



Economic Outlook: How is the current financial and economic situation affecting consumers, debtors and creditors

2nd December 2011



Structure of the presentation



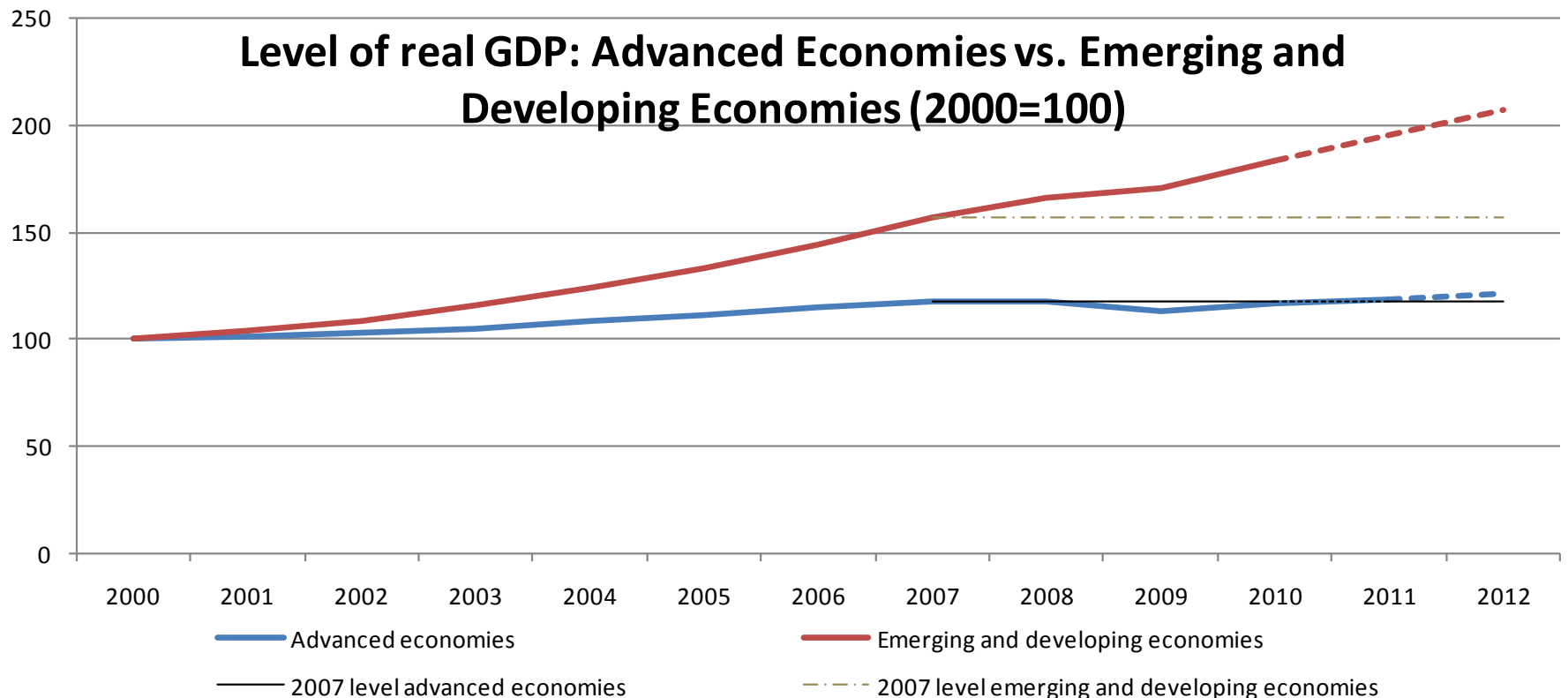
- ❑ General world-wide context
- ❑ A perspective on recent economic developments
- ❑ Where is the UK economy heading
- ❑ Outlook for secured and unsecured debt



The world economic environment – 2 very different outcomes



Growth in advanced economies has remained essentially flat while emerging economies are closing the gap rapidly

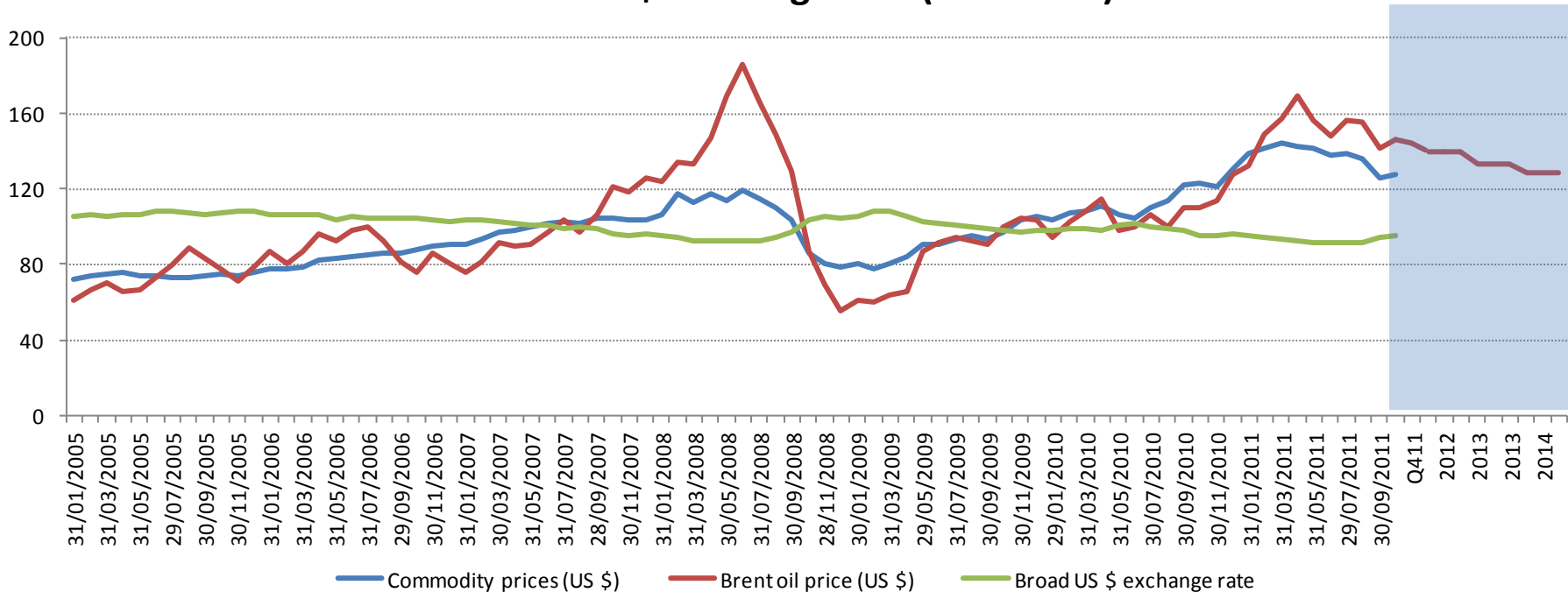


The world economic environment – commodity prices



Commodity prices have continued to rise – and remain historically high . Given the broad constancy of the US\$ exchange rate, this will result in a deterioration of the UK Terms of Trade - and will result in reduced standards of living

Index of commodity prices (US \$, CRB), Brent crude oil price (US \$) and broad US \$ exchange rate (2007=100)



