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Economic Bulletin

NO TIME FOR COMPLACENCY ON UK ECONOMY



- Major success in reducing unemployment and public sector share of economy in UK since 2010.
- But UK's record current account deficit of 5.1% of GDP poses threat to continued economic recovery.
- Stagnation in UK exports is frustrating £1 trillion 2020 target. 8% annual growth in exports from 2012 required, but Government has only achieved 2.7% growth over two years.
- Household-debt ratio set to surpass pre- financial crisis levels.
- Autumn Statement must turbo charge UK productivity growth.

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1. SOME SUCCESS SINCE 2010

Since 2010, the UK economy is slowly becoming more resilient. GDP growth has remained strong, with the UK achieving the highest level in the G7 at 2.8% in 2014. Unemployment has continued on its downward trajectory, with the number of unemployment claimants falling by just over 17% in the last year. The claimant rate fell faster in the North East, Yorkshire and the Humber, the East Midlands and the West Midlands than in London, according to figures published by the [House of Commons Library](#). There is also strong evidence of some regions outperforming London in economic growth. For example, the [Office for National Statistics](#) (ONS) suggests that gross value added in the West Midlands for 2012-13 outpaced London, increasing by 2.8% compared to London's 2.6%.

The Government has also achieved success in rebalancing the economy away from public sector spending. UK public spending as a proportion of GDP is estimated to have fallen around four percentage points since its peak in 2011, dropping from 45.3% to 41.4% in 2015. As a consequence, significant progress has been made in reducing the UK's budget deficit – which stood at a peacetime record of 10.2% of GDP in 2010/11. The budget deficit stands at 3.7% for the year 2014/15 and is anticipated to move into surplus by 2019/20.

The UK's performance on increasing business investment in the economy has also been positive, growing at an average rate of 5.2% a year for the last five years. More recently, business investment has continued to show strong growth, increasing by 5% when comparing Q2 2015 to Q2 2014. This compares favourably to the growth of 3.7% in retail sales – a good indicator of consumer spending – suggesting a move away from consumer spending-led growth towards more sustainable investment growth.

2. UPCOMING RISKS FOR UK ECONOMY

However, there is no room for complacency. The UK faces a series of global external risks, including from the Eurozone and the slowdown in China. There are also a number of concerns relating to the UK's domestic economy.

3. UK EXPORTS ARE STAGNATING

The lack of progress in boosting exports over the past year is accounted for by the muted performance of industries producing visible goods. Net trade in services increased by £8.1 billion in 2014, but this was more than offset by a widening deficit in the balance of trade in goods. The [ONS](#) reported a £10.8 billion fall in the export of goods over the same period, leading to the UK's goods deficit increasing by £8.4 billion. More recent data highlights concerns for both the exports of goods and services. A [British Chambers of Commerce survey](#) suggests the balance of exports in both services and goods has slumped between Q2 2015 and Q3 2015, highlighting major concerns for the Government's export ambition target of £1 trillion by 2020.



Table 1: UK exports in Goods and Services

	Exports (Goods) £bn	Exports (Services) £bn	Total Exports	Annual Increase	Annual Increase Needed since 2012 for 2020 Export Target
2012	304.3	197.4	501.7		
2013	306.2	214.8	521.0	3.8%	8%
2014	295.4	219.8	515.2	- 1.1%	8%

Source: *Office for National Statistics – Pink Book 2015*

In 2012, the Government stated an ambition of achieving £1 trillion of exports in goods and services by 2020, requiring an 8% growth in exports year-on-year. However, exports have stagnated since then, increasing by a mere 2.7% over two years. This means that exports now need to grow by 11.7% annually to hit the 2020 target. As a result, the Office for Budget Responsibility (OBR) now forecasts that the cash value of total exports will be £630 billion by 2020, around a third lower than the Government's £1 trillion export aspiration.

