1.6	-1.9	-2.0	-1.8	-1.4
PSNB (£bn, financial year)	125	110	-	-	-	-
% of GDP (financial year)	8.1	6.9	-	-	-	-
<b>World Scene (%y/y)</b>						
World GDP <sup>5</sup>	3.9	3.8	4.0	3.8	3.8	3.7
US GDP	3.0	2.0	3.0	2.9	2.2	1.8
Euro-zone GDP	1.0	0.5	1.5	0.5	0.3	0.7
G7 Consumer Price Inflation	2.0	0.7	2.2	1.8	0.9	0.5
World Goods & Services Trade Volumes	8.0	6.0	9.0	7.0	6.0	6.0
Oil Price (Brent, \$ per barrel, end period)	85	75	95	85	80	75

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

## The US may need more QE

- The rapid rise in food and energy prices appears to be constraining real US economic growth. As long as the surge in inflation is temporary and doesn't feed into higher inflation expectations or pay growth, the Fed will stand out as one central bank that is still a long way from hiking interest rates.
- Certain parts of the economy still appear healthy, with the ISM activity surveys at multi-year highs. (See Chart 1.) And even the unemployment rate has fallen, from 9.8% in November to 8.8% in March. (See Chart 2.)
- Admittedly, a lot of that fall is due to a decline in the size of the labour force. But employment growth has improved too, with the economy adding 200,000 net new jobs in March. (See Chart 3.) Boosted by the payroll tax cut that began at the start of the year, nominal income is growing at a decent annual rate of 6%.
- But this is not translating into more real consumption, as higher incomes are being offset by higher prices for items such as gasoline and food. I estimate that the latest 13% rise in gasoline prices and the 45% gain in agricultural commodity prices that has yet to feed in full into higher food prices in the stores will mean households have to spend an extra \$80bn just to buy the same amount of gasoline and food. That's worth 0.8% of consumption.
- Higher prices have already put a dent in consumer confidence. (See Chart 4.) And after rising at an annualised rate of 4% in the fourth quarter of last year, real consumption may have halved to 2% in the first.
- The renewed fall in house prices will place an extra restraint on consumption growth. (See Chart 5.) And the continued downward trend in homebuilding will put a further dent in activity. After growing at an annualised rate of 3% in the fourth quarter, GDP may have struggled to expand by 2% in the first.
- With the boost to activity from the second fiscal stimulus set to fade later this year and the Fed due to complete QE2 by the end of June, it is hard to see the economy bouncing back significantly. I expect GDP growth of 3% this year and just 2% next year. (See Chart 6.)
- By the summer, higher gasoline and food prices will have pushed headline CPI inflation up from 2.1% in February to around 3%. Core inflation may edge a bit higher too. But headline inflation will fall back not long after energy and commodity prices stop rising. And against a backdrop of continued tepid economic growth, core inflation will probably fall back below 1%. (See Chart 7.)
- I doubt that higher prices will feed into higher inflation expectations or pay growth. The rise in households' inflation expectations already seen will go into reverse once gasoline prices fall. (See Chart 8.) An unemployment rate of above 8% will contain earnings growth.
- The Fed will therefore look through the temporary spike in inflation and instead will focus on the downside risks to growth. Interest rates will not rise this year or next and I would not completely rule out QE3.

Chart 1. ISM activity indices

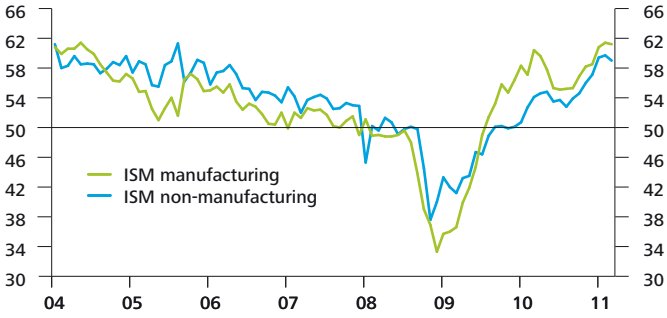


Chart 2. Unemployment rate (%)



Chart 3. Private non-farm payroll employment (000s)

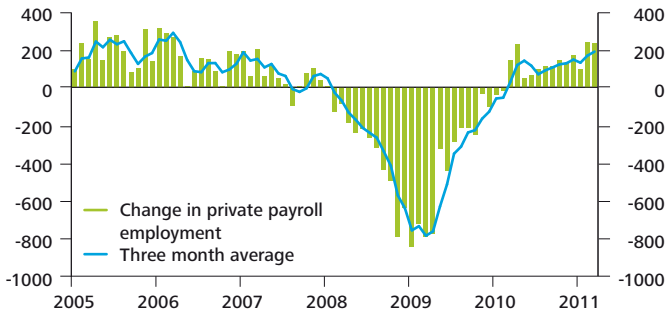


Chart 4. Real consumption & consumer confidence

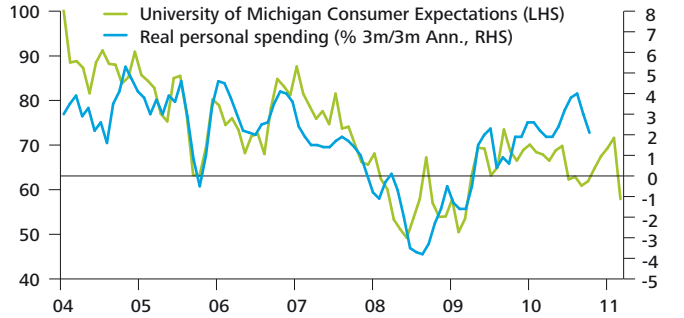


Chart 5. Case-Shiller 20-city house prices (%/m)

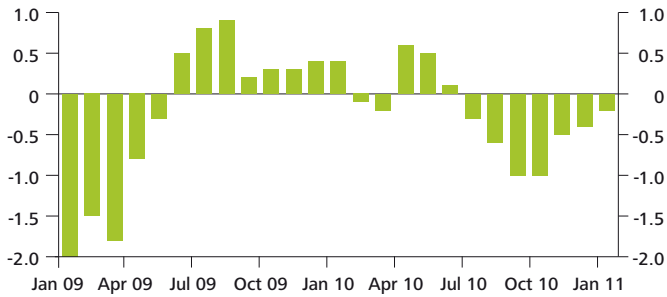


Chart 6. GDP growth (%/q/q annualised)

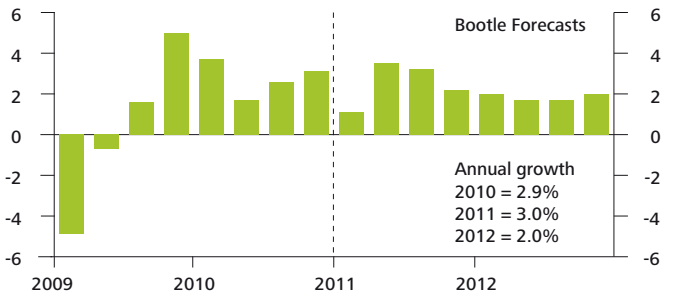
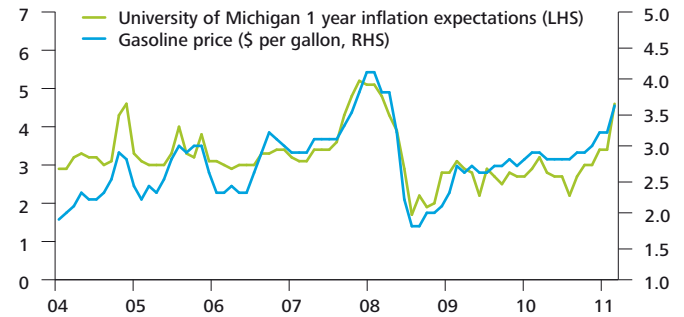


Chart 7. CPI inflation (%)



Chart 8. Household inflation expectations & gasoline price



Sources – Thomson Datastream, Bootle Forecasts

# Analysis: The world economy

## Hawkish ECB adds to euro-zone woes

- Growing political tensions in the region and the periphery's bleak economic prospects suggest that there remains a strong chance that at least one peripheral euro-zone government eventually defaults.
- Recent changes to the size and flexibility of the European Financial Stability Facility (EFSF) have reduced the chances of a government liquidity crisis in the near term. But hopes that the "Grand Bargain" would mark the first steps towards fiscal union have been dashed and concerns over the solvency of some peripheral governments certainly remain.
- What's more, while the recent strength of euro-zone business surveys suggest that growth may have recently picked up (see Chart 9), I still expect the recovery to falter before long.
- After all, it appears inevitable that trade growth will start to slow after last year's exceptionally strong gains. And given the euro's strength, exporters may struggle to maintain market share, particularly those in the less competitive periphery. (See Chart 10.)
- Meanwhile, although consumer sentiment has recently improved (see Chart 11), the outlook for household spending is far from bright. After all, the fiscal squeeze will intensify this year as it spreads to the core. (See Chart 12.) And high inflation (see Chart 13) and weak wage growth will lead real labour income to shrink, even if the unemployment rate continues to fall.
- Despite all this, and the fact that core inflation remains subdued, the ECB remains concerned that second-round effects may emerge. While I expect the tightening of conventional policy to be modest, it could still prove damaging for the peripheral economies, particularly if unconventional measures are simultaneously wound down.
- In all, then, I still expect the euro-zone to expand by just 1% in 2011 and 0.5% in 2012. (See Chart 14.) While the German economy will perform rather better, the peripheral economies may struggle even to expand.
- Given this backdrop, it appears increasingly likely that at least one peripheral government eventually defaults. For now, the negative impact of this on the euro has been offset by the ECB's hawkish stance. But concerns about the fiscal crisis and its impact on the region will surely grow as the recovery fades and may prompt the euro to reverse its recent gains.
- Norway, Switzerland and Sweden, all look set for mild fiscal squeezes at worst suggesting that they will all outgrow the euro-zone. (See Chart 15.) But modest inflation, in part down to their strong currencies, will ensure that interest rates only rise gradually.
- The recovery in Emerging Europe remains broadly on track. The region should grow by around 4% this year, with Turkey, Poland and Russia leading the way. (See Chart 16.) But with prospects for much of the region – particularly Central Europe – tied to Germany, the current pace of growth is likely to fade in the second half of the year. Meanwhile, Russia will suffer if oil prices fall back, as I expect.

Chart 9. Euro-zone GDP & the composite PMI

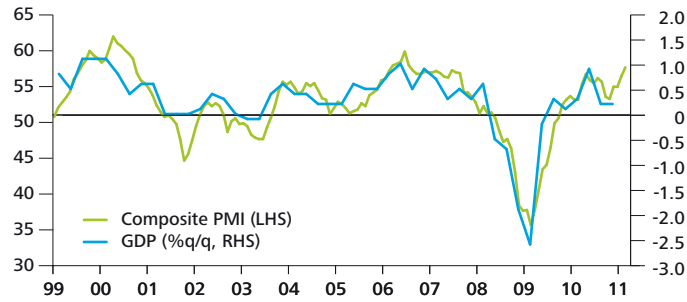


Chart 10. Euro-zone exports & the trade-weighted Euro

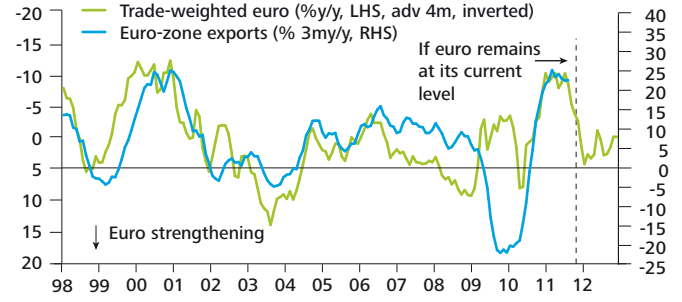


Chart 11. Euro-zone consumer confidence & spending

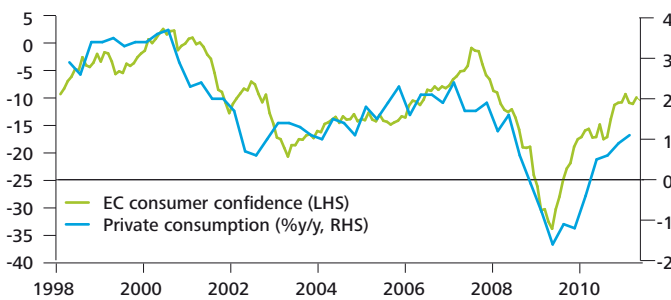


Chart 12. Euro-zone fiscal stance (% of GDP)

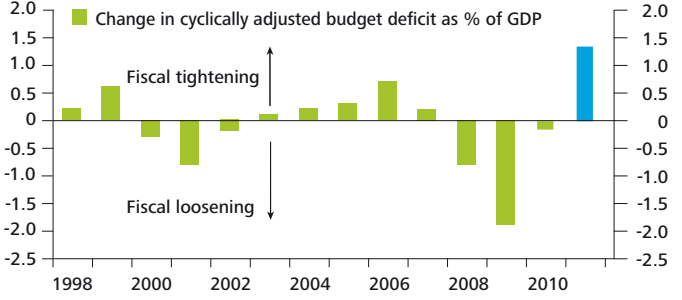


Chart 13. Euro-zone HICP Inflation (%/y)

