Plenary 2

Keynote: The Economic outlook for 2023

Speaker: Professor Trevor Williams

Chaired by: Mike Turner

Room: Main Hall

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Geopolitical shocks are becoming more frequent

- The last 15 years have seen a global financial crisis, a global health crisis, and a global energy crisis triggered by Russia's invasion of Ukraine. This year, risk of war over Taiwan, China reopening after the COVID lockdown, flashpoints in the Middle East, Turkey, and Africa wars and escalation in Ukraine. Upside, US and EU will avoid recession, and inflation could fall more quickly allowing lower rates.

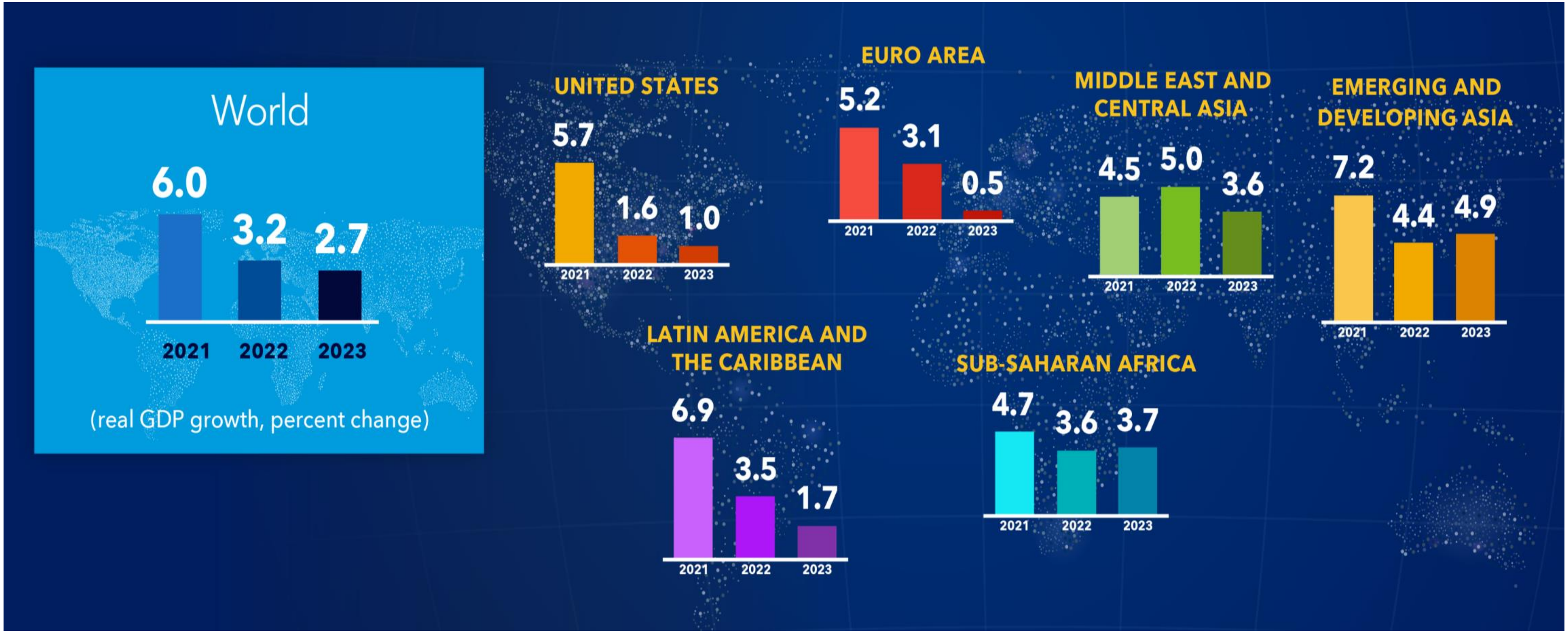
- These global shocks, added to climate change and other geopolitical issues like the rise of autocrats (even in the US), are placing great strain on international institutions and the rules-based order that has unlocked so much global prosperity in the last 75 years.

- Rising inflation rates means a paradigm shift has occurred to higher interest rates and tighter fiscal policy this year to combat it.

- It's easy to be negative based on some of these events, but global economic growth is still occurring – though at a slower pace - and technological change is accelerating. Allied with this, the global population is ageing fast, leading to rising savings, more investable funds, and higher employment, opening new growth opportunities and challenges.

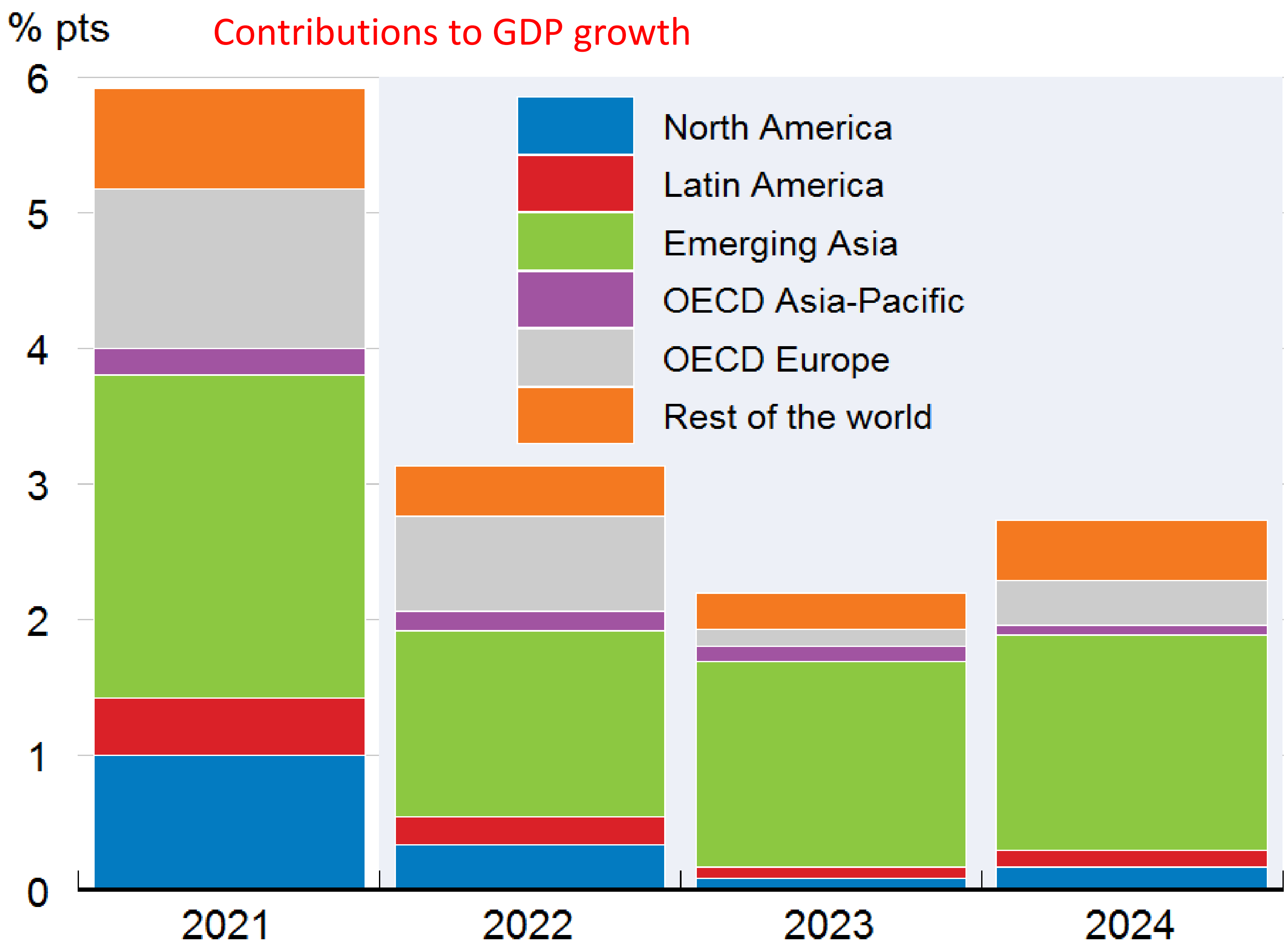
Slower growth but still positive…

% increase in GDP per year



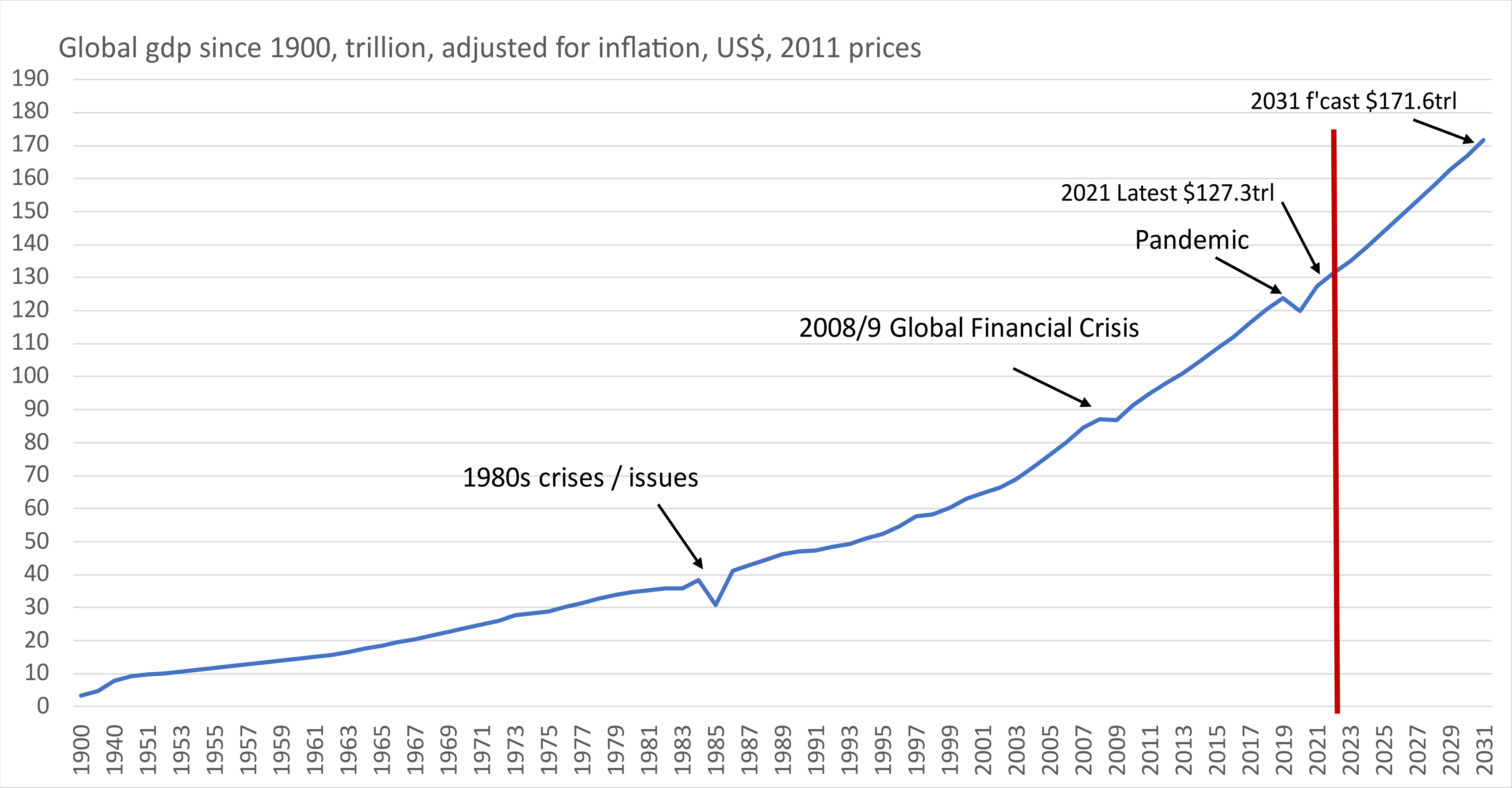
Source: IMF

…driven by emerging Asia



Source: OECD

But we have been here before and the world economy always recovers



Increase of $44trln

Source: OECD, tfw calculations

Focus on the UK

UK outlook has deteriorated sharply, but we expect a mild recession

- Economic growth will fall in 2023 and 2024. A recession is now unavoidable though its severity is still uncertain.

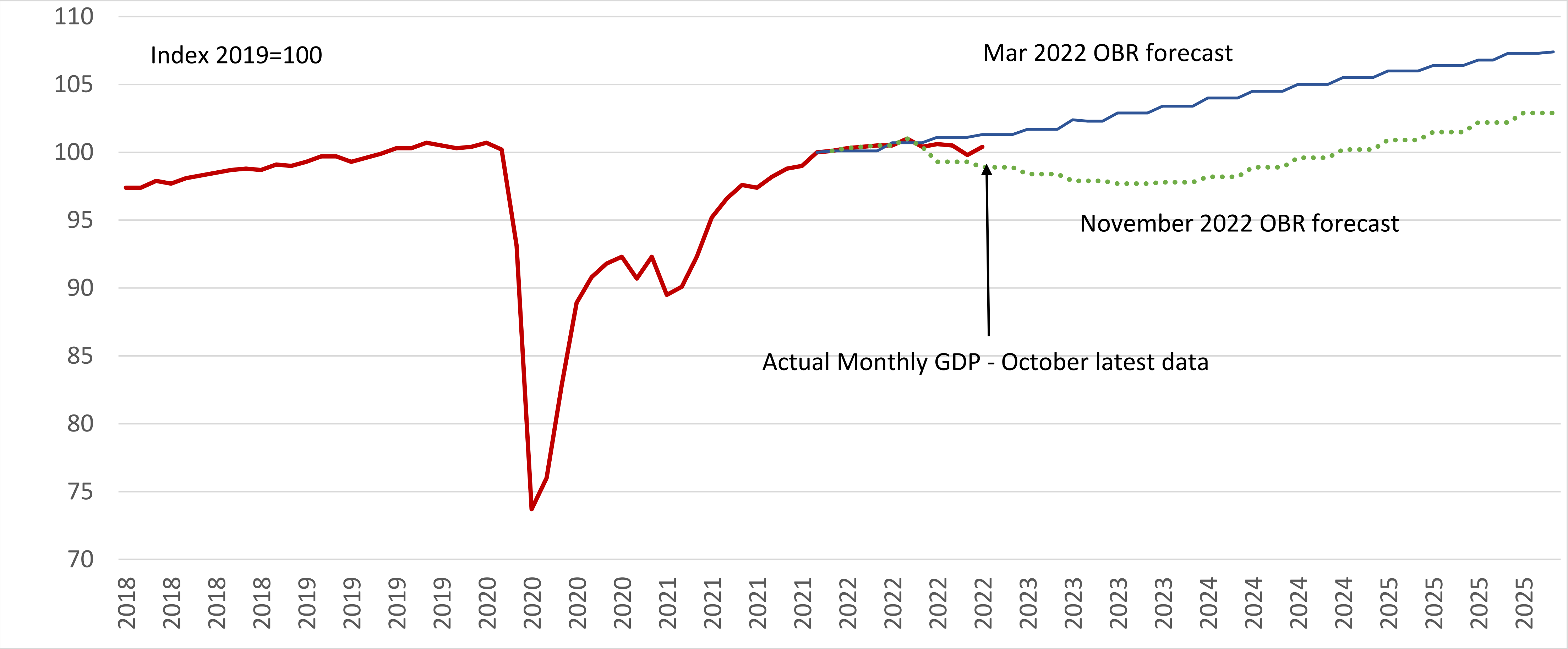
- Consumer price inflation will keep rising and peak at around 10-12% at the end of 2022, due to a tight labour market, supply shortages and high energy prices, before gradually declining to 4.7% by the end of 2023.

- As rising prices erode household income growth, consumer spending will slow sharply, and real pay growth will remain negative. Business and consumer confidence reflect this bleak picture.

