The Economic Outlook

By

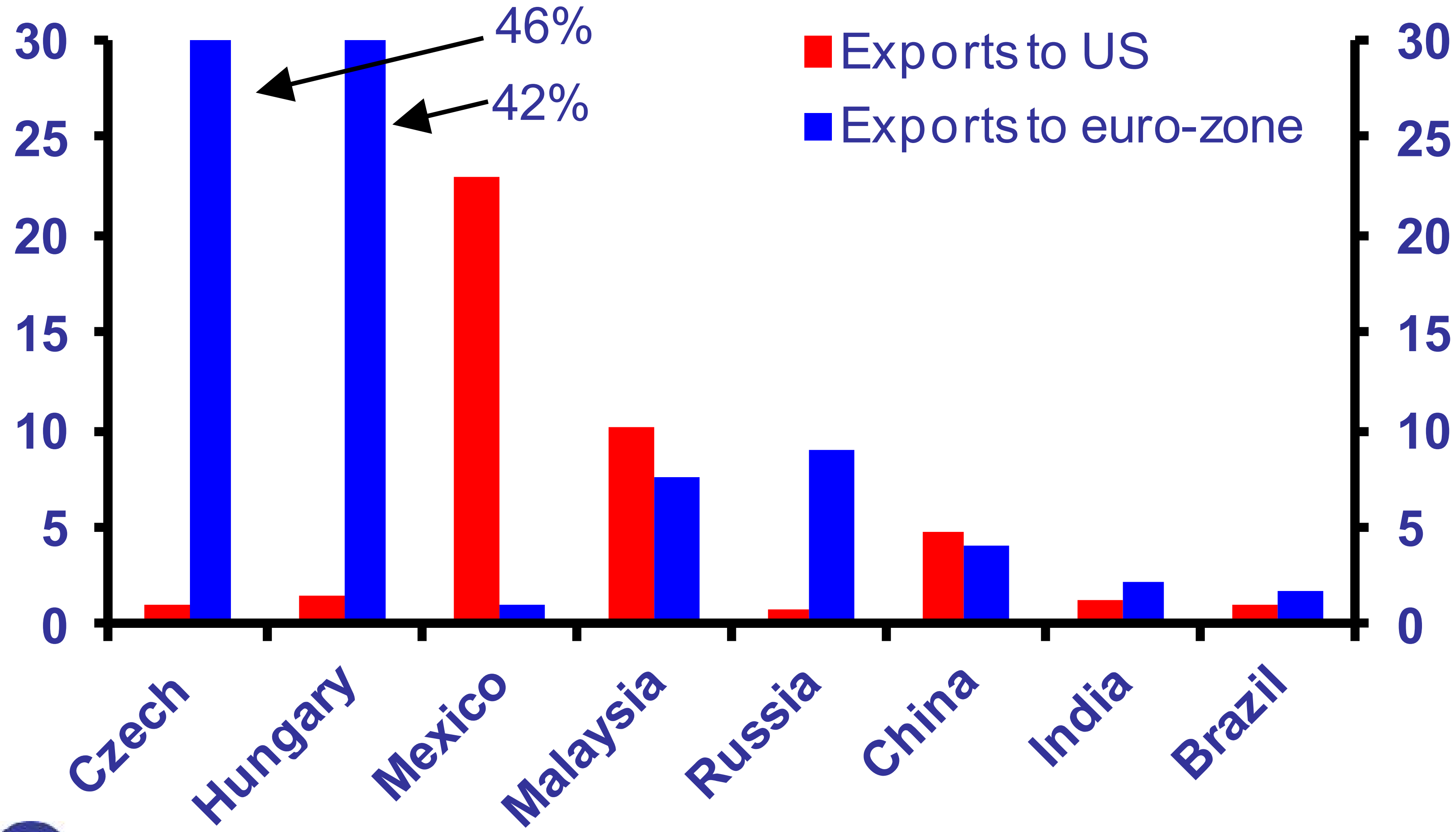
Roger Bootle

1. Agenda

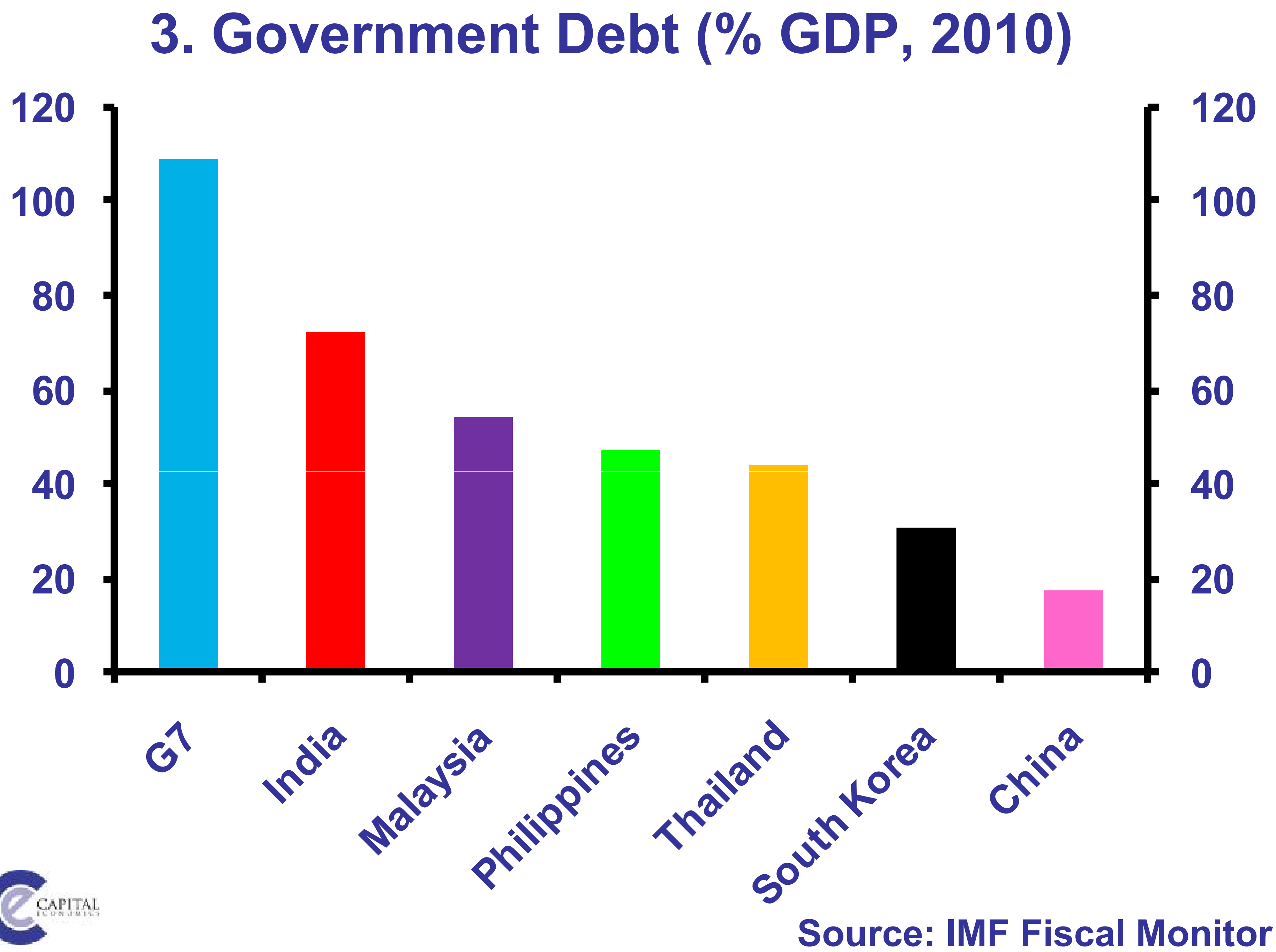
- Prospects for Asia and America.
- The euro: survival or implosion?
- Prospects for the UK
- Implications for the markets.

CAPITAL ECONOMICS

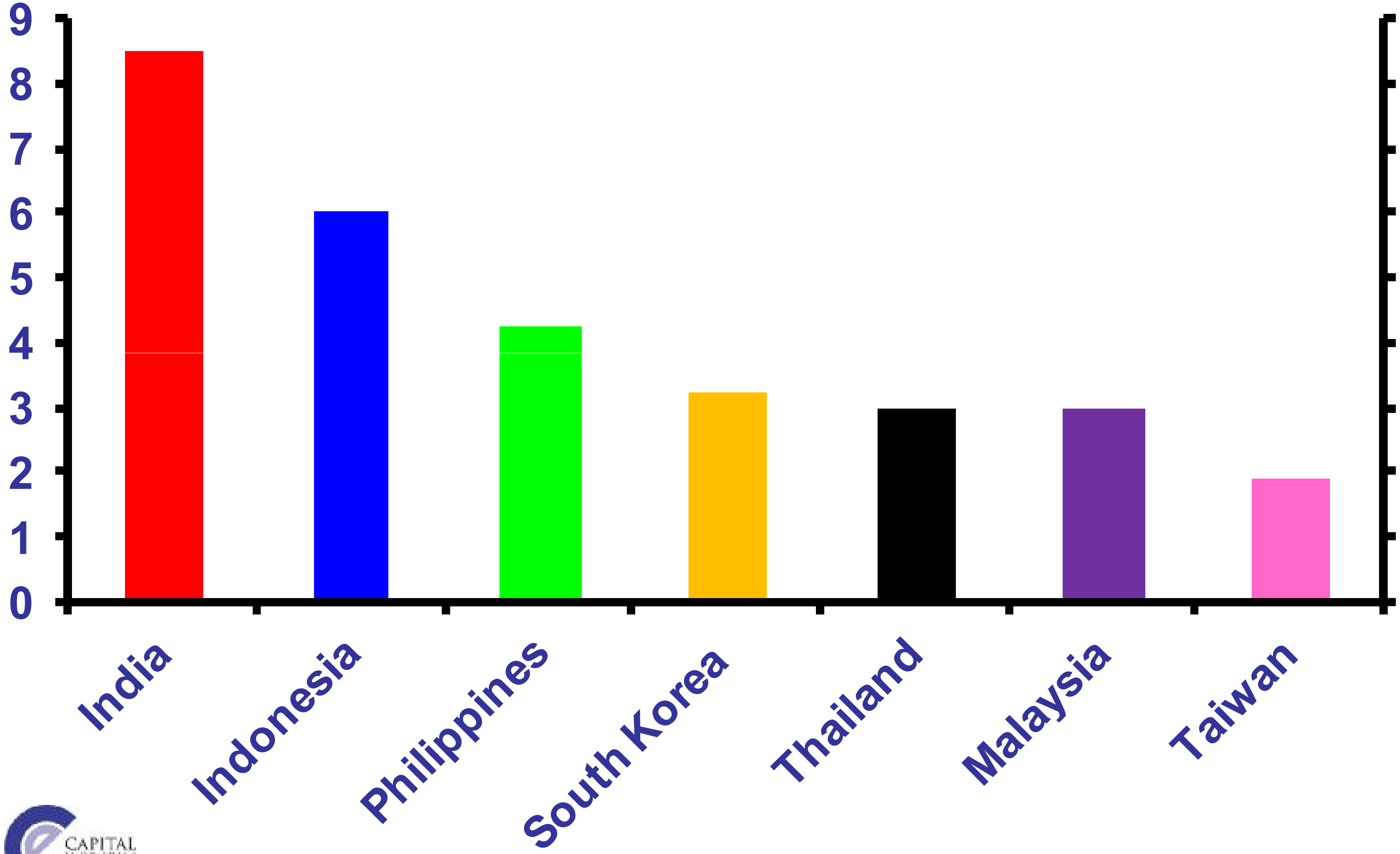
2. Merchandise Exports to US & Euro-zone (As a % of GDP) (2010)



Sources: Thomson Datastream, Capital Economics

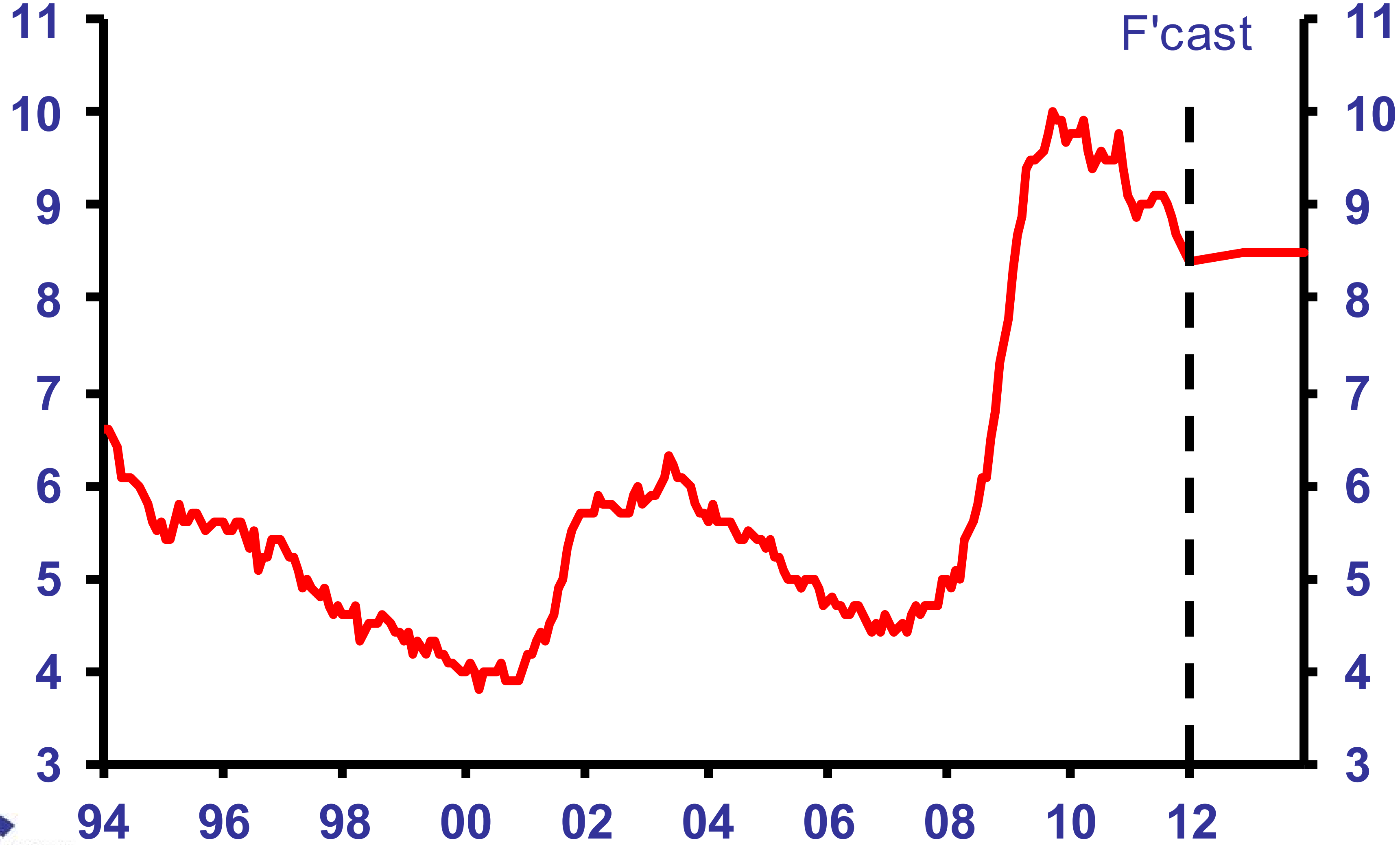

3. Government Debt (% GDP, 2010)
120
100
80
60
40
20
0
G7
India
Malaysia
Philippines
Thailand
South Korea
China
Source: IMF Fiscal Monitor

