

CLASH OF THE TITANS



Welcome to the fourth annual Clash of the Titans

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Presentation to:
Economic Research Council

LlewellynConsulting
Independent Economics



The UK economy: the international dimension

John Llewellyn

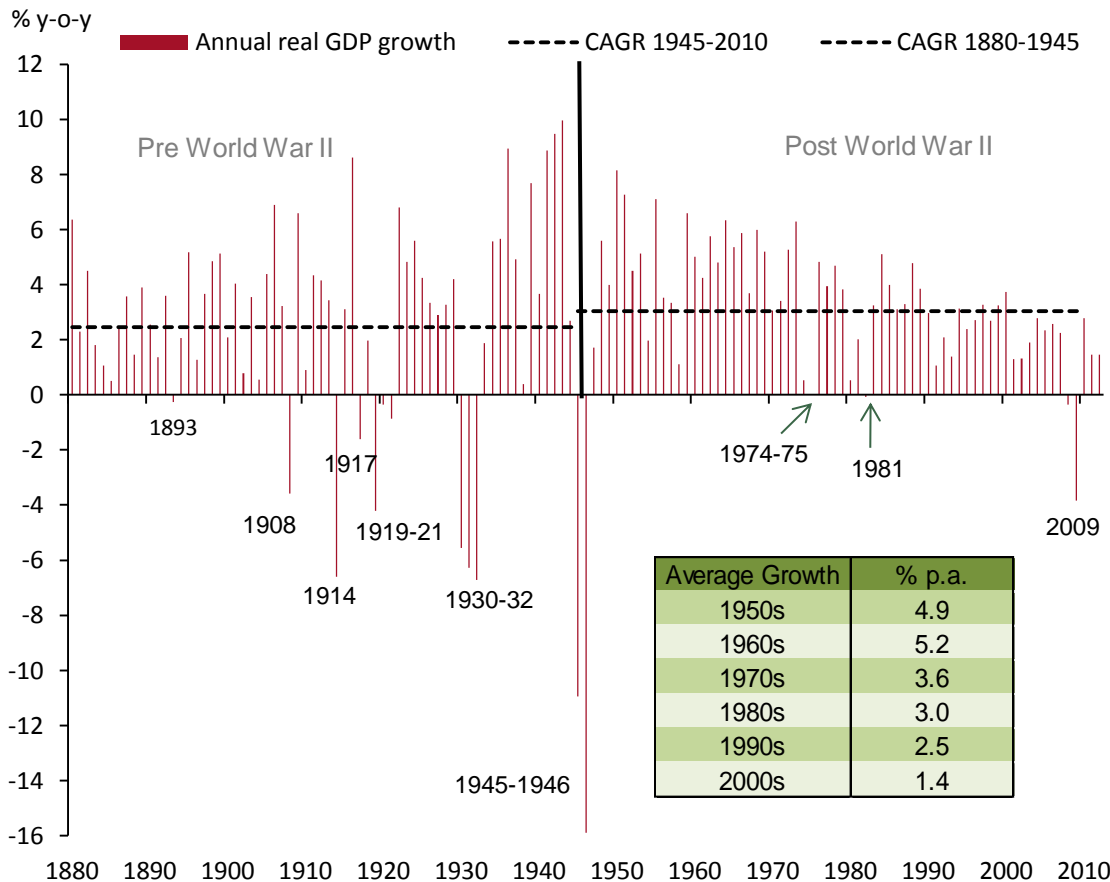
Clash of the titans, 18 December 2014

www.llewellyn-consulting.com

G7 GDP growth has trended down over the post-WWII period

This might have been expected to continue, even without the 2008 crisis

G7 real GDP growth, 1880-2012



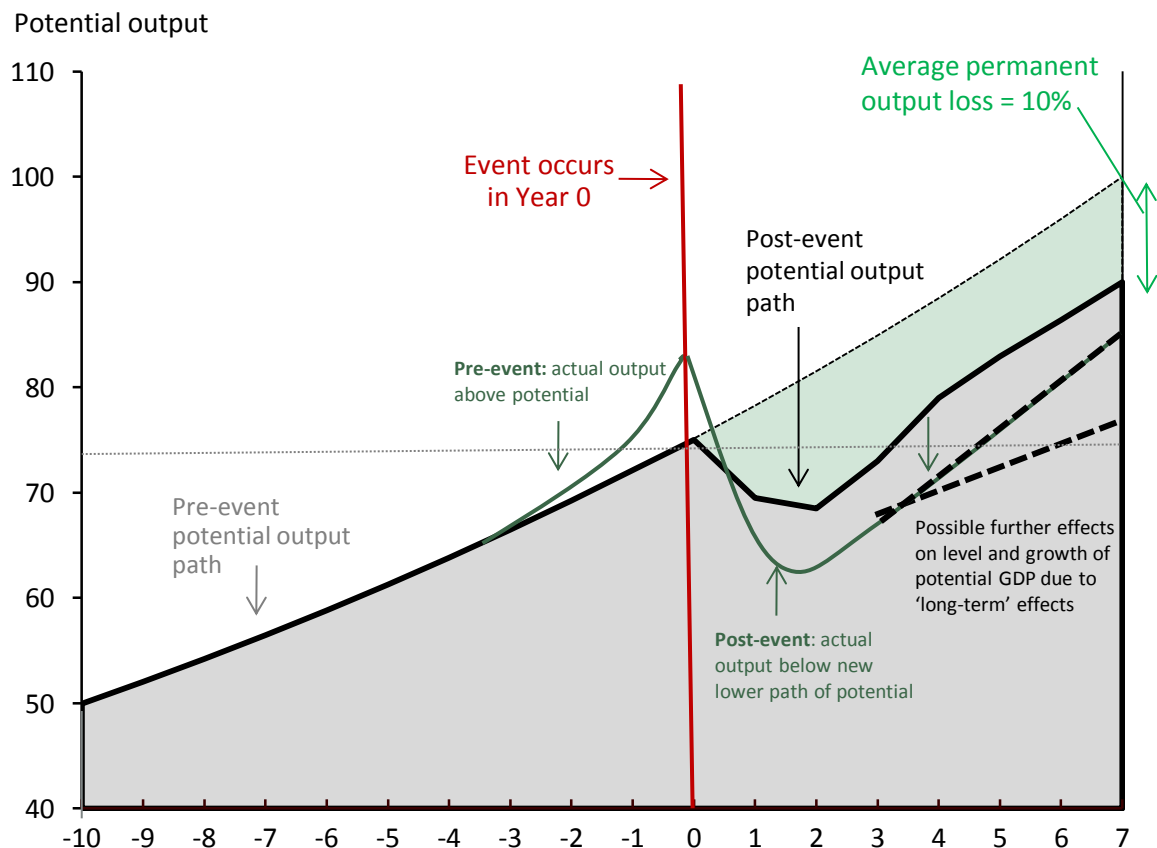
Source: Angus Maddison database and IMF World Economic Outlook database, April 2013

- **Before WWII**, real GDP was volatile: large falls were common
- **After WWII**, the G7 as a whole went for more than 60 years without GDP ever falling
 - On average, growth was slightly higher in the post-WWII period
- **'Catch-up' growth** may well have been important in the early post-War years
- **From the 1960s**, however, growth decelerated progressively
- **The trend slowdown** might have been expected to continue, even without the recent crisis
- **The 2009 crisis** brought the first decline in G7 GDP for over 50 years

Financial crises are expensive, and the aftermath uncertain

The loss of output (relative to trend) can be 50% of one year's worth of GDP

Stylised financial crisis: fall in potential output



Source: IMF World Economic Outlook 2009 and Llewellyn Consulting
Note: not drawn to scale.

