GLOBAL ECONOMIC OUTLOOK - JULY

2017

Monetary Department
External Economic Relations Division

CZECH NATIONAL BANK

Cut-off date for data
14 July 2017

CF survey date
10 July 2017

GEO publication date
21 July 2017

Notes to charts

ECB and Fed: midpoint of the range of forecasts.
The arrows in the GDP and inflation outlooks indicate the direction of revisions compared to the last GEO. If no arrow is shown, no new forecast is available. Asterisks indicate first published forecasts for given year. Historical data are taken from CF, with exception of MT and LU, for which they come from EIU.
Leading indicators are taken from Bloomberg and Datastream.
Forecasts for EURIBOR and LIBOR rates are based on implied rates from interbank market yield curve (FRA rates are used from 4M to 15M and adjusted IRS rates for longer horizons). Forecasts for German and US government bond yields (10Y Bund and 10Y Treasury) are taken from CF.

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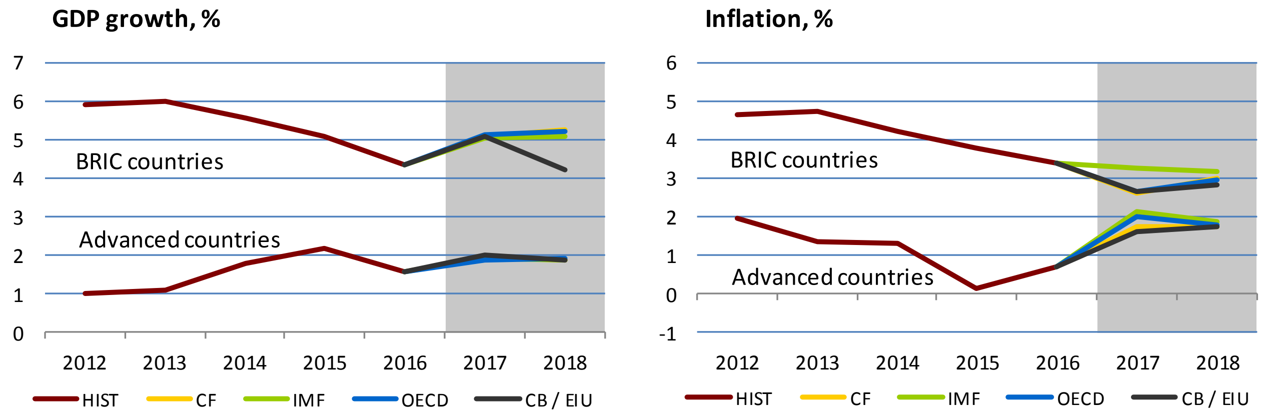
The July issue of Global Economic Outlook presents the regular monthly overview of recent and expected developments in selected territories, focusing on key economic variables: inflation, GDP growth, leading indicators, interest rates, exchange rates and commodity prices. In this and the following August issue, we also focus on one of the main current economic phenomena – Brexit. At the end of June, a year elapsed since the referendum in which the United Kingdom voted to leave the European Union. In both articles we focus on assessing this decision's economic impacts on the UK. The July issue is devoted to the short-term effects. It is apparent from a whole range of indicators that the conclusions of the many studies that warned of a negative Brexit shock for the UK economy are gradually materialising – from the initial visible nervousness of the financial markets, through the announcement of the referendum, to creeping and gradual impacts on the real economy. The final form of the terms negotiated with EU institutions will decide whether these impacts will be short- or long-term. This aspect – along with possible medium-term outlooks – will be the subject of a follow-up article in the August issue.

A look at the outlooks for annual GDP growth in the advanced countries we monitor mostly shows increases in expected economic growth in euro area countries compared to the previous month. The consumer inflation outlooks for the euro area remain flat or falling. This is complicating the normalisation of European monetary policy, as inflation in the euro area and in its strongest economy, Germany, is still about half a percentage point short of the 2% target. The GDP growth and inflation outlooks for the world's strongest economy, the USA, were revised downwards slightly. Despite that, both figures are higher in the USA than in euro area partners. The growth outlook for the UK, which is leaving the EU, was unchanged from the previous month. The UK economy is expected to grow slightly more slowly than the euro area economy, maybe due to the effects of Brexit as discussed in this issue, but amid higher inflation, which should lead to a policy tightening in the form of an interest rate hike. By contrast, new data for the Japanese economy slightly lowered the inflation outlook again. The 0.5% inflation level expected for this year is thus also sending out warning signals and calls for a monetary policy response to this gloomy, albeit typical situation for Japan over the last almost three decades.

The outlooks for India, one of the fastest growing countries, brought a downward revision of inflation compared to the previous month amid sustained high economic growth rates. The new outlooks for the Chinese economy also saw a drop in consumer inflation, although its expected level may not even reach 2%. Nevertheless, the good news not only for the Chinese economy, but also for the global economy in general is that economic growth next year was revised to slightly higher levels, though this still means no change in the gradual downward trend in Chinese economic growth. The less dynamic BRIC countries (Russia and Brazil) recorded a shift in outlook towards lower consumer inflation compared to the previous month. A shift in outlook in the same direction was recorded for Brazilian economic growth. The previous month's outlooks for the Russian economy were confirmed.

The outlooks for euro area interest rates remain very low and negative over the entire horizon, reflecting uncertainty regarding the ECB's future monetary policy stance. As for the USA, the pressures for further growth of interest rates can be expected to ease slightly after the rise in rates in June. According to CF, the US dollar will depreciate slightly against the euro, the British pound and the Indian rupee, and more markedly against the Chinese renminbi and the Brazilian real, at the one-year horizon. Against the other monitored currencies it should be broadly stable. The outlook for the average Brent crude oil price has dropped below USD 50 a barrel. Prices of non-energy commodities are expected to rise slightly at the one-year horizon, due mainly to food commodity prices, with prices of wheat, rice and corn expected to go up.

GDP growth and inflation development and outlook in monitored countries



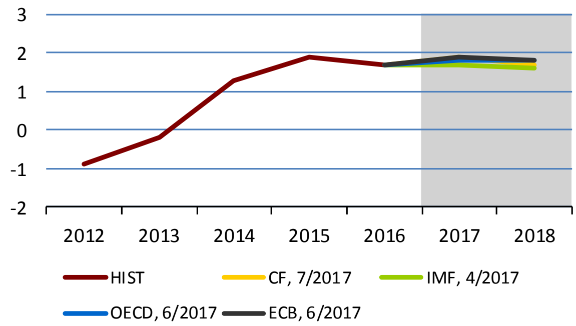
Note: The figures represent the weighted averages of historical series / outlooks in individual countries. The weights are based on nominal GDP measured in USD during 2011–2015 (source: EIU). Advanced countries: euro area, United States, United Kingdom, Japan. BRIC countries: China, India, Russia, Brazil.

II.1 Euro area

GDP growth in the euro area rose to 0.6% in quarter-on-quarter terms at the start of this year, still driven primarily by private domestic demand. Recently published coincident and leading indicators are positive, signalling that the economy will continue to grow at a relatively solid pace in Q2. Industrial production rose by 4% year on year in May and its growth will remain strong over the outlook according to leading indicators. The PMI in manufacturing, for example, increased again in June, reaching a more than six-year high. It is signalling faster expansion in most of the large and small economies monitored. In addition, household demand continues to be supported by favourable labour market developments, the ECB's accomodative monetary policy and positive sentiment in the economy. Overall, the euro area economy will grow by 1.9% this year and 1.7% next year, according to CF. The other institutions expect similar growth rates as CF.

