

# United Kingdom Business Forecast Report Q4 2014

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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 2.9% from 2.6% previously.

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Core Views  
Major Forecast Changes  
Key Risks To Outlook

### **CHAPTER 1: POLITICAL OUTLOOK**

SWOT Analysis  
BMI Political Risk Ratings  
Domestic Politics  
Scottish Referendum Primer

Although we still believe that the upcoming Scottish independence referendum in September will be rejected by the electorate, the Unionists may only win by a single-digit lead. Such a small margin between victory and defeat for the nationalists mean that either outcome cannot be completely discounted. With this in mind, we take a closer look at the details of the referendum and the main political and economic issues which dominate the vote.

Table: Political Overview

### **CHAPTER 2: ECONOMIC OUTLOOK**

SWOT Analysis  
BMI Economic Risk Ratings  
Economic Activity

Resurgence In Business Investment Bodes Well For Sustainable Recovery  
The Office for National Statistics confirmed that the UK economy expanded by 3.0% y-o-y during the first quarter of 2014. With higher frequency data for the first half of the year showing no let up in positive momentum, and with business investment growth surging to multiyear highs, we have revised up our full-year growth forecast for this year to 2.9% from 2.6% previously.

Table: ECONOMIC ACTIVITY

Monetary Policy  
Carney Paving The Way For Earlier Rate Hike  
Having held out as long as he could on keeping interest rates low for an extended period, Mark Carney has now fired the starting

gun on monetary tightening. In light of the surprising rapidity with which the labour market is recovering, and Carney's hawkish verbal intervention, we have dropped our contrarian policy rate view. Having previously expected the first hike to come in early 2016, we now expect the BoE to move by the beginning of 2015.

#### Table: MONETARY POLICY

##### Debt Policy

##### The Deleveraging Sweet Spot

Strong real GDP growth, positive inflation and low interest rates have significantly eased the burden of debt deleveraging in the UK. This has been particularly beneficial for the household sector, which has so far been unable to pay down nominal debt liabilities. Moreover, with the Bank of England nearing the point at which it will start to hike policy rates, households may attempt to overpay mortgages in a bid to get ahead of the pending rise in debt service costs.

##### Exchange Rate Policy

##### GBP: Pausing For Breath

The British pound has made solid gains against the US dollar as a result of both greenback weakness and the UK's own remarkable economic turnaround. However, we stress that given the extent to which the UK good news story has been priced in, the scope for additional sustained sterling gains against the dollar is now more limited.

#### Table: BMI Currency Forecast

##### Regional Economic Outlook

##### Assessing The Aftermath Of ECB Policy Action

The European Central Bank (ECB) has delivered on nearly all of the policy options that we were expecting for the June 5 meeting. This is a step in the right direction in terms of warding off the risk of deflation and will be positive for European equities and sovereign bonds. However, we warn - as we have done countless times during previous easing rounds - that the efficacy of ECB policy action will be limited absent structural reforms in the eurozone at the national and federal level.

#### Table: EXCHANGE RATE

##### Banking Sector

##### Aggressive Deleveraging To Continue

Aggressive banking sector deleveraging has resulted in the industry's relative size in the economy shrinking sharply, to 437% of GDP from a peak of 600% in early 2010. With banks still under pressure to reduce exposure to risky assets, combined with robust nominal

GDP growth, the industry will shrink further over the medium term.

## **CHAPTER 3: 10-YEAR FORECAST**

The UK Economy To 2023

Outperforming The 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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