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UK outlook 2020: the critical issues

The decisive election victory for UK Prime Minister Boris Johnson and his Conservative Party on 12 December 2019 has tilted the balance of factors that will decide the medium-term path for the economy from negative to positive. As we look for the UK to enjoy a cyclical upswing over the medium term (Chart 1), we ask the following questions.

1) Following very weak growth in 2019, most forecasters see only a modest recovery in 2020. Berenberg is more optimistic. Why?

2) Businesses have reacted negatively to the heightened political uncertainty in recent years and remain pessimistic about Brexit. What is the outlook for business confidence and activity?

3) Unless the UK and EU either strike a trade agreement in time, or agree to extend the transitional period, there could be a hard Brexit at the end of 2020. How likely is this outcome?

4) PM Johnson has promised to end austerity. How big could the fiscal impulse be in the coming years?

5) Reacting to the global slowdown and intensifying domestic risks, the labour market lost some of its erstwhile momentum in late 2019. Will the labour market rebound in 2020?

6) Stronger sterling and falling energy prices tipped headline inflation below the BoE's 2% target in late 2019. What is the outlook for inflation?

7) With a new governor at the BoE, what can we expect from monetary policy?

8) Which sectors are likely to do well over the medium term if Brexit risks remain contained and global demand improves?

9) Turning to the risks, how high is the recession risk in the next couple of years? Through which channels could that occur?

10) Sterling and gilts have tracked political developments closely since the Brexit vote, will this continue?

Chart 1: UK set for medium-term rebound in real GDP growth

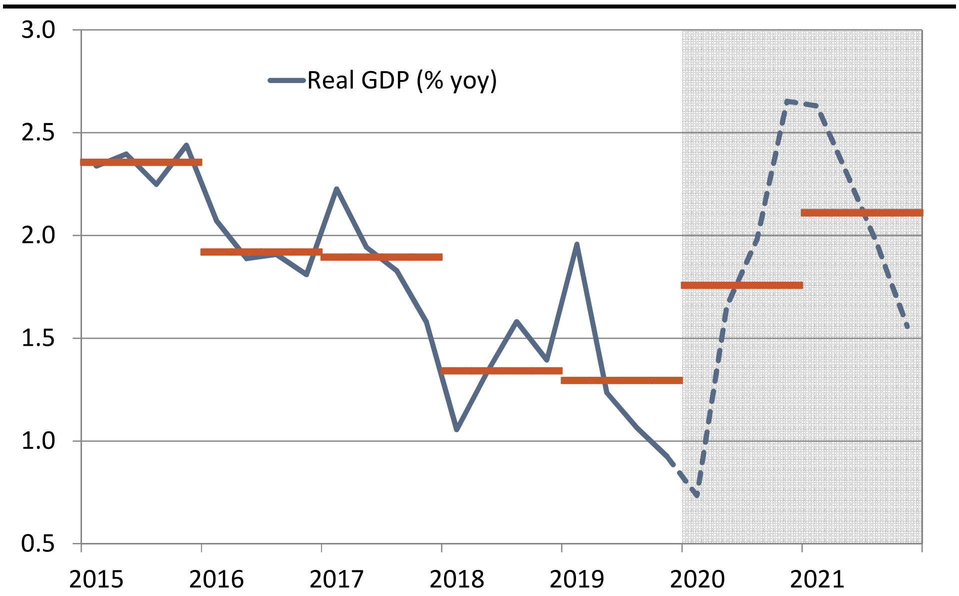

Chart shows annual change in real GDP. Shaded area highlights Berenberg forecasts. Red lines show annual average growth. Quarterly data. Source: ONS

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1. Following very weak growth in 2019, most forecasters see only a modest recovery in 2020. Berenberg is more optimistic. Why?

We expect real GDP growth to accelerate in 2020 (1.8%) and 2021 (2.1%) after subdued growth of 1.3% in 2019. Our calls are well above consensus. According to Bloomberg consensus, the market expects 1.0% growth in 2020, rising to 1.5% in 2021 (taken 8 January 2020). At a glance, the gap between our calls and consensus looks stark, but the difference is more subtle than the annual projections suggest. Comparing our calls to consensus on a quarterly basis better highlights the difference. We project a stronger rebound with average quarterly growth of c0.65% for 2020. By 2021, our quarterly projections remain in line with consensus (c0.4% qoq). The difference between our calls and consensus in 2021 is entirely due to our above-consensus quarterly calls for 2020.

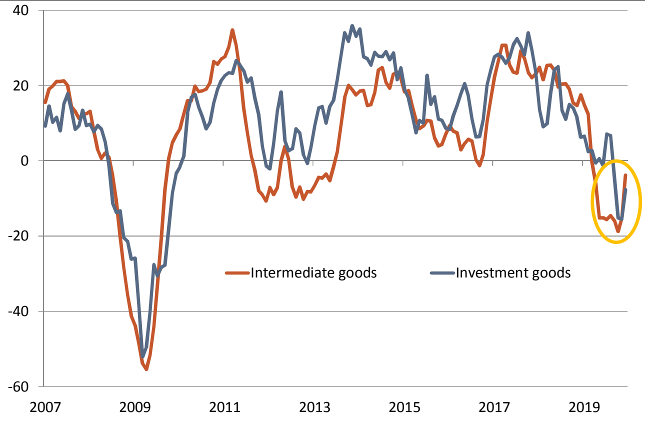
One key factor underpins our projection for a major economic rebound in 2020, namely a material reduction in uncertainty. Beginning in June 2016 when the UK voted to leave the EU, one by one, new factors added uncertainty: noisy UK-EU negotiations; a badly judged election by the-then Prime Minster Theresa May in which she lost her majority in parliament; the subsequent difficulty of getting parliament to agree on a Brexit deal; and, finally, PM Johnson's decision to call snap elections late last year. Facing accumulating risks, firms and households held back spending and investment.

But Johnson's election gamble paid off. While the risk of a hard Brexit at the end of 2020 will continue to hang over the UK like a sword, the sweeping 12 December election win for Johnson and his Conservative Party has brought much of the damaging uncertainty to an end. Three positive factors can underpin an economic rebound.

