

July 2019

UNITED KINGDOM 2019-2020 SCENARIO DEAL OR NO DEAL, THAT IS THE QUESTION

Slavena NAZAROVA

“

So we are getting ready to come out
on October the 31st. Come what
may ... Do or die. ”

Boris Johnson

UNITED KINGDOM 2019-20 SCENARIO

(outlook as at Q2 19)

- 1 | OVERVIEW: FASTEN YOUR SEATBELT
- 2 FOCUS: CAN A NO-DEAL BREXIT BE AVOIDED ONCE AGAIN?
- 3 LATEST ECONOMIC DEVELOPMENTS
- 4 THE BASIS OF OUR SCENARIO

OVERVIEW OF OUR SCENARIO

ANOTHER BREXIT EXTENSION, SNAP ELECTION BY YEAR-END

BREXIT: HIGHER RISK OF NO-DEAL BREXIT ON 31 OCTOBER.

Theresa May's inability to get her withdrawal agreement through Parliament has polarised British voters, forcing both Conservatives and Labour to take radical Brexit stances: exiting the EU on 31 October at the latest, with or without a deal for the Conservatives, or in Labour's case, arguing for a second referendum. The European Union has ruled out reopening any negotiations on the withdrawal agreement, which automatically increases the probability of a no-deal Brexit on 31 October 2019. **While risks of no-deal have risen, in our central scenario, we believe that a snap election along with an extension of Article 50 is more likely than a no-deal Brexit.** Parliament is largely opposed to a no-deal Brexit, and the government's already thin majority has fallen even further during Theresa May's leadership (effective majority of only 4 MPs). The government is therefore more vulnerable to a vote of 'no-confidence' than before, which could lead to a snap election taking place before year-end provided that at least seven weeks are needed between a vote of no-confidence and the staging of a general election. A further postponement of Brexit would be needed, making the assumption that the Parliament would be able to oblige the government to ask for an extension of Article 50 and that the EU

would agree to it. At this stage it is difficult to predict the outcome of an election, but the opinion polls are suggesting that a left-wing coalition has marginally more chance of obtaining a majority in Parliament than a new Conservative government.

INCREASED GROWTH VOLATILITY IN THE SHORT TERM, AND A PROBABLE CONTRACTION IN GDP IN THE SECOND QUARTER.

Fears of a no-deal Brexit on 29 March 2019 bolstered manufacturing growth in the first quarter, as firms built up record inventories. This behaviour was reversed at the start of the second quarter, leading to a near 4% drop in manufacturing production in April. The service sector, which is more dependent on domestic demand, continued to show modest but steady growth in the first quarter. But monthly data at end-April shows that activity has been stalled for three months. **We are forecasting stable GDP in the second quarter (and growth of 1.4% in 2019, the same as in 2018); but with a -0.2% carryover in April, the risks around our forecast are on the downside.**

MORE IMBALANCED, MORE FRAGILE GROWTH.

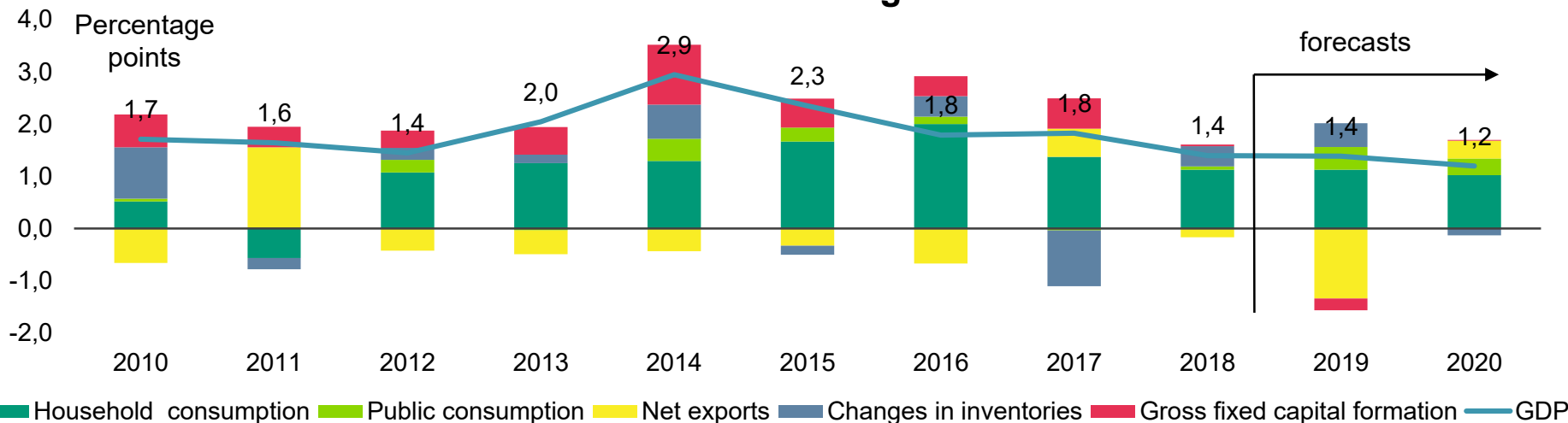
Brexit uncertainties will continue to adversely impact private investment and weigh on growth. Household consumption will remain the key driver for growth thanks to still favourable fundamentals, and in

particular a labour market seeing full employment, with an unemployment rate of just 3.8%, and where wages growth (3.4% in the private sector) is close to its cyclical peaks. Purchasing power measured by gross disposable income deflated by the consumer expenditure deflator, rose 2.1% in 2018 after two years of near stagnation. It should continue to pick up over the coming months against a backdrop of falling inflation. That said, households' financial situation is fragile, as suggested by their low personal savings ratio (4.4% in Q1 2019) and a debt ratio, which at 148% of disposable income in 2018, is one of the highest in advanced economies. Foreign trade could continue to benefit from the weak pound, but we are forecasting a negative contribution to growth from net exports on a quarterly basis in 2020, given the expected slowdown in the Eurozone and the United States, and moderate growth in UK domestic demand. The policy mix will remain supportive. Growth in public sector consumption is likely to remain sustained as the government has eased its budgetary policy and more fiscal easing is likely to come under the leadership of the next prime minister. The economy should continue to benefit from favourable monetary and financial conditions, with a monetary-policy tightening that is likely to be paused by the BoE.

ECONOMIC OUTLOOK

FORECASTS: BELOW POTENTIAL GROWTH, HEAVILY RELIANT ON HOUSEHOLD CONSUMPTION

Contributions to GDP growth



Sources: ONS, Crédit Agricole SA / ECO

- **On Brexit, we assume a relatively benign core scenario:** either Brexit is delayed, thereby prolonging the status quo, or the UK gets out of the EU with a transition period. However, needless to say, uncertainty on the long-term relationship is there to last and will continue to weigh on growth, especially on investment.
- **GDP growth is expected to weaken significantly in Q2** to a stagnation or even a recession due to Brexit risks and the global manufacturing crisis. So far, the labour market is holding up well, but signs of moderation are visible.
- **Household consumption remains the key growth driver, but its resilience is fragile.** It is expected to grow steadily in line with real disposable income growth, which is likely to firm up further in the short term on the back of falling inflation and a tight labour market.
- **Weak business investment will continue to restrain the economy.** Ebbing momentum in key trading partners such as the EU and the US will add downward pressure to investment growth. Fundamentals are deteriorating.
- **Net trade contributes poorly** as global demand weakens and some reappreciation in GBP is likely at the end of the year in a smooth Brexit scenario.
- **The BoE is expected to drop its hawkish bias in August.** We expect downward revision to its growth and inflation projections in August due to weaker global prospects and the bank rate to be left unchanged this year and next. In case of No-deal Brexit, we expect the BoE to cut rates.
- **Budget policy is expected to be eased** whoever the next Prime Minister (B. Johnson, J. Hunt or J. Corbyn) through higher spending and lower taxes, but a Labour government also aims to change the business-model of the economy.

UNITED KINGDOM 2019-20 SCENARIO

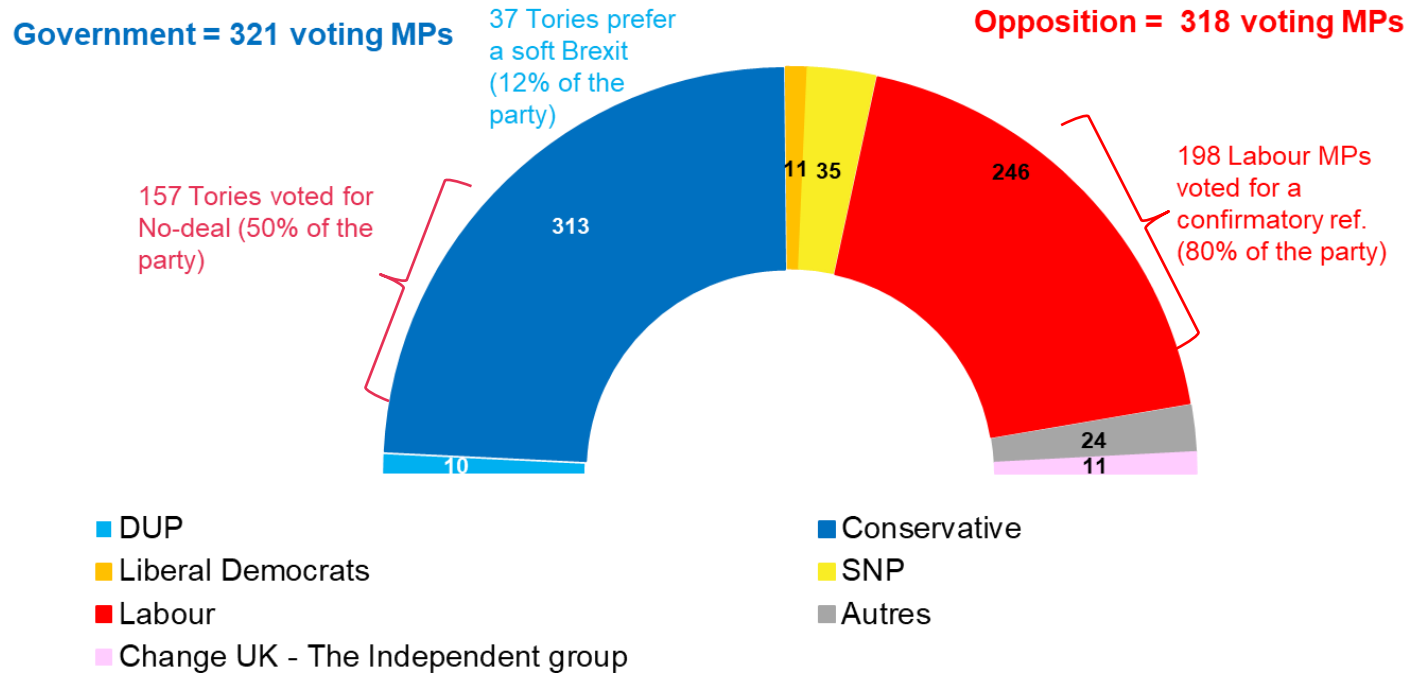
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CAN A NO-DEAL BREXIT BE AVOIDED AGAIN?

PARLIAMENTARY CONSTRAINTS TO A NO-DEAL BREXIT

Composition of the House of Commons



Source : UK Parliament, Crédit Agricole SA/ECO

We believe that the parliamentary arithmetic would make it difficult for the next PM to push for a No-deal Brexit. The working majority of the Government (Conservative party + DUP) has fallen from 13 MPs post the 2017 general election to only four MPs and will possibly fall to three after a by-election in August. Hence, in theory, it would be easier for the opposition to trigger and win a no-confidence vote, provided that some pro-EU Conservative MPs vote against the government. However, divisions within the Labour party itself make it less certain. During the last attempt of the Labour party on 12 June to prevent a no-deal Brexit, eight Labour MPs voted with the government, almost cancelling out the ten Conservatives who voted with Labour. Our base scenario assumes that a vote of confidence will probably take place in early October, after a failure by the PM to negotiate with the EU and that it will lead to snap election by the end of the year.

CAN A NO-DEAL BREXIT BE AVOIDED AGAIN?