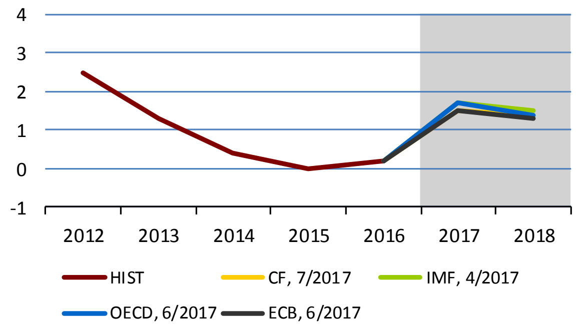
Both inflation and the inflation outlooks remain subdued despite solid growth of the real economy. HICP inflation fell to 1.3% in June, the lowest rate this year. The drop was due mainly to a lower contribution from energy prices. By contrast, core inflation was stable just above 1%. Inflation should remain at low levels for the rest of the year. According to CF, it will hover at 1.5% on average this year. Next year, average inflation is expected to drop slightly as the positive contribution from energy prices unwinds. It will reach 1.8% in 2019, according to the ECB. The observed absence of inflation pressures from the core components of the consumer basket and low wage growth, coupled with faster economic growth, represent an uncertainty regarding the setting of monetary policy parameters by the ECB, whose next meeting takes place on 20 July. In this context, government bond yields increased quite sharply at the end of June. The market outlooks for money market rates also shifted in the same direction compared to the previous issue of GEO. Nevertheless, the 3M EURIBOR is expected to be negative until the end of 2018.

GDP growth, %



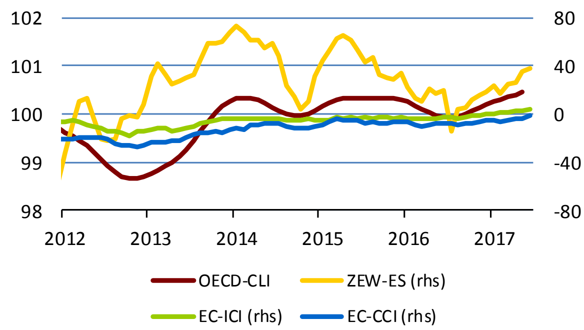
	CF		IMF	OECD	ECB
2017	1.9		1.7	1.8	1.9
2018	1.7		1.6	1.8	1.8

Inflation, %



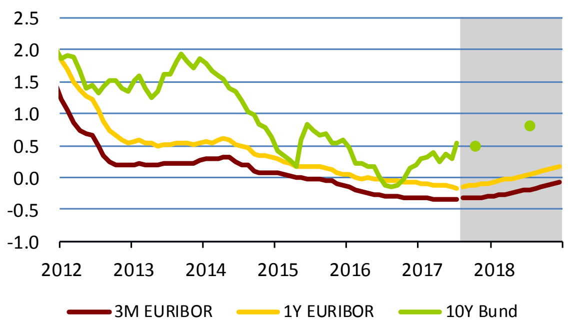
	CF		IMF	OECD	ECB
2017	1.5		1.7	1.7	1.5
2018	1.4		1.5	1.4	1.3

Leading indicators



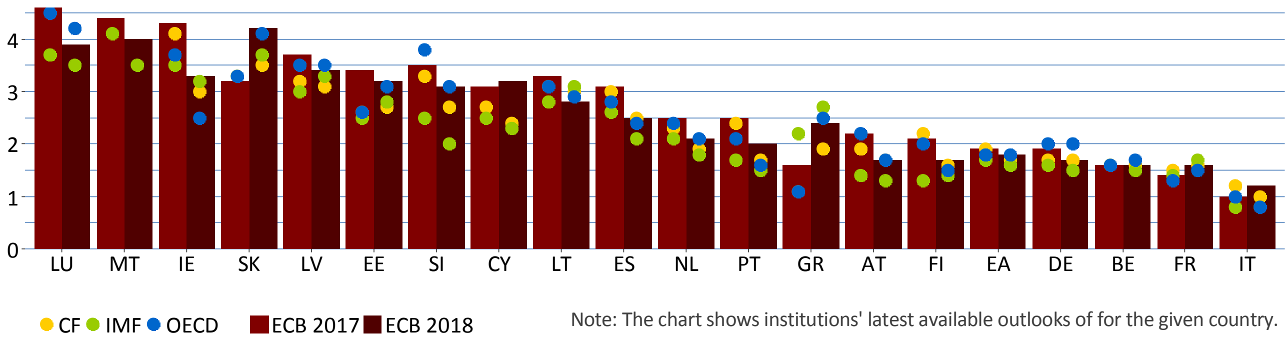
	OECD-CLI	ZEW-ES	EC-ICI	EC-CCI
4/17	100.4	26.3	2.6	-3.6
5/17	100.5	35.1	2.8	-3.3
6/17		37.7	4.5	-1.3

Interest Rates, %



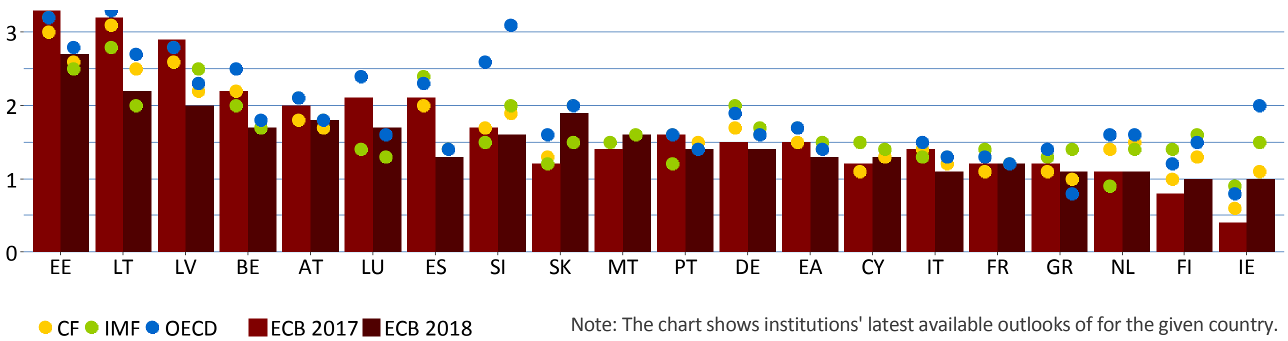
	06/17	07/17	10/17	07/18
3M EURIBOR	-0.33	-0.33	-0.31	-0.18
1Y EURIBOR	-0.15	-0.16	-0.12	0.05
10Y Bund	0.29	0.53	0.50	0.80

GDP growth outlooks in the euro area countries in 2017 and 2018, %



Note: The chart shows institutions' latest available outlooks of for the given country.

Inflation outlooks in the euro area countries in 2017 and 2018, %

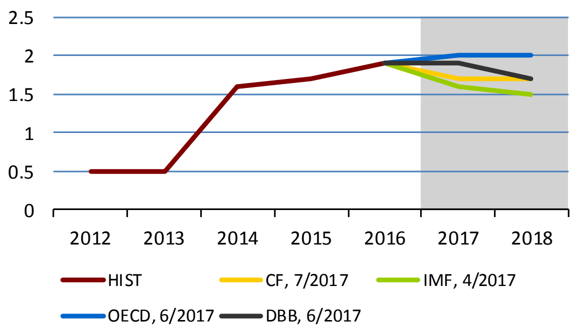


Note: The chart shows institutions' latest available outlooks of for the given country.

II.2 Germany

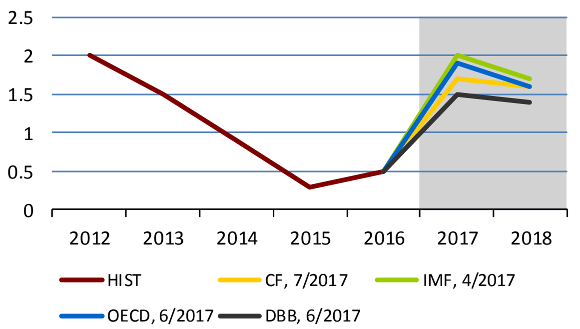
The German economy continues to grow at a robust pace, building on the growth rate of 0.6% quarter on quarter recorded in Q1. This is signalled by leading indicators (the PMI in manufacturing, for example, is at a six-year high) and by newly published data from the economy. Industrial production went up by 5% year on year in May. The unemployment rate remains at record-low 3.9%, and labour market developments, combined with positive sentiment, contributed to year-on-year retail sales growth of 5% in May. Export growth is also strong, reaching 14.1% year on year in May. CF revised its growth outlook for this year upwards. GDP growth should thus reach 1.7%, and the same figure is expected for next year. Inflation remains subdued. HICP inflation was 1.5% in June. Its average levels for this year and the next are expected to range between 1.4% and 2%.

