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The Economic Outlook for 2010

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Overview

- Review of recent data:
 - UK has been one of the stragglers...
 - ...but the recovery is now finally under way
- Does this mean that the Bank of England has done enough?
- What profile will the recovery have?
- Risks to the outlook – alternative scenarios

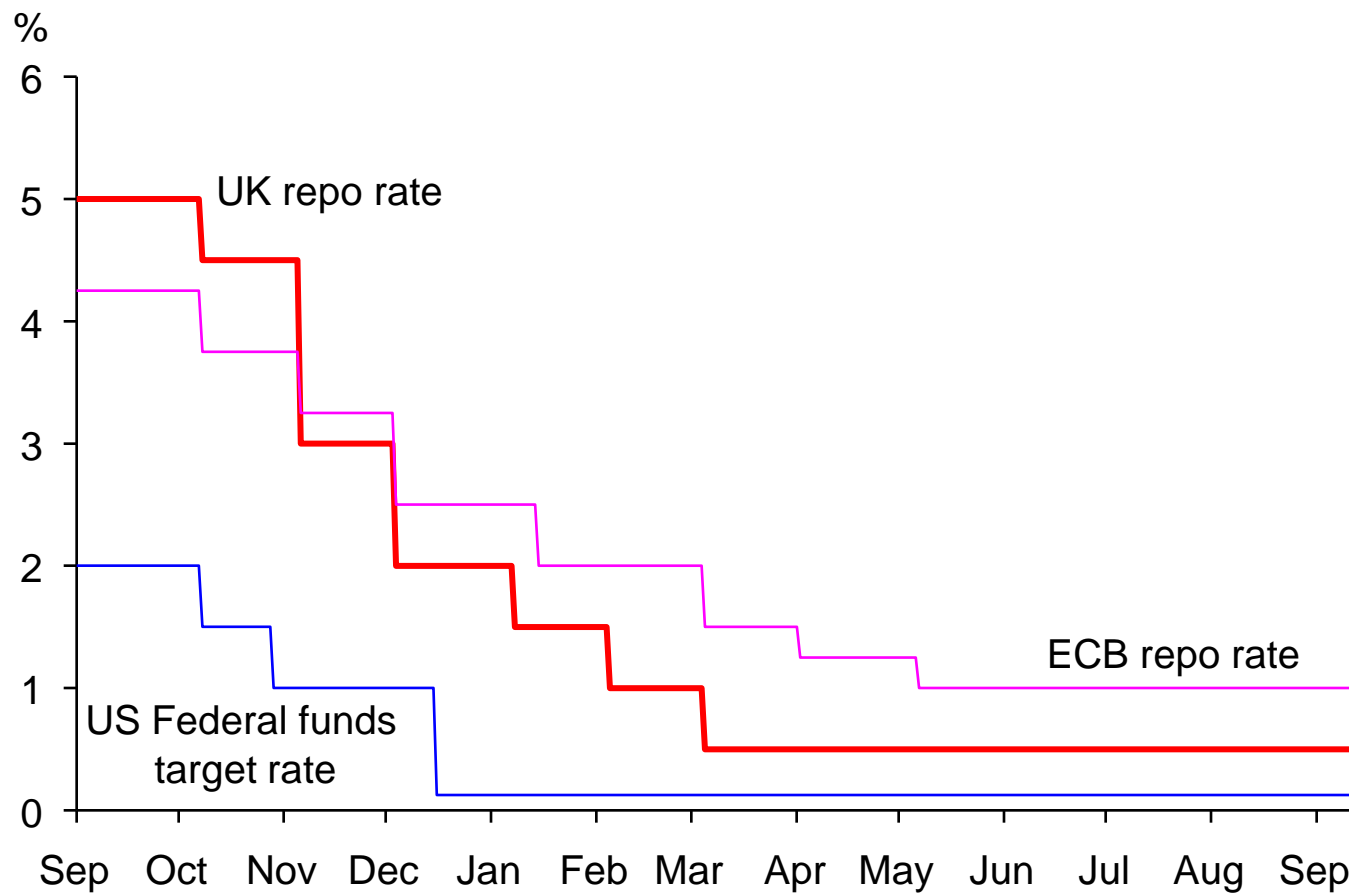
OUTLINE

- Brief recap of economic events
 - First year of the credit crisis: mild recession and global decoupling
 - Second year of the credit crisis: deep and synchronised global downturn
 - Third year: massive policy response leads to stabilisation
 - Fourth year: economic recovery?

- Future prospects
 - Outlook for interest rates, exchange rates, commodities
 - Recovery to become widespread in 2010?
 - The shape of the UK recovery: export led, manufacturing based?
 - Which industry sectors are likely to outperform?

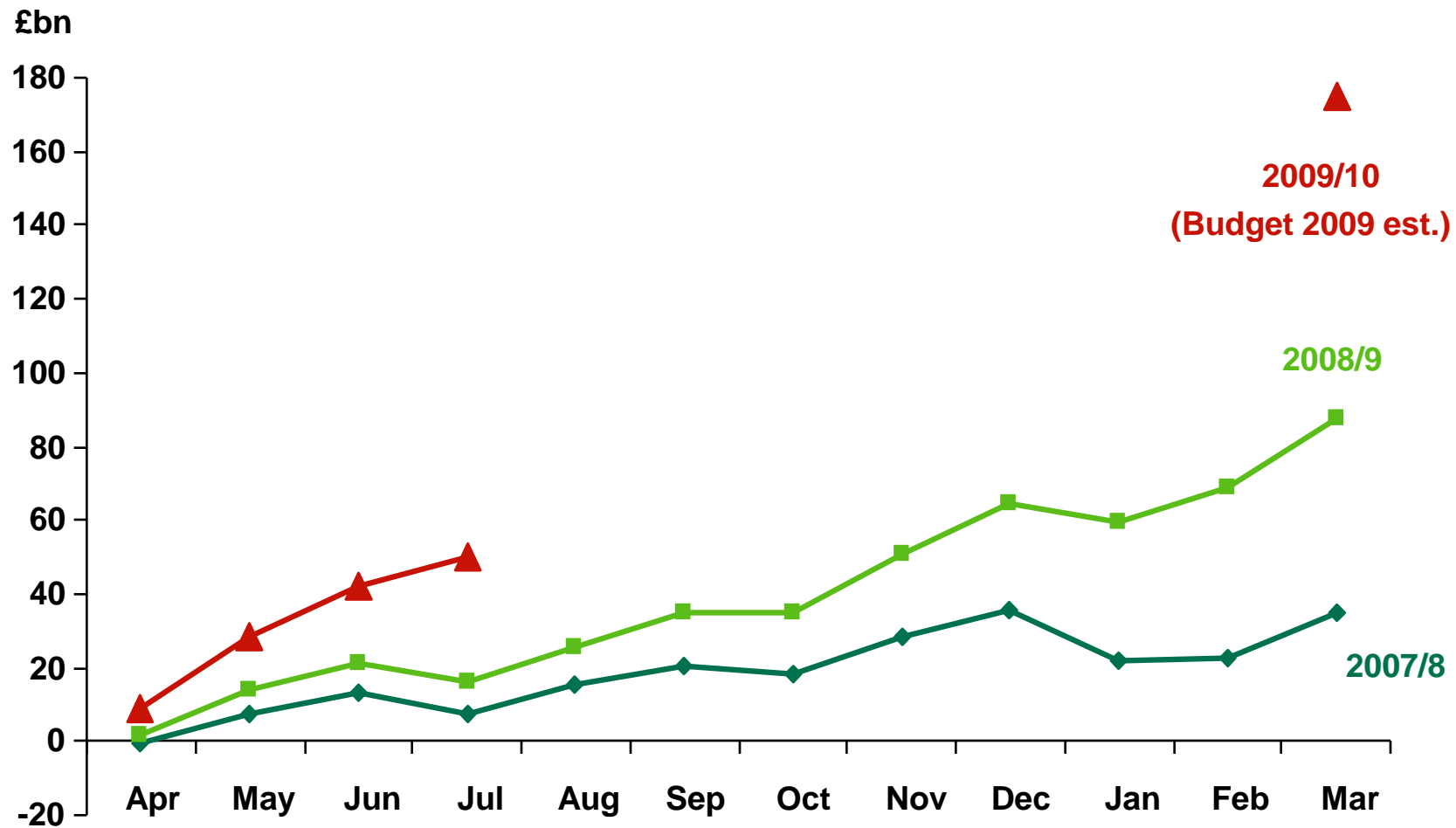
Fast and aggressive monetary response in late-2008...

Official interest rates



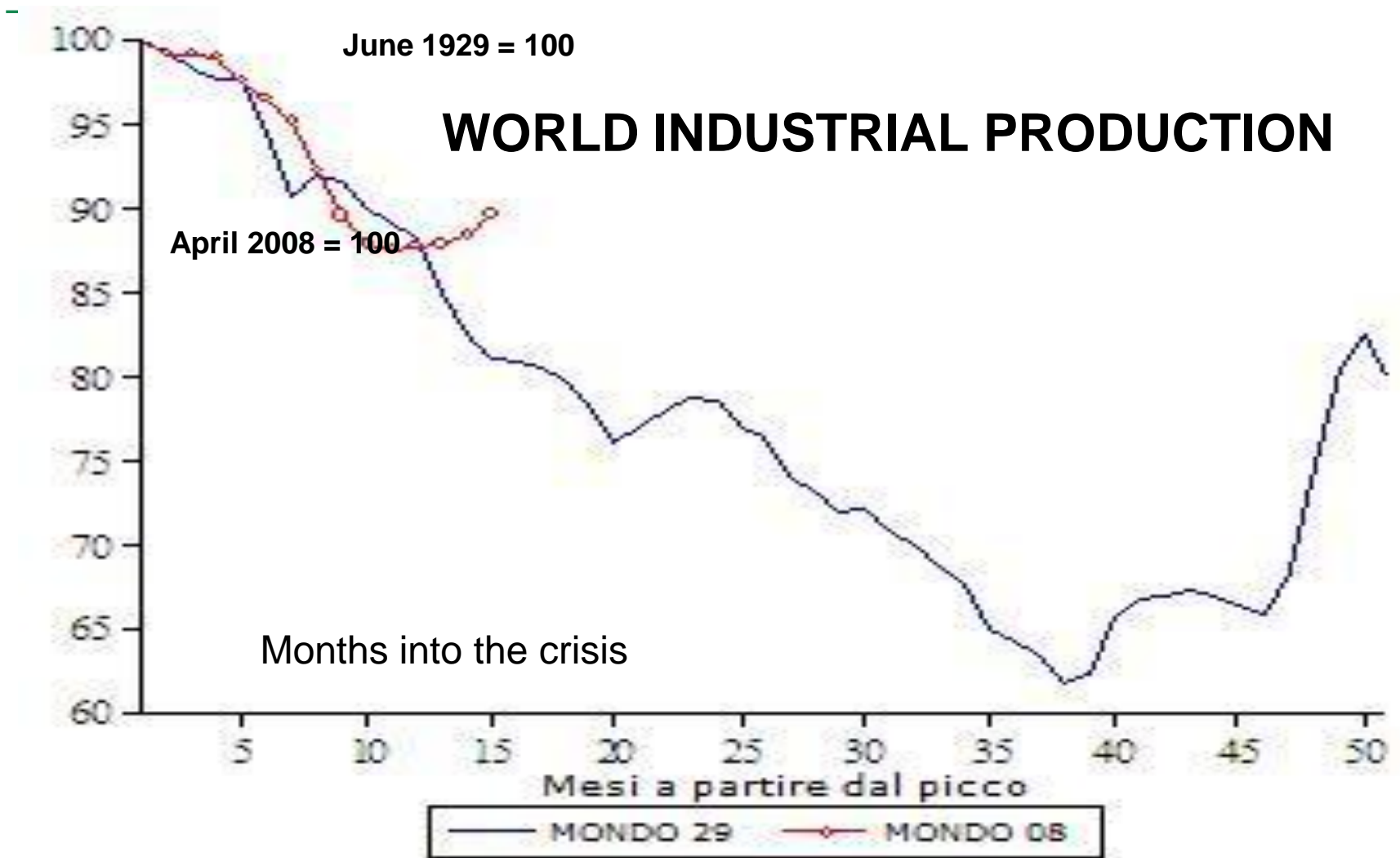
Source : Haver Analytics

Aggressive fiscal stimulus....