A perspective on economic growth after a financial crisis



- ❑ Economic recovery in advanced economies affected by financial crisis **likely to be slow and extend over a number of years**

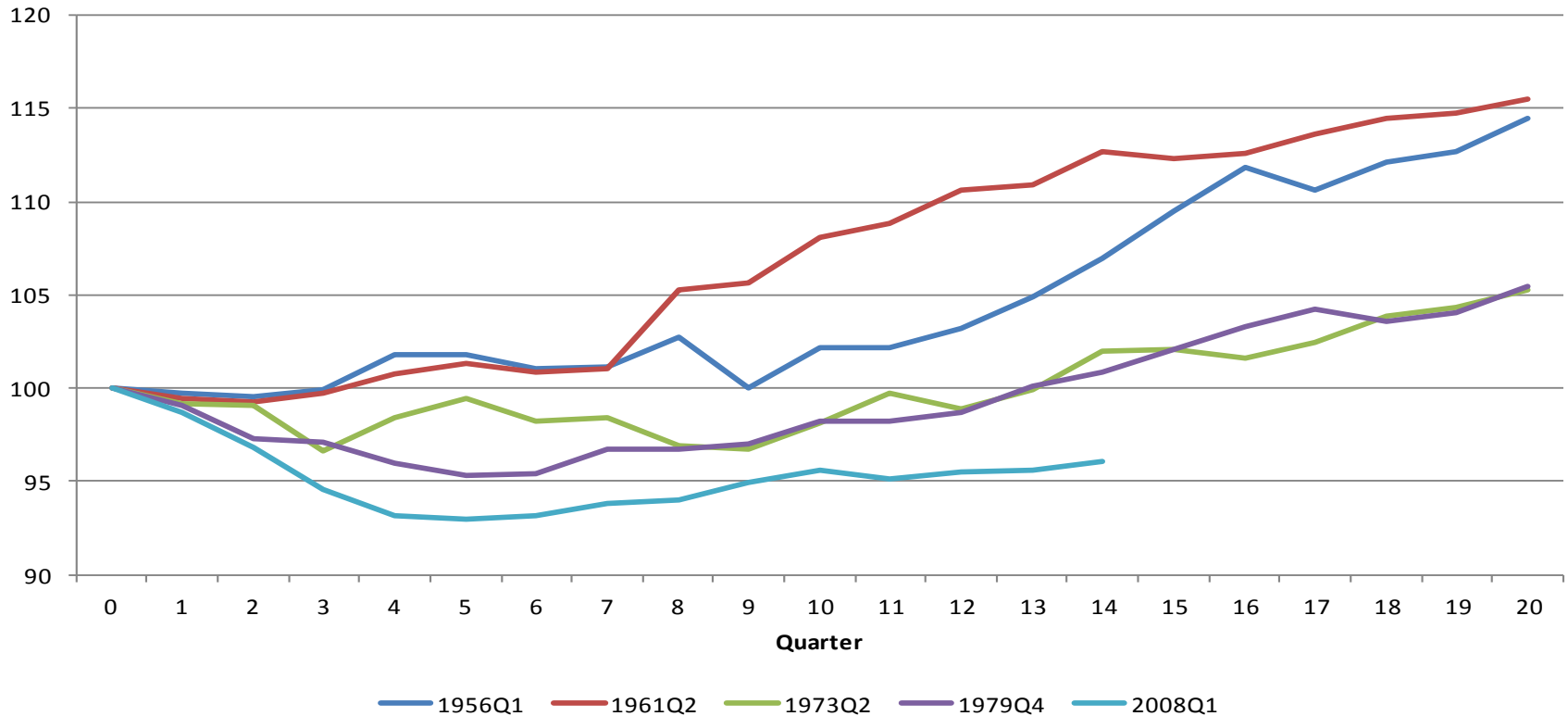
- ❑ Research undertaken at the IMF found that:
 - a **typical recession in advanced economies** lasts almost **4 quarters** and is associated with an output drop from peak (i.e. onset of recession) to trough of about **2.5%** on average and, on average, the **recovery** to pre-recession level takes **often 5 quarters**
 - however, while a **recession with severe credit crunch/house price bust** also lasts about 4 quarters on average, the output drop from peak to trough is much larger – between **5%** in the presence of a severe house price bust, to **10%** in the presence of a severe credit crunch
 - Recovery in these circumstances is much slower than typical recovery

The UK economy – a perspective on recent developments



In previous UK recessions, output recovered relatively quickly after modest falls. This recession is deeper and longer lasting than previous recessions, with no recovery in sight

Level of GDP at constant prices, n quarters following peak quarter



The UK economy – a perspective on recent developments



The current recession has seen a deeper drop from peak to trough and 9 quarters after the low point, there is still a way to go before re-attaining the 2008Q2 level of economic output

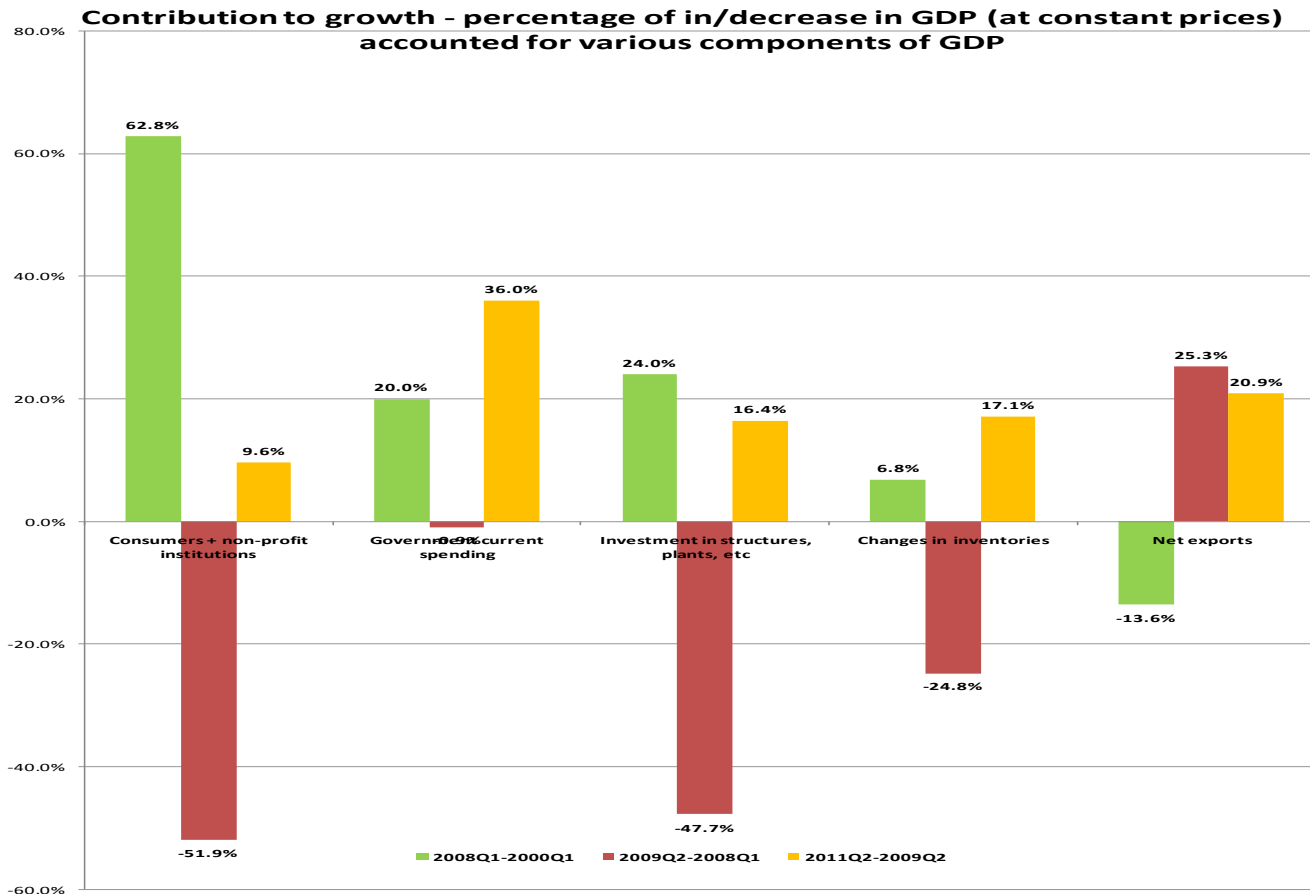
Quarter before start of recession	1956Q1	1961Q2	1973Q2	1979Q4	2008Q2
Percentage decrease in GDP (at constant prices) peak to trough	-0.5%	-0.7%	-3.4%	-4.7%	-7.1%
Number of quarters of negative growth	2	2	3	5	5
Number of quarters from trough to previous peak level	2	2	11	8	?
Percentage increase in GDP (at constant prices) 9 quarters after trough (9 quarters = 2011Q3 in 2008Q2 recession)	2.7%	9.7%	2.4%	5.9%	3.3%