Direct effects

- Typically, seven years or so after a financial crisis, GDP is some 10% below its pre-crisis (extrapolated) trend
- Much of the “lost” output owes to investment being 30% -odd below its trend level

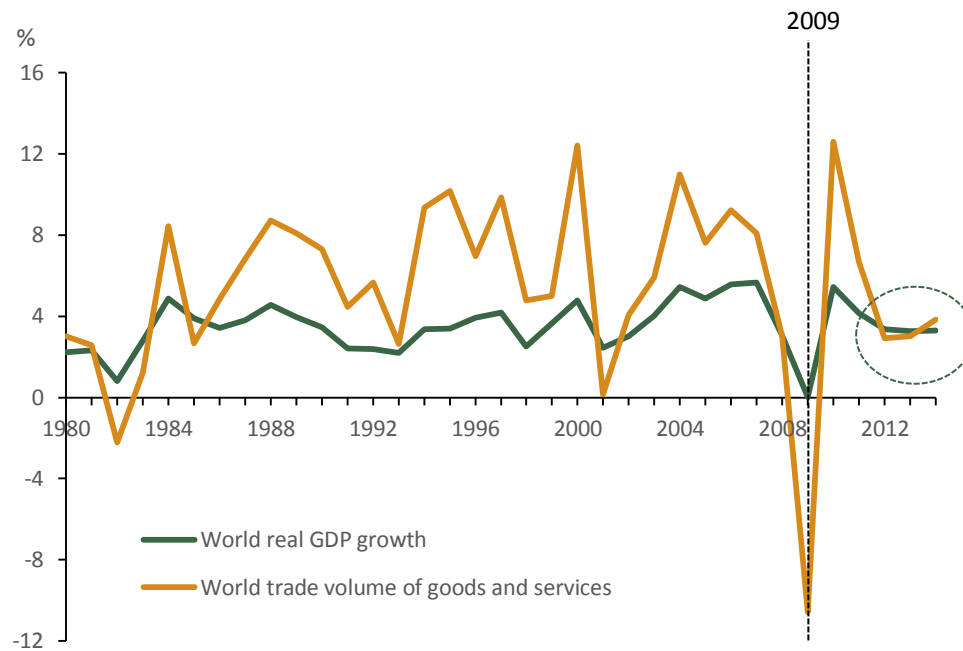
Indirect effects:

- Labour market (hysteresis) effects can further reduce productive potential
- If low investment persists and the labour force suffers continuing damage, growth of potential could slow further

World trade usually rebounds strongly with GDP growth

... since 2010, however, its growth has been lacklustre

World trade volume and real GDP - growth rates



- Typically world trade grows, on average, around twice as fast as world GDP
- World trade is highly procyclical:
 - Usually it rebounds strongly, and fairly durably, as GDP recovers from a slowdown
- In 2010, world trade did indeed rebound: but then it fell back sharply
- Over the past three years, world trade has grown only at the same rate as GDP

Source: IMF WEO, October 2014

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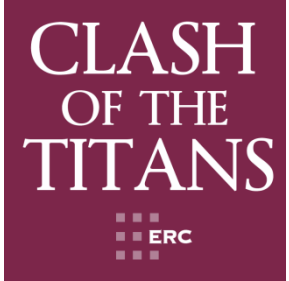
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Major reports include





John Llewellyn

	2014		2015	
	Q4	Q1	Q2	Q3
GDP	0.6	0.6	0.6	0.7
Inflation	1.2	0.9	1.1	1.3
Unemployment	5.9	5.8	5.7	5.6
Interest Rates	0.5	0.5	0.5	0.75
Earnings Growth	1.4	1.6	1.8	2.1
Yen to Dollar	High of 135			

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CLASH of the TITANS



Kate Barker
Senior Adviser
Credit Suisse
December 18, 2014

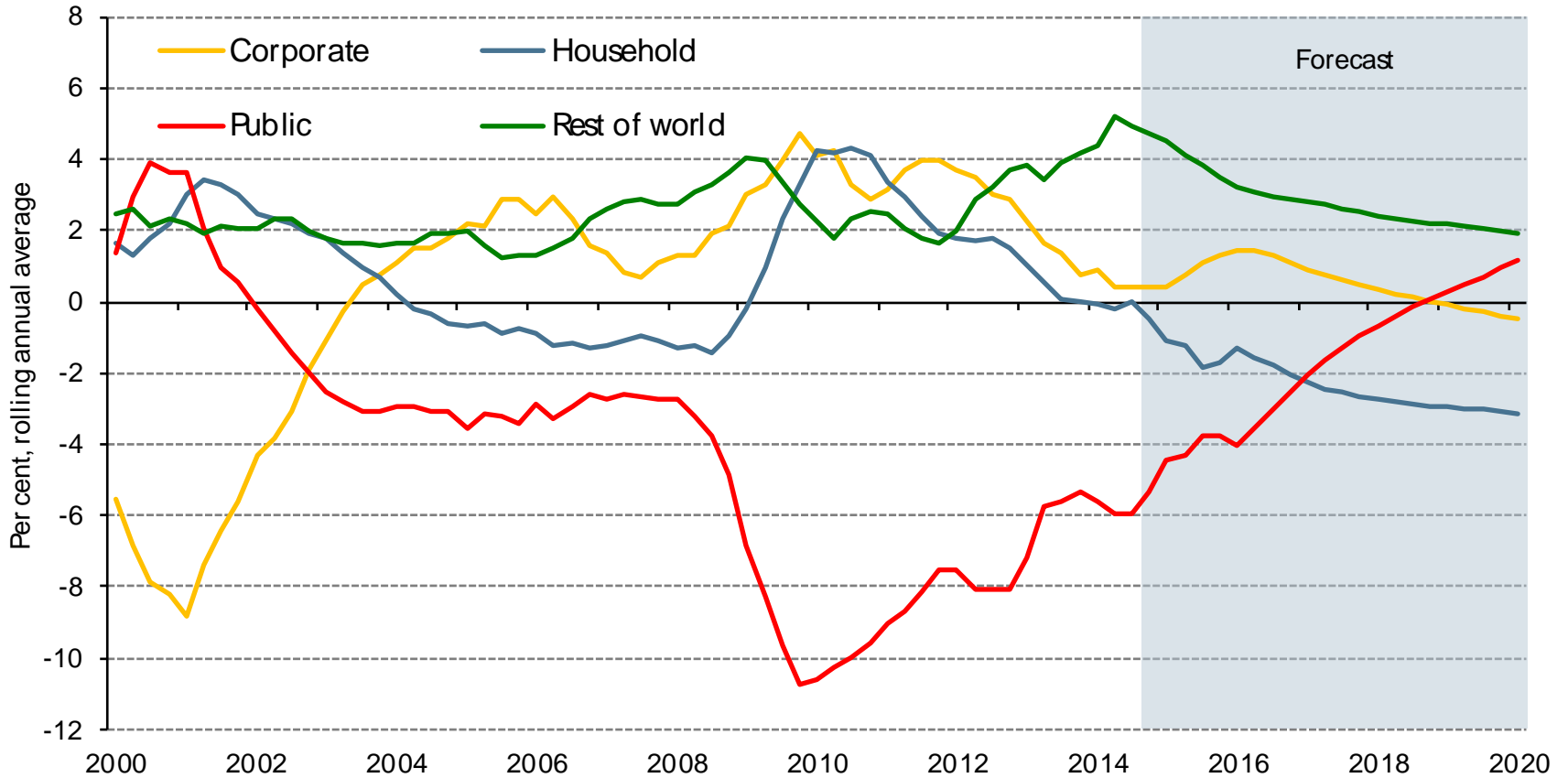
2015 – Start of the second half?

- Key features of financial crisis:
 - Balance sheet recession
 - Most of developed world
 - Long and bumpy recovery – but:
 - Euroarea tensions and near-collapse
 - Productivity stalling even in recovery
- Result: very long and very bumpy.....