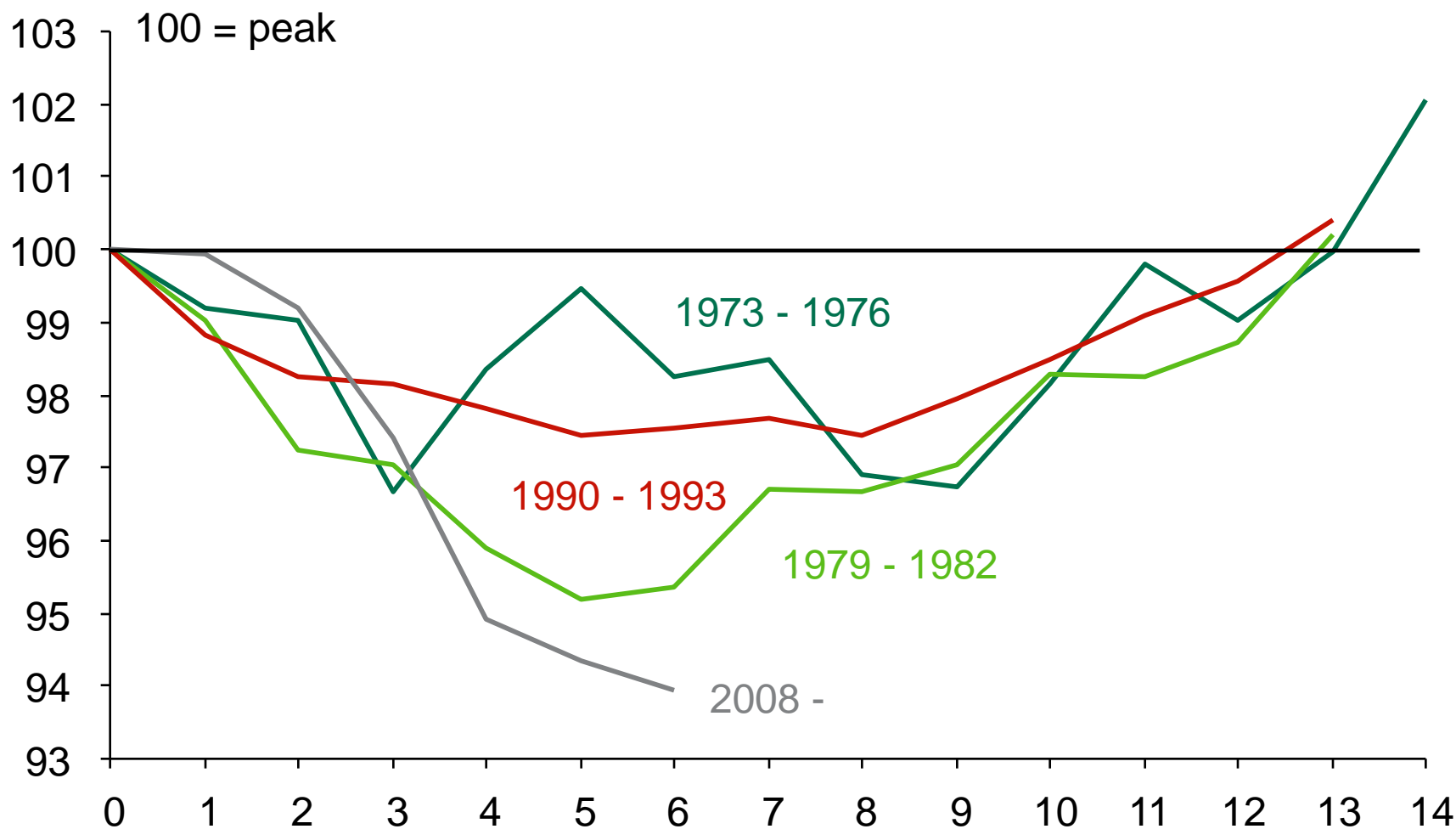


Source: LTSB Corporate Markets Economic Research and Datastream

...means 1930s style downturn has been avoided...



..but UK is in a deep downturn



Global recovery to be apparent in 2010

SHORT-TERM PROSPECTS (GDP; percentage changes)

	weight	2007	2008	2009	2010	2011
United States	23.7	2.1	0.4	-2.7	2.6	3.1
UK	3.2	2.6	0.6	-4.7	0.7	2.3
Eurozone	22.3	2.7	0.6	-4.0	0.7	1.6
East Asia*	19.4	6.7	3.3	0.1	4.2	4.9
World	100.0	3.	1.6	-2.3	2.5	3.6

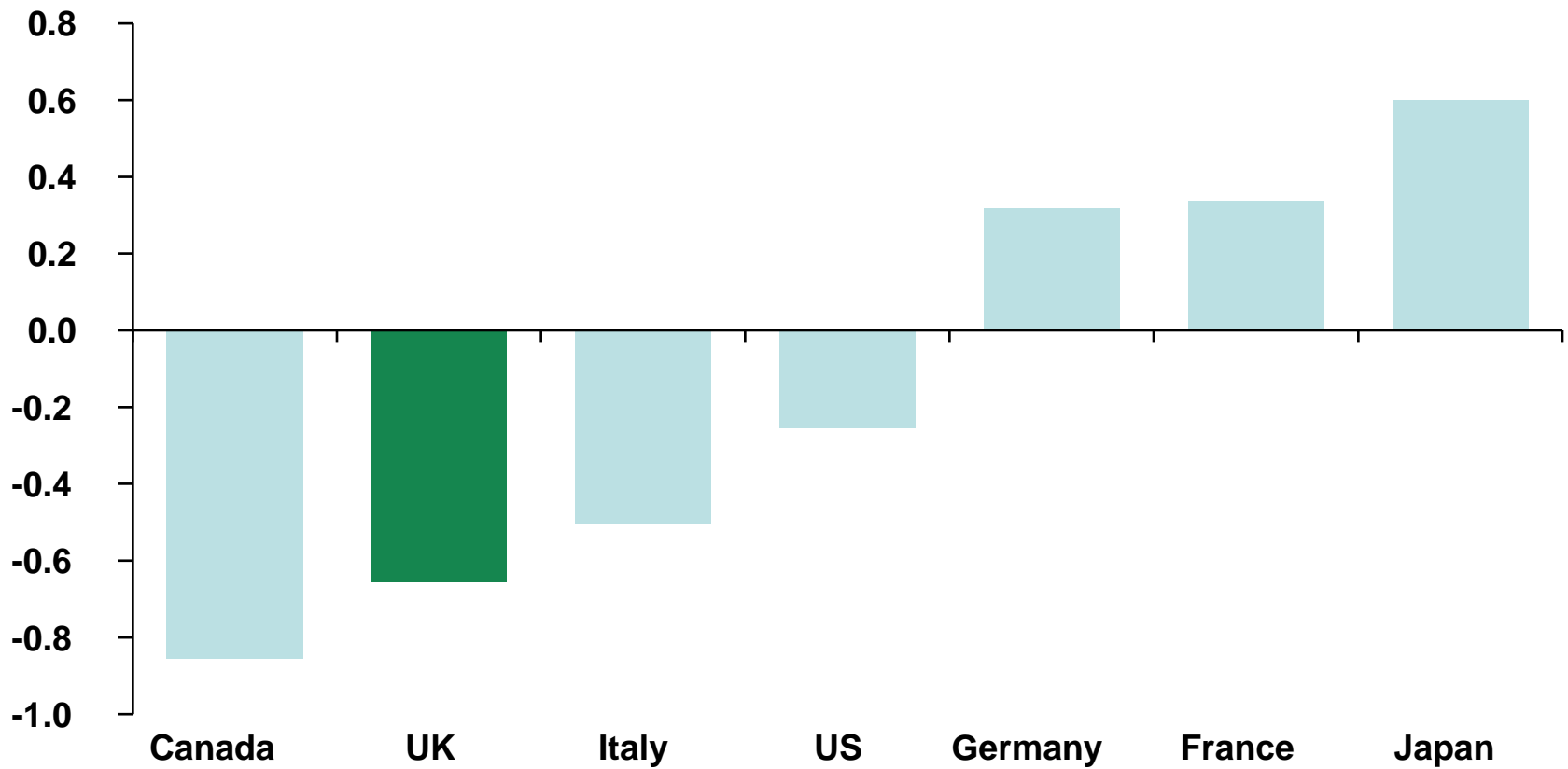
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* Including Japan.

...but UK is lagging behind...