THE RISKS OF NO-DEAL ARE HIGHER THAN BEFORE. IT WOULD BE DIFFICULT TO BLOCK A NO-DEAL, BUT NOT IMPOSSIBLE

The result of the Conservative leadership contest will be known on 23 July. Boris Johnson is expected to be the next Prime minister by a large margin over Jeremy Hunt. Johnson's objective is to leave the EU with a deal on 31 October and will use the No-deal threat (and refusal to pay the financial bill) as a means to obtain more concessions from the EU. He thinks that chances to leave without a deal are very small.

However, the EU has consistently said that the Withdrawal agreement (WA) will not and cannot be renegotiated. The impossibility to renegotiate May's deal mechanically raises the odds of a No-deal Brexit on 31 October. We estimate the probability of the UK crashing out of the EU at close to 25%, but it could be even greater. The next Conservative leader is unlikely to ask for an extension in order to avoid it, unless Parliament obliges him to do.

It will be more complicated than before for MPs to block a No-deal. Indeed, there is no need of further 'meaningful votes' and MPs may not have an opportunity to vote on a Brexit motion, if the government does not bring any major bill before the House. Furthermore, even if a Brexit motion is voted down, this is not legally-binding. The only legal way to stop a No-deal would be through a vote of no confidence and this would require some Conservative MPs to vote against the government.

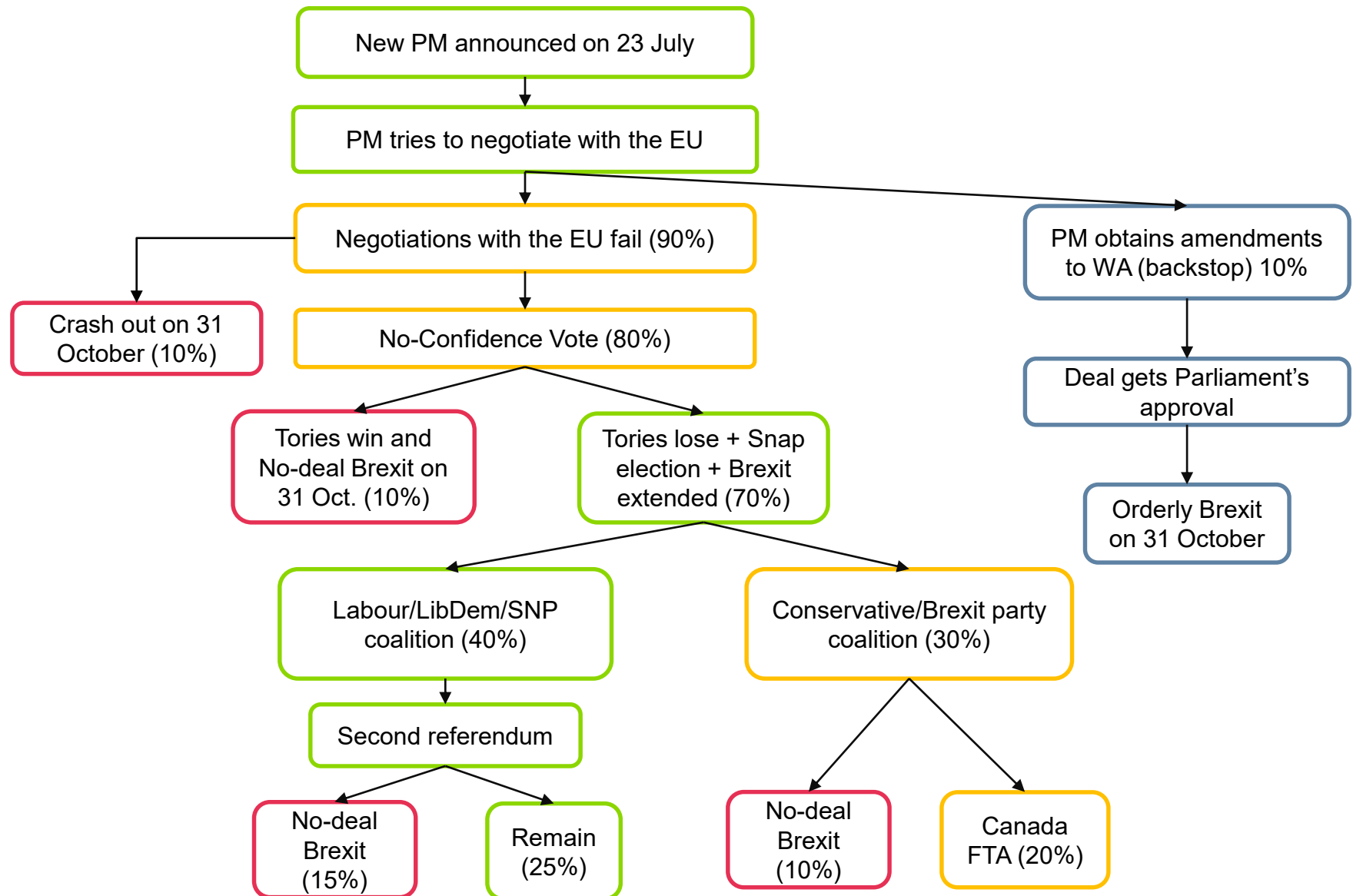
If the government loses a vote of confidence, then there are 14 days for an alternative government to be formed which wins the confidence of the House. If an alternative government is not confirmed, then an election can take place provided there are 25 sitting days between the dissolution of Parliament and the staging of a General election.

The timetable is extremely tight. A vote of confidence can be called immediately after the nomination of the next Conservative leader in July, in early September or in October. The Parliament is in summer recess from 25 July to 3 September and during three weeks for the Conservative Party conference which will take place from 26 September to 2 October. The House of Commons will then be back in October, only a few weeks before the current deadline of Brexit on 31 October.

- 25 July 2019 - 3 September 2019: House of commons' summer recess
- 29 September - 2 October: Conservative Party conference
- 17-18 October 2019: Meeting of the EU Council: the last such meeting before 'Brexit day'
- 31 October 2019 : Brexit day

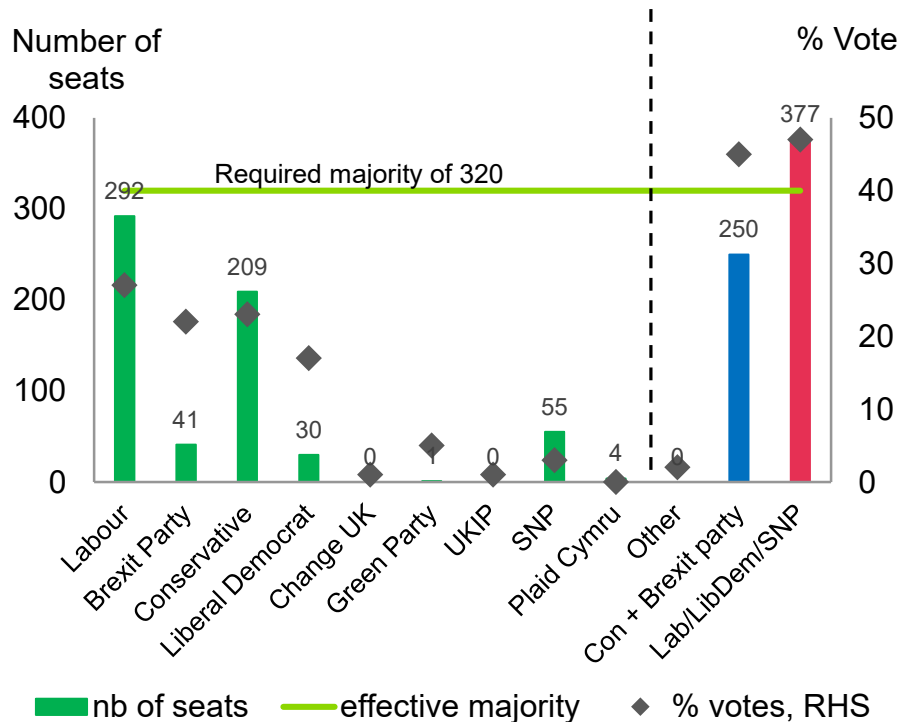
If a vote of confidence is lost in October, after unsuccessful attempts by the new PM to renegotiate with the EU, a new election could therefore take place by year-end. The probability of a second referendum has also increased significantly recently after Labour leader Jeremy Corbyn officially backed a second referendum on a No-deal Brexit versus Remain.

CAN A NO-DEAL BREXIT BE AVOIDED AGAIN? SCENARIOS (AND PROBABILITIES)



CAN A NO-DEAL BREXIT BE AVOIDED AGAIN? THE RESULT OF A SNAP ELECTION REMAINS DIFFICULT TO PREDICT

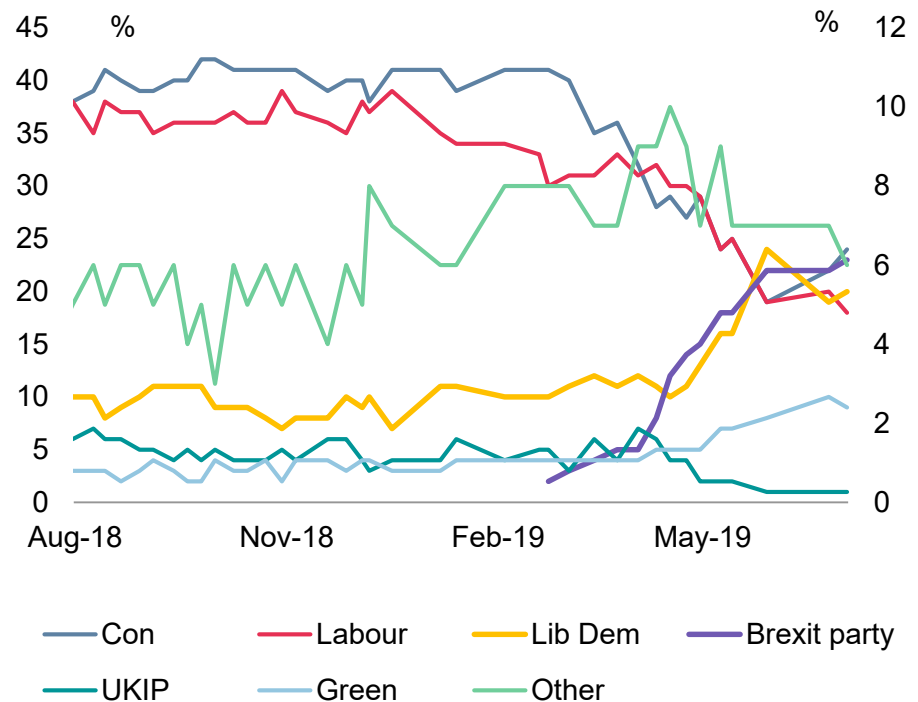
Voting intentions in case of general election and number of seats



Sources: ComRes poll 11 June 2019, Crédit Agricole SA / ECO

The result of a snap election is difficult to predict. Based on current polls, a coalition of the left Labour/ LibDem, potentially including the SNP, looks marginally more likely than another minority Conservative government. Such an outcome would increase the probability of a soft Brexit (at least a custom union) and of a second referendum.