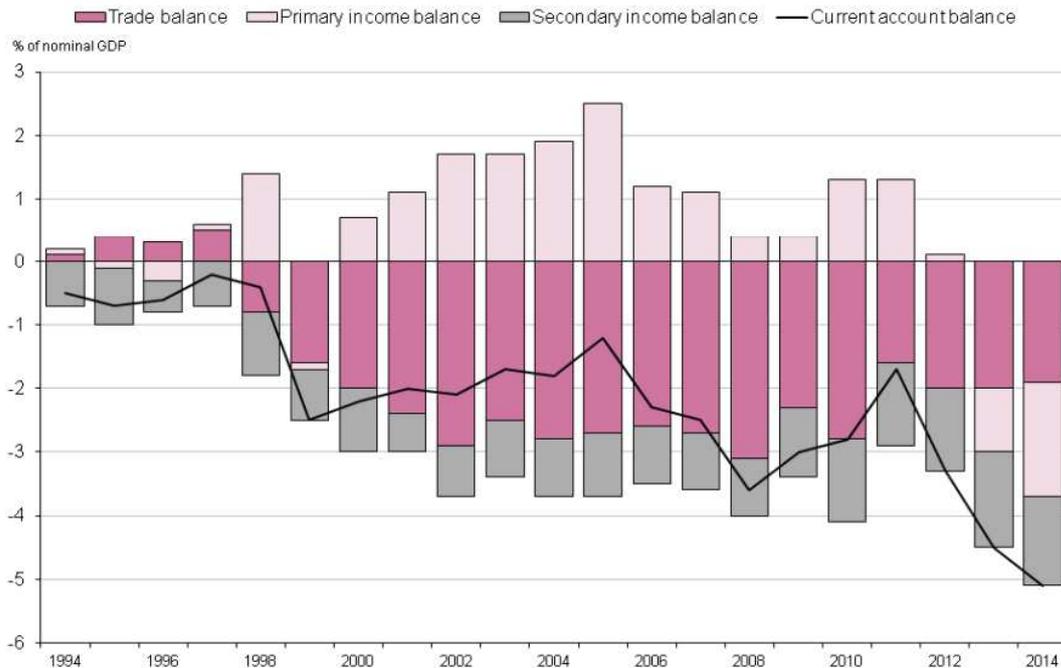
4. STRUGGLING CONSTRUCTION AND MANUFACTURING INDUSTRY

Although UK factory growth has been strong this month, recent data from the ONS' economic review confirms that output of the UK's manufacturing and construction industry has fallen over the past three months. Over the longer term, the output of the manufacturing sector remains 6.3% below its pre-crisis peak. On the other hand, output in services is estimated to be 11.1% above its pre-downturn peak.



5. UK'S CURRENT ACCOUNT DEFICIT AT RECORD HIGH

Figure 1: UK Current Account Balance as % of Nominal GDP



Source: Office for National Statistics – Pink Book 2015

Graph Notes

Trade Balance: Exports of goods and services – Imports of goods and services

Primary Income Balance: Income flows in and out of the UK

Secondary Income Balance: General Government transfers between Governments or non-Government transfers where the UK Government acts an agent.

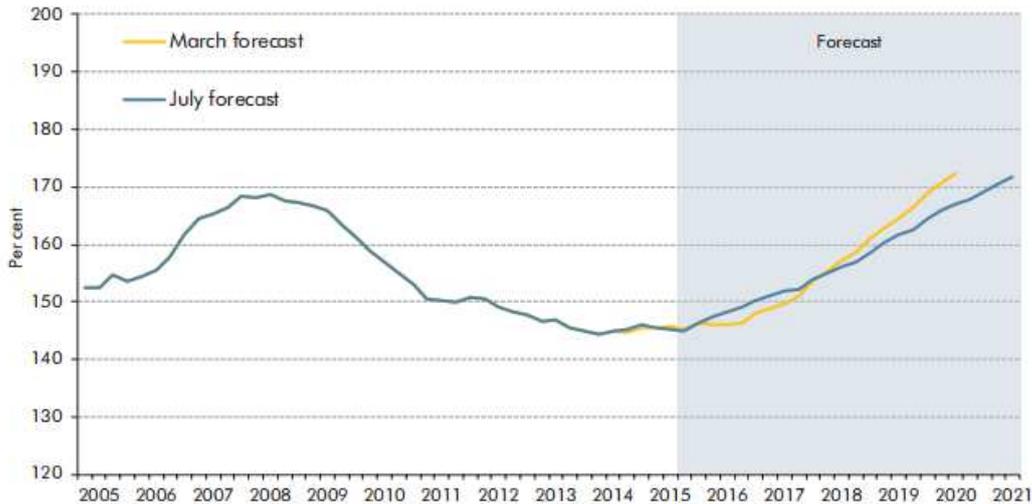
The deficit on the UK's current account balance widened in 2014 to £92.9 billion, equating to 5.1% of GDP. The current account deficit is the difference between exports and imports as well as the balance of overseas income and income received by non-UK citizens on UK investments.

In both measures, this was the largest annual deficit since records began in 1948. However, the rapid hike in the UK's current account deficit should be treated with caution. For example, the incoming governor of Ireland's central bank has suggested that corporate financial engineering may be behind a fall in the return on Britain's Foreign Direct Investment Assets.



6. UK'S HOUSEHOLD INDEBTEDNESS SET TO SURPASS PRE-CRISIS LEVELS

Figure 2: Household gross debt to income ratio



Source: Office for Budget Responsibility - 2015

Households have undergone significant deleveraging since the onset of the financial crisis. However, the OBR projects that this trend will be reversed over the next six years.