4. Official Interest Rates (as of 1 Feb 12)



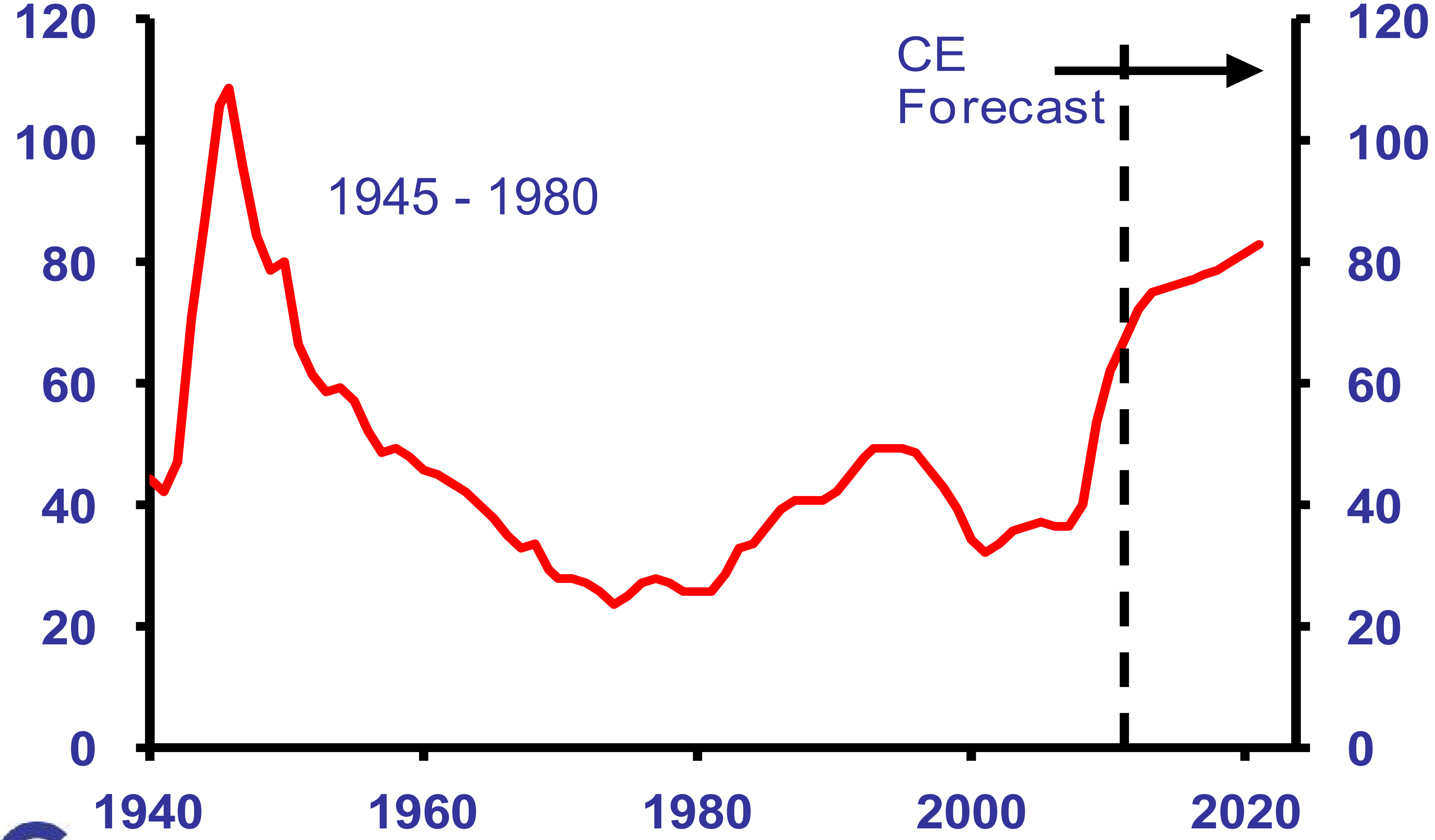
Source: Bloomberg

5. US Unemployment Rate (%) (Latest = December)



Source: Thomson Datastream

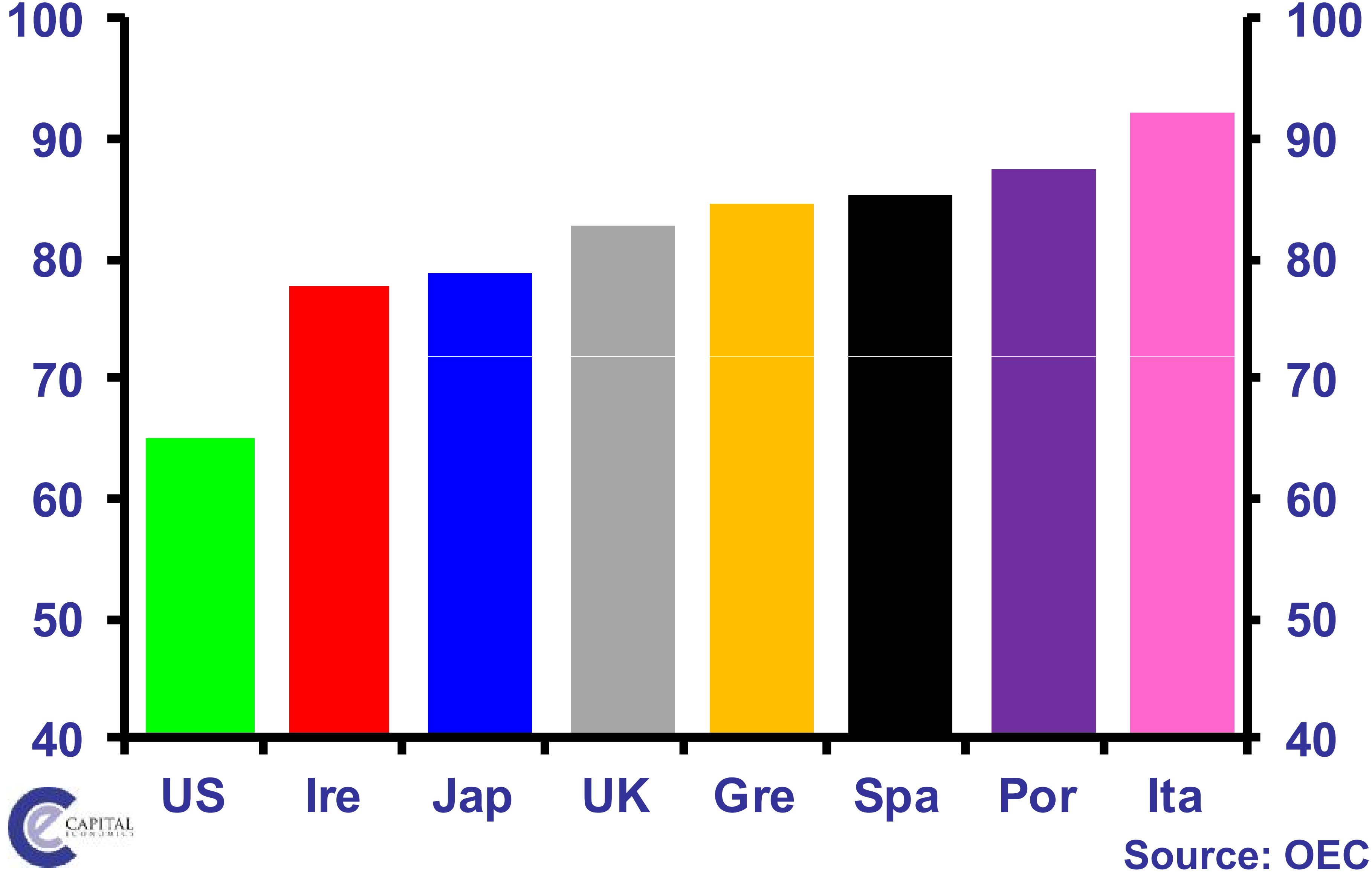
6. US Government Net Debt (As a % of GDP) (1940 – 2020)