Voting intentions suggest no clear winner in case of election & another hung parliament



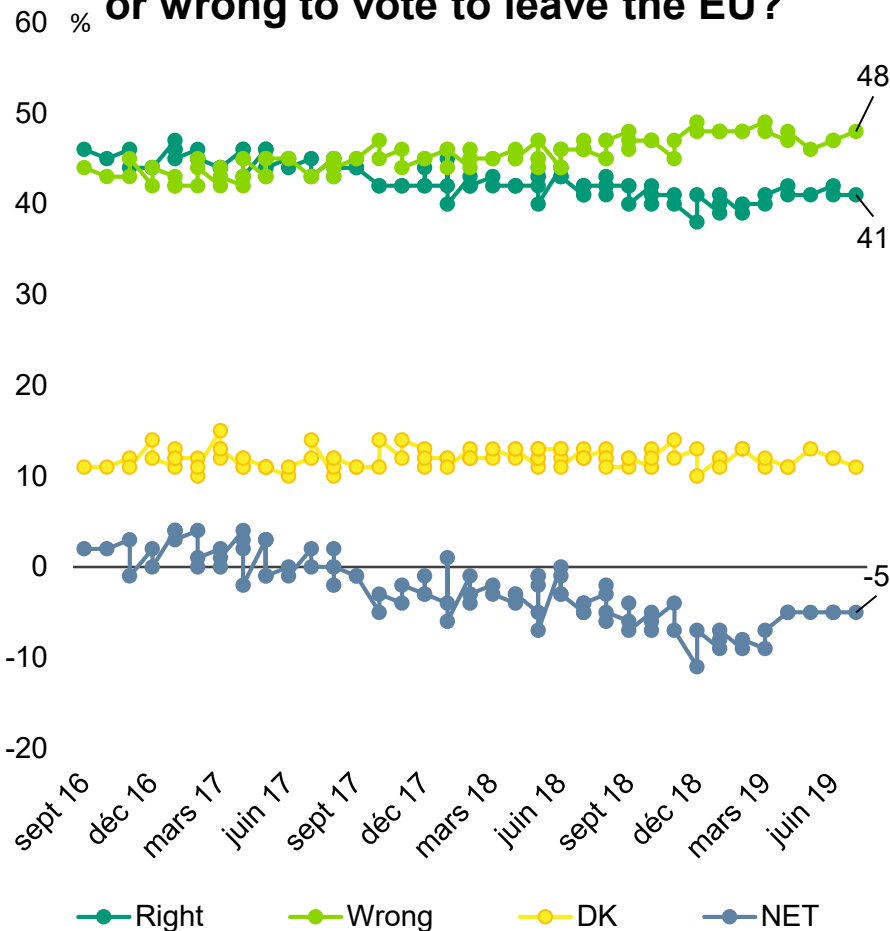
Sources: YouGov 3 July 2019, Crédit Agricole SA / ECO

However, the positive effects of a Labour government on markets and the economy from Brexit would be mitigated by the prospects of a less business-friendly fiscal policy (higher corporation and income taxes in order to fund greater public spending) and pro-nationalisations plans (rail companies, energy supply networks, water systems and mail delivery).

CAN A NO-DEAL BREXIT BE AVOIDED AGAIN?

THE CASE OF A SECOND REFERENDUM HAS RISEN AS WELL

In hindsight, do you think Britain was right or wrong to vote to leave the EU?



Sources: Yougov as of 3 July 2019, Crédit Agricole SA / ECO

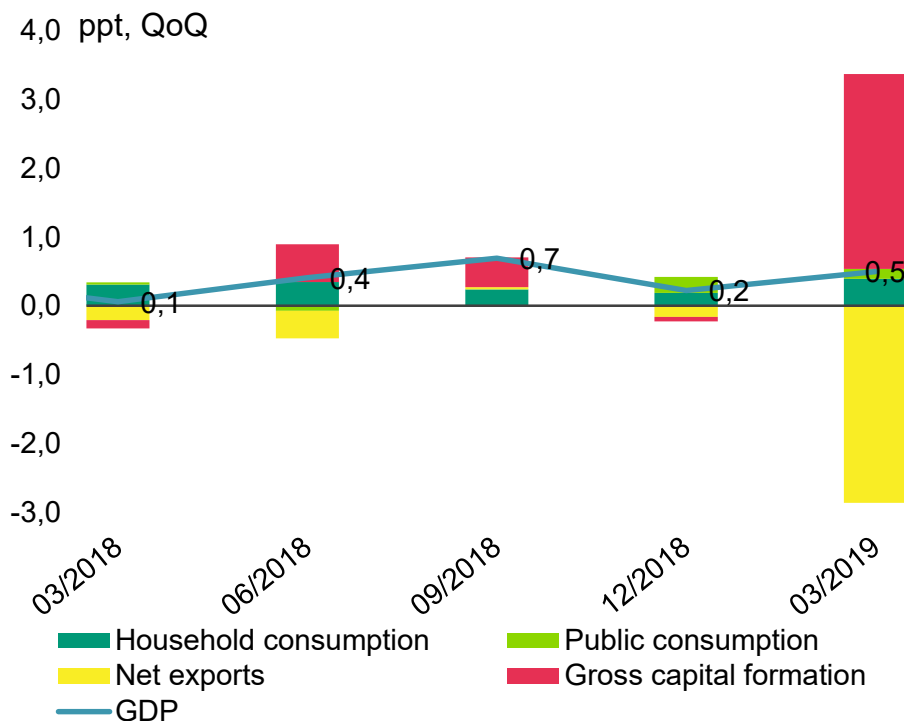
- Labour party leader Jeremy Corbyn has now officially backed a second referendum.
- Initially it was supposed to be a confirmatory referendum on any deal signed with the EU, but now that a No-deal risk has risen, he wants a referendum **on No-deal versus Remain**.
- There are **legislative constraints** to a second referendum. It necessitates the government's approval.
- **The implementation process is very long – at least 21 weeks** (it took 56 weeks for the referendum in 2016):
 - **legislation** (minimum 11 weeks): specifying the question, timing, franchise ...
 - **campaign period** (minimum 10 weeks)

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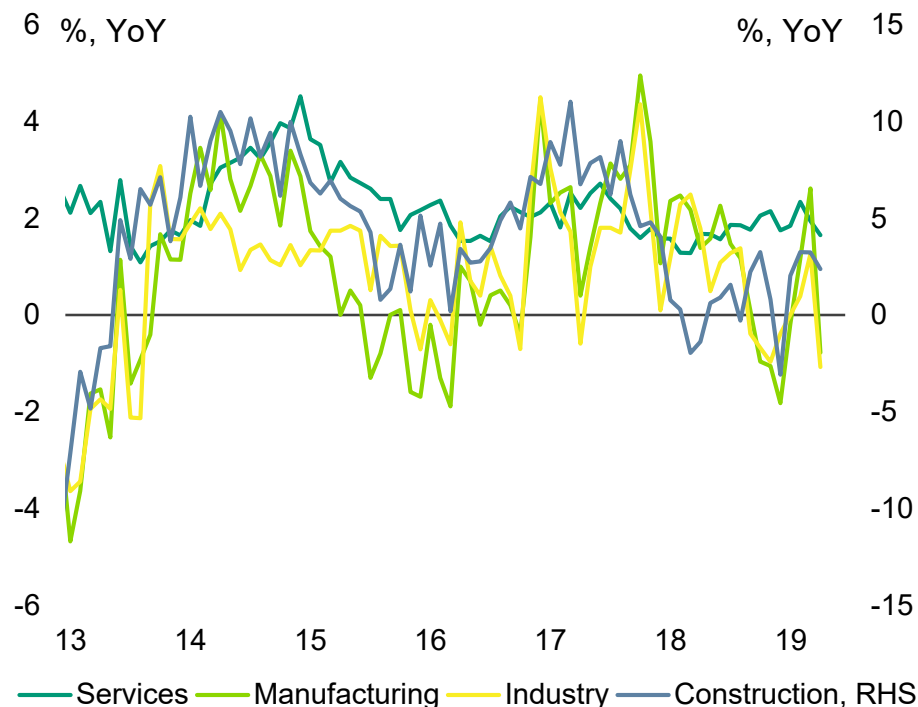
GDP and expenditure breakdown



Sources: ONS, Crédit Agricole SA / ECO

GDP expanded by a relatively strong 0.5% QoQ in Q119. Household consumption (0.6% QoQ), public consumption (0.8% QoQ) and investment (1.2% QoQ) contributed positively, while net trade contributed negatively (-2.9pp). Business investment surprised positively with a 0.4% QoQ increase after having contracted in the previous four quarters. Survey evidence has pointed to a sharp increase in businesses increasing their inventories of stock. Stock-building also boosted imports which rose a whopping 10.8% QoQ.

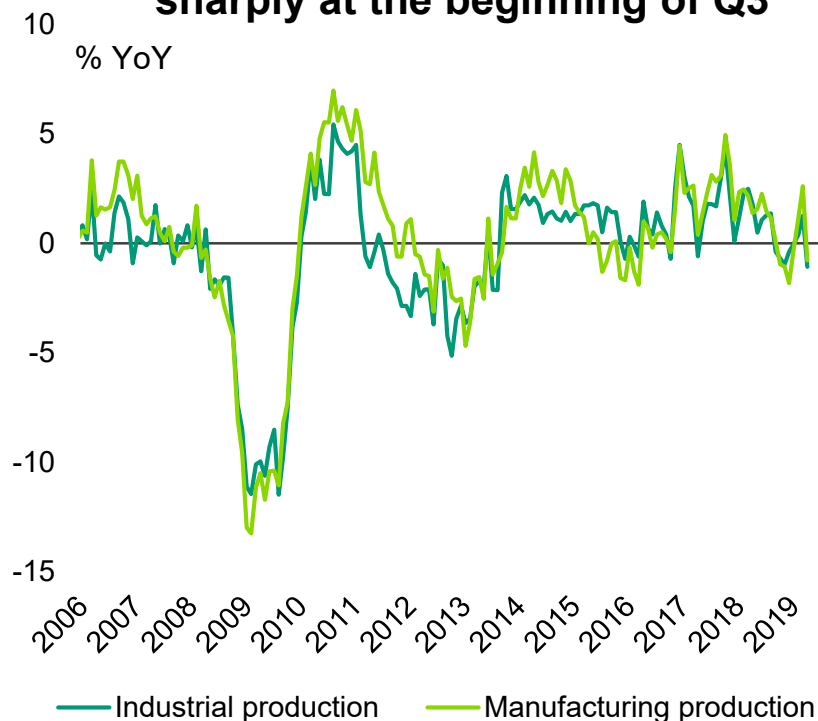
GDP and key sectors



Sources: ONS, Crédit Agricole SA / ECO

All three main sectors expanded in Q1. The services sector slowed slightly (0.4% QoQ after 0.5% QoQ average growth per quarter in 2018), but industrial production surged (1.1% QoQ), as manufacturing production rose by 1.9% QoQ, its strongest rate since Q399. According to the ONS, the pickup in manufacturing production was mainly attributed to food, beverages and tobacco and is consistent with evidence from surveys of stock-building from companies as part of their contingency planning for Brexit ahead of the original departure date from the EU.

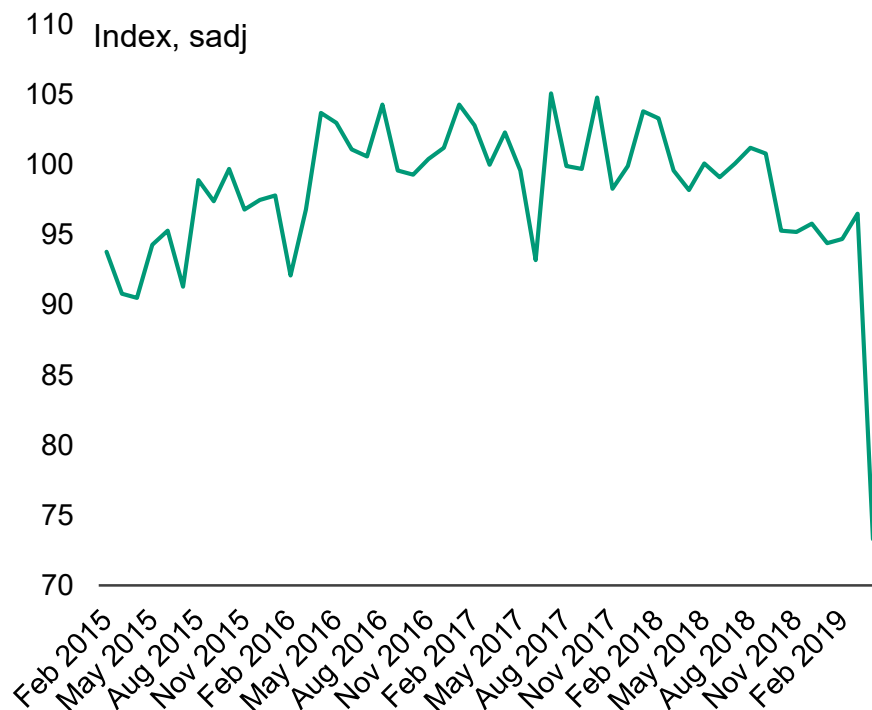
Manufacturing production contracted sharply at the beginning of Q3



Sources: ONS, Crédit Agricole SA / ECO

Manufacturing production plummeted by 3.9% MoM in April, its largest fall since June 2002. Industrial production contracted by 2.7% MoM. The carry-over effect for Q2 is thus highly negative amounting to -2.9%. Brexit-related effects, but also weak domestic demand and a gradual decline in export sales in the car industries are weighing on production.