The UK economy – a perspective on recent developments



Growth was driven by consumers between 2000 and 2008. Negative growth between 2008 and 2009 driven by consumers and lack of investment.

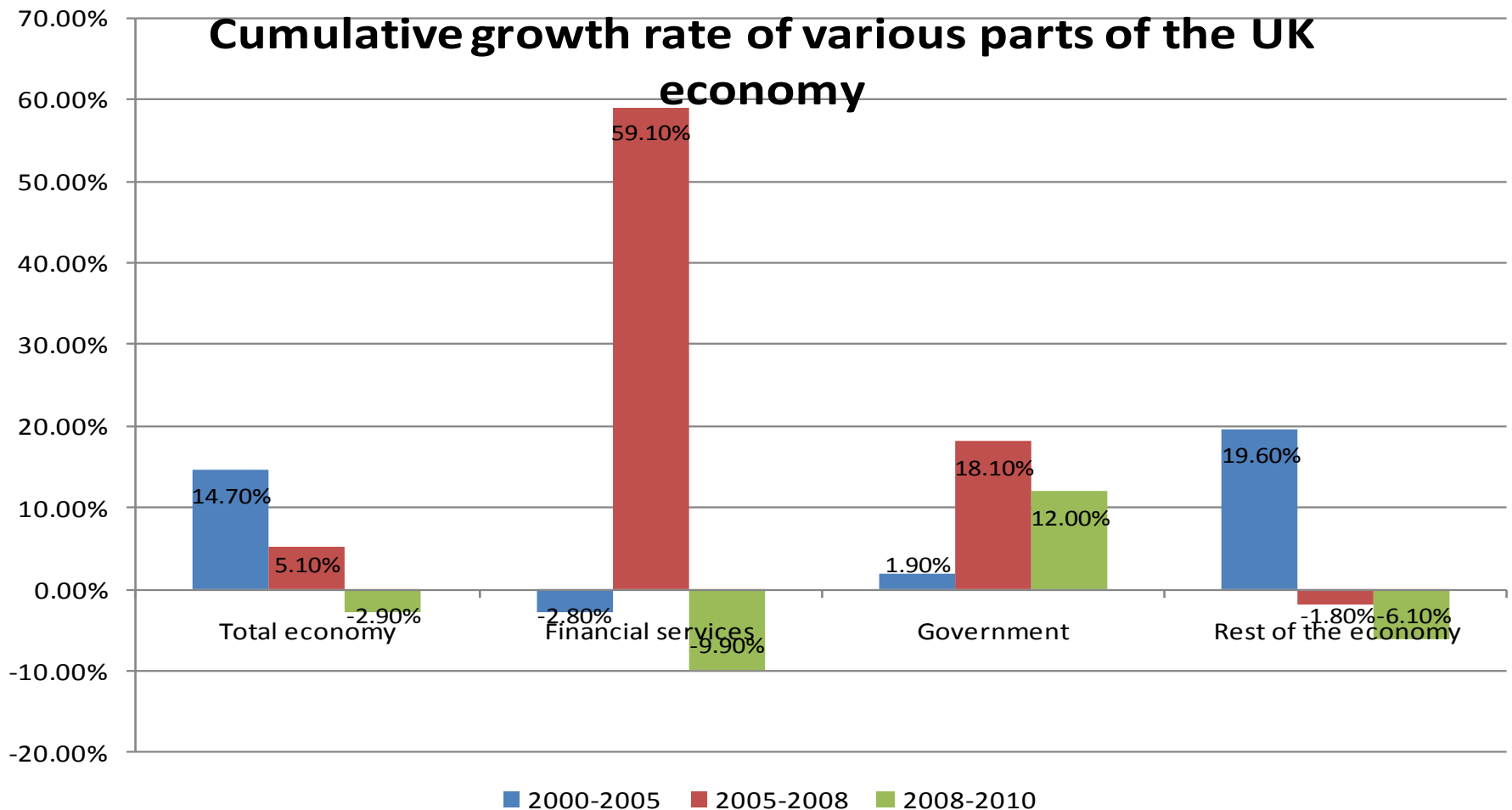
So far in the recovery, the government sector accounts for 26% of growth, which is likely to fall going forward. The erosion of consumer incomes is likely to offer a limited source of growth. This leaves the export driven sector as offering the only growth prospects



The economy, financial services and government



Growth between 2005 and 2008 was driven by the financial services sector (and the government sector to a lesser extent). The rest of the economy was already declining between 2005 and 2008