CAPITAL ECONOMICS

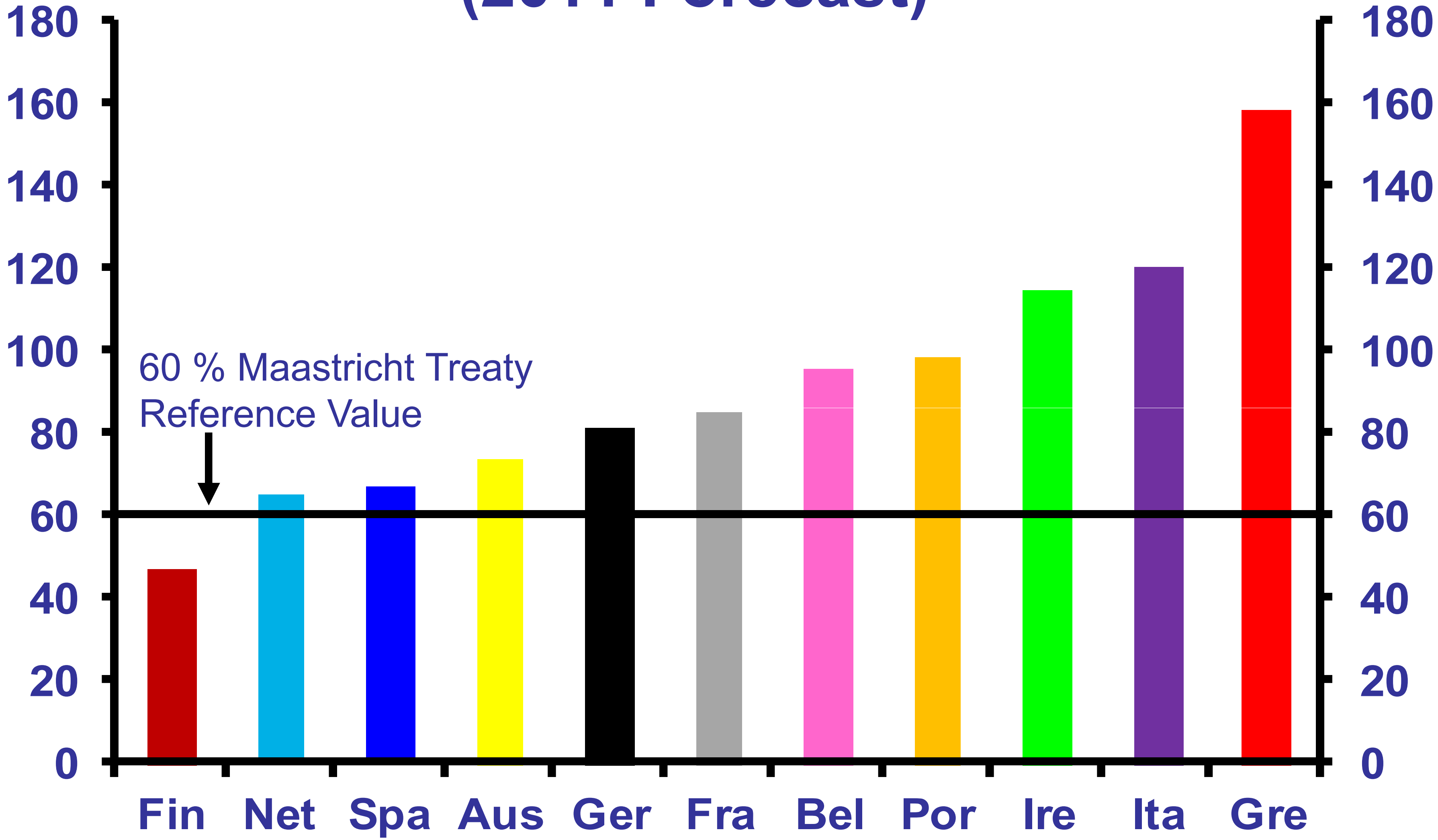
Source: Thomson Datastream

7. Government Receipts (As a % of Outlays) (2011)



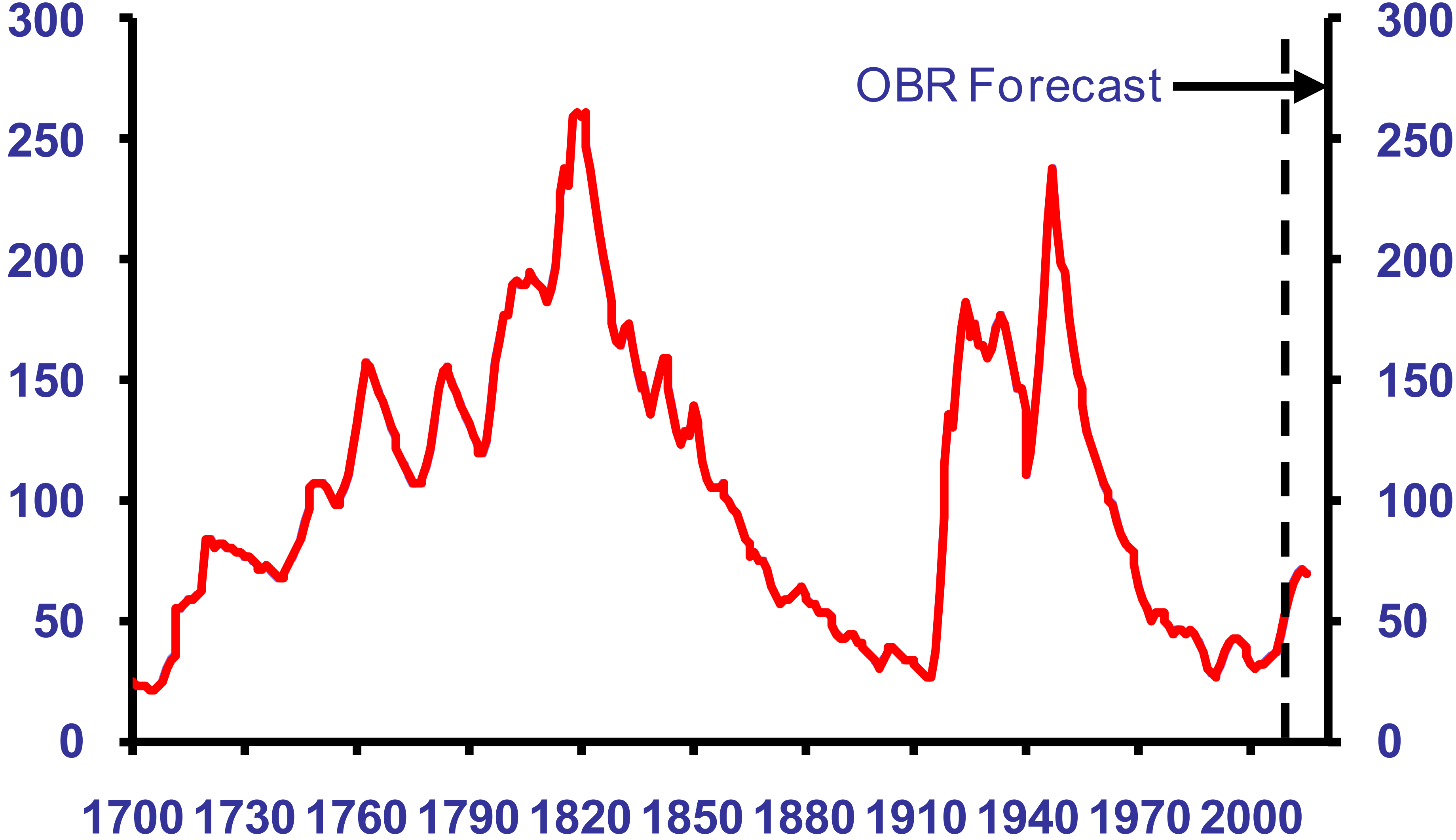
Source: OECD

8. Public Sector Debt (As a % of GDP) (2011 Forecast)



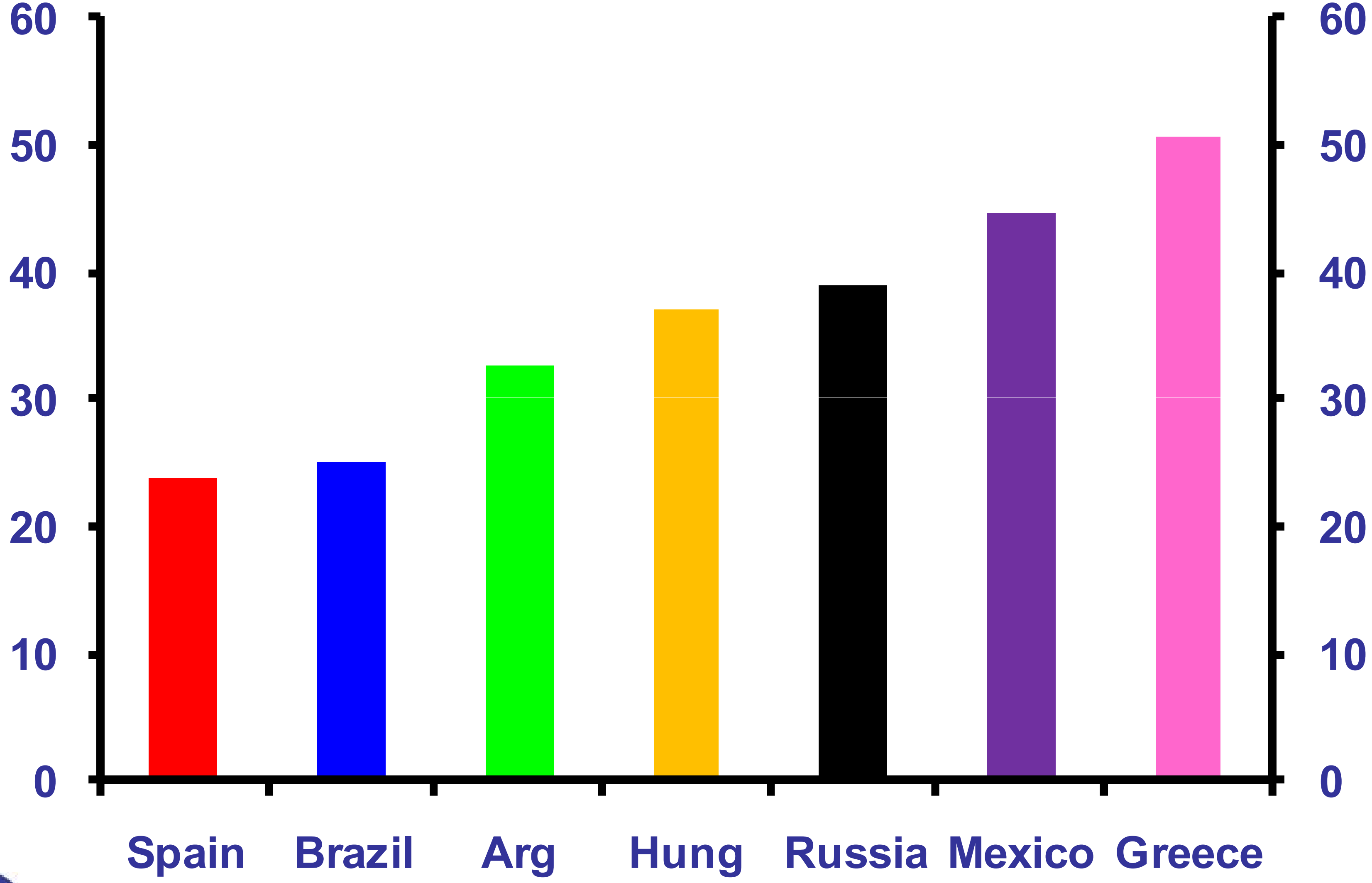
Source: Capital Economics

9. UK Government Net Debt (As a % of GDP) (1700 – 2020)



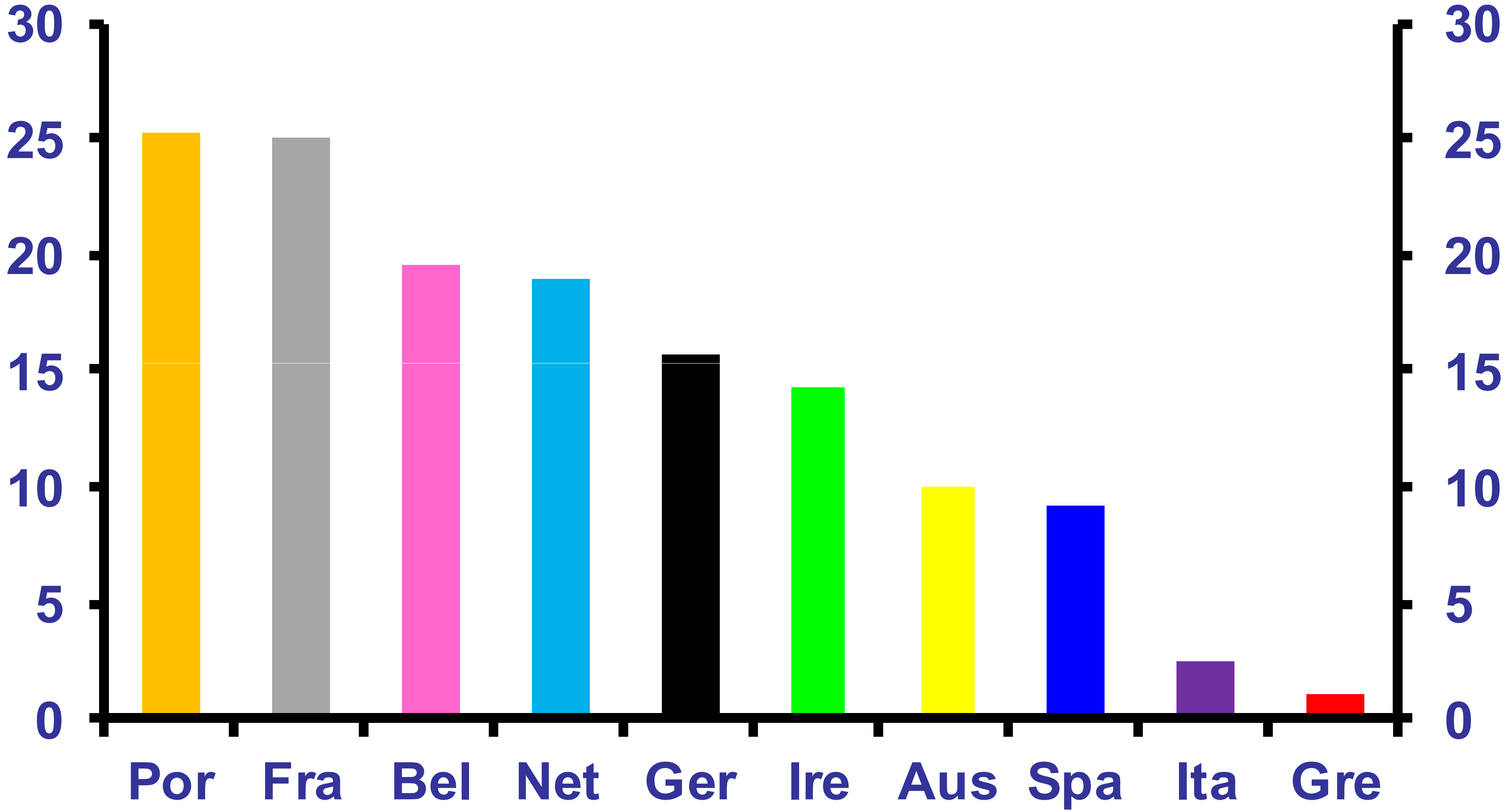
Sources: Thomson Datastream, OBR

10. Share of Years in Default (%)
(since 1800 or independence)



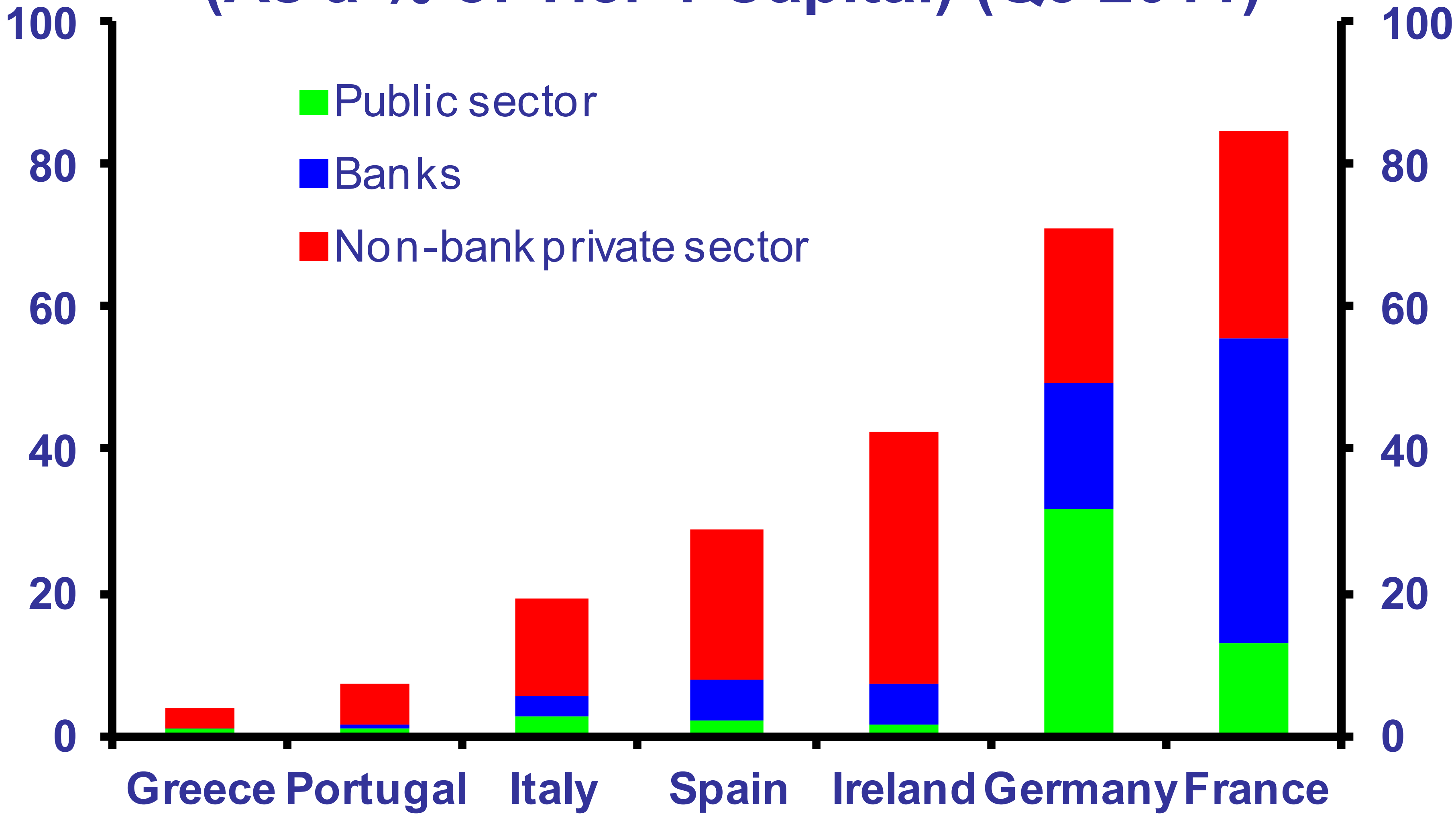
Source: Reinhart and Rogoff, "This Time is Different"

11. Banks' Exposures to Peripheral Economies (As a % of GDP) (Q1 2011)



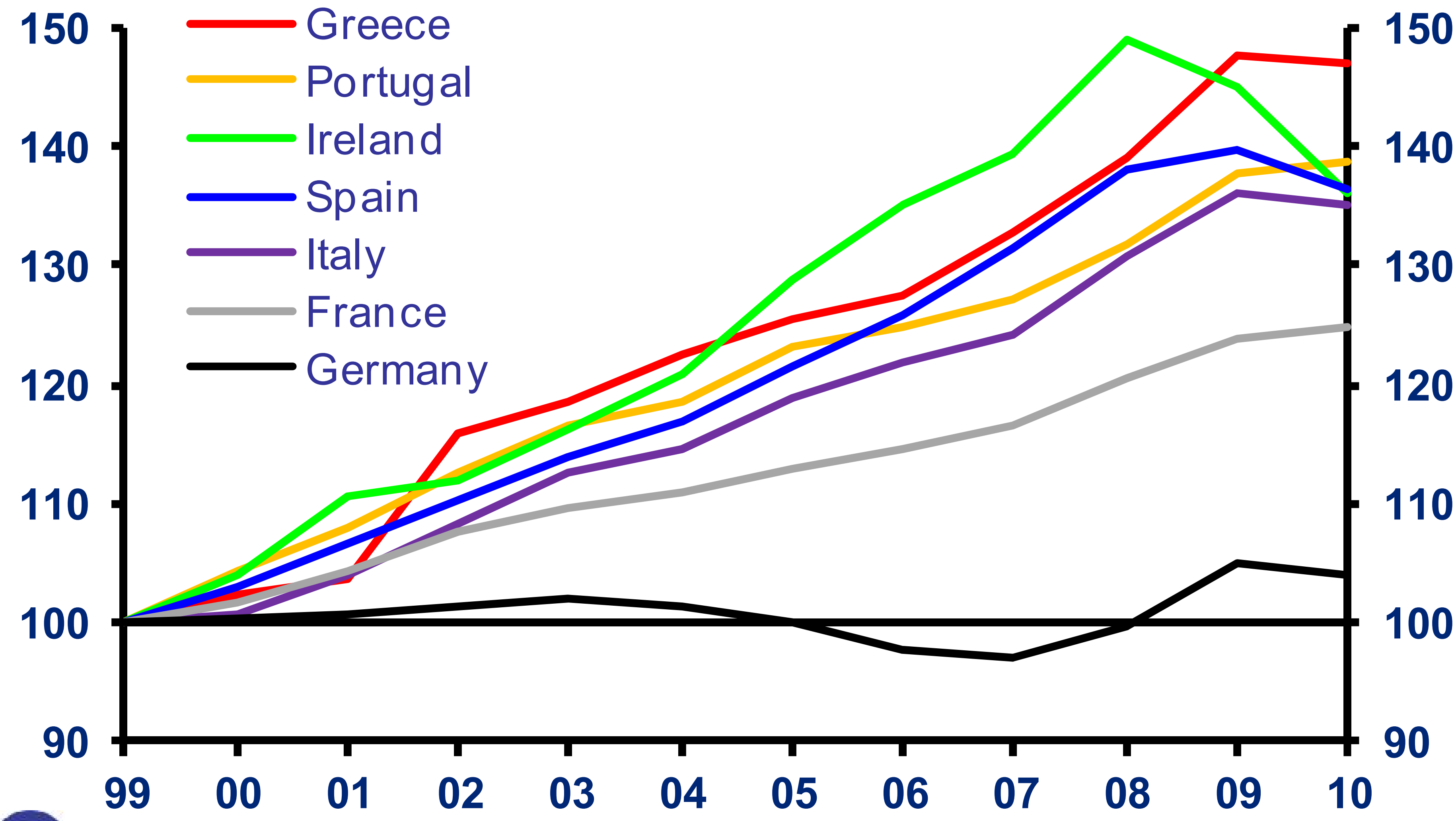
Source: BIS

12. UK Banks' Exposures to Euro-zone (As a % of Tier 1 Capital) (Q3 2011)



Sources: Thomson Datastream, Bank of England

13. Unit Wage Costs (1999 – 2010) (1999 = 100) (Latest = 2010)



CAPITAL ECONOMICS

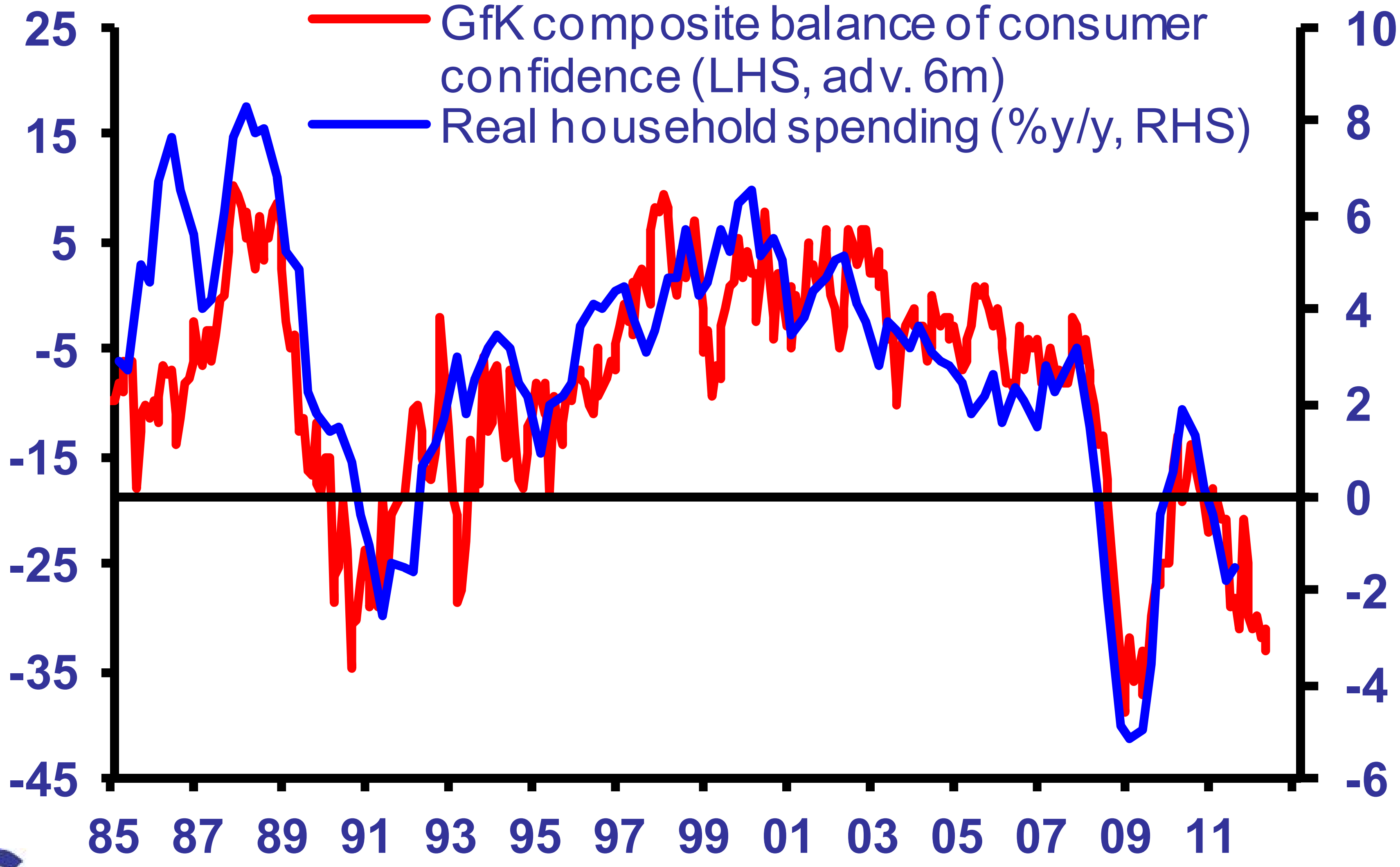
Source: OECD

14. The future of the euro

- Badly conceived from the start.
- Requires fiscal and political union.
- This cannot work for the current membership.
- The euro should split into two - north and south.
- More likely, Greece will leave, later followed by other countries.