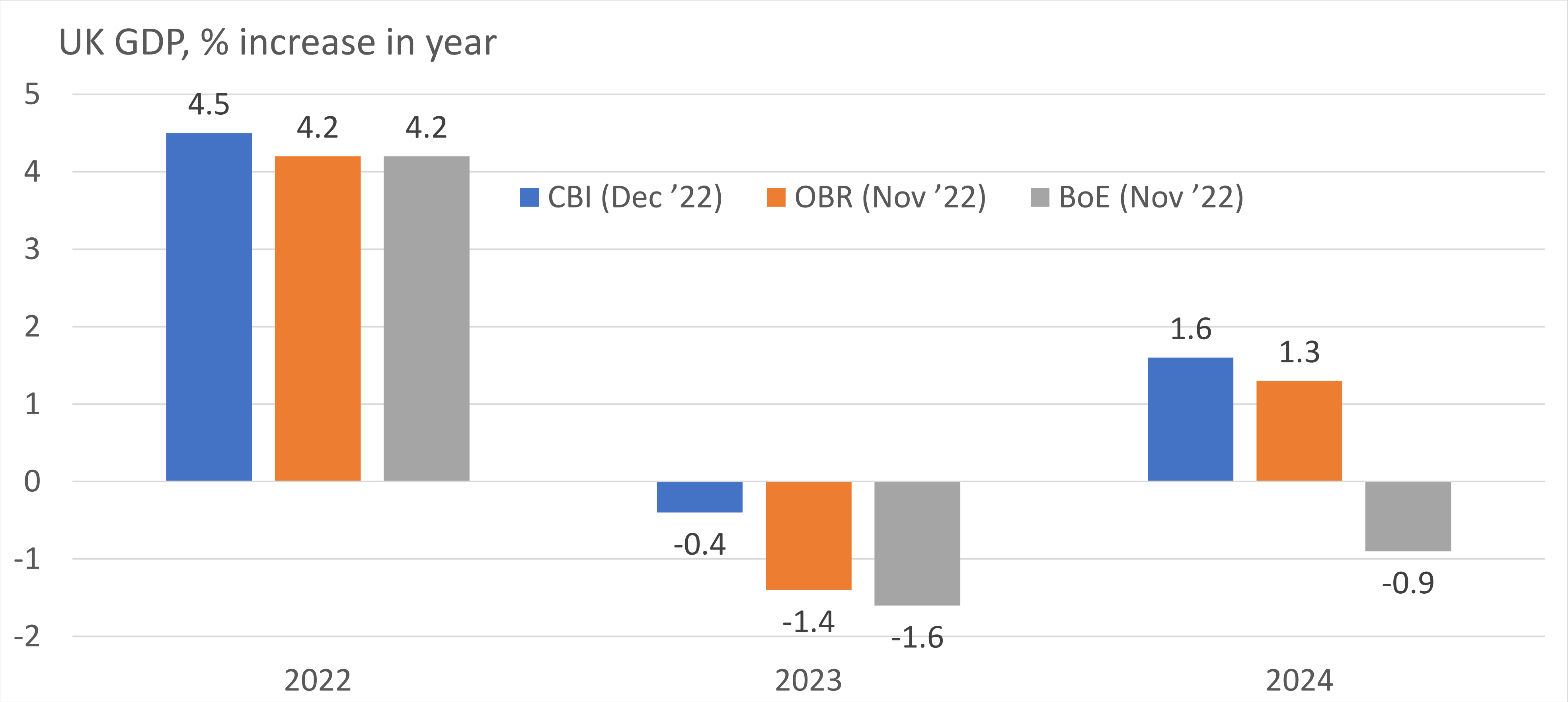
- Public and private investment spending will weaken in the next few years, as recession and higher costs bite. This is where the biggest hit to housing comes from, as costs rise. Not enough being done to build more homes, harming productivity and with societal costs. Why is this the policy choice?

- Rays of good news are in a still tight labour market / low unemployment scenario and continued fast change in technology. Climate change and an aging population offers prospects for new innovations to meet these challenges and so drive productivity and growth.

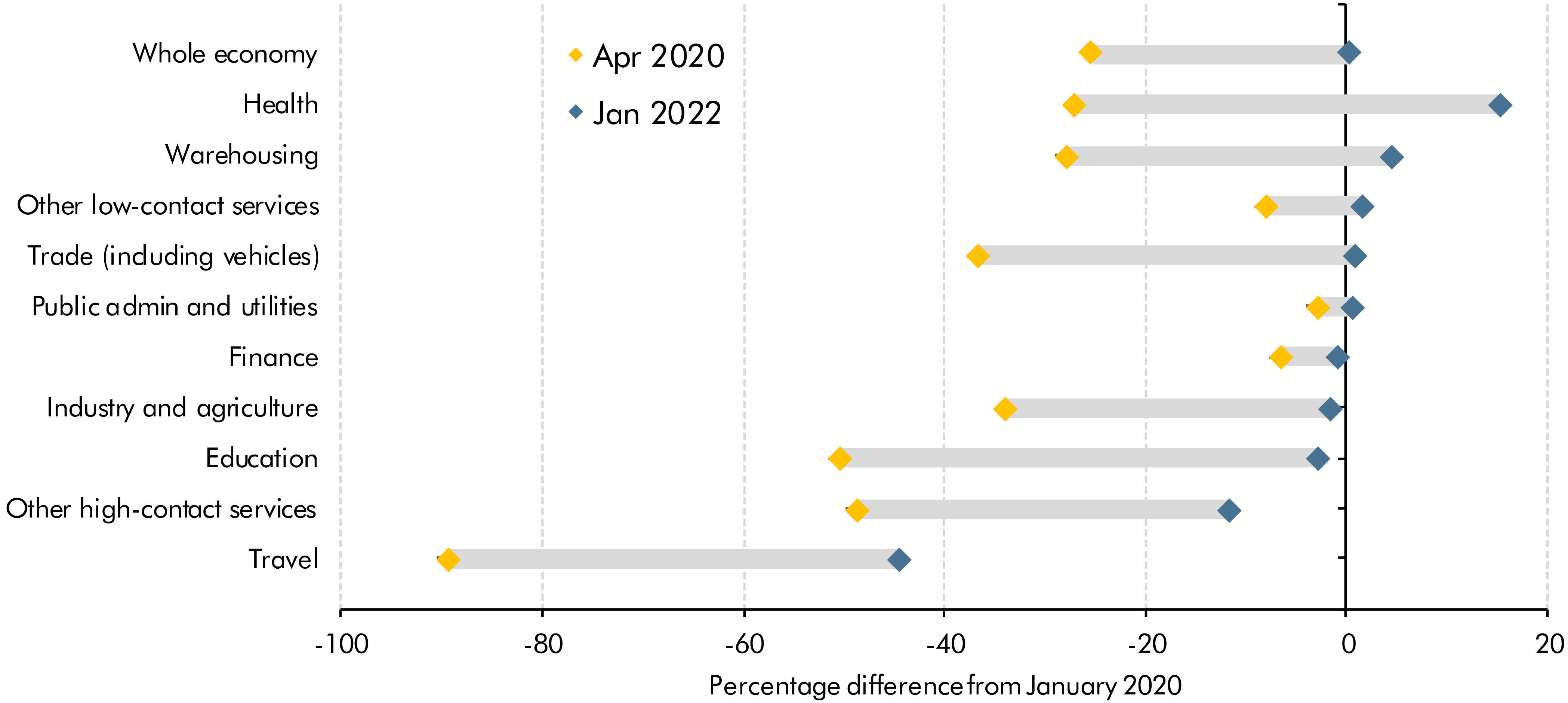
UK economy already in recession



It’s just a question of how much it shrinks

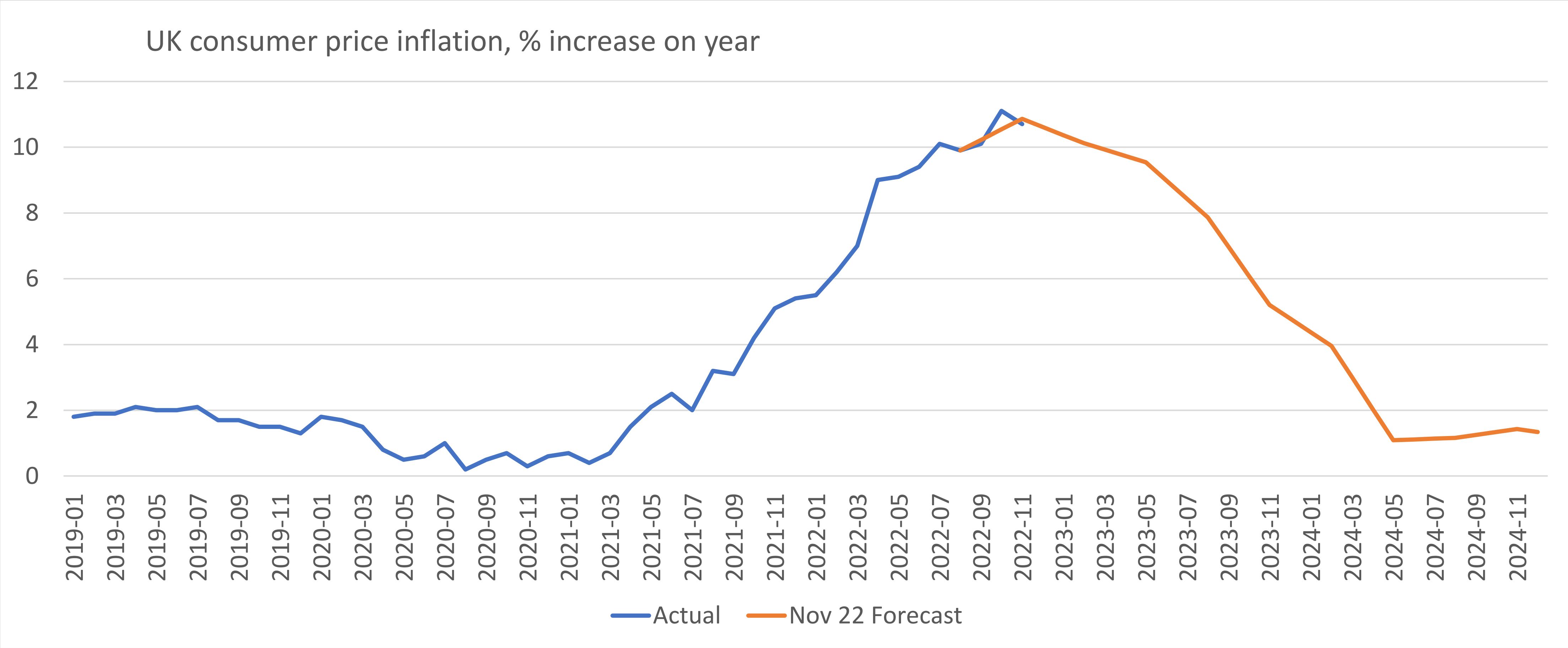


Which sectors have been impacted the most since the Pandemic?

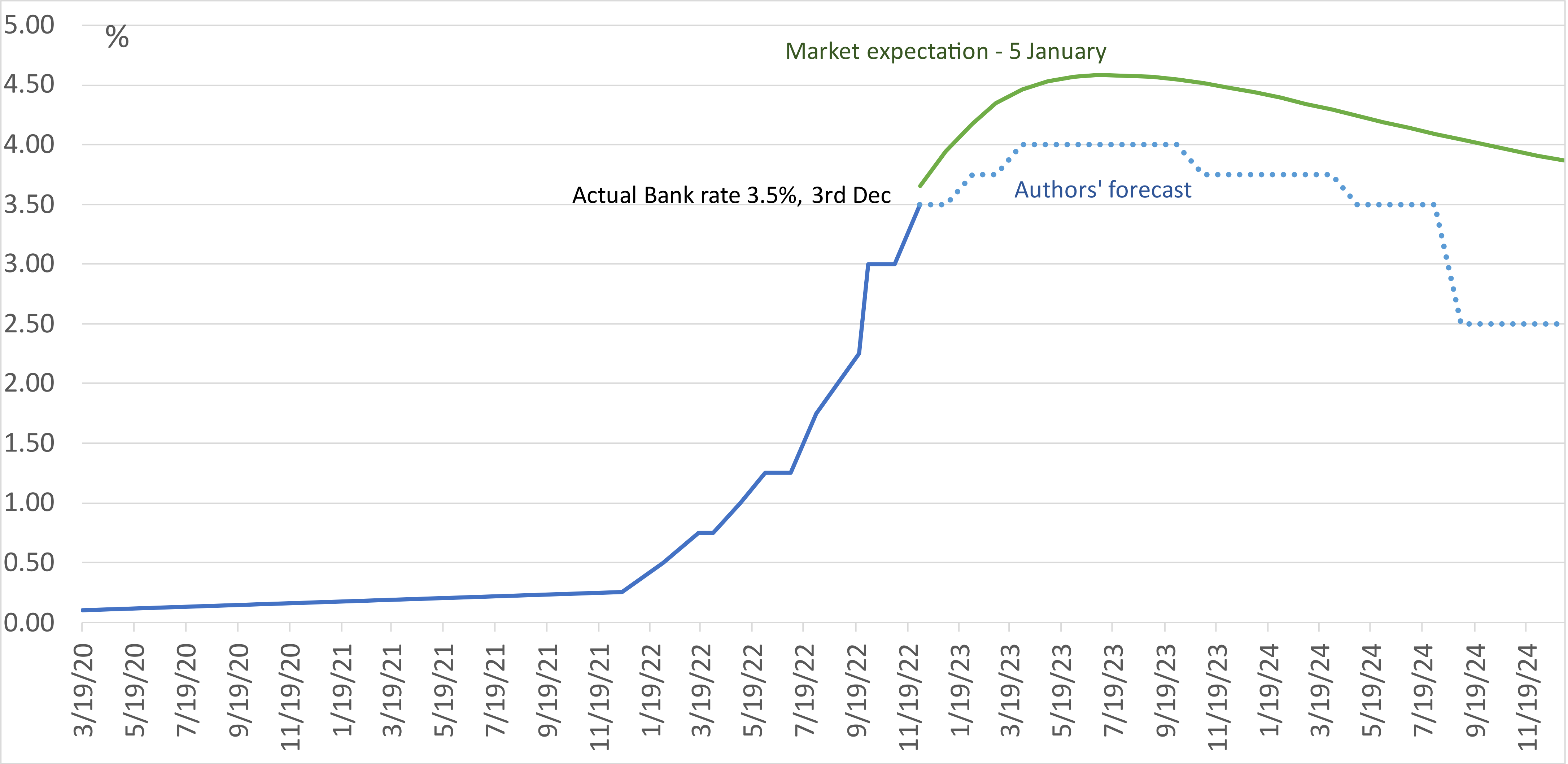


Note: Other low contact services includes real estate, ICT, professional, scientific and technical services, and gambling. Travel includes air and rail transport and travel agency services, while warehousing includes other transport, postal and warehousing services.
Source: ONS