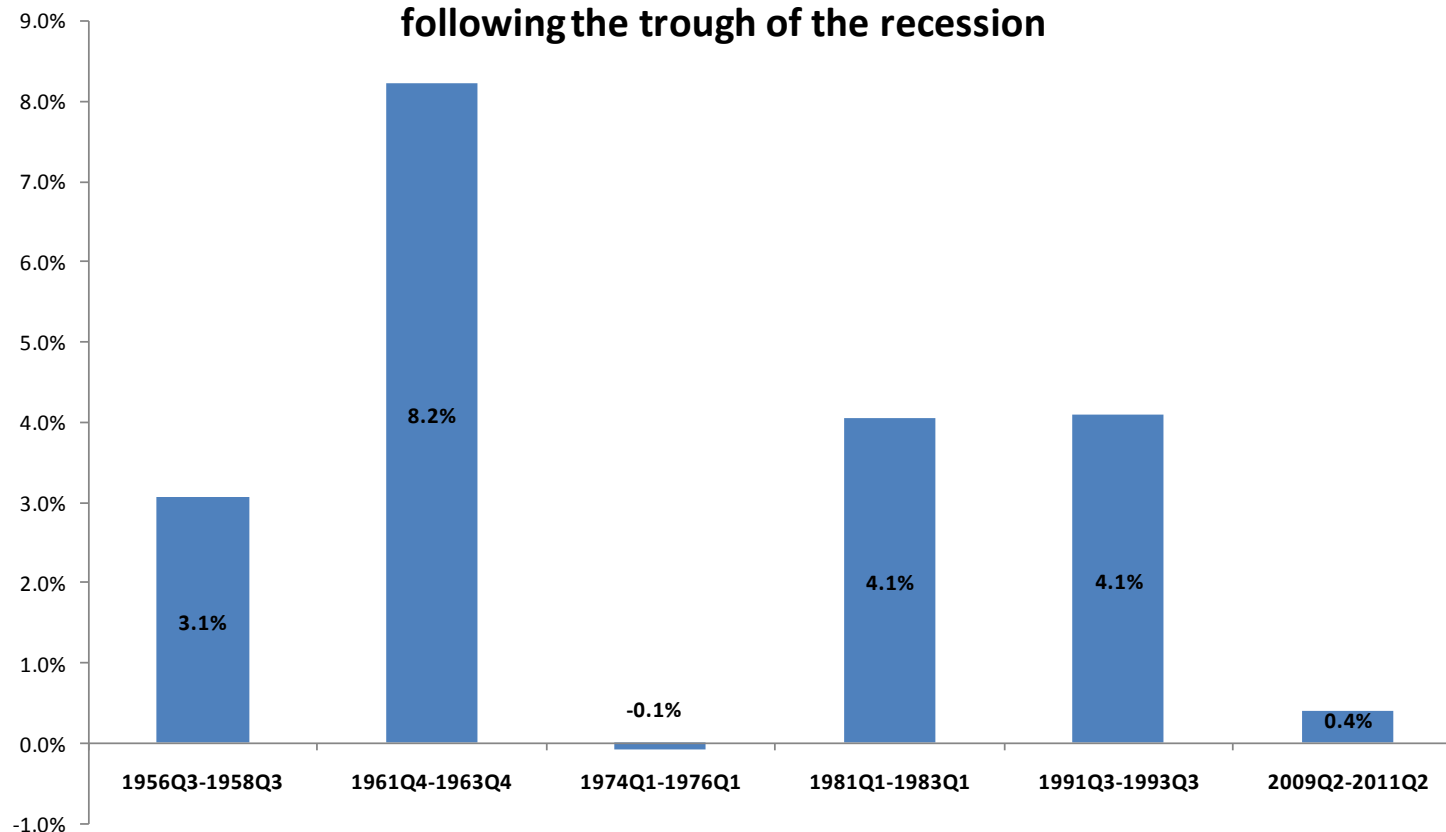


The UK economy – a perspective on recent developments



Growth in consumer expenditures remain exceptionally weak, which is unsurprising given household incomes

Cumulative growth in consumer expenditures over 8 quarters following the trough of the recession

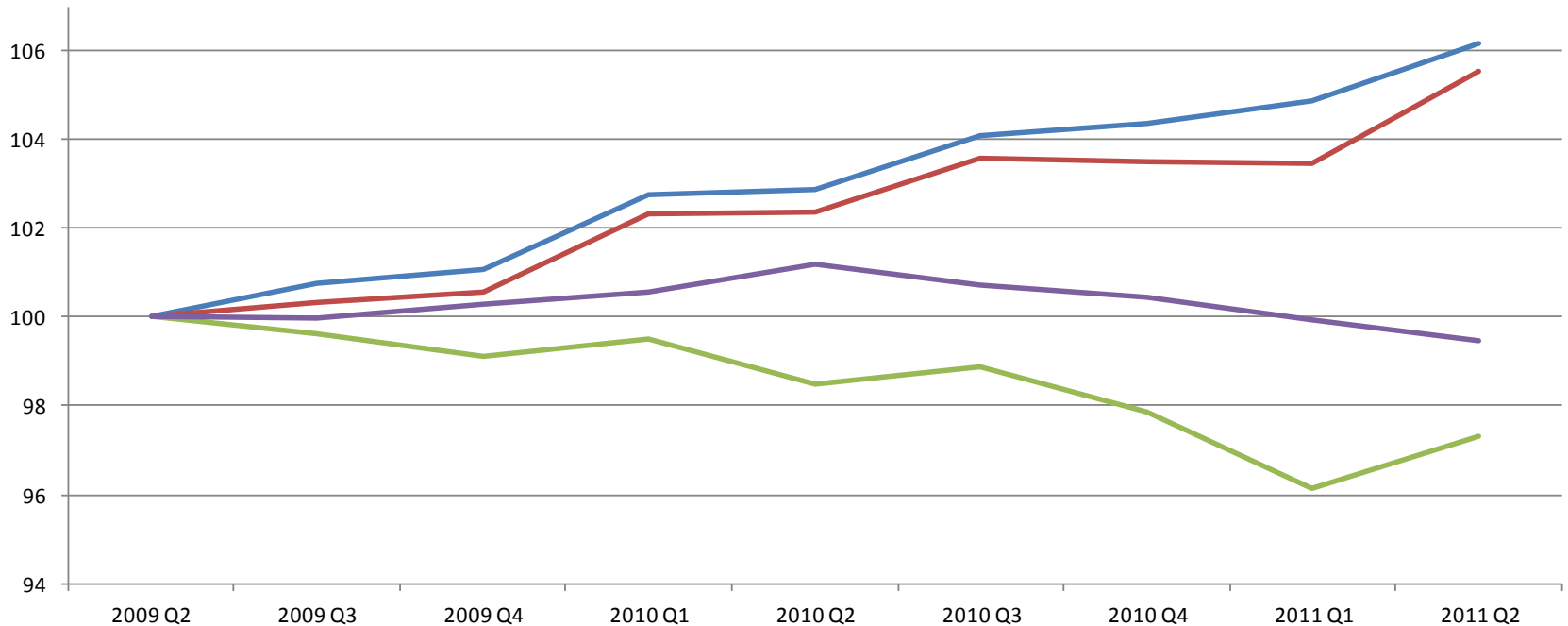


The UK economy – a perspective on recent developments



Adjusting for savings and inflation, household disposable incomes are lower in real terms 2 years after the recession trough