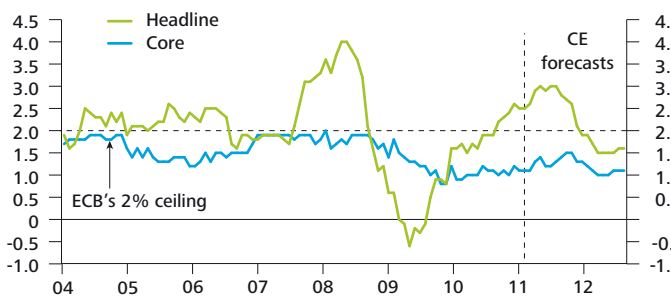


Chart 14. Euro-zone GDP

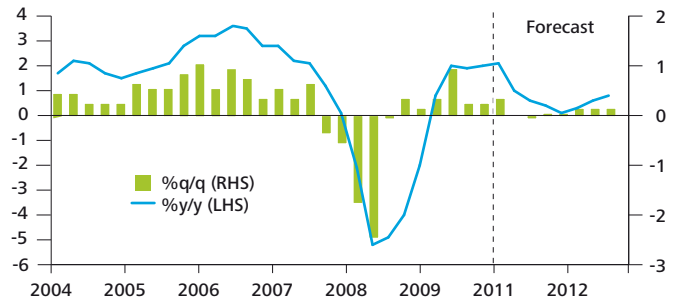


Chart 15. Developed Europe GDP (%/y)

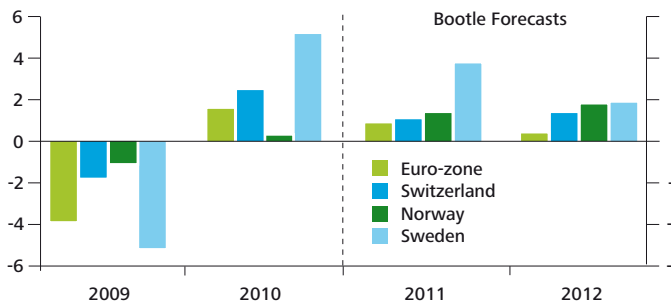
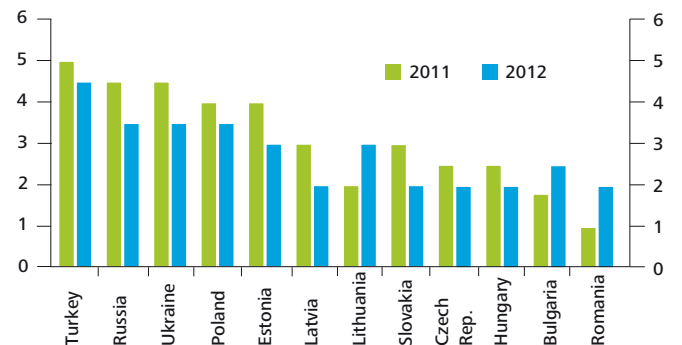


Chart 16. Emerging Europe GDP (%/y)



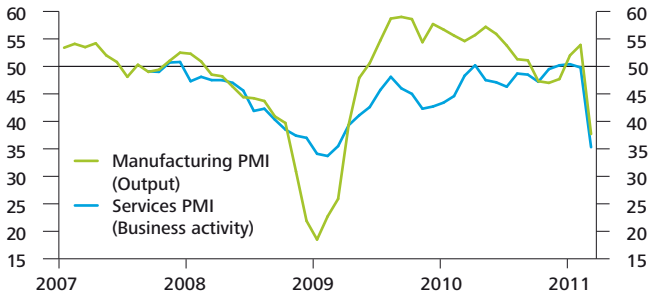
Sources – ECB, IMF, Markit, Thomson Datastream

# Analysis: The world economy

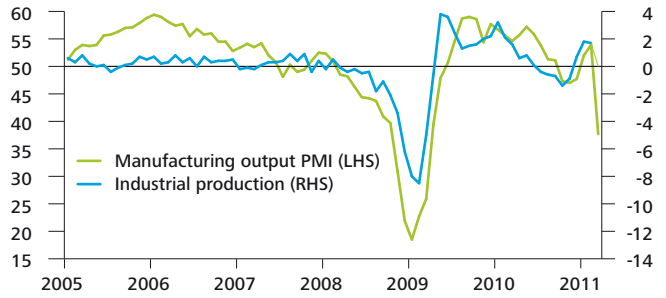
## Japan in recession

- The earthquake that struck on 11 March is first and foremost a tragedy for the people of Japan. However, it will also have a profound effect on the economy. The purchasing managers' surveys for March were the first to be taken after the event and reported sharp falls in activity in both the manufacturing and services sectors. (See Chart 17.)
- These falls may not be quite as large as those that followed the global financial crisis. (See Chart 18.) After all, Japan's GDP fell by more than 6% in 2009. But the blow to activity will still be sufficient to drag the economy into recession. What's more, the early survey results may be understating the extent of the damage as the firms worst affected are also the least likely to respond.
- Japan's GDP should then rebound in the second half of the year as activity recovers from the initial shock and reconstruction spending kicks in. But even though reported GDP will be higher as a result, this would not mean that Japan is any better off: lost assets will simply have been replaced and productive potential will be no higher than before.
- The recovery will also be held back by the increases in taxes and cuts in other expenditure required to help pay for the government's contribution. Japan's public finances were already in a dire state before the disaster (see Chart 19) and the patience of the bond markets is limited. The upshot is that I now expect Japan's GDP to fall by around 1.5% this year, with only a fragile recovery thereafter. (See Chart 20.)
- Disruption to supply chains has transmitted the shock of the disaster around the region, affecting firms in Korea, Taiwan and China in particular. However, some firms in these economies have also gained market share from Japanese firms that are temporarily sidelined.
- In the meantime, China's economy shows signs of starting to slow, while inflation seems to be levelling off after rising rapidly in the second half of 2010. (See Charts 21 and 22.) Price pressures are still largely confined to food. Assuming no further disruption to harvests, I expect inflation to fall sharply in the second half of the year. This in turn should free policymakers to loosen constraints on lending if the economy weakens too far.
- Overall, the immediate risk of either overheating or a hard landing in China is low. However, other problems remain. There has been little progress towards lasting rebalancing of China's economy. Household spending growth has slowed, with domestic demand still driven by investment. The trade surplus has narrowed as commodity prices have risen. But trade surpluses with Europe and the US are still near record highs. (See Chart 23.)
- High commodity prices are adding to inflation pressures across the region. These pressures are particularly acute in India, where inflation is still uncomfortably high a full year after it peaked. (See Chart 24.) In general, though, fundamentals are healthy enough for monetary policy to be tightened further across the region without derailing the economic recoveries.

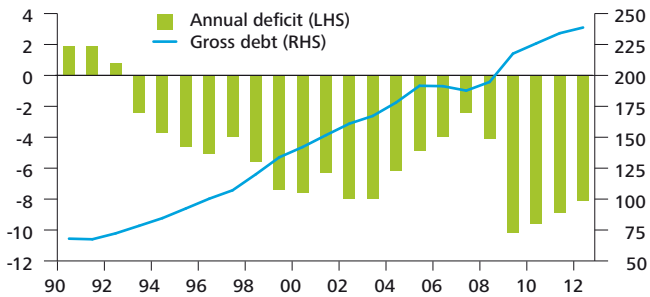
**Chart 17. Japan output components of PMI surveys**



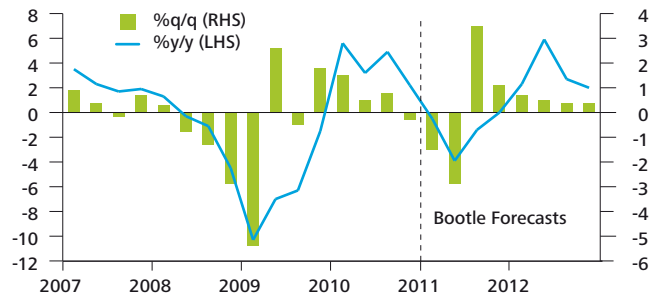
**Chart 18. Japan manufacturing PMI & production**



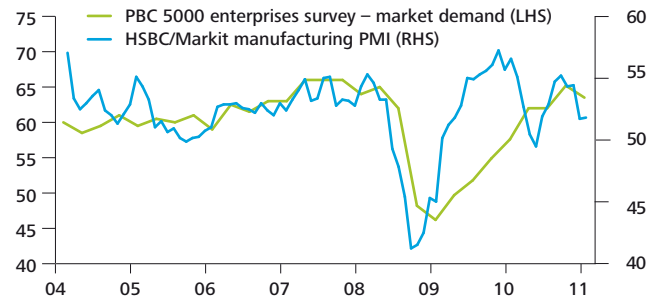
**Chart 19. Japan public finances (% of GDP)**



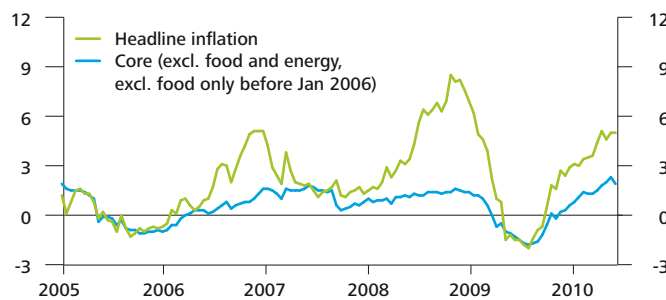
**Chart 20. Japan GDP**



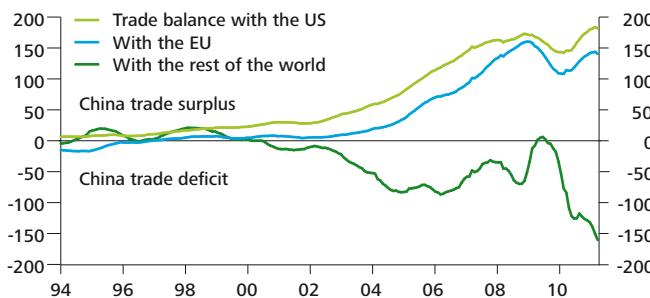
**Chart 21. China manufacturing PMI & PBC Enterprise Survey**



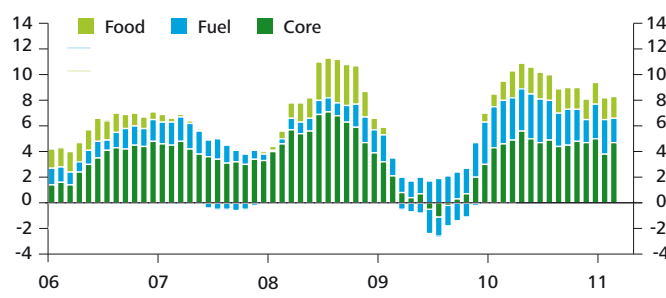
**Chart 22. China consumer prices (%/y)**



**Chart 23. China merchandise trade surplus (\$bn, 12m sum)**



**Chart 24. India wholesale price inflation (% pt contribution)**



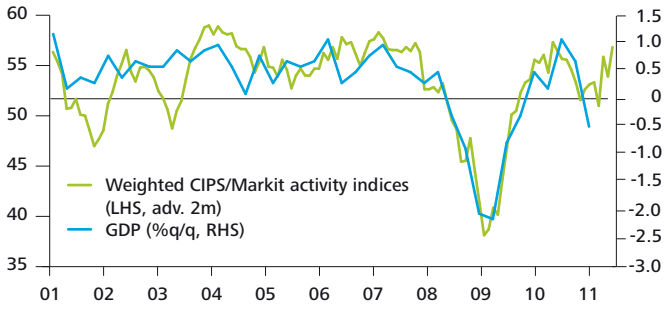
Sources – Markit, Thomson Datastream, IMF

# Analysis: UK output and activity

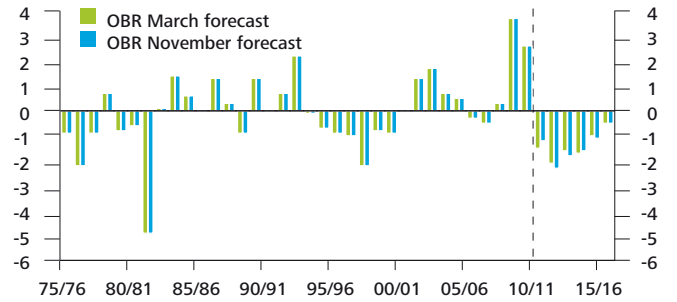
## A renewed consumer downturn is getting underway ...