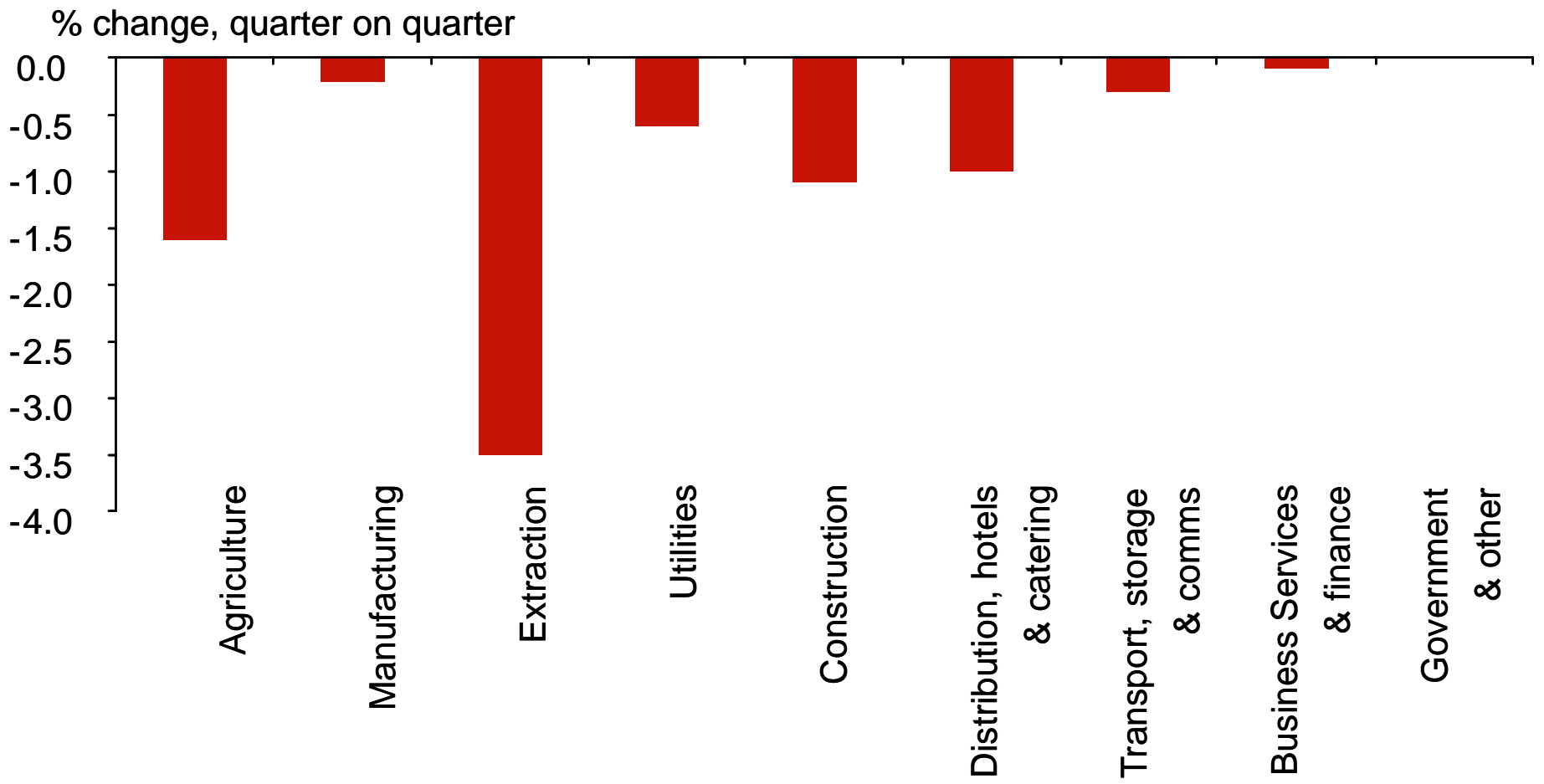
GDP growth, 2009q2

%/quarter

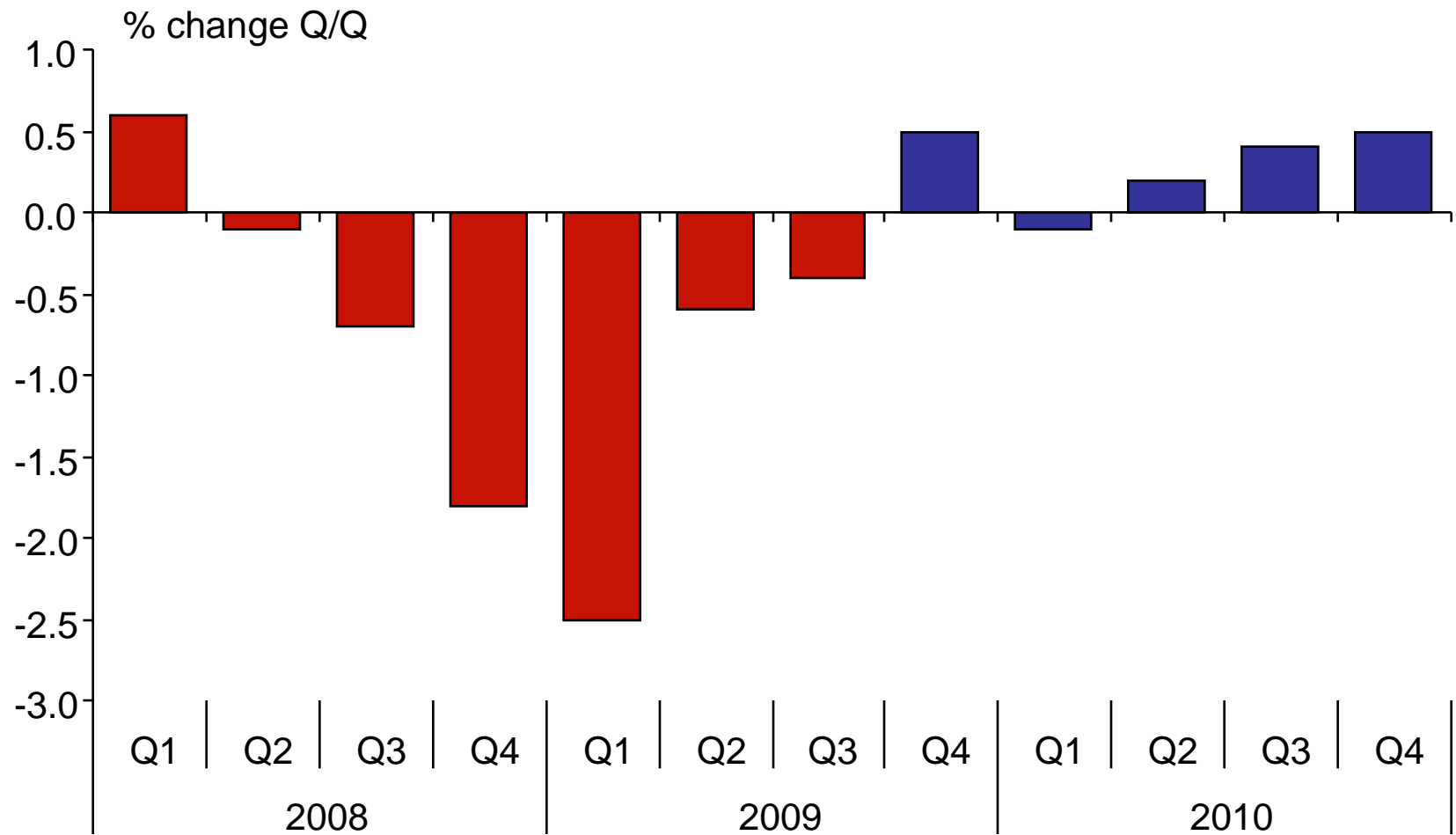


Source : Haver Analytics

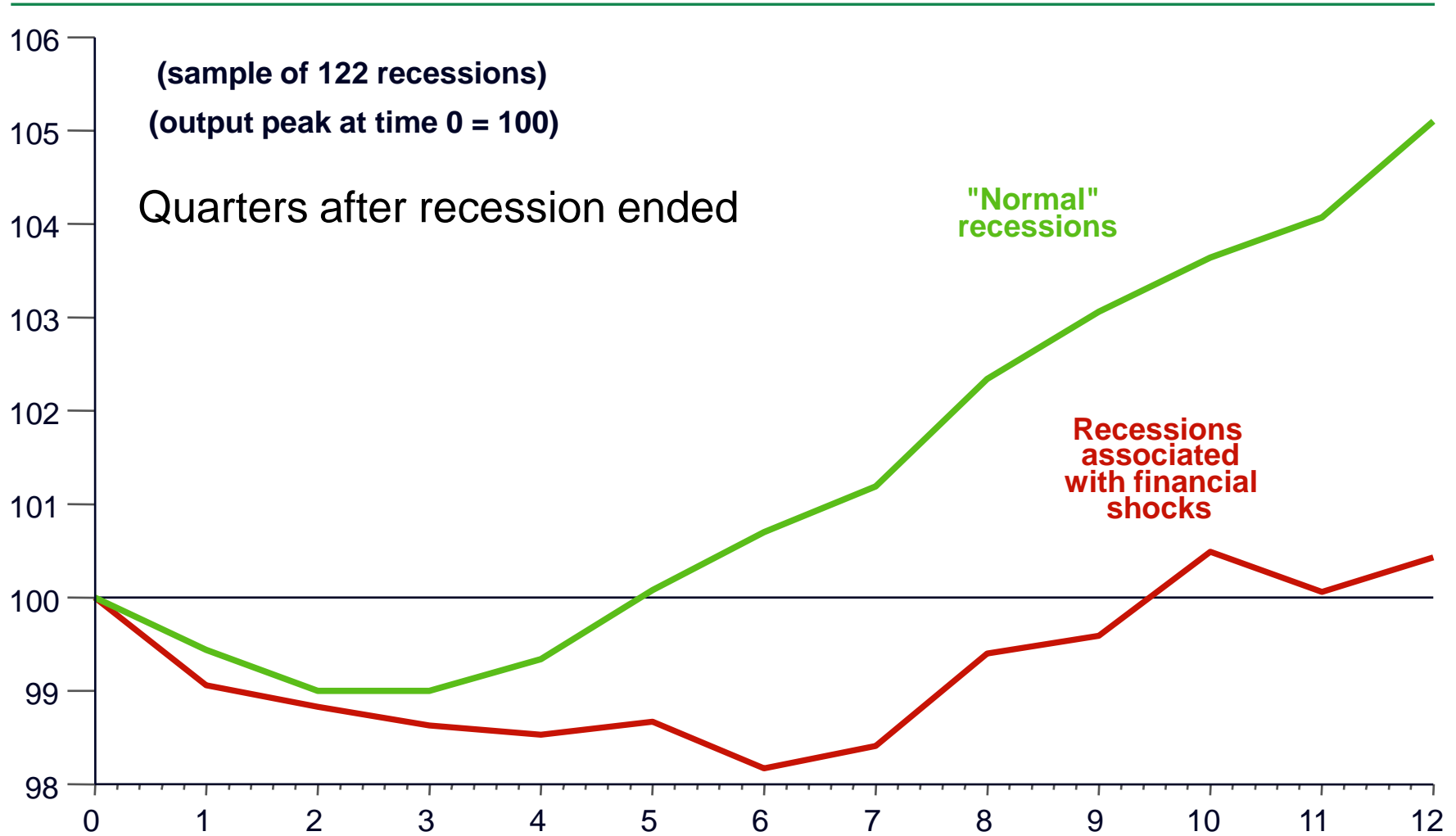
No sector saw growth in Q3...