GDP growth, %



	CF		IMF	OECD	DBB
2017	1.7		1.6	2.0	1.9
2018	1.7		1.5	2.0	1.7

Inflation, %



	CF		IMF	OECD	DBB
2017	1.7		2.0	1.9	1.5
2018	1.6		1.7	1.6	1.4

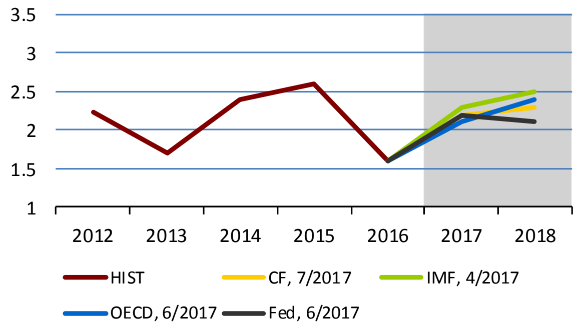
II.3 United States

As expected, the estimate of US economic growth in 2017 Q1 was revised upwards again, with investment growth in particular coming as a surprise for financial markets. The final GDP growth estimate was 1.4% (in quarter-on-quarter annualised terms). In particular, the consumer expenditure component – with 1.1% growth (in quarter-on-quarter annualised terms) – recorded an upward revision. Export growth and corporate investment growth were also higher than indicated by preliminary estimates. The contributions of government expenditure and change in inventories were negative. The current US economic expansion is the third-longest in history, but also the weakest in the past 70 years. According to the latest data, the economy will accelerate further in Q2.

Concerns that the US labour market trend is beginning to reverse are not materialising as yet. However, wage pressures are falling compared to the start of the year. Non-farm payrolls rose by 222,000 (as against an expected 187,000) in June. Unemployment grew to 4.4% and the average hourly wage went up by 2.5% year on year. According to the Conference Board survey, consumer confidence remained relatively high in June. However, the expectations component worsened compared to the previous month. According to consumers, the economy will continue to expand in the coming months, but the growth will not probably accelerate further. Year-on-year growth in retail sales slowed in June (to 2.8%). Industrial production increased by 2% in year-on-year terms. However, its future evolution is uncertain. The leading indicator for the US manufacturing industry fell further to a nine-month low, due mainly to the new orders component.

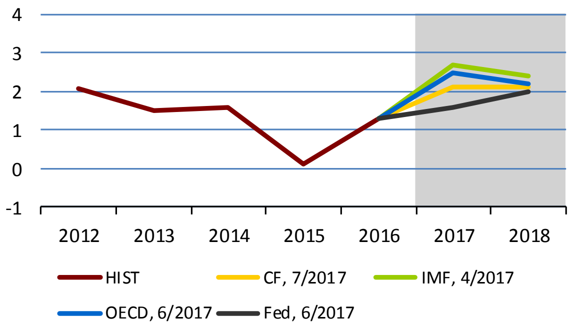
A drop in inflation pressures in the US economy is also apparent, with annual headline inflation slowing to 1.6% in June. Core inflation was the same as in the previous month (1.7%). Despite the drop in inflation pressures observed since March, the central bank is still indicating one more rate increase by the year-end. Financial markets expect the Fed to reduce its balance sheet, but give a further monetary policy tightening just a 50% chance. The July CF lowered its outlooks for growth in 2018 and inflation in both years.

GDP growth, %



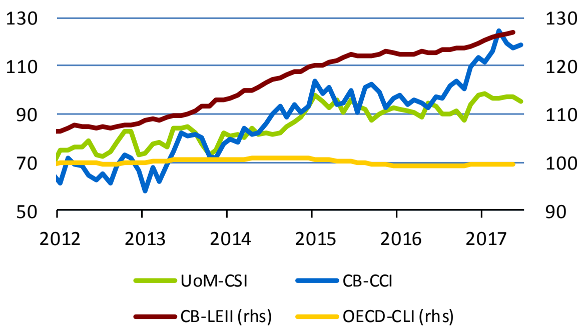
	CF	IMF	OECD	Fed
2017	2.2	2.3	2.1	2.2
2018	2.3	2.5	2.4	2.1

Inflation, %



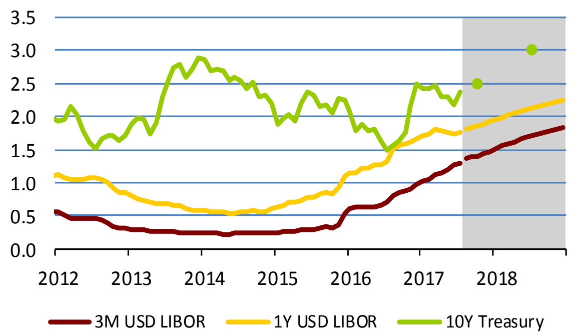
	CF	IMF	OECD	Fed
2017	2.1	2.7	2.5	1.6
2018	2.1	2.4	2.2	2.0

Leading indicators



	UoM-CSI	CB-CCI	CB-LEII	OECD-CLI
4/17	97.0	119.4	126.6	99.7
5/17	97.1	117.6	127.0	99.6
6/17	95.1	118.9		

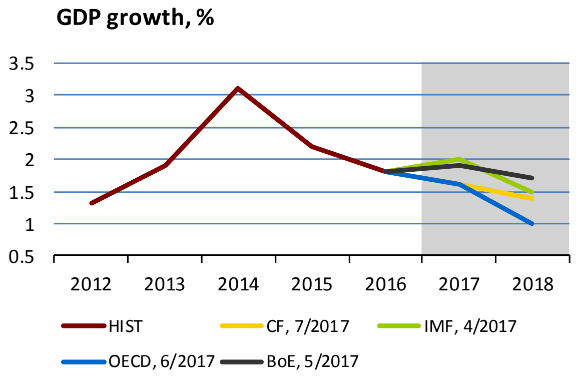
Interest Rates, %



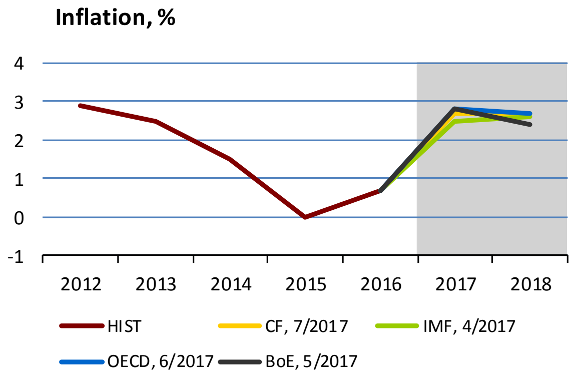
	06/17	07/17	10/17	07/18
USD LIBOR 3M	1.26	1.30	1.39	1.71
USD LIBOR 1R	1.73	1.73	1.86	2.12
Treasury 10R	2.18	2.38	2.50	3.00

II.4 United Kingdom

Final data confirmed that UK economic growth slowed markedly in Q1 (to 0.2% quarter on quarter). The UK Office for National Statistics will publish the first estimates for Q2 at the end of July. However, data from the real economy are not very encouraging. Industrial production and retail sales both fell in May. The London-based NIESR, which publishes its own monthly calculation of GDP growth in the past three months, has concluded that the slowdown of the UK economy was not just temporary, publishing quarterly growth estimate of 0.3% for Q2. As for the following quarters, leading indicators are none too optimistic. The PMI in services and manufacturing remains in the expansion band but has been falling for two months now, as has the OECD composite indicator. Despite declining unemployment (4.5% in May), consumer confidence is also falling due to rising inflation. The BoE could thus raise its policy rate in early August.