Political uncertainties

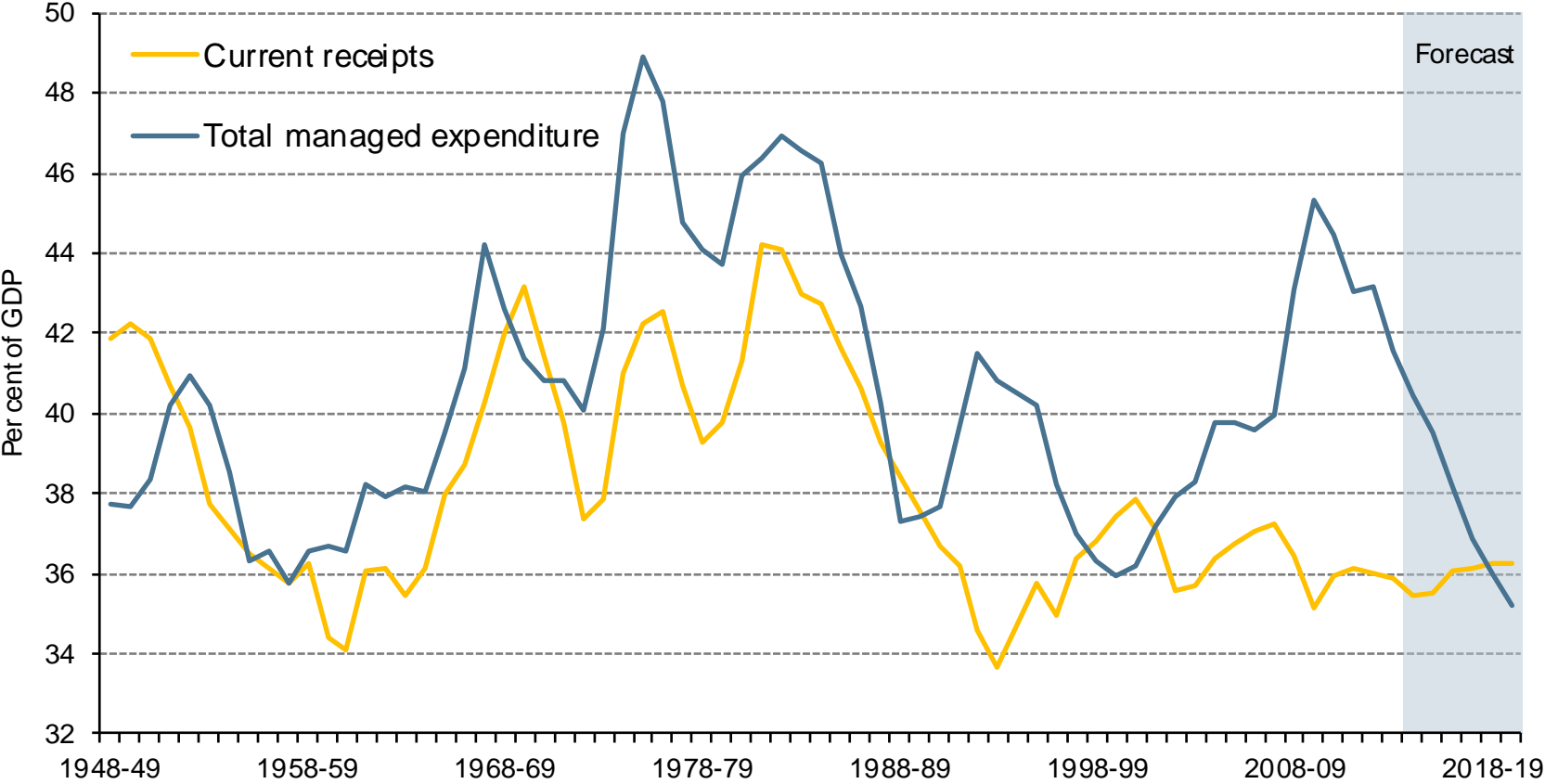
- UK – May election – minority government?
- Euroarea:
 - Rise of new parties
 - Elections in Spain, Poland, Greece?
- Tensions in Ukraine, Syria
- Oil price – economics?
- Political disillusion
- Inequality debate

Public finances versus other sectors



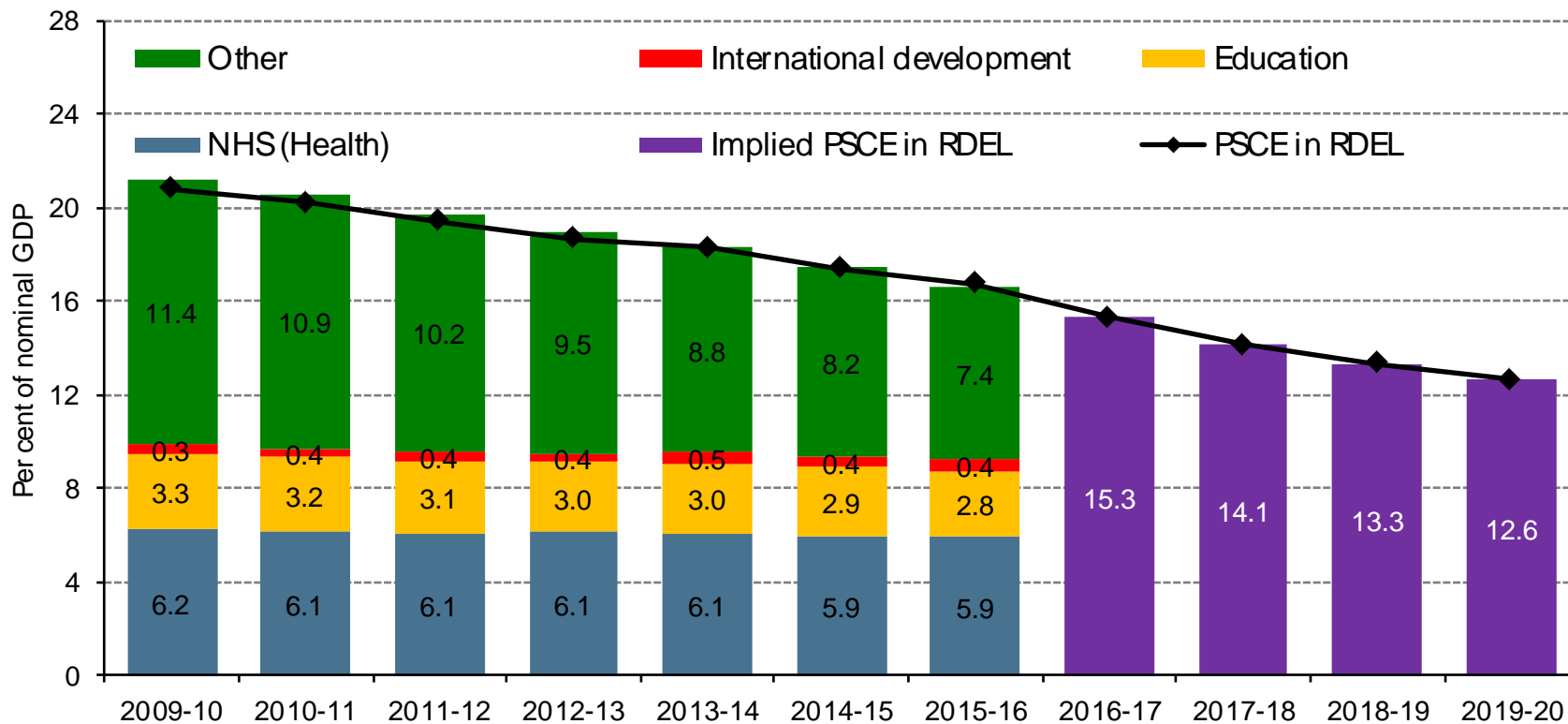
Source: ONS, OBR

Total public spending and receipts



Source: ONS, OBR

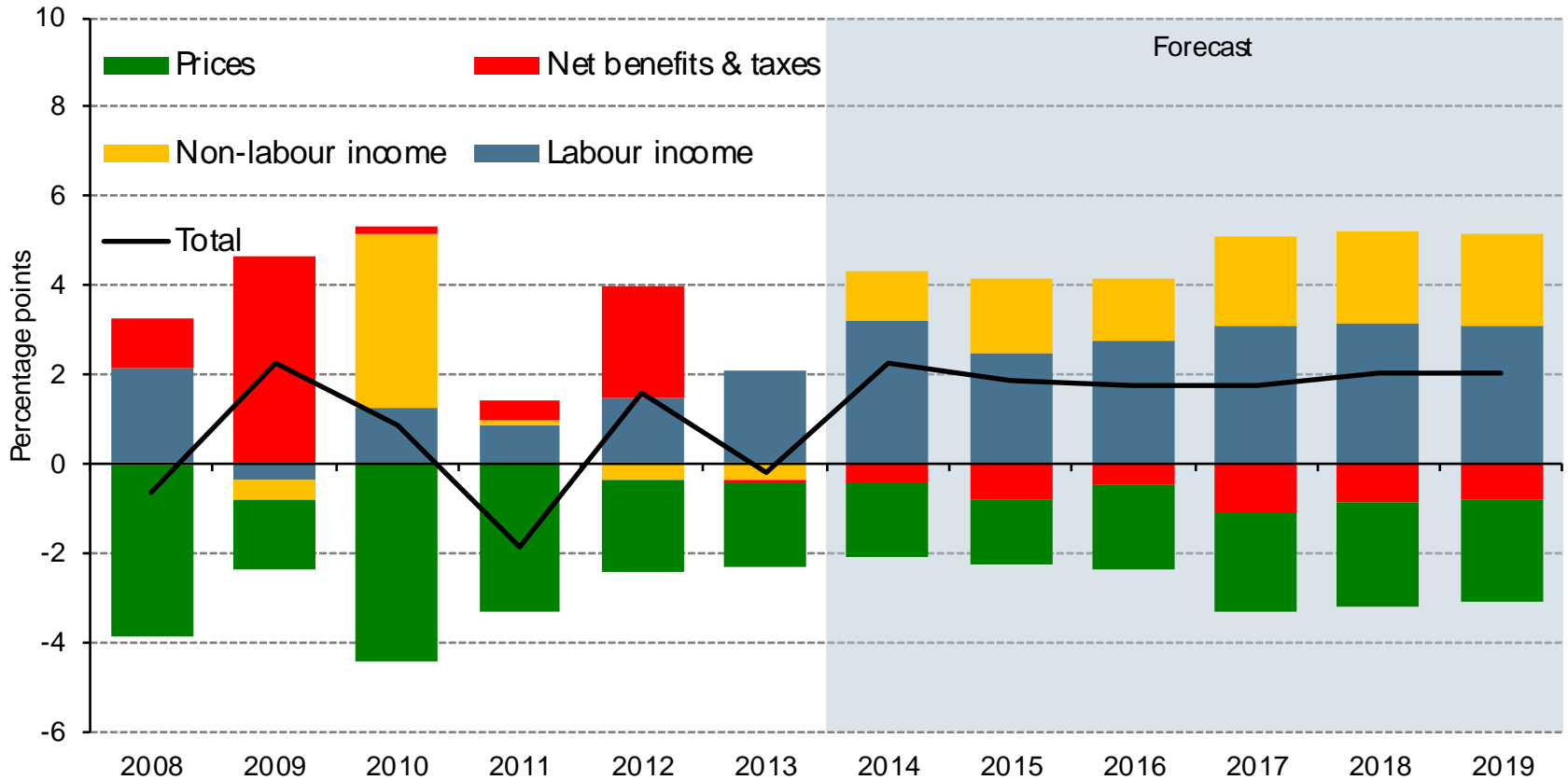
Are the fiscal plans credible?