Price inflation will fall rapidly in 2023…

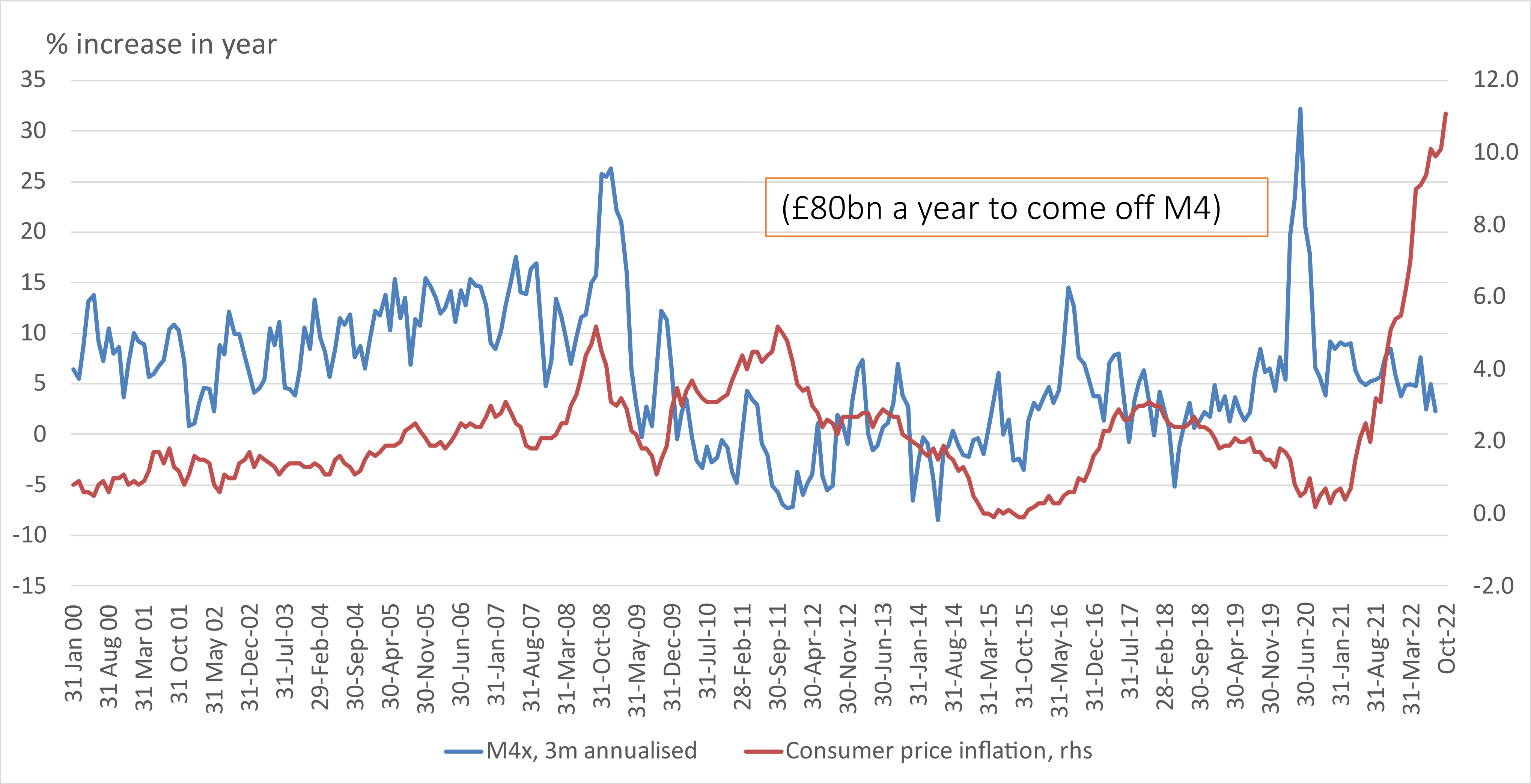


…from the sharp rise seen in rates, energy prices and a slowing economy…



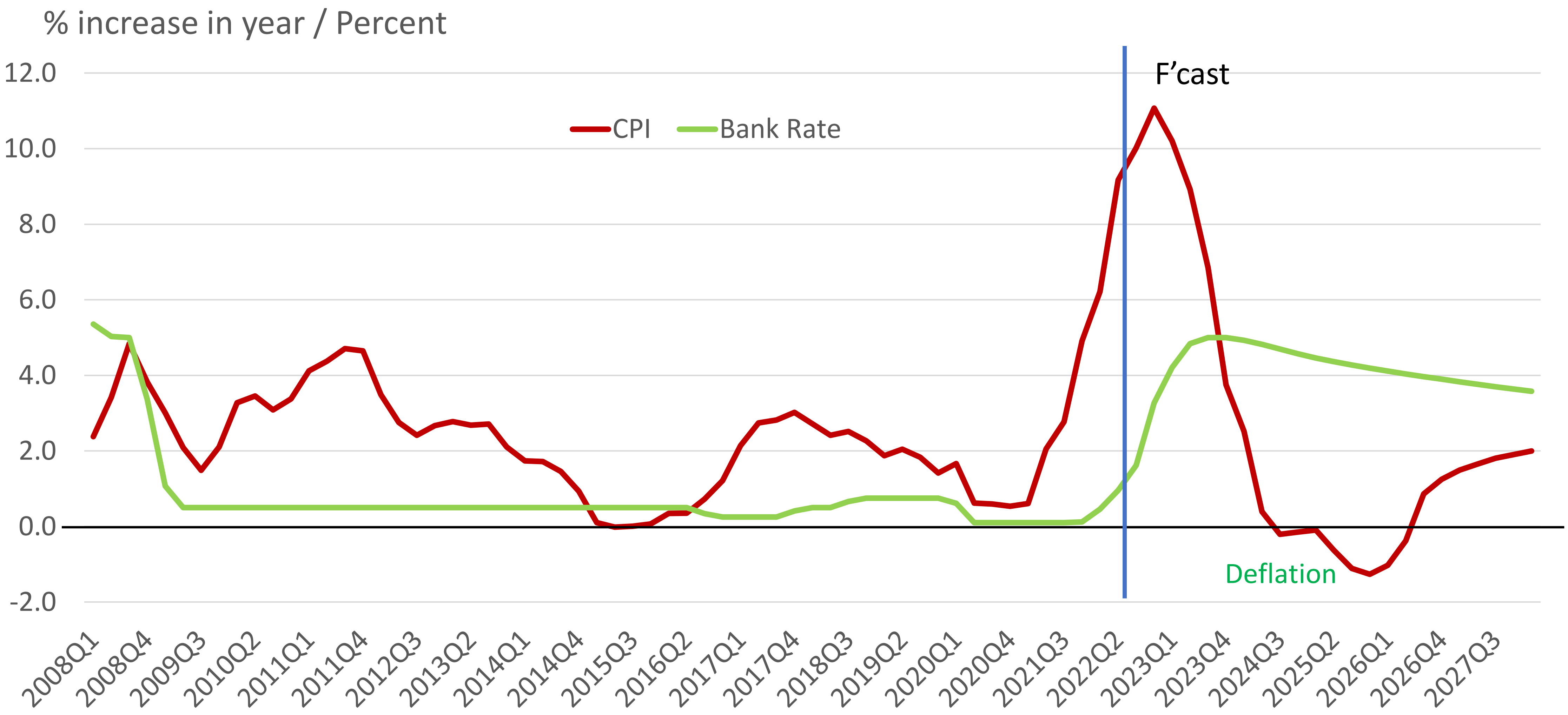
Source: TW calculations based on Bank of England data

…supported by shrinking M4 money supply driven by quantitative tightening



Source: ONS, bank of England

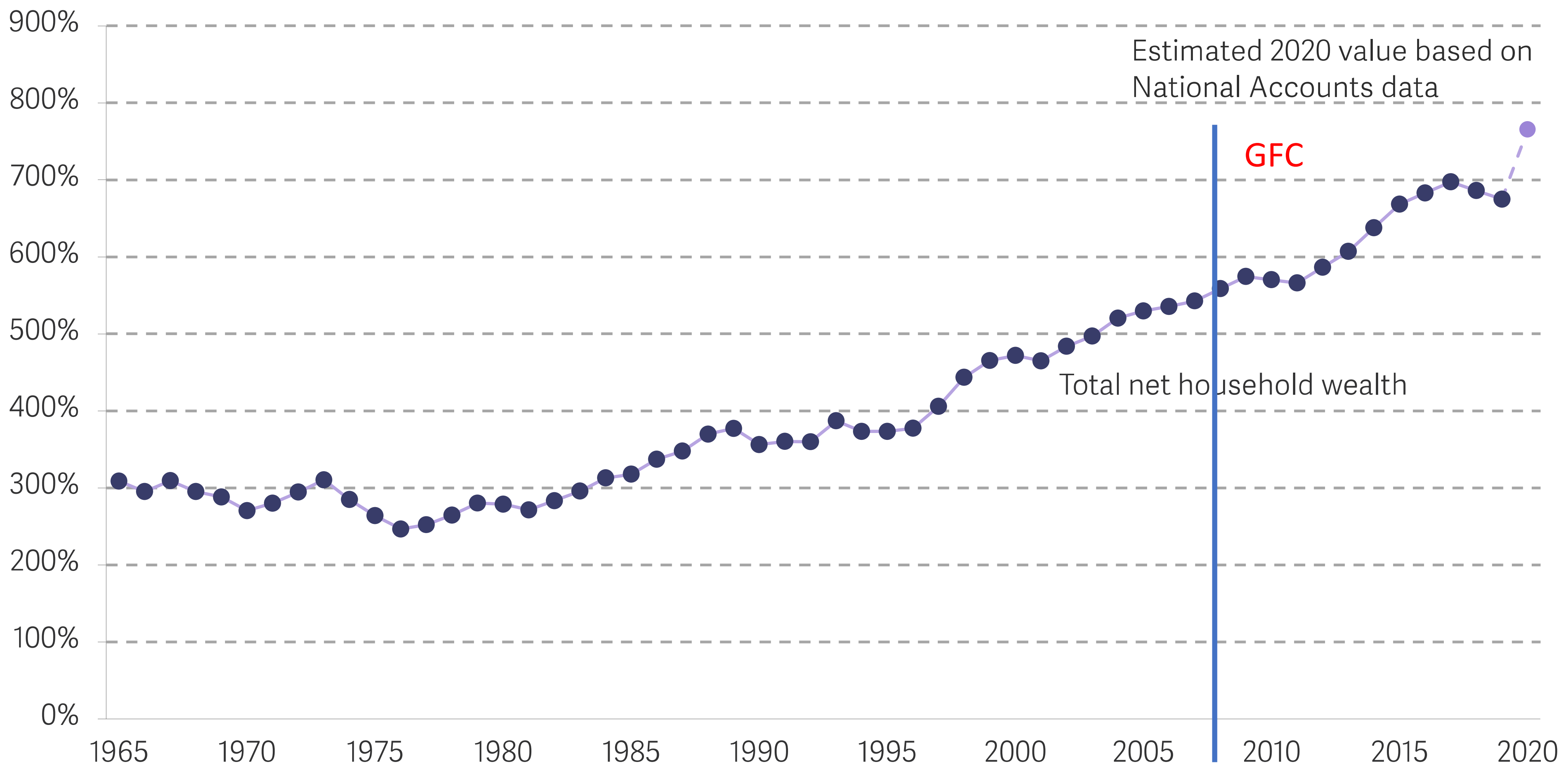
Deflation could result in 2024, if bank rate hits 5%



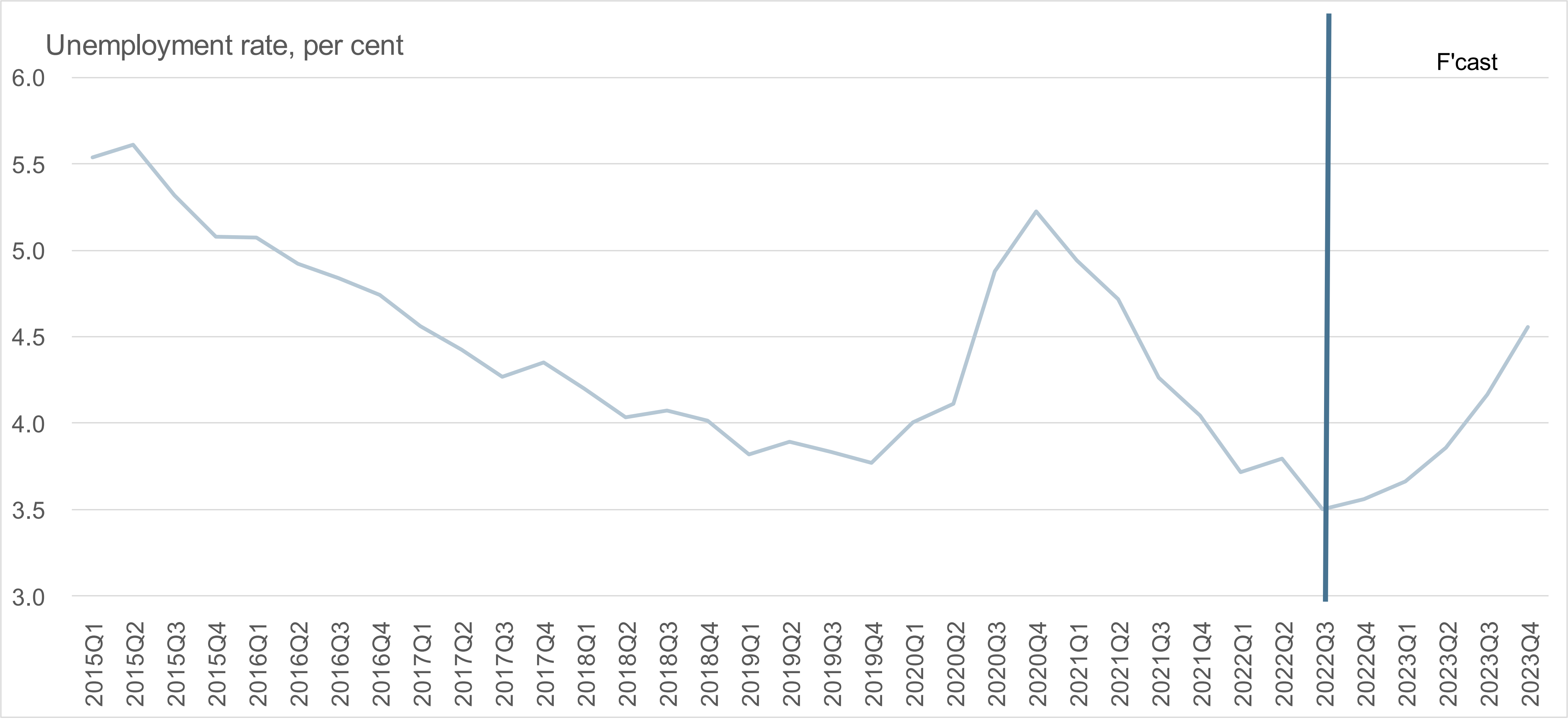
Source: OBR, Nov 2022

'Real pay' to remain under pressure

Wealth as continued to rise – housing and capital markets

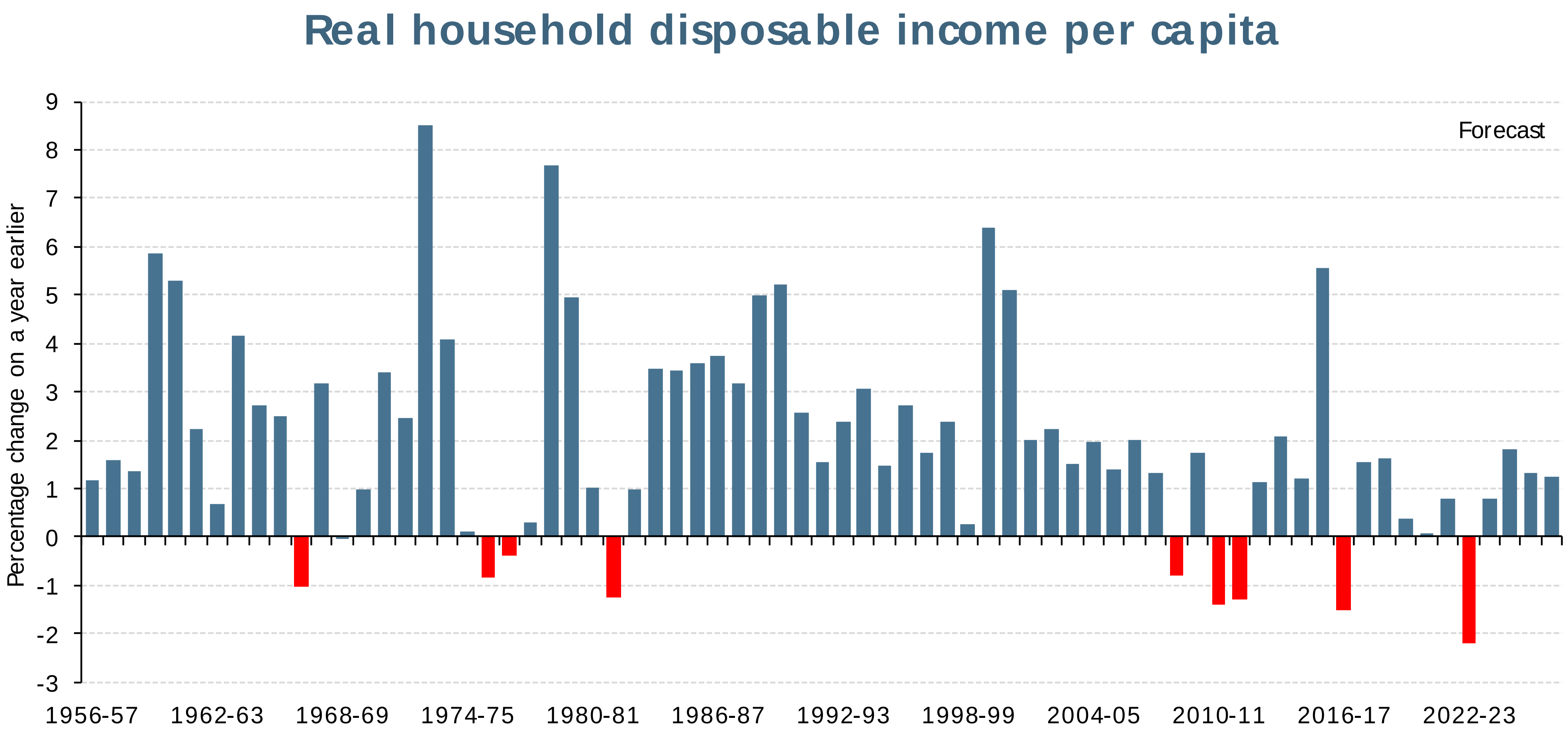


UK unemployment will rise only modestly as vacancies fall



Source: OBR, ONS

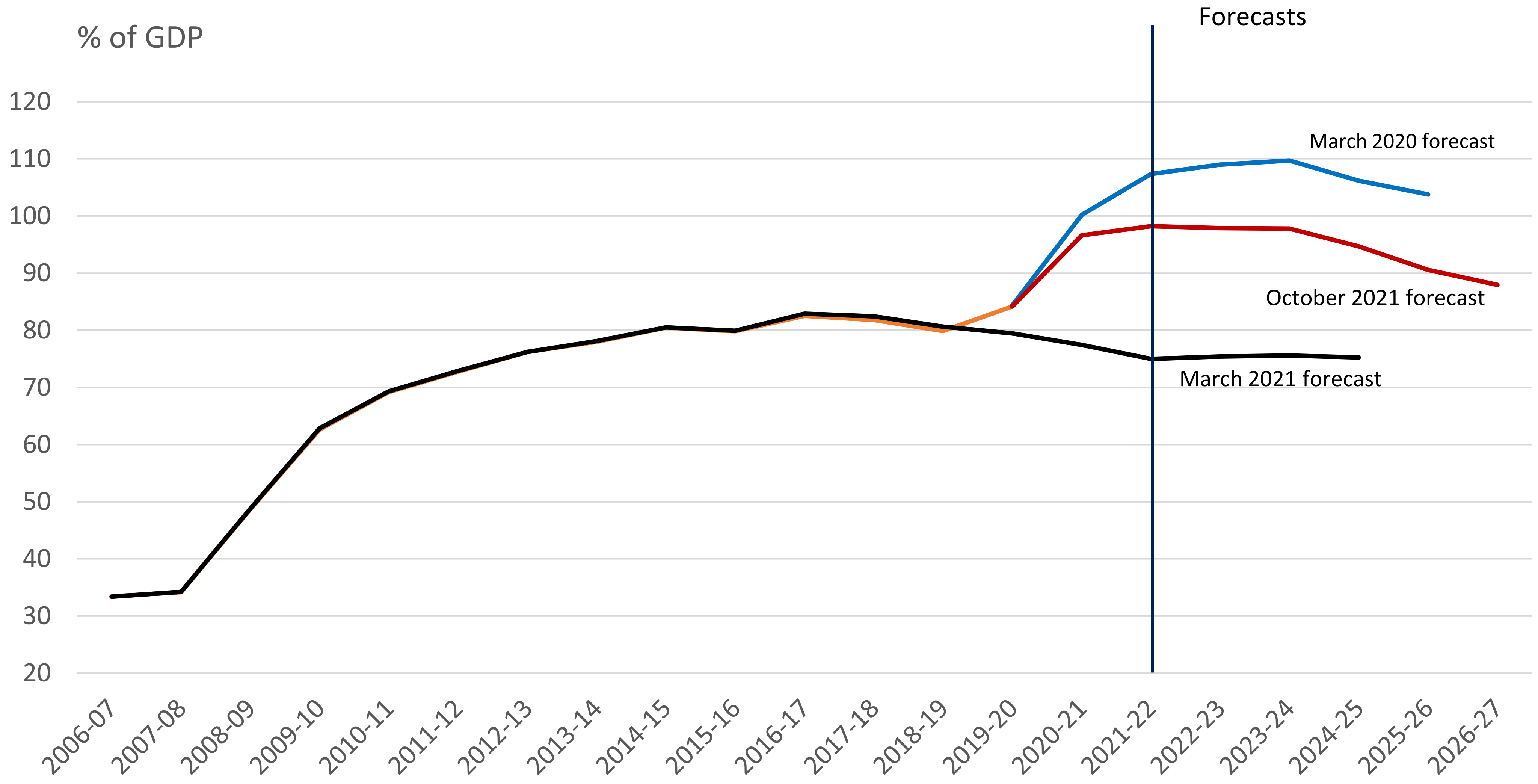
But it’s the biggest hit to living standards in any financial year post war