- A recovery in global demand that lifts output in export-oriented industries. Latest survey data for production expectations among manufacturers of intermediate and investment goods seem to have bottomed out, with some tentative signs that a rebound is underway (Chart 2).
- Stronger household confidence can underpin a pick-up in real consumption growth (up from 1.2% in 2019 to 2.0% in 2020). Wages are rising at a decent clip of +3.5% yoy while households continue to report solid finances (Chart 3). Facing fewer political risks at home, consumers should now have the confidence to spend more.
- Stimulative fiscal policies can reinforce the uptick in private spending. Johnson has already legislated for the fastest growth in day-to-day government spending in 15 years. Expect a further step up in investment spending at the upcoming budget on 11 March.

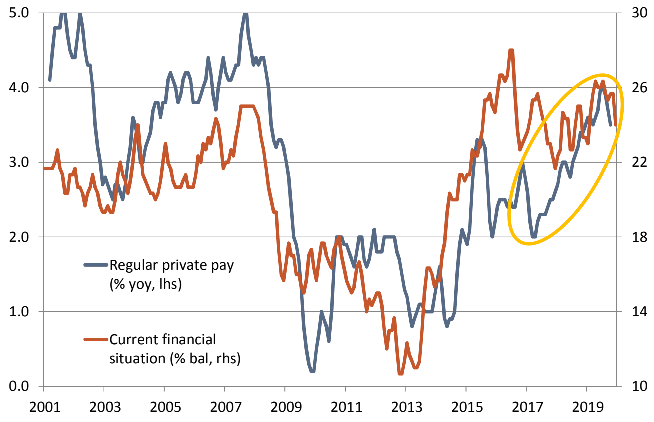
Looking beyond the next two years, we calculate that, based on Johnson's plans for future UK-EU trade (see question three), UK potential growth could fall to c1.6-1.7% versus 2.1% as an EU member. On a one- or two-year basis, this is not much, but it will add up badly over time.

Chart 2: Production expectations bottoming out (% bal)



Three-month moving averages. Monthly data. Source: European Commission

Chart 3: Households – solid pay growth and financial situation



Three-month moving averages. Monthly data. Source: GfK, ONS

2. Businesses have reacted negatively to the heightened political uncertainty in recent years and remain pessimistic about Brexit. What is the outlook for business confidence and activity?

Along with a hard Brexit, the risk that Jeremy Corbyn could become prime minister and damage the economy with his far-left policy agenda had weighed on business sentiment in recent years. The strong position of the newly re-elected Conservative government can help to lift confidence among businesses. With the biggest majority for any prime minister since 2001, Johnson will be able to get his – mostly pro-business and pro-growth – policies through parliament. He could also react quickly to any crisis.

However, relative to the expected uptick in household confidence and the recent rebound in UK-oriented risk assets, businesses will remain timid in 2020 and perhaps beyond, as they continue to tussle with the uncertainty about the future UK-EU relationship.

The UK will remain a highly open economy even after it leaves the EU, but Brexit-related changes in the rules that govern UK trade with the EU and some non-EU countries will impact major parts of the economy. A few stylised facts help put the issue into context.

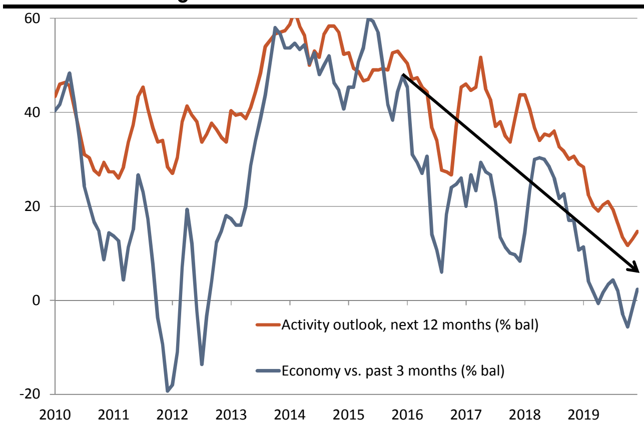
- The UK's trade ratio – exports plus imports as a percentage of GDP – is a little over 60%.
- While sales to the EU make up just less than half of all UK exports, roughly two-thirds of all UK trade is with the EU or with other jurisdictions covered by EU trade agreements.
- More than two-thirds of earnings for FTSE 100 companies, and one-third for FTSE 250 firms, come from abroad.

Many UK firms that sell to UK and non-UK consumers and whose supply chains include elements of foreign production, especially those with just-in-time manufacturing process, face large potential disruptions from Brexit. Other firms that sell just to the UK market, but use imports as part of the production process, and firms that produce in the UK, but sell their wares abroad, also face challenges. These are just the direct effects. Smaller, local businesses that do not directly rely on trade, but sell to trade-oriented firms, face indirect negative effects on demand for their goods and services. These effects could potentially be severe for smaller companies serving large trading firms.

The improved political situation at home, a likely global rebound and stronger household spending should still put an end to the collapse in business confidence since the Brexit vote in 2016 (Chart 4), despite the still-elevated Brexit uncertainty. Private business investment, which remains nearly 15% below the pre-referendum trend (Chart 5), may remain soft for another year or until the UK-EU outlook becomes clearer.

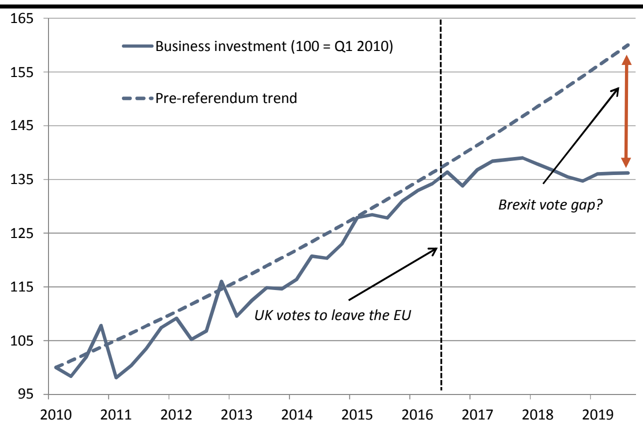
Relative to 2019, when the softness in business activity was broad-based, we will likely see a divergence in fortunes across sectors in 2020. Expect investment in the most Brexit-affected sectors – manufacturing and technology – to remain soft while firms in the mostly domestic-oriented sectors such as construction and retail enjoy the benefits from a less-uncertain domestic political environment, stronger household demand and a major fiscal stimulus.