Plans for RDEL excluding depreciation upto 2015-16. Beyond 2015-16 based on implied PSCE in RDEL calculated from the Government assumption for TME. Other includes unallocated amounts.

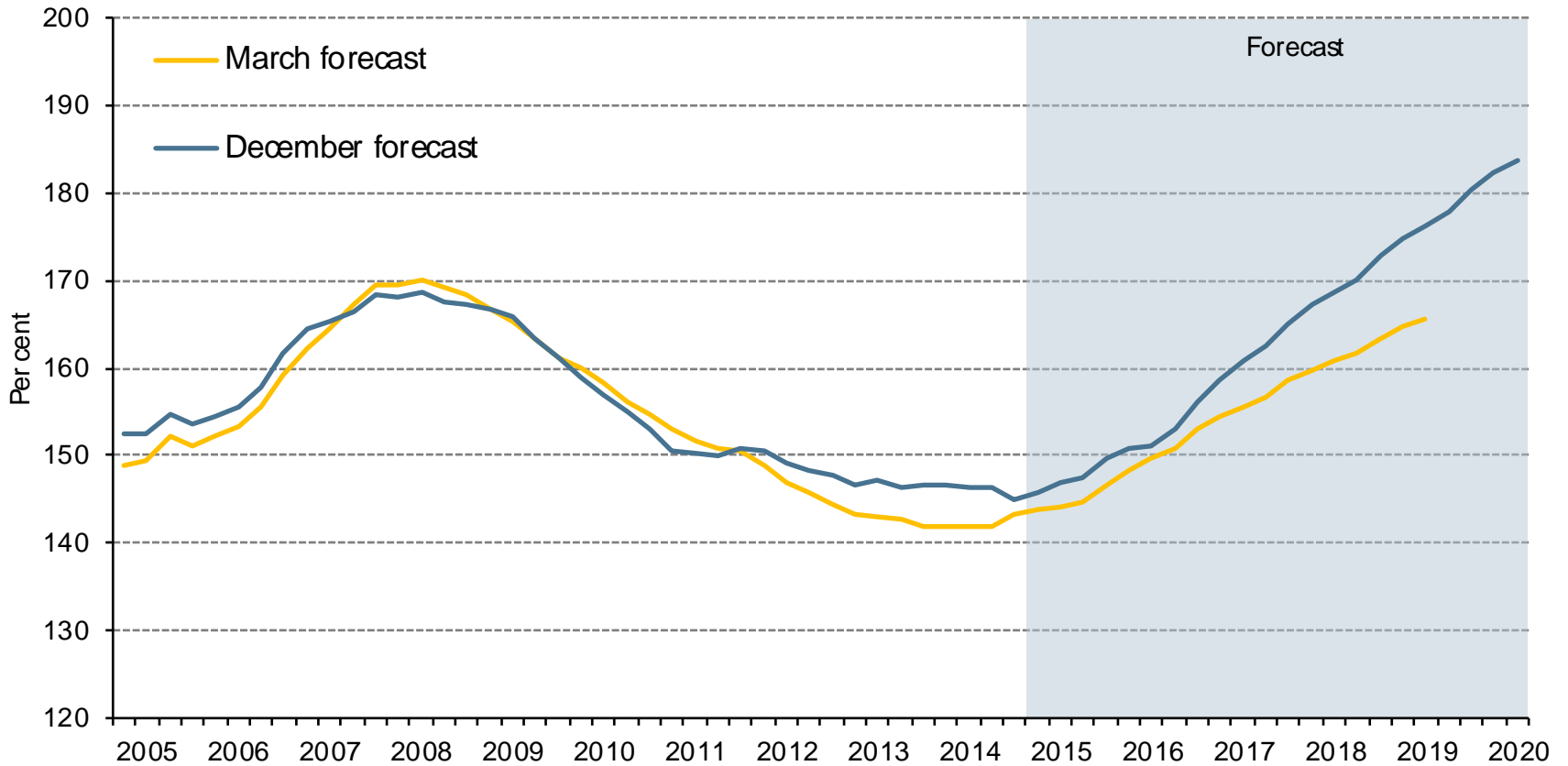
Source: HM Treasury Autumn Statement 2014, HM Treasury Public Expenditure Statistical Analyses, July 2014