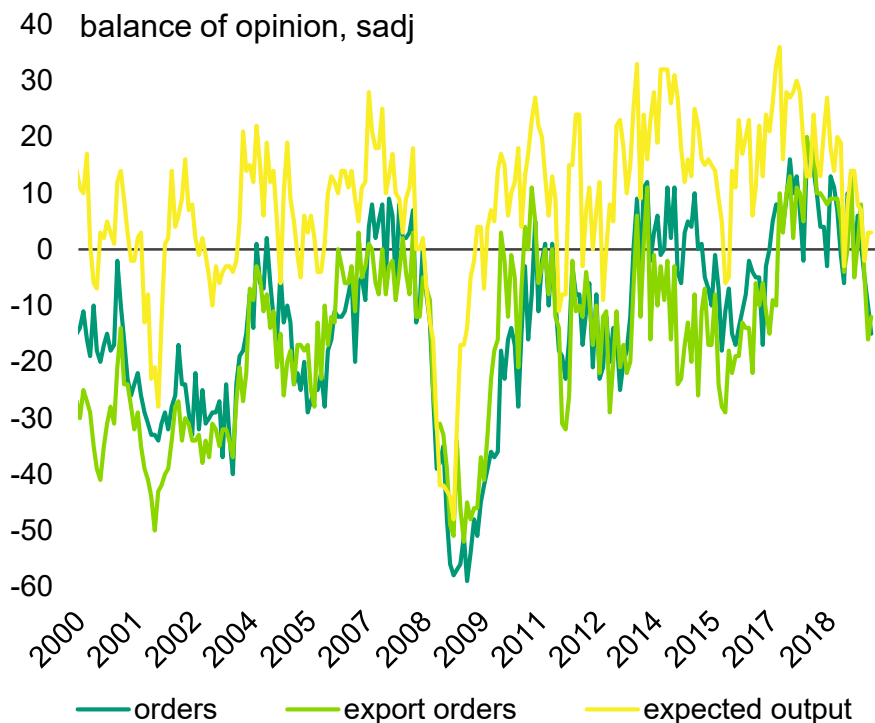
Due to a record fall of motor vehicles



Sources: ONS, Crédit Agricole SA / ECO

The largest downward contribution to the monthly fall in manufacturing production was provided by transport equipment which fell by 13.4%, the largest fall since January 1974. Within this group, production of motor vehicles posted a record historical drop of 24% due to the impact of Brexit-related planned shutdowns within this industry in April 2019, as well as weaker domestic and external demand.

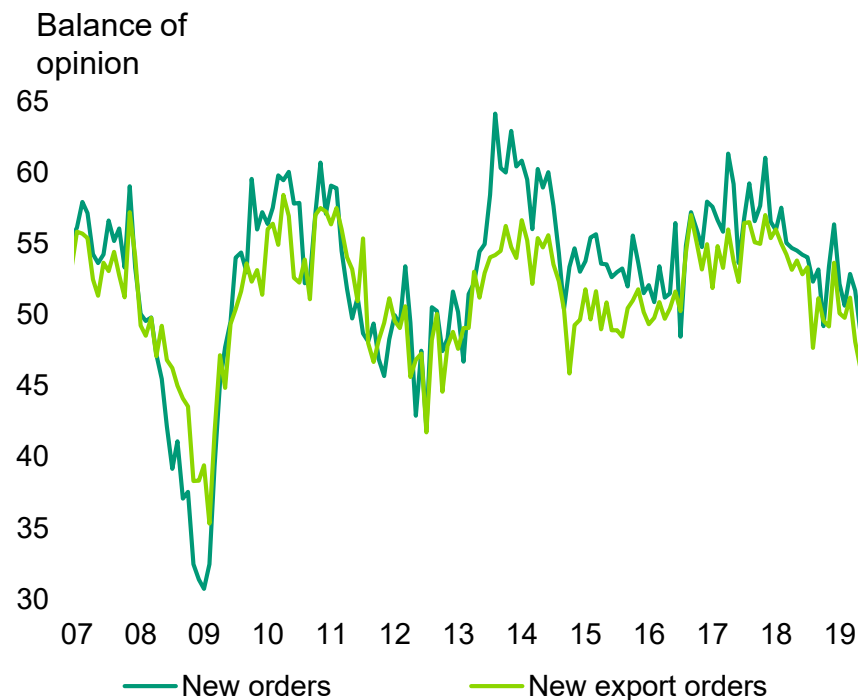
CBI surveys in industry as of June 2019



Sources: CBI, Crédit Agricole SA / ECO

Industrial orders are falling due to weaker export and domestic demand. This is evidenced by CBI and PMI surveys. Evidence from the BoE's Agents survey in Q2 shows that activity is likely to be temporarily higher than usual in August as shutdowns were brought forward to April due to the original date of Brexit. Hence production is likely to be higher in August this year than what is usually observed.

PMI orders in the industrial sector



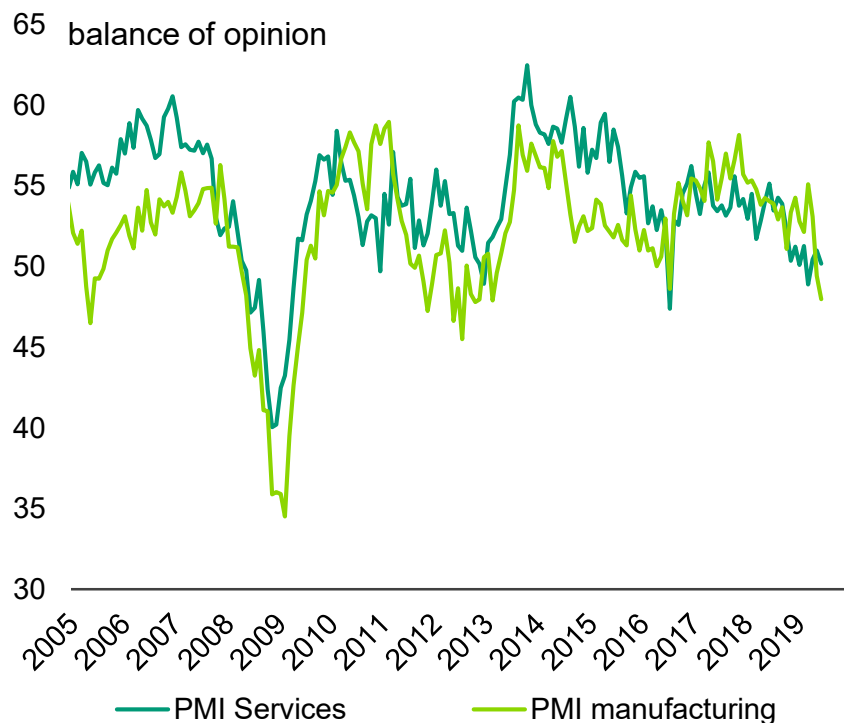
Sources: Markit, Crédit Agricole SA / ECO

The PMI survey in manufacturing production shows that total orders are now contracting for the second-consecutive month. June manufacturing PMI fell to its lowest level since February 2013. This was the effect of the unwinding of earlier pre-Brexit stockpiling. Companies reported that high stock levels, ongoing Brexit uncertainty, the economic slowdown and rising competition as the factors having contributed to decreases in new orders and production.

LATEST ECONOMIC DEVELOPMENTS

A SLIGHT CONTRACTION OF GDP IS LIKELY IN Q2

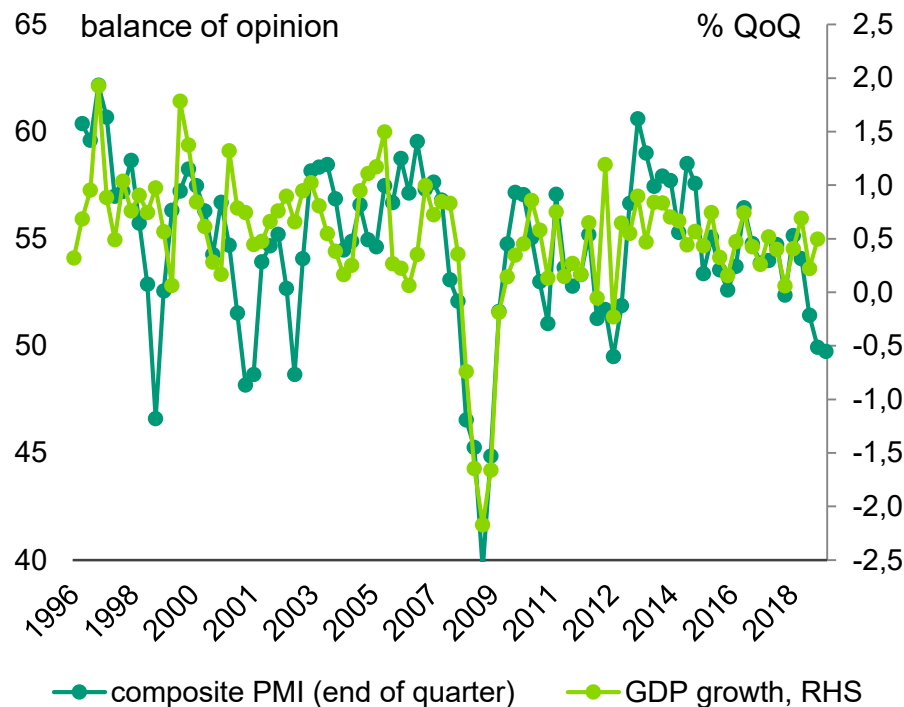
PMI surveys as of June



Sources: Markit, Crédit Agricole SA / ECO

The composite PMI fell to 49.7 in June, below the 50 threshold for the first time since July 2016, the month immediately after the Brexit referendum. Output growth is slowing in the services sector, though it is more resilient than in industry, where contraction is deepening.

PMI suggest a contraction of activity for the first time since the Brexit referendum



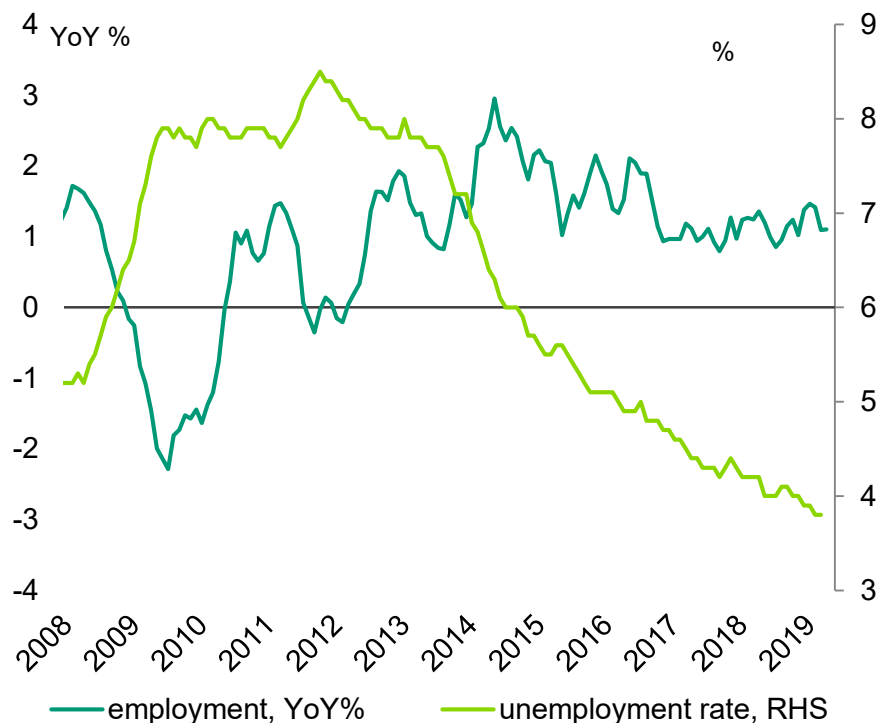
Sources: Markit, Crédit Agricole SA / ECO

We expect 0% QoQ GDP growth in Q219, but surveys as of June and weak hard data in industry at the beginning of the quarter suggest that activity may even contract slightly in Q2. PMIs for instance suggest GDP growth of around -0.1% QoQ.