...but a rise expected in Q4



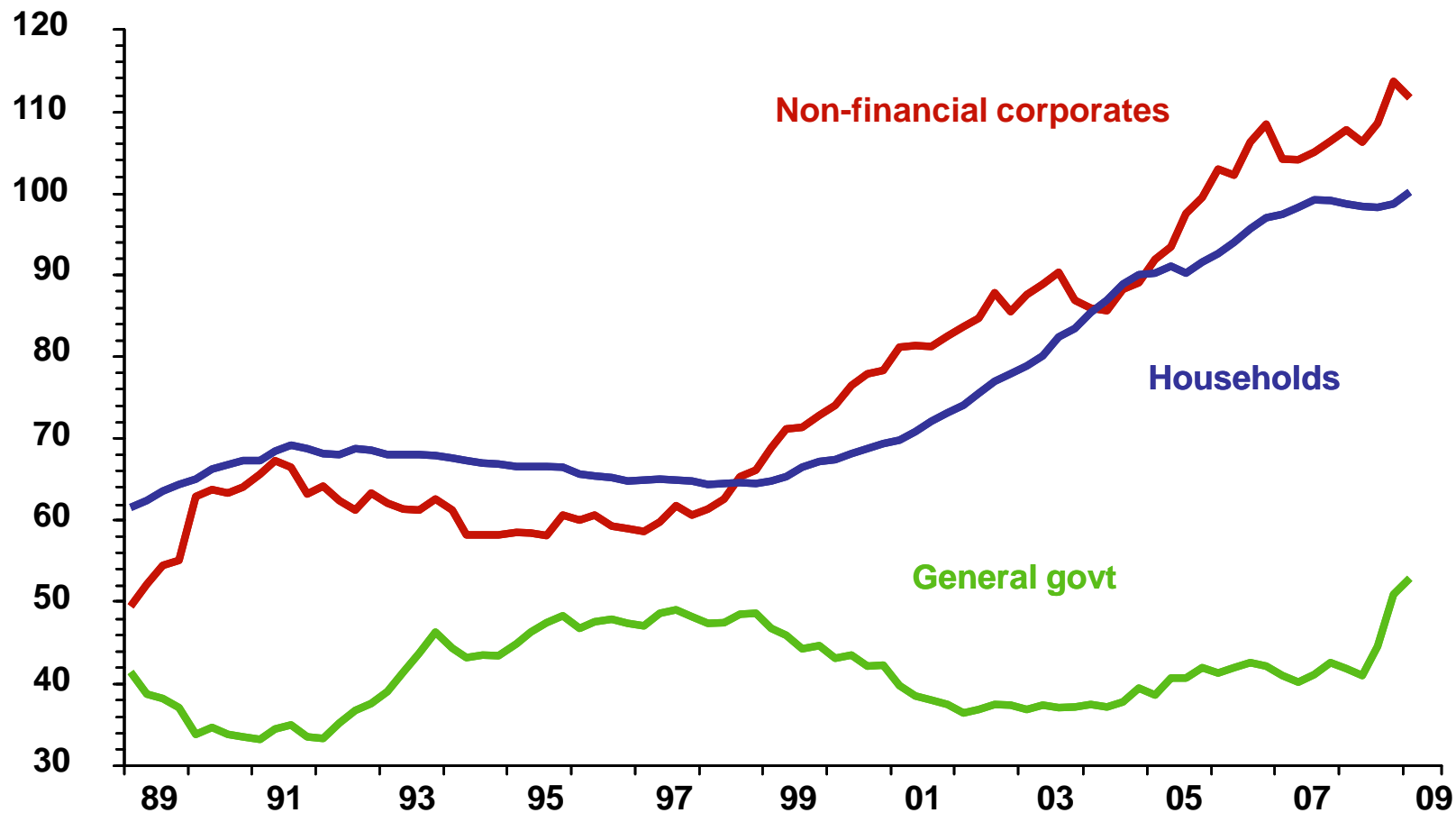
The reason is that recessions linked to financial crisis last longer and make recovery slower



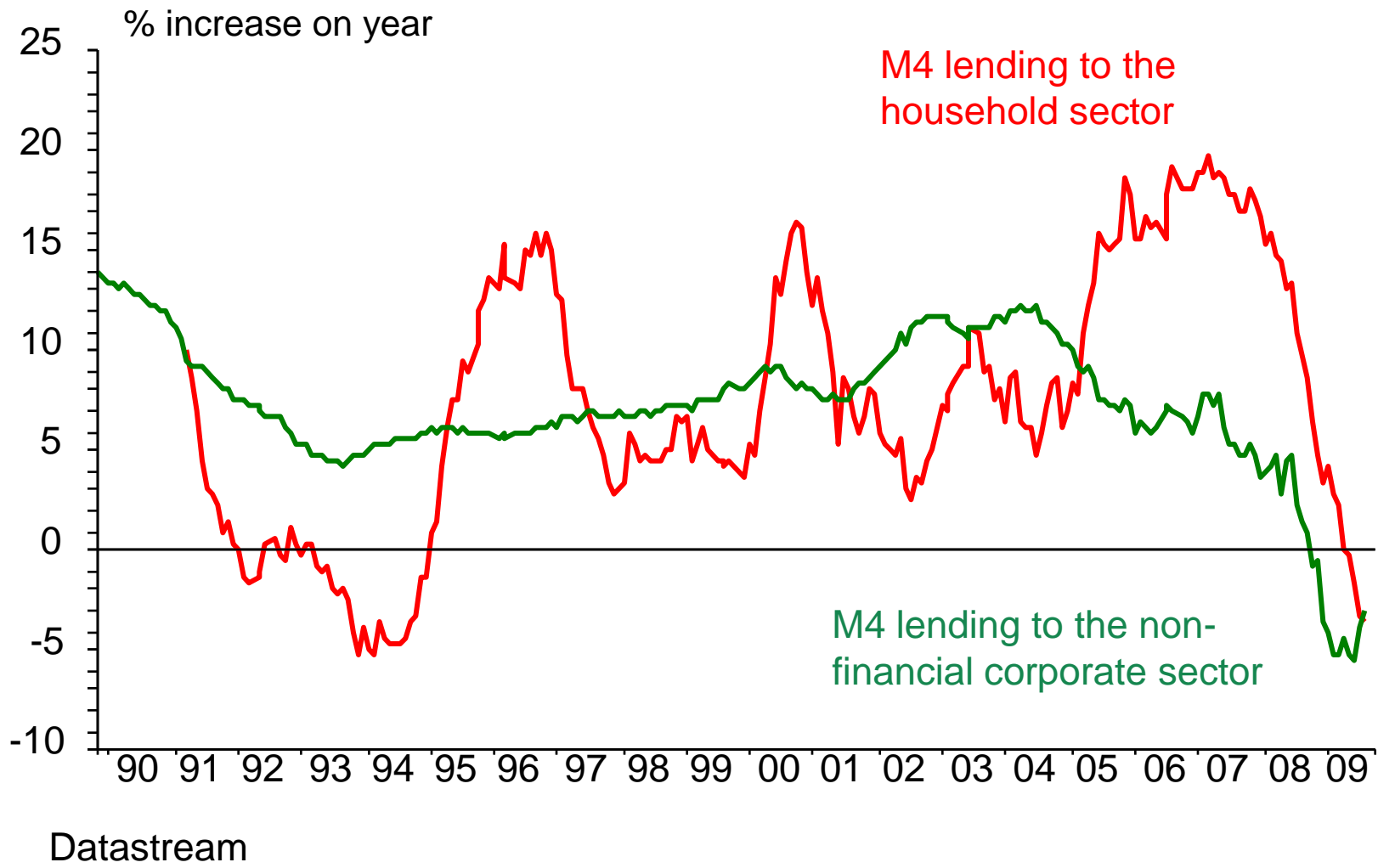
Source: IMF

UK corporate and household sectors need to deleverage

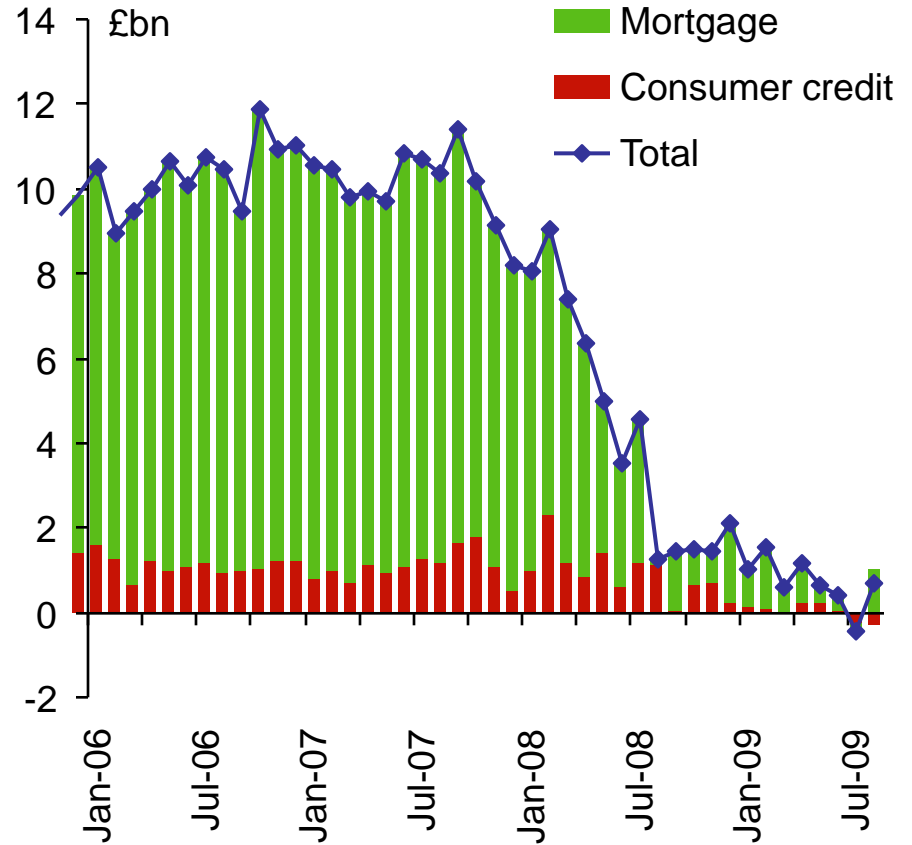
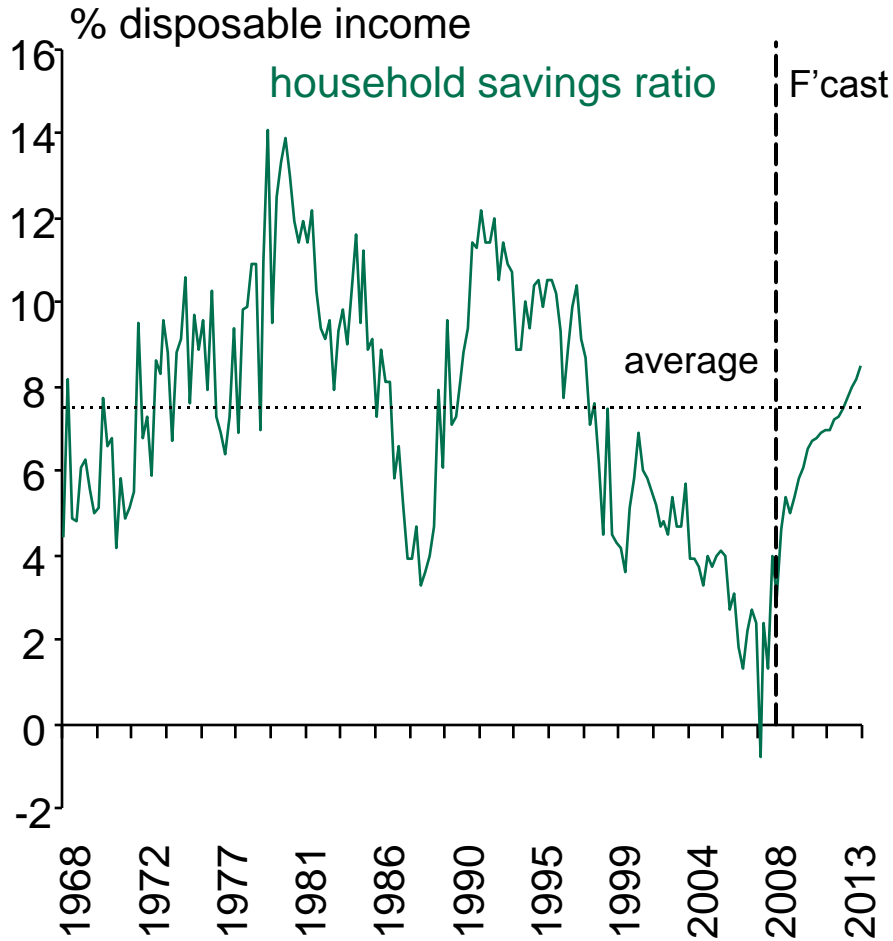
%, Debt/GDP