Contributions to household income



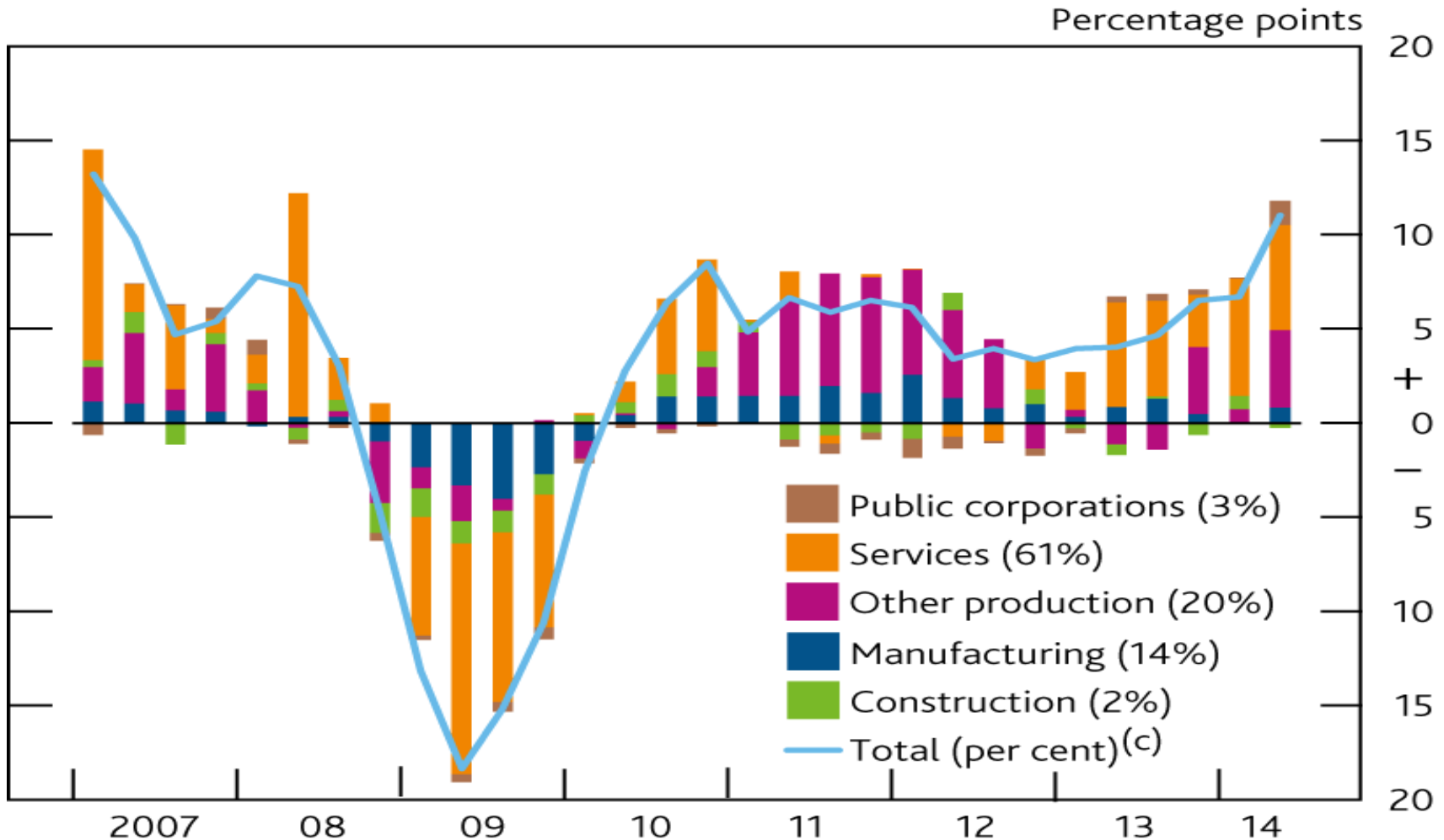
Source: ONS, OBR

Household debt as % of income



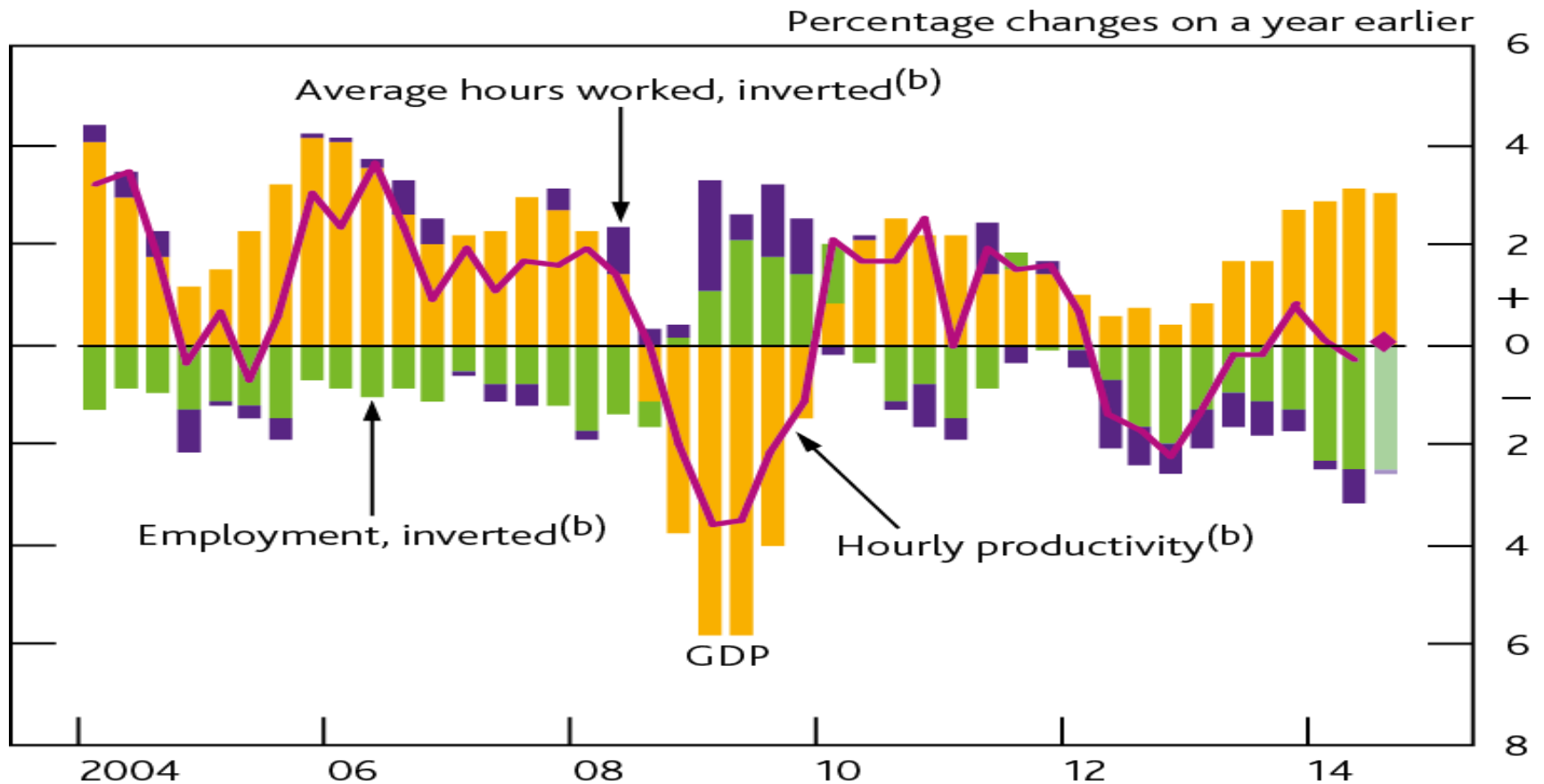
Source: ONS, OBR

Business Investment (Growth on prior year)



Source: Bank of England *Inflation Report* November 2014

Hourly productivity growth

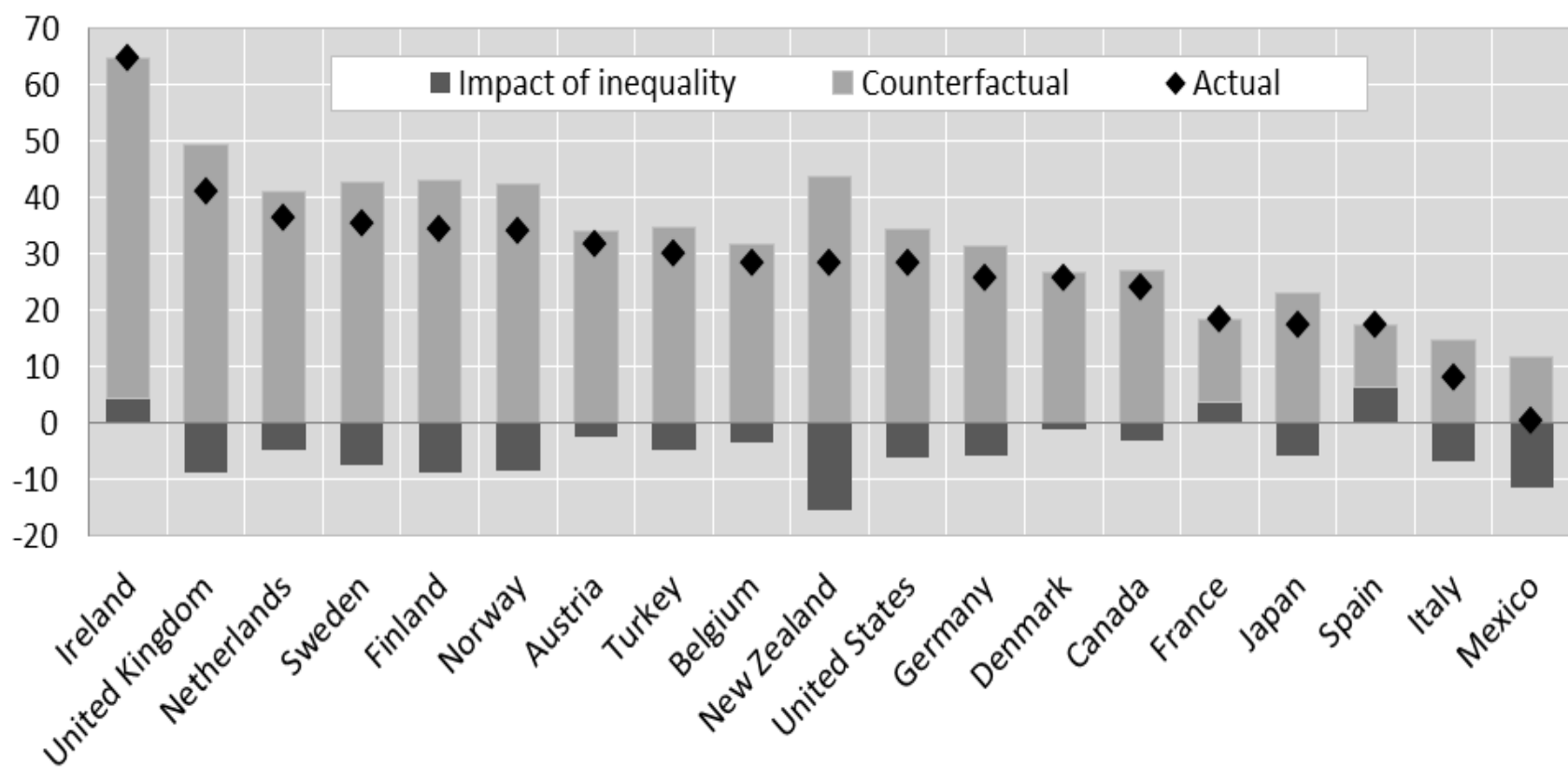


Source: Bank of England *Inflation Report* November 2014

Labour Market Surprises

- Strong participation rate: more women and older people in work
- Jobs rich growth – unemployment rose far less than expected
- Weak real earnings even in recovery period
- Low rate of job churn – reflects uncertainty
- Good or bad news?