LATEST ECONOMIC DEVELOPMENTS

SIGNS OF SOFTENING IN THE LABOUR MARKET

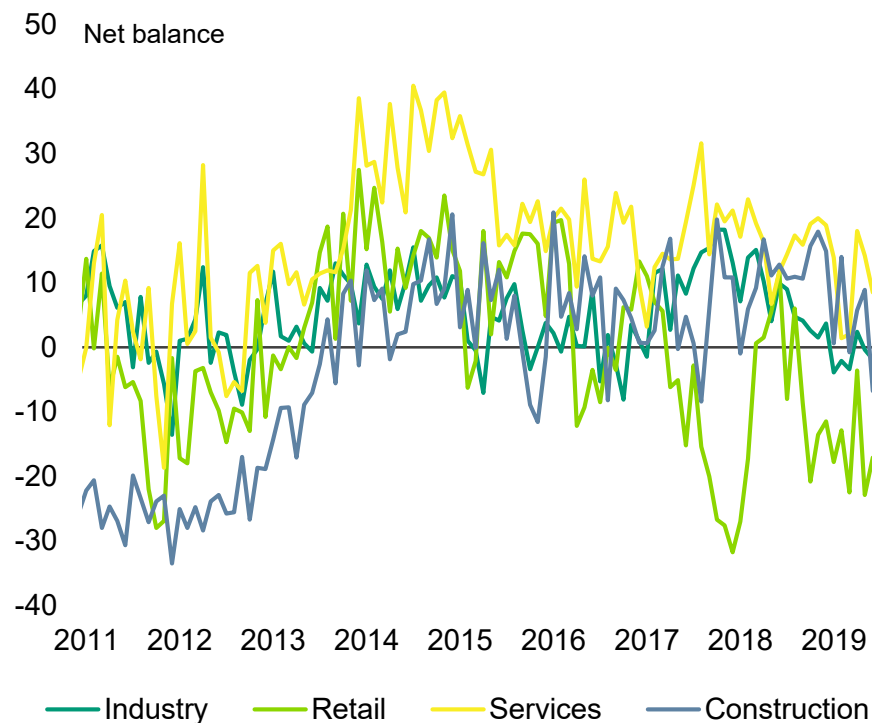
Tight labour market : steady employment growth and historically low unemployment rate



Sources: ONS, Crédit Agricole SA / ECO

Employment growth has hovered around 1.1% YoY on average for the last three years. It has remained solid this year despite Brexit uncertainties. While it fell by 24,000 in March, it was still up 100,000 as a whole in Q119, after 166,000 in Q418. The unemployment rate has continued to drift lower, reaching 3.8% in the three months to April (NAIRU estimate at 4.25%). Alternative measures of labour market slack have also continued to decline. However, there are signs that labour demand may have softened.

But employment expectations are softer, pointing to lower labour demand



Sources: DG Ecfm, Crédit Agricole SA / ECO

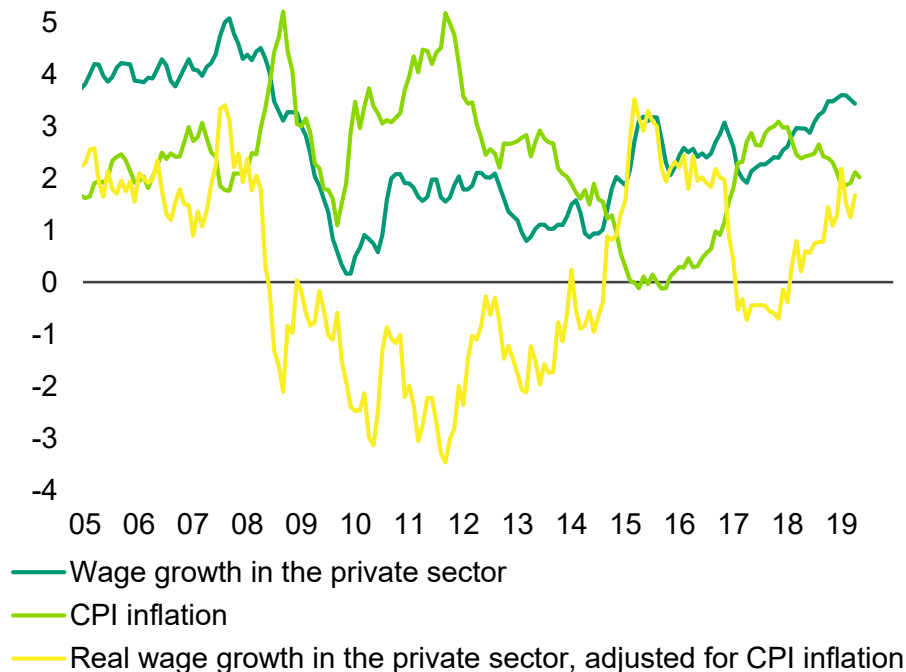
Employment expectations have adjusted downwards across all sectors. Surveys of recruitment difficulties have also become more mixed. The BoE's agents score survey has continued to suggest a tight labour market, but the CBI surveys have fallen recently from high levels. The number of job vacancies has been falling since end-2018.

LATEST ECONOMIC DEVELOPMENTS

WAGE GROWTH EXPECTED TO MODERATE

Nominal wage growth stabilises, real wage growth continues to accelerate

6 3mma, YoY, %

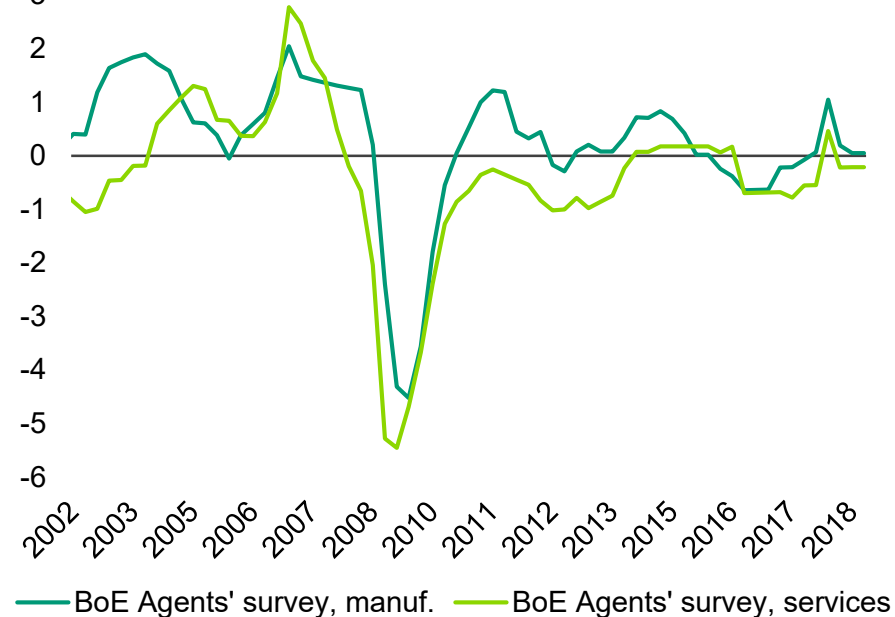


Sources: ONS, Crédit Agricole SA / ECO

Wage growth picked up during 2018, driven by the tightness in the labour market and some compositional effects which may unwind in the short term. Since October 2018, wage growth has stabilised at close to 3.4% YoY on a three-month average (3.5% YoY in the private sector), still above its post-crisis average. However, moderating inflation (CPI inflation fell to 2% in April) has caused real wage growth to accelerate further (1.7% YoY in the three months to April).

Surveys of pay settlements suggest wage growth should moderate near term

4 Nb of st.dev. away from mean since 1998



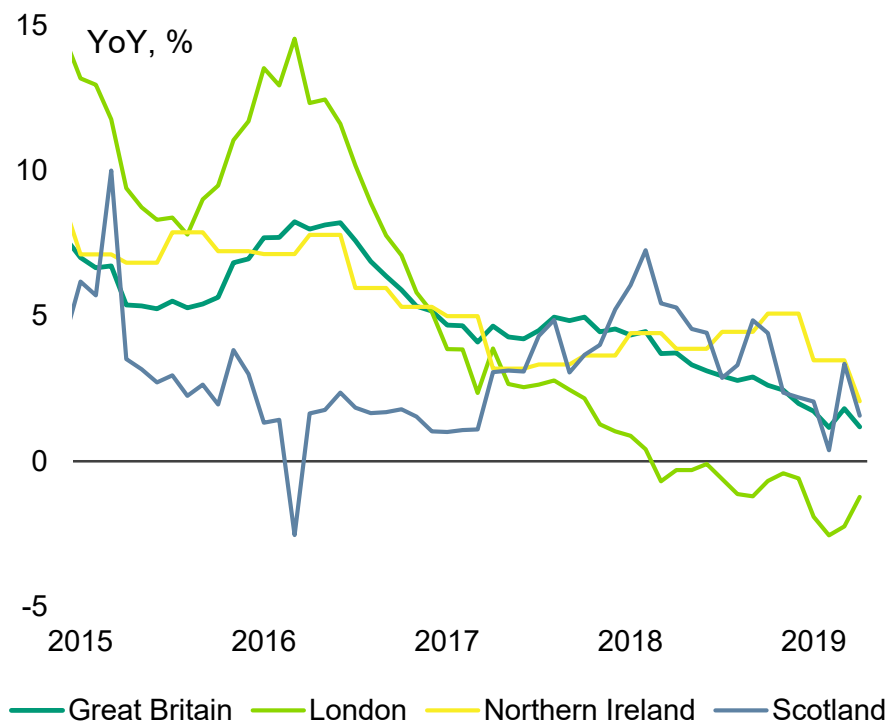
Sources: BoE, Crédit Agricole SA / ECO

Surveys of pay settlements and high-frequency indicators suggest that wage growth might have levelled off and that it will likely moderate in the coming months. In the medium term, a faster rate of increase in productivity gains will be necessary before we see any lasting pressures on wage growth. The combination of strong wage growth so far and weak productivity growth (0.8% in Q119 YoY) has led to higher-than-expected unit labour costs growth (2.1% YoY in Q119), explaining the relative hawkishness of the Bank of England.

LATEST ECONOMIC DEVELOPMENTS

CONTINUED WEAK TRENDS IN THE HOUSING MARKET

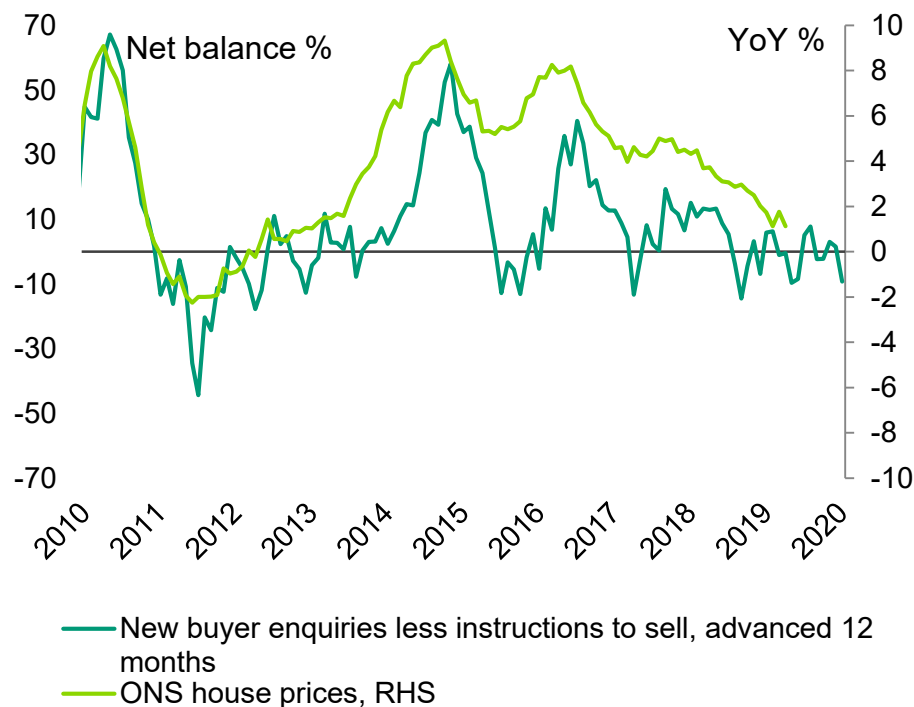
Soft landing in house prices



Sources: ONS, Crédit Agricole SA / ECO

The gradual slowdown in the housing market has continued and has broadened to all parts of the United Kingdom. Annual house price inflation has slowed to 1.4% on average in the three months to April, the weakest rate since 2013. Growth of gross lending for house purchase, which is closely related to house price inflation, has been close to zero in the past three months while it was close to 10% two years ago.