Source: ONS, OBR

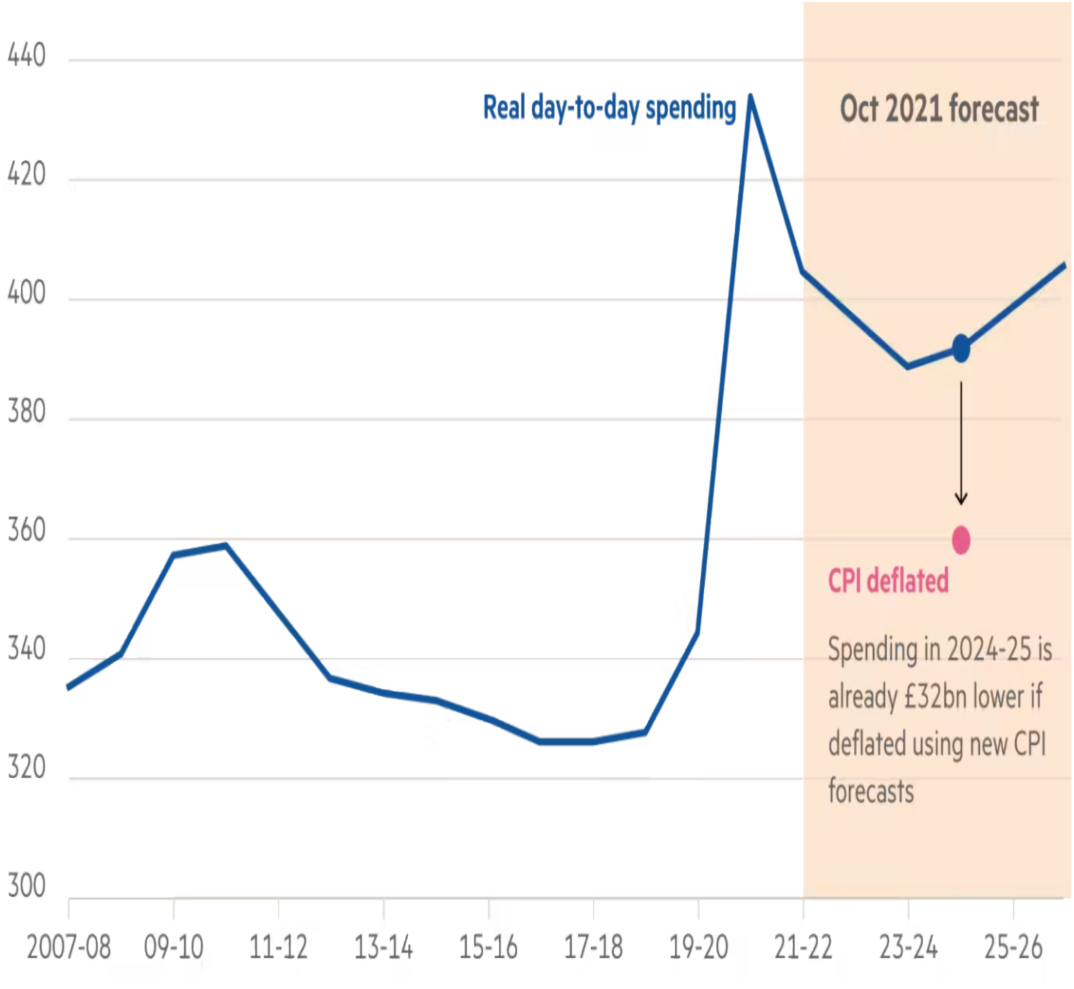
Public sector net debt to remain near 100% of GDP…

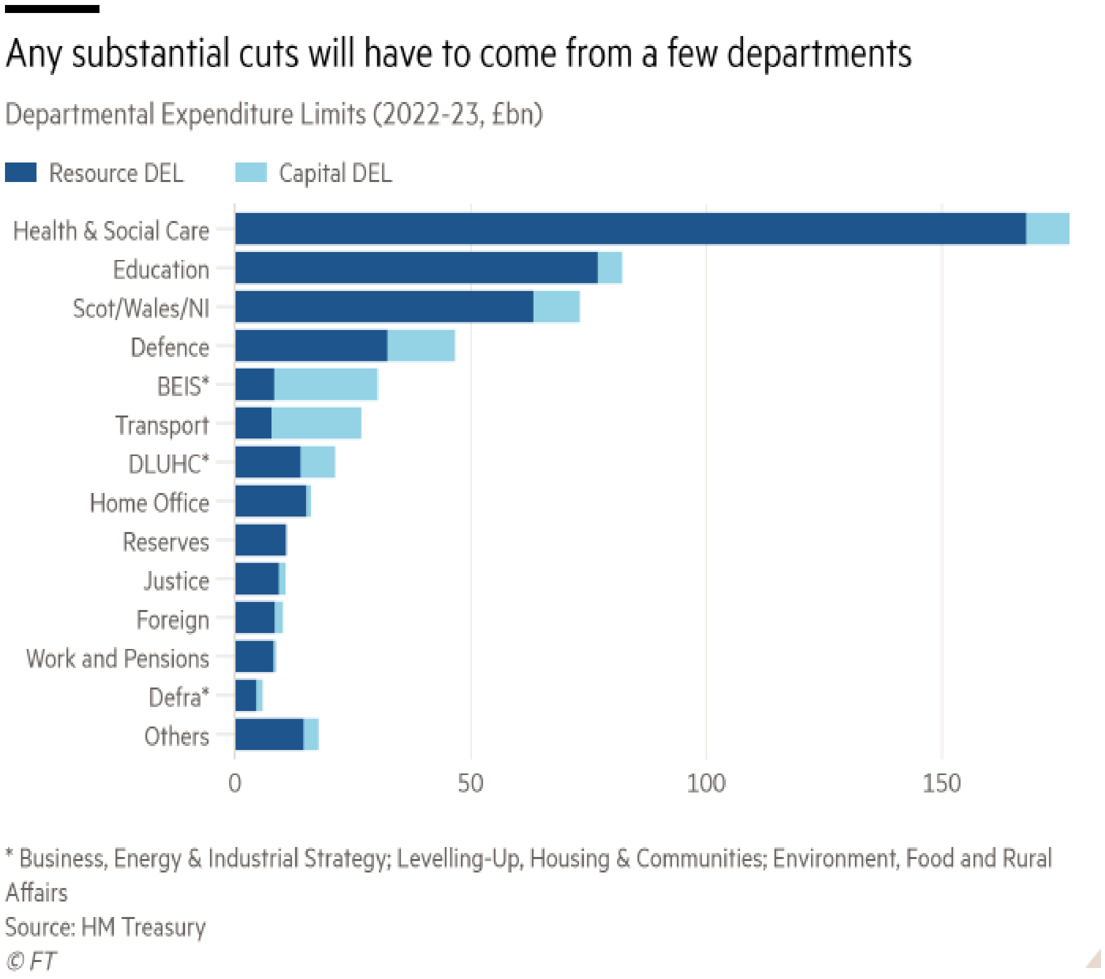
If you think it's too high, what programs would you cut?



Source: OBR

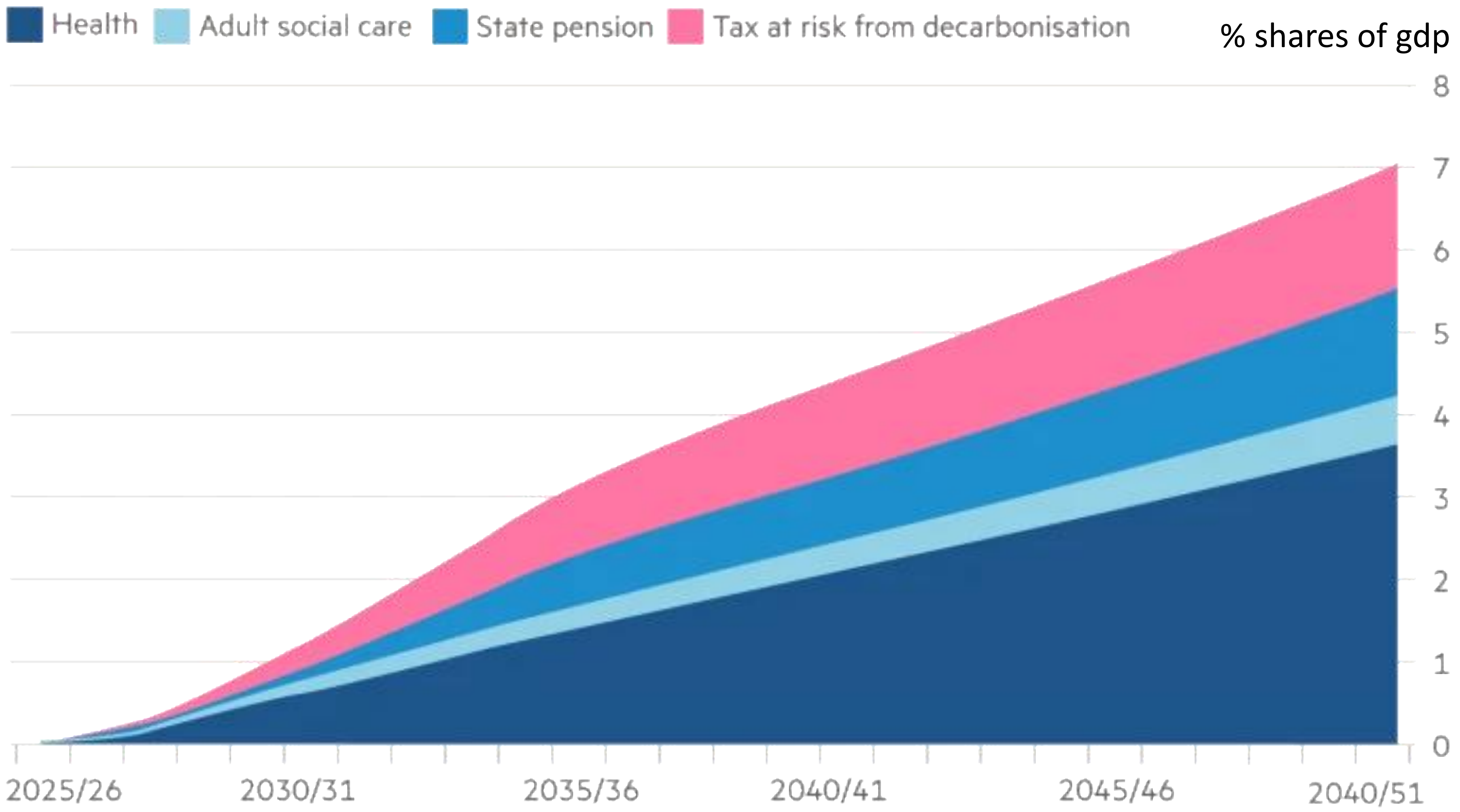
If its austerity mark 2, what to cut?





Source: OBR

Future drivers of increased state spending…



Source: OBR

Inflation reduces the ‘real interest’ on Budget Deficit (£bn),

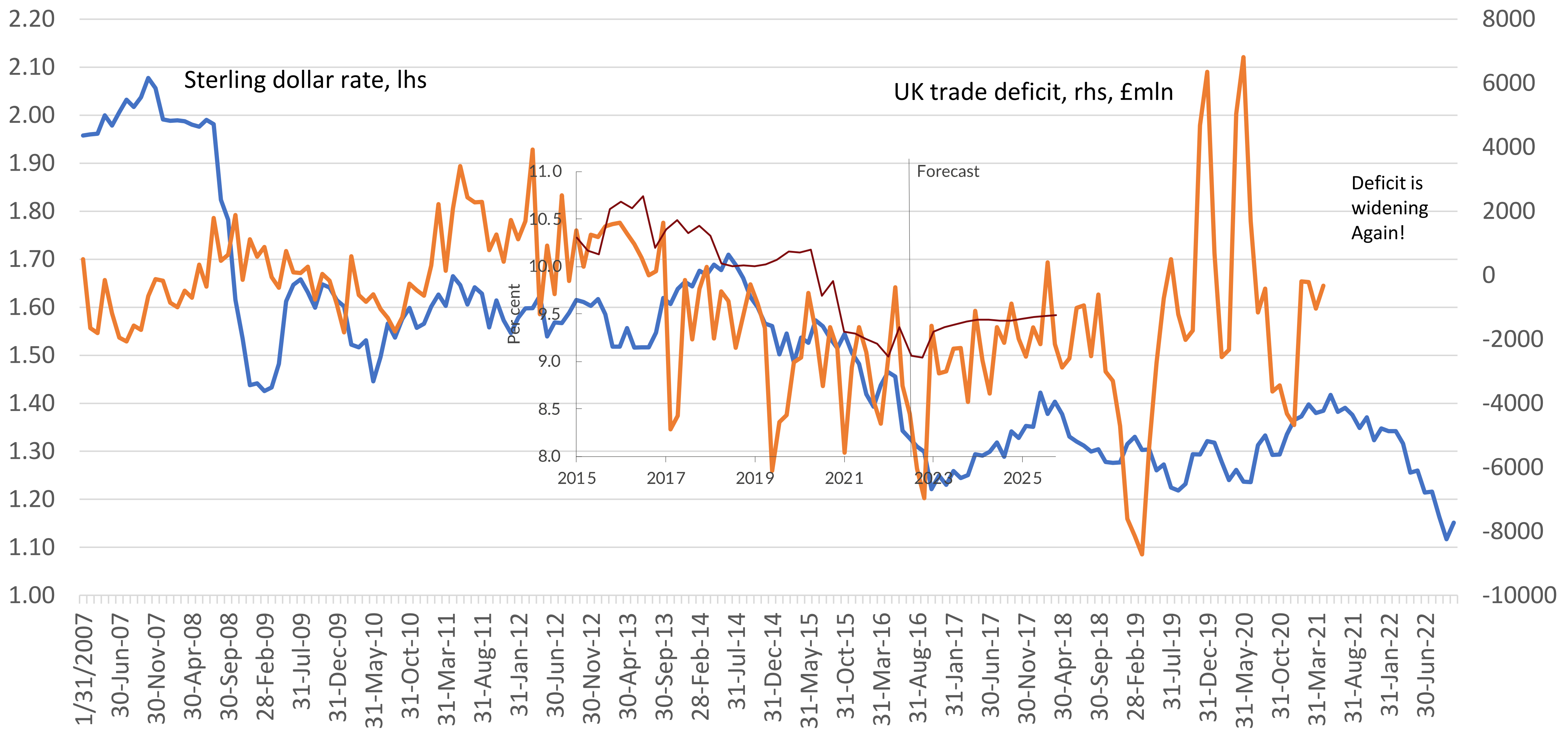
Time	Inflation Tax (£bn)	Government Deficit (£ bn)	Inflation Tax Adjusted Deficit (£bn)
3Q 2020	6.8	-74.1	-67.3
4Q 2020	1.7	-63.4	-61.7
1Q 2021	3.6	-42.2	-38.6
2Q 2021	28.8	-60.1	-31.3
3Q 2021	17.0	-37.3	-20.3
4Q 2021	40.7	-29.2	11.5
1Q 2022	31.6	-6.8	24.8
2Q 2022	70.4	-41.8	28.6
3Q 2022	24.9	-30.6	-5.7

Note: Accelerating inflation can be relatively positive for the government fiscal position. The government’s current fiscal budget deficit for the third quarter of 2022 is £30.6 billion, however a £24.9 billion inflation tax somewhat offsets the severity of the deficit and reduces it by a factor of 5 to £5.7 billion. Additionally, all the published deficits since the fourth quarter of 2021 have been turned into a surplus because of this inflation tax. Thus, the government has a lot more fiscal space for spending than appears from the published data which omits the inflation tax. Inflation is rapidly reducing the real value of government debt.

Negative real rates enhance this effect is enhanced even more.

Source: ONS, OBR.