Household income since the through of the recession, 2009Q2=100



— Total household income

— Total household disposable income

— Total household disposable income adjusted for inflation

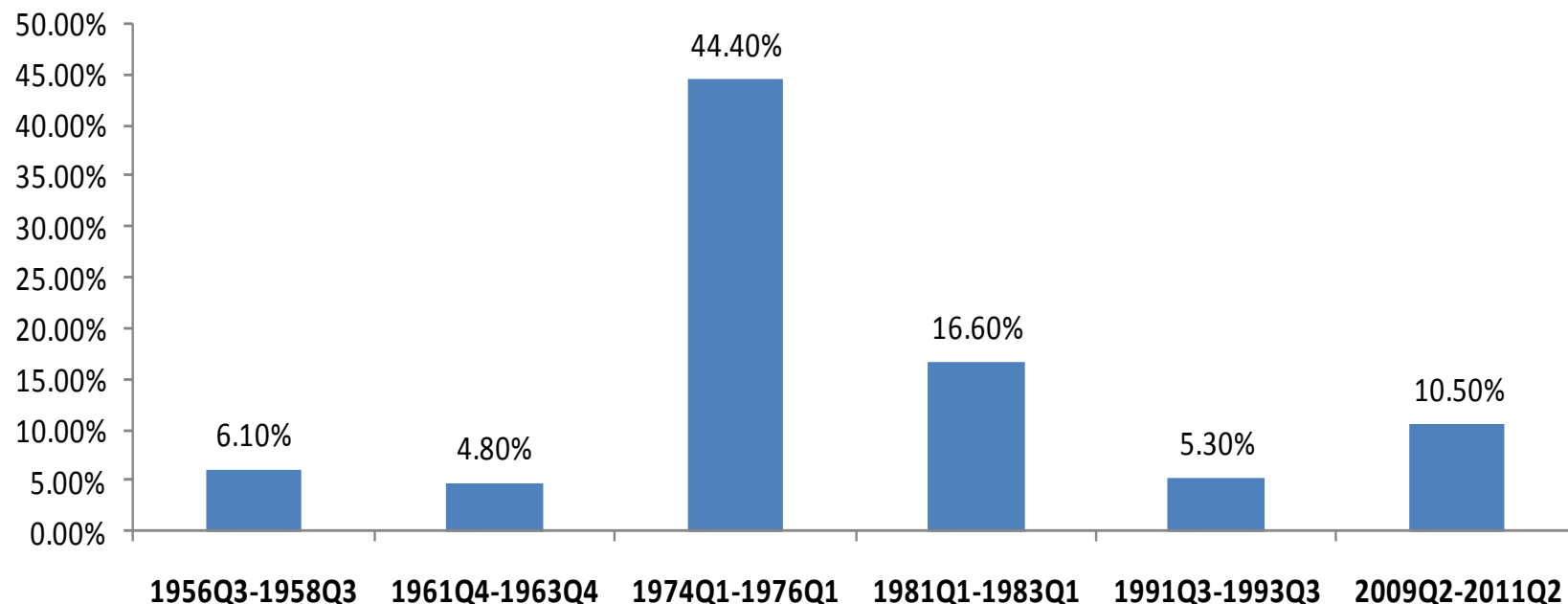
— Total household disposable income after savings adjusted for inflation

The UK economy – a perspective on recent developments



Prices have increased more than in previous recessions except those that followed high inflation periods (74-76 and 81-83)

Cumulative increase in prices (RPI) from recession through to 8 quarters later



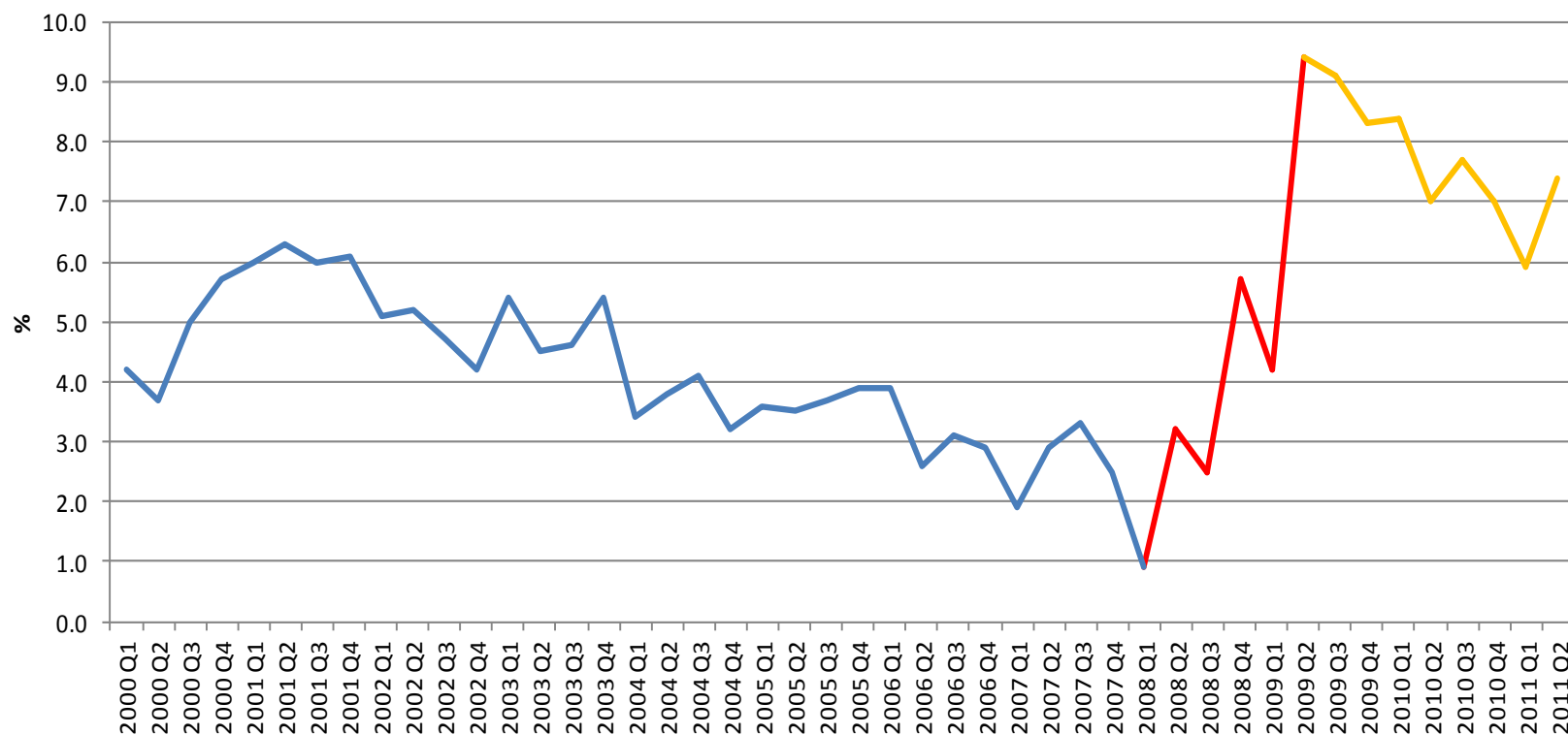
The UK economy – a perspective on recent developments



Households reaction to onset of crisis by sharply boosting their savings rate. Since then have reduced savings rate marginally to offset low income growth but savings rate remain well above pre-crisis levels