Chart 4: Declining business confidence since the Brexit vote



Three-month moving average. Monthly data. Source: Lloyds Bank

Chart 5: UK business investment has stalled since June 2016



Quarterly data. Source: ONS, Berenberg

3. Unless the UK and EU either strike a trade agreement in time, or agree to extend the transitional period, there could be a hard Brexit at the end of 2020. How likely is this outcome?

Uncertainty about the final shape of Brexit – ie the future UK-EU economic relationship – will continue to hang over the UK during 2020 and, perhaps, even beyond. Johnson hopes to agree a deal with the EU on future trade by the end of 2020 when the planned transitional period ends. That seems ambitious, to put it mildly. If the UK and the EU fail to sign a trade agreement in 2020, the UK could still have a no-deal hard exit from the single market and customs union at the end of this year.

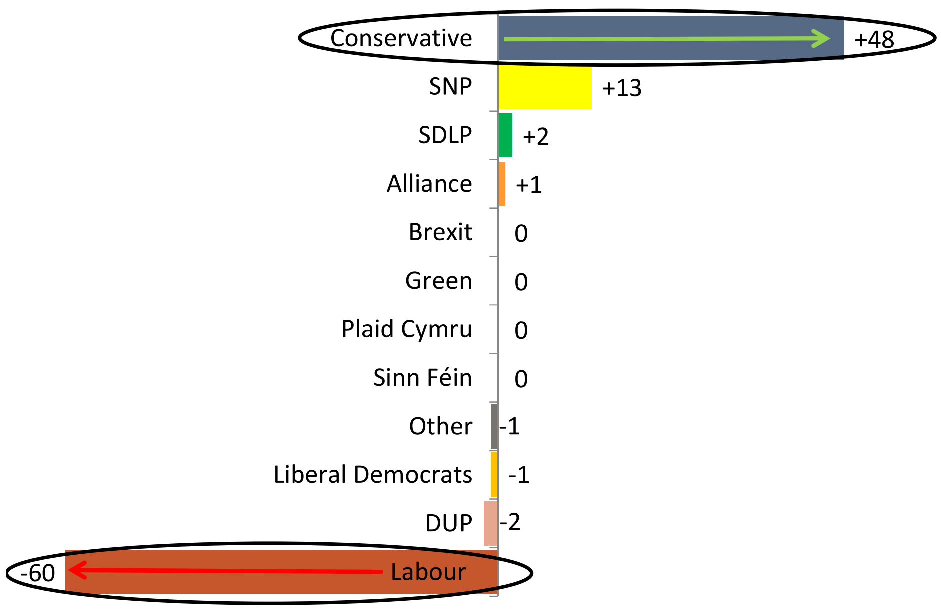
The final agreement on UK-EU trade may deviate from the general declaration on future relations – that mainly focuses on trade in goods – that Johnson negotiated as part of his Brexit deal in October 2019. It envisaged a relationship that is much less comprehensive than EU membership, which includes both goods and services trade as well as finance and the movement of people. Johnson has said that he intends for the UK to deviate from EU regulations after Brexit, which further limits the scope for any trade agreement. Across the spectrum of potential future UK-EU agreements, Johnson's plans tilt towards the harder end.

Noisy negotiations and the risk of a hard Brexit present the biggest downside risks for our positive UK economic outlook. A hard Brexit is not our base case, though. We see several potential ways to avoid that outcome. The UK could, for instance, ask the EU for just a bare-bones deal that could be agreed in time for the start of 2021. That would be equivalent to a semi-hard Brexit with a deal that covers major parts of manufacturing and some temporary measures to smooth the transition for the other parts of the economy. This seems the most likely outcome for now.

In a blue-sky scenario, Johnson may try to go for a political fudge to lengthen the transitional period. That would buy more time to negotiate an agreement on future trade. This should be possible. With an 80-seat working majority, the largest for any government since 2001, the hardline eurosceptic wing of the Conservative Party will matter less than before. However, by implementing a hard deadline for the end of 2020, Johnson has set a difficult tone for the start of the UK-EU talks, which begin in March.

In case of a hard Brexit, with his big majority Johnson would find it easy to react with a domestic economic stimulus – that could partly limit some of the economic damage in the short run.

Chart 6: Net change in seats, 2019 versus 2017 elections



Source: PA via FT.com

4. PM Johnson has promised to end austerity. How big could the fiscal impulse be in the coming years?

At the recent Spending Round in September 2019, Chancellor Sajid Javid announced plans for the fastest rise in real day-to-day spending in 15 years, extending the sharp pick-up in government spending growth that started in 2019 (Chart 7). Based on our projection for 4% growth, government spending will contribute c0.8ppt to headline growth in 2020, up from c0.6ppt in 2019. This implies a marginal boost of 0.2ppt to the headline GDP growth rate this year.

In addition to the planned rise in day-to-day spending, we expect a material step up in public investment spending beginning in 2020. On 7 November, Javid updated the UK's fiscal rules. The costings document released by the Conservative Party alongside its manifesto for the 2019 election states that the new rules allow:

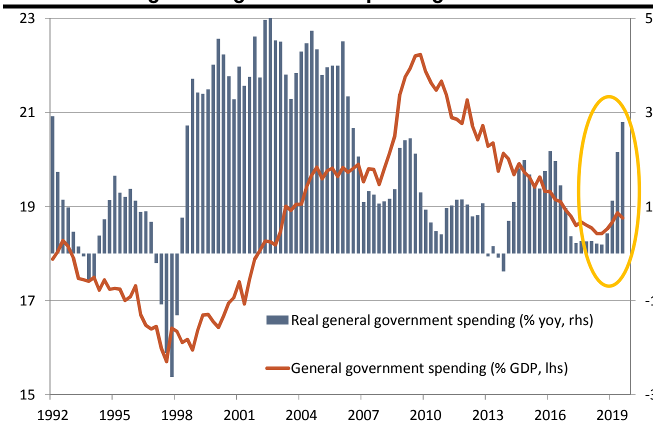
> "Public sector net investment to go up to 3%of GDP, averaged over the standard five-year forecast horizon, provided that interest rates do not rise significantly. Accordingly, these new rules make possible approximately £80bn in additional capital spending over the next four years, 2020-24 (and £100bn over five), not all of which has yet been allocated to specific projects. The capital spending set out below totals approximately £22bn and will be accommodated within that envelope. Further detail will be set out by the Chancellor at budget."