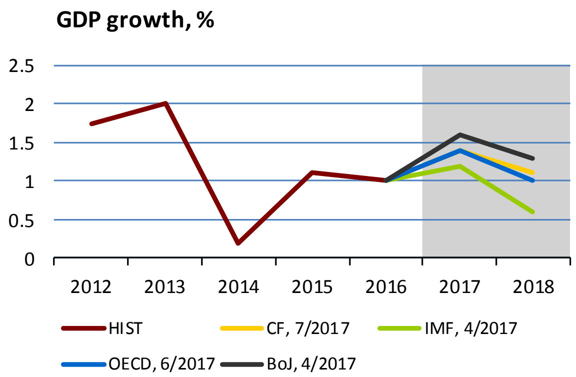
	CF	IMF	OECD	BoE
2017	1.6	2.0	1.6	1.9
2018	1.4	1.5	1.0	1.7



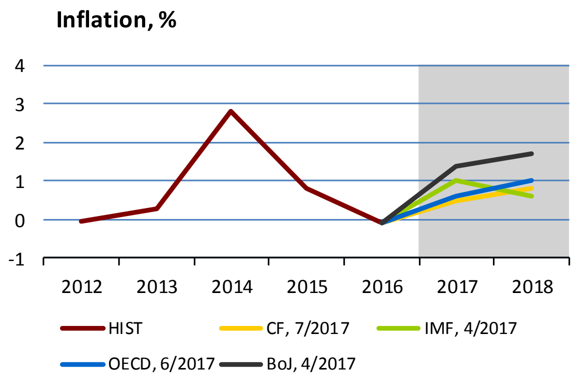
	CF	IMF	OECD	BoE
2017	2.7	2.5	2.8	2.8
2018	2.7	2.6	2.7	2.4

II.5 Japan

Retail sales growth slowed in both month-on-month and year-on-year terms in May, due mainly to a drop in sales in department stores and supermarkets, but also to an unexpected rise in unemployment to 3.1%. However, the slowdown was more moderate than expected due to stronger wage growth. The year-on-year decline in household expenditure thus decreased markedly. Year-on-year growth in industrial production rose in May, but in month-on-month terms the growth slowed considerably. The PMI in manufacturing fell to 52.4 points in June. According to purchasing managers, the drop was due to slower growth in output and new orders. The outlooks for Japanese economic growth were unchanged. Headline inflation stayed at 0.4% in May. Energy prices rose faster but were offset by slower growth in prices of fresh food. CF lowered its inflation forecast for this year by 0.1 pp in July.



	CF	IMF	OECD	BoJ
2017	1.4	1.2	1.4	1.6
2018	1.1	0.6	1.0	1.3

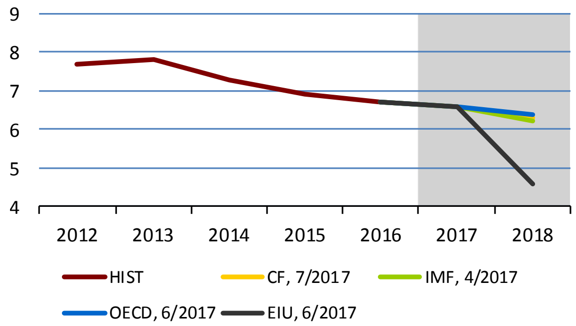


	CF	IMF	OECD	BoJ
2017	0.5	1.0	0.6	1.4
2018	0.8	0.6	1.0	1.7

III.1 China

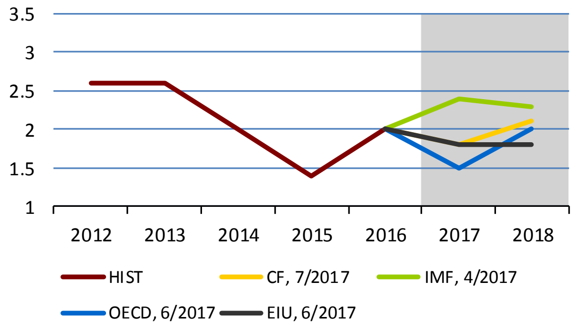
New data from the Chinese economy suggest continued stable expansion in 2017 Q2. Retail sales recorded year-on-year growth of over 10% in both April and May, and consumer confidence remains high. Industrial production rose at a solid annual rate of 6.5% in the same period. However, government debt-cutting measures are expected to affect investment activity in the coming months. Headline and core inflation rose slightly in June (to 1.5% and 2.2%). The central bank's efforts to liberalise financial markets are also continuing. In particular, its powers to adjust interest rates and use lending facilities and reverse repos will increase. The exchange rate regime has also changed. The daily exchange rate fix now contains a countercyclical factor enabling the central bank to be more flexible in setting the rate. The July CF raised its GDP growth outlook for 2018, whereas the inflation forecast was lowered for both years.

GDP growth, %



	CF	IMF	OECD	EIU
2017	6.6	6.6	6.6	6.6
2018	6.3	6.2	6.4	4.6

Inflation, %

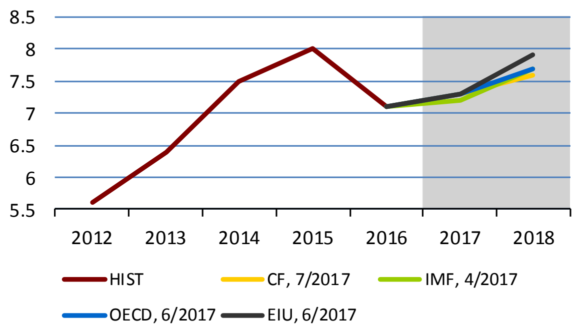


	CF	IMF	OECD	EIU
2017	1.8	2.4	1.5	1.8
2018	2.1	2.3	2.0	1.8

III.2 India

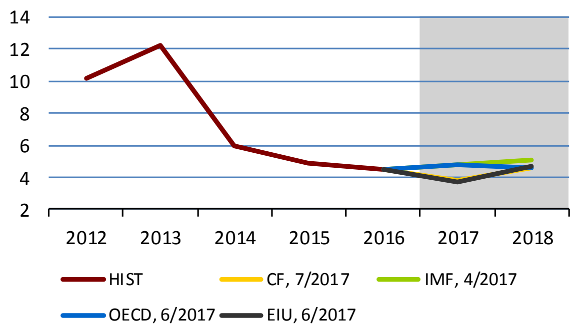
Indian industrial production has been less than impressive in recent months. Its year-on-year growth slowed further (to 1.7%) in May due to a marked slowdown in mining and manufacturing output growth. The PMI in manufacturing fell again in June, to 50.9 points. According to purchasing managers, this was due to slower growth in output and new orders, but also to weaker business sentiment. CF did not change its GDP growth outlooks in July. However, the EIU raised its outlooks by 0.1 pp for both fiscal years monitored. Inflation was 1.5% in July, falling by a sizeable 0.7 pp from the previous month. Food prices fell at a faster rate than expected due to a favourable monsoon. For this and other reasons, CF and the EIU cut their inflation outlooks for this fiscal year by 0.6 pp and those for the next by 0.3 and 0.2 pp respectively.

GDP growth, %



	CF	IMF	OECD	EIU
2017	7.3	7.2	7.3	7.3
2018	7.6	7.7	7.7	7.9

Inflation, %

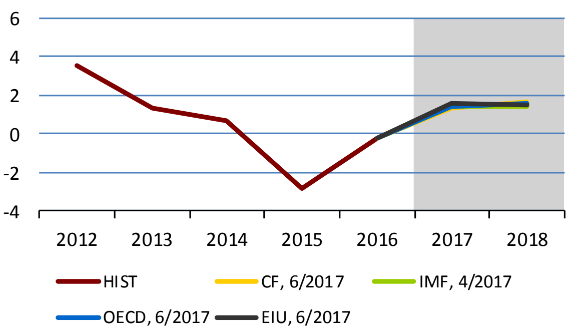


	CF	IMF	OECD	EIU
2017	3.8	4.8	4.8	3.7
2018	4.6	5.1	4.6	4.7

III.3 Russia

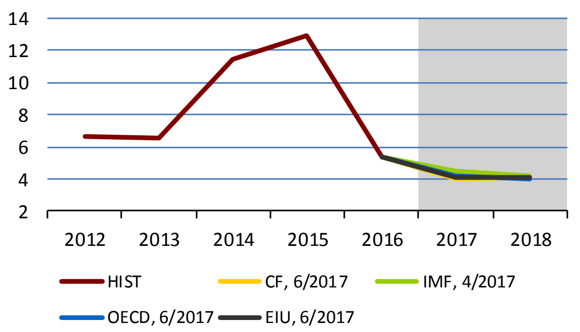
The Russian statistical office confirmed that GDP rose by 0.5% in Q1, as the preliminary estimate had indicated. In year-on-year terms, the fastest growth was recorded by imports, which went up by 16.5%. Exports also grew at a solid rate (7.1%). The growth of the other main components was less marked. Household consumption increased by 2.7% and government consumption by 0.4%. Total investment was virtually flat (although growth in gross fixed capital formation reached 2.3%). Although the PMI in manufacturing has been in the economic expansion band for almost a year now, it dropped markedly in June again, suggesting somewhat worse business activity in the short term. To anchor inflation expectations, the RCB cut its key rate by a further 0.25 pp to 9% in June. The new CF expects 1.3% GDP growth this year and just a 0.4 pp faster rise next year. Foreign trade will continue to be constrained by sanctions, which the EU extended until January 2018 at the end of June, as expected.