- The underlying momentum of the economic recovery looks pretty weak. And it's hard to see how the pace of the recovery will pick up when the squeeze on households from high inflation and fiscal austerity is set to intensify. Net trade and business investment may support growth, but not by enough to offset weaker consumer spending.
- Admittedly, measures of business activity such as the CIPS/Markit surveys suggest that growth was quite strong in Q1. (See Chart 1.) But a good portion of this growth probably reflected output lost in the fourth quarter as a result of the snow being made up in the first. Indeed, even if underlying GDP growth is essentially zero, growth could be as much as 1% q/q in Q1 if all of the lost output is made up.
- Moreover, the coalition looks set to stick to its austere fiscal plans, come what may. Granted, the recent Budget cut consumers a little slack by reducing fuel duty by one pence per litre and by raising the income tax personal allowance by another £630 in 2012/13.
- But in macroeconomic terms, the Budget was a non-event. As Chart 2 shows, the forecasts for the annual change in cyclically-adjusted public borrowing have barely changed. The fiscal squeeze is still set to knock over 2% off GDP in 2011/12 and the squeeze will be only a little less severe in future years.
- Households are still set to bear the brunt of the spending cuts and tax rises. As part of this, I think that 500,000 or so public sector jobs will be lost during this Parliament.
- The private sector looks unlikely to compensate by hiring many more workers. Firms hoarded labour during the downturn, causing productivity to fall far below its trend level. (See Chart 3.) As a result, firms can still produce more using their existing workers. So I still think that unemployment (on the ILO measure) may eventually rise to near 3 million. (See *Analysis: Labour Market*, pages 28-29.)
- Households are also being squeezed by high inflation, which is unlikely to fall back until 2012. As a result, real household incomes could easily fall by around 2% this year. (See Chart 4 & *Main Article*, pages 2-11.)
- Admittedly, households could still support their current level of spending by saving a smaller proportion of their income. But the saving ratio is still below its long run average level. (See Chart 5.)
- Furthermore, I doubt that households will be able or want to support spending by borrowing either. The Bank of England's latest Credit Conditions Survey revealed that demand for credit is still falling. (See Chart 6.) And the current level of consumer confidence suggests that households will cut back on their spending. (See Chart 7.)
- Finally, although the latest data on the housing market suggest that house prices might temporarily have found a floor, stretched measures of affordability suggest that prices are still set to fall over the next few years. And consumer spending usually falls when house prices fall. (See Chart 8.)

**Chart 1. Real GDP growth & business surveys**



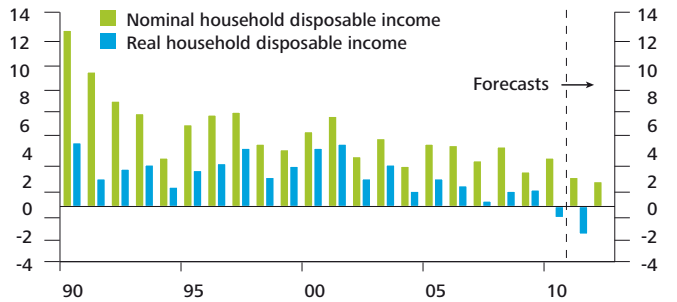
**Chart 2. Change in cyclically-adjusted PSNB as a % of GDP**



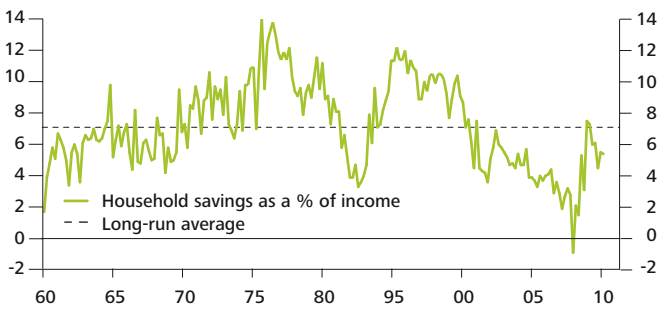
**Chart 3. Difference in actual from trend productivity (%)**



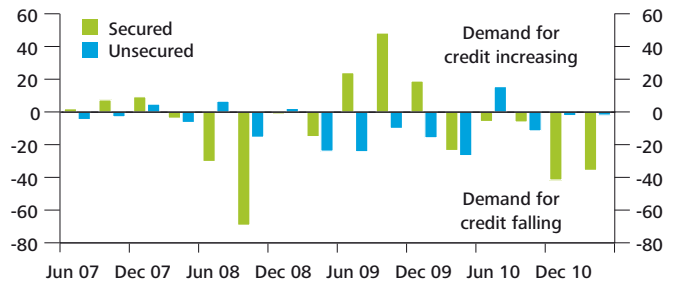
**Chart 4. Nominal & real household income (%/y)**



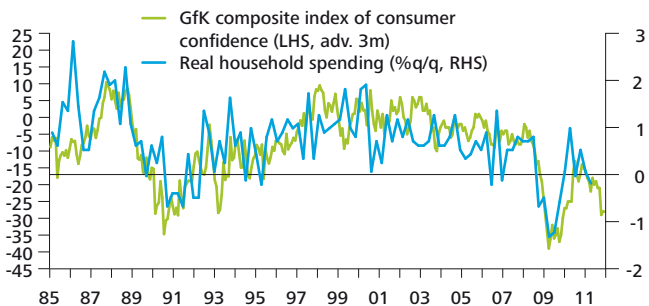
**Chart 5. Household saving ratio (% of income)**



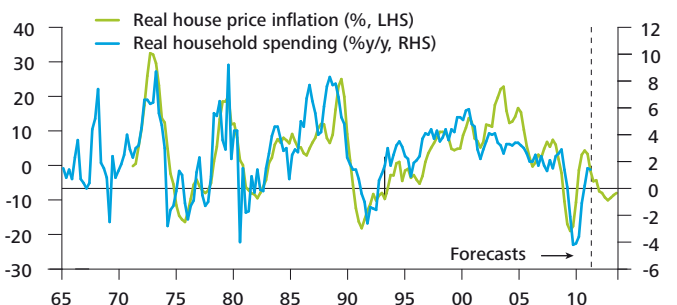
**Chart 6. Net % balance of lenders reporting change in demand for credit from households in past 3 months**



**Chart 7. Consumer confidence & real household spending**



**Chart 8. House price inflation & household spending**



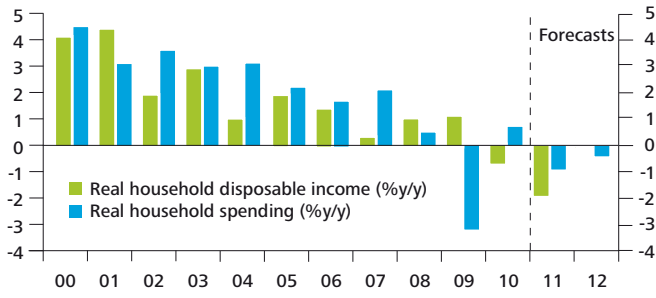
Sources – Thomson Datastream, OBR, BoE & Bootle Forecasts

# Analysis: UK output and activity

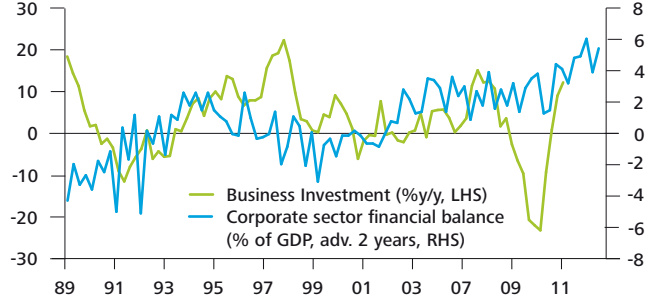
## ... while the boost to the recovery from net trade remains in doubt

- As a result, I think that real household spending could fall by around 1% in 2011 and a further 0.5% in 2012. (See Chart 9.)
- The big question, then, is can the other parts of the economy compensate for falling household spending? The outlook for business investment looks encouraging. Profits of non-financial firms rose by 4.6% q/q in Q4. Firms have also built up their cash reserves, so they can invest without borrowing. (See Chart 10.) The cuts in corporation tax should also boost investment.
- I therefore think that overall investment may grow by 6% or so in 2011 and 2012. Nonetheless, investment accounts for only 15% or so of GDP, so net trade will also have to support growth to prevent the recovery from slowing. However, net trade is still struggling to boost growth – indeed it subtracted over 1% from GDP growth in 2010. (See Chart 11.)
- This poor record has reflected two problems. First, UK exporters are losing market share, despite the weak pound. As Chart 12 shows, while sterling's weakness has supported goods exports, services exports have underperformed relative to global demand. This seems to have partly reflected weaker demand for financial services which the UK specialises in.
- Nonetheless, export growth still looks set to pick up. As Chart 13 shows, the export orders balance of the CIPS manufacturing survey points to faster export growth ahead.
- The second problem is that import growth has been very strong. While the 3% q/q surge in imports in Q4 partly reflected a tax change on aircraft imports in January, imports had been growing strongly throughout 2010.
- Indeed, as Chart 14 shows, imports have risen broadly in line with demand. This suggests that higher import prices as a result of the weaker pound have not led customers to buy domestic alternatives.
- This could reflect structural problems with the economy, but I think it more likely reflects the long time lags in investing in new capacity. If so, import growth may still ease in time, leading to a modest trade boost.
- But overall, the prospects for the recovery look bleak. I think that annual GDP growth may be as low as 1.5% or so in both 2011 and 2012. (See Chart 15.) Admittedly, growth further ahead could return to – or even exceed – the 3% rates seen prior to the recession. The large amount of slack in the economy points to a period of above-trend growth eventually. But over the next few years, I struggle to see how demand will grow at more than meagre rates.
- What's more, there are some downside risks to my forecasts. I still think that the MPC will refrain from raising interest rates. But if it does not, the hikes will not be painless. The direct effects of a rate rise on debt servicing costs may be fairly small. (See Chart 16.) But if the rise exacerbates fears of a further tightening, the effects on confidence and the exchange rate could be much greater. In this situation, it is possible that the fiscal tightening would be scaled back – but this would depend on markets being willing to accept slippage on the fiscal plans.

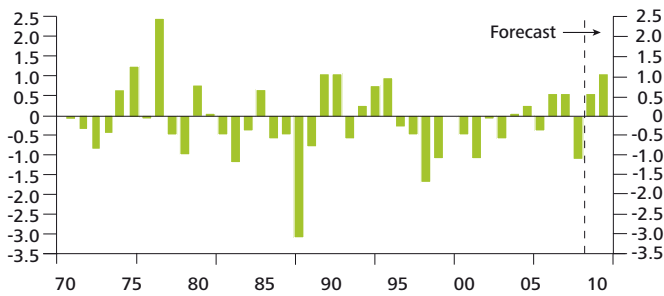
**Chart 9. Household spending and disposable income**



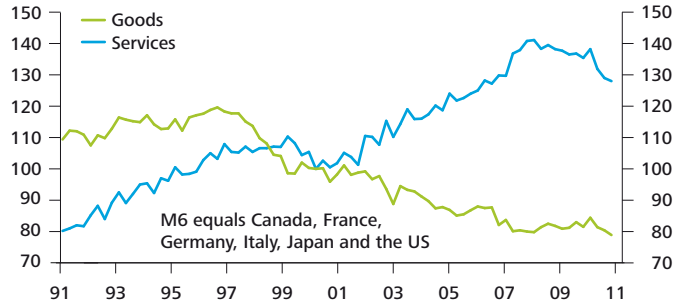
**Chart 10. Business investment & corporate financial balance**



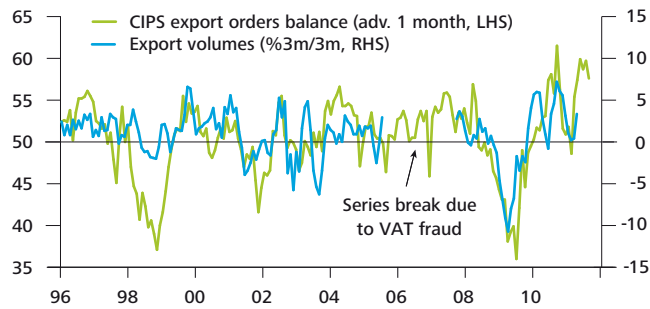
**Chart 11. Net trade contribution to annual GDP growth (%)**



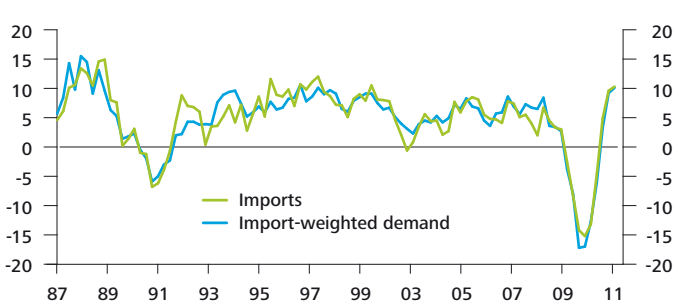
**Chart 12. Ratios of UK exports to UK-weighted M6 imports (2000 Q1 = 100)**



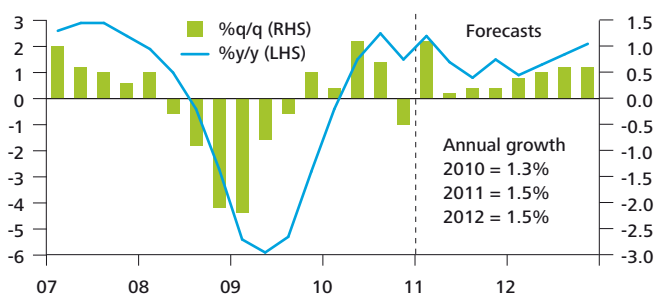
**Chart 13. Export goods volumes & export orders**