RICS survey suggest a prolonged stagnation in prices



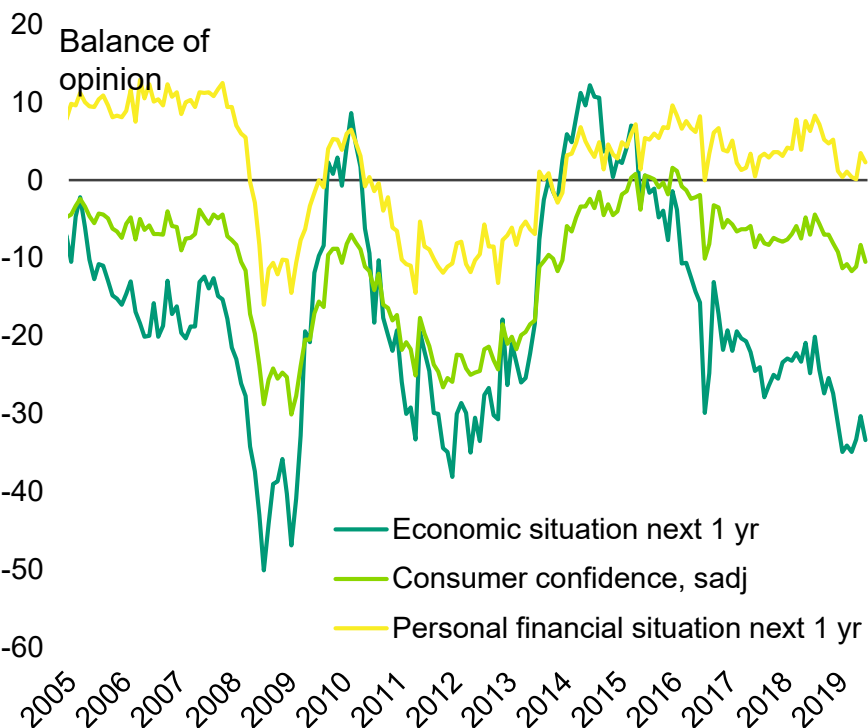
Sources: RICS, ONS, Crédit Agricole SA / ECO

Brexit-related uncertainties are a key factor of weakness of house price inflation, according to surveyors of the RICS, alongside other factors such as policy changes in the buy-to-let market and affordability constraints. Supply factors have also weighed on prices as house building help up well after the referendum, leading to excess supply of housing in some regions. House price inflation is expected to fall further in the near term.

LATEST ECONOMIC DEVELOPMENTS

MIXED SHORT-TERM INDICATORS FOR CONSUMER SPENDING

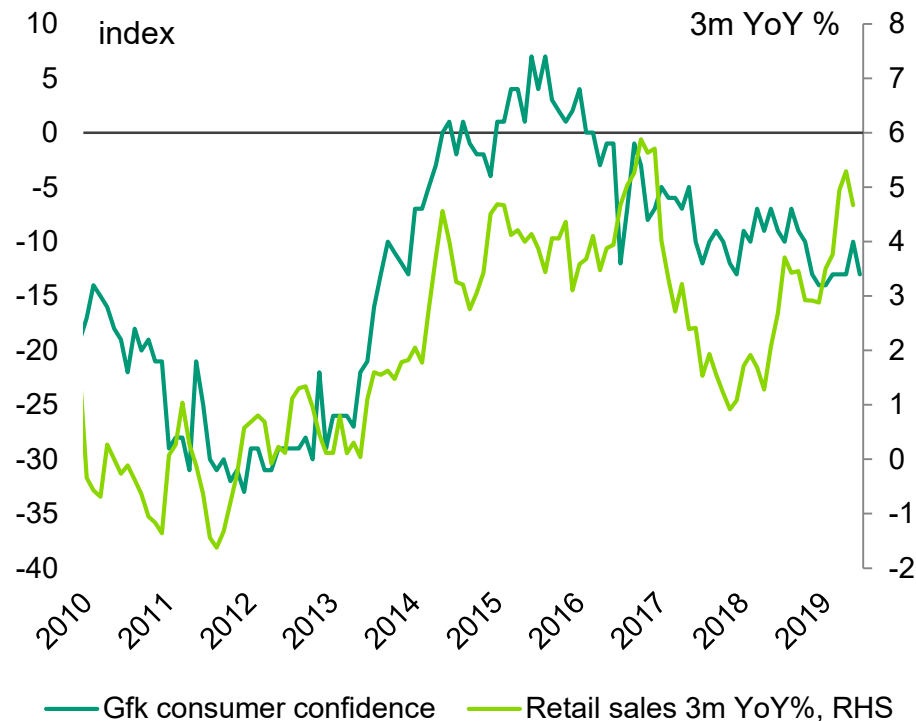
Consumers still optimistic about their own prospects



Sources: EC, Crédit Agricole SA / ECO

After having fallen sharply in 2018, consumer confidence indicators have been relatively stable since the beginning of the year. Consumers remain optimistic about their own financial situation, while being much less confident in the general economic outlook. They have continued to support their consumption by using savings. The savings rate fell further in Q119 to 4.4%, down from 4.8% in Q418.

Retail sales growth temporarily boosted by Brexit



Sources: ONS, Crédit Agricole SA / ECO

Other advanced indicators are less buoyant. Car registrations are down -2.1% YoY in June 2019 and retail sales growth slowed to 2.3% YoY in May. We expect household consumption to slow to 0.4% QoQ in Q219, after 0.6% QoQ in Q119, as the temporary effect of Brexit on stockpiling ahead of the initial Brexit date progressively unwinds.

UNITED KINGDOM 2019-20 SCENARIO

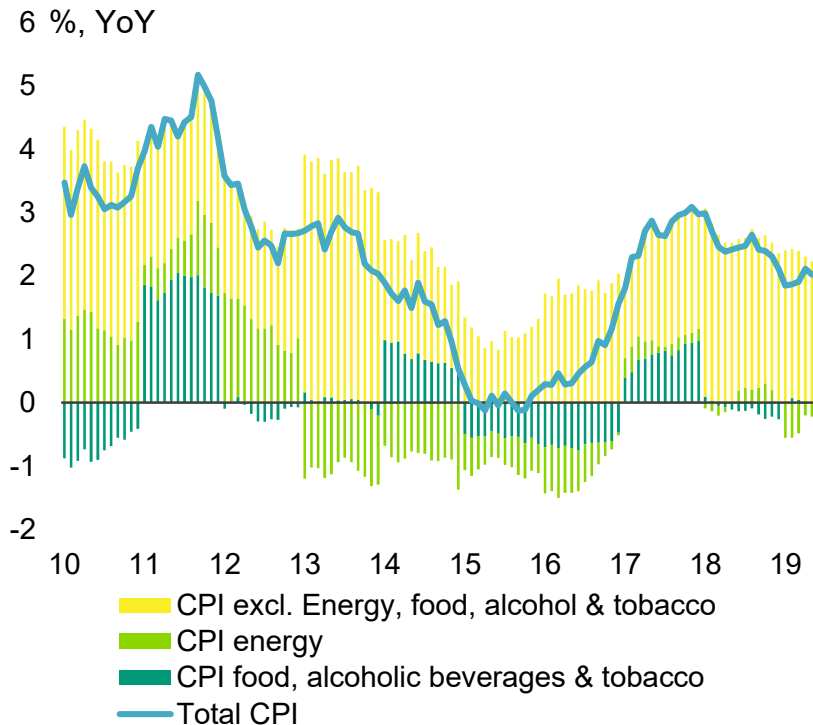
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THE BASIS OF OUR SCENARIO

INFLATION TO FALL TEMPORARILY BELOW TARGET

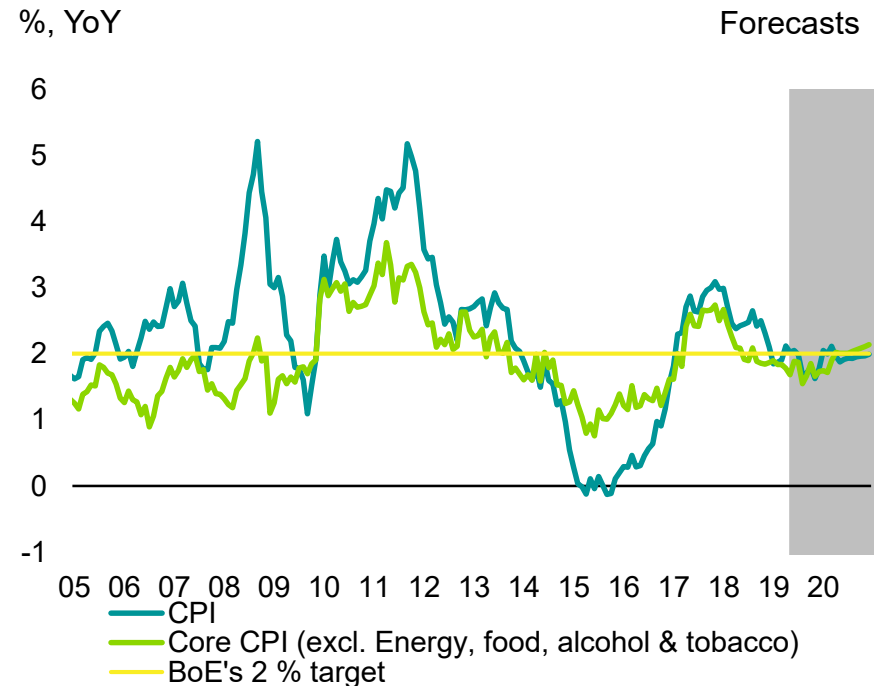
CPI inflation and key components



Sources: ONS, Crédit Agricole SA / ECO

CPI inflation fell to 2% in May, in line with our expectations and hitting the BoE's target, as the effects of the post-referendum depreciation of GBP on imported inflation have dissipated. The non-energy industrial goods inflation, which is sensitive to exchange-rate variations, is now close to 0% versus 2.5% as at end-2017. Core inflation declined to 1.7% YoY in May, its lowest rate since January 2017, suggesting that rising labour costs have not yet been passed on through higher prices by companies. Services inflation eased to 2.5% in May down from 2.8% in November.