CAPITAL ECONOMICS

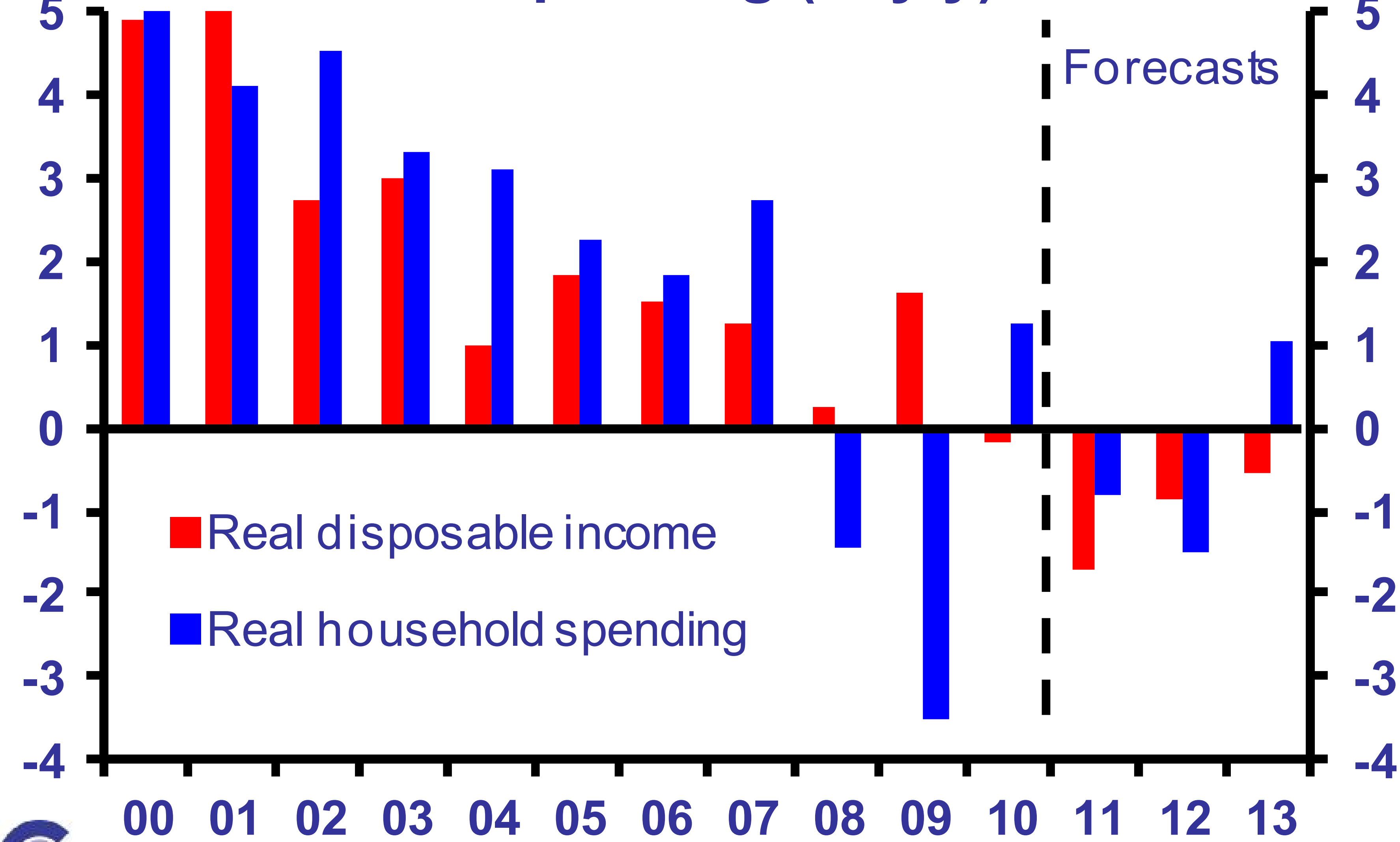
15. UK Consumer Confidence & Real Household Spending (Latest = December)



CAPITAL ECONOMICS

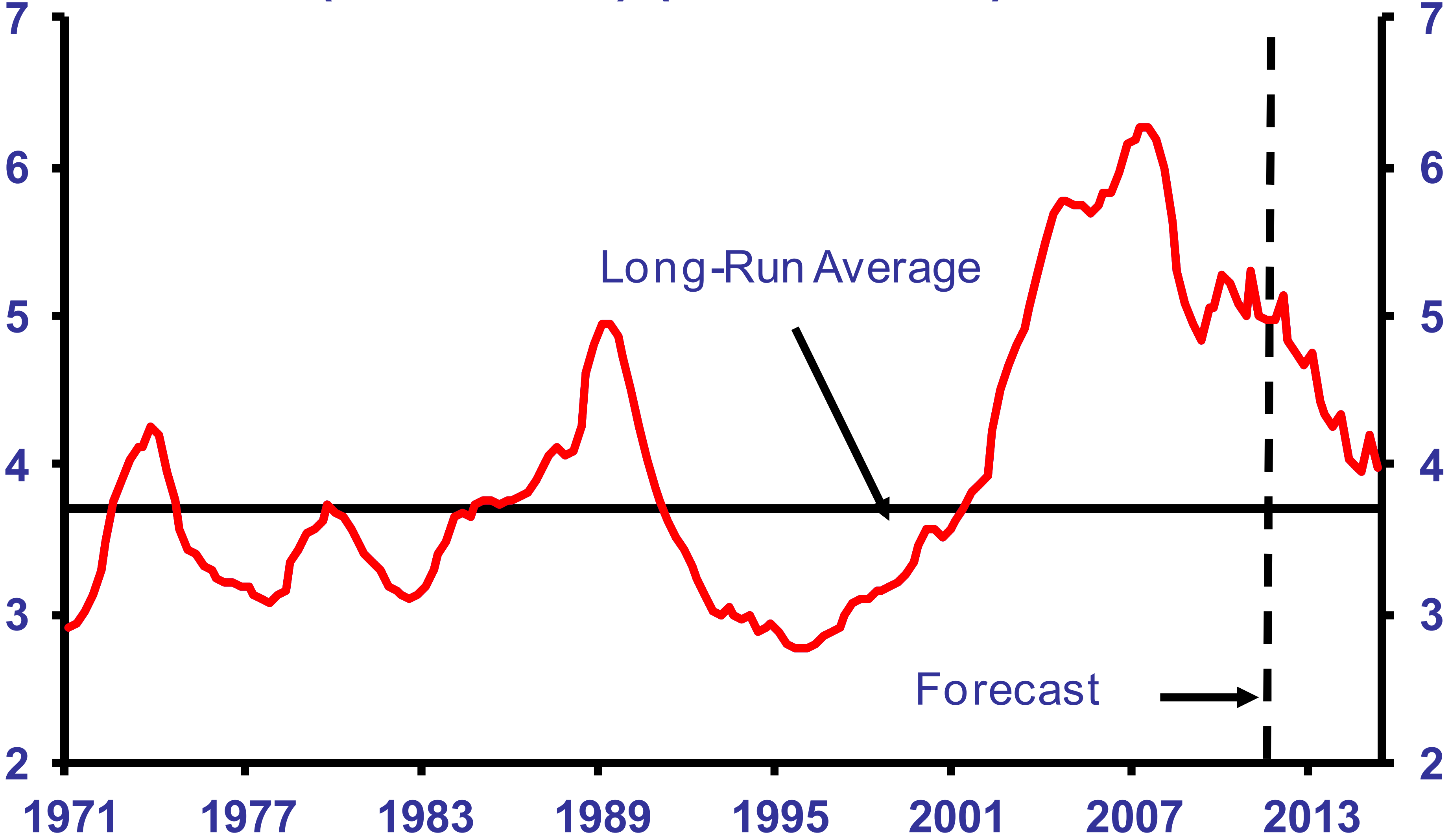
Source: Thomson Datastream

16. UK Real Household Disposable Income & Spending (% y/y)



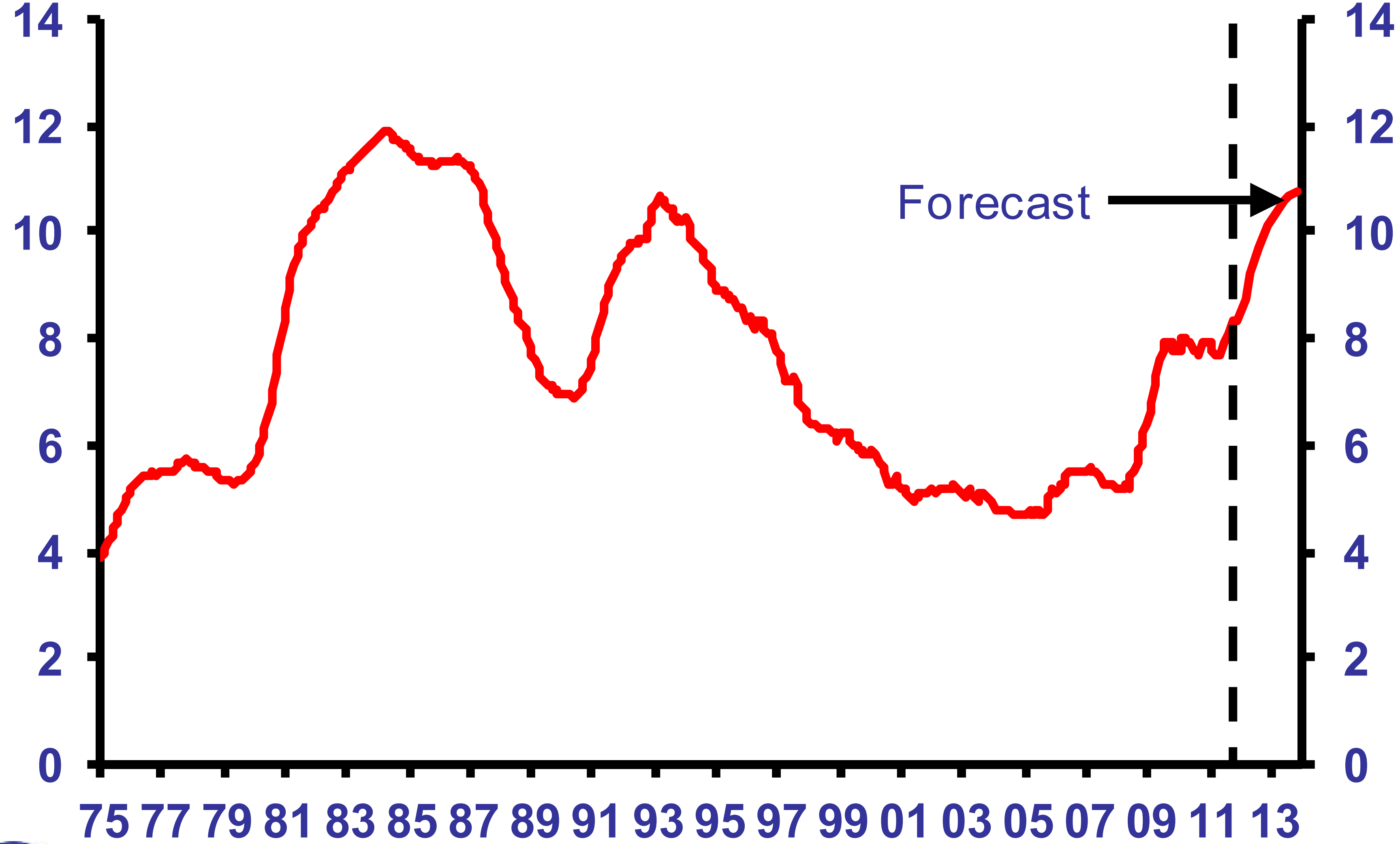
Sources: Thomson Datastream, Capital Economics

17. UK House Price to Earnings Ratio (1971-2015) (Latest = Q3)



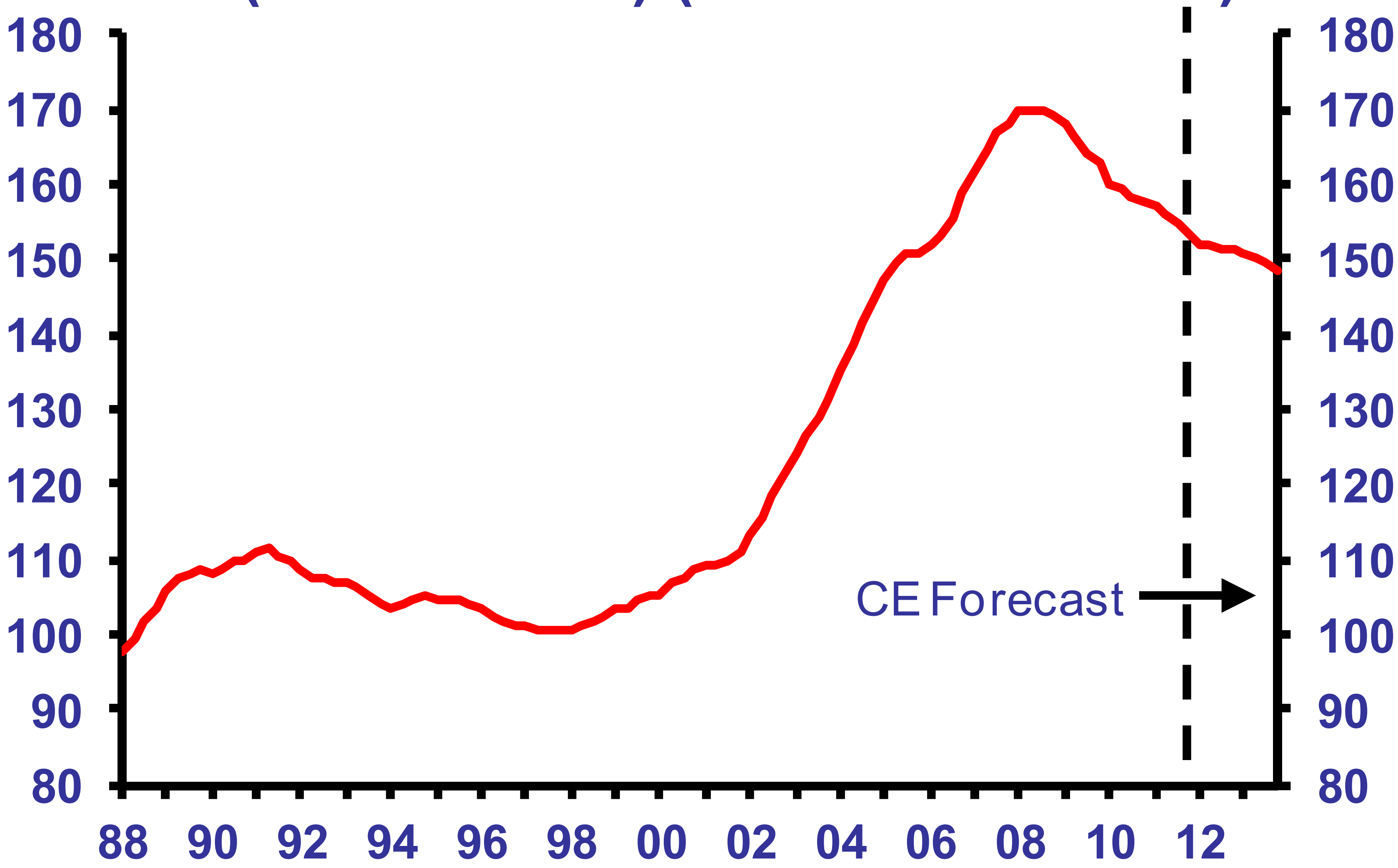
Sources: Nationwide, Thomson Datastream, Capital Economics