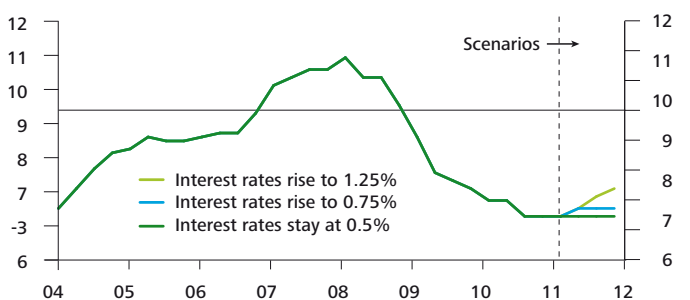
**Chart 14. Imports & import-weighted demand (%/y)**



**Chart 15. Real GDP growth**



**Chart 16. Households' interest payments (as a % of income)**



# Analysis: UK inflation

## High inflation could damage the recovery

- High and rising inflation is threatening to damage the economic recovery by squeezing real incomes and forcing the Bank of England to raise interest rates. But there are still good reasons to expect it to fall back sharply next year and beyond.
- UK consumer price inflation has continued to head higher in the early months of 2011. As Chart 1 shows, the main measures have now climbed all the way back to the recent peaks seen in 2008.
- Inflation has therefore continued to come in well above the forecasts of the Bank of England's Monetary Policy Committee (MPC). As Chart 2 shows, only in one quarter of the last 12 has inflation actually undershot the Committee's expectations.
- Of course, much of the upward pressure continues to come from forces largely, if not entirely, unconnected to the state of the UK economy and hence outside of the MPC's control. As Chart 3 shows, the effects on food, petrol and other energy price inflation of the rises in global oil and commodity prices have accounted for much of the increase.
- Nonetheless, these forces could grow still stronger over the coming months. As Chart 4 shows, even if agricultural commodity prices rise no further, the lagged effects of the increases already seen could push food inflation comfortably into double figures.
- Meanwhile, the impact on UK inflation of high oil prices is also likely to intensify further. Admittedly, unless oil prices keep rising, the upward influence of petrol prices on inflation may not increase much further. (See Chart 5.) But other energy components like gas prices could continue to have a bigger effect as wholesale price rises gradually feed through to household bills. (See Chart 6.)
- Together, these forces could push headline CPI inflation towards, or even through, 5% over the coming months. Needless to say, this will intensify the squeeze on households' real spending power. (See *Main Article*, pages 2-11.)
- However, global food and energy prices are certainly not the whole story. As Chart 7 shows, core (ex. food and energy) inflation has remained much higher in the UK than elsewhere, suggesting that underlying domestic price pressures have also been more stubborn.
- Of course, part of this stubbornness reflects the impact of the various Value Added Tax (VAT) changes seen over the last couple of years. If fully passed through, the increases from the reduced rate of 15% back to 17.5% in January 2010 and the further rise to 20% in January 2011 would have added roughly 1.5% to CPI inflation over the last year or so.
- As a result, measures of inflation which supposedly strip out such effects, such as CPIY, have remained correspondingly lower than headline inflation. Nonetheless, Chart 8 shows that even these measures have recently moved higher and are now well above the MPC's 2% target for overall CPI inflation.

Chart 1. UK inflation measures (%)

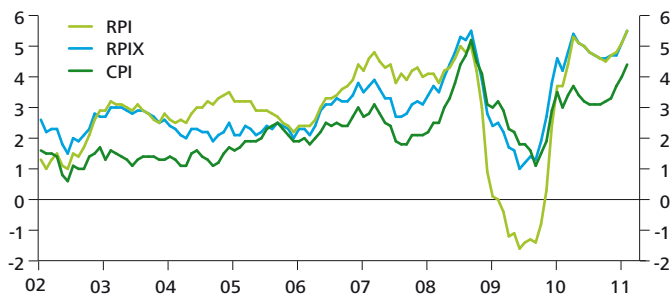


Chart 2. Inflation outturns vs. MPC forecasts (%pts)

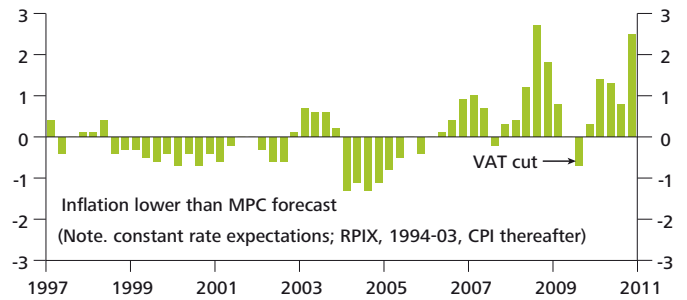


Chart 3. Contributions to inflation (% points)

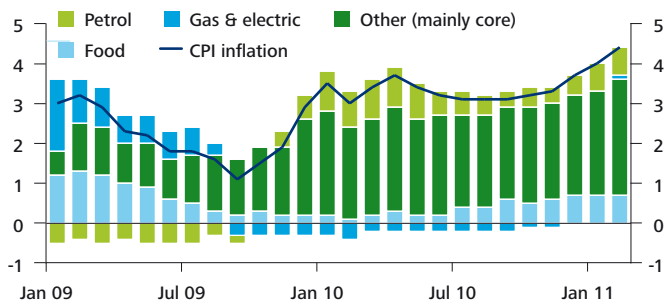


Chart 4. Ag. commodity prices & CPI food inf. (%)

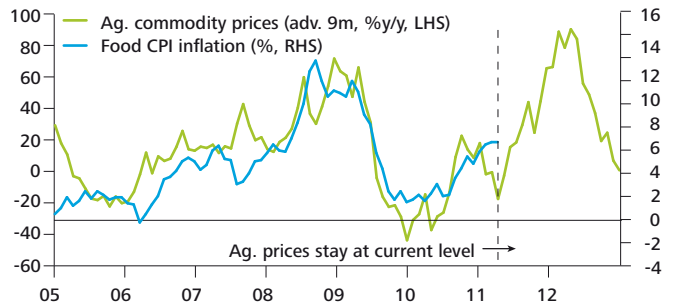


Chart 5. Oil prices & contribution of petrol cont. to CPI

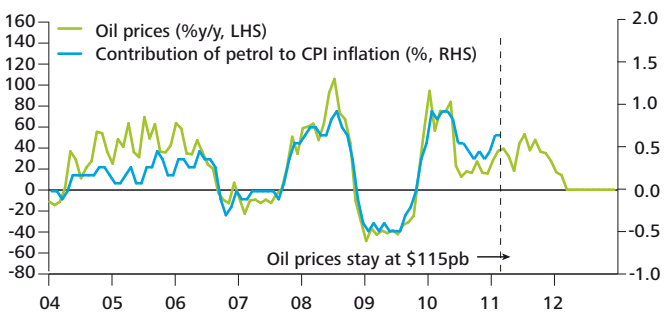


Chart 6. Wholesale gas prices & gas cont. to CPI

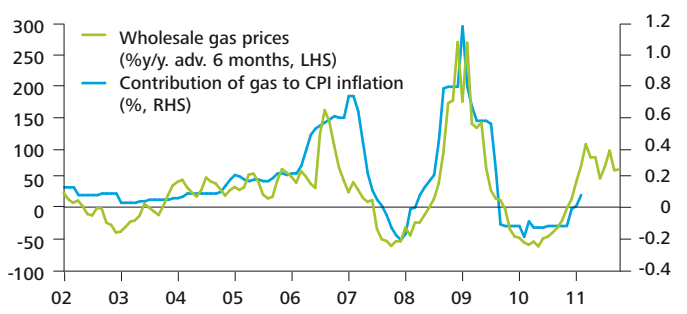


Chart 7. International core CPI inflation (%)

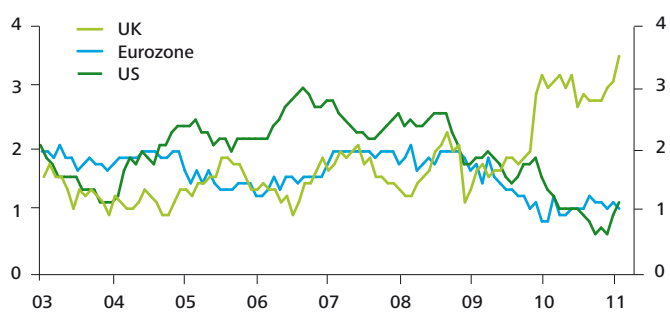
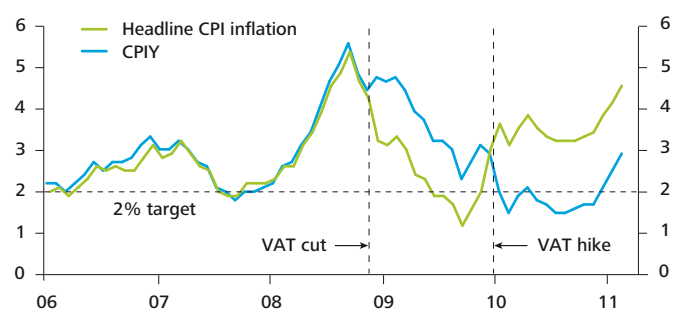


Chart 8. CPI & CPIY inflation (%)



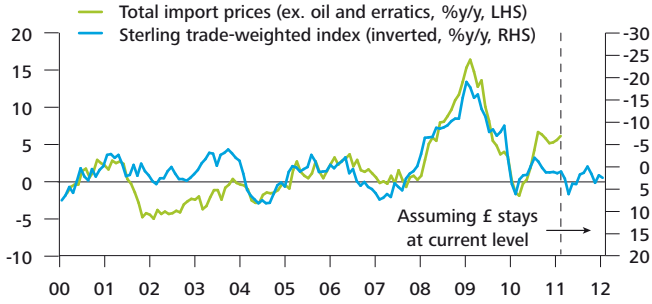
Sources – Thomson Datastream, Bloomberg, Bank of England

# Analysis: UK inflation

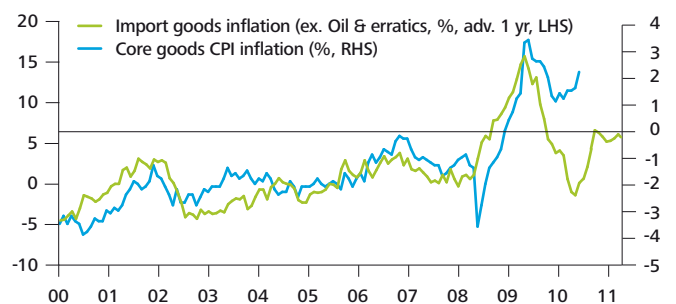
## Economic slack should eventually bring inflation down

- Despite all of this, I still think that there are good reasons to expect inflation to fall back fairly sharply over the medium-term. For a start, provided that global oil and commodity prices do not carry on rising at the same rate, the upward pressure on food and energy inflation in the UK should eventually fade.
- Meanwhile, the inflationary influence of the sharp fall in the exchange rate seen a couple of years ago should continue to fade over the coming months. As Chart 9 shows, import price inflation has picked back up somewhat over the last year or so but, provided that the pound stays roughly where it is, it should soon ease back again.
- Admittedly, Charts 10 and 11 show that the pass-through of previous falls in both import prices and domestic producer output prices into high street goods prices has been interrupted in recent months.
- This might partly reflect the distortionary effects of the latest VAT rise. However, there has also been speculation that retailers have taken advantage of an increase in pricing power in order to re-widen their profit margins. This, in turn, might be an indication that there is less spare capacity or slack in the economy than has generally been thought – or that a given amount of spare capacity has a smaller downward influence on inflation.
- One factor which might support this more pessimistic interpretation is the continued stubbornness of inflation in the services sector, which Chart 12 shows has also been above equivalent measures in other countries. This is less readily explained by VAT or the pound.
- But I continue to find it hard to believe that the aftermath of the deepest recession for decades will have no downward effect on inflation at all. Chart 13 shows that marked variations in spare capacity in previous cycles have had clearly observable effects on core inflation, albeit after some quite long lags.
- Indeed, one part of the economy in which spare capacity clearly already is bearing down on prices is the labour market. The combination of weak wage growth and the recent pick-up in productivity growth has prompted a sharp slowdown in the growth of unit labour costs. (See Chart 14.) On past form, this should help to bring core inflation down before too long.
- Meanwhile, other medium-term determinants of inflation such as the growth of the broad money supply also continue to point to *downward*, rather than upward, pressure on prices. (See Chart 15.)
- Overall, then, inflation is set to remain at uncomfortably high levels throughout 2011, squeezing spending power and perhaps forcing the MPC to seek to weaken the economy with tighter monetary policy. But inflation should drop back sharply next year and beyond. Indeed, hard though it is to imagine at the moment, worries about *deflationary* pressures could even return to the fore. (See Chart 16 and *Forecast Table: Inflation* on page 36.)