Relative to current plans for net investment of c2.36% of GDP in 2020, the new rule would allow for an extra 0.64ppt of gross capital spending this year, rising to c0.85ppt by 2023 in order to keep net investment at the 3% limit.

Javid will announce his fiscal plans at the upcoming budget on 11 March. Depending on the scale of his plans for capital spending and any tax hikes, together with the changes to current spending announced in September 2019, the UK could be set for a stimulus of between 0.5% and 0.8% of GDP in 2020. Expect Javid to allocate much of the extra infrastructure spending on northern England – where traditional Labour strongholds swung to the Conservatives at the December election – and other struggling regional economies.

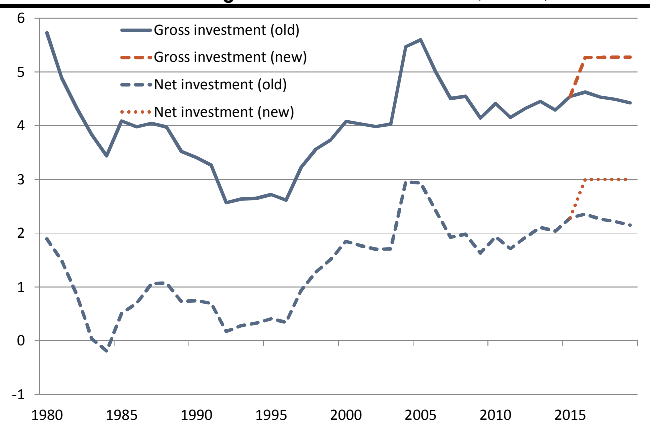
We have written at length about potential details and risks from a fiscal stimulus. See UK fiscal stimulus ahead? Consequences and risks (4 July 2019) and UK fiscal boost – still on track? (13 November 2019).

Chart 7: Change in UK government spending and as a % of GDP



Annual change in spending is four-quarter moving average. Quarterly data. Source: ONS, Berenberg calculations

Chart 8: Public sector gross and net investment (% GDP)



Annual data. Source: OBR, Berenberg calculations

5. Reacting to the global slowdown and intensifying domestic risks, the labour market lost some of its erstwhile momentum in late 2019. Will the labour market rebound in 2020?

On the whole, the UK labour market remains in solid shape. From a low of 70.1% in August 2011, the employment rate for prime-age workers (16 to 64) hit a record high of 76.2% in late-2019, driven by employment gains of +1% yoy. The unemployment rate, at 3.8%, is the lowest since the early 1970s (Chart 9). In late 2019, however, intensifying Brexit uncertainty and the deepening of the downturn in global trade and production started to take a toll on the labour market.

Data on vacancies and redundancies shows some fraying at the edges. By October 2019, vacancies had dropped by c8% from the record high in December 2018. The redundancy rate edged up from 3.1% in October 2018 to 4.3% by October 2019 (Chart 10). Annual growth in regular pay slowed to 3.5% in the three months to October from 3.9% in June.

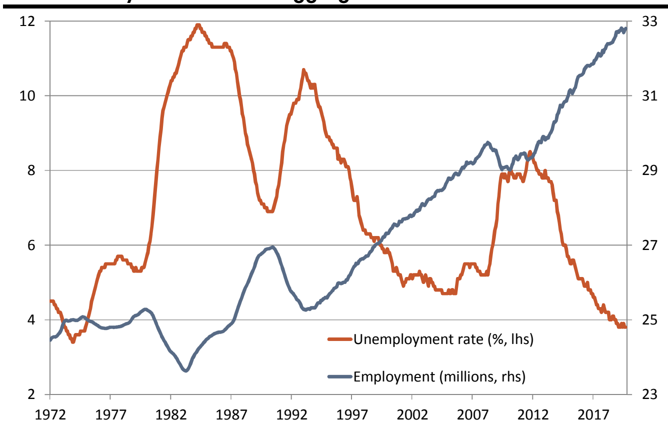
Should we worry? Not much. Labour demand should recover on the back of an economic improvement. This should show up in higher vacancies in early 2020 and, by the middle of the year, a rebound in wage growth.

Two additional points are noteworthy.

- The weakening of the labour market in late 2019 is not just a UK story. Towards the end of last year, other export-oriented advanced economies facing industrial weakness and risks from trade wars – including Germany, the US and Canada – experienced a moderate softening in labour market momentum either via slower jobs growth or weaker wages.
- The still-strong demand for labour, high employment and rising wages despite the very uncertain climate and serious downside risks, reflects healthy underlying economic fundamentals. If fundamentals were shaky, firms – anticipating a major further fall in demand – would have shed a lot of labour quickly last year. That could have tipped the economy into a full-blown recession rather than a garden-variety slowdown.

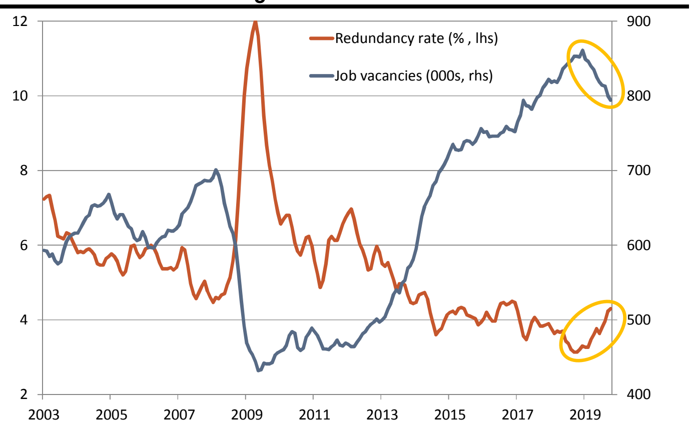
Both arguments support our call for a labour market rebound in 2020 if the global economy recovers and domestic and Brexit risks remain contained.