18. Unemployment (ILO Measure) (%) (Latest = October)



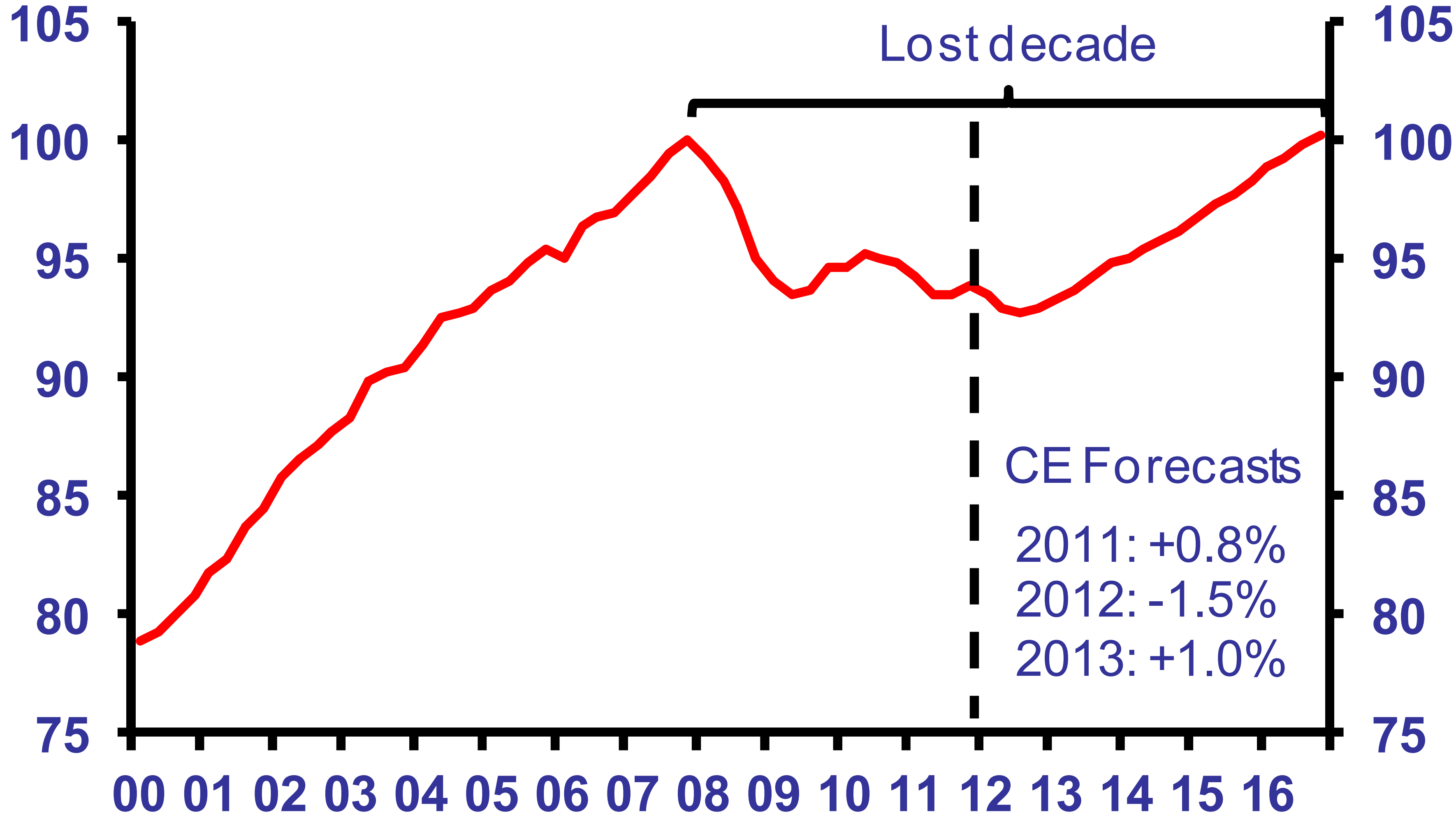
Source: Thomson Datastream

19. Household Debt (As a % of Income) (1988 – 2013) (Latest = Q3 2011)



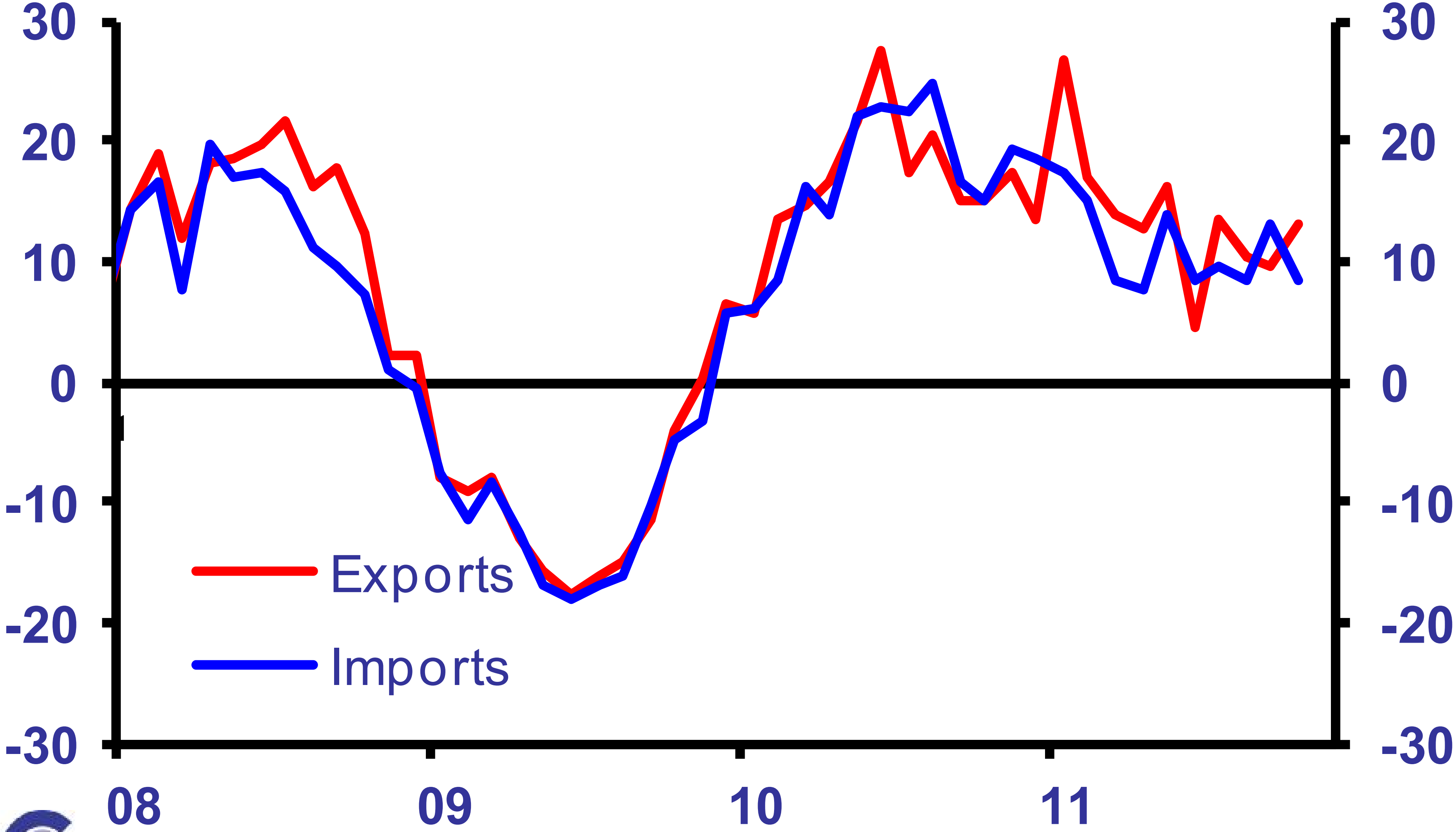
Sources: Thomson Datastream, Capital Economics

20. Level of Real Household Spending (Q4 2007 = 100) (2000 – 2016) (Latest = Q3 2011)



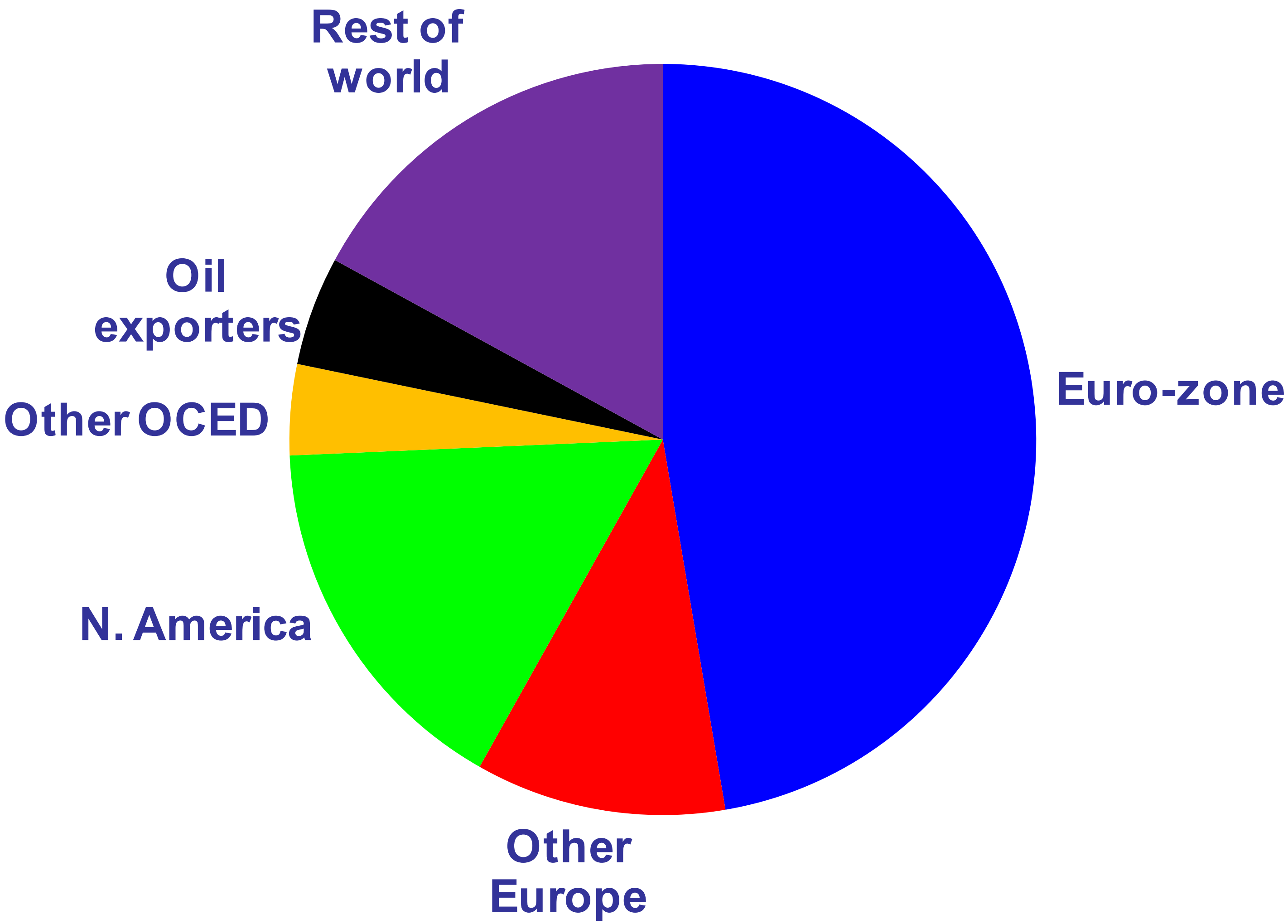
Sources: Thomson Datastream, Capital Economics