GDP growth, %



	CF	IMF	OECD	EIU
2017	1.3	1.4	1.4	1.6
2018	1.7	1.4	1.6	1.5

Inflation, %

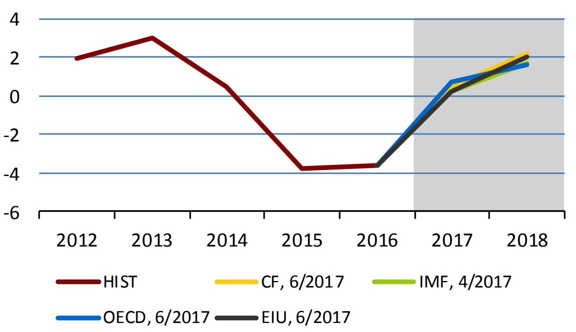


	CF	IMF	OECD	EIU
2017	4.0	4.5	4.2	4.1
2018	4.1	4.2	4.0	4.1

III.4 Brazil

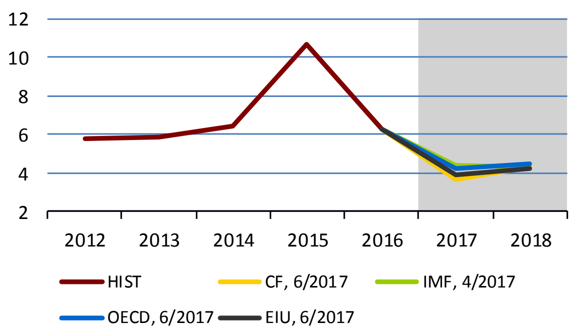
The May short-term indicators for the Brazilian economy were mixed this time. Industrial production returned to positive year-on-year growth and unemployment showed a drop instead of the expected growth. Retail sales growth also improved. However, leading indicators deteriorated significantly. The PMI in manufacturing returned to 50 in June and the PMI in services fell to 47.8. Business confidence also decreased, due, among other things, to political developments. Producer price, foreign trade and consumer price inflation slowed. Headline inflation fell to a ten-year low (3.0%) in June due to slowing growth in food and electricity prices. In month-on-month terms, inflation actually fell (by 0.2 pp), the first price drop since November 1998. The new CF and EIU forecasts expect GDP growth of 0.2%–0.5% and inflation below 4% this year.

GDP growth, %



	CF	IMF	OECD	EIU
2017	0.5	0.2	0.7	0.2
2018	2.2	1.7	1.6	2.0

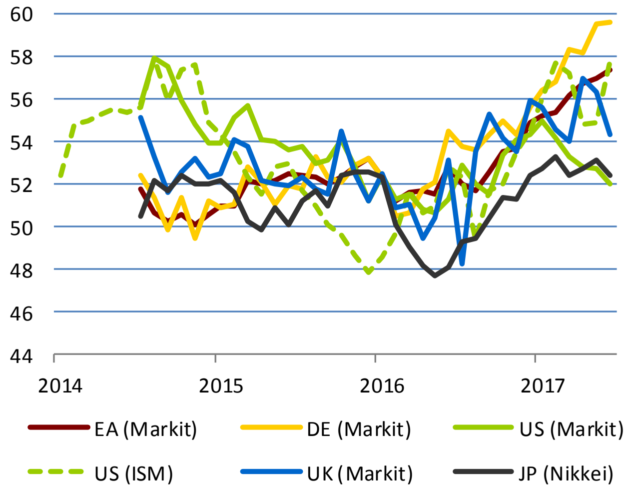
Inflation, %



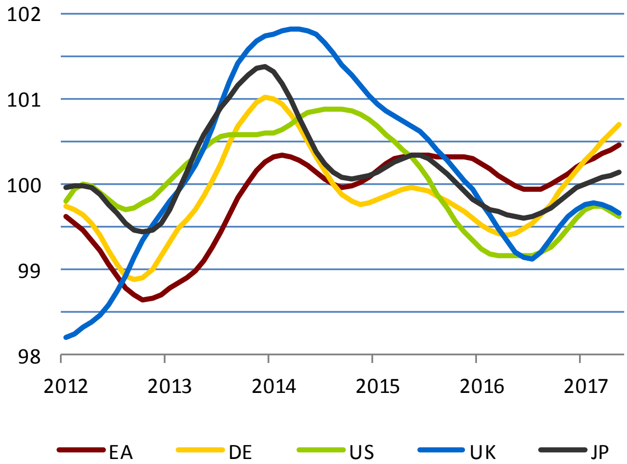
	CF	IMF	OECD	EIU
2017	3.7	4.4	4.2	3.9
2018	4.3	4.3	4.5	4.2

IV.1 Advanced economies

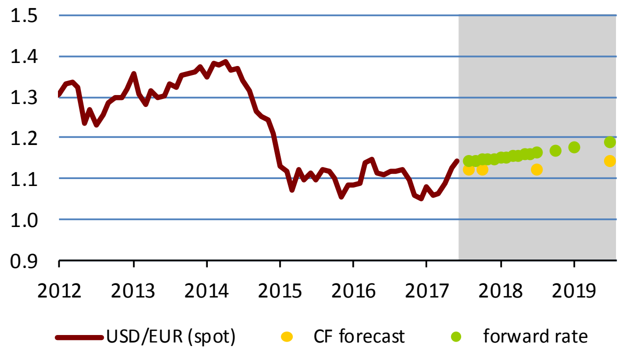
PMI in manufacturing



OECD Composite Leading Indicator

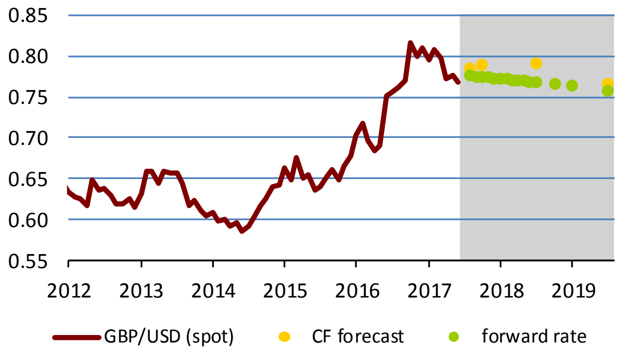


The US dollar (USD/EUR)



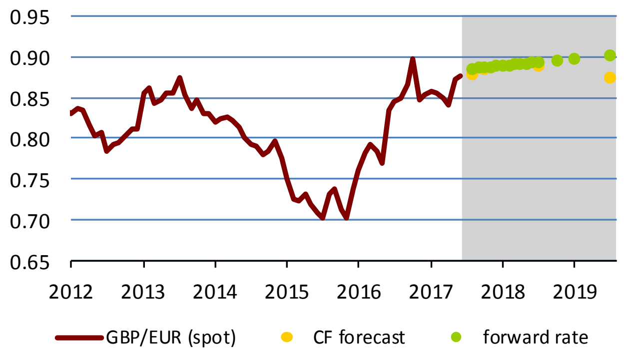
	10/7/17	08/17	10/17	07/18	07/19
spot rate	1.139				
CF forecast		1.120	1.121	1.122	1.143
forward rate		1.142	1.145	1.163	1.189

The British pound (GBP/USD)



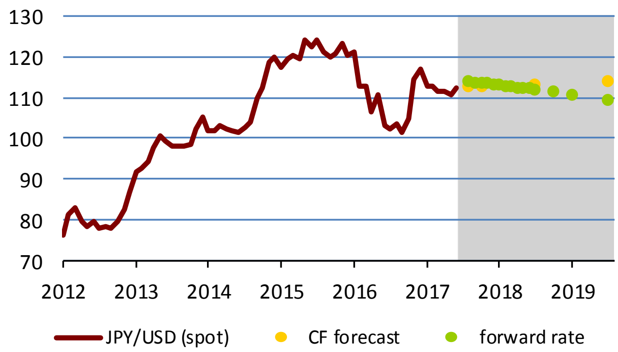
	10/7/17	08/17	10/17	07/18	07/19
spot rate	0.778				
CF forecast		0.784	0.790	0.792	0.765
forward rate		0.776	0.774	0.768	0.758