Chart 9: Key labour market aggregates remain solid...



Monthly data. Source: ONS

Chart 10: ...but at the margin there is evidence of weakness



Redundancy rate based on three-month moving average. Monthly data. Source: ONS

6. Stronger sterling and falling energy prices tipped headline inflation below the BoE's 2% target in late 2019. What is the outlook for inflation?

Continuing the post-Lehman trend, forecasting inflation remains a challenge. In Table 1 we compare various measures of inflation and some of its key drivers such as wages and sterling (1998-2007 versus 2010-2019). We exclude 2008/09 when abnormal factors linked to the global financial crisis distorted the underlying picture a lot. Three points are noteworthy.

- At 2.2%, the average rate of headline inflation has slightly exceeded the BoE's 2% target from 2010-19 and is well above the pre-Lehman average of 1.6%. Average core inflation is much higher at 2.1% in the post-Lehman period versus 1.2% before.
- Despite higher headline and core inflation in the post-Lehman period, some measures of average domestic inflation (including services, wages) are lower while average import-driven goods price inflation is higher. This partly reflects the big drop in sterling in 2016 related to the Brexit vote that pushed up import prices.
- Estimates of standard deviation and variance of the various inflation measures show that the dispersion of inflation increased after 2010.

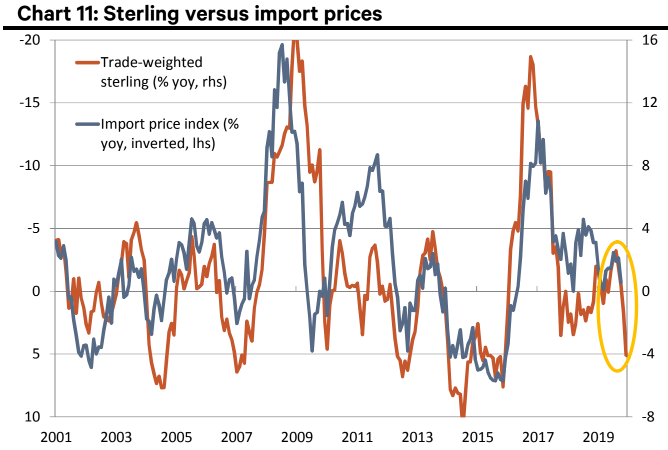
The recent swings in the price of oil and the sterling appreciation following the UK election point to further inflation volatility ahead. We expect headline inflation to remain close to 1.5% yoy in early 2020 before rising above the BoE's 2% target by the end of the year and into 2021, lifted by the higher oil price (near term) and, over the medium term, a rise in domestic inflation as demand growth outpaces supply growth. Although we expect solid gains in demand, persisting Brexit uncertainty will continue to constrain business investment and tight labour markets will constrain employment gains. Growth in unit labour costs and wages hit a post-Lehman high of 4% yoy in Q2 2019 (Chart 13, next page). Over time, as wages edge higher, firms will pass on the higher labour costs to consumers. The likely fiscal stimulus and downside risks to sterling during the UK-EU trade talks tilt the risks to the inflation outlook to the upside.

Table 1: Inflation and its drivers (decades pre- versus post-financial crisis)

	Mean		Standard deviation		Variance	
	1998-2007	*2010-2019*	*1998-2007*	*2010-2019*	*1998-2007*	*2010-2019*
Headline CPI	1.6	2.2	0.6	1.3	0.3	1.6
CPI core	1.2	2.1	0.5	0.7	0.3	0.4
Goods inflation	0.0	1.6	0.9	1.9	0.9	3.8
Services inflation	3.7	3.0	0.4	0.7	0.2	0.5
Import deflator (goods and services)	0.2	1.5	2.7	4.1	7.1	16.7
Regular wages	4.1	2.0	0.6	0.8	0.4	0.7
Retail Price Index	2.8	3.1	0.9	1.2	0.9	1.5
Trade-weighted sterling	1.4	-0.1	3.8	5.7	14.3	32.9

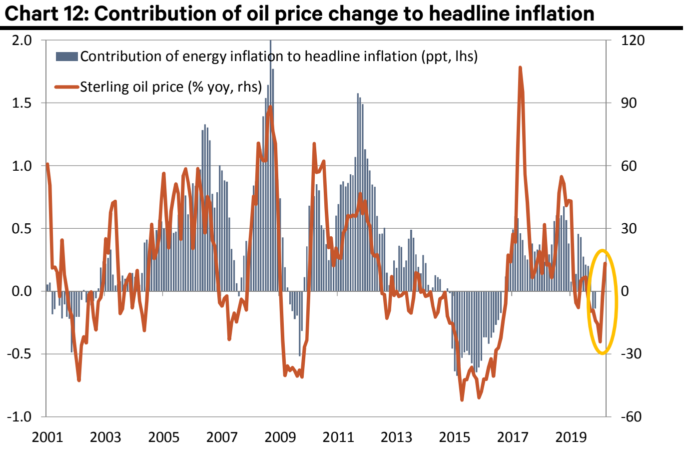
Data runs until November 2019 for all series except import deflator and wages (up to October 2019) and trade-weighted sterling (up to December 2019). Source: ONS, Bank of England Berenberg calculations

Chart 11: Sterling versus import prices



Monthly data. Source: ONS, Bank of England

Chart 12: Contribution of oil price change to headline inflation



Monthly data. Source: ONS, Bank of England, Energy Information Administration

7. With a new governor at the BoE, what can we expect from monetary policy?

Reacting to still-elevated risks in the near term, we look for the BoE to remain somewhat dovish in its policy guidance by emphasising that monetary policy could react to a further deterioration in economic conditions. Further out, though, we expect the BoE to turn hawkish and hike rates by 25bp in Q3 2020 and again by 25bp in Q3 2021. This would take the bank rate to a still-low 1.25% by the end of 2021. Even with two further rate hikes, the real bank rate would remain deeply negative, and well below the BoE's estimate of the long-run real equilibrium rate (Chart 14). The latest Monetary Policy Committee minutes from December 2019 note that:

> "Monetary policy could respond in either direction to changes in the economic outlook in order to ensure a sustainable return of inflation to the 2% target… If global growth fails to stabilise or if Brexit uncertainties remain entrenched, monetary policy may need to reinforce the expected recovery in UK GDP growth and inflation. **Further ahead, provided these risks do not materialise and the economy recovers broadly in line with the MPC's latest projections, some modest tightening of policy, at a gradual pace and to a limited extent, may be needed to maintain inflation sustainably at the target.**"

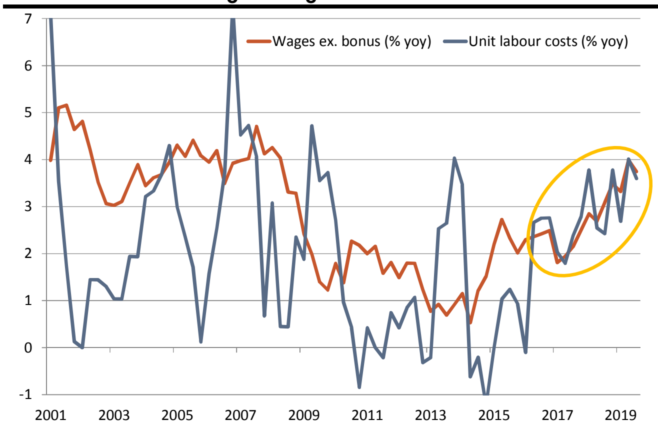
We base our call on the final part of the guidance (see bold). Two factors that will add to inflation pressure should underpin the hawkish tilt by the BoE in H1 2020: 1) growing evidence in early 2020 of rising confidence and demand linked to falling domestic political uncertainty; and 2) the likely announcement by Chancellor Javid on 11 March of further fiscal stimulus. Critically, the BoE can only react to fiscal plans that parliament has approved. It cannot base its policy on expected fiscal changes and, hence, the BoE will likely wait until the 7 May 2020 Monetary Policy Report before properly integrating the new fiscal plans into its own policy consideration.

The risks to our call are obvious: 1) a further deterioration in the global backdrop; and/or 2) a re-emergence of Brexit-related troubles could weigh on economic momentum. We thus cannot rule out a surprise rate cut in the very near term or a short burst of asset purchases.

Current BoE governor Mark Carney's term ends on 15 March 2020. He will be replaced by the current Financial Conduct Authority CEO Andrew Bailey. With extensive experience at the BoE, Bailey is a safe pair of hands, so we do not expect any major surprises when it comes to monetary or financial policy early on in his tenure.

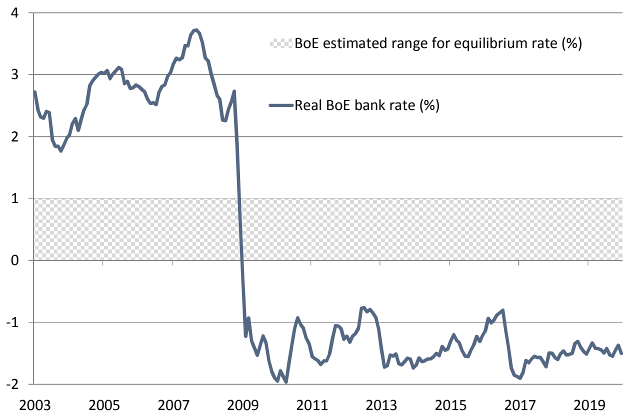
However, as the key UK institution for monetary and financial policy, the BoE will play an important role during the UK's transition from EU member to non-member. Carney has received heavy criticism by expressing a preference for the UK to remain in a close partnership with the EU after Brexit, so Bailey may try to re-establish the BoE in its proper role as a neutral operator when it comes to politics. Separately, a lot will depend on what the BoE, as the UK regulator, decides to do with the rules that govern financial services. Upon leaving the EU, the UK will lose its competitive advantage exporting to the EU market. Whether or not the UK can preserve some of its privileged EU market access will depend on how closely aligned the UK is with the EU market. This will become a big issue for the BoE in the months to come.

Chart 13: Annual change in wages and unit labour costs



Quarterly data. Source: ONS

Chart 14: Real bank rate vs. BoE's estimate of real equilibrium rate



Real rate = BoE bank rate minus five-year breakeven forward rate. We further cut 1ppt from the estimate as the five-year breakeven rate is based on the retail price index which is typically around 1ppt above core consumer price inflation. Monthly data. Source: Bank of England, Berenberg calculations

8. Which sectors are likely to do well over the medium term if Brexit risks remain contained and global demand improves?

While we expect a broad-based improvement in demand for all major sectors in 2020, the following subsectors can outperform as the economy rebounds.

Construction

- **The housing market** has sagged since the Brexit vote. Uncertainty has weighed on demand and limited housebuilders' pricing power. Low interest rates and policies, such as Help to Buy that subsidise deposits for mortgages, have only partly offset the weakness in underlying fundamentals. London has suffered the double whammy of Brexit and the government's decision in 2015 to increase stamp duty on second homes. However, 2020 should mark a turning point in the sector. Supported by still cheap financing costs, improving economic fundamentals and falling political risk should lift housing demand. RICS data suggests the rebound started late last year already (Chart 15). With more pricing power, housebuilders will likely build more houses.
- **Infrastructure** output growth already far exceeded the gains in the rest of the construction sector in 2019. Annual growth in infrastructure output in the first three quarters of 2019 averaged 8.2% versus 1.4% for total construction excluding infrastructure. Johnson and Javid look set to commit up to an extra £20bn on public-sector investment in 2020 and a total of £100bn over the next five years. Much of that spending will go to construction, especially infrastructure in the north of the UK. In 2019, total nominal spending on construction was around £120bn. Just a £10bn step up in public-sector construction spending in 2020 would be a big jump in demand for the sector. But watch the risks. Up from less than 1% yoy in 2017, prices for infrastructure investment increased by 5.8% yoy in Q3 2019. A surge in demand could worsen the existing inflation risks.

