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UK Economic Outlook

Mark Gregory, Chief Economist for the UK&I at professional services firm EY, gives his forecast for the UK economy in 2016 and beyond. **Dawn Murden** reports

Despite miserable headlines, the UK economy is expected to grow by 2.6 per cent in 2016 and continue with steady growth for the next two years, according to the latest EY ITEM Club report.

Current turmoil in the financial markets highlights how difficult it can be for senior business leaders to make sense of ongoing uncertainty in the global economy.

Mark Gregory, Chief Economist for UK&I at EY, shared his thoughts – together with the EY ITEM Club's latest figures – during a Criticaleye Discussion Group on what senior executive and non-executive directors should expect in 2016.

Consumers Will Drive Growth

In 2015, consumer spending was the main driver of UK economic growth, which is expected to continue this year.

Real household disposable incomes increased by 4 per cent in the year to the third quarter, and consumer spending growth rose by 3 per cent. It's expected that consumer spending didn't rise in equal measure in 2015 because people were more inclined to save. It can also take time for consumers to adjust to income increases, meaning it's likely to be redirected onto spending this coming year.

The second half of 2016 will deliver the tax changes announced in last year's Budget. While Mark notes that this could squeeze consumer spending, he says it will be balanced by the introduction of the National Living Wage.

"The introduction of the National Living Wage will help, and boost consumers particularly at the lower end of the scale," he explains. "The think-tank, Resolution Foundation, says 2.9 million people will get a pay rise in April due to the NLW, plus 1.3 million others who supervise them.

"Overall, we think that consumer spending will increase by about 2.8 per cent this year."

Inflation is Set to Remain Low

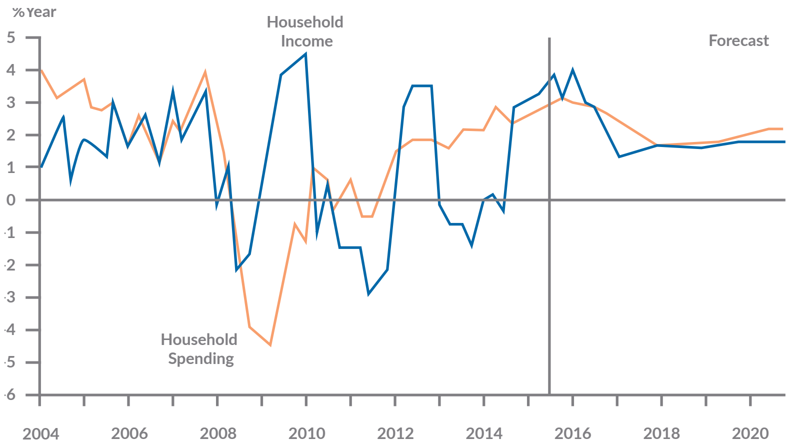
The fall in commodity prices, particularly oil, continues to drag on inflation.

Consumer price inflation is predicted to average at 0.7 per cent in 2016. Beyond that, it's likely that it will remain below the 2 per cent target set by the Government for an extended period, averaging at about 1.6 per cent in 2017.

The Bank of England came close to raising interest rates but then recoiled, possibly over worries about its impact on household and business debt.

However, Mark believes corporates would endure a rise in interest rates. "We've heard the worries about >

UK: Real Household Income and Spending



Source: EY ITEM Club

UK: CPI Inflation

Source: EY ITEM Club

zombie companies but actually profitability, cash and liquid assets are pretty high by historical standards," he explains. "It does appear that interest rates, despite what classic economy theory tells us, are not the biggest driver of investment. Expectations of profit are a bigger driver."

US and Europe Remain Key Markets for UK Businesses

EY ITEM Club calculates that in 2015 UK exports grew by 5.6 per cent, while imports grew by 5.9 per cent.

People have started to move back to the developed markets. "Last year, 50 per cent of global M&A by value was in the US, and if we add Europe it was over 70 per cent by value," says Mark.

The US and Europe will continue to be key markets for the UK. "In the previous year to November, UK exports to the US were up 30 per cent, 10 per cent to Europe and down about 30 per cent to China. Our export markets are growing and that's actually bolstering the fact that emerging markets are slowing. The UK is much less exposed," Mark comments.

"The UK's failure to fully penetrate China now looks like a rather well thought out strategy."

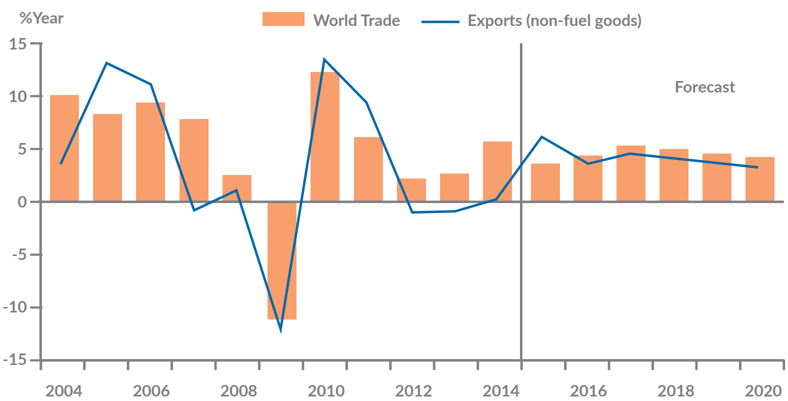
Businesses Appear to be Risk Adverse

UK corporations ran a financial surplus of 2.9 per cent of GDP in Q3 of 2015, the largest in more than three years. This means that although profits have risen as a share of GDP, much of this has not been invested.

Mark says companies appear to be risk averse, which is due to caution and preparation for "new burdens" such as the National Living Wage and, for large companies, the Apprenticeship Levy due to be introduced in April 2017.

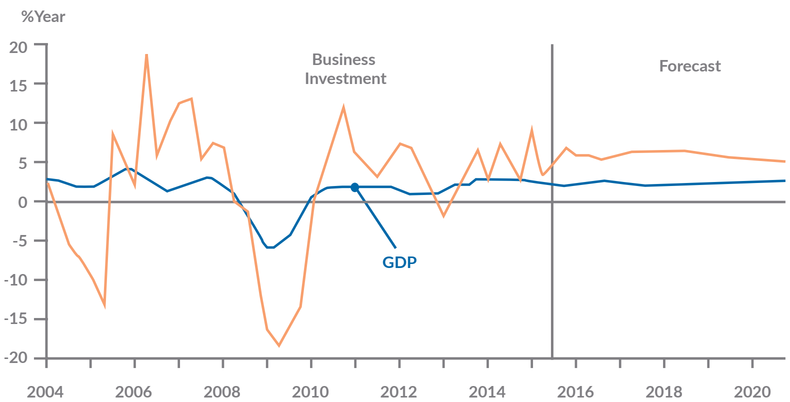
Another source of uncertainty could be the UK's upcoming 'Brexit' referendum. ■

UK: Exports and World Trade



Source: EY ITEM Club

UK: Business Investment and GDP



Source: EY ITEM Club

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Mark has over 25 years' experience, working in more than 40 countries as an advisor to governments and industry on economics, policy and regulation.

He is the Sponsoring Partner for the EY ITEM Club and identifies the implications of the economy on businesses. He is also currently co-ordinating EY's efforts to support clients in developing contingency plans for alternative economic scenarios for the Eurozone.

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