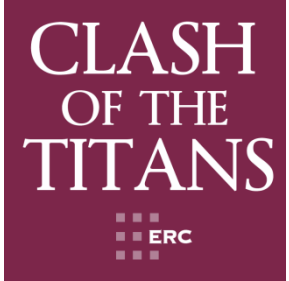
Does inequality affect growth?



Source: OECD Social, Employment and Migration Working Papers no 163 (2014)

Summary

- Second half of post-crisis period:
 - realisation of change in level of output compared to what expected
 - big question about what level of public service we are prepared to pay for
- Balance sheet issues:
 - to lower public debt – household debt has to rise further?
 - higher taxation?
 - corporate sector reluctant to raise borrowing
- Fall in oil price affords temporary stimulus
- Sustained productivity growth vital for balance sheets
- UK and global politics will be key to economy in 2015



Kate Barker

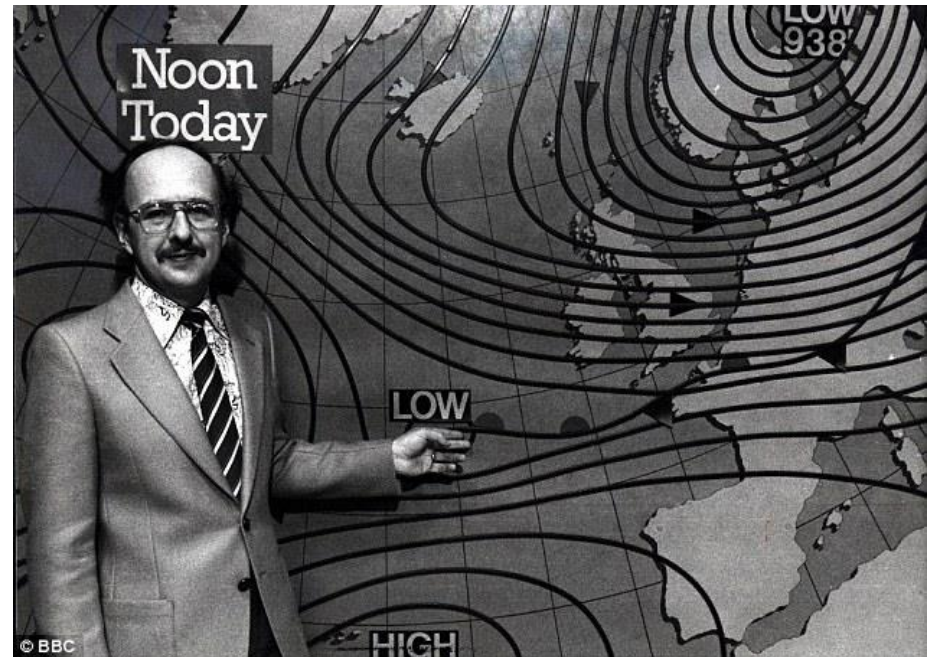
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Inflation	1.1	0.9	1.2	1.8	
Unemployment	5.8	5.7	5.6	5.6	
Interest Rates	0.5	0.7	0.75	0.9	
Earnings Growth	1.2	1.7	2.1	2.4	
Yen to Dollar	High of 135				

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The LSE view

Forecasting: A hard job?

“Perhaps it would not be out of place for me to say a word here about the status of such forecasts. **Like long-term weather forecasts, they are better than nothing.** But no one who has held office in the Treasury or, indeed, who has had the job of following Treasury activity from outside will deny that they are subject to wide margins of error.” Healy, 1974.



But they, at least, know the weather today!

My predictions:

	2014	2015		
	Q4	Q1	Q2	Q3
GDP				
Inflation				
Unemployment				
Interest Rates				
Earnings Growth				
Yen to Dollar				

GDP growth

- Model versus statistical approach
- Statistical approach adopted here for GDP:

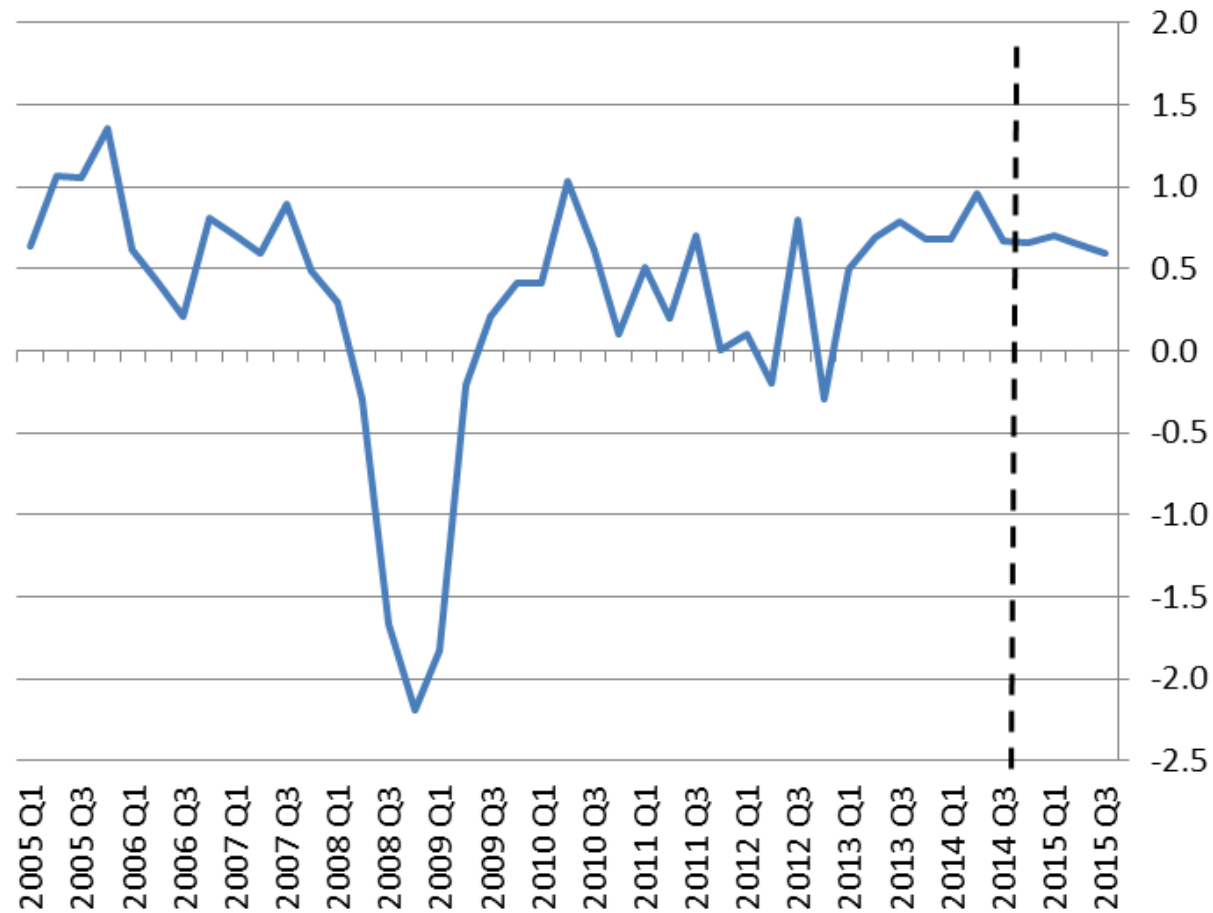
“Following The Trend: Tracking GDP When Long-run Growth Is Uncertain”
By Juan Antolin-Diaz, **Thomas Drechsel** and Ivan Petrella