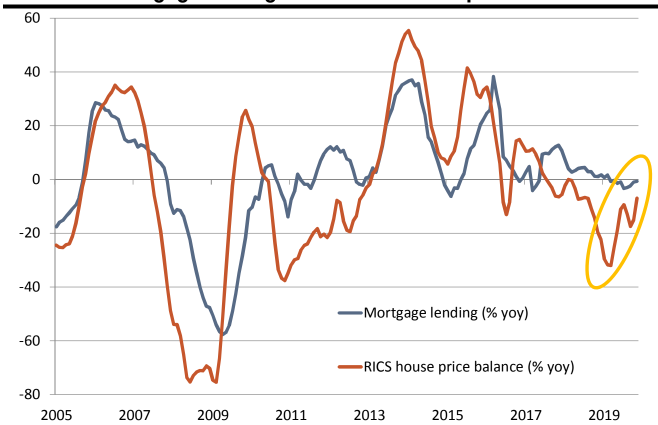
Services

- **Retail spending** looks set to do well as household spending growth accelerates. Consumer fundamentals are solid and should improve over the medium term as employment and real incomes continue to expand at healthy rates. Supported by easy credit conditions and high net wealth, households' finances are in good shape. Because of the large discretionary component in retail sales, trends in the sector exaggerate trends in total consumption. Based on the historical correlation, our projection for 2% gains in real consumption in 2020 implies real retail sales growth of between 2-4% yoy.

Industry

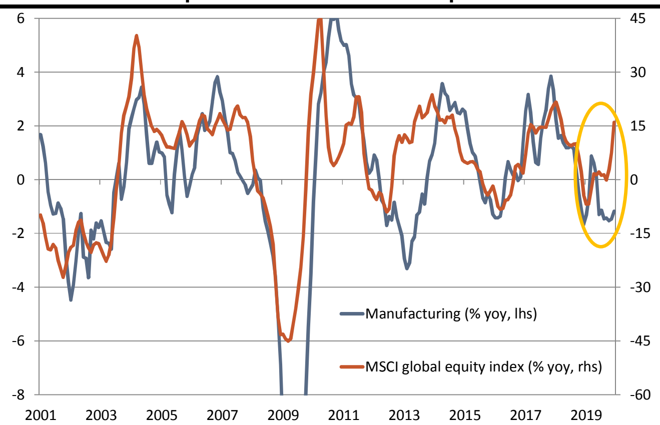
- A series of shocks tipped export-oriented UK **manufacturing** into recession in mid-2019. Reflecting the chance of a phase one US-China trade deal and falling Brexit risks, global equities rebounded at the end of last year (Chart 16). The improving global outlook sets the stage for a manufacturing recovery even as continued Brexit risks weigh on confidence and investment in the sector. Producers of machine and investment goods should benefit most from a recovery in global risk appetites.

Chart 15: Mortgage lending versus RICS house price balance



Three-month moving average. Monthly data. Source: Bank of England, RICS

Chart 16: Global equities versus UK industrial production



Three-month moving average. Monthly data. Source: ONS, MSCI

9. Turning to the risks, how high is the recession risk in the next couple of years? Through which channels could that occur?

The risk of a recession remains low. The post-Lehman UK upswing has not yet run its course. Although the expansion is entering its 11th year, we see none of the usual excesses that suggest a generic downturn is around the corner. Activity in housing, investment, credit and inflation remains tame, but looking beyond economic fundamentals, we see three potential risks.

- **Hard Brexit:** That the UK could crash out of the EU's Single Market at the end of 2020 without a deal in place for future UK-EU trade remains the biggest downside risk to the UK economic outlook. The mere heightened threat of a hard Brexit dramatically depressed UK economic activity from mid-2019 onwards last year. A genuine hard Brexit could still tip the UK into recession.

- **Protracted global slump:** In our global outlook 2020, we identified a number of risks that could extend the global downturn in trade and production through 2020: a re-escalation of the US-China trade skirmish; heightened tensions in the Middle East that caused a major disruption the global supply of oil, jarring production and consumer spending; and surprise deepening of the ongoing slowdown in China. Such further deterioration in global conditions could keep the UK economy at near stagnation through 2020.

- **A sudden inflation surge:** If Johnson overdoes the fiscal stimulus and/or if wage growth surprises to the upside on a sustained basis – say +4.5% yoy – the BoE may be forced to step on the brakes and hike rates by much more than expected. In such a scenario, BoE tightening could keep growth well below potential (c1.6-7%) until inflation expectations and wage growth dropped to rates consistent with the bank hitting its 2% inflation target.

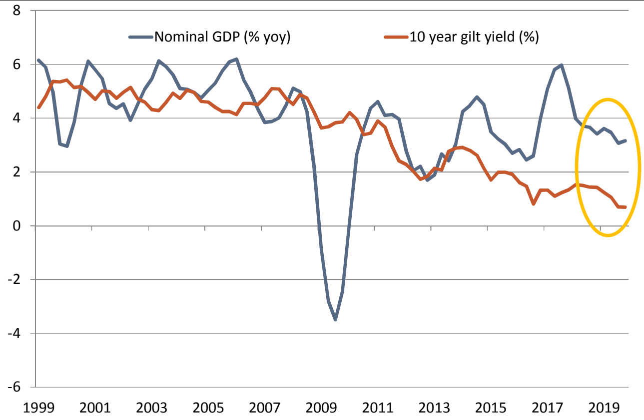
10. Sterling and gilt have tracked political developments closely since the Brexit vote, will this continue?

Reflecting improving economic fortunes and lower political risks, we expect financial market sentiment towards the UK to continue to improve over the course of the year. However, negotiations about the future UK-EU relationship and the risk of a hard Brexit will continue to dominate financial markets' assessment of the appropriate value for gilts and sterling.