Household savings rate since 2000

Pre-recession, recession, recovery

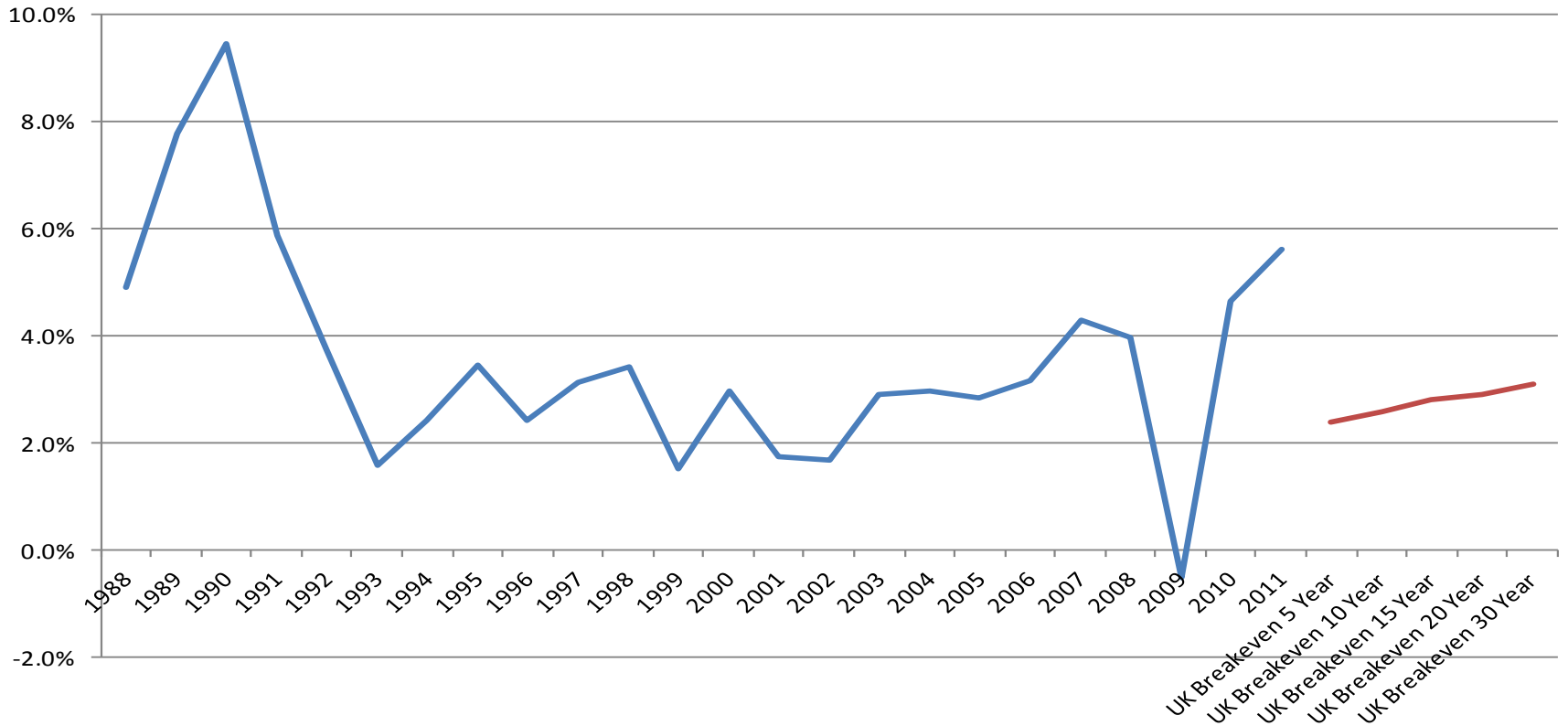


The UK economy – outlook for some key drivers of the economy and consumer spending



While inflation is currently high, financial markets expect it to fall to between 2% and 3% over the longer term

Annual inflation rate (RPI) and **expected inflation**

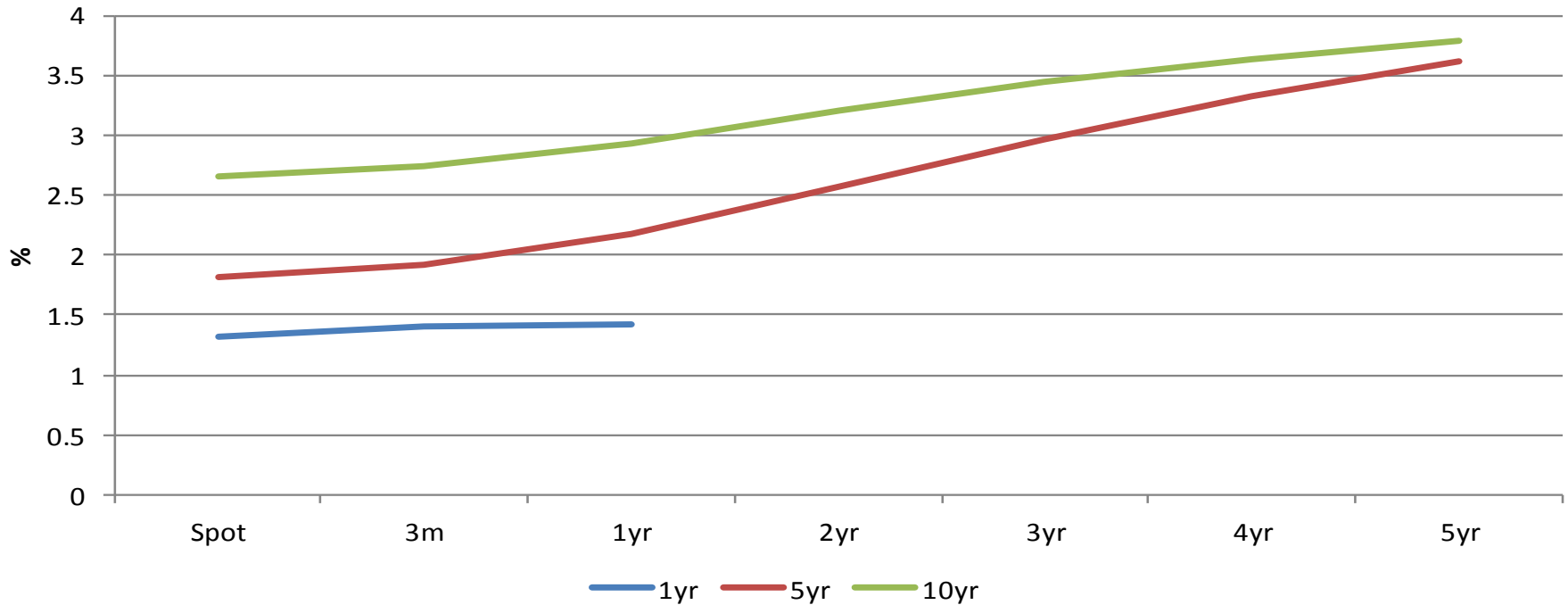


The UK economy – outlook for some key drivers of the economy and consumer spending