The British pound (GBP/EUR)



	10/7/17	08/17	10/17	07/18	07/19
spot rate	0.886				
CF forecast		0.878	0.885	0.888	0.875
forward rate		0.886	0.887	0.893	0.902

The Japanese yen (JPY/USD)

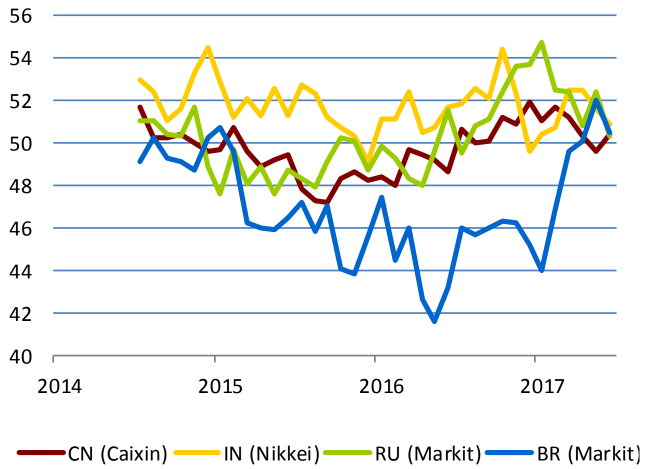


	10/7/17	08/17	10/17	07/18	07/19
spot rate	114.2				
CF forecast		112.8	112.8	113.3	113.8
forward rate		113.9	113.6	111.9	109.4

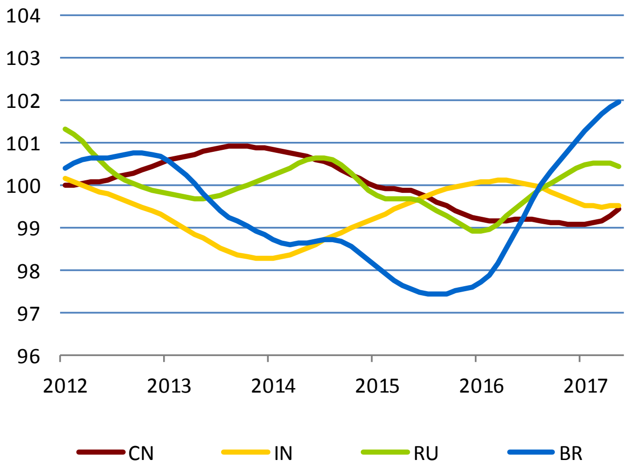
Note: Exchange rates as of last day of month. Forward rate does not represent outlook; it is based on covered interest parity, i.e. currency of country with higher interest rate is depreciating. Forward rate represents current (as of cut-off date) possibility of hedging future exchange rate.

IV.2 BRIC countries

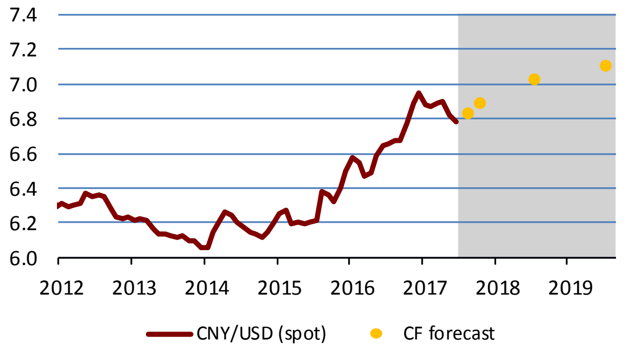
PMI in manufacturing



OECD Composite Leading Indicator

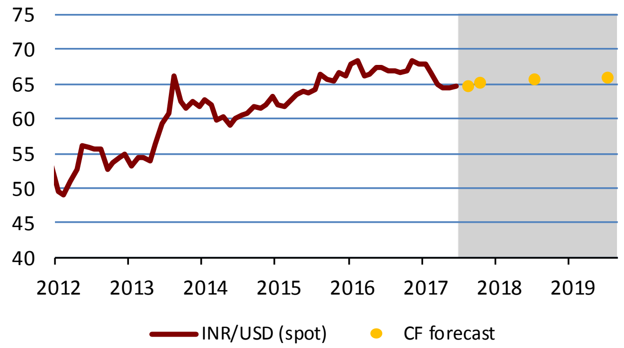


The Chinese renminbi (CNY/USD)



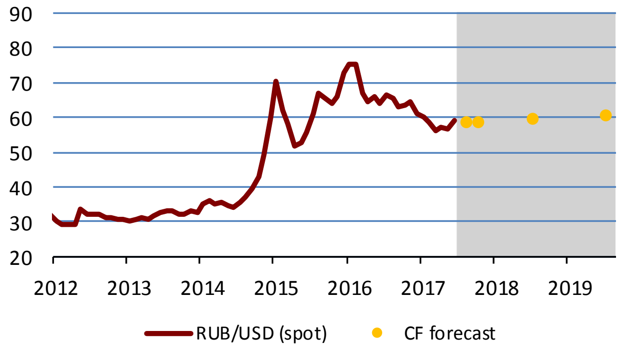
	10/7/17	08/17	10/17	07/18	07/19
spot rate	6.802				
CF forecast		6.835	6.893	7.023	7.103

The Indian rupie (INR/USD)



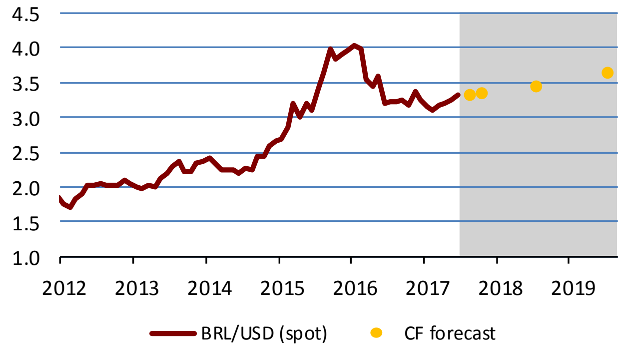
	10/7/17	08/17	10/17	07/18	07/19
spot rate	64.53				
CF forecast		64.70	65.07	65.63	65.82

The Russian rouble (RUB/USD)



	10/7/17	08/17	10/17	07/18	07/19
spot rate	60.27				
CF forecast		58.77	58.51	59.6	60.56

The Brazilian real (BRL/USD)



	10/7/17	08/17	10/17	07/18	07/19
spot rate	3.262				
CF forecast		3.321	3.342	3.435	3.644

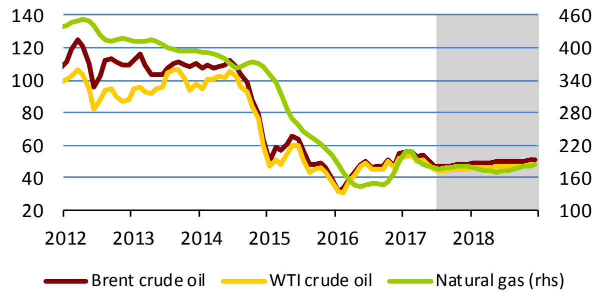
Note: Exchange rates as of last day of month.

V.1 Oil and natural gas

The opinion that not even the extended output cuts by large producers will lead to a quick return of the market to equilibrium is growing stronger on the oil market. While OPEC did not rule out a resumption of talks and a further cut in output, Russia resolutely rejected such a move. The oil price is thus under pressure. Most analytical institutions are cutting their average price forecasts for this year and the next, and hedge funds are reducing their net long futures positions (mainly by increasing their short positions). Fast production growth in Libya and Nigeria and weaker compliance with voluntary output limits by some OPEC members have recently been fostering negative sentiment on the market. On the other hand, news that should bolster the oil price, such as weakening growth in the active rig count in the USA and strong growth in global demand for oil in 2017 Q2, which according to the IEA implies a drop in global stocks at a rate of 0.7 million barrels a day in that quarter, were not enough to turn around the oil market. Even a further depreciation of the US dollar failed to stop prices falling. The average Brent crude oil price thus reached USD 47.6/bbl in June, dropping below USD 50/bbl for the first time since November 2016. It remained at similar levels in the first half of July.