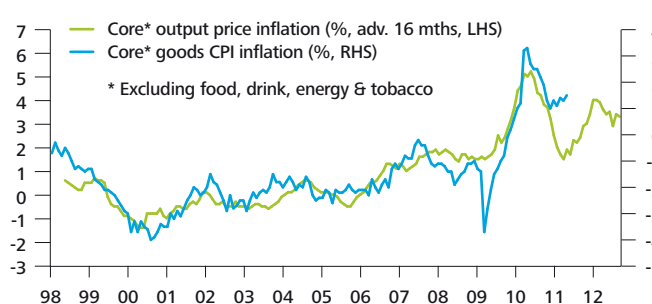
**Chart 9. Sterling & import prices (%/y)**



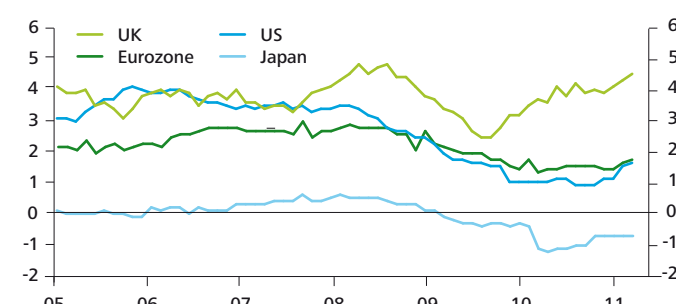
**Chart 10. Import prices & core goods CPI inflation (%)**



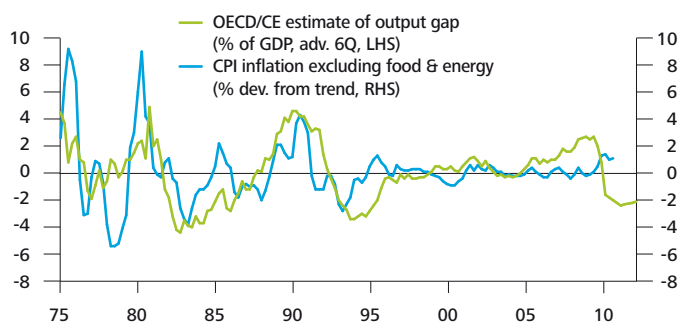
**Chart 11. Core PPI & CPI goods inflation (%)**



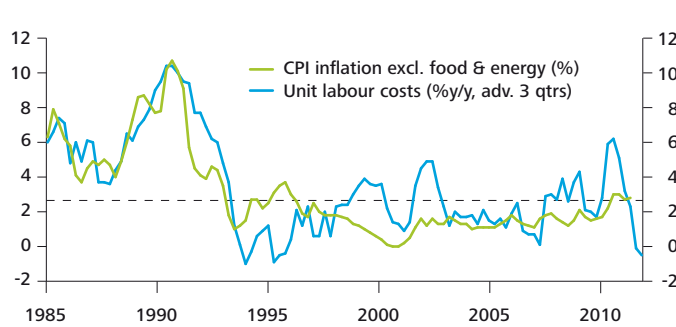
**Chart 12. International services inflation (%)**



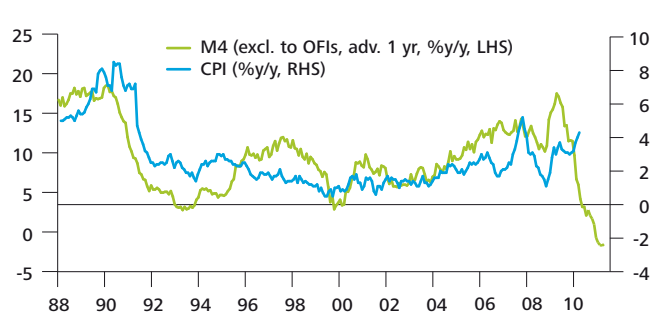
**Chart 13. Core CPI inflation & output gap estimates**



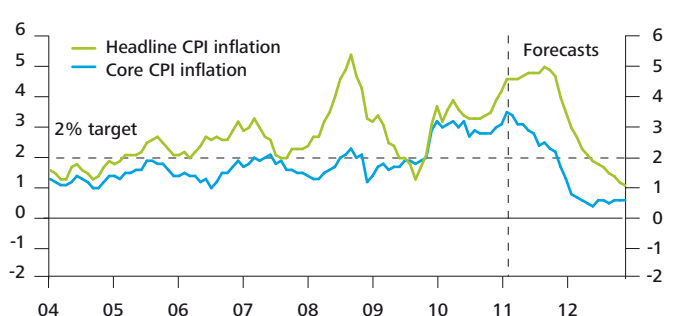
**Chart 14. Core CPI inflation & unit wage costs**



**Chart 15. Broad money growth & CPI inflation**



**Chart 16. CPI inflation forecasts (%)**



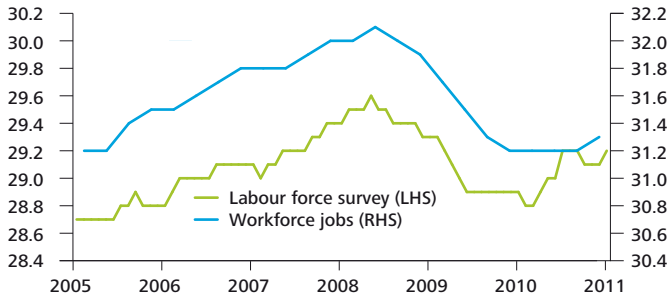
Sources – Thomson Datastream, Citigroup/YouGov, OECD

# Analysis: UK labour market

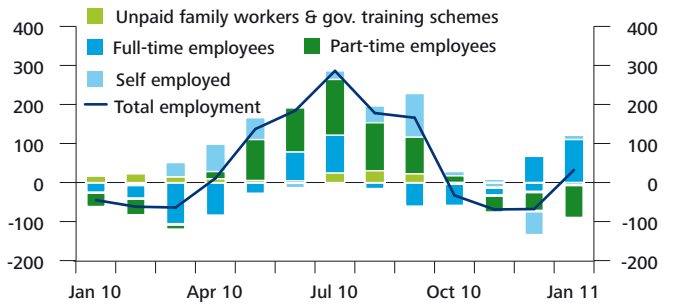
## Pay growth unlikely to catch up with inflation

- The labour market recovery has petered out somewhat in the past few months and I still expect unemployment to rise further. What's more, the squeeze on households' real pay is likely to persist into next year.
- Employment growth has remained quite volatile, with the two main measures still painting slightly different pictures. However, it seems that employment is broadly tracking sideways. (See Chart 1.)
- Given that the workforce (the number of people in or seeking work) has been rising, the main ILO measure of unemployment has therefore been rising.
- At least the jobs that are being created look permanent. Full-time employment is rising quite strongly, whereas part-time and self-employment have fallen back. (See Chart 2.)
- What's more, the number of job vacancies has risen and points to a pick-up in employment growth. (See Chart 3.)
- Admittedly, vacancies have been temporarily boosted by recruitment for the census. But other forward-looking measures have improved too. For example, the KPMG/REC Report on Jobs has recovered from its previous falls. (See Chart 4.)
- Accordingly, a modest improvement in the labour market might be seen in the near-term. But beyond that, I think that the outlook remains gloomy. The pressure from cuts in government spending is likely to mount. I expect about 400,000 public sector jobs to be lost over the next few years, in addition to the 100,000 shed over the last year.
- And I still doubt that the private sector will generate enough jobs to offset this. After all, I think that the fiscal squeeze could also lead to the loss of about 100,000 private sector jobs a year through cuts in procurement.
- Meanwhile, productivity remains well below its pre-recession level. Admittedly, this partly reflects the fact that many firms cut workers' hours, rather than jobs, during the recession. But output per hour worked remains low too. (See Chart 5.) Accordingly, I still see scope for output to rise using the existing workforce.
- As a result of all this, I still expect overall employment to fall – by perhaps 500,000 from its recent peak. For now, I expect the falls to be concentrated in the next two years, but the adjustment could be more drawn-out than I expect. (See Chart 6 & *Forecast Table: Labour market* on page 37.)
- The resulting slack in the labour market is likely to keep pay growth subdued. Pay settlements have started to rise. But they remain well below the 3.7% level reached when inflation was last this high. (See Chart 7.)
- Overall average earnings should still rise a bit faster this year than last. But I expect growth of only 2.5% or so, meaning that real pay falls again. Only when inflation drops sharply next year will real pay growth return to its long-run average growth rate of 1.8%. (See Chart 8.)

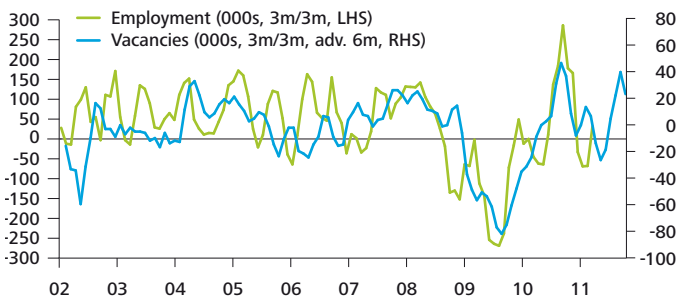
**Chart 1. Employment (Mns)**



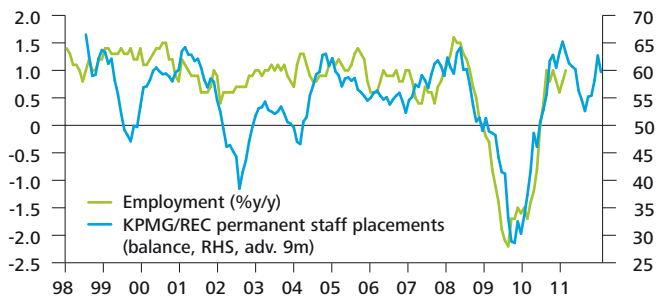
**Chart 2. LFS Employment (000s, q/q)**



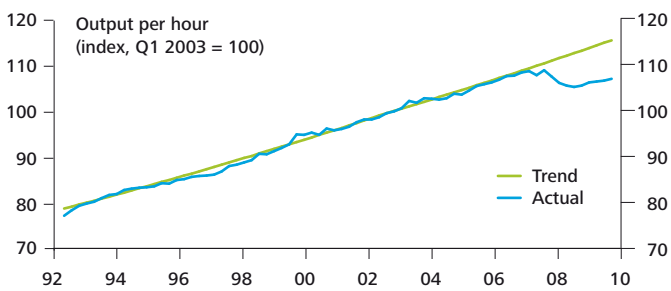
**Chart 3. Employment growth & job vacancies**



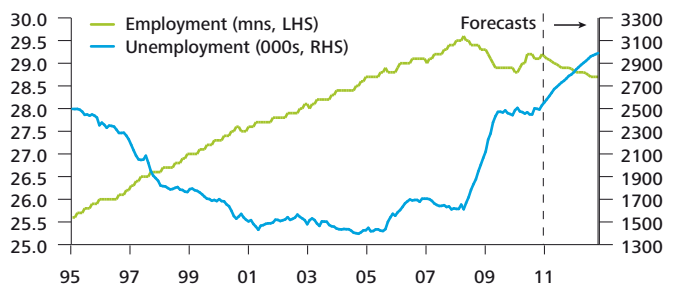
**Chart 4. Employment growth & permanent staff placements**



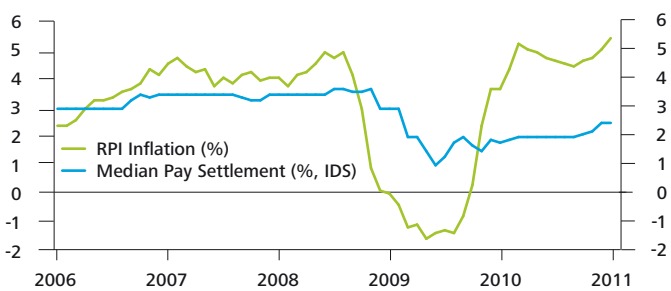
**Chart 5. Productivity**



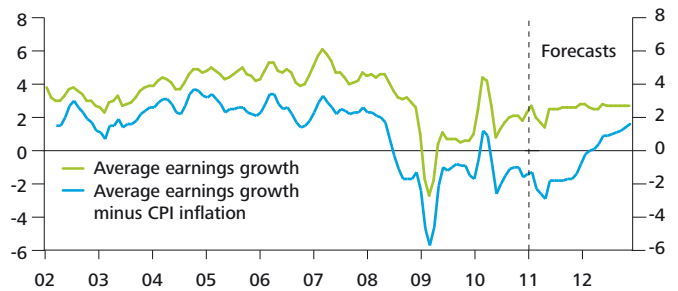
**Chart 6. Employment & unemployment levels**



**Chart 7. Pay settlements & inflation**



**Chart 8. Average earnings (%/y)**



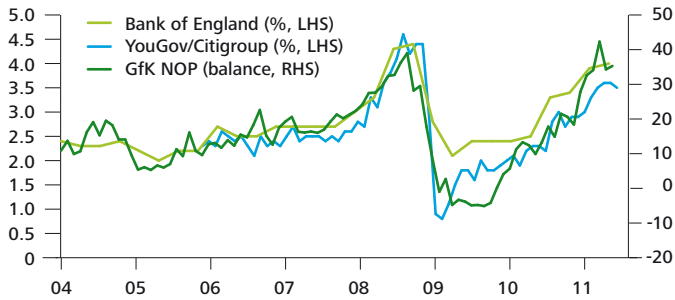
Sources – Thomson Datastream, IDS KPMG/REC