21. UK Trade in Goods (£bn, % y/y) (Latest = November)



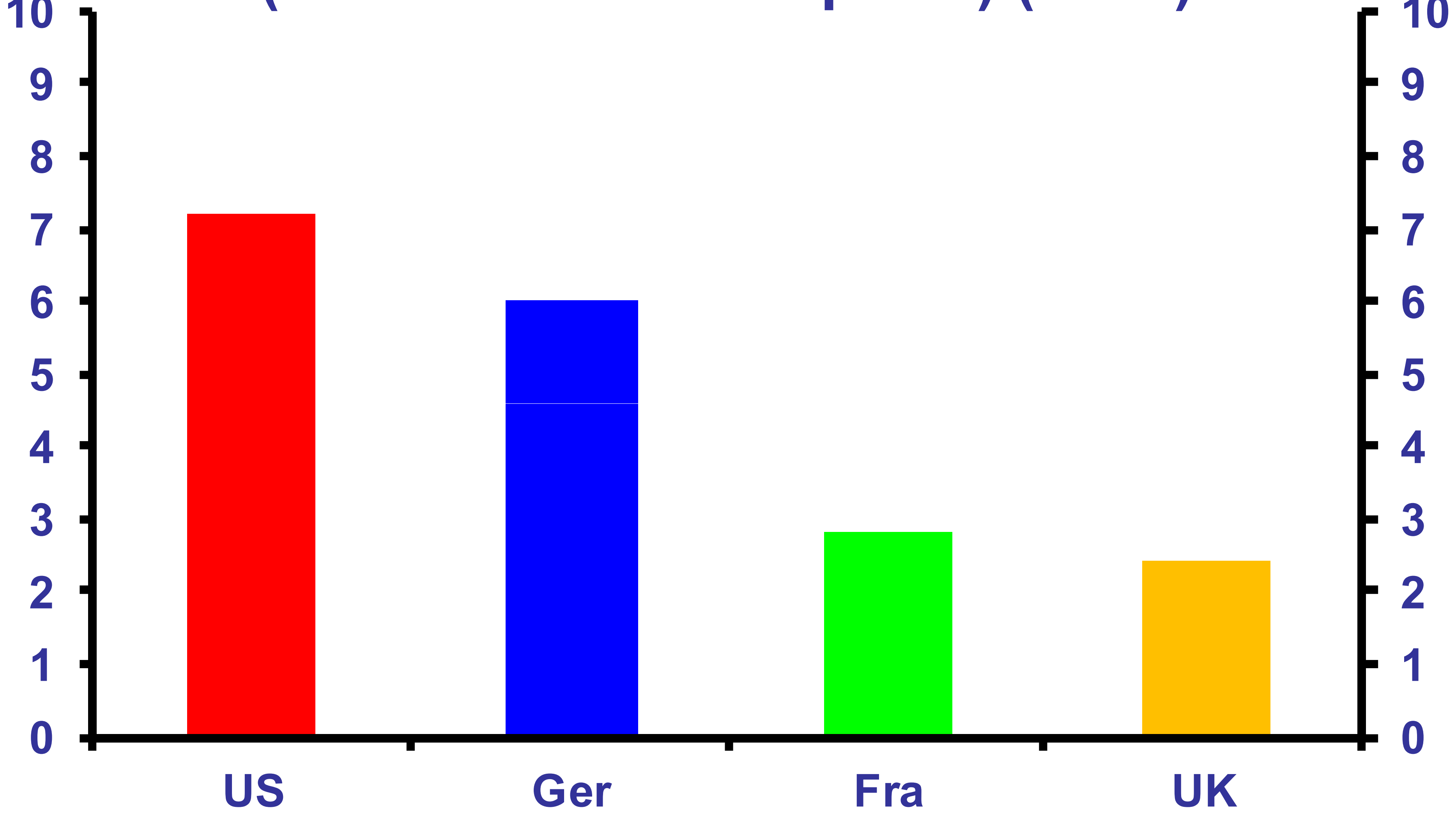
Source: Thomson Datastream

22. Destination of UK Goods Exports (As a % of Total) (2010)



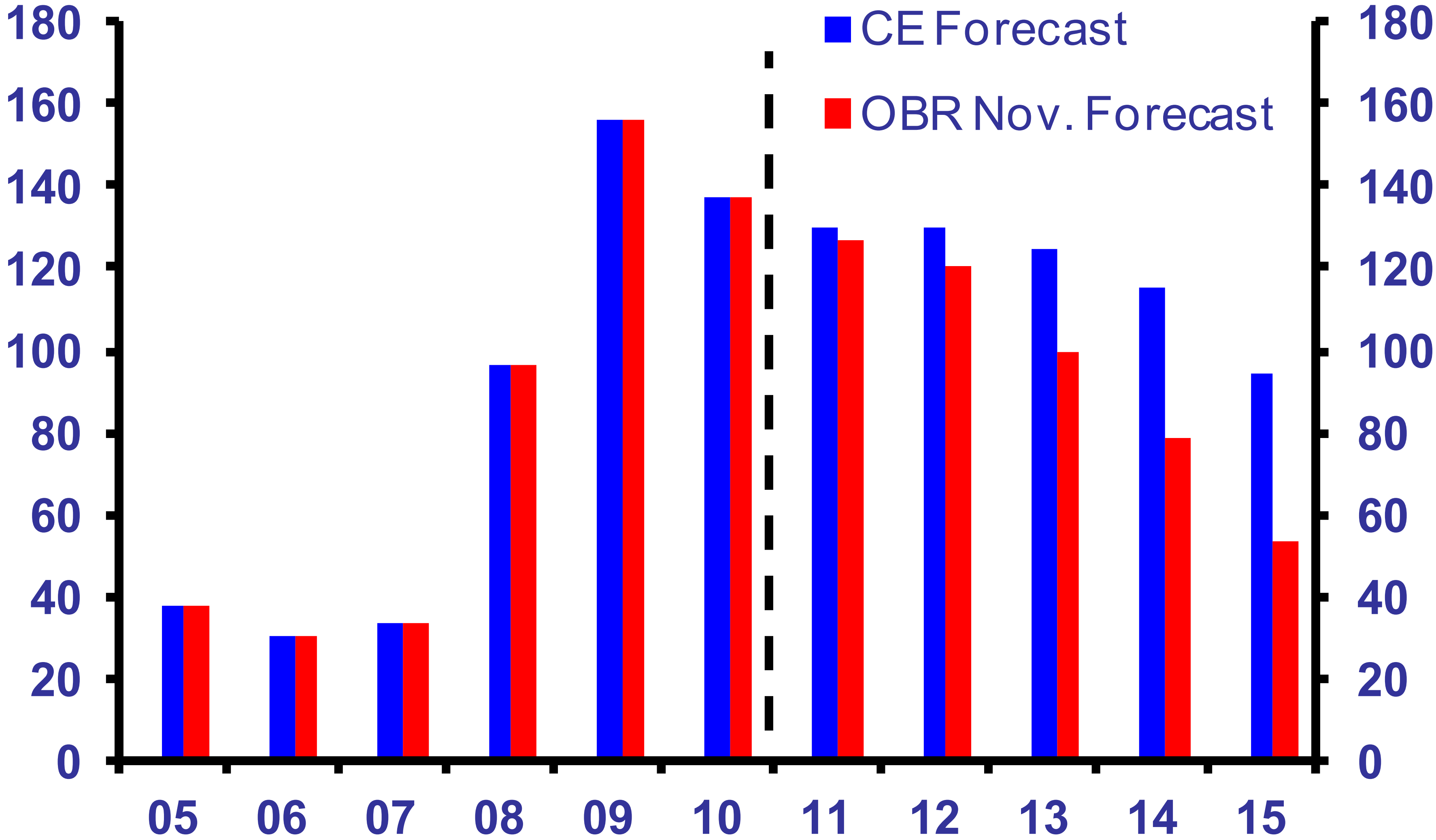
Source: Thomson Datastream

23. Shares of Exports to China (As a % of Total Exports) (2010)



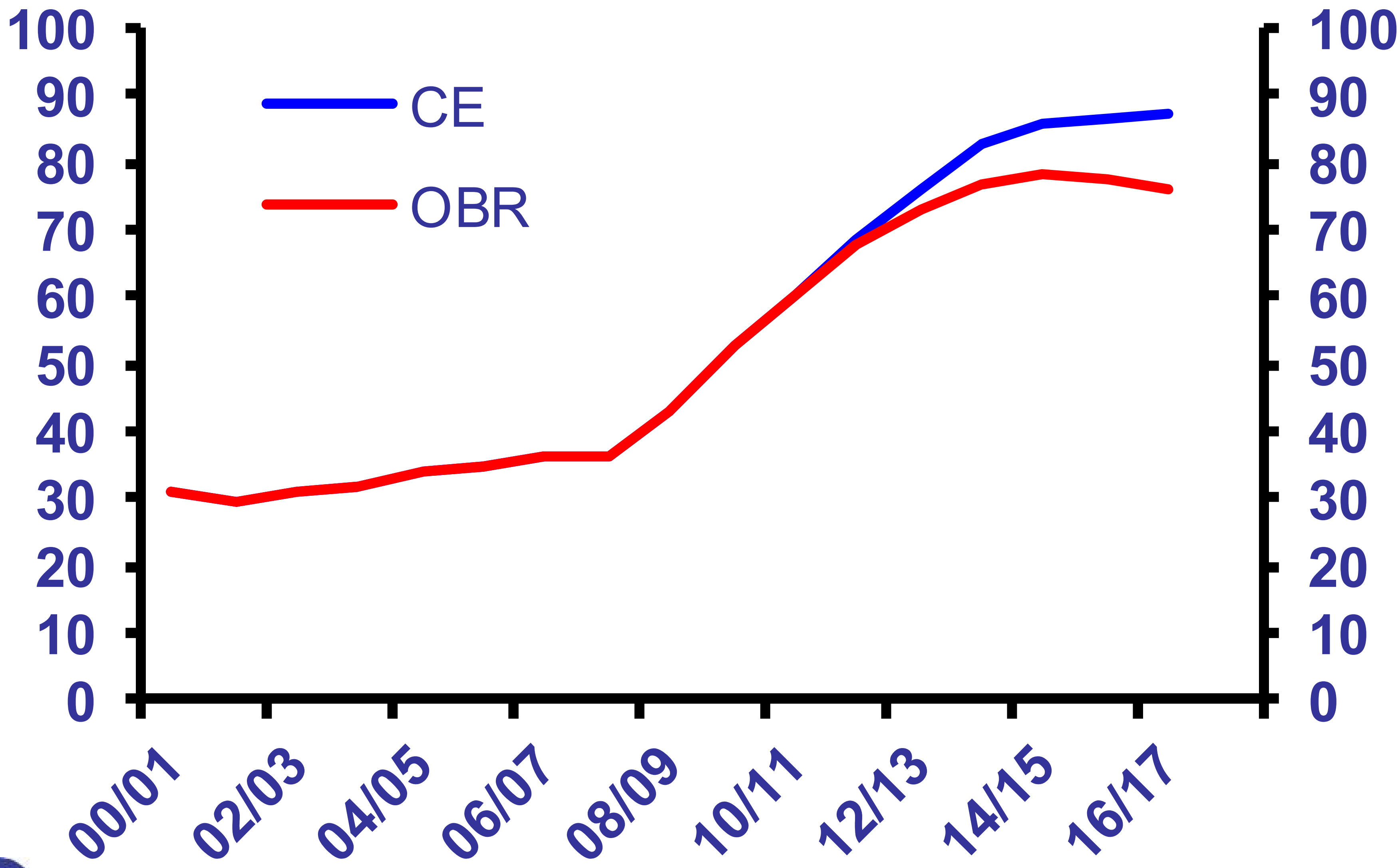
Source: Thomson Datastream

24. UK Public Sector Borrowing As a % of GDP (Latest = 2010/11)



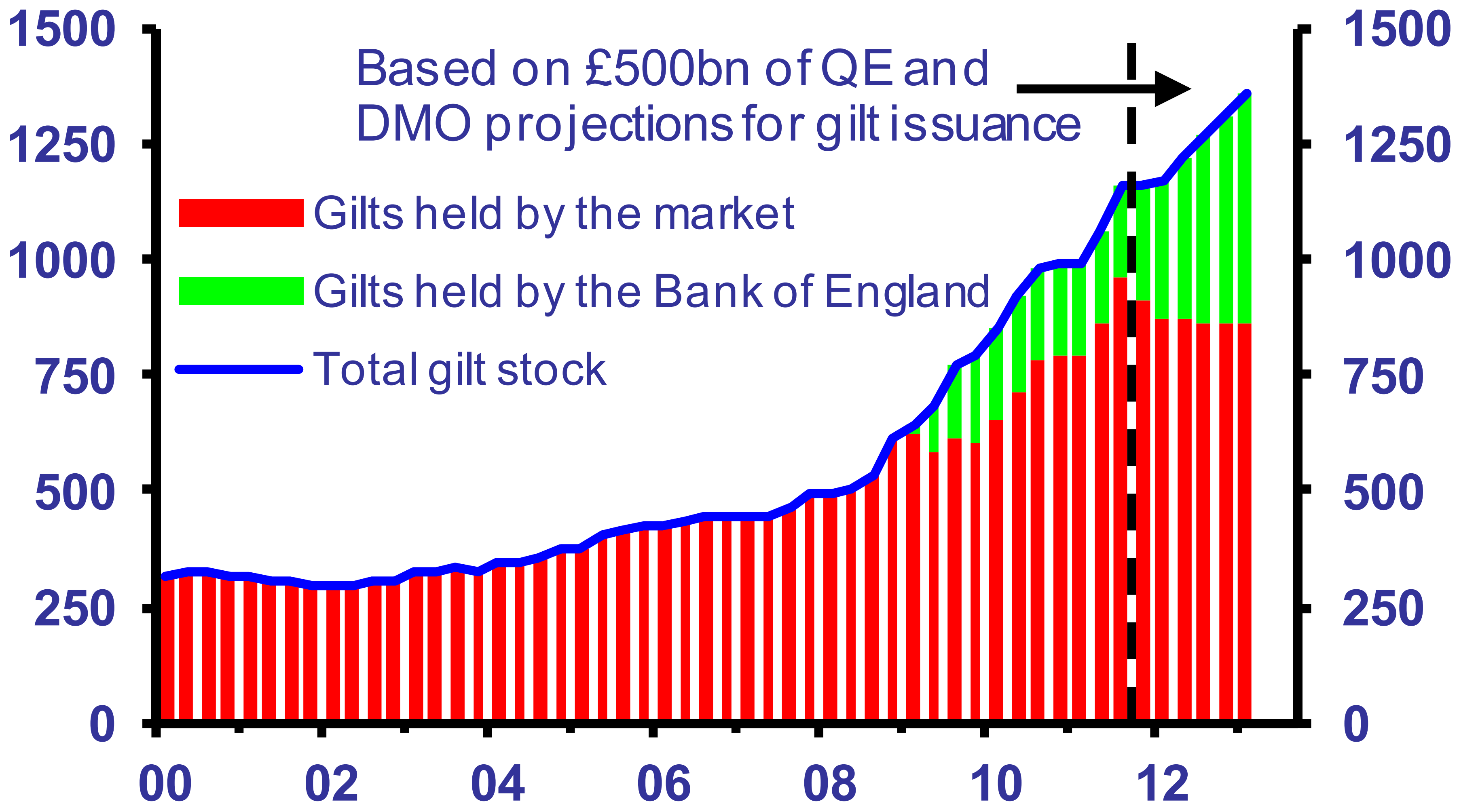
Sources: OBR, Capital Economics

25. Net debt as a share of GDP (%) (2000-2017)



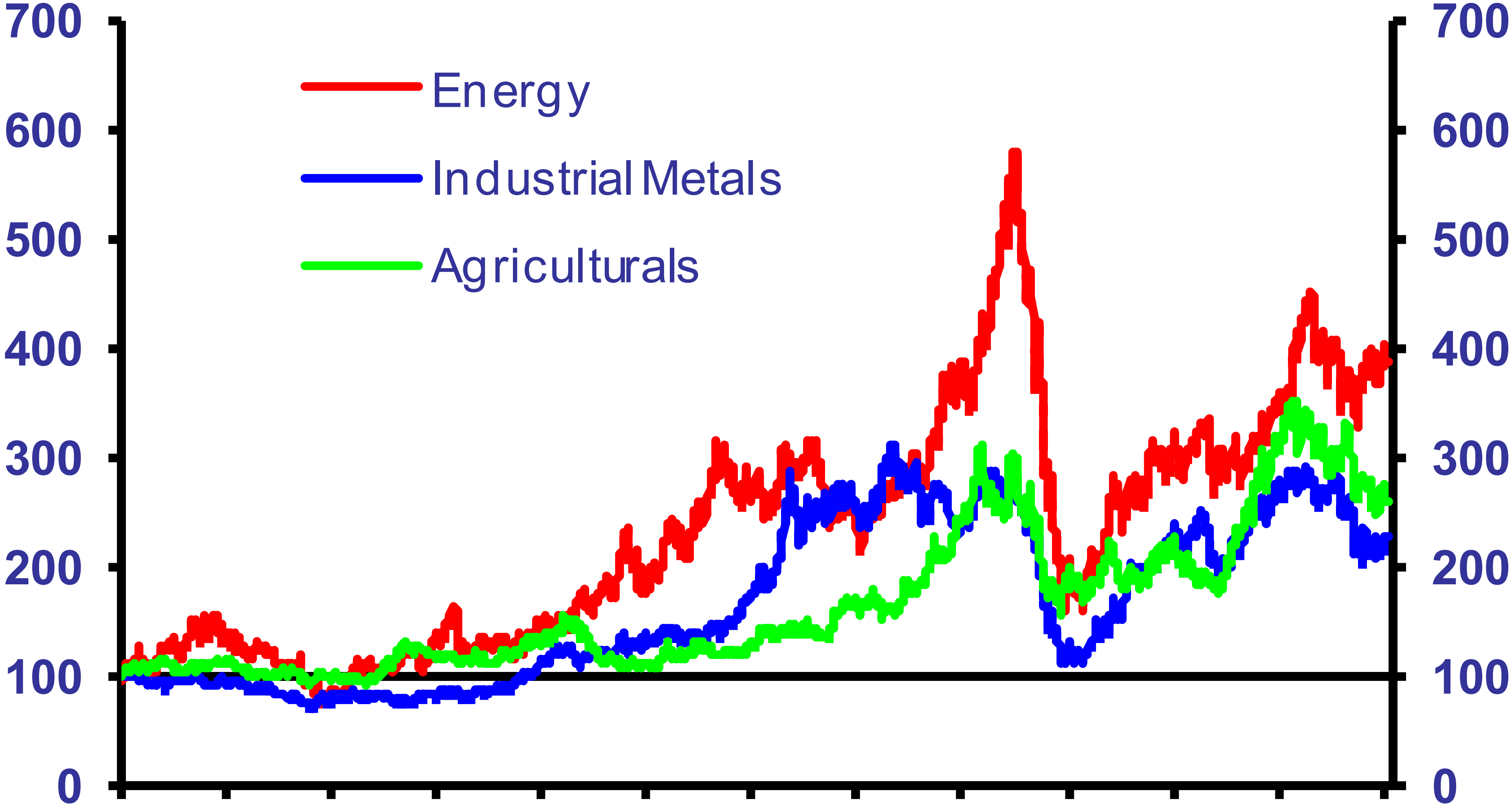
Sources: OBR, Capital Economics

26. Breakdown of Gilt Holdings (2000 – 2013) (Latest = Q3 2011)



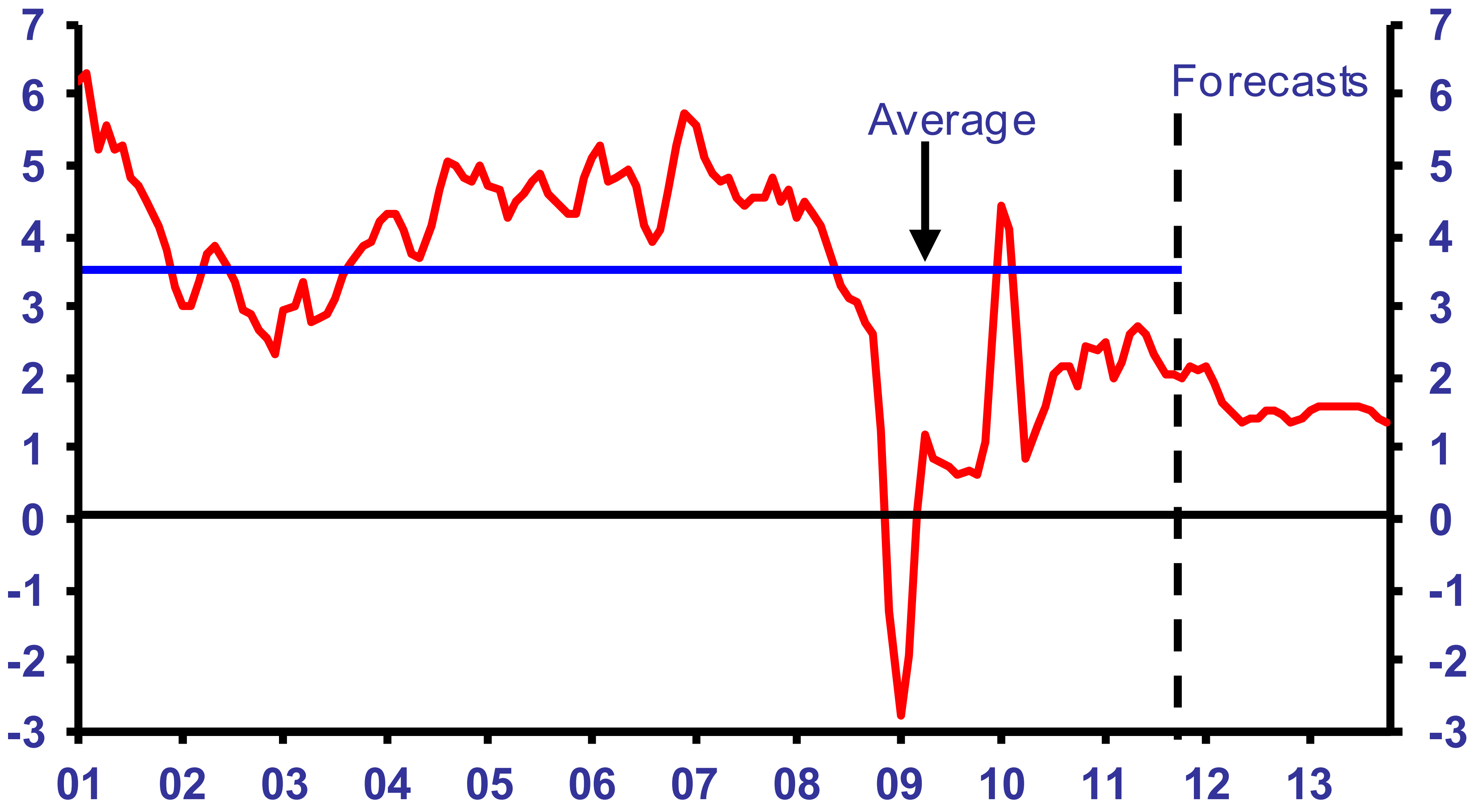
Sources: DMO, Bank of England

27. Commodity Prices (Jan. 2000 = 100)
(Latest = 1 Feb)



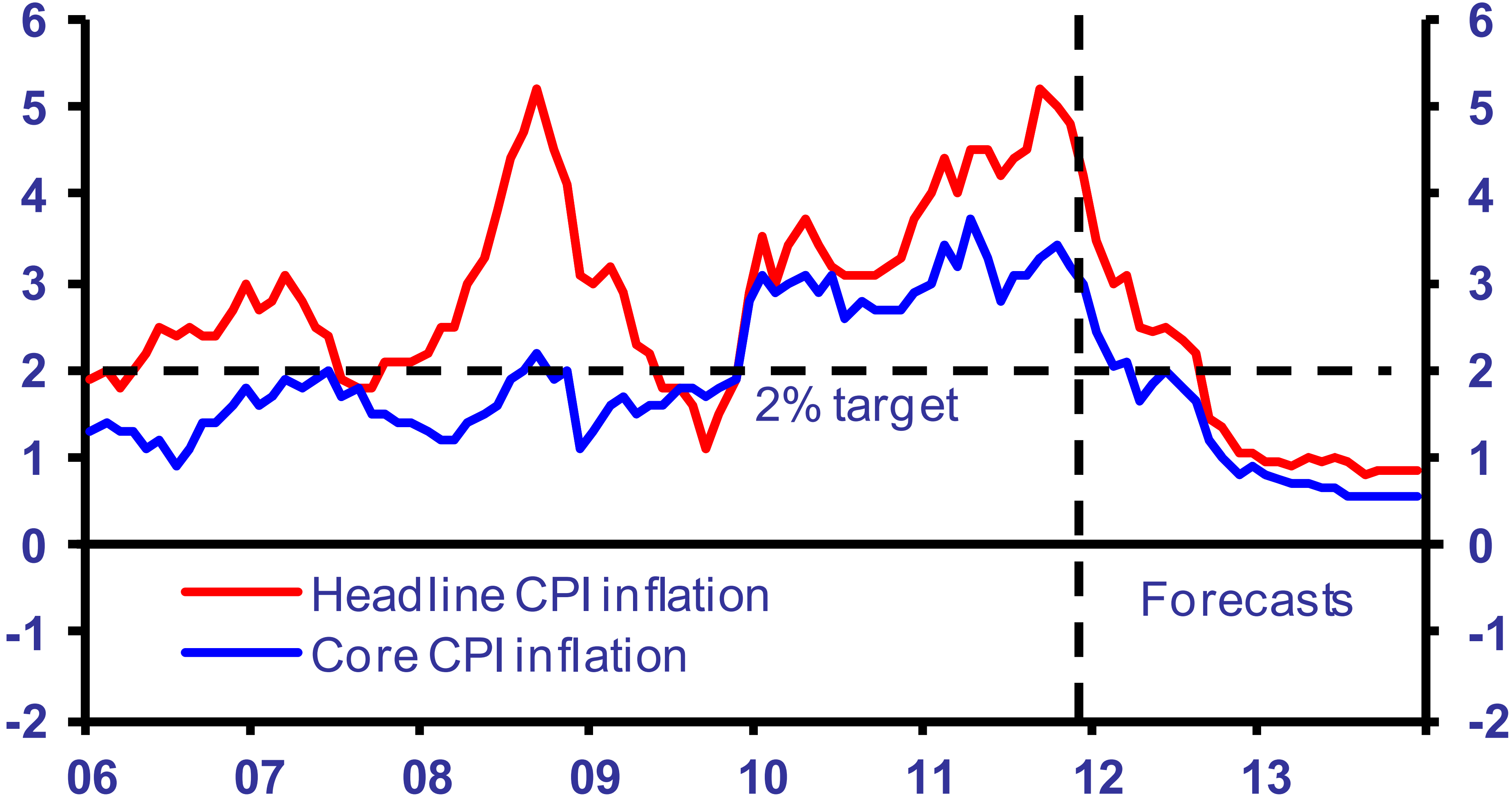
Sources: Thomson Datastream

28. UK Average Earnings (2001-2013) (% y/y) (Latest = October)



Source: Thomson Datastream

29. UK Consumer Price Inflation (%)