The OBR expects the ratio of total debt to income to rise by 26 percentage points from the start of 2015 to the start of 2021. This will mean the household debt to income ratio will surpass the level observed during the 2008/09 financial crisis by 2021, raising fears about the impact of prospective interest rate rises over the coming years.

Nearly 12 percentage points – equal to around half of the increase – will be accounted for by the projected strong growth in house prices and transactions. Savills forecast that house prices will rise by 20% over the next five years. This highlights the consequences for households that are arising from the UK's sluggish construction activity.

7. RECOMMENDATIONS

7.1 Simplify Planning Laws and Free-Up Public Assets for Building

Annual house building starts in England reached 140,500 over the last year, lagging behind the 250,000 required to keep up with rising demand. The Government needs to promote a planning system that is lighter and more streamlined to keep up with these pressures. Ministers should also review whether it can increase its current target of releasing public land for up to 150,000 homes during this parliament. (See *Pink Planning*)

7.2 Introduce Infrastructure Project Bonds

The Government is set to commit to £100bn of spending on infrastructure in the Autumn Statement. The Chancellor should examine the creation of infrastructure bonds to finance investment, rather than relying on the public sector or other vehicles such as the Private Finance Initiative.

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Infrastructure bonds could build on London's expertise in financial innovation, provide attractive yields for prospective investors and unlock new streams of cheap infrastructure finance.

(See [An idea whose time has come: project bonds](#))

7.3 A Final Decision on Airport Expansion

Britain's airport capacity is at stretching point, with Heathrow operating at capacity and Gatwick quickly approaching the same point. A new runway is desperately needed in the South East to continue promoting trade and investment into the UK. The Davies' Commission has expressed a clear recommendation that a third runway at Heathrow represents the best economic opportunity for the UK. The Government must now make a rapid and decisive decision on where airport capacity should expand. *(See [Double Up On Heathrow](#))*

7.4 Remove Unilateral Burdens on UK Industry

The Government needs to review the impact that unilateral green measures are having on UK industry. For example, UK energy-intensive firms face some of the highest electricity prices in the EU. Ministers should consider scrapping the Carbon Price Floor – which is solely faced by UK manufacturers – and pursue a continued push to bear down on the costs of renewable energy subsidies.

7.5 Promote Shale Exploration

Shale gas exploration could be a major boon to the UK economy. Furthermore, as the majority of the resource is in the North of England, it could help continue to rebalance the UK economy geographically. However, the planning process for many shale exploration applications has been sluggish – the most recent example being Lancashire County Council, who took over a year to deliberate on a fracking application. The Government must show renewed initiative to ensure that the planning process for shale exploration applications is fast-tracked.

(See [Why Every Serious Environmentalist Should Favour Fracking](#))

7.6 Reform the UK's Apprenticeship Scheme

While the Government's commitment to 3 million new apprenticeships is welcome, Ofsted's recent report into UK apprenticeships highlights major concerns about the Government's strategy. There has been an excessive growth in the number of service based apprentices, with little improvement in the number of apprentices in the engineering, manufacturing and technology sectors. The apprenticeship programme must be altered to promote apprenticeships in industries that have the strongest demand for a skilled workforce.

(See [Time to Reform the Government's Apprenticeship Programme](#))

7.7 Promote Trade Opportunities

The Government must promote trade opportunities to help UK firms increase exports. The proposed Transatlantic Trade and Investment Partnership could offer a boost to many of the UK's export industries, particularly the motor manufacturing industry. Ministers must lobby for the reduction in non-tariff barriers between the UK and the US – whether the UK remains in the



European Union or not. Furthermore, the Government should examine ways of reducing the barriers that British businesses are facing when exporting to the emerging economies.

7.8 Promote the Sharing Economy

The sharing economy is one of the UK's fastest growing sectors, hosting a number of new companies using information technology to allow consumers, businesses and the public sector to make better use of existing resources and assets. The UK must resist measures that will frustrate innovation and progress in these sectors, particularly proposals such as those from TfL that would impose a mass of regulation on Uber taxis. (See "[*Unleashing the Sharing Economy*](#)")

7.9 Expand Water Industry Competition

The Government must examine ways of introducing more competition into various sectors. For example, the water market has been operating as a series of regional monopolies. While it is welcome that retail sector competition is due to begin in April 2017 for non-households, the Government should also seek rapidly to expand this consumer choice and competition to households in the water market. (See "[*Britain's creaking water industry need real competition*](#)")

8. MUST BE READ

- [The deficit nobody is talking about ... and is a real concern](#) – Oliver Kamm
- [Annual Prosperity Index 2015](#) – Legatum Institute

9. MUST BE READ ON CAPX

- [We are in desperate need of new laws which adapt to sharing economy](#) – Daniel Dalton
- [The hypocrisy and hot air of the 'save our steel' crowd](#) – Iain Martin

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