

United Kingdom Business Forecast Report Q1 2015

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Abstracts

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Core Views

The UK economy is set to outperform most major developed states in 2014, and will continue to expand at a robust clip in 2015. In light of positive structural economic reforms undertaken by the government, coupled with flexible monetary and exchange rate policies, we remain bullish on the long-term economic prospects for the UK relative to the eurozone over the longer term. Despite numerous ructions between the ruling Conservatives and Liberal Democrats, we expect the coalition government to hold firm through to the next parliamentary election in 2015.

Major Forecast Changes

We have revised up our 2014 real GDP forecast to 3.1% from 2.9% previously

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CHAPTER 1: POLITICAL OUTLOOK

SWOT Analysis

BMI Political Risk Index

Domestic Politics

The Union Is Saved. The Cost Is Constitutional Change

Far from being a vote for the status quo, the Scottish referendum result is the trigger for constitutional change across the whole of the United Kingdom. Although this upheaval will fundamentally alter the politics of the UK, we are fairly sanguine about the impact of devolution, and believe that it would actually kill off the Scottish independence movement for decades, if not indefinitely.

Table: Political Overview

Long-Term Political Outlook

The Road To 2015

Despite just two years elapsing since the last parliamentary election, the UK's main political parties are already gearing up for the next ballot in 2015. For the ruling Conservatives the election will hinge on the state of the economy and success of its proposed fiscal reforms. Meanwhile, for the beleaguered opposition Labour party, a credible alternative to the government's core economic strategy is needed, in addition to reviving its image, which has been tainted by the fractious Brown-Blair era.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Index

Economic Activity

Fixed Investment Rebound Crucial For Sustainable Recovery

The UK economy will be one of the fastest growing developed states in 2014, but we warn that sustaining a robust rate of expansion

in the following years will depend on a turnaround in real wage growth and fixed investment spending, both of which have yet to fully recover.

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Tightening Monetary Policy Is Still A Risky Strategy

We believe that the Bank of England (BoE) will begin hiking the bank rate in the first quarter of 2015 and expect a modest pace of monetary tightening over the medium term. However, we stress that despite the strength of headline economic data, the recovery remains weak and fragile, with monetary tightening still a risky strategy. With the bank rate currently at 0.50%, the BoE has little room to manoeuvre if policy tightening proves premature.

Table: MONETARY POLICY

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Shifting Rate Expectations Pressurising GBP

The recent depreciation of the British pound ties in with our view that a revaluation of market interest rate expectations would let some of the heat out of the sterling rally, which has been playing out since mid-2013. However, a still robust economic growth trajectory and the gradual normalisation of monetary policy will supply the fundamental support needed to drive up the value of the pound over a multiyear period.

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Banking Sector

Growth Trajectory Diverging From Broader Economy

The pace of deleveraging in the UK banking sector has intensified further in recent months, despite the economy being on track to post one of the fastest rates of growth among developed states in 2014. This has motivated a downward revision to our medium-term growth forecasts. We also stress that while a smaller banking sector (in relative terms) has reduced the potential impact to the broader economy from any future financial ructions, asset contraction has starved key sectors of the economy (particularly SMEs) of credit.

CHAPTER 3: 10-YEAR FORECAST

The UK Economy To 2023

UK Will Outperform Eurozone Over The Long Term
Despite the current economic stagnation in the UK, we hold to a more upbeat assessment over the longer term and expect growth to outperform the eurozone. Supportive of this view is the relatively competitive nature of the UK economy, independent monetary and exchange rate policies as well as a major fiscal reforms. However, we warn that a number of challenges remain, such as an ageing workforce as well as low educational and training attainment in the poorest areas.

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