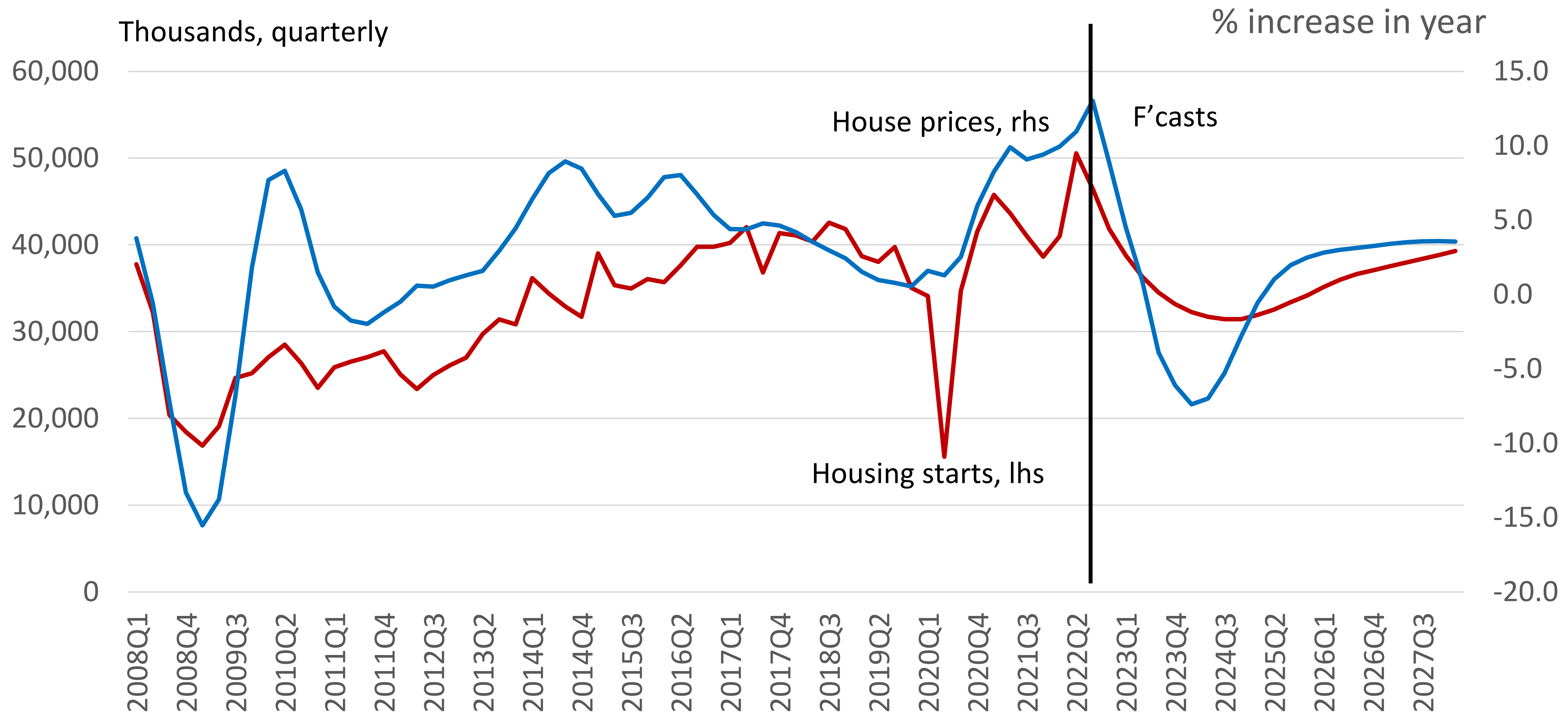
Sterling to remain weak, helping exports and funding the deficit



Source: ONS, Bank of England

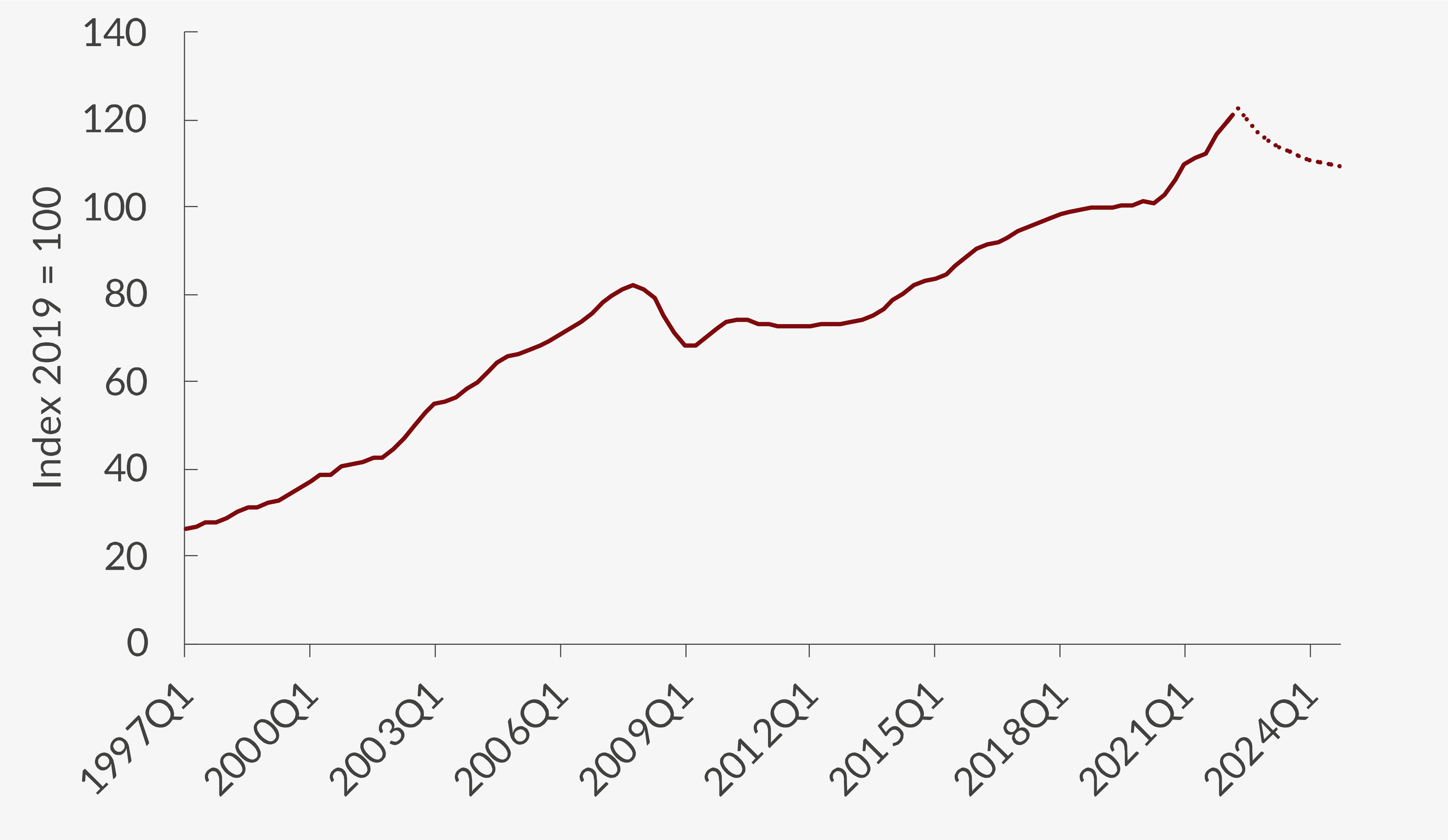
The outlook for the housing market

Residential UK house price inflation fall but levels remain elevated

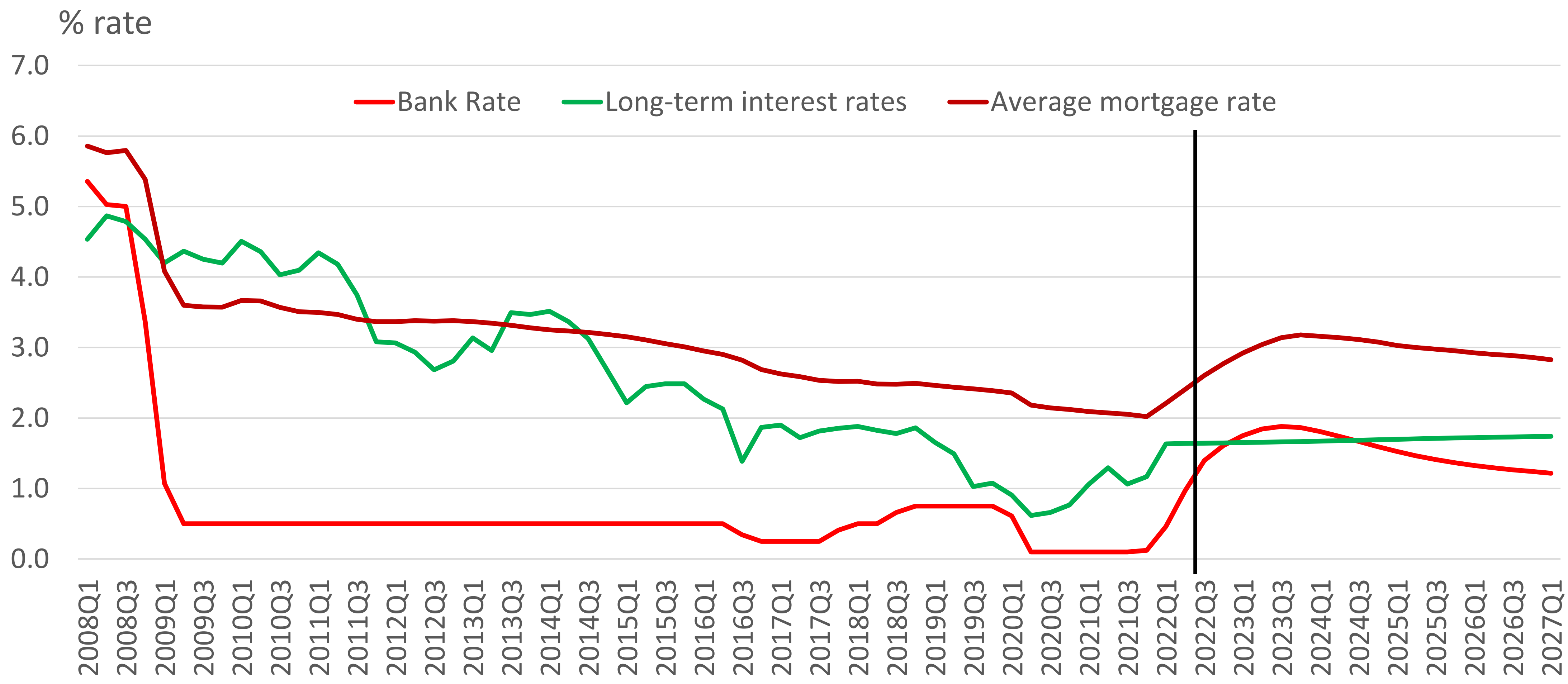


Source: OBR, Nov 2022

Average house price in the UK back to 2021 levels?