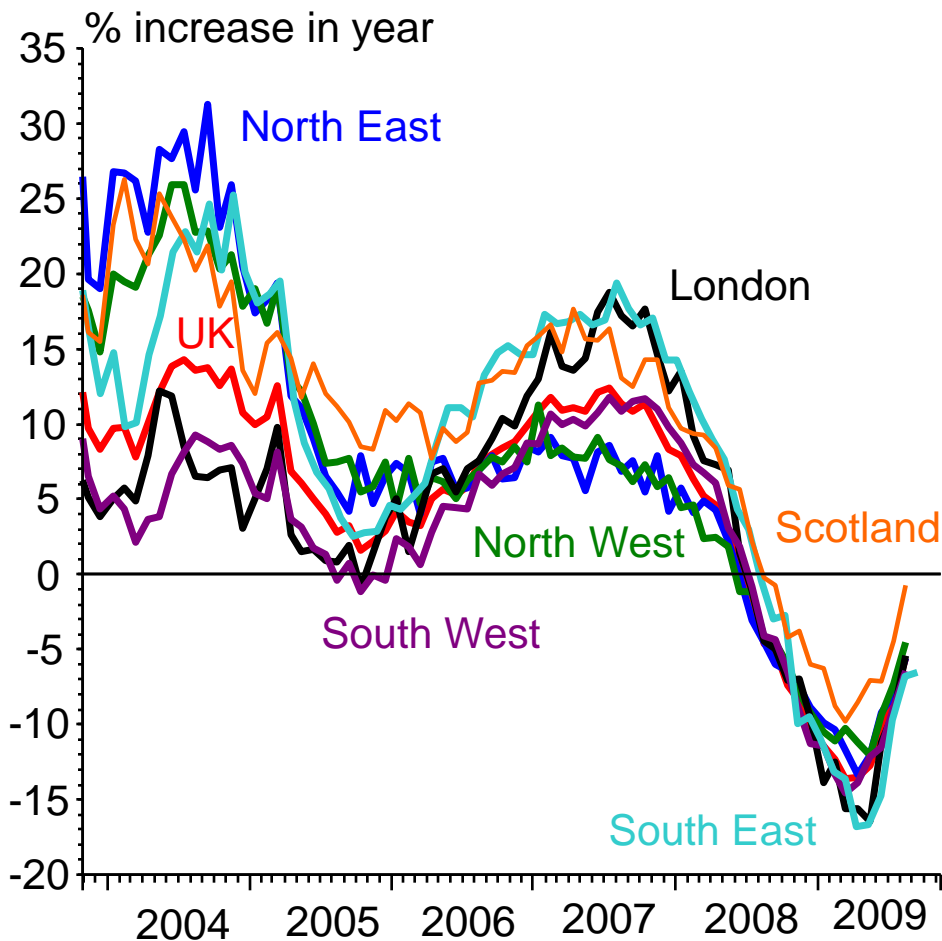
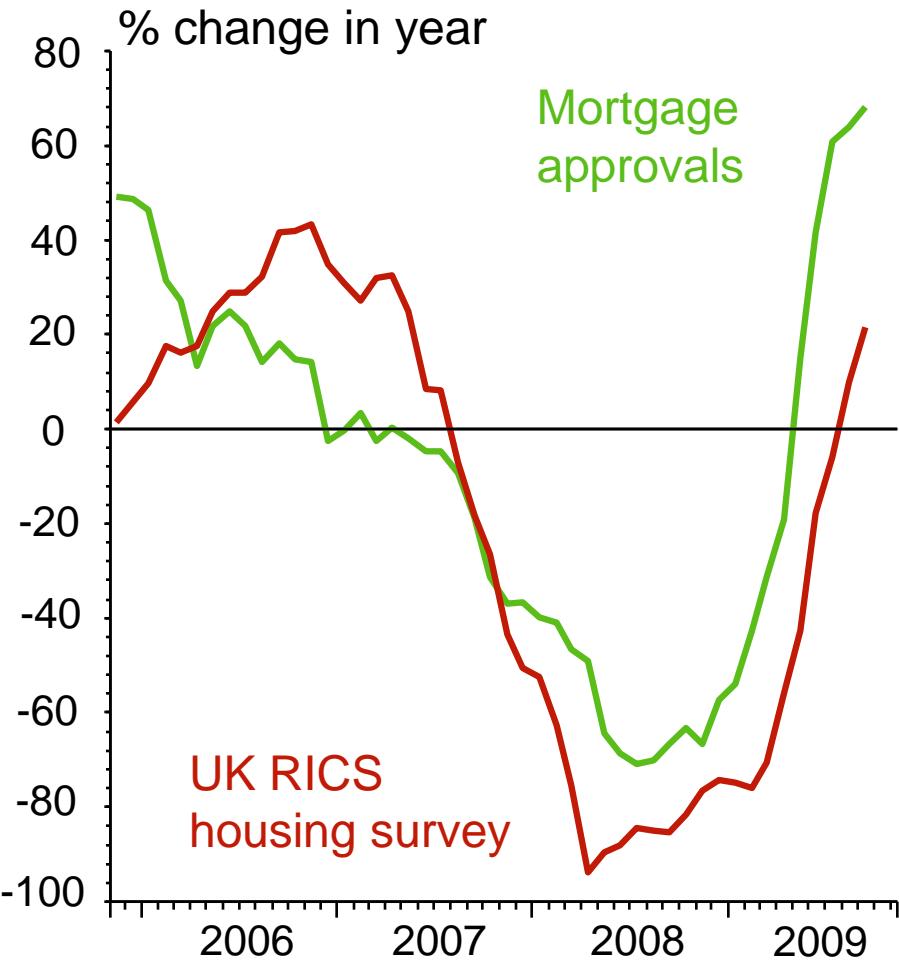
Lending to UK household and corporate sectors is contracting...



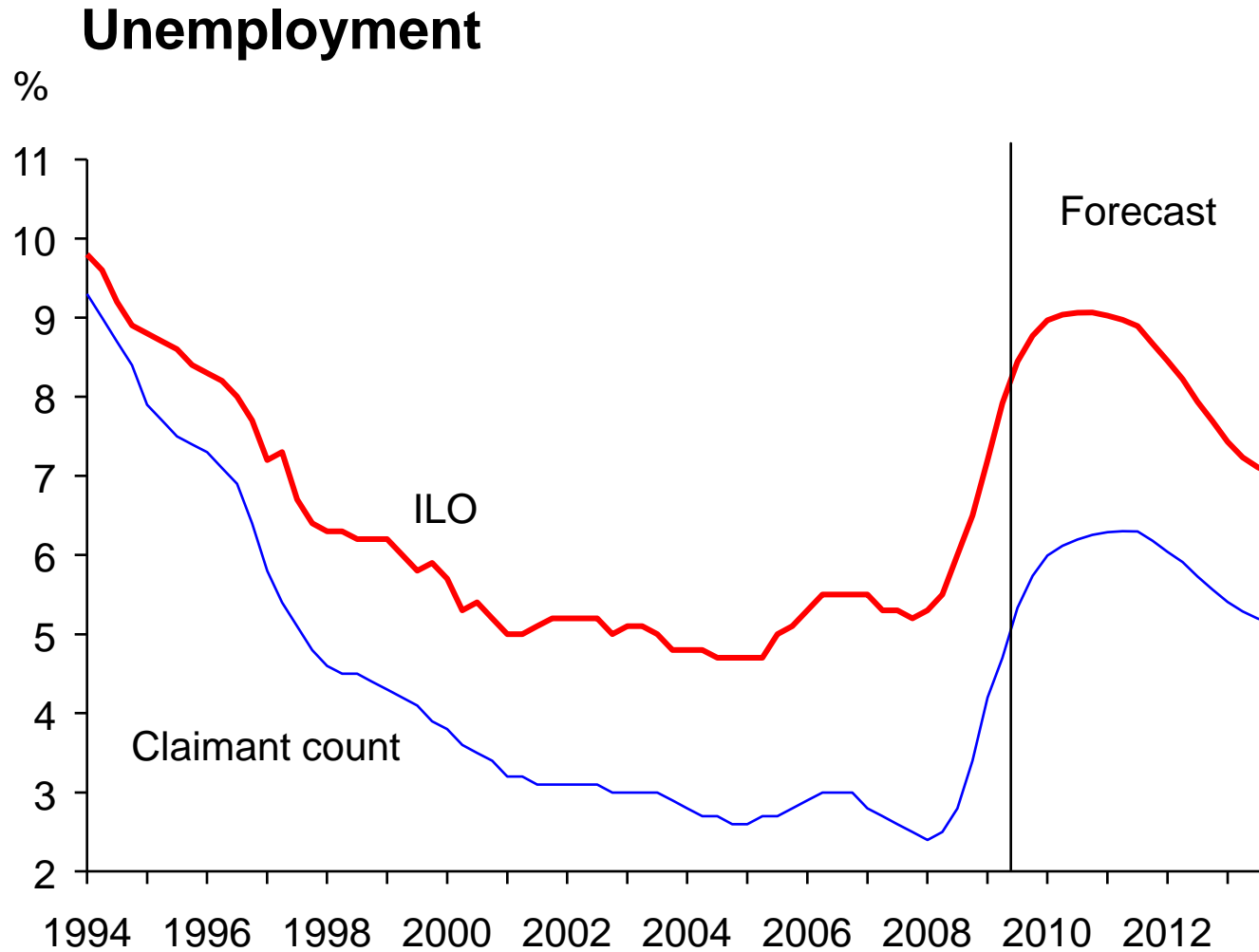
...as households start to rebuild savings and reduce debt...



Housing market showing signs of recovery...but will it last?