# Analysis: UK monetary policy

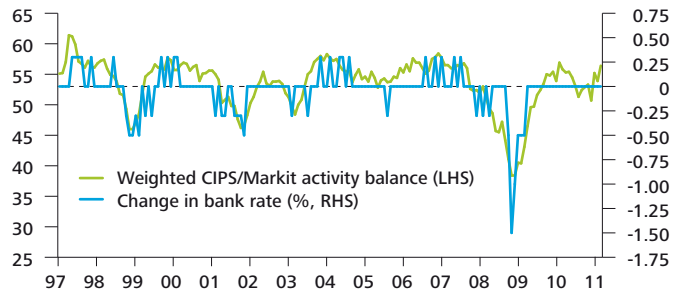
## Rates to remain historically low

- The risk of a near-term interest rate rise has increased in recent months. But signs that the economic recovery is struggling could yet keep the Monetary Policy Committee (MPC) on hold. Even if rates rise, I doubt that this will mark the start of a “normal” tightening cycle.
- Theories that the MPC is colluding with the Government to keep inflation high to reduce the debt burden continue to abound. I think this is far-fetched. If higher inflation were to push up government bond yields, it might not do much to ease the debt burden anyway.
- In any case, three MPC members are now voting to raise interest rates. Andrew Sentance wants a 50bps rise, while Martin Weale and Spencer Dale want a 25bps increase.
- Andrew Sentance thinks that raising rates gradually now can avoid a sharper and more damaging rise later. Meanwhile, Spencer Dale is concerned that the full effects of the rise in inflation on inflation expectations are yet to be seen and takes scant comfort from the limited rise in expectations seen so far. (See Chart 1.)
- But others are not convinced that rates should rise. Mervyn King has even said that a rate rise would be a “futile gesture”. The majority also wants to wait for more news on how the economic recovery is faring. The CIPS/Markit surveys are now consistent with a rate hike. (See Chart 2.) But more forward-looking indicators – like confidence – have weakened.
- If the economic data improve and suggest that Q4 was just a blip, a rate rise will start to look unavoidable. However, the recent weakening in some of the economic data – on the consumer sector, in particular – suggest that a rate rise might yet be avoided.
- Indeed, markets have pushed back their expected timing of the first rate rise from May to June or July. (See Chart 3.) Expectations for rates at the end of this year have fallen back by about 25bps since February. (See Chart 4.)
- While I would hardly be surprised if interest rates rose, my central forecast is still that rates remain on hold throughout this year and next. Even if rates do rise, this is unlikely to mark the start of the prolonged period of monetary tightening that markets expect. In fact, if markets responded by ratcheting up their expectations of further tightening, the resulting damage to the economy could even mean any rise would have to be reversed.
- In fact, it is not out of the question that the MPC will eventually need to give more support to the economy. My forecasts for economic growth and inflation are much lower than the Committee’s. (See Charts 5 and 6.) And one member, Adam Posen, is still voting for more QE. But additional asset purchases, if they do come, are perhaps unlikely until 2012.
- Gilt yields have recently fallen back in line with interest rate expectations. (See Chart 7.) So if I am right in expecting the latter to fall further, yields should drop back too. I still think that ten year yields could even fall back below 3% again. (See Chart 8 and *Forecast Table: Monetary*, page 38.)

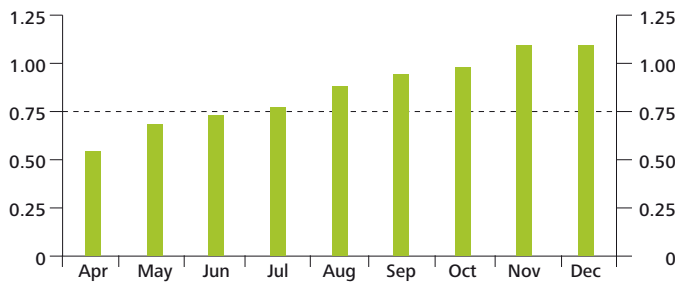
**Chart 1. Households' inflation expectations (%)**



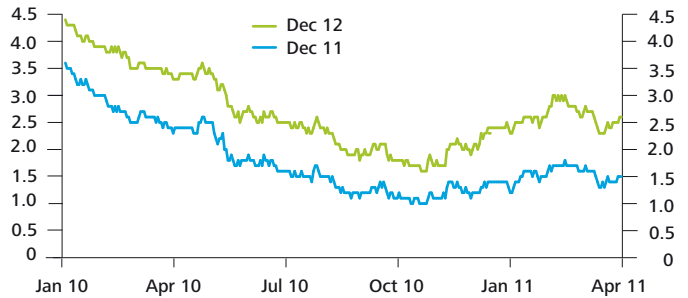
**Chart 2. CIPS/Markit surveys & official interest rates**



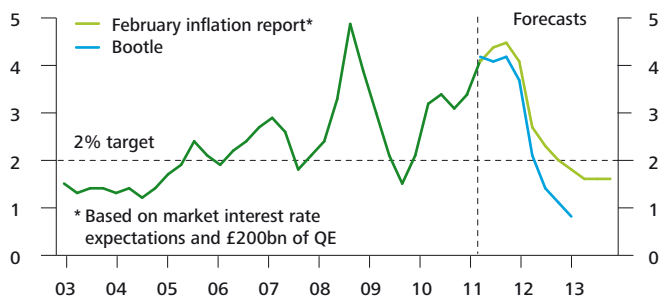
**Chart 3. Implied overnight interest rates (%)**



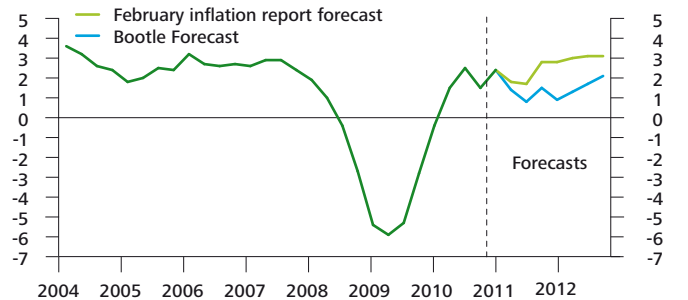
**Chart 4. Implied expectations for 3m LIBOR rates (%)**



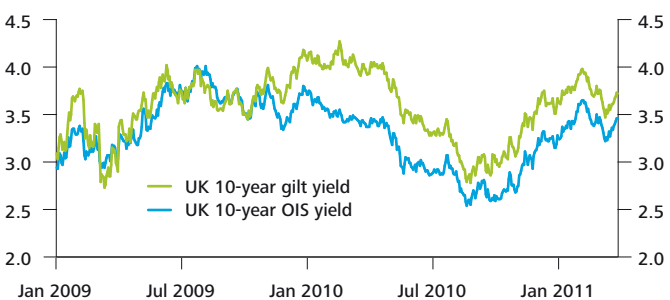
**Chart 5. CPI inflation forecasts (%)**



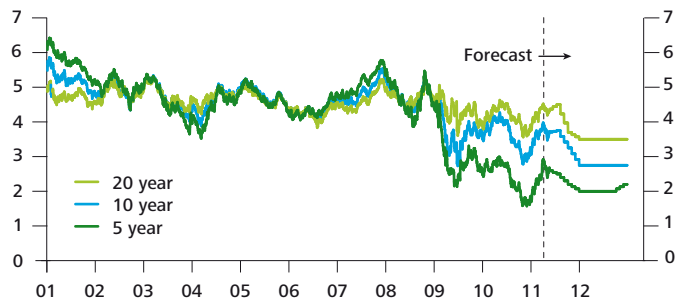
**Chart 6. Real GDP (%/y)**



**Chart 7. 10 Year gilt yield & OIS rate (%)**



**Chart 8. Bond yields (%)**



Sources – Thomson Datastream, Bloomberg, Bank of England

# Analysis: UK public finances

## Fingers tightly crossed for Plan A!

- There are still major doubts over whether the economy will be strong enough to withstand the Government's fiscal austerity plans.
- The public finances have continued to follow a modestly improved trend over recent months. (See Chart 1.) This prompted the Office for Budget Responsibility (OBR) to nudge down its forecast for Public Sector Net Borrowing (PSNB) in 2010-11 in the recent Budget.
- However, the predicted path of borrowing in later years was raised by roughly £10bn per annum in response to higher projected inflation and its expected effects on inflation-linked public spending. (See Chart 2.)
- This restricted the Chancellor George Osborne to a fiscally neutral Budget in which cuts in fuel duty and corporation tax were financed by higher North Sea taxation and measures to reduce tax avoidance. But it still left the Government on track, in the OBR's judgement, to meet its fiscal mandate of returning the cyclically adjusted current budget to balance by 2015-16 a year early. (See Chart 3.)
- The Government's austerity plans have clearly helped to improve confidence in the UK's fiscal outlook and keep borrowing costs much lower than in the fiscally-troubled economies of the euro-zone. (See Chart 4.)
- However, there are still uncertainties over whether the plans for historically deep cuts in public spending are actually achievable, given growing concerns (and protests) over the impact on some public services. (See Chart 5.)
- Meanwhile, the plans also rest heavily on a strong expansion in the economy over the next few years. Although the OBR nudged down its forecast for GDP growth in 2011 from 2.1% to 1.7%, it expects above-consensus growth of 2.5% in 2012 and 2.9% in 2013. (See Chart 6.)
- This has maintained concerns over the apparent lack of a so-called "Plan B" should the economy be weaker than expected. My own GDP forecasts suggest that borrowing will fall much less quickly than the OBR expects without further policy changes. (See Chart 7.)
- The fiscal mandate allows for some slippage in the pace of deficit reduction in response to a weaker economy. It also allows for increased borrowing for investment purposes. But market pressures and the supplementary target for the debt to GDP ratio to be falling by 2015-16 suggest that any deviation from the current plans will be fairly limited.
- Accordingly, there is a clear danger that a further fiscal tightening will be needed at a time when the economy is already weak. All of this leaves Plan A still heavily dependent on the Monetary Policy Committee to continue to support the economy.
- High borrowing levels and heavy bond redemptions will keep gilt issuance elevated over the next few years. (See Chart 8.) But gilts have benefited from safe-haven demand amidst the euro-zone fiscal crisis and I therefore expect yields to remain at historically low levels. (See *Forecast Table: Public Finances*, page 39.)

Chart 1. Public sector net borrowing (£bn)

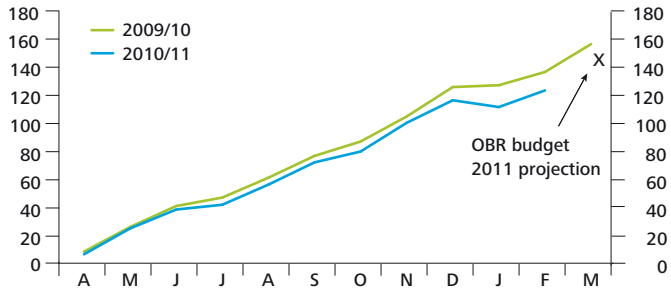


Chart 2. PSNB forecasts (£bn)

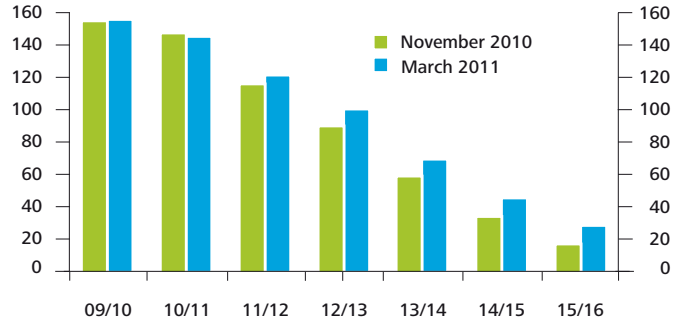


Chart 3. Cyclically adjusted current budget (% GDP)

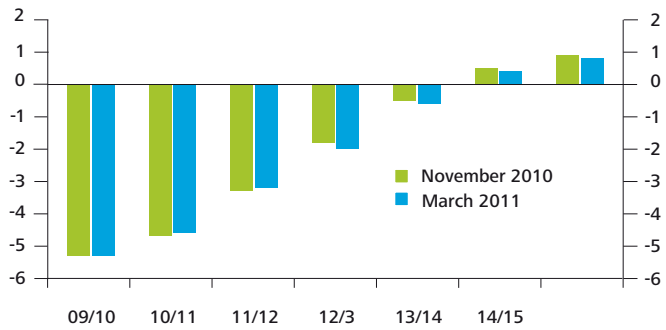


Chart 4. Ten year government bond yields (%)

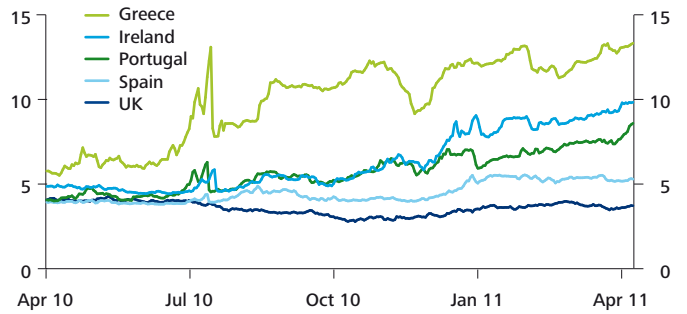


Chart 5. Total real public spending (%/y)