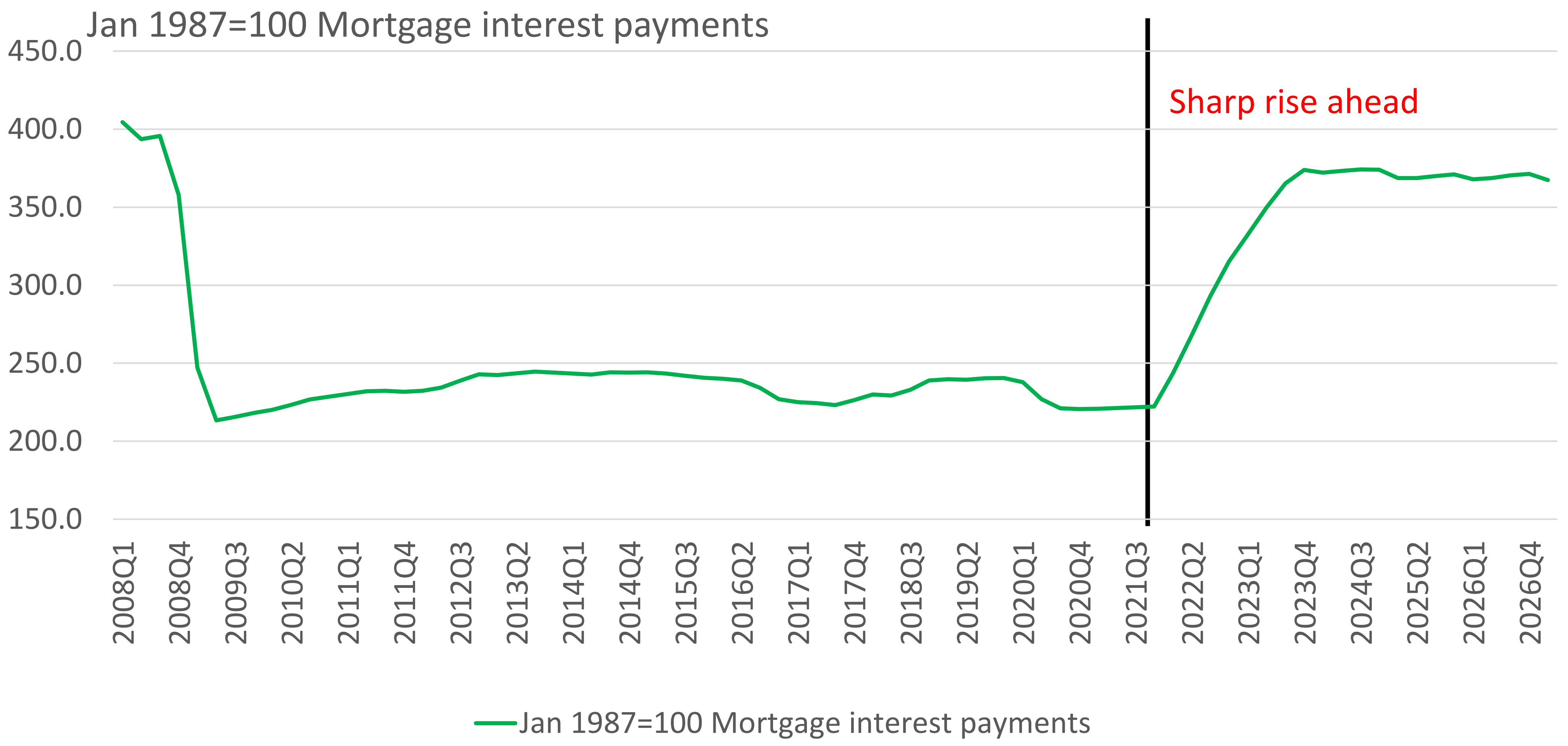


A higher cost of borrowing across for all…

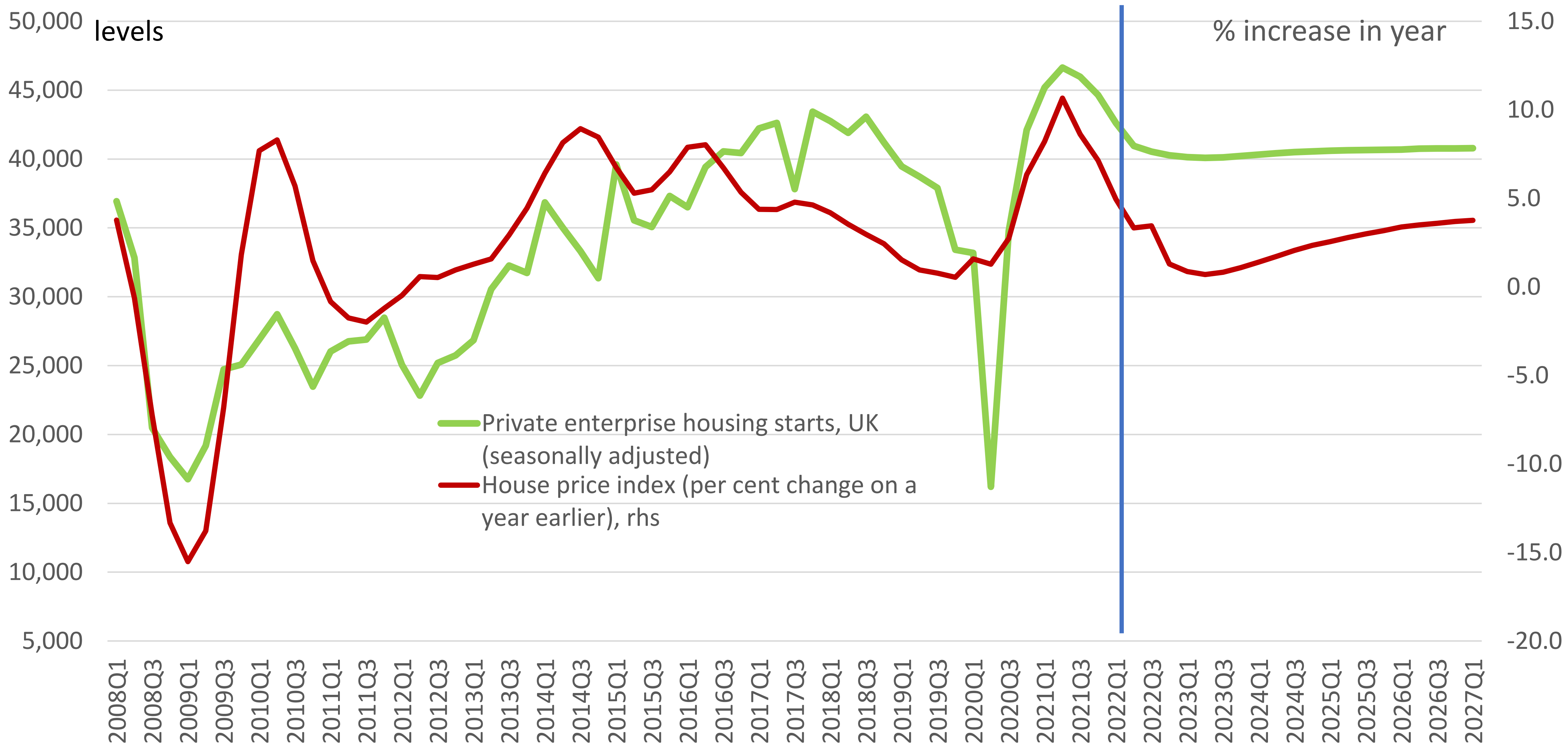


OBR, Mar 2022

…will raise mortgage interest payments

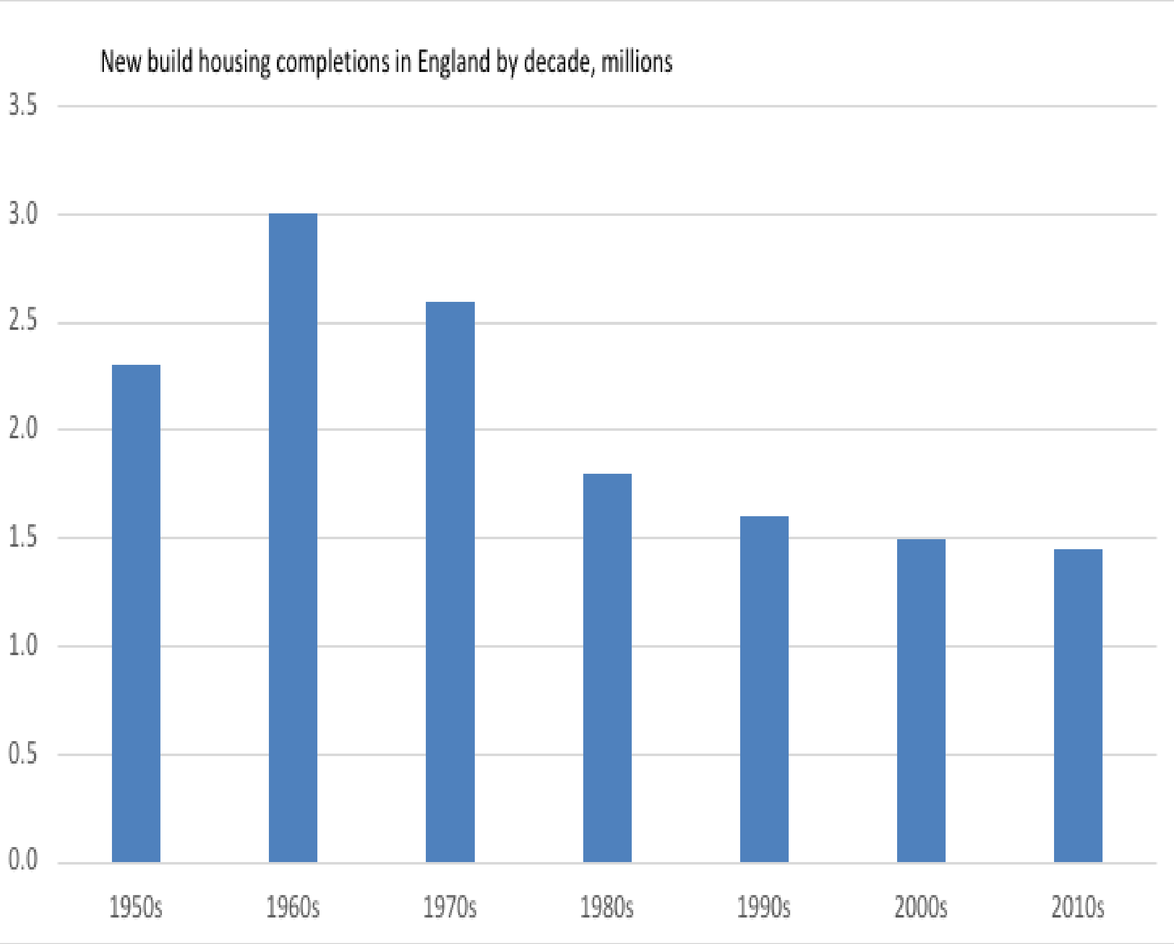


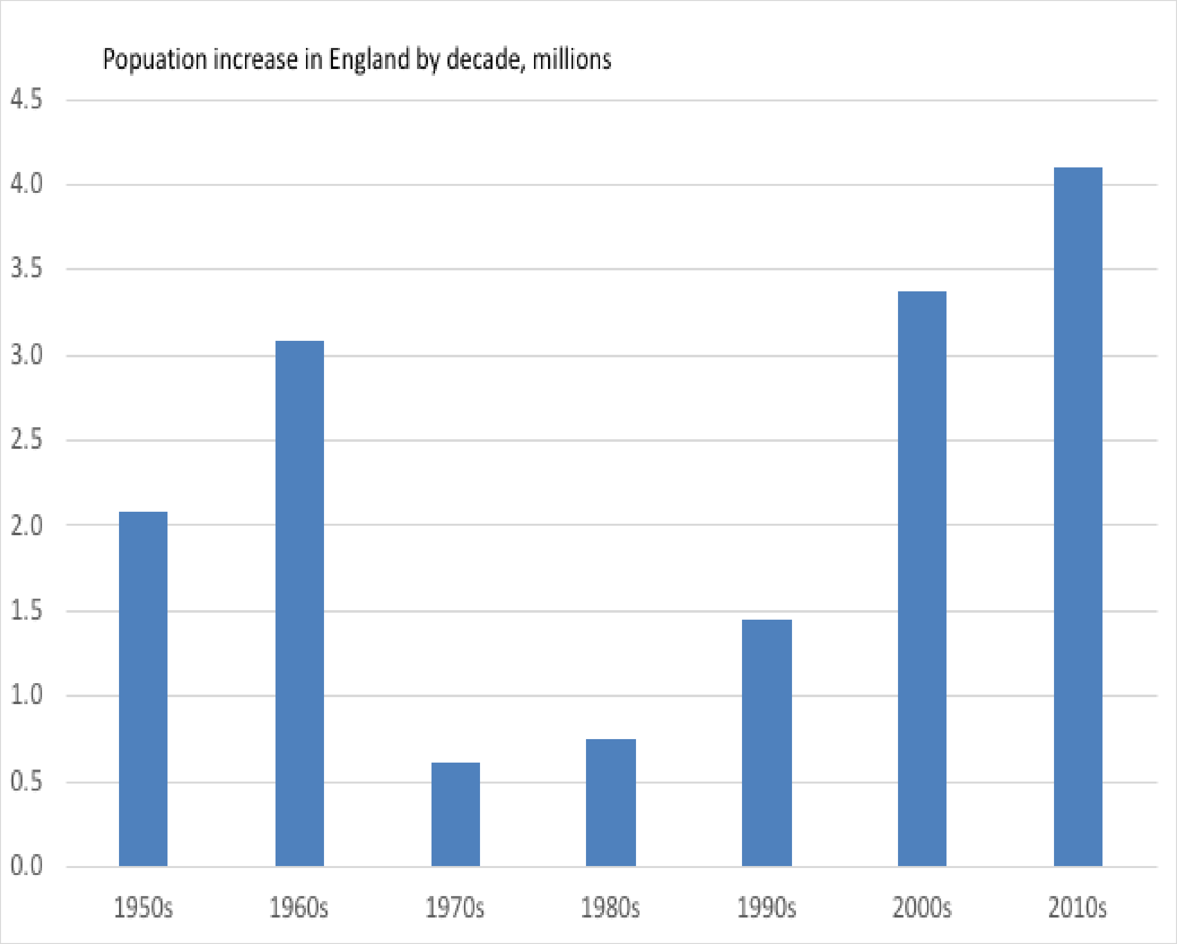
But we are still not building enough homes



OBR, Mar 2022

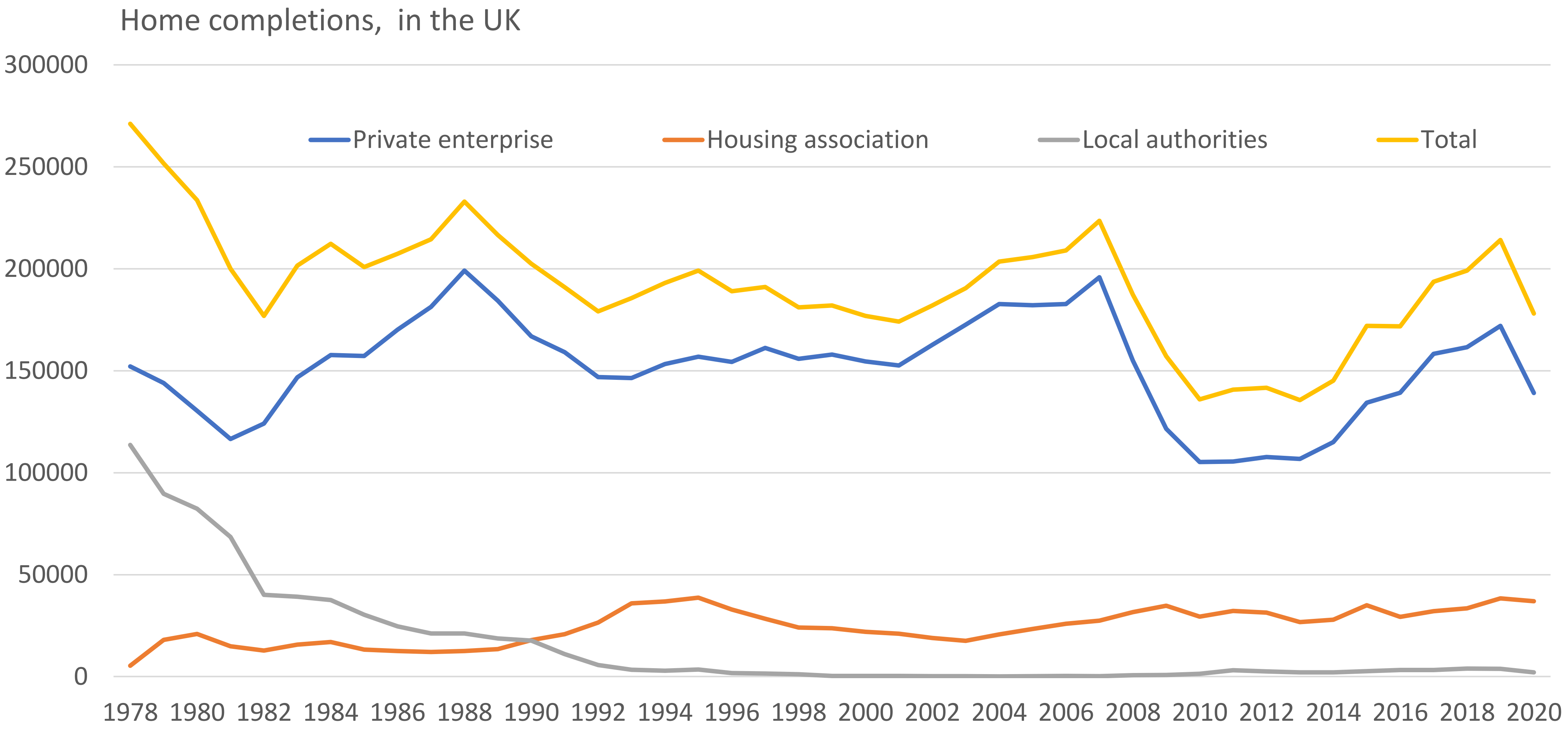
Too few homes have been built since 2000s relative to demand…





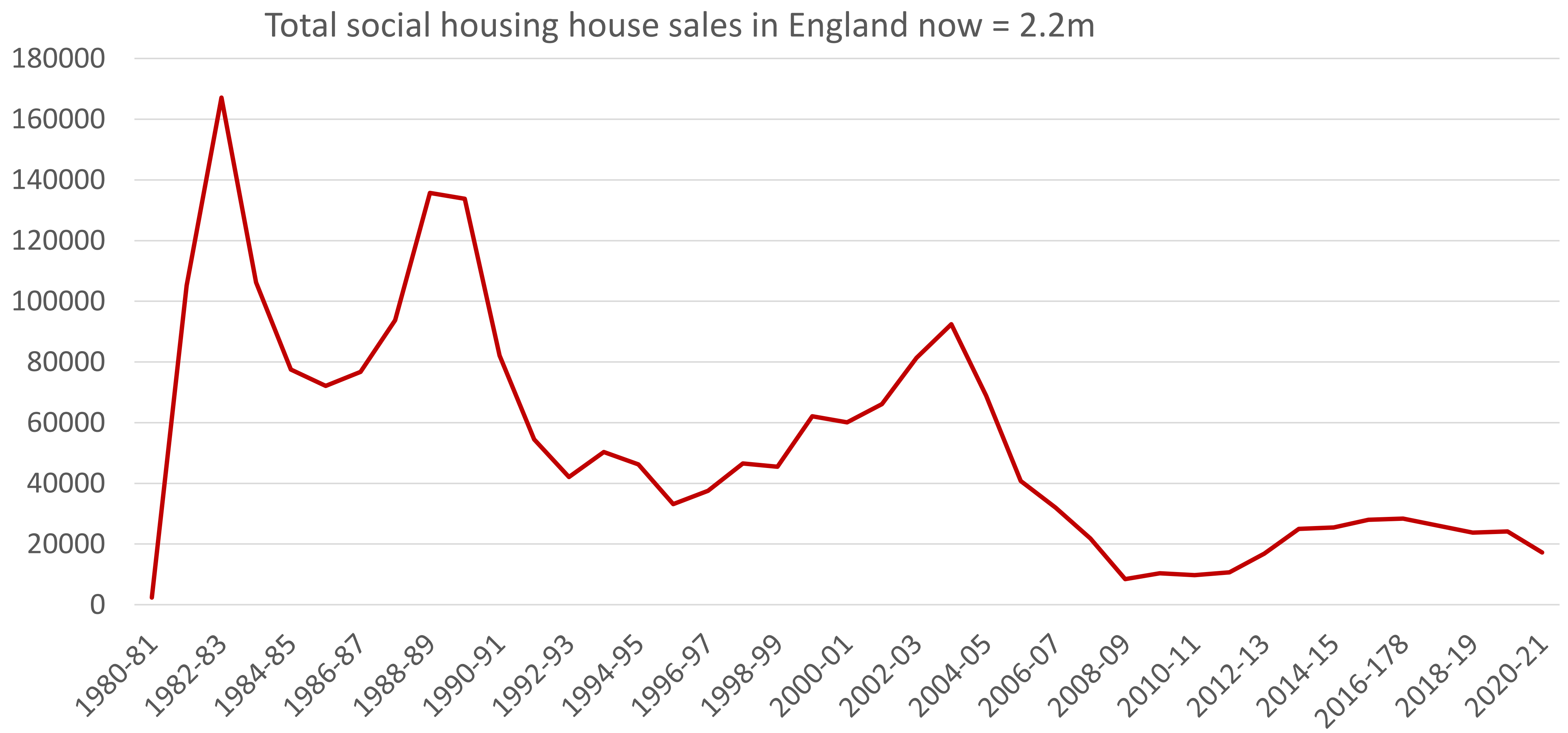
- Sources: Ministry of Housing, Communities and Local Government, ONS and Bank calculations.(a) Chained-volume measure, 2016 prices. Excludes major repairs and improvements to existing dwellings.(b) Number of permanent dwellings started/completed by private enterprises up to 2018 Q3 for England and Northern Ireland. Data from 2011 Q2 for housing starts in Wales and from 2018 Q3 for housing starts and completions in Scotland have been grown in line with permanent dwelling starts/completions by private enterprises in England. Data are seasonally adjusted by Bank staff.

