

Economics in Brief



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United Kingdom: Recovery with risks

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The British economy has returned to growth path in 2013; the purchasing manager index for the service sector recently posted its highest level since 1997. With an expected growth of 1½ % in 2013 and 2% 2014, Britain occupies a pole position among industrialised countries. However, the British growth model is still not well balanced.

Savings ratio on a declining trend

British growth is largely driven by private consumption combined with a recovery of the real estate market. In the first half of 2013, private consumption expenditure – with a ratio of 65% the most important GDP aggregate – increased by 1.7% year-over-year. As income growth was weak, private households were relying on a reduction of their savings. As a consequence the savings ratio fell from an average of 6.8% in 2012 to 5.2% in the first half of 2013. Without a marked improvement in income and employment (current unemployment rate: 7.7%), the room for further increases in consumption will remain limited.

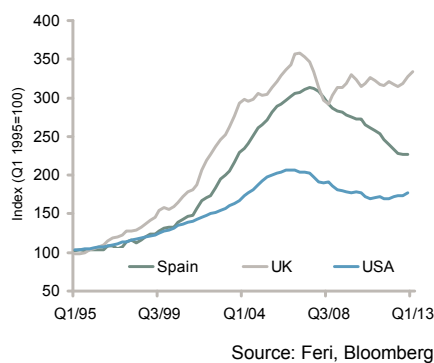
Residential property market is burgeoning

In contrast to many other countries, there was only a limited correction in British house prices since the start of the financial crisis (see figure). Since the beginning of 2013, house prices have started climbing again. The recovery is fuelled by two public programmes:

(1) The government's "Help to buy" programme assists households with lower incomes to acquire homes. Potential homeowners need to contribute at least 5% of the property price as deposit, in order to get another 20% of the purchase price as a loan or guarantee from the government.

(2) With the "Funding for lending" scheme, banks and building societies get access to cheap refinancing funds from the Bank of England in dependence of the development of their net lending activities.

Figure: House prices in comparison
(Q1 1995=100)



These measures have been successful in promoting mortgage lending. Mortgage approvals are at the highest level since the start of 2008; the amount of outstanding private mortgage loans is presently nearly 32% higher than in 2008.

The increase in supply of new residential property is not keeping pace with the upturn in demand. It is estimated that the volume of housing completions was almost 40% below demand in 2012. New real estate price bubbles therefore seem likely.

Manufacturing sector is problem child

Despite the "Funding for lending" scheme, the corporate sector is facing difficult lending conditions. The granting of new loans is weak. The total amount of outstanding loans to the non-financial corporate sector is presently 25% below the level of 2008. In parallel to this, there is a pronounced weakness in corporate investment activities. In the first half of

2013, gross fixed capital formation was 6% lower on a price adjusted basis than in previous year. After a long period of decline fixed investment amounted to only 14.5% of GDP in 2012 (Germany: 17.4%).

The manufacturing sector remains a problem child. Its contribution to overall price-adjusted gross value added has constantly declined in recent years (2012: 10%). In contrast, services related to the housing market have markedly gained ground (2012: 22%). Beside the health / social sector, they were the only ones with a higher real gross value added in 2012 as in the pre-crisis year 2007.

Against this backdrop, the "rebalancing of the economy" promoted by the British government, i.e. the establishment of a growth model with a greater emphasis on the export-orientated manufacturing sector, seems hardly achievable in the foreseeable future. There is thus also little hope of a turnaround in the trend in the current account balance. Due to a chronic shortfall in the trade balance, the British current account balance has been in deficit for the last 30 years. In relation to nominal GDP, it amounted to -3.8% in 2012. According to estimates by the IMF there will only be a limited improvement in 2013 (-2.8%).

Outlook

The current positive trend in growth in Britain rests on a very shaky foundation. In the absence of a strong industrial base, Britain must revert to its customary mix, strong consumer demand combined with an ongoing recovery in the housing market. In order to kick start the real estate market, the government relies entirely on stimulating the demand side. It does not hesitate to rely on instruments, which in view of Britain's starting point – an only limited correction in house prices – seem risky. This could prove to be a boomerang for the British economy and the public finances in future. ■