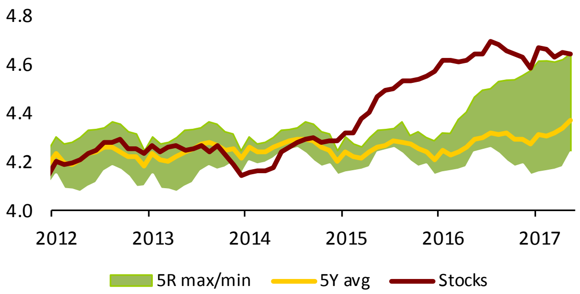
The market futures curve as of the July CF survey date had shifted only slightly lower compared to the previous month and implied an average price of USD 47.8/bbl for the rest of this year and USD 49.8/bbl next year. The EIA also cut its average price forecast for this year and the next (by USD 4). According to the EIA, global oil stocks will stagnate in the rest of this year and Brent will cost around USD 50/bbl on average until mid-2018. The price should then rise as high as USD 55/bbl at the end of 2018.

Outlook for prices of oil (USD/barrel) and natural gas (USD / 1000 m³)

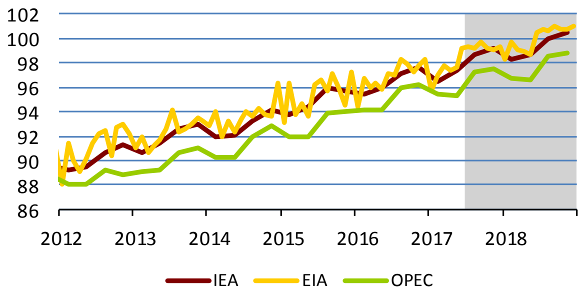


	Brent	WTI	Natural gas
2017	50.28	47.57	185.68
2018	49.79	46.88	176.40

Total stocks of oil and oil products in OECD (bil. barrel)

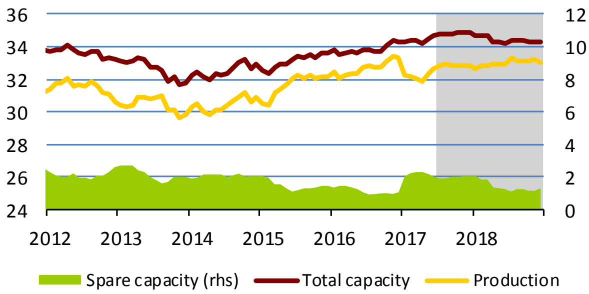


Global consumption of oil and oil products (mil. barrel / day)



	IEA	EIA	OPEC
2017	97.95	98.38	96.38
2018	99.36	100.00	97.65

Production, total and spare capacity in OPEC countries (mil. barrel / day)



	Production	Total capacity	Spare capacity
2017	32.53	34.61	2.08
2018	33.00	34.40	1.40

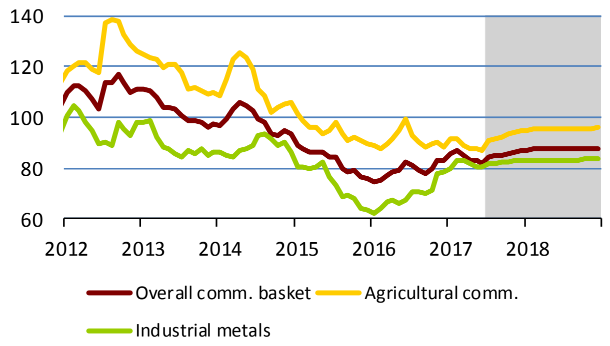
Source: Bloomberg, IEA, EIA, OPEC, CNB calculation
Note: Oil price at ICE, price of Russian natural gas at German border – IMF data, smoothed by the HP filter. Future oil prices (grey area) are derived from futures and future gas prices are derived from oil prices using model. Total oil stocks (commercial and strategic) in OECD countries – IEA estimate. Production and extraction capacity of OPEC – EIA estimate.

V.2 Other commodities

The aggregate non-energy commodity price index dropped slightly in June, mainly because of a fall in agricultural commodity prices. They were squeezed by persisting high stocks. A record soy crop is expected in Brazil, so the USDA has raised its estimate of global stocks of that commodity after this year's harvest. The sugar price continued to fall on news that Brazilian sugar refineries intend to process a larger proportion of the harvest into sugar (and a smaller proportion into ethanol). The cocoa price is also at its lowest level in years. However, prices of grain (especially wheat and soy) surged at the end of June due to drought in the US Northern Plains. Rice prices increased for the second month in a row because of floods in South-East Asia. Pork prices rose to a seasonal high. By contrast, beef prices have been falling recently.

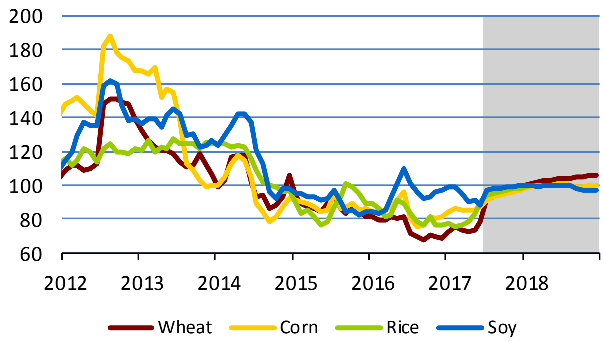
Basic metals prices were also mixed. They were boosted by the improving condition of the manufacturing industry in China and a halt in the drop of the global JP Morgan PMI in manufacturing (which stagnated at 52.6 in June). The price of copper was also pushed up by a decline in stocks at the LME. On the other hand, higher production in China (by 11% year on year between the start of the year and May) is pushing against a further rise in the price of aluminium. The price of nickel is at its lowest level in eight and a half years due to the prospect of mines in the Philippines reopening and to continued growth in exports from Indonesia. Iron ore prices were flat at a one-year low in June on account of high stocks in Chinese ports, but rose again at the end of the month in line with steel prices. Global steel output increased by 2% year on year in May (and by 1.8% in China), but was lower than in April. Coal prices surged due to higher demand from power stations in China. However, coal mining is simultaneously rising there (by 12% year on year in May).

Non-energy commodities price indicies



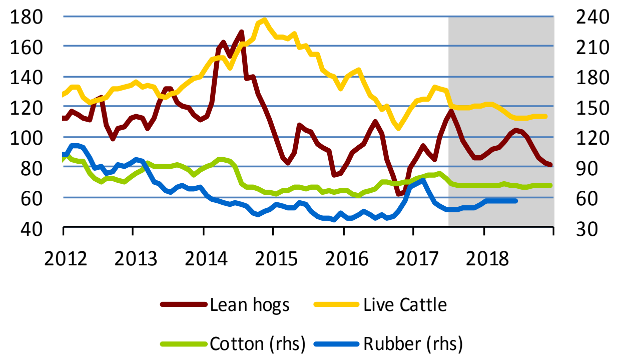
	Overall		Agricultural		Industrial	
2017	85.0	↗	90.9	↗	82.0	↗
2018	87.6	↗	95.5	↗	83.3	↗

Food commodities



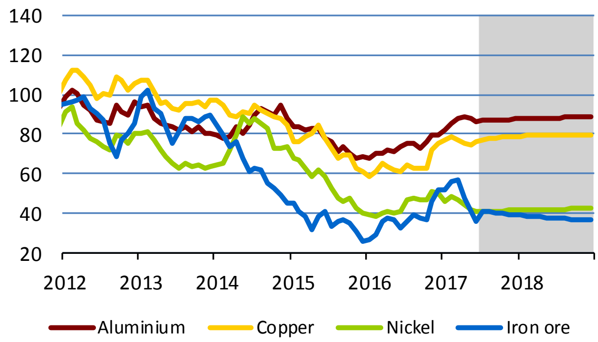
	Wheat		Corn		Rice		Soy	
2017	85.0	↗	90.2	↗	88.3	↗	96.1	↗
2018	103.5	↗	99.6	↗	100.2	↗	99.0	↗

Meat, non-food agricultural commodities



	Lean hogs		Live Cattle		Cotton		Rubber	
2017	95.9	↗	124.1	↘	76.6	↘	55.7	↗
2018	93.4	↘	115.4	↘	71.9	↘	57.0	↗

Basic metals and iron ore



	Aluminium		Copper		Nickel		Iron ore	
2017	86.7	↗	77.2	↗	43.0	↗	44.2	↗
2018	88.2	↗	79.3	↗	42.0	↗	37.6	↗

Source: Bloomberg, CNB calculations.