The private sector & housing associations have not accounted for loss of LA build



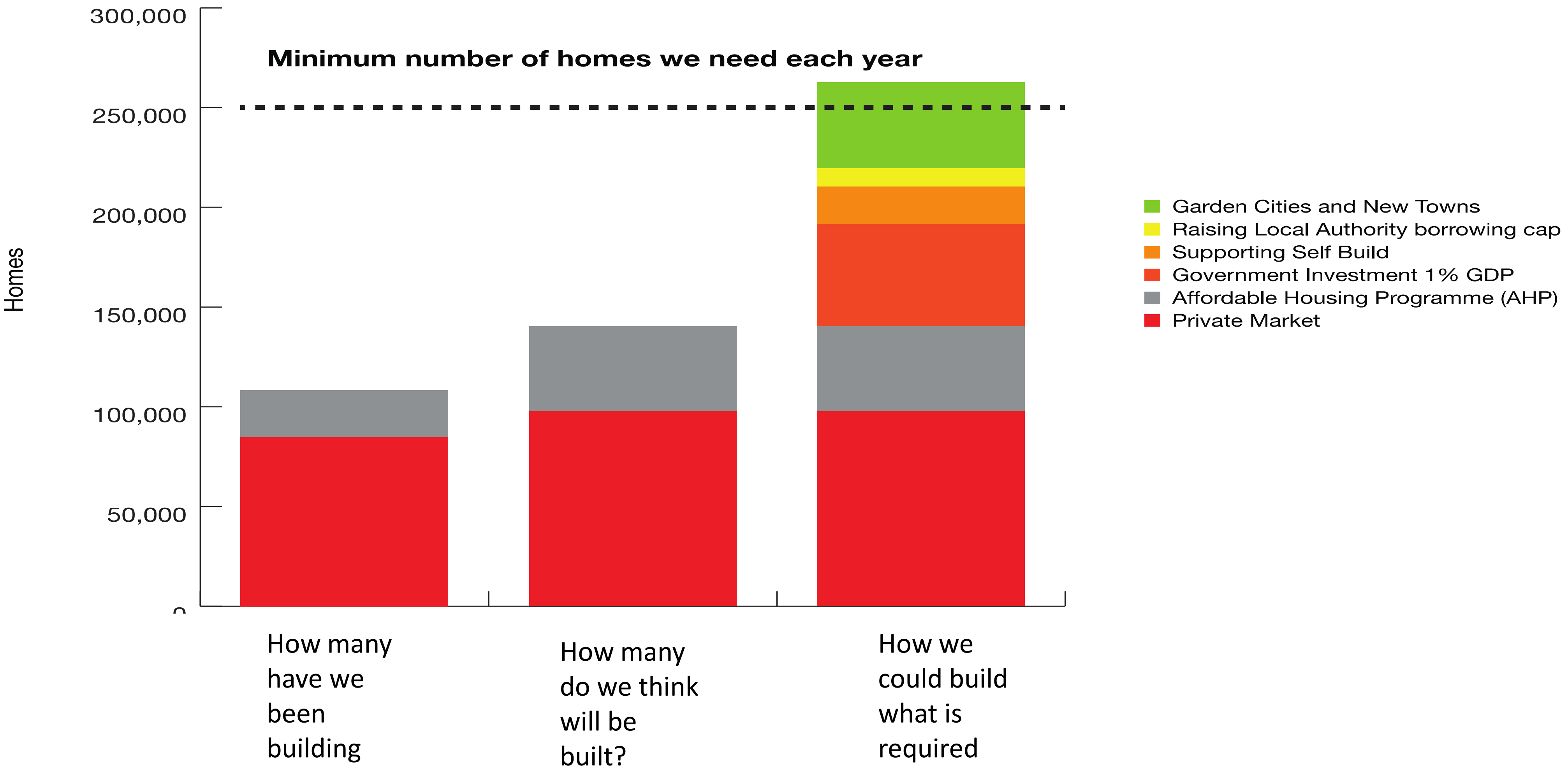
Source: ONS, TW consultancy

…and selling off council homes is now *reducing* home ownership ratios…



But here is how to build more – if there was the political will

- When will underbuilding end?
- Probably when there is a political crisis as a result of a housing crisis

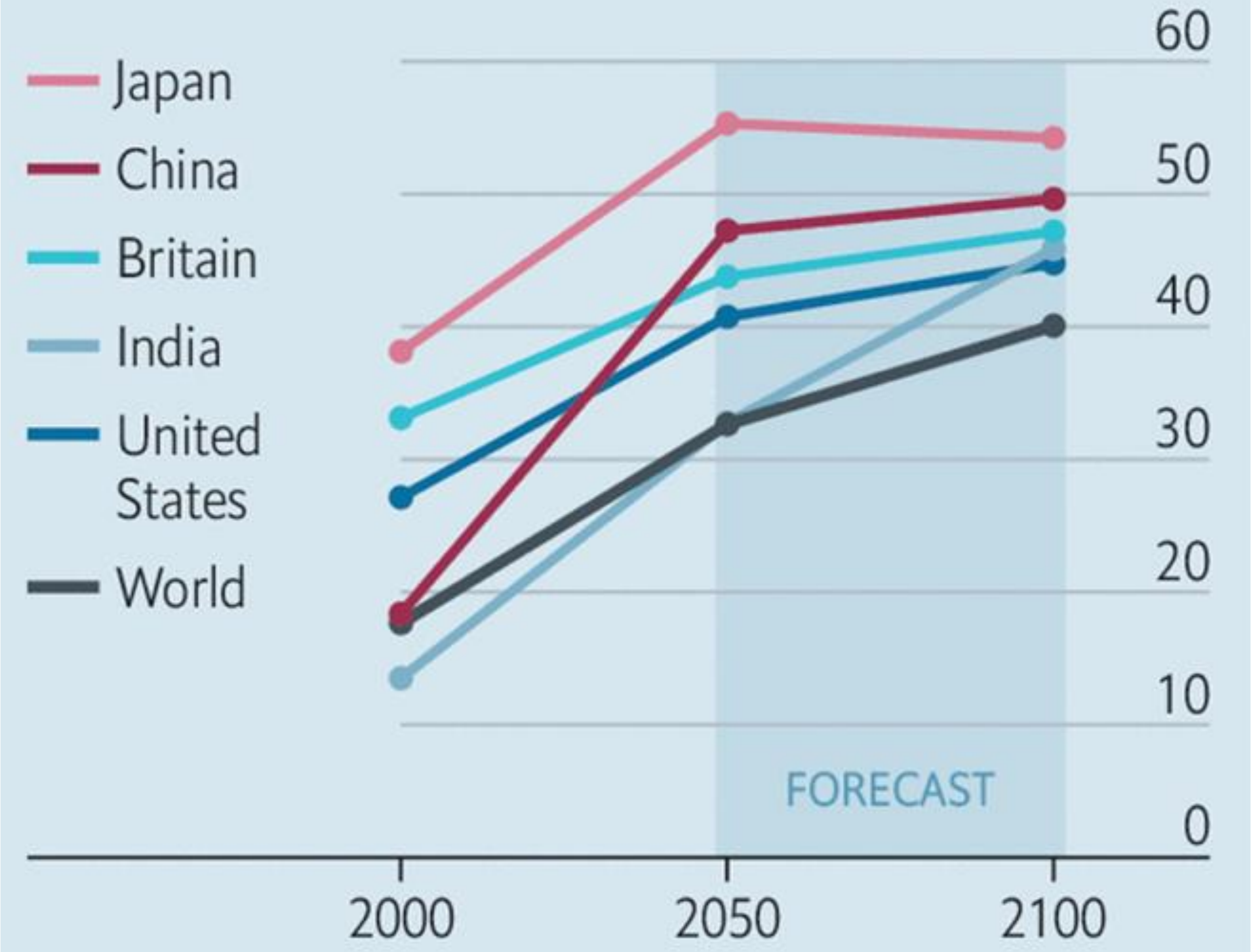


Source: ONS, TW consultancy

Some other important structural trends

As world population ages…

Population aged 50 and over, % of total



Source: UN, World population prospects 2019

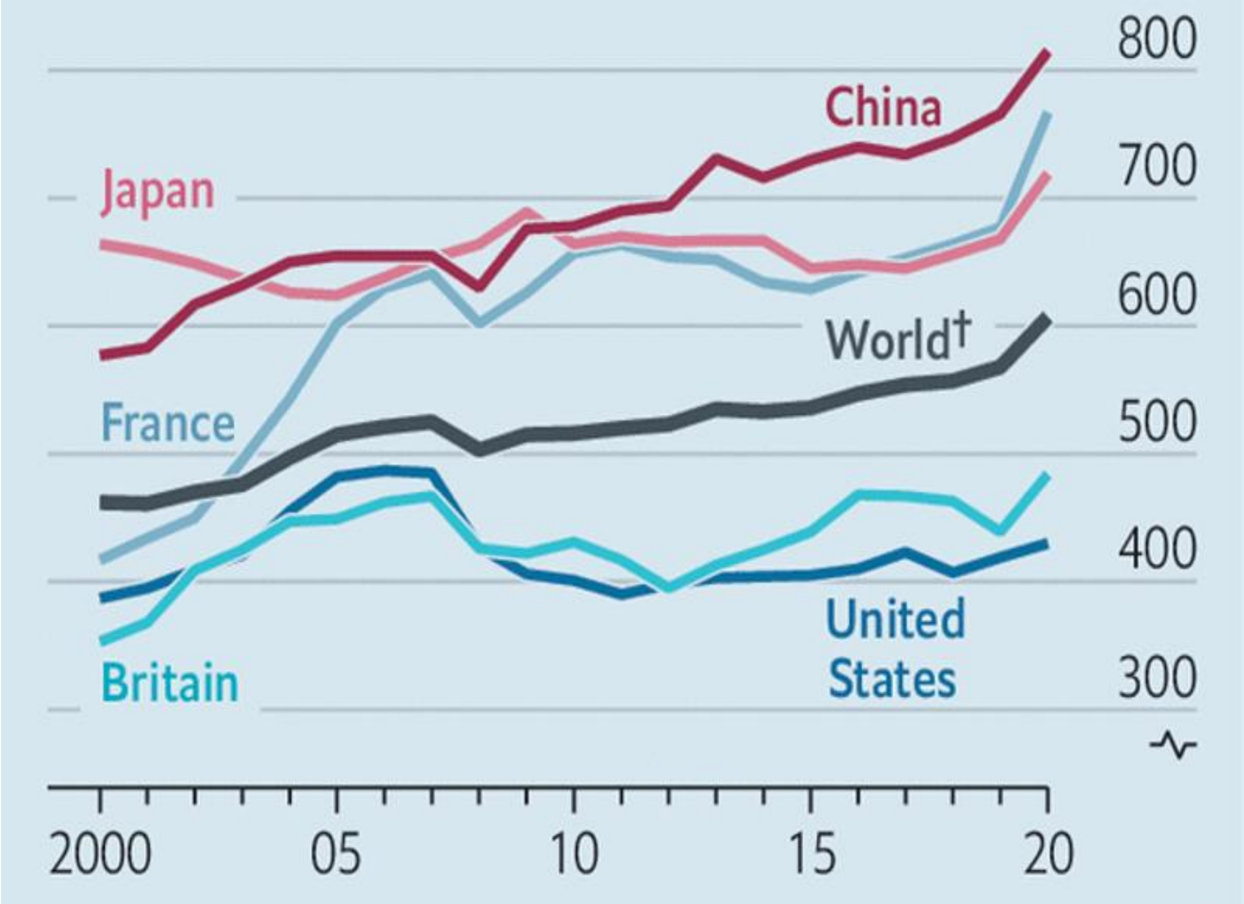
The share of global population over the age of 50 rose from 15% in the 1950s to 25% today and is expected to rise to 40% by 2100).

The saving cohort therefore rises sharply, so long as global markets remain connected savings will flow.

It means persistently weak growth, low inflation and low bond yields. In Japan, the 30-year bond yield in 0.8% and government debt is 259% of GDP.

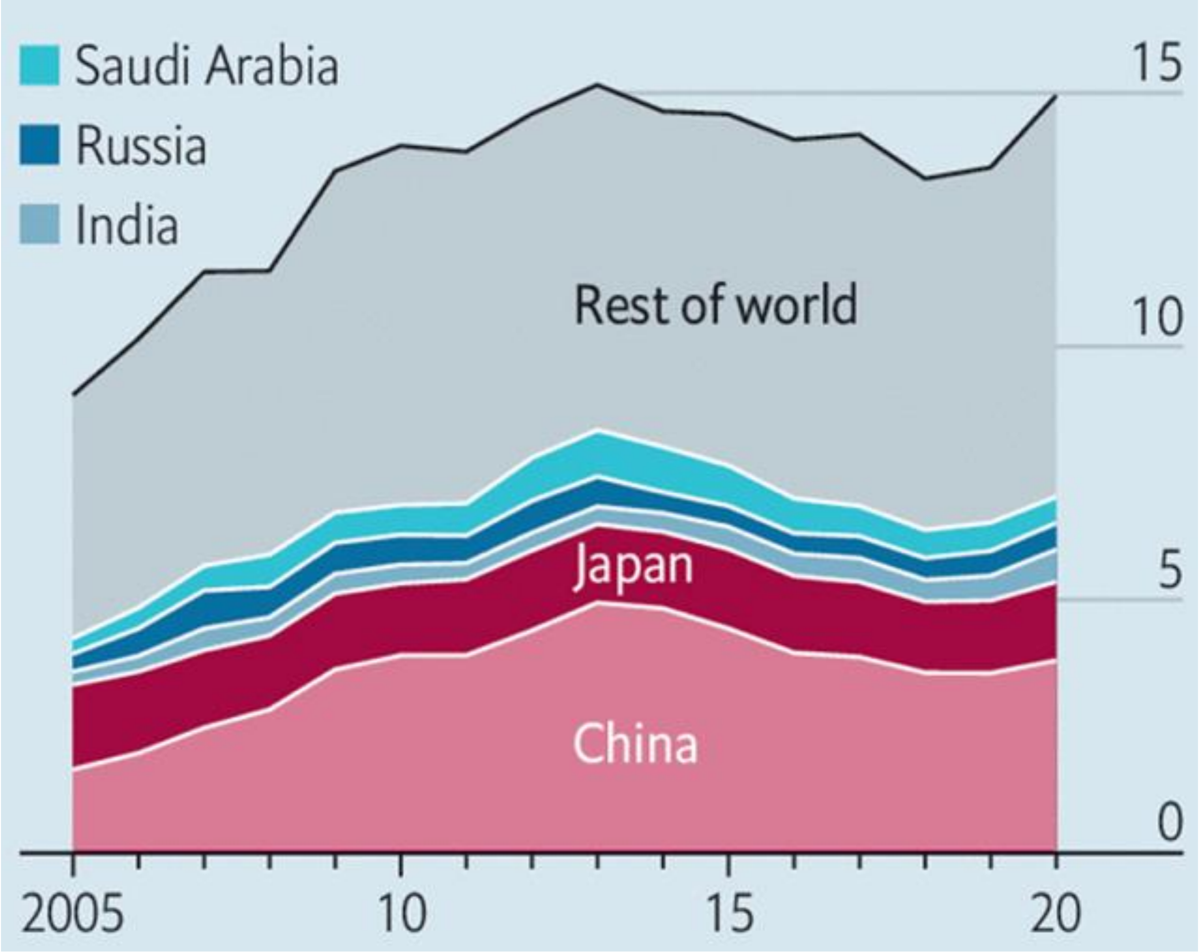
Global saving are rising…

National wealth* as % of GDP



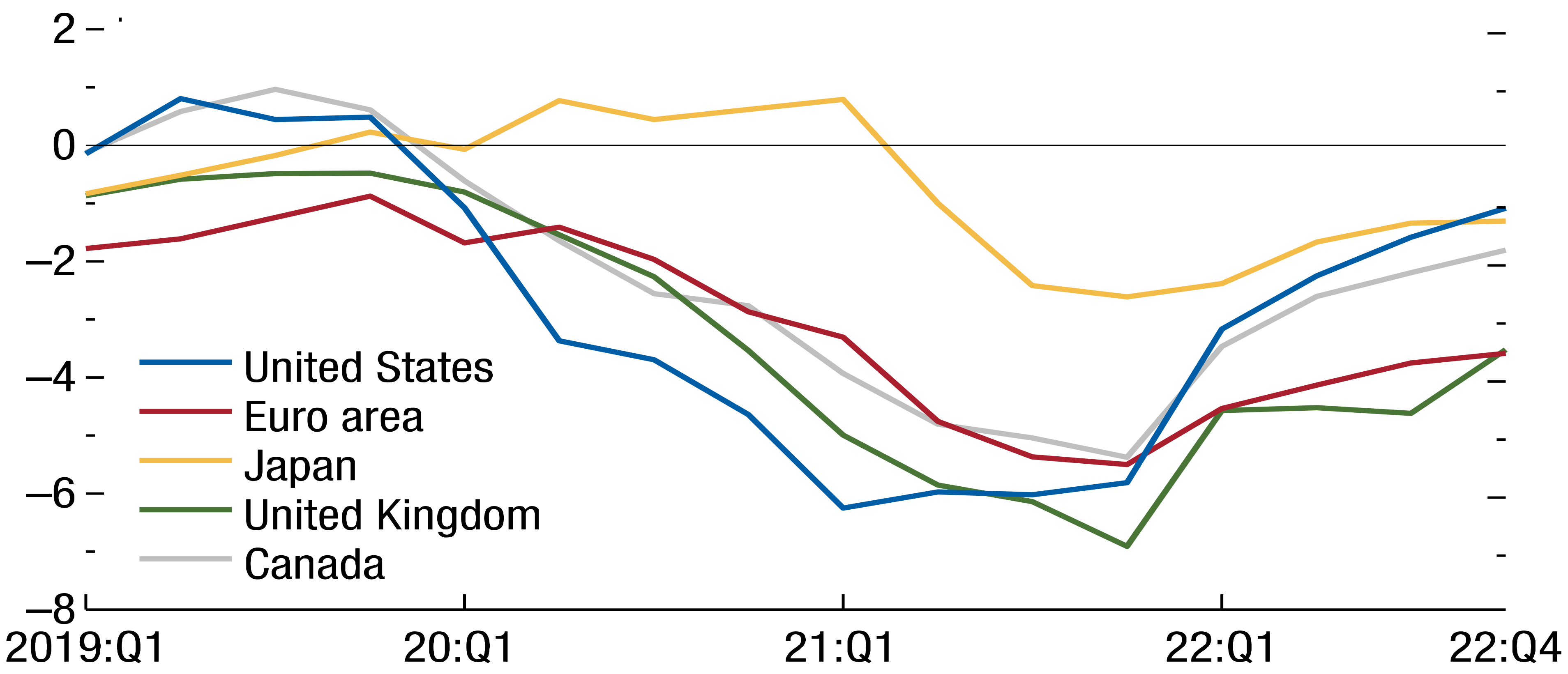
*Real assets net of financial assets and liabilities. Extrapolated from weighted average of ten countries based on GDP Source: McKinsey Global Institute