CPI inflation expected below target for most of the forecast period



Sources: EC, GfK, ONS, Crédit Agricole SA / ECO

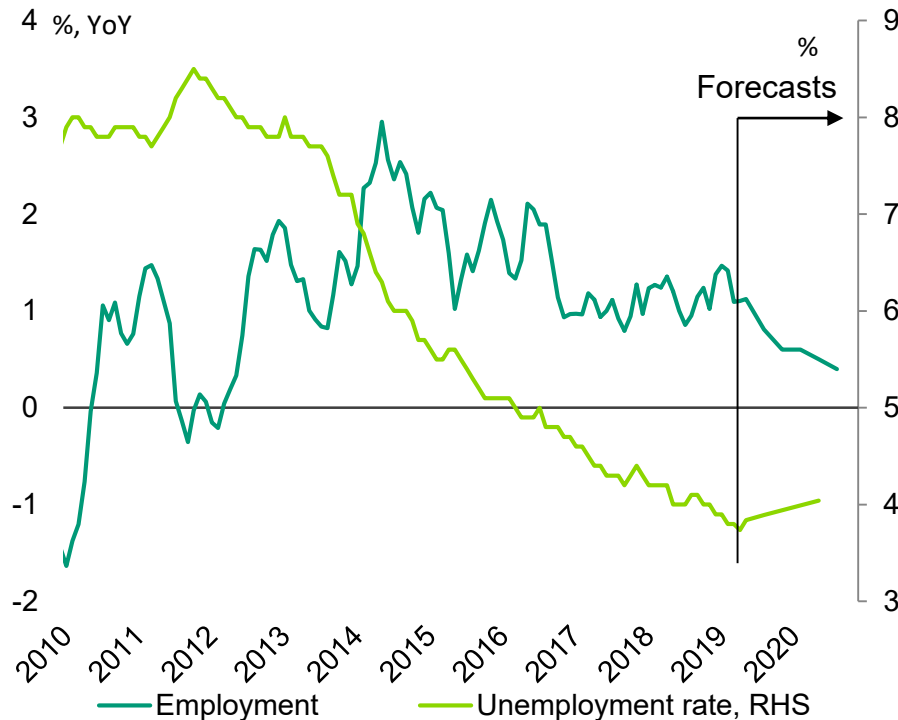
We are forecasting that inflation will ease further this year to 1.7% YoY on average in Q419, driven by the falling contribution from energy prices, before rebounding to the 2% target in Q120. Core inflation is expected to remain close to current rates, as we do not expect an acceleration in domestic inflationary pressures. Indeed, wage growth is expected to stabilise in the coming months and to ease in 2020 as the labour market responds to weaker growth prospects with less strong employment growth.

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THE BASIS OF OUR SCENARIO

THE LABOUR MARKET, AT FULL EMPLOYMENT, TO SOFTEN GRADUALLY

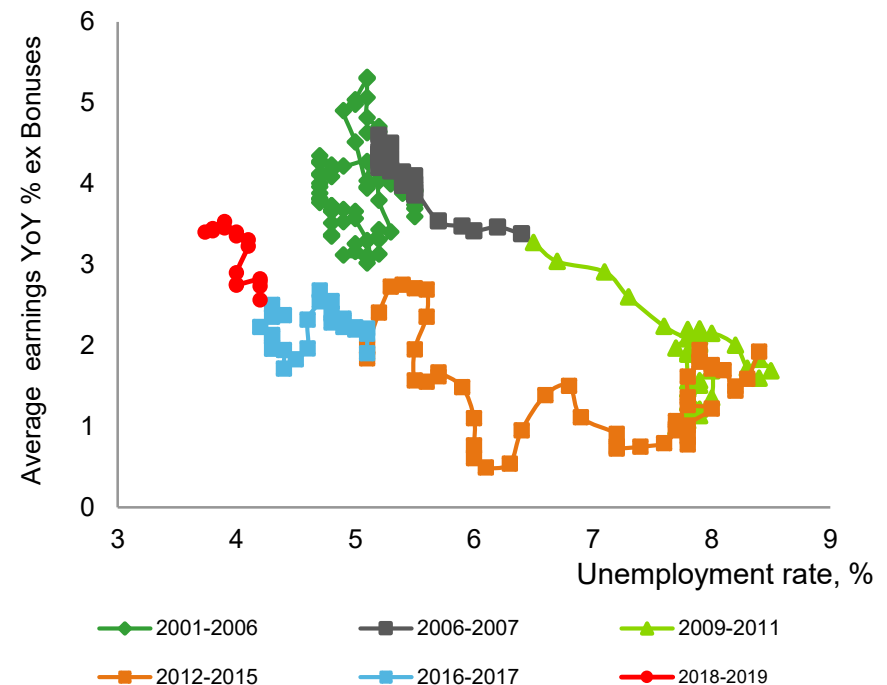
Employment and unemployment rate projections



Sources: ONS, Crédit Agricole SA / ECO

We expect softer employment growth going forward and a slight increase in the unemployment rate throughout 2020 to 4%, still below the long-term equilibrium rate, assuming a stable participation rate at 63.8%. We expect wage growth to moderate slightly this year, but to remain close to the current high rates as the labour market remains tight. The outlook for next year is less certain as it will furthermore depend on the migration policy adopted post Brexit. In our scenario we assume an extension in Article 50

The Phillips curve has steepened since 2018



Sources: ONS, Crédit Agricole SA / ECO

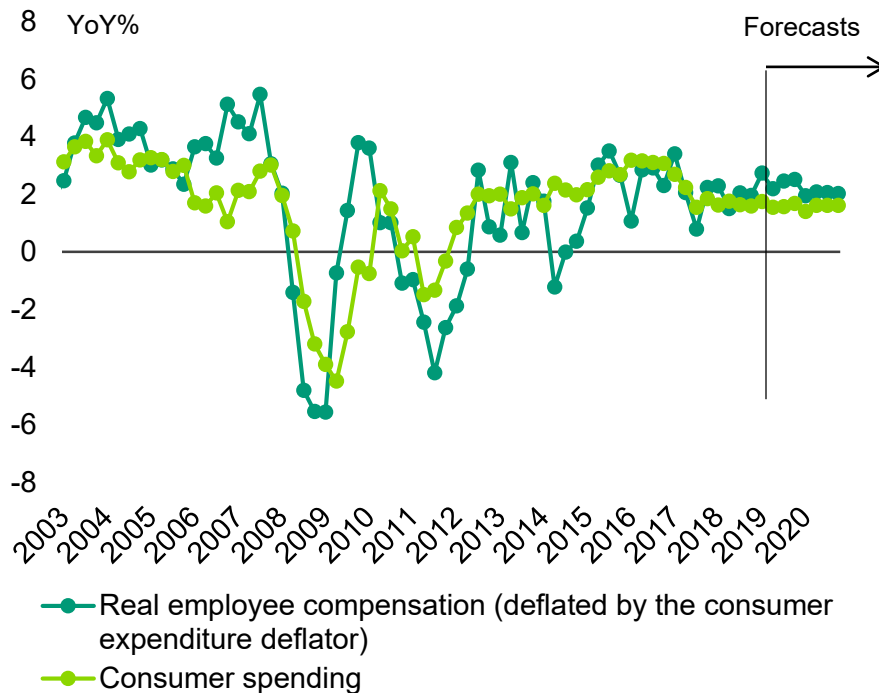
which means that there will be no changes in the free movement of EU citizens over the forecast period. However, possible shortages of labour force related to lower rates of EU immigration means that some sectors are likely to continue to experience recruitment difficulties and to generate upward pressure on wages. For instance, the BoE expects average weekly earnings growth to accelerate to 3.5% in 2020 and 3.75% in 2021, but it will likely revise these figures down in the August inflation report.

4

THE BASIS OF OUR SCENARIO

HOUSEHOLD CONSUMPTION : A FRAGILE PILLAR TO GROWTH

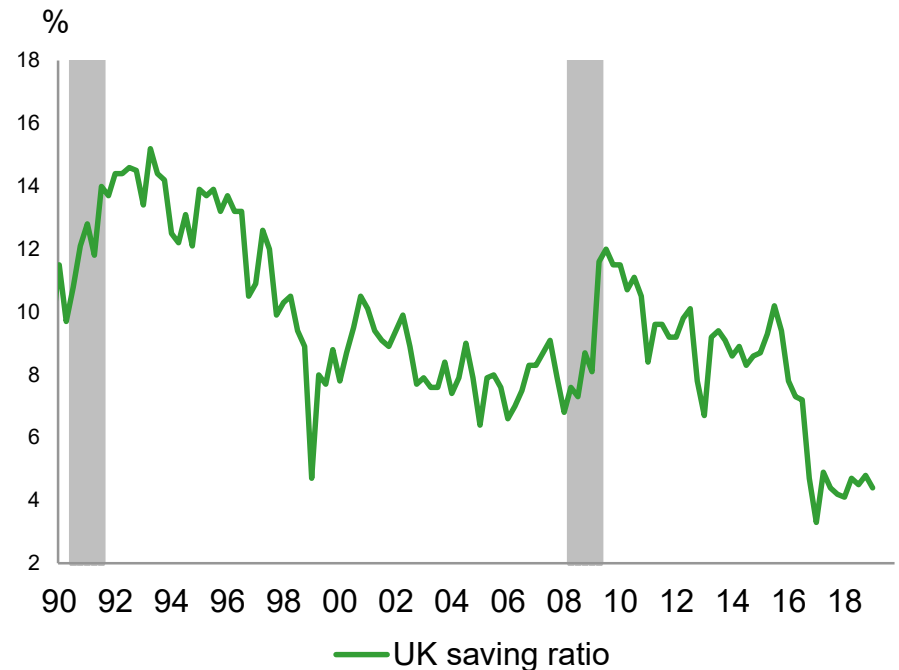
Household consumption to grow broadly in line with real income growth



Sources: ONS, Crédit Agricole SA / ECO

Household consumption is expected to continue to grow in line with real income growth. The purchasing power is expected to grow solidly this year due to the effect of a forecast easing of inflation which should compensate for some easing in wage growth. However, the expected slowing in employment growth on the back of lower growth in 2020 and some rebound in inflation, is likely to lead to slightly softer growth in the purchasing power next year. As long as households are confident about their future situation, they should continue to save less and borrow more

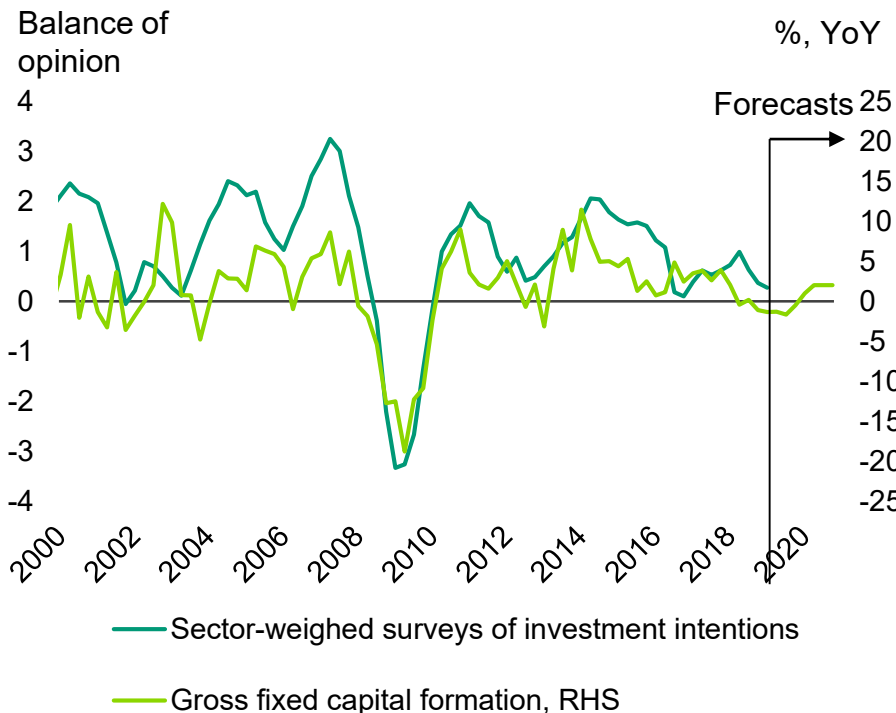
The savings ratio remains extremely low



Sources: Gfk, ONS, Crédit Agricole SA / ECO

in order to sustain their consumption. We therefore expect household consumption to grow at close to current rates (by 1.7% in 2019 and 1.6% in 2020). Prudent monetary policy setting and accommodative fiscal policy should remain key tailwinds. However, the household financial situation is fragile. The low savings rate is worrying in terms of the resilience of household consumption in case of a shock. The risk of a correction in spending is significant if households adjust sharply their expectations for future earnings.