Nominal interest rates are expected to return gradually to more normal levels

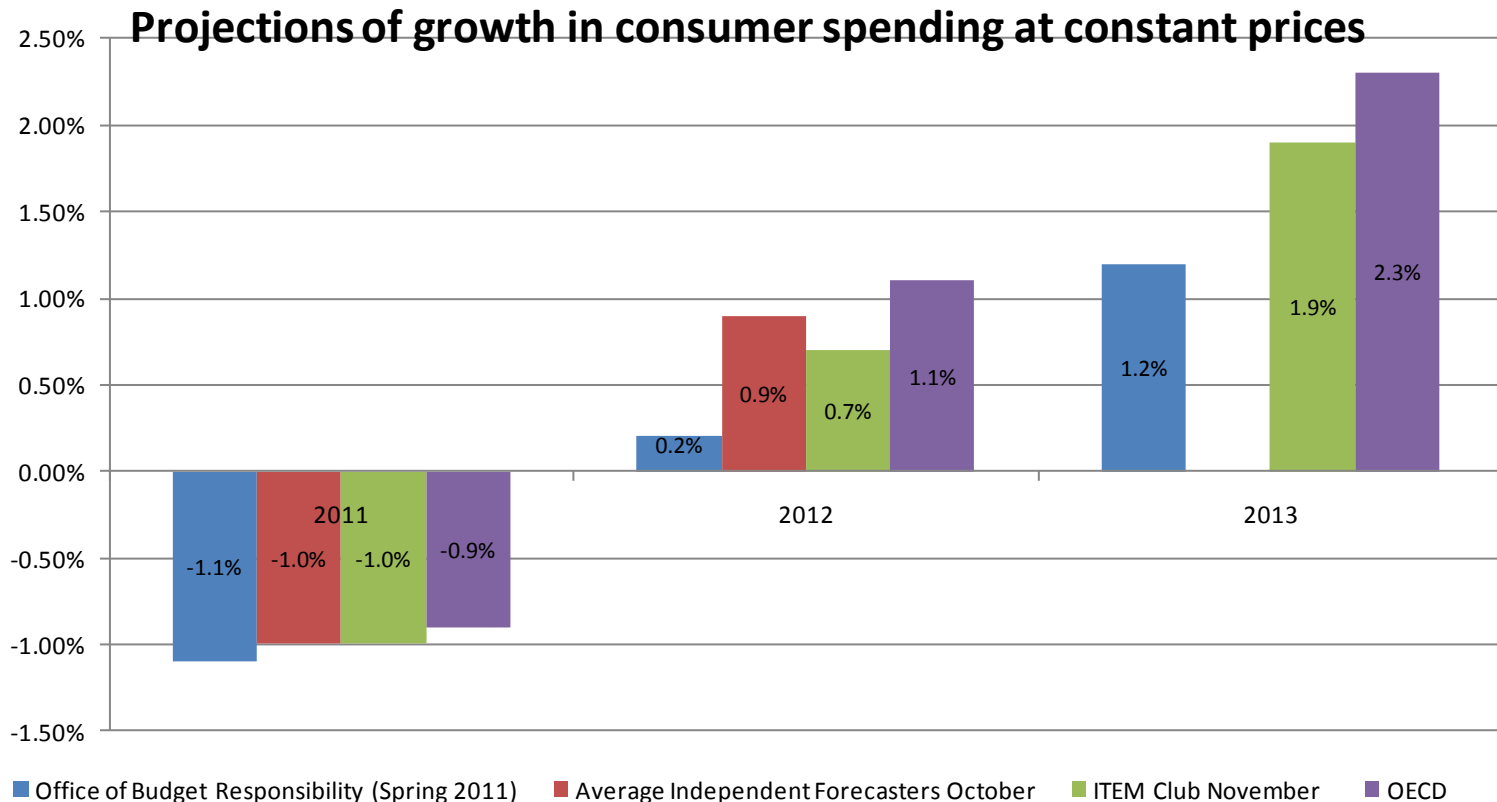
Spot and forward rates for different tenors



The UK economy – economic outlook



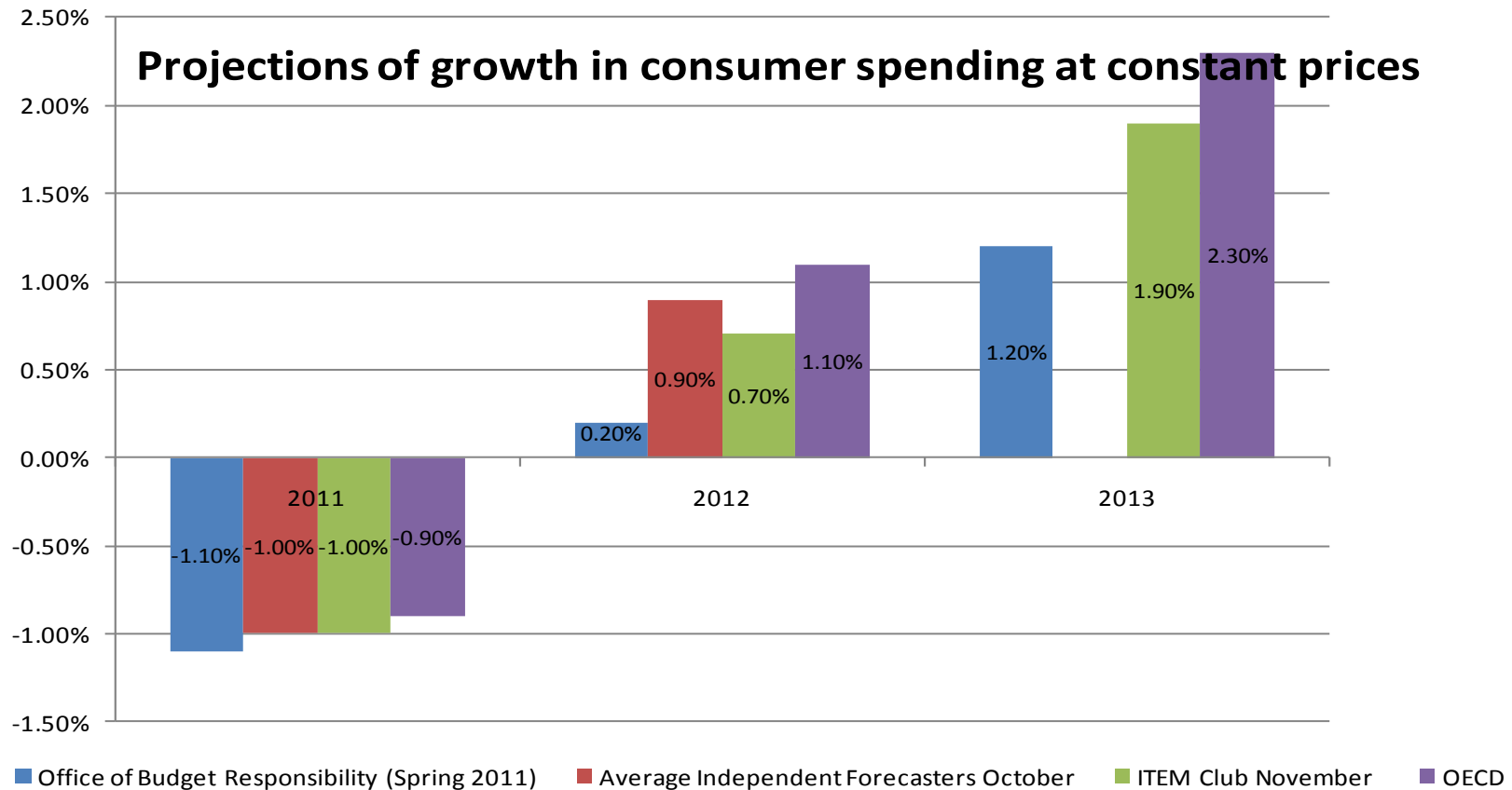
Overall, economic outlook remains very weak for 2012 and minimal improvement expected in 2013 – not enough to close the output gap