- Combined with narrative and expectations

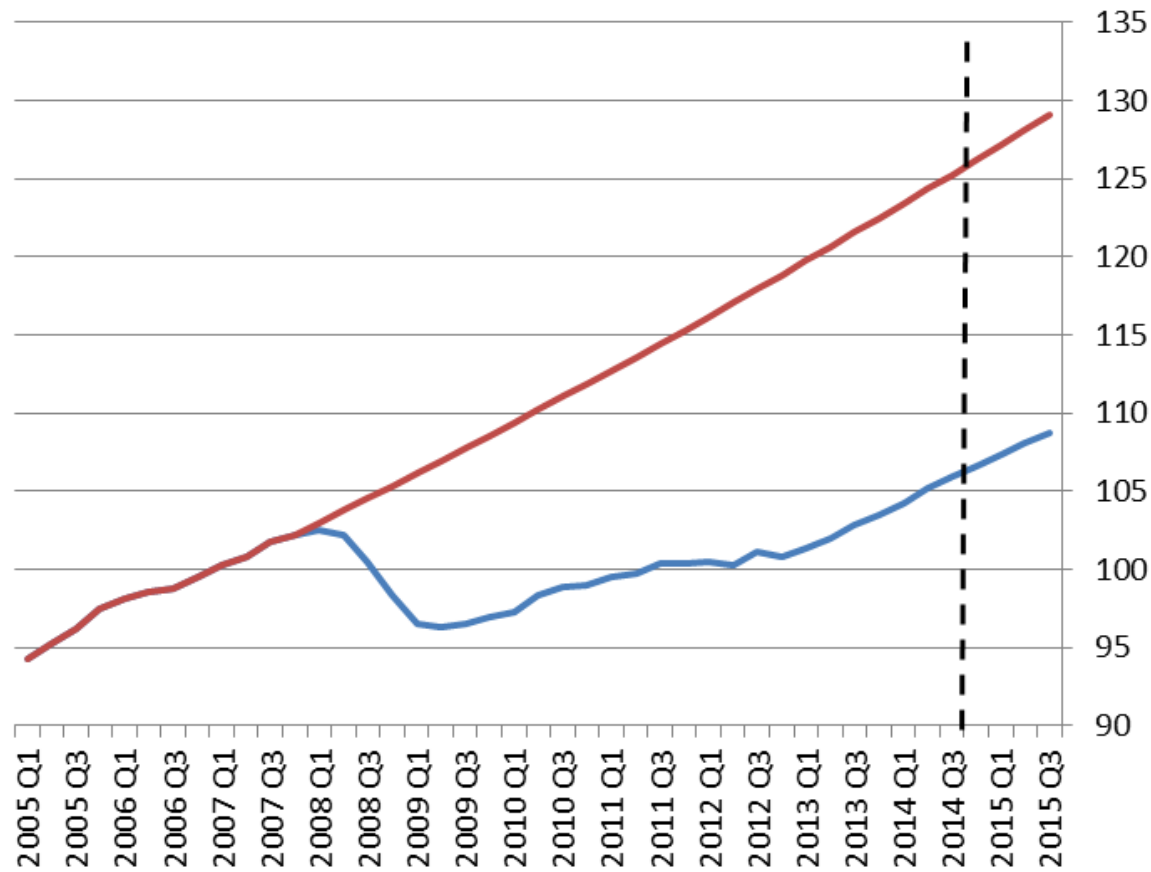
My predictions: GDP growth

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	Q4	Q1	Q2	Q3
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Inflation				
Unemployment				
Interest Rates				
Earnings Growth				
Yen to Dollar				

GDP growth (% change, oqa)



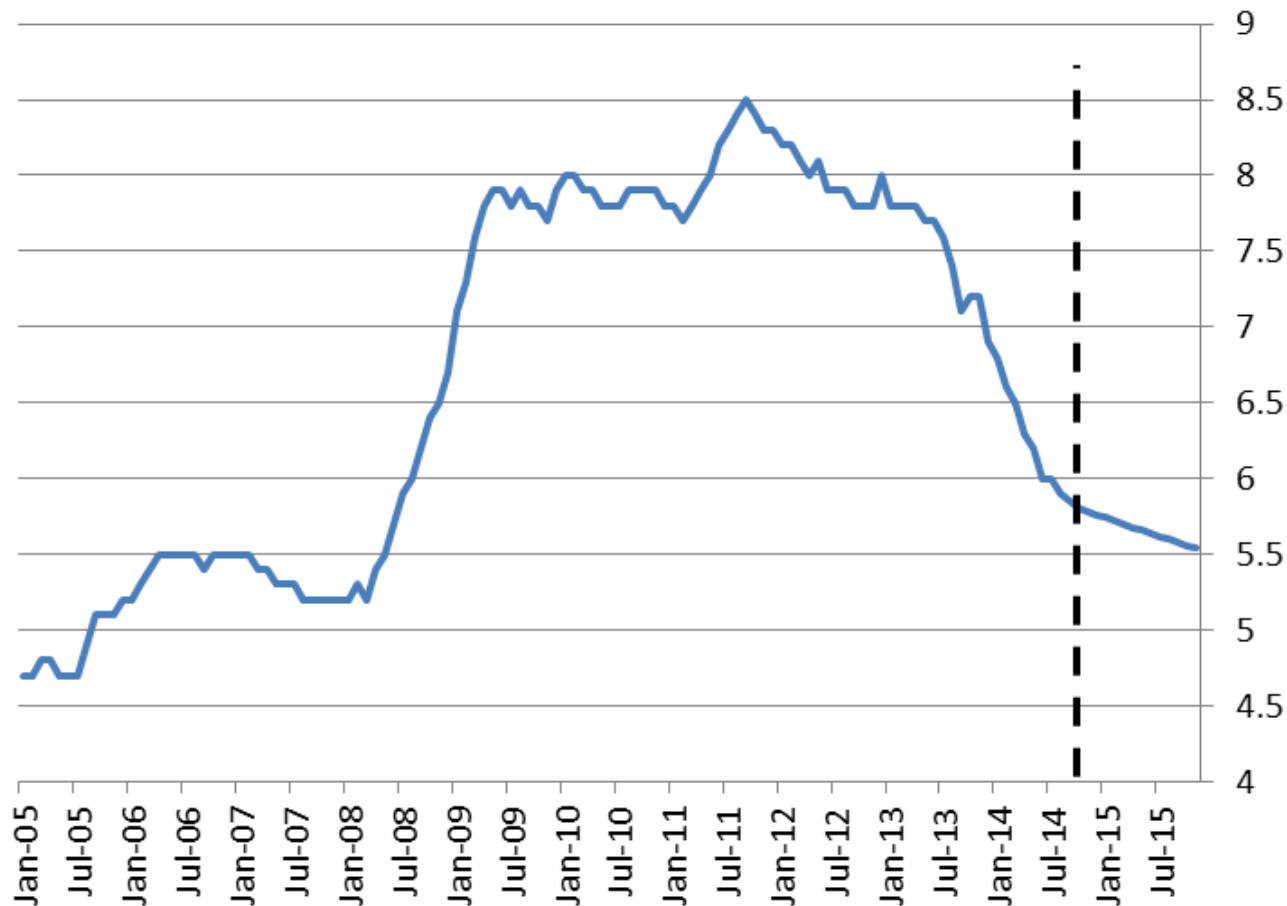
Real GDP level (vs pre-crisis trend)



My predictions: Unemployment Rate

	2014	2015		
	Q4	Q1	Q2	Q3
GDP	0.7	0.7	0.65	0.6
Inflation				
Unemployment	5.8	5.7	5.7	5.6
Interest Rates				
Earnings Growth				
Yen to Dollar				