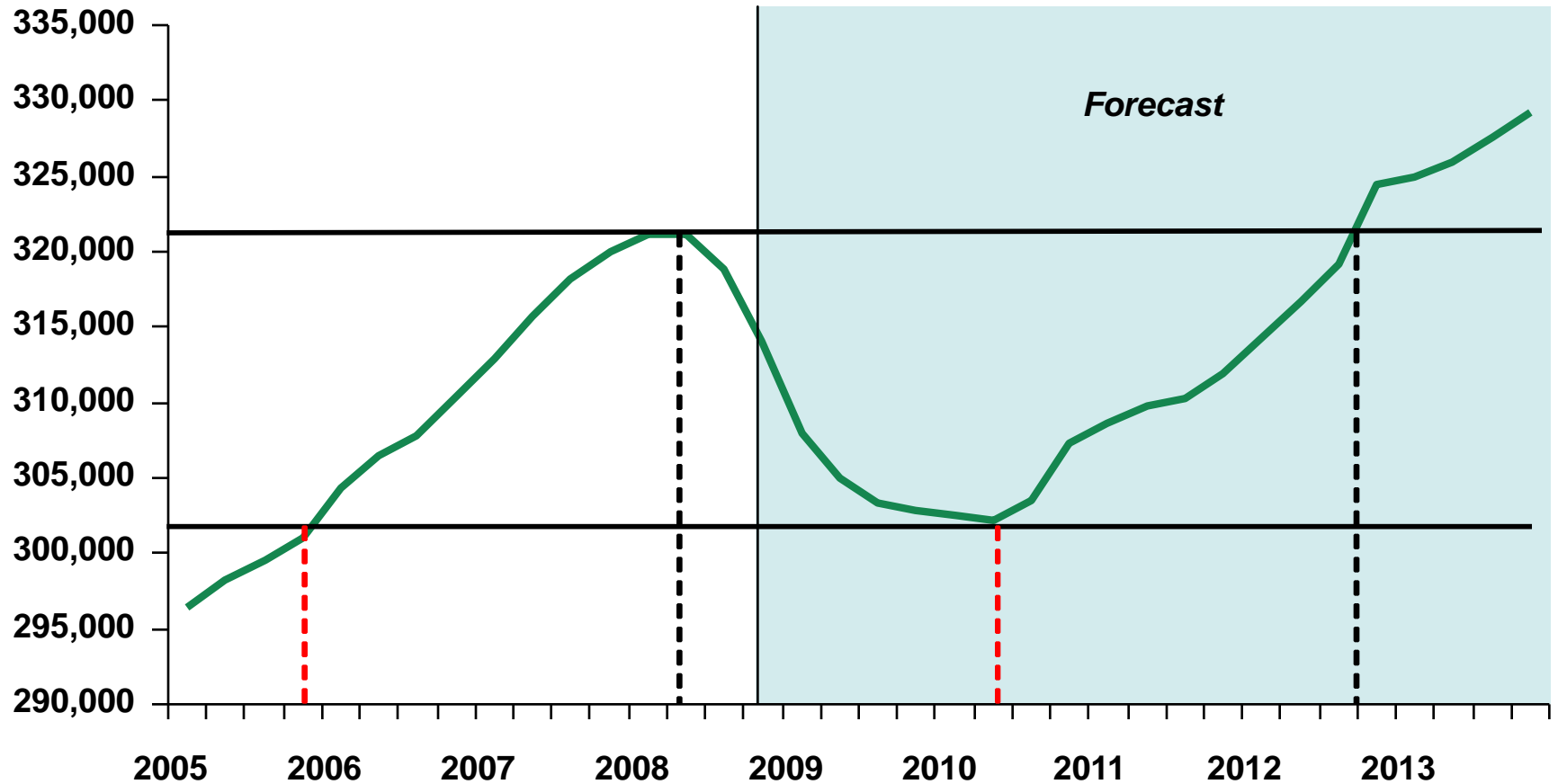
Unemployment will rise into 2010...



Source: Oxford Economics

...and it will probably take until 2012/13 for the UK to regain the Q1 2008 high in gdp, i.e. for real recovery to have occurred

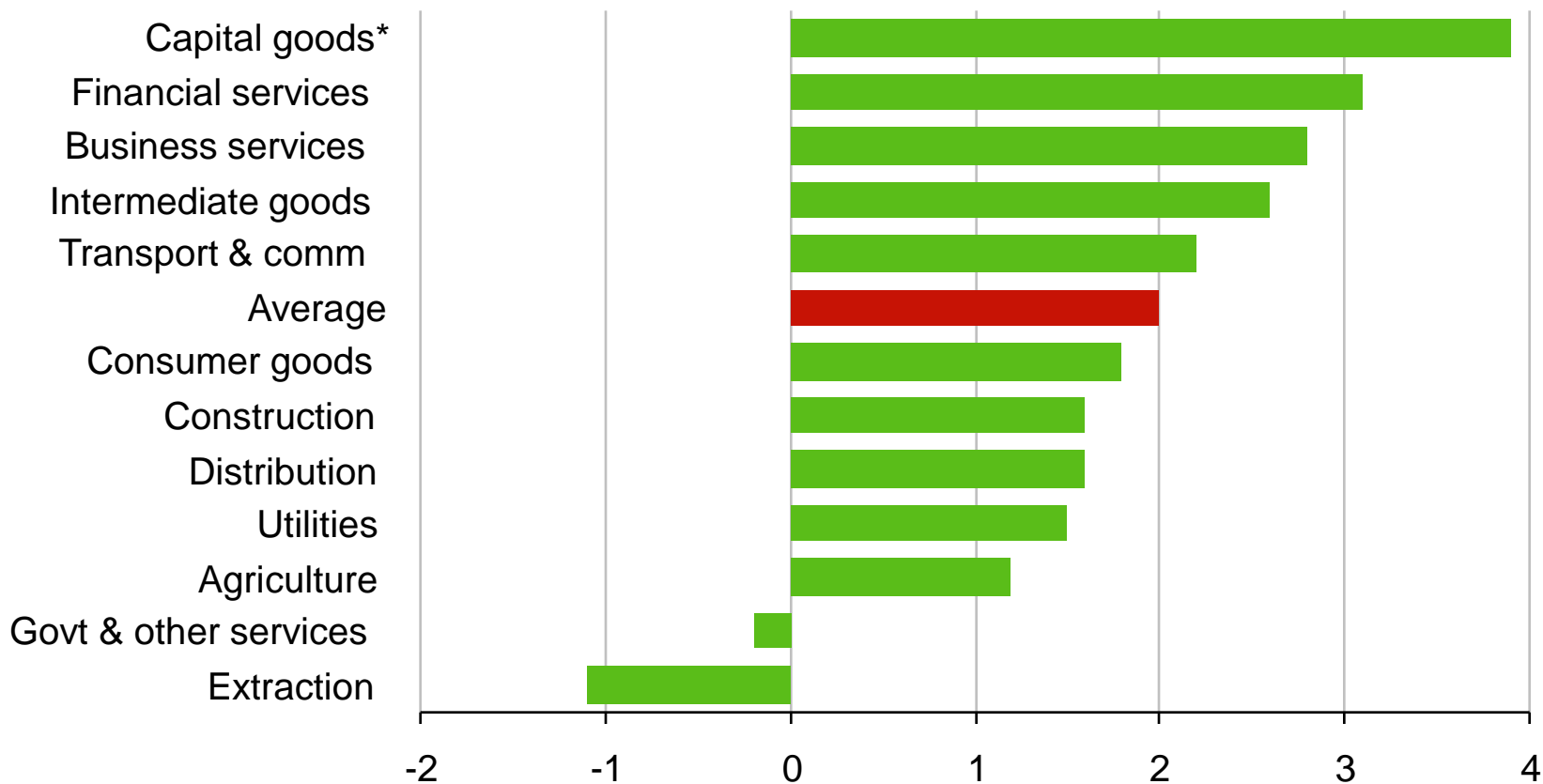
£mn quarterly, real GDP



What is the sector profile of the recovery?

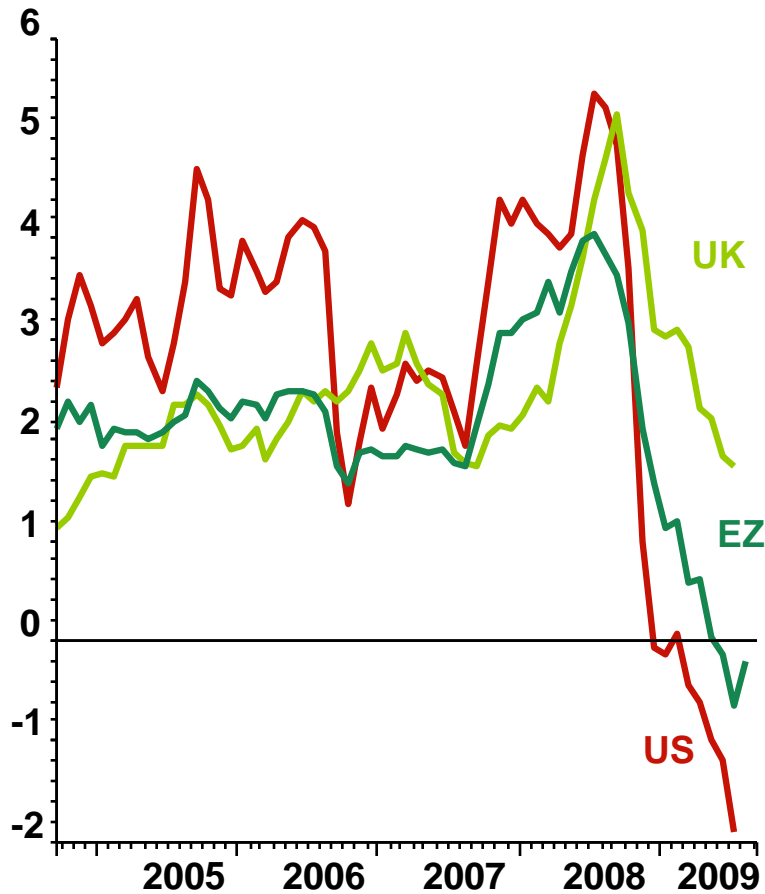
* Capital goods include engineering, hi-tech and aerospace

% output growth per annum, 2010-13 avg.