The UK economy – economic outlook



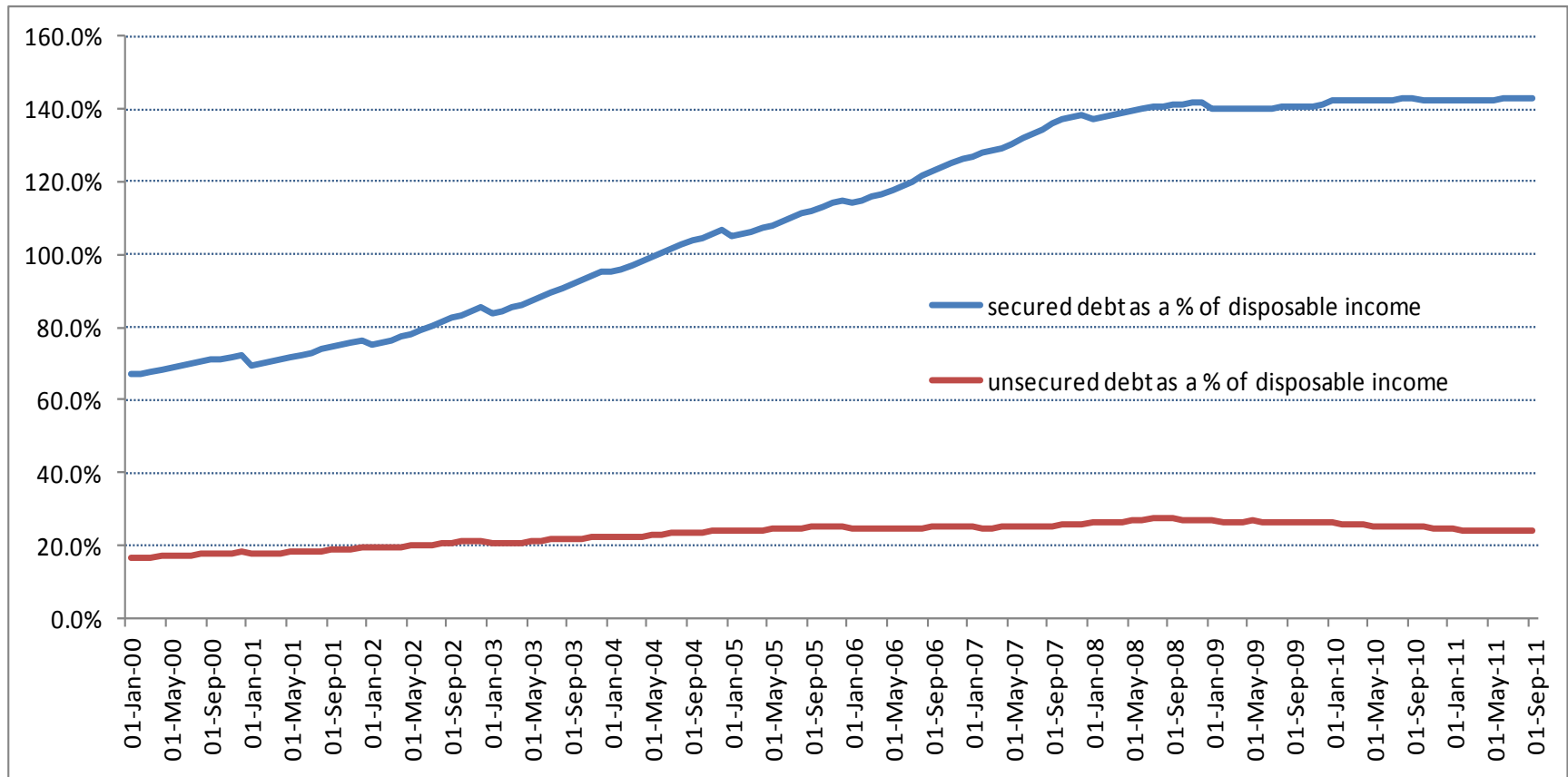
Consumption continues to be held back by lack of real income growth



Ratio of household secured and unsecured debt to household disposable income



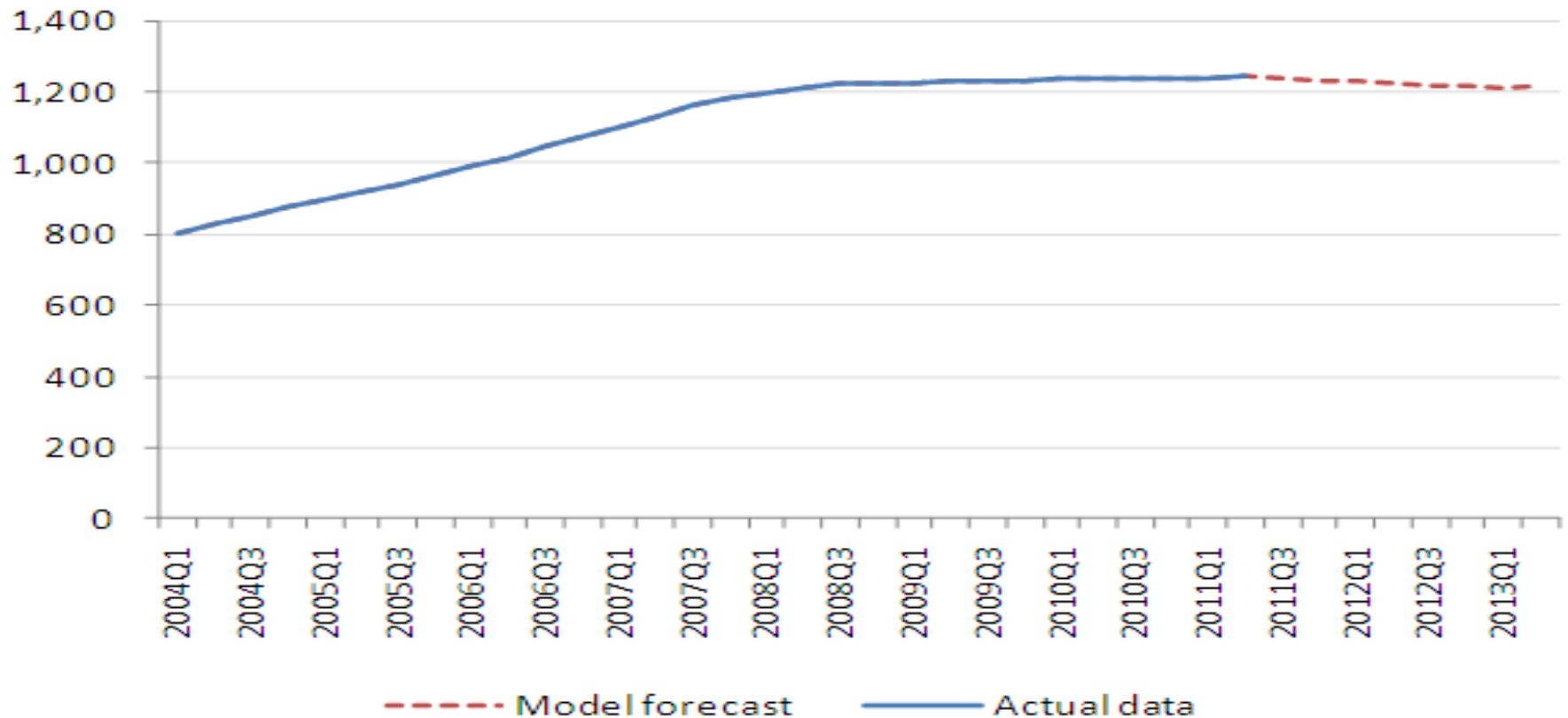
Secured debt as % of household disposable income stabilised at high levels while unsecured debt fell back to 2004 levels



Forecast of level of household secured debt (£bn)



Level of secured debt is expected to decline slightly in 2102 and 2013



Forecast of level of household unsecured debt (£bn)



Decline in level of unsecured debt is expected to continue as well but at a more moderate pace than over past 3 years