(Latest = December)

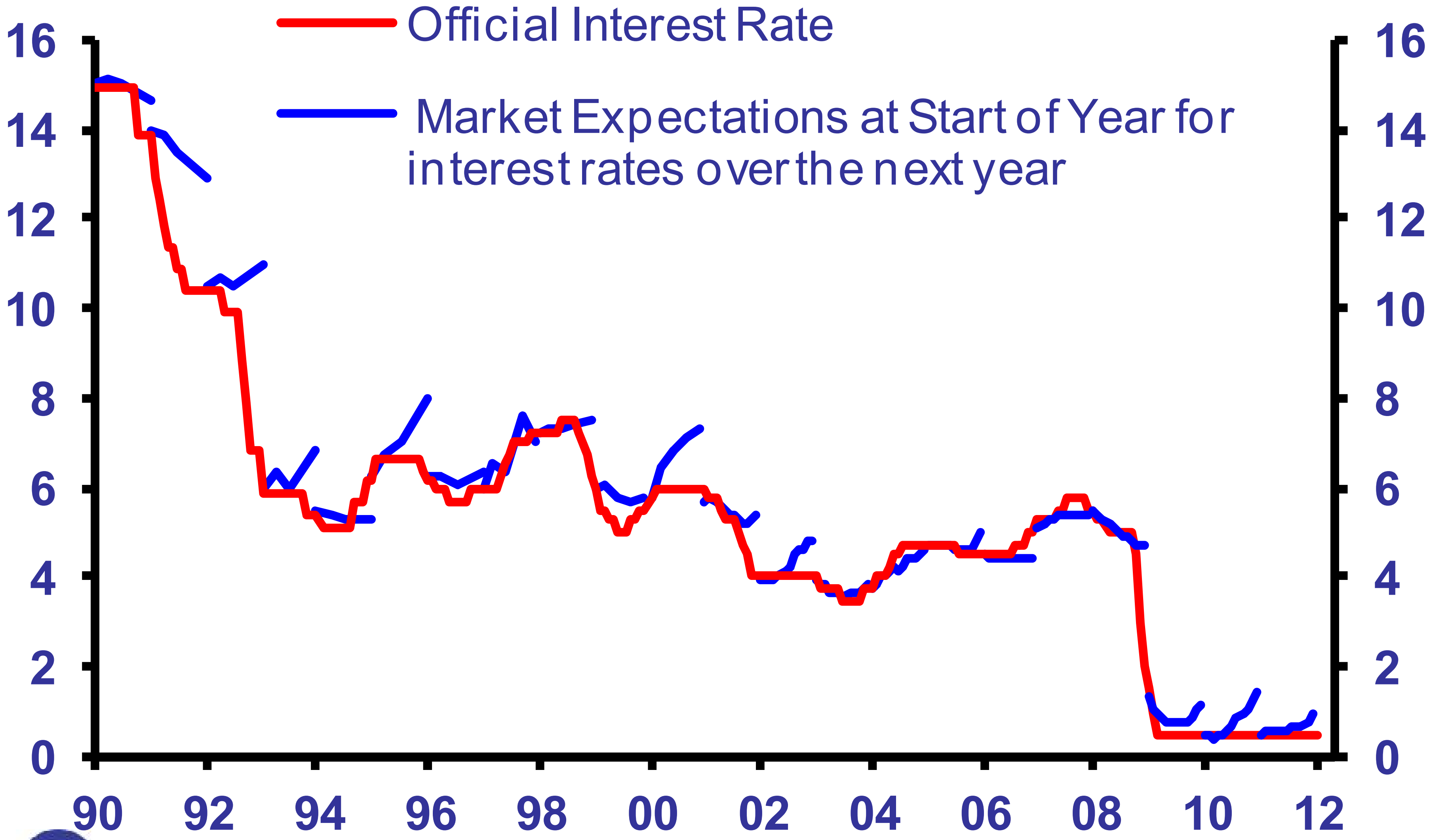


Sources: Thomson Datastream, Capital Economics

30. What will bring escape from recession?

- Fiscal and monetary policy can be relaxed in most of the emerging markets.
- A move towards stronger domestic demand and higher exchange rates in Asia, led by China.
- More QE in the US and the UK.
- Structural measures to incentivise private investment spending.
- Relief from the euro crisis.
- Lower commodity prices, leading to higher consumer real incomes.

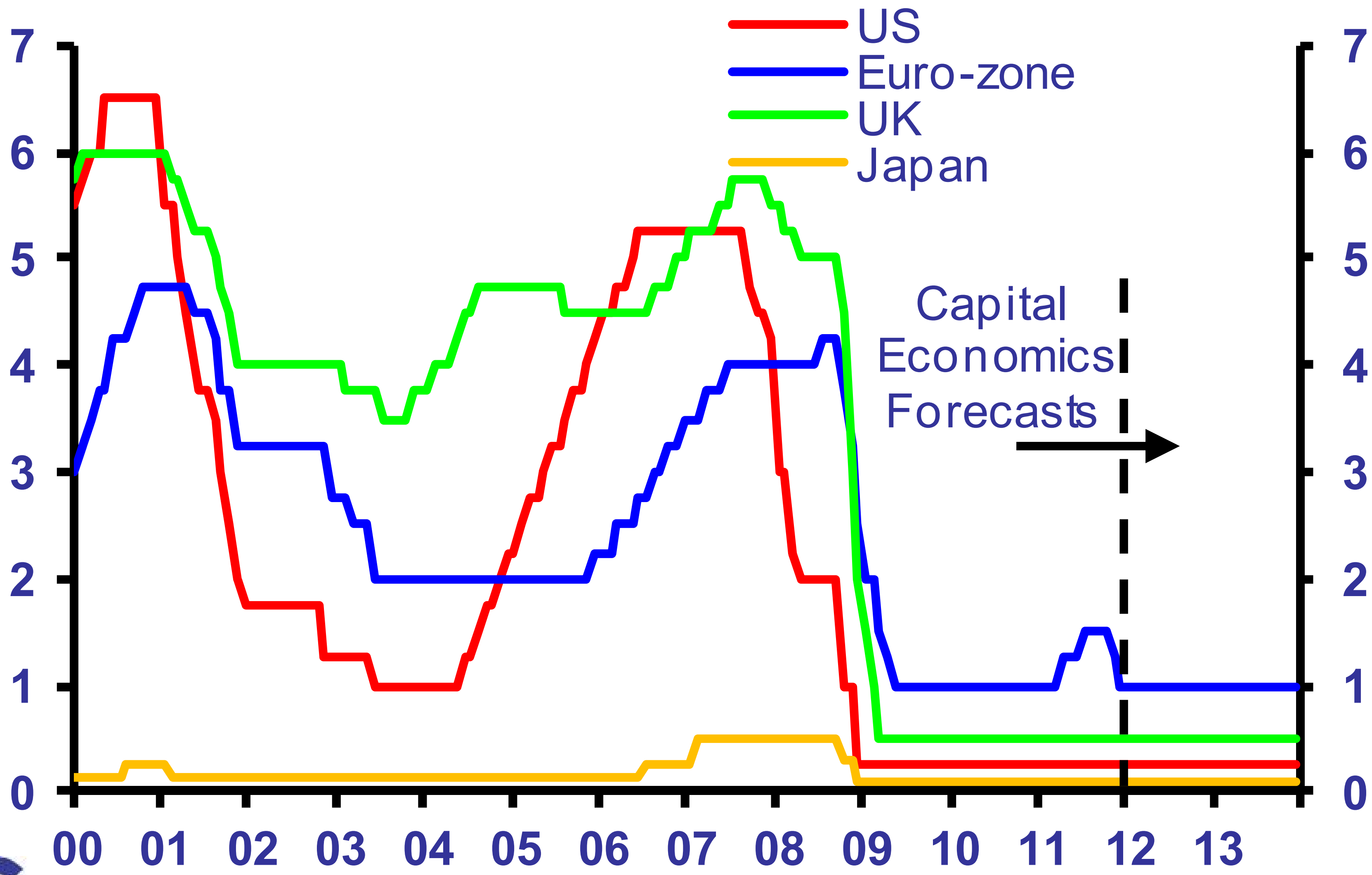
31. UK Official Interest Rates and Market Interest Rate Expectations (1990-2011) (%)



CAPITAL ECONOMICS

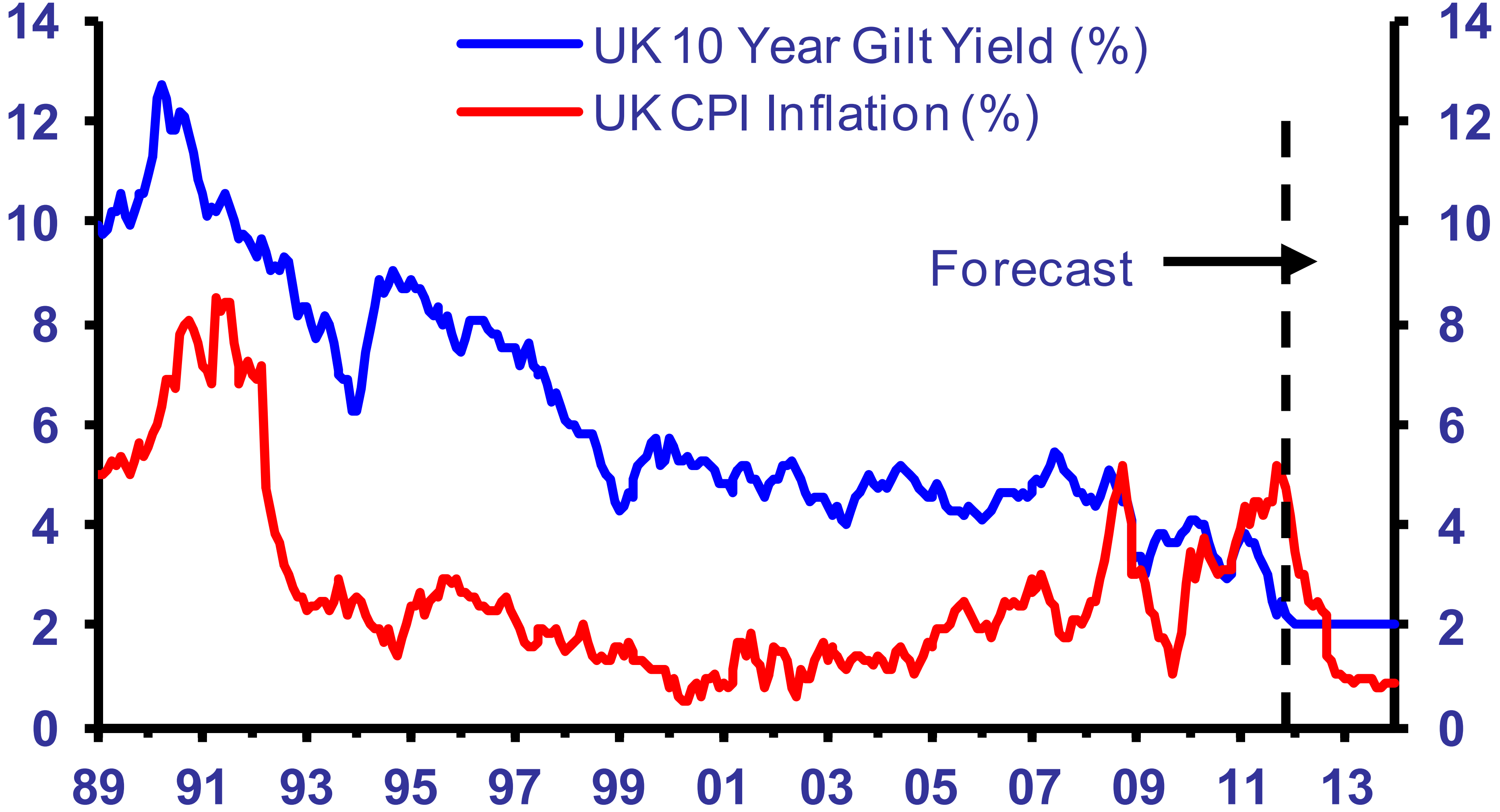
Source: Bloomberg

32. Capital Economics Rate Expectations (%) (2000 – 2013) (Latest = 1 Feb)



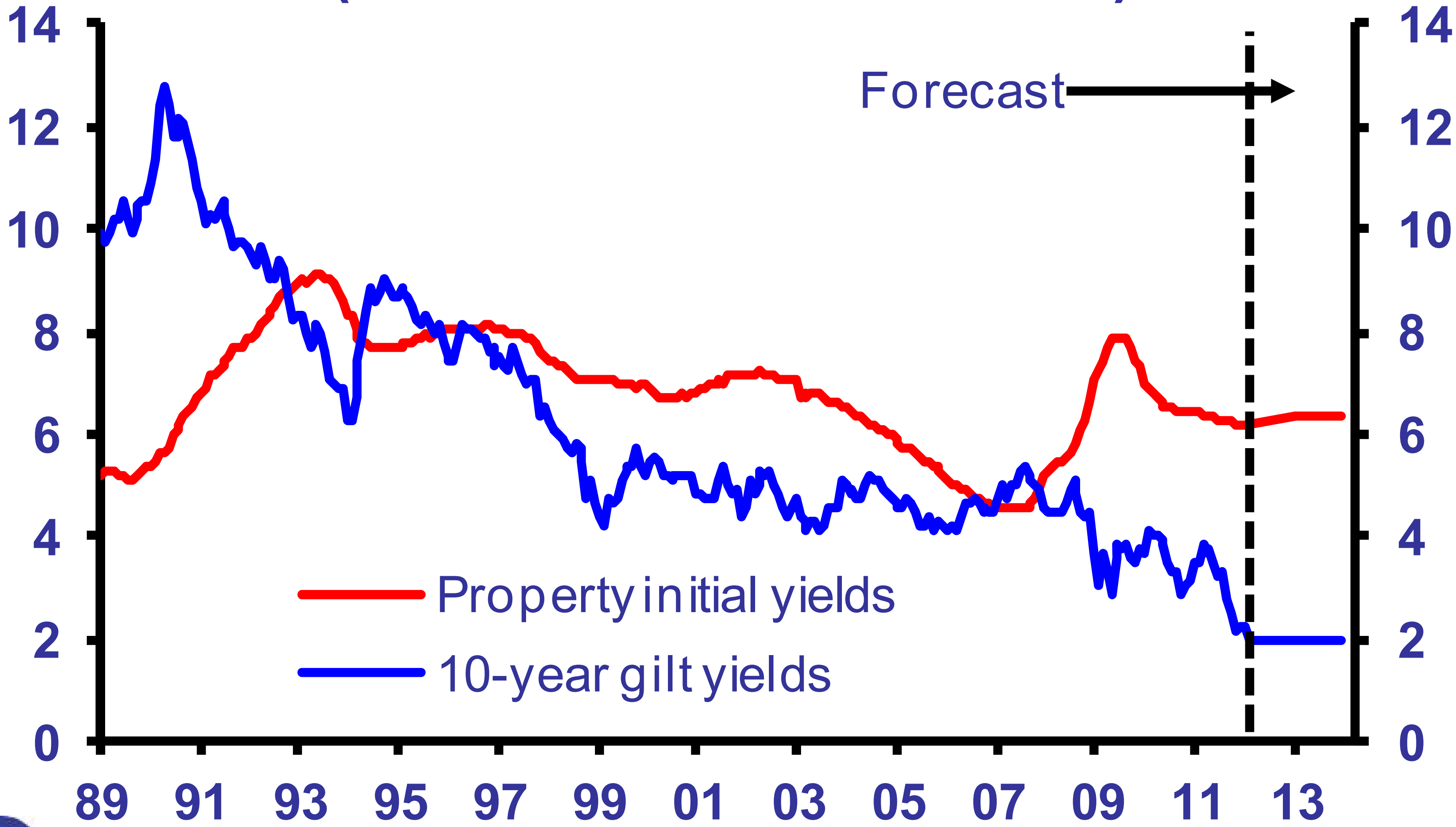
Sources: Thomson Datastream, Capital Economics

33. UK Gilt Yields & Inflation (1990 – 2013) (Latest = 1 Feb)



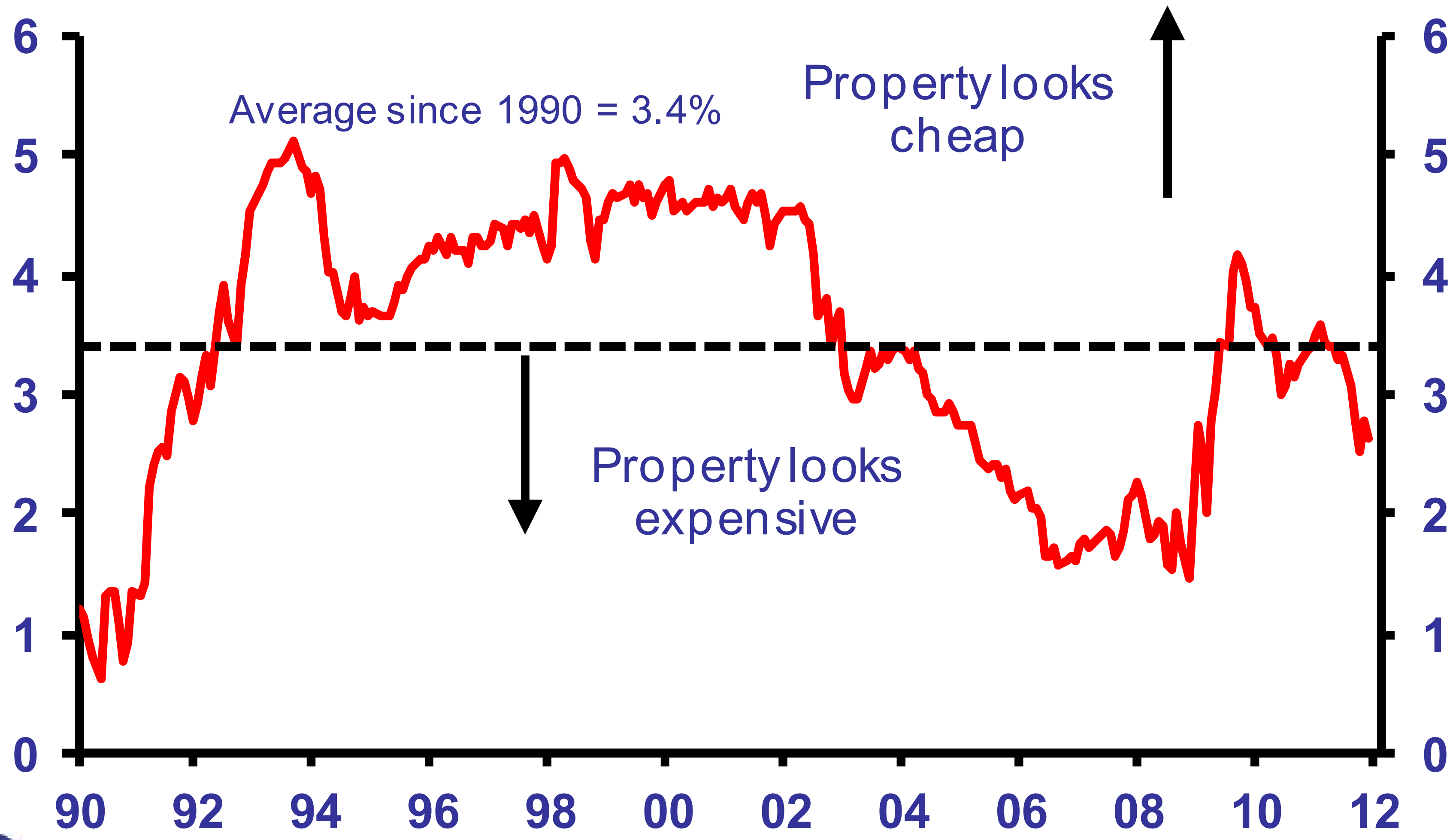
Source: Thomson Datastream, Capital Economics