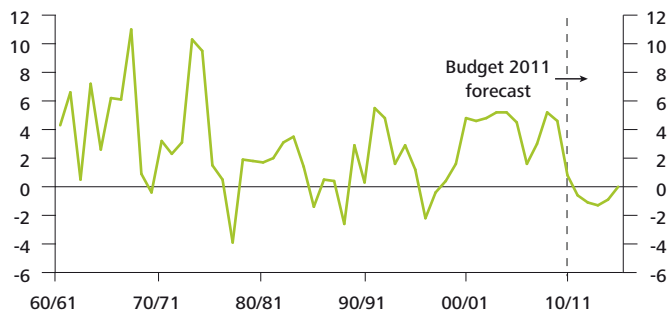


Chart 6. Real GDP growth forecasts (%/y)

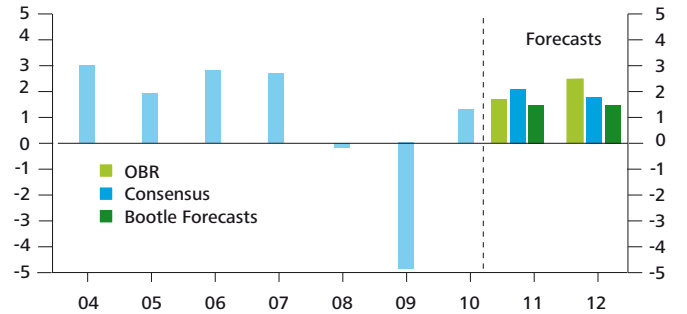


Chart 7. PSNB forecasts (£bn)

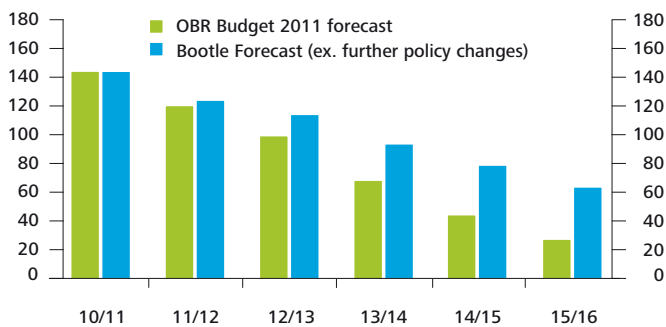
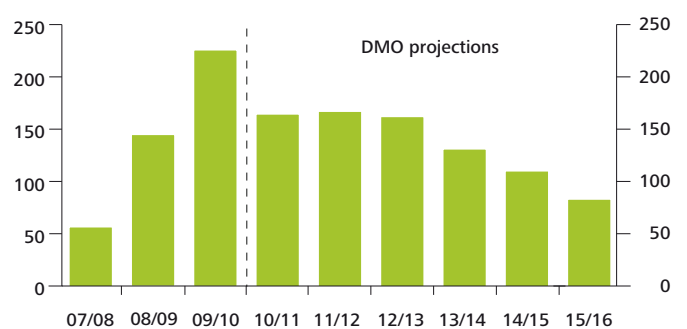


Chart 8. Gross gilt issuance (£bn)



Sources – Thomson Datastream, HMT/OBR

# Analysis: UK external sector

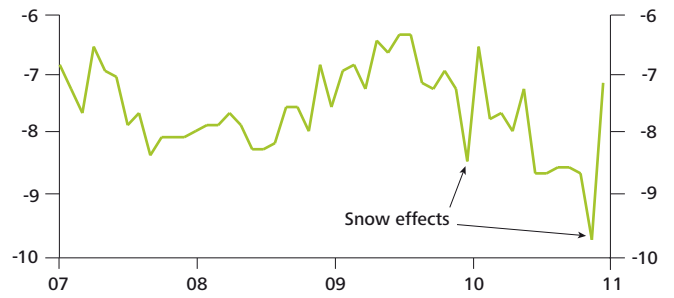
## Trade boost unlikely to offset the fiscal squeeze

- While the external sector failed to support the economic recovery in 2010, I am still hopeful that a trade boost to growth will come through eventually. However, the sector is still unlikely to be able to offset all of the effects on GDP growth of the intensifying fiscal squeeze.
- So far net trade has generally hindered rather than helped the economic recovery. Indeed, it has dragged on GDP growth in five of the last six quarters. (See Chart 1.) And while the monthly trade deficit has been volatile recently as a result of the bad weather, my impression is that the underlying trend in the deficit is perhaps flat at best. (See Chart 2.)
- The problem is still that, although exports are growing strongly, imports are rising at a similar pace. But I am hopeful that, as the year progresses, export growth will stay strong while import growth cools.
- Indeed, surveys of export orders continue to point to strong rises in exports. (See Chart 3.) And the recent pick-up in manufacturing investment might mean that firms are investing in order to exploit the lower pound.
- At the same time, import growth may slow as the fiscal squeeze prompts domestic demand to weaken. (See Chart 4.) If strong import growth has reflected the poor substitutability of imports for domestically-produced alternatives, import growth should slow as domestic capacity is built up.
- That said, there are several key risks. So far, export growth has reflected the pick-up in global trade, rather than the competitive advantage resulting from the lower pound – indeed, UK exporters have lost market share on some measures. So if the rise in oil prices cools global demand, UK exports will suffer. Chart 5 highlights the impact of past oil price shocks on the global economy.
- The UK will also suffer if demand fails to recover in the sectors in which the UK specialises (such as financial services).
- Lastly, there is a risk that sterling appreciates sharply, particularly if UK interest rates rise, prompting markets to re-evaluate their views on the likely pace of tightening. Indeed, a 1% rise in relative UK rate expectations could see the pound rise to above \$1.80. (See Chart 6.) That said, I still think that the MPC will hold back from raising interest rates this year. (See *Analysis: Monetary Policy*, pages 30-31.)
- Given these potential threats, the trade deficit seems likely to narrow only gradually. (See *Forecast Table: External Sector*, page 40.)
- At least the weak pound – if it persists – should bode well for investment income, as it will boost the sterling value of income flowing into the UK. My assumption is that the surplus remains above its long-run average during the next few years. (See Chart 7.)
- Nonetheless, while the current account deficit may narrow, it is likely to do so at a sluggish pace. I have penciled in a drop in the deficit from £35bn in 2010 to around £25bn in 2012. (See Chart 8.)

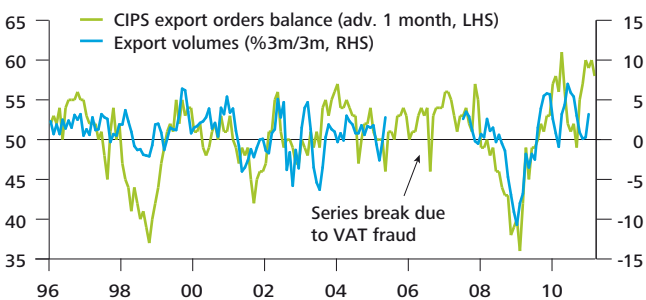
**Chart 1. Net trade contribution to quarterly GDP growth (%)**



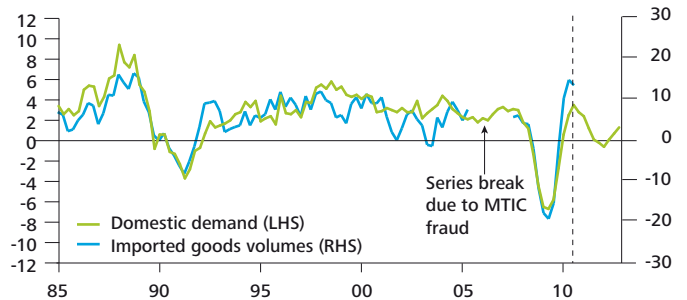
**Chart 2. Trade in goods balance (£bn)**



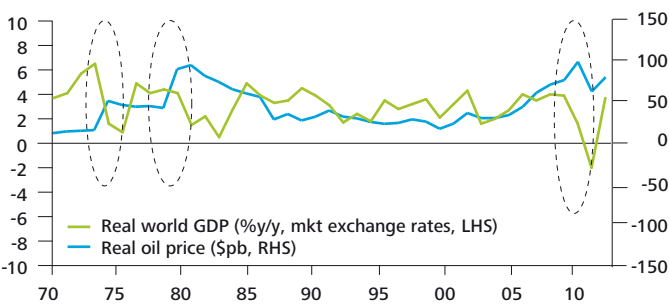
**Chart 3. Export goods volumes & export orders**



**Chart 4. UK domestic demand & import goods volumes**



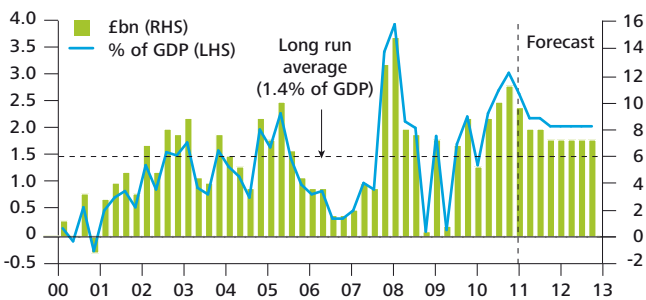
**Chart 5. Global GDP growth & real oil prices**



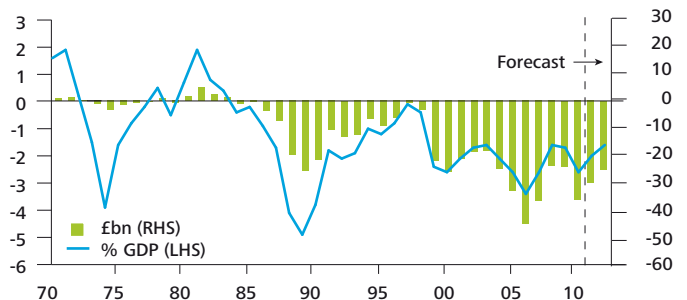
**Chart 6. £/\$ & UK/US relative interest rate differentials**



**Chart 7. UK investment income balance**



**Chart 8. Current account balance**



Sources – Thomson Datastream, Bootle Forecasts

# Forecast table: UK inflation

	Monthly Effect on Index							Annual Rate				
	Other Items						Level of the CPI Index	All CPI	CPI Core <sup>1</sup>	RPI	RPIX	
	s.a. Core	Rent	Alc & Tobac.	Energy	Food	Seas Eff.						Total Change
<b>2010</b>												
Jan	0.4	0.0	0.2	0.1	0.0	-0.8	-0.2	112.4	3.5	3.1	3.7	4.6
Feb	0.2	0.0	0.0	0.0	0.1	0.2	0.4	112.9	3.0	2.9	3.7	4.2
Mar	0.1	0.0	0.0	0.1	0.0	0.3	0.5	113.5	3.4	3.0	4.4	4.8
Apr	0.3	0.0	0.1	0.2	0.0	0.1	0.6	114.2	3.7	3.1	5.3	5.4
May	0.0	0.0	0.0	0.0	0.0	0.2	0.2	114.4	3.4	2.9	5.1	5.1
Jun	0.2	0.0	0.0	-0.1	0.0	0.2	0.2	114.6	3.2	3.1	5.0	5.0
Jul	-0.2	0.0	0.0	0.0	0.1	-0.2	-0.3	114.3	3.1	2.6	4.8	4.8
Aug	0.2	0.0	0.0	0.0	0.0	0.4	0.5	114.9	3.1	2.8	4.7	4.7
Sep	0.1	0.0	0.0	0.0	0.0	-0.1	0.0	114.9	3.1	2.7	4.6	4.6
Oct	0.2	0.0	0.0	0.1	0.1	-0.1	0.3	115.2	3.2	2.7	4.5	4.6
Nov	0.2	0.0	0.0	0.1	0.2	0.0	0.3	115.6	3.3	2.7	4.7	4.7
Dec	0.2	0.0	0.0	0.3	0.2	0.5	1.0	116.8	3.7	2.9	4.8	4.7
<b>2011</b>												
Jan	0.5	0.0	0.2	0.3	0.0	-0.8	0.1	116.9	4.0	3.0	5.1	5.1
Feb	0.4	0.0	0.0	0.1	0.1	0.2	0.8	117.8	4.4	3.4	5.5	5.5
Mar	0.0	0.0	0.0	0.2	0.1	0.3	0.5	118.4	4.4	3.3	5.4	5.4
Apr	0.0	0.1	0.3	0.1	0.1	0.1	0.6	119.2	4.4	3.0	5.4	5.4
May	0.0	0.0	0.0	0.0	0.1	0.2	0.3	119.6	4.5	3.0	5.5	5.4
Jun	0.0	0.0	0.0	0.0	0.1	0.1	0.2	119.8	4.6	2.8	5.5	5.4
Jul	-0.3	0.0	0.0	0.0	0.2	-0.2	-0.2	119.6	4.6	2.7	5.6	5.5
Aug	0.0	0.0	0.0	0.0	0.2	0.3	0.5	120.2	4.6	2.3	5.5	5.4
Sep	0.1	0.0	0.0	0.0	0.1	-0.1	0.2	120.4	4.8	2.4	5.6	5.5
Oct	0.0	0.0	0.0	0.0	0.2	-0.1	0.2	120.6	4.7	2.2	5.5	5.3
Nov	0.0	0.0	0.0	0.0	0.1	0.0	0.1	120.8	4.5	2.1	5.2	5.1
Dec	0.0	0.0	0.0	0.0	0.1	0.3	0.4	121.2	3.8	1.6	4.5	4.4
<b>2012</b>												
Jan	0.0	0.0	0.1	0.1	0.1	-0.8	-0.4	120.8	3.3	1.2	4.0	3.9
Feb	0.0	0.0	0.0	0.0	0.0	0.2	0.3	121.1	2.8	0.7	3.4	3.4
Mar	0.0	0.0	0.0	0.0	0.0	0.2	0.3	121.5	2.5	0.6	3.1	3.1
Apr	-0.1	0.1	0.1	0.0	0.0	0.1	0.2	121.7	2.1	0.5	2.8	2.8
May	-0.1	0.0	0.0	0.0	0.0	0.1	0.1	121.9	1.9	0.4	2.7	2.7
Jun	-0.1	0.0	0.0	0.0	0.0	0.1	0.0	121.9	1.7	0.3	2.6	2.5
Jul	-0.1	0.0	0.0	0.0	0.0	-0.2	-0.3	121.6	1.6	0.5	2.5	2.5
Aug	0.0	0.0	0.0	0.1	0.0	0.3	0.4	122.0	1.5	0.5	2.5	2.5
Sep	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	122.0	1.3	0.4	2.7	2.7
Oct	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	122.0	1.2	0.5	2.6	2.6
Nov	0.0	0.0	0.0	0.0	0.0	0.0	0.0	122.0	1.0	0.5	2.5	2.4
Dec	0.0	0.0	0.0	0.0	0.0	0.3	0.3	122.3	0.9	0.5	2.4	2.3