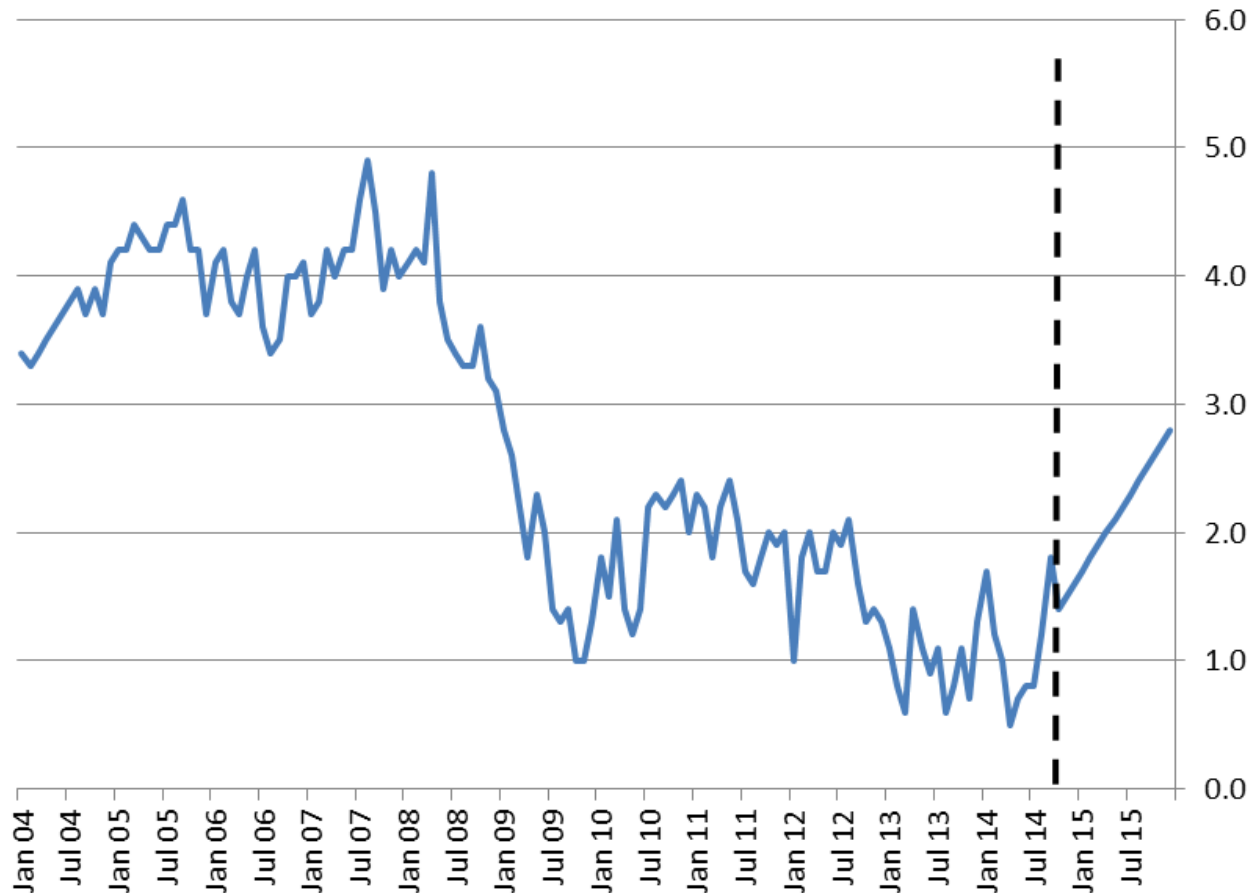
Unemployment rate: slower decline



My predictions: Earnings

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Inflation				
Unemployment	5.8	5.7	5.7	5.6
Interest Rates				
Earnings Growth	1.5	1.8	2.1	2.4
Yen to Dollar				

Average Earnings Growth (% , oqa)



My predictions: CPI Inflation

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Yen to Dollar				

CPI Inflation



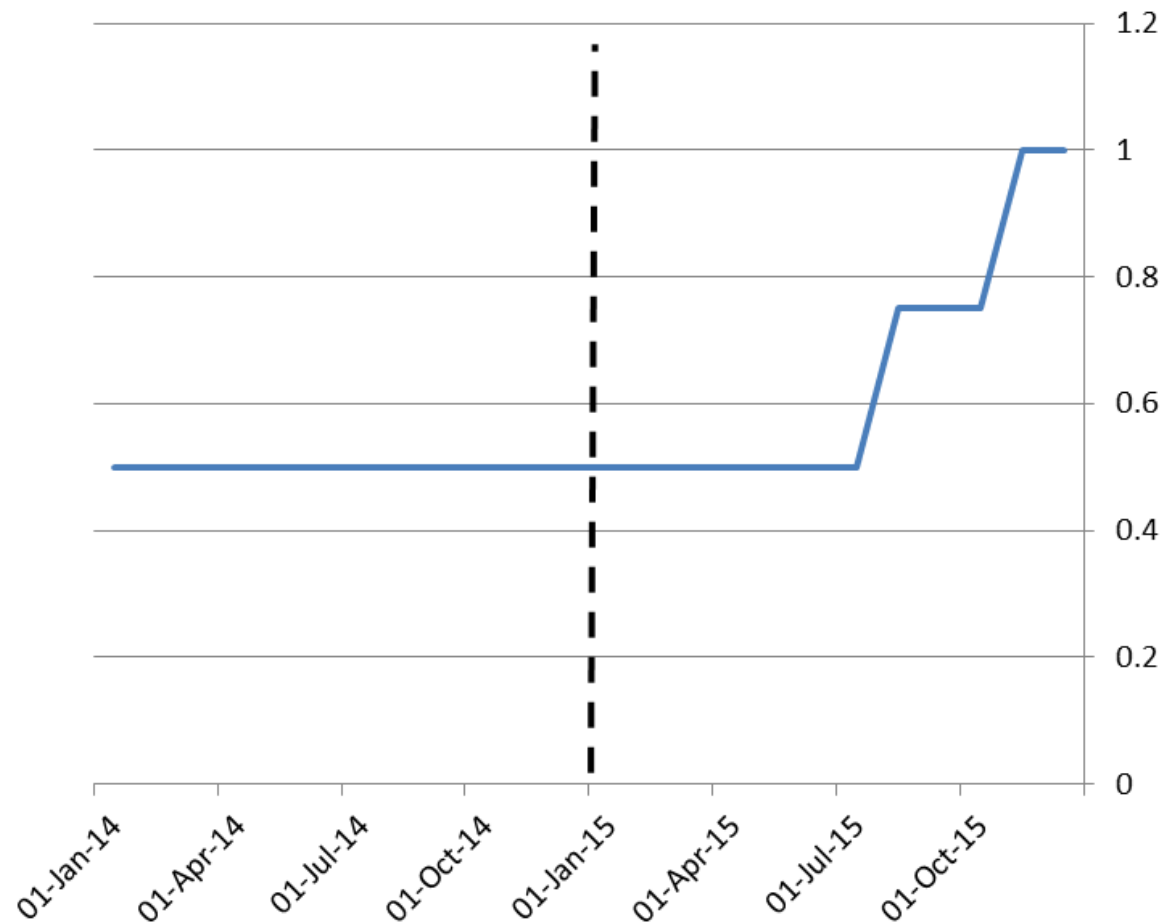
Implied Real Wages



My predictions: Monetary Policy

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Interest Rates	0.5	0.5	0.5	0.67
Earnings Growth	1.5	1.8	2.1	2.4
Yen to Dollar				

MPC: “watching like a dove”



My predictions: Tie-Breaker

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Yen to Dollar	130¥ per dollar			

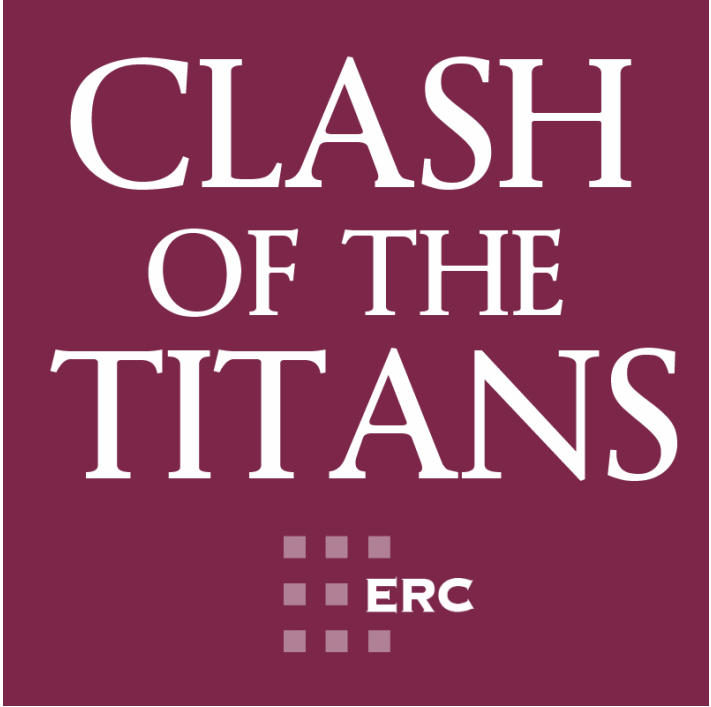
John Llewellyn		2014		2015	
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Michael McMahon		2014		2015	
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