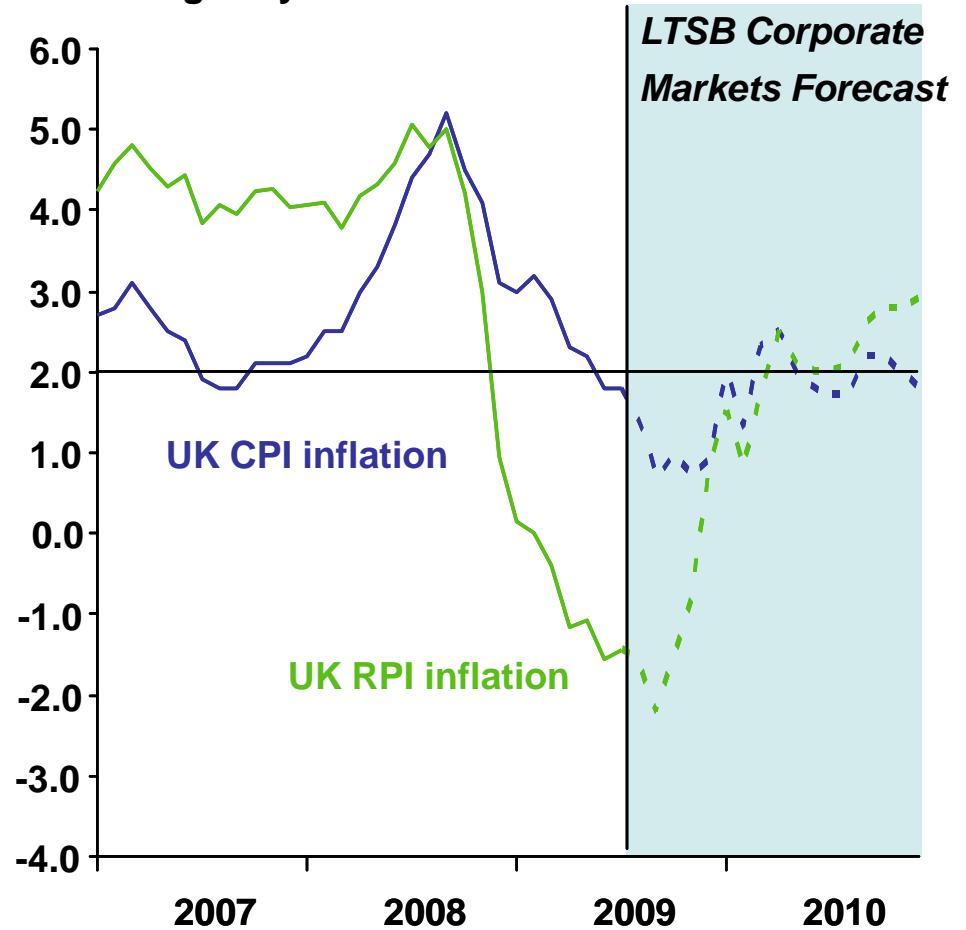


Rise in spare capacity and weak wage growth are likely to keep inflation pressures benign

Annual CPI inflation rate, %



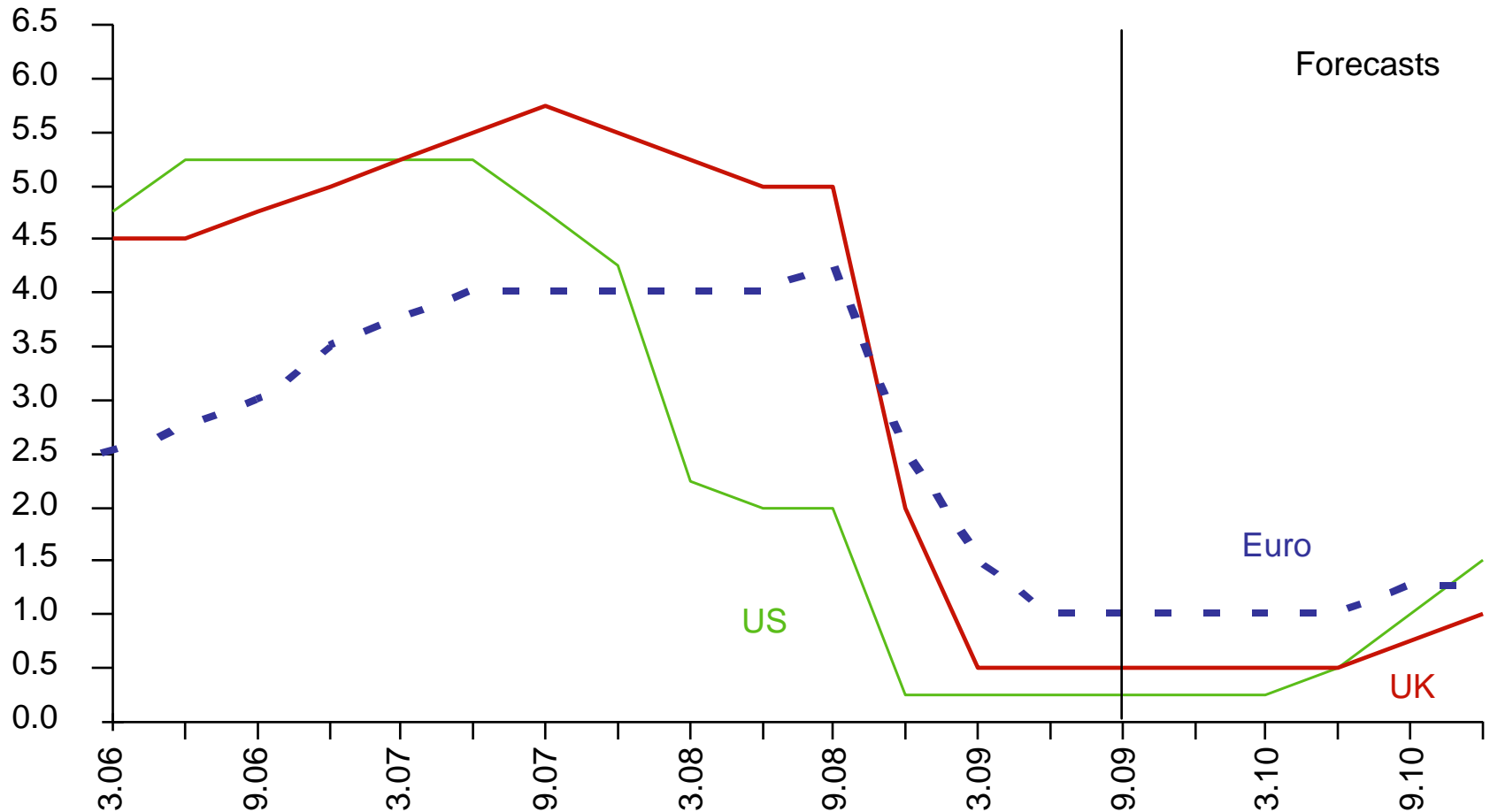
% change in year



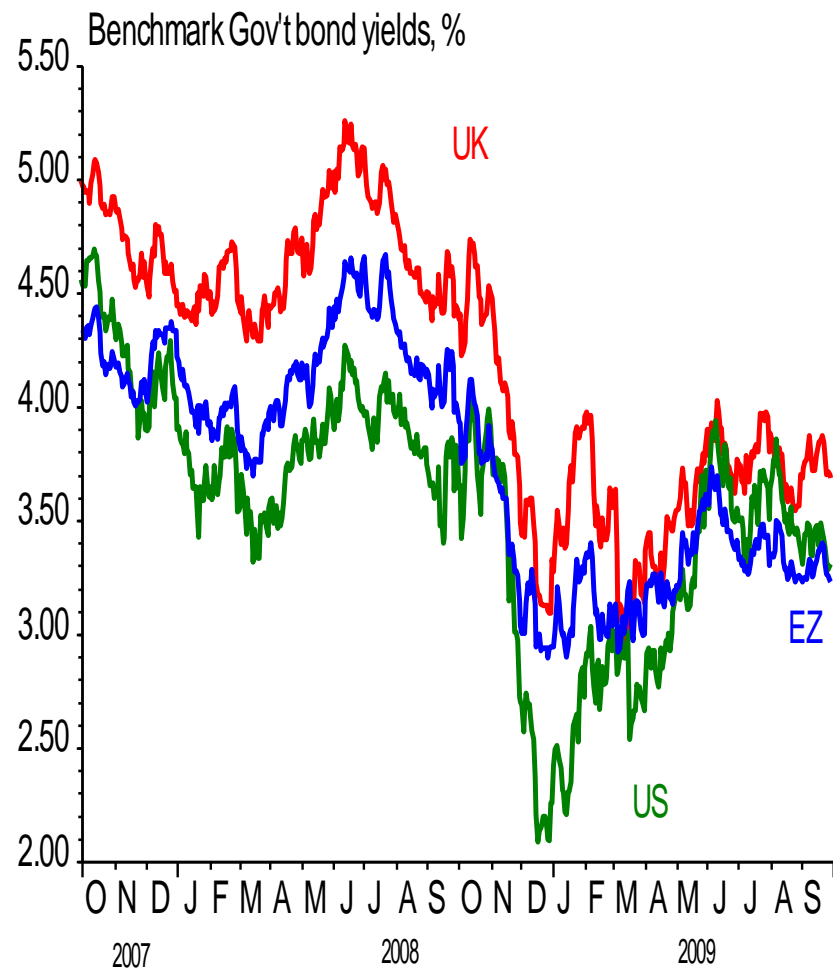
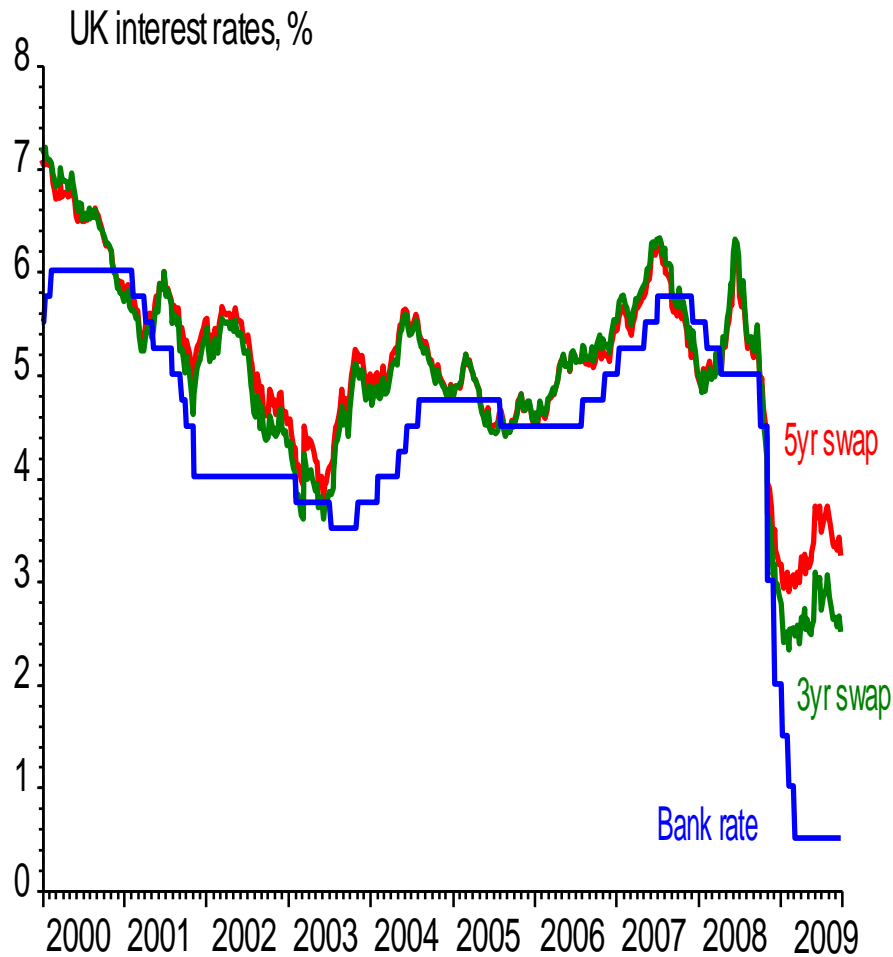
Source: DataStream, Lloyds TSB Corporate Markets

Interest rates are set to remain low for some time, while the exchange rate should also remain favourable for sterling exporters