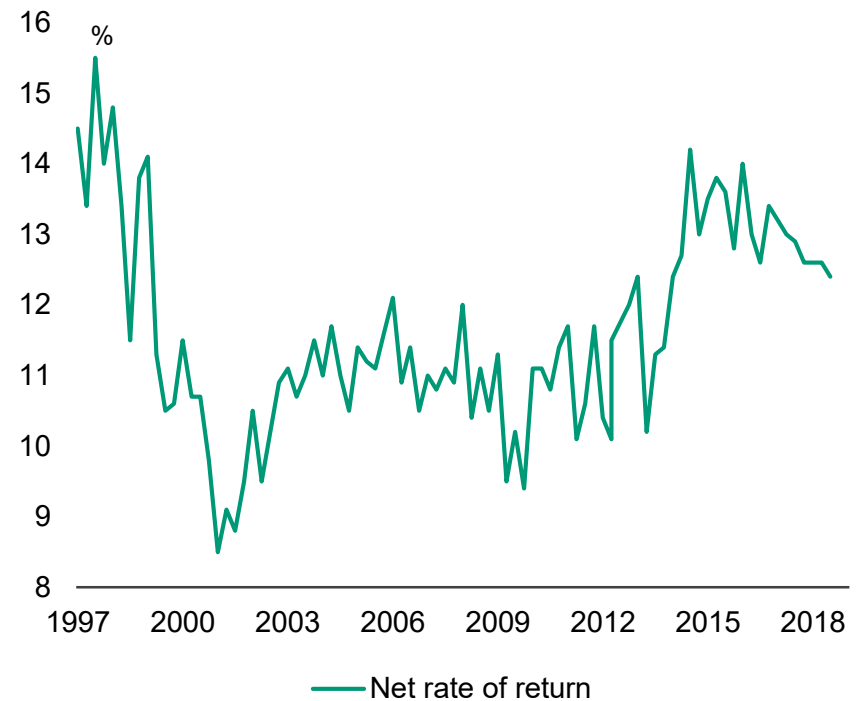
Investment intentions and capital formation



Sources: ONS, Crédit Agricole SA / ECO

Business investment was down by 0.4% in annual growth in 2018, contracting for four quarters in a row. It has underperformed both compared to previous recoveries and relative to other G7 countries. Brexit has been one of the three most important sources of uncertainty for companies. BoE's Governor Mark Carney estimates that it has caused a 12% hit in business investment. Investment intentions have weakened further at the end of last year and the beginning of this year, both in the manufacturing sector and in services, suggesting a further slowdown in

Weaker profitability



Sources: ONS, Crédit Agricole SA / ECO

investment in the coming quarters.

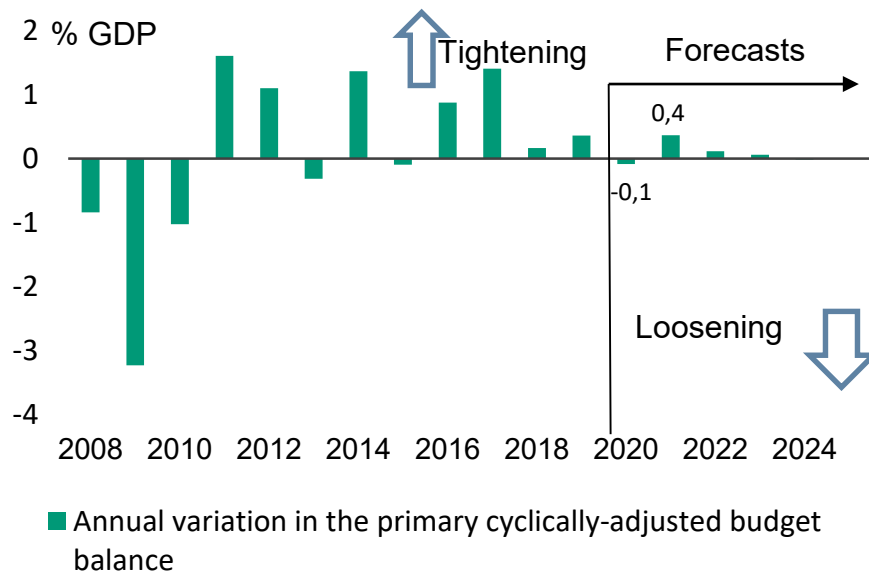
We do expect some improvement next year on the back of smooth Brexit assumptions, but it should be modest. Fundamentals have deteriorated with profitability falling on the back of rising unit labour costs. The more uncertain global environment adds to Brexit uncertainty and argues for continued weak growth in business investment, despite the low interest rate environment.

4

THE BASIS OF OUR SCENARIO

FISCAL EASING TO COME WHOMEVER THE NEXT PM

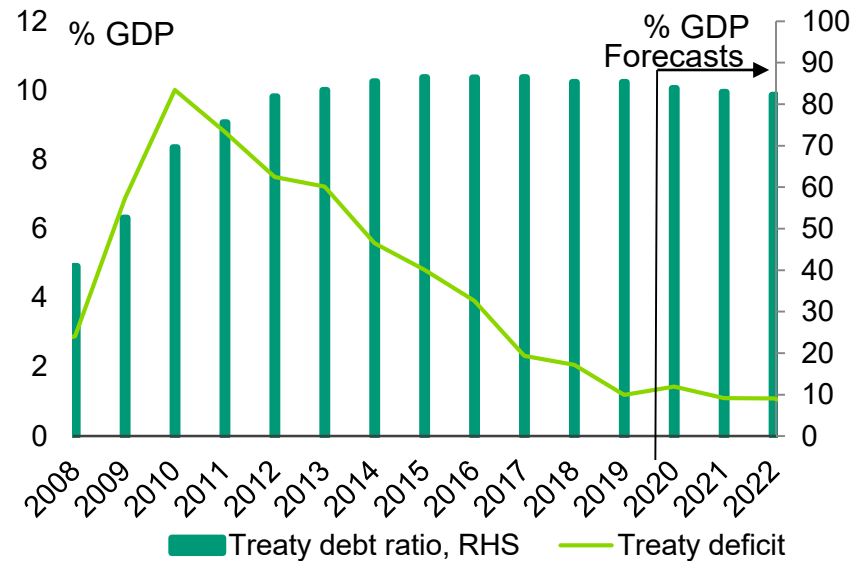
Fiscal tightening is planned to be resumed in 2020/21, according to current plans



Source: OBR 2019 Spring Statement

The budget presented in October 2018 for fiscal year 2019/20 delivered the biggest fiscal easing since the 2008/09 crisis. There was a significant increase in spending for the NHS system (GBP27.5 by 2023/23), in social spending as well as some lower taxation. The OBR then had estimated that these measures were to allow for a 0.3% loosening in the cyclically-adjusted primary surplus in FY 2019/20. This figure was revised to a more modest 0.1% loosening following the Spring statement in March. Tax receipts from corporate and income tax have continued to perform better-than-expected on the back of stronger-than-expected wage growth, employment and participation rate. Alongside lower debt interest costs, this led to the lowest budget deficit in 2018/19 since 2001/02 at GBP24bn (1.1% of GDP). Budget projections are conditioned on the assumption of

The fiscal windfall is used to bring down public debt



Source: OBR 2019 Spring Statement

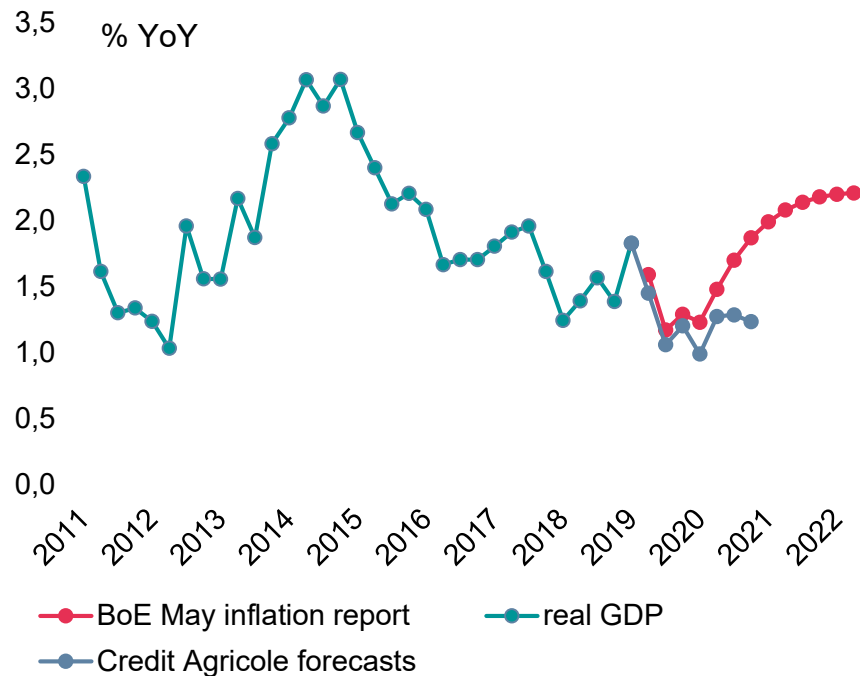
an “orderly departure from the EU on 29 March into a transition period that lasts to the end of 2020”.

Both potential new Prime ministers are pledging fiscal easing, similar or larger than Labour’s 2017 manifesto (1-2% of GDP). B. Johnson’s two main tax proposals are to increase the high-rate income tax threshold from £50,000 to £80,000 and to raise the point at which people start paying NICs. If implemented, these measures are expected to increase the public deficit by GBP25bn per year (1.2% of GDP), according to the IFS. J. Hunt is proposing an even larger fiscal easing (amounting to GBP42bn) including a corporation tax cut to 12.5% and higher defence spending to 2.5% of GDP over the next five years.

THE BASIS OF OUR SCENARIO

THE BANK OF ENGLAND TO (AT LEAST) POSTPONE ITS NORMALISATION

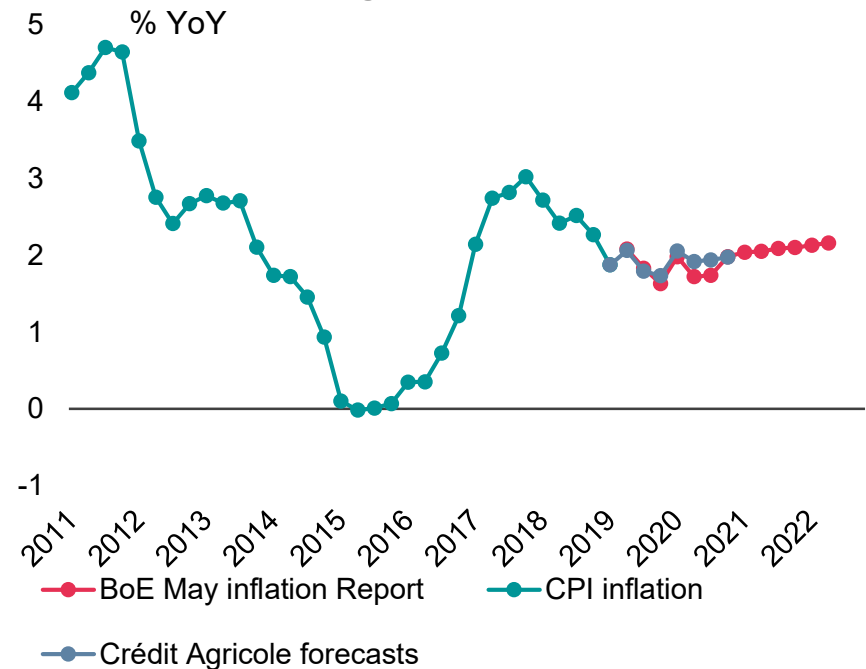
BoE's GDP growth forecasts are too optimistic



Sources: ONS, BoE, Crédit Agricole S.A.

Contrary to the Fed and the ECB, the BoE has maintained a hawkish bias suggesting that a very gradual monetary-policy tightening is set to continue over its three-year forecast period. In its June minutes, the BoE reiterated its relatively optimistic baseline outlook for the medium term: "as excess demand emerges, domestic inflationary pressures are expected to firm, such that CPI inflation picks up to above the 2% target in two year's time and is still rising at the end of the three-year forecast period". Short term however, it expects a slight margin of slack to open, wage growth to moderate and inflation to fall below target.

CPI inflation is expected to drift below target near term



Sources: ONS, BoE, Crédit Agricole S.A.

The MPC looks split on the inflation outlook and monetary policy prospects. Governor Mark Carney has recently suggested that weaker global growth and US trade tensions are likely to have more importance on the rates outlook than previously thought. Other MPC members are however still upbeat about the economic and inflation forecast. Sylvana Tenreiro continues to see the need for a "small amount of policy tightening" over the forecast period.

We have changed our baseline scenario from one rate hike in Q120 previously to unchanged monetary policy this year and next.



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