<sup>1</sup> Excludes energy, food, alcohol & tobacco.

# Forecast table: UK labour market

Activity	Workforce		ILO/Labour Force Survey Employment		ILO Unemployment		Claimant Count Unemployment	
	Millions	%y/y	Millions	%y/y	Millions	%	Millions	%
	2009	31.4	0.6	29.0	-1.5	2.4	7.6	1.5
2010	31.5	0.4	29.0	0.0	2.5	7.8	1.5	4.8
2011f	31.7	0.6	29.0	0.0	2.7	8.5	1.7	5.2
2012f	31.7	0.0	28.8	-0.8	2.9	9.2	1.8	5.8
Q1 2010	31.3	-0.1	28.8	-1.4	2.5	7.9	1.6	5.0
Q2	31.4	0.3	29.0	-0.1	2.5	7.8	1.5	4.7
Q3	31.6	0.6	29.2	1.0	2.5	7.8	1.5	4.7
Q4	31.6	0.0	29.1	0.7	2.5	7.9	1.5	4.8
Q1 2011	31.7	0.1	29.1	0.9	2.6	8.1	1.6	4.9
Q2	31.7	0.1	29.0	-0.1	2.7	8.4	1.6	5.2
Q3	31.7	0.0	28.9	-0.8	2.7	8.6	1.7	5.3
Q4	31.7	0.0	28.9	-0.8	2.8	8.8	1.7	5.5
Q1 2012	31.7	0.0	28.8	-0.8	2.8	9.0	1.8	5.6
Q2	31.7	0.0	28.8	-0.8	2.9	9.2	1.8	5.7
Q3	31.7	0.0	28.7	-0.8	3.0	9.3	1.9	5.9
Q4	31.7	0.0	28.7	-0.7	3.0	9.4	1.9	5.9

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		
2009	-0.1	1.7	0.5	-2.2	-3.1	5.1
2010	2.3	1.9	-2.4	-1.0	1.2	0.7
2011f	2.4	2.3	-2.7	-1.7	1.7	0.7
2012f	2.7	2.3	-0.1	0.9	2.3	0.4
Q1 2010	4.4	1.8	0.5	1.2	1.1	2.3
Q2	0.8	1.3	-4.3	-2.6	1.3	-0.1
Q3	2.0	2.2	-2.7	-1.1	1.7	-0.5
Q4	1.8	2.3	-2.9	-1.6	0.8	1.0
Q1 2011	2.0	2.1	-3.4	-2.3	1.5	0.5
Q2	2.5	2.5	-2.7	-1.6	1.4	1.1
Q3	2.6	2.2	-2.6	-1.7	1.7	0.9
Q4	2.6	2.4	-2.0	-1.3	2.3	0.3
Q1 2012	2.6	2.4	-0.6	0.0	1.7	0.9
Q2	2.8	2.3	0.1	0.8	2.1	0.6
Q3	2.7	2.3	0.0	1.0	2.5	0.2
Q4	2.7	2.3	0.1	1.6	2.8	-0.1

# Forecast table: UK 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
2009	0.50	4.12	4.41	0.25	0.25	1.00	-0.50
2010	0.50	3.51	4.01	0.25	0.25	1.00	-0.50
2011f	0.50	2.75	3.50	0.25	0.25	1.50	-1.00
2012f	0.50	2.75	3.50	0.25	0.25	1.50	-1.00
Q1 2010	0.50	3.94	4.39	0.25	0.25	1.00	-0.50
Q2	0.50	3.31	4.01	0.25	0.25	1.00	-0.50
Q3	0.50	2.89	3.62	0.25	0.25	1.00	-0.50
Q4	0.50	3.51	4.01	0.25	0.25	1.00	-0.50
Q1 2011	0.50	3.69	4.31	0.25	0.25	1.00	-0.50
Q2	0.50	3.75	4.50	0.25	0.25	1.25	-0.75
Q3	0.50	3.25	3.70	0.25	0.25	1.50	-1.00
Q4	0.50	2.75	3.50	0.25	0.25	1.50	-1.00
Q1 2012	0.50	2.75	3.50	0.25	0.25	1.50	-1.00
Q2	0.50	2.75	3.50	0.25	0.25	1.50	-1.00
Q3	0.50	2.75	3.50	0.25	0.25	1.50	-1.00
Q4	0.50	2.75	3.50	0.25	0.25	1.50	-1.00

Sterling exchange rates (end period)					
Sterling versus...	\$	¥	Euro	Euro <sup>1</sup>	ERI <sup>2</sup>
2009	1.62	147	0.89	1.13	80.8
2010	1.56	126	0.86	1.17	79.8
2011f	1.50	135	0.87	1.15	78.4
2012f	1.40	140	0.71	1.40	86.8
Q1 2010	1.52	140	0.89	1.12	78.2
Q2	1.49	133	0.82	1.22	81.9
Q3	1.57	133	0.87	1.15	79.9
Q4	1.56	126	0.86	1.17	79.8
Q1 2011	1.60	134	0.89	1.13	79.0
Q2	1.65	144	0.88	1.14	80.1
Q3	1.60	144	0.88	1.14	79.5
Q4	1.50	135	0.87	1.15	78.4
Q1 2012	1.40	126	0.86	1.17	77.2
Q2	1.40	133	0.79	1.27	81.6
Q3	1.40	140	0.71	1.40	86.8
Q4	1.40	140	0.71	1.40	86.8

1 Pound per euro. 2 Effective exchange rate index.

# Forecast table: UK public finances<sup>1</sup>

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 <sup>2</sup>	(5) Current balance	(6) Net investment	(7) = (4) + (6) Total expenditure
<b>Recent history</b>							
06-07	519	n/a	519	526	-7	26	552
07-08	549	n/a	549	555	-6	29	584
08-09	533	n/a	533	583	-50	37	620
09-10	513	n/a	513	620	-107	50	670
<b>OBR forecast</b>							
10-11	549	n/a	549	653	-105	41	694
11-12	589	n/a	589	679	-90	32	710
12-13	620	n/a	620	693	-73	28	720
13-14	660	n/a	660	706	-46	24	730
14-15	698	n/a	698	720	-22	24	744
<b>Bootle forecast</b>							
10-11	550	0	550	653	-103	42	695
11-12	586	0	586	678	-92	33	711
12-13	608	5	613	693	-80	30	723
13-14	638	10	648	710	-62	23	733
14-15	669	15	684	726	-42	23	749

Government borrowing & debt							
	PSNB		Public sector net cash requirement (PSNCR) £bn	General government gross debt % GDP <sup>3</sup>	Public sector net debt % GDP	Gross gilt sales £bn	
	£bn	% GDP					
<b>Recent history</b>							
06-07	31.8	2.4	35.1	43.3	36.0		62.5
07-08	35.6	2.5	21.5	43.2	36.5		58.4
08-09	86.7	6.1	59.6	55.8	44.0		147.0
09-10	156.4	11.1	204.1	71.2	52.7		148.0
<b>OBR forecast</b>							
10-11	145.9	9.9	145	78.7	60.3		185
11-12	122	7.9	129	84.1	66.1		187
12-13	101	6.2	109	87.0	69.7		159
13-14	70	4.1	83	87.2	70.9		141
14-15	46	2.5	52	85.7	70.5		142
<b>Bootle forecast</b>							
10-11	145	9.9	145	79.7	61.3		190
11-12	125	8.1	133	85.5	67.5		190
12-13	110	6.9	118	89.6	72.3		170
13-14	85	5.1	98	91.2	74.9		155
14-15	65	3.7	71	90.3	75.1		160

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

# Forecast table: UK 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
2009	-82.4	-5.9	52.7	3.8	21.2	1.5	-14.7	-1.0	-23.9	-1.7
2010f	-83.8	-6.0	51.7	3.7	14.5	1.0	-19.7	-1.4	-36.2	-2.6
2011f	-95.9	-6.2	51.9	3.4	31.0	2.0	-17.0	-1.1	-30.0	-2.0
2012f	-92.1	-5.8	55.1	3.5	28.0	1.8	-16.0	-1.0	-25.0	-1.6
Q1 2010	-22.6	-6.3	12.9	3.6	4.6	1.3	-4.4	-1.2	-9.5	-2.6
Q2	-22.7	-6.3	11.6	3.2	7.8	2.2	-4.3	-1.2	-7.6	-2.1
Q3	-25.7	-7.0	12.7	3.5	9.2	2.5	-4.9	-1.3	-8.7	-2.4
Q4	-26.8	-7.3	12.1	3.3	10.3	2.8	-6.1	-1.7	-10.5	-2.9
Q1 2011	-23.4	-6.1	12.5	3.3	9.0	2.4	-5.0	-1.3	-6.9	-1.8
Q2	-24.4	-6.4	12.9	3.4	7.5	2.0	-4.0	-1.0	-7.9	-2.1
Q3	-24.1	-6.3	13.2	3.4	7.5	2.0	-4.0	-1.0	-7.4	-1.9
Q4	-24.0	-6.2	13.4	3.4	7.0	1.8	-4.0	-1.0	-7.7	-2.0
Q1 2012	-23.7	-6.0	13.4	3.4	7.0	1.8	-4.0	-1.0	-7.4	-1.9
Q2	-23.3	-5.9	13.7	3.5	7.0	1.8	-4.0	-1.0	-6.6	-1.7
Q3	-22.8	-5.8	13.9	3.5	7.0	1.8	-4.0	-1.0	-5.9	-1.5
Q4	-22.2	-5.6	14.1	3.5	7.0	1.8	-4.0	-1.0	-5.1	-1.3

Exports, imports & prices (£bn)								
	Goods		Services		Goods & services		Prices <sup>1</sup>	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports %y/y	Imports %y/y
2009	227.6	310.0	163.2	110.6	390.9	420.6	6.2	6.4
2010f	234.0	317.8	161.2	109.5	395.2	427.3	3.2	3.9
2011f	299.6	395.5	166.7	114.8	466.3	510.3	3.5	5.0
2012f	311.7	403.8	172.7	117.6	484.4	521.4	2.0	2.0
Q1 2010	62.2	84.8	40.5	27.6	102.7	112.3	1.4	-0.2
Q2	66.1	88.8	40.4	28.8	106.5	117.6	3.9	4.3
Q3	66.7	92.3	41.2	28.5	107.8	120.8	3.7	5.8
Q4	70.4	97.2	40.9	28.8	111.3	126.0	3.7	5.7
Q1 2011	74.5	97.9	41.1	28.6	115.6	126.5	2.3	5.6
Q2	74.5	98.8	41.5	28.6	116.0	127.5	2.9	4.2
Q3	75.0	99.1	41.9	28.7	116.9	127.8	4.7	5.3
Q4	75.6	99.6	42.2	28.8	117.8	128.4	3.9	4.7
Q1 2012	76.4	100.1	42.6	29.2	119.0	129.3	3.5	3.3
Q2	77.3	100.6	43.0	29.3	120.3	130.0	2.5	2.5
Q3	78.4	101.2	43.4	29.5	121.8	130.7	1.5	1.6
Q4	79.6	101.8	43.7	29.6	123.3	131.4	0.6	0.7

<sup>1</sup> Excludes prices of oil and other erratic items.



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