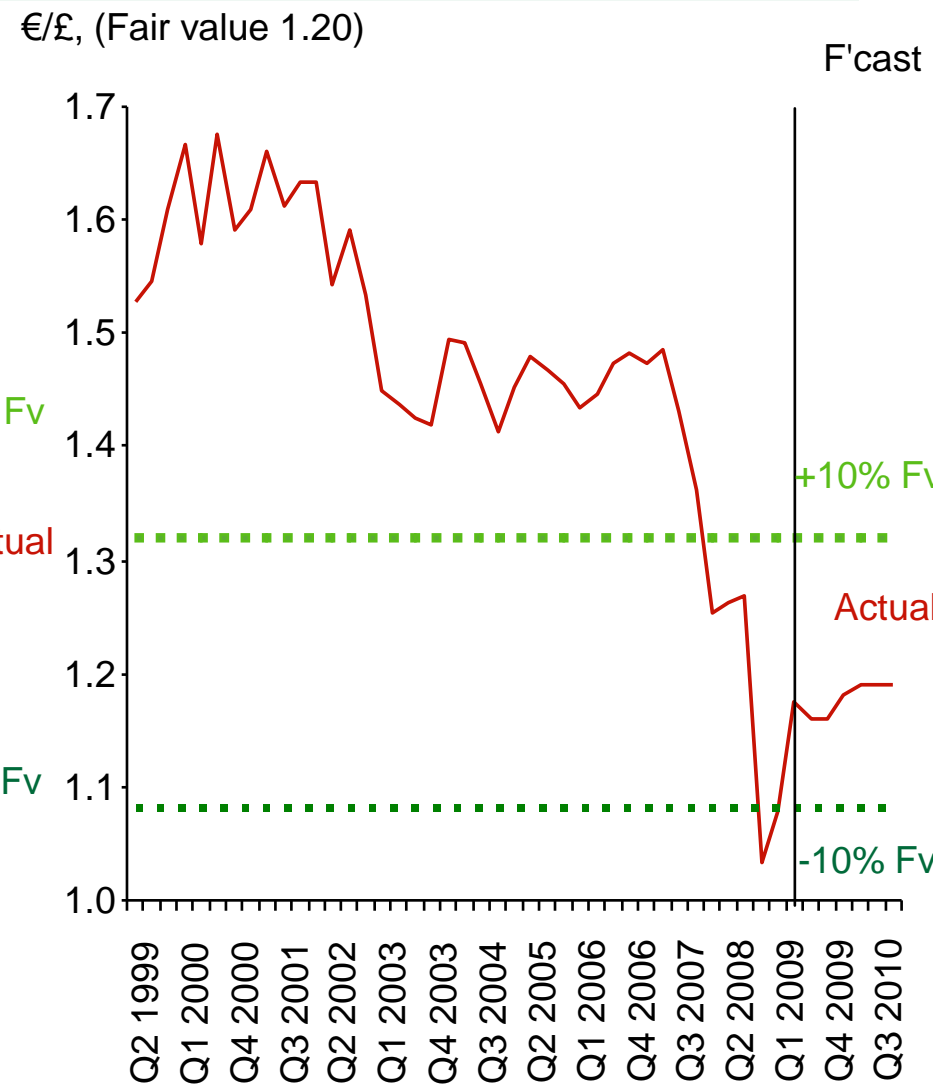
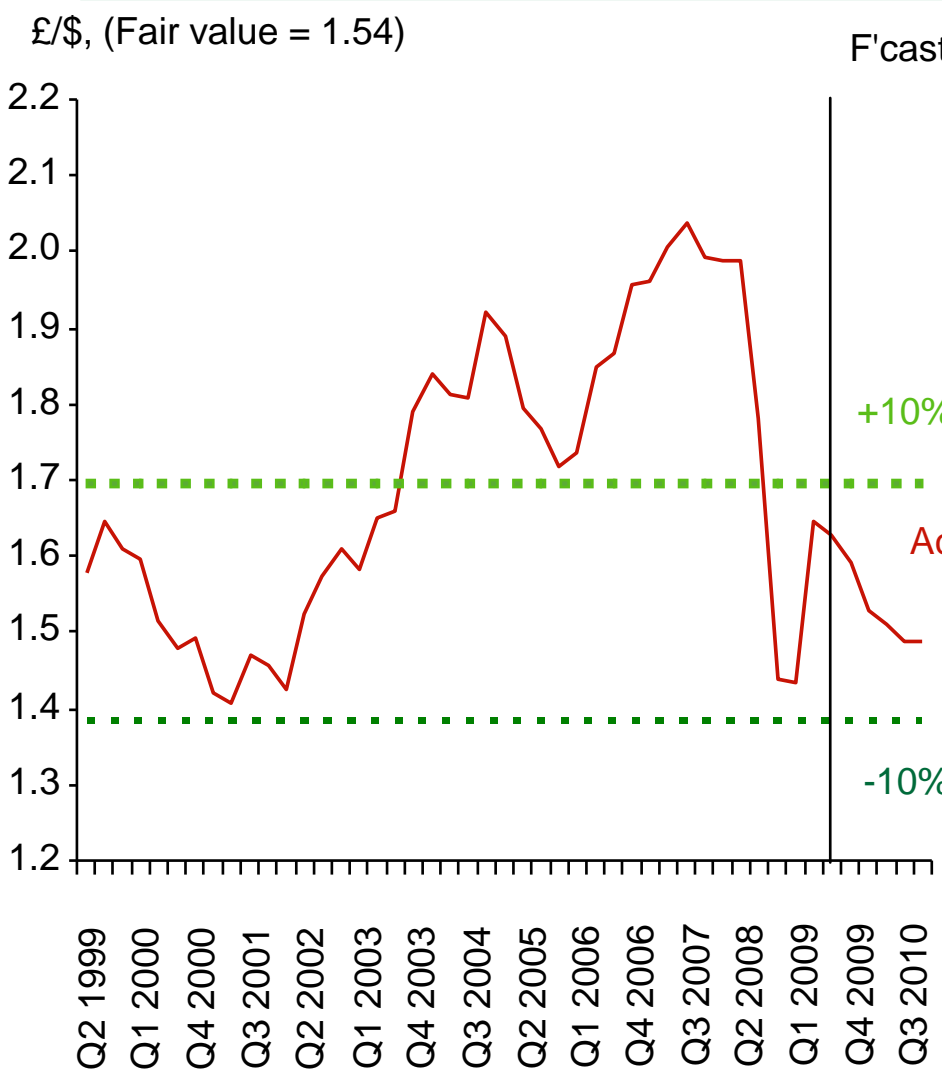
Short term interest rates, %



....and market interest rates?

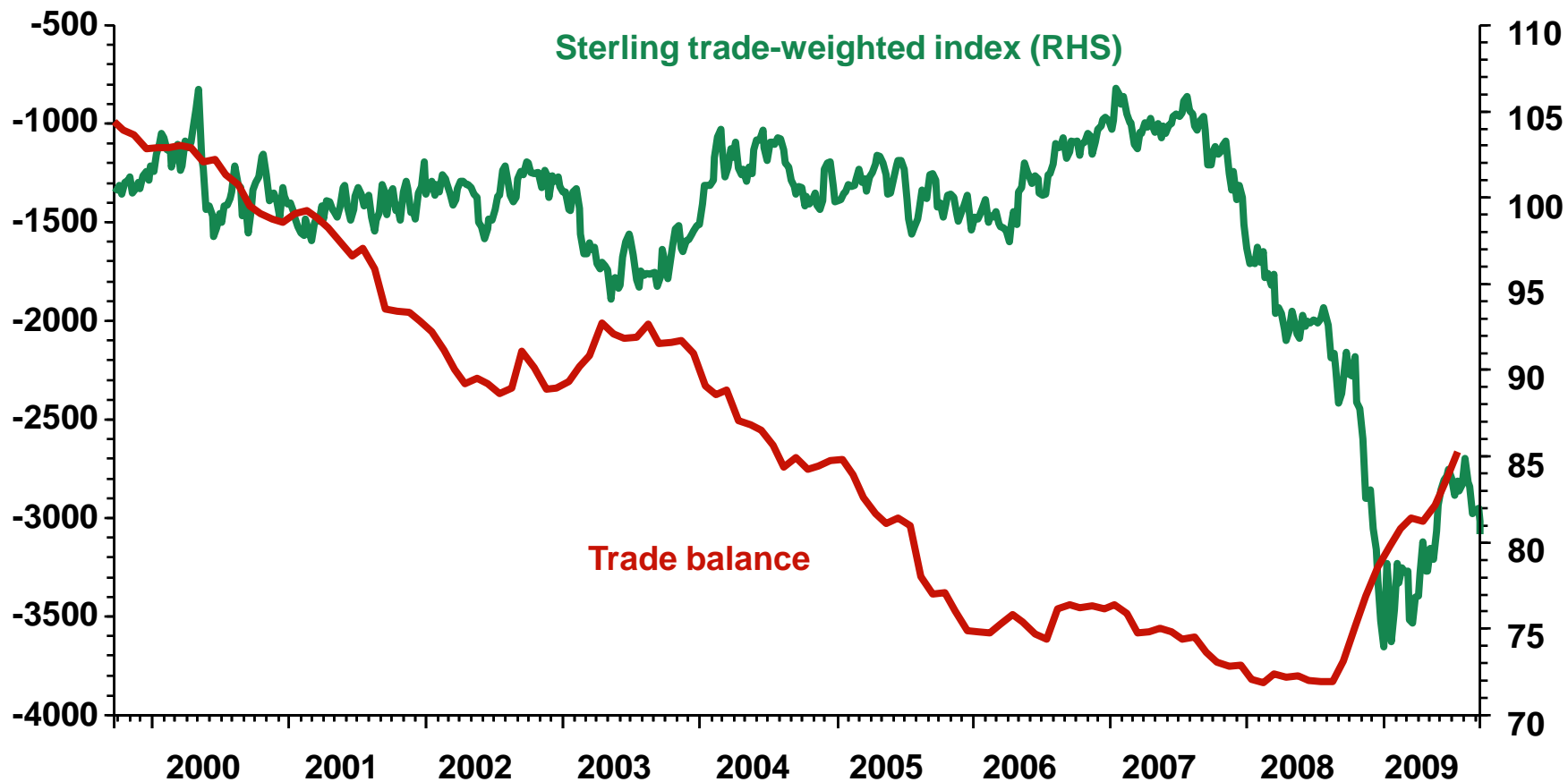


What about sterling?



The UK needs to rebalance away from domestic demand towards net exports

rolling 12-mth ave.



Source: Thomson Datastream

Some further things to think about

How much is the present recovery merely a stock building cycle ?

What happens when the fiscal stimulus ends ?

Could commodity prices squeeze real incomes as they did in 2008 ?

Summary

- UK GDP is forecast to contract by around 4.7% this year - its sharpest downturn since WWII – and rise by a modest 0.7% in 2010.
- Some seeds of optimism: lower inflation, fiscal stimulus, monetary easing and weaker pound are supporting economic activity.
- But risks to growth and inflation are skewed to the downside, as unemployment rises, bad debts increase and fiscal policy is tightened.
- Sustainable growth dependent on global imbalances being resolved: US/UK to deleverage and rely less on consumption, Asia to save less/consume more.
- Over the medium term, the withdrawal of policy stimulus will pose substantial risks. The failure to manage an orderly exit strategy could precipitate a sharp fall in sterling, a rise in inflation and a surge in long-term interest rates.

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