Relative to the outlook for faster GDP growth and tighter BoE policy, the gilt curve is too flat, in our view. Consistent with past trends, 10-year gilt yields should edge up as nominal GDP growth accelerates (Chart 17). As growth accelerates over the course of this year, we look for 10-year gilt yields to rise to 1.7% by the end of 2020 from 0.7% currently.

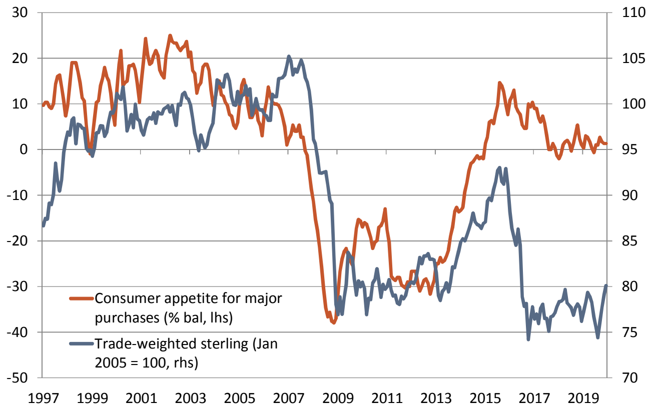
While sterling remains weak relative to fundamentals and underlying domestic confidence (Chart 18), persisting Brexit uncertainty as the UK and EU negotiate the future relationship may still weigh on the currency. We look for a modest further appreciation versus the euro – from 1.17 currently to 1.20 by the end of 2020 – with a bigger gain versus the dollar – 1.31 to 1.38 over the same period – reflecting broad-based dollar weakness as global markets become more risk-on.

Chart 17: 10-year gilt yields versus nominal GDP growth



Nominal GDP data is four-quarter moving average. Quarterly data. Source: ONS, Bank of England

Chart 18: Sterling versus consumer appetites for major purchases



Consumer data is three-month moving average. Monthly data. Source: Bank of England, GfK

UK economic forecasts

		2018	2019	2020	2021	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
GDP	% y/y	**1.3**	**1.3**	**1.8**	**2.1**	2.0	1.2	1.1	0.9	0.7	1.7	2.0	2.7	2.6	2.3	2.0	1.6
	% q/q					0.6	-0.2	0.4	0.1	0.4	0.7	0.7	0.7	0.4	0.4	0.4	0.3
	%q/q ann.					2.5	-0.7	1.7	0.3	1.7	3.0	3.0	3.0	1.6	1.6	1.6	1.4
Private Consumption	% y/y	**1.6**	**1.2**	**2.0**	**1.9**	1.3	1.2	1.0	1.2	1.6	1.8	2.2	2.5	2.3	2.1	1.8	1.5
	% q/q					0.2	0.4	0.3	0.3	0.6	0.6	0.7	0.6	0.4	0.4	0.4	0.3
Government Consumption	% y/y	**0.4**	**3.2**	**4.0**	**2.8**	2.8	4.1	2.8	2.8	3.3	3.2	4.9	4.6	3.5	3.0	2.5	2.0
	% q/q					1.0	1.2	-0.6	1.3	1.5	1.0	1.0	1.0	0.5	0.5	0.5	0.5
Investment	% y/y	**-0.2**	**0.9**	**2.9**	**3.4**	1.1	0.7	0.6	1.1	1.2	2.8	3.5	4.1	3.6	3.4	3.3	3.2
	% q/q					1.1	-0.6	0.2	0.4	1.2	1.0	0.9	0.9	0.8	0.8	0.8	0.8
Final Domestic Demand [1]	% y/y	**1.1**	**1.5**	**2.5**	**2.3**	1.5	1.6	1.3	1.5	1.9	2.2	2.9	3.1	2.7	2.5	2.2	1.9
	% q/q					0.5	0.4	0.1	0.5	0.9	0.7	0.8	0.7	0.5	0.5	0.5	0.4
Net Exports [1]	% y/y	**-0.2**	**-0.5**	**0.9**	**-0.3**	-3.6	-0.9	1.0	1.5	3.9	1.4	-1.0	-0.5	-0.2	-0.2	-0.3	-0.4
	% q/q					-2.8	2.5	2.3	-0.5	-0.4	0.0	-0.1	0.0	-0.1	-0.1	-0.1	-0.1
Stockbuilding [1]	% y/y	**0.2**	**-0.4**	**-1.2**	**-1.7**	1.2	0.3	-1.0	-1.8	-2.2	-1.7	0.0	0.0	0.0	0.0	0.0	0.0
	% q/q					0.4	-0.5	-1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current Account Balance	GBP bn	**-82.9**	**-94.7**	**-83.5**	**-69.1**	-37.4	-24.2	-12.8	-20.4	-22.2	-21.3	-20.4	-19.5	-18.6	-17.7	-16.8	-15.9
	% of GDP	**-3.9**	**-4.3**	**-3.7**	**-3.0**	-6.8	-4.4	-2.3	-3.7	-3.9	-3.8	-3.6	-3.4	-3.2	-3.1	-2.9	-2.8
Industrial Production [2]	% y/y	**0.1**	**-1.0**	**0.7**	**1.5**	-0.8	-0.9	-1.4	-0.9	-0.5	0.7	1.2	1.6	1.5	1.5	1.4	1.4
	% q/q					0.1	-0.8	-0.1	-0.1	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Unemployment Rate [2]	%	**4.1**	**3.8**	**3.7**	**3.6**	3.9	3.8	3.8	3.8	3.7	3.7	3.7	3.7	3.6	3.6	3.6	3.5
CPI [2]	% y/y	**2.5**	**1.8**	**1.9**	**2.2**	1.9	2.0	1.9	1.4	1.5	1.8	2.1	2.2	2.3	2.2	2.1	2.0
General Govt. Balance [3]	% of GDP	**-1.6**	**-1.6**	**-3.0**	**-2.6**												
General Govt Debt [3]	% of GDP	**87.3**	**86.3**	**87.1**	**87.9**												
BoE Bank Rate [4]		**0.75**	**0.75**	**1.00**	**1.25**	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	1.25

[1] Contribution to GDP growth [2] Period averages [3] Maastricht basis [4] End period

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