34. All-Property Initial Yields and 10-Year Government Bond Yields (%) (1989 – 2013) (Latest = December 2011)



Sources: IPD, Thomson Datastream, Capital Economics

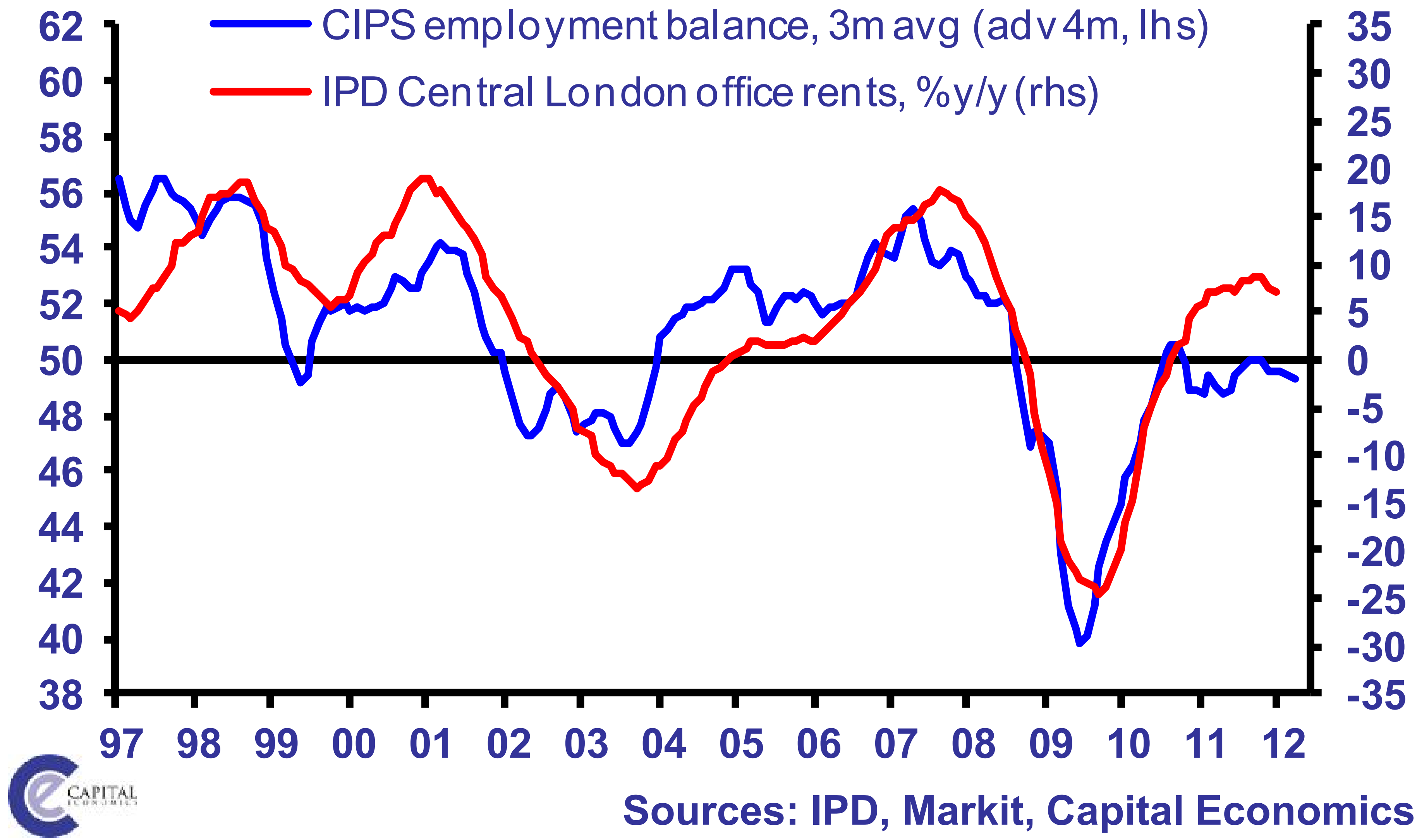
35. All-Property Initial Yields Less Equity Dividend Yields (%) (1990- 2011) (Latest = December)



CAPITAL ECONOMICS

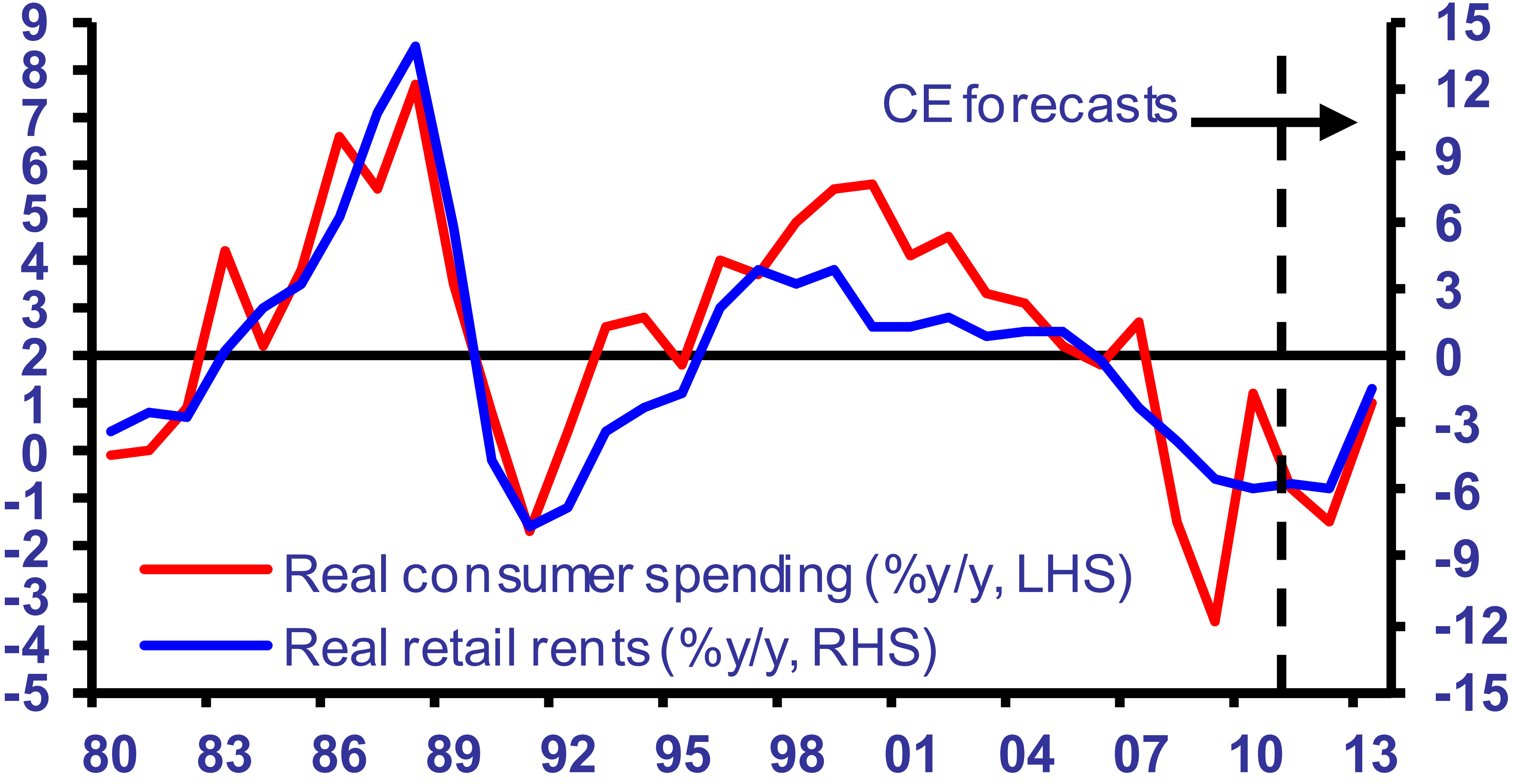
Source: Thomson Datastream, IPD

36. Service Sector Employment Index and Central London Office Rental Values (1997-2011) (Latest =December)



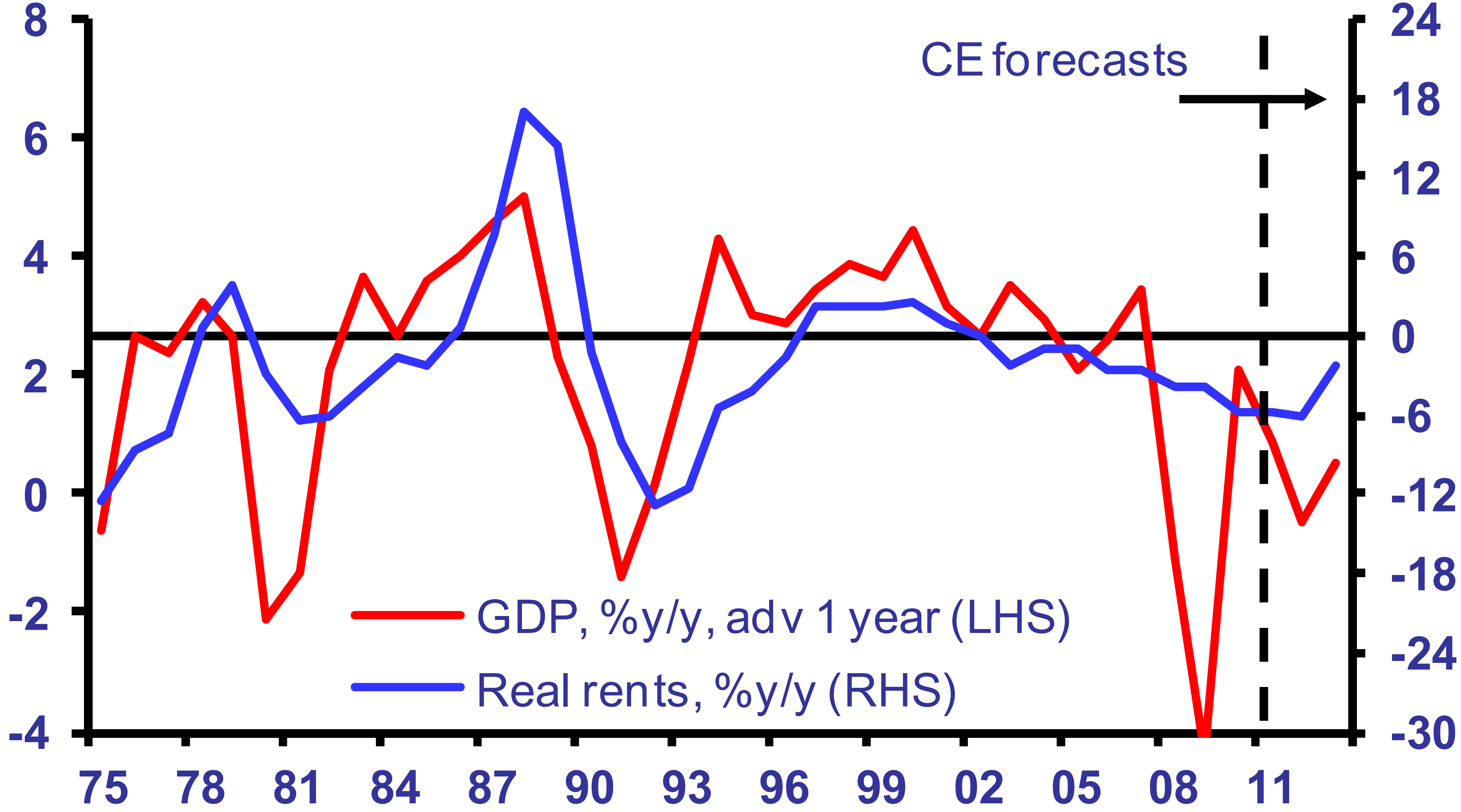
Sources: IPD, Markit, Capital Economics

37. Consumer Spending and Real Retail Rental Values (1980 – 2013)(latest = Q3 2011)



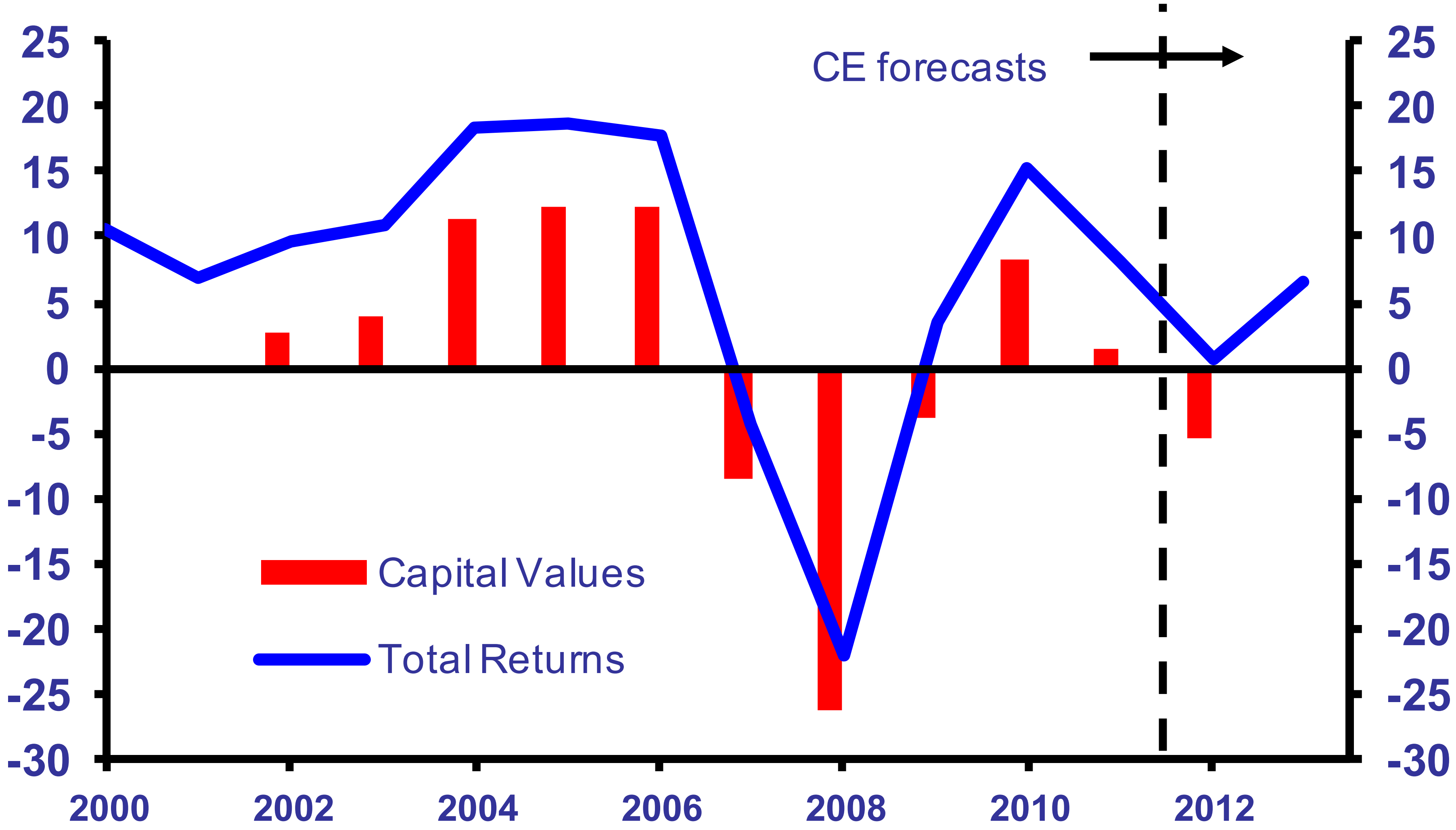
Sources: IPD, Thomson Datastream, Capital Economics

38. Real GDP and Real Industrial Rental Values (1975 – 2013) (Latest = Q4 2011)



Sources: IPD, Thomson Datastream, Capital Economics

39. All-Property Capital Values and Total Returns (%y/y) (2000- 2013) (Latest =2011)



CAPITAL ECONOMICS

Sources: IPD, Capital Economics

40. Conclusions

- Asia to continue to grow strongly.
- The US, euro-zone and UK will continue with austerity and face a long slog back to prosperity.
- The euro will not survive in its present form.
- Inflation will fall sharply.
- Interest rates will remain at near-zero for years.
- Bonds overvalued but will probably rise further.
- Outside the US, equities reasonably valued.
- UK commercial property is at fair value.

CAPITAL ECONOMICS

The Economic Outlook

By
Roger Bootle

CAPITAL
ECONOMICS