Foreign currency reserves* as % of world GDP



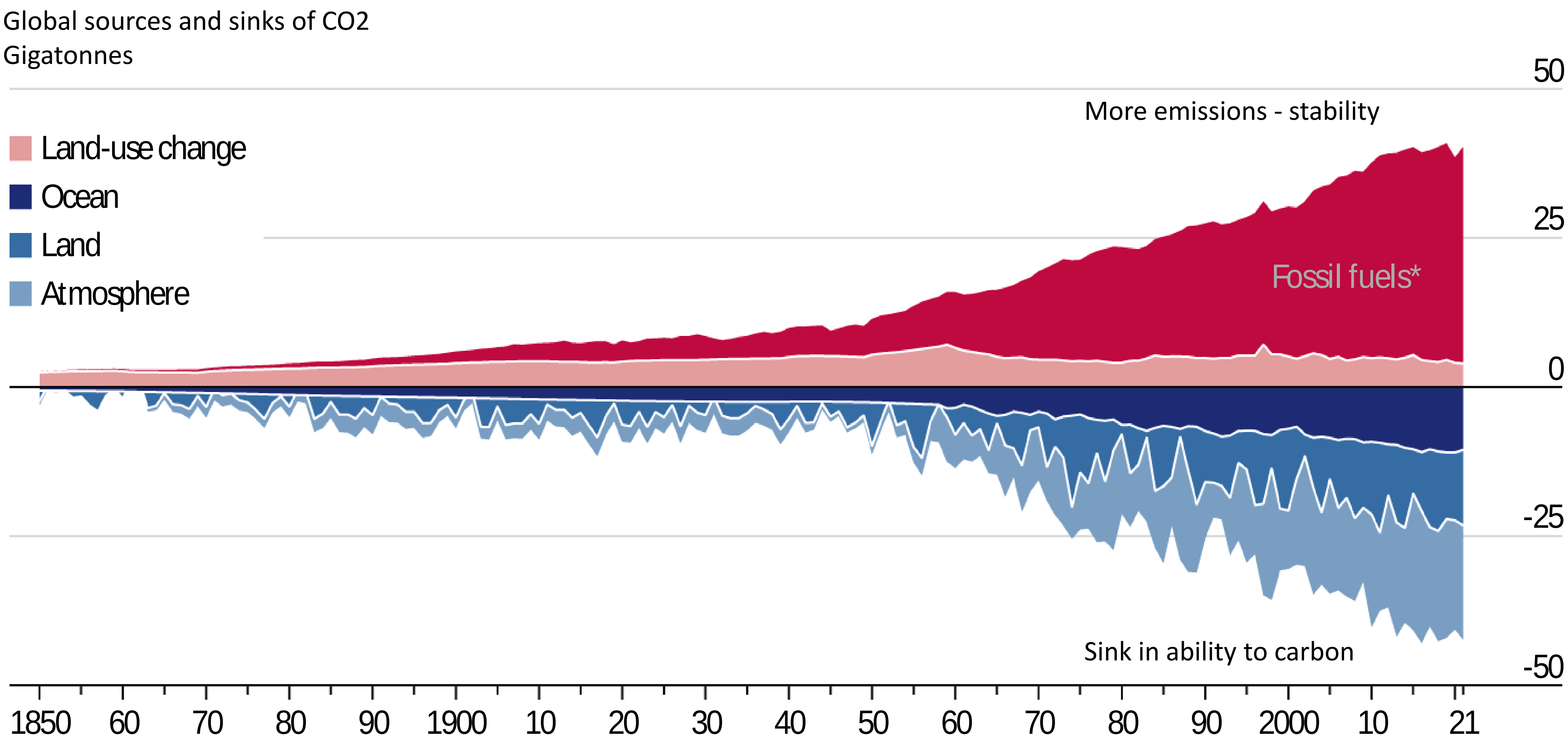
*Excluding gold. Source: IMF

…and increased savings explain negative real interest



Source: IMF staff calculations.
Note: Projection for the euro area is estimated using projections for 16 individual euro area countries. Real rate computed as short-term nominal interest rate less core inflation one year ahead.

Carbon emissions are slowing but 1.5c target will be missed



* includes carbonisation

Source: Global Carbon Project

In the early 2000s, the rate at which pollutants increased was about 3% a year.

In the past decade it has fallen to 0.5%.

COP27 takeaway – not quite enough to satisfy anyone

- Mitigation, adaptation and loss and damage are inextricably linked.
- Faster, more ambitious decarbonisation will reduce the bill for adaptation. Better mitigation and adaptation will mean that less money has to be spent rebuilding after disasters.
- Loss and damage fund created for first time but no argument on how to fund it and by how much so….
- …the negotiations that unfolded in Sharm el-Sheikh were proof that the world has not yet worked out how to tackle all three simultaneously.
- Alok Sharma hailed the creation of a loss and damage fund but regretted that more had not been accomplished:
- "Emissions peaking before 2025…Not in this text. Clear follow-through on the phase down of coal: not in this text. A clear commitment to phase out all fossil fuels: not in this text."

Carbon pricing set to become part of business as usual, like calories in food*

- A kilogram of coffee delivered in UK has a carbon footprint of about 315 kilograms of C02. If farmed and shipped more sustainably this carbon footprint drops to 3.5 kilograms.

- Assuming a £100/tonne carbon tax, that's either £1.50 or 35 pence increase per cup of coffee.

- Since you can make dozens of coffee with a kilogram, coffee drinkers may not notice the price rise. Moreover, competition will drive the price towards 35p rather £1.50.

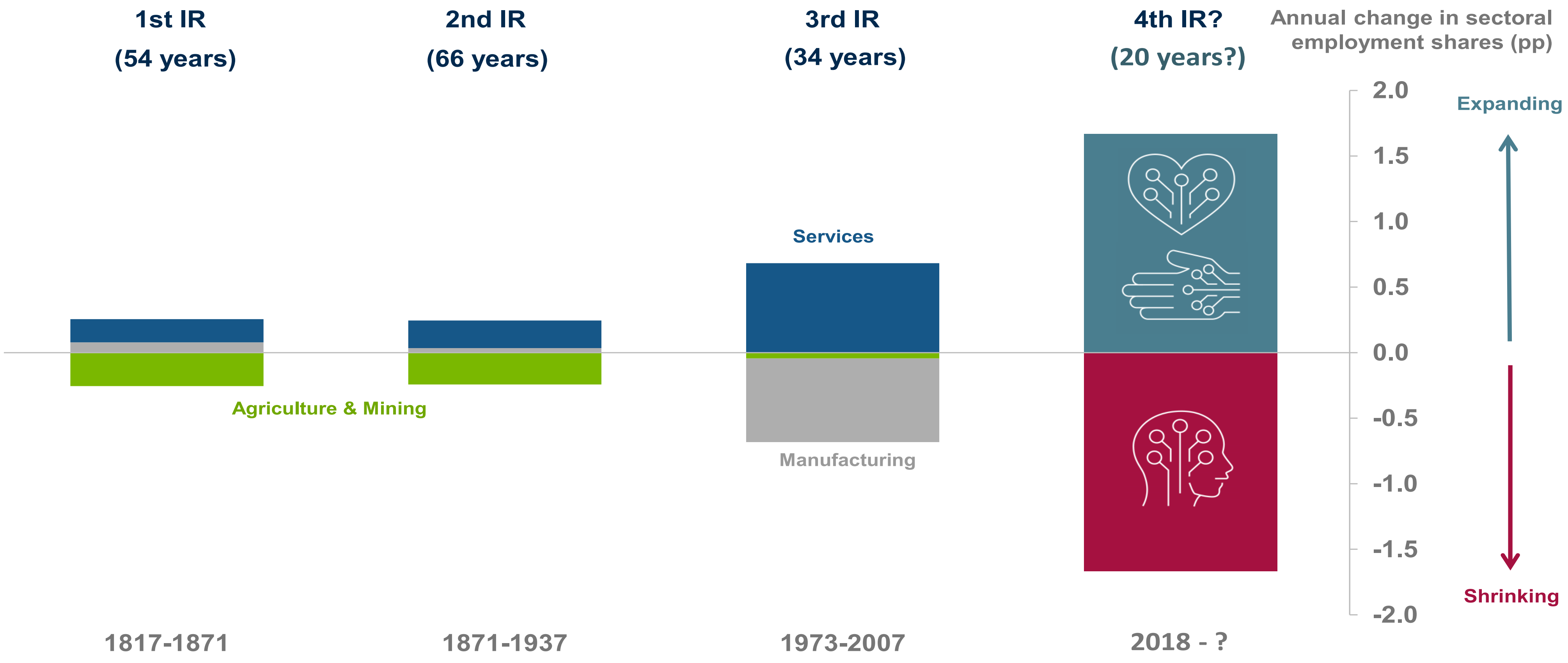
- A £100/tonner carbon tax would increase the cost of living by £2 a day, covering 5% of tax revenue.

- The more you spend (resources consumed) the more you will pay, either driving, flying etc. But a subsidy each month from the government would be required to make it palatable for the less well off, paid from carbon tax proceeds.

* Illustrative example of a carbon tax in the UK, like calories in meals now are:

The pace of technological change is accelerating

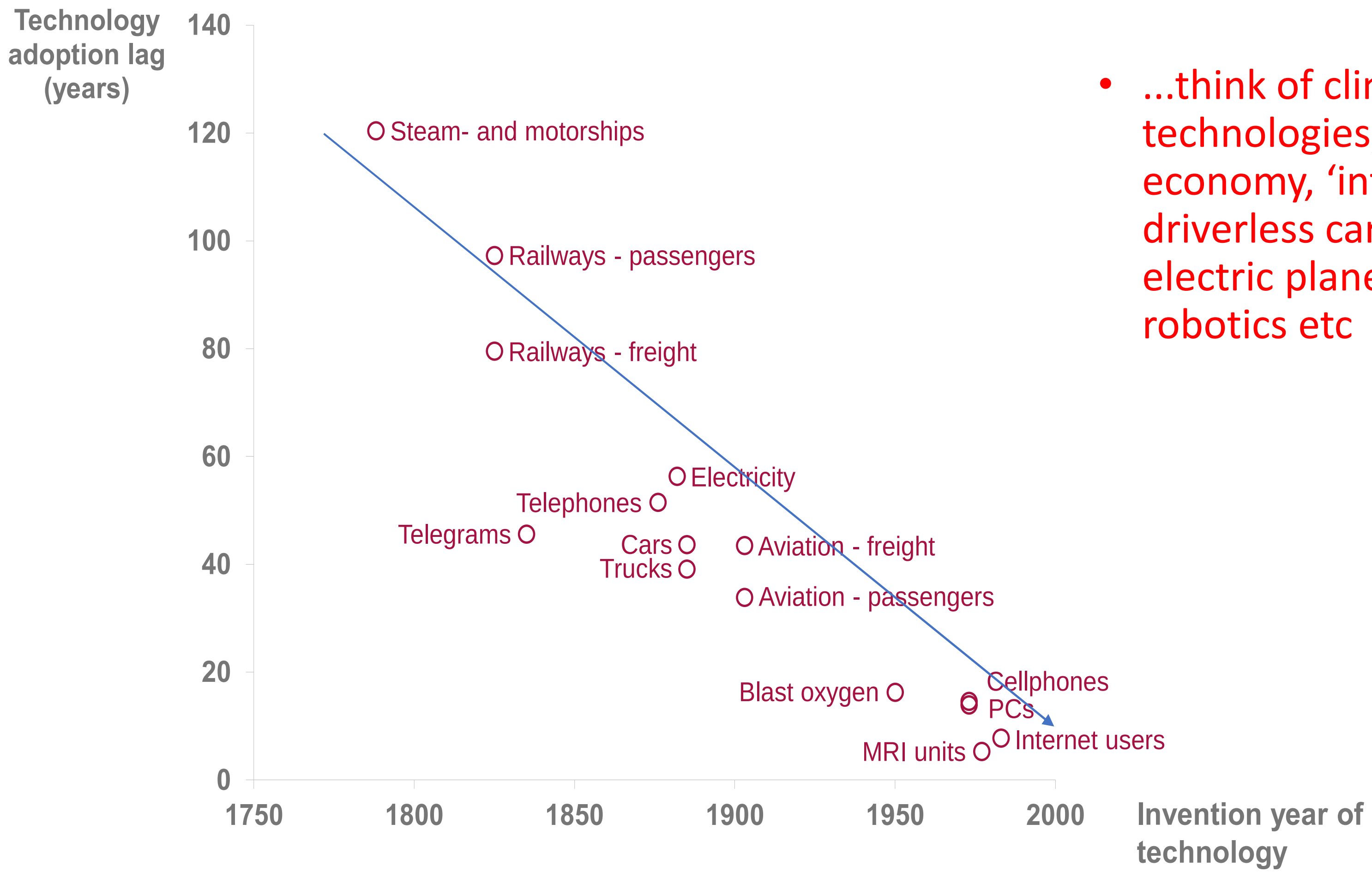
This time it's faster?



Source: IMF, TW

Why: adoption is faster

Technology adoption accelerating

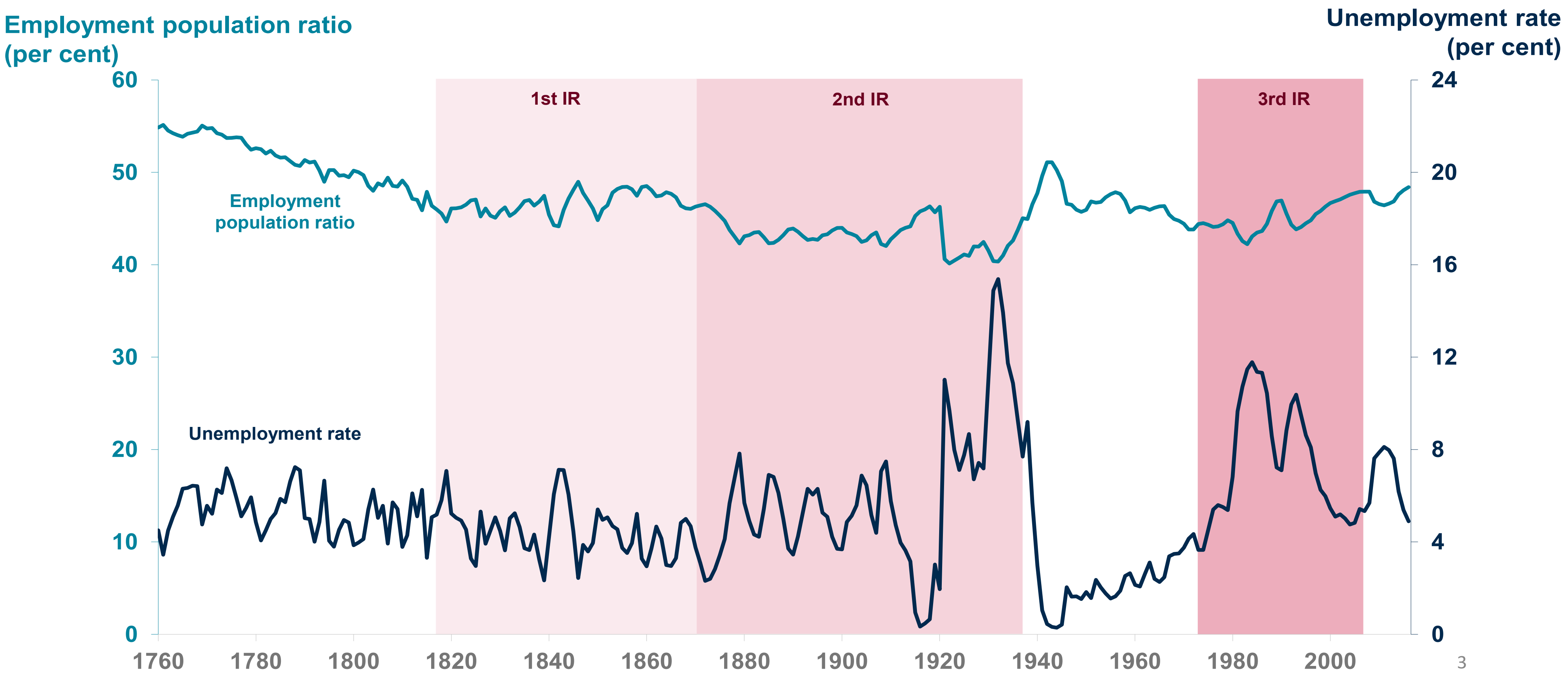


- ...think of climate reduction technologies, the 'sharing' economy, 'internet of things' - driverless cars / flying taxis, electric planes, delivery drones, robotics etc

Notes: Technology adoption lag is a mean estimated lag in cross-country technology diffusion.
Source: Comin, D and Hobijn, B (2010), 'An exploration of technology diffusion', *American Economic Review*, Vol. 100, No. 5, pp2031-59.

Jobs are not lost but they are different

Little evidence of technological unemployment over long term



Source: IMF, TW

Thank you.

See you at the
next conference!

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