Note: Structure of non-energy commodity price indices corresponds to composition of The Economist commodity indices. Prices of individual commodities are expressed as indices 2010 = 100.

Brexit a year after the referendum: The economic impacts on the United Kingdom so far[1]

A few weeks ago, a year elapsed since the date of a landmark referendum in the United Kingdom, a referendum in which voters decided whether the country should stay in, or leave, the European Union. The campaigns of the two camps were heated. Besides political topics, the economic pros and cons of EU membership were much discussed. Many economic studies were published attempting to estimate as accurately as possible how Brexit would affect the British economy.[2] With few exceptions, they concurred that Brexit would not benefit the UK. This article sets out to determine whether these forecasts are materialising or whether they were just scaremongering.

1 Negotiations about reforming the EU

British society's disappointment and disillusionment with the EU had started to set in long before the referendum. Rising discontent had caused part of the public to prefer to leave the EU. However, this view had never become shared by the British public as a whole – the Brexiters were opposed by another section of the population that conversely regards the presence of the UK[3] in the EU as a privilege it is not willing to give up. Society was thus sharply polarised in its positions on the EU. The situation was similar among political representatives. The Conservative Party, in power since 2010, was also divided on this issue, and remains so. The then Prime Minister David Cameron decided to reconcile the two camps. In January 2013 he opened an ambitious debate in the European context about what the British dislike about the current shape of the EU. He announced that he wanted to negotiate changes in the conditions of membership which would increase the satisfaction of British citizens. He then told voters they would have their say on the deal and on membership itself in a referendum and that the government would respect the result.

In February 2016, the European Council adopted an agreement[4] taking on board Britain's demands to amend certain aspects of the current functioning of the EU. It addressed four areas: economic governance, competitiveness, sovereignty and social benefits and free movement of persons (see Box 1 for details). However, it never took effect, as it was conditional on the UK deciding to remain in the EU. The formal confirmation and expansion in the deal of all the existing derogations[5] enjoyed by the UK in the EU (especially the right not to participate in deeper integration) proved insufficient for the British electorate to vote yes to the UK staying in the EU. The Brexiters won the referendum of 23 June 2016 with 51.9% of the votes cast. Theresa May, who replaced David Cameron at the helm of the British government after the referendum, formally activated Article 50 of the Lisbon Treaty in March 2017, thereby officially confirming that the UK would leave the EU and starting the two-year period for negotiations on the terms of exit.

2 The (dis-)advantages of membership

While accession to the EU has, since its establishment, been perceived by the acceding states as an opportunity to reap economic benefits, diverse opinions about whether Brexit would do the island kingdom economic harm or good could be heard from the UK during the referendum campaign.[6, 7] This is of course mainly because the EU was founded by countries which have long ranked among the strongest European economies[8] and then gradually expanded to include smaller ones. For these economies, the opportunity to participate in such a deep trade alliance with advanced economies offered clear economic gains and a hope of faster economic convergence towards the more successful countries. In later waves of EU enlargement, the significant advantages of membership included the EU's cohesion policy, which attempted to further accelerate convergence between the Member States' different economic levels by redistributing funds from the richer countries to the poorer ones.

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[1] Author: Pavla Břízová. The views expressed in this article are those of the author and do not necessarily reflect the official position of the Czech National Bank. This article is the first of two articles focusing on the economic impacts of Brexit. The second one, analysing the longer-term impacts, will be published in the next issue of Global Economic Outlook.
[2] For example, PwC (2016), Dhingra et al. (2016), OECD (2016), Economists for Brexit (2016), Baker et al. (2016) and Ebell and Warren (2016).
[3] This article discusses the state officially called the United Kingdom of Great Britain and Northern Ireland (the United Kingdom for short). However, it deviates from this terminology in some passages, replacing it with other commonly used (albeit inaccurate) terms such as Britain for reasons of linguistic variety.
[4] European Council (2016).
[5] For example, a derogation from euro adoption (officially granted only to the UK and Denmark), a derogation from becoming a member of the Schengen area and also, for example, a special derogation (the "rebate") ensuring that the UK pays lower contributions to the EU budget than it would under the standard calculation.
[6] It is true, however, that the former were clearly dominant, at least in the economic community.
[7] EU membership is a very complex issue and its advantages can be evaluated from many perspectives. However, this article deals solely with the economic costs and benefits of membership and leaves aside, for example, the political, social and cultural viewpoints.
[8] The founding members of the EU were Germany, France, Italy, Belgium, the Netherlands and Luxembourg.

Box 1: A new settlement for the United Kingdom within the European Union

Section A of the European Council's February 2016 decision reacting to the UK's request for clarification and new arrangements on certain issues regarding the functioning of the EU focuses on **economic governance**. It gives countries whose currency is not the euro certain rights and competences they did not have before. The most important is the right not to participate in the further deepening of European integration, which is otherwise considered necessary for the proper functioning of the economic and monetary union. However, the non-euro area countries must not impede deeper integration of the euro area. In return, they now have a written guarantee that they cannot be discriminated against in any way in EU decisions on economic issues and will not bear the costs of emergency and crisis measures addressed to safeguarding the financial stability of the euro area.

Section B is devoted to **competitiveness**. Here, the UK was promised that the EU would make all efforts to complete and strengthen the internal market. To this end, the EU must work to enhance competitiveness by taking concrete steps to lower administrative burdens, repeal unnecessary legislation and pursue an active trade policy.

Section C strengthens the importance of the subsidiarity principle (which says that decisions should be taken as close as possible to the citizen, i.e. at the lowest level ensuring that the issue is dealt with effectively). This is closely linked with an emphasis on maintaining the Member States' **sovereignty**. The UK obtained explicit permission not to pursue deeper political integration in the EU. It also pushed through a clause stating that references in EU Treaties to the process of creating an ever closer union among the peoples of Europe can no longer be interpreted as meaning that competences conferred on the EU cannot be taken away from it. This was a breakthrough in that it *de facto* turned the commitment to ever closer integration into a possibility to loosen integration.

The final section responds to the UK's displeasure with the strong inflow of workers from other EU countries under the **free movement of persons**. The decision recognises that labour migration is not always a consequence of the desirable smooth functioning of the internal market. Instead, it may be motivated in reality by differences in social security systems, which are not harmonised across Member States. In such cases, Member States should be entitled to restrict migration. However, this is to be done not by refusing entry to foreign workers, but only by tightening the conditions for granting social benefits to such workers where this is justified.

The UK, too, regarded EU membership as economically beneficial when it joined. It had refused an offer to become a founding member of the EU[9] in 1951 (it had been attracted by the advantages of free trade, but had not wanted to transfer part of its sovereignty to the common institutions governing the union).[10] Ten years later, though, Britain did apply for membership. However, its application was vetoed by France at the time. As a result, the UK did not become an EU member until 1973. As regards the costs and benefits, the economic advantages outweighed the perceived political disadvantages. Over time, however, the rules of international trade were relaxed globally. As a result, the advantages of participating in the EU internal market relative to the hypothetical alternative of operating outside it (with trade governed solely by the rules of the World Trade Organisation) gradually decreased. On the other hand, the importance of redistribution in the EU budget increased. As the second-largest EU economy, the UK became an important net contributor. Its taxpayers thus co-finance development projects in less developed regions of the EU. These two arguments – the advantages of the internal market and payments to the EU budget – were the cornerstones of the British debate about the future of EU membership.

In the end, the citizens of the UK voted to leave the EU in the referendum. However, the UK will remain a full member of the EU until the exit agreement is signed. It can thus enjoy full access to the internal market and must still contribute to the EU budget. Nevertheless, the Brexit decision is already affecting the British economy. There are whole range of economic impacts which are not tied to the instant of formal exit from the EU and which are therefore already having an impact on the UK economy. Some of them had begun to be felt long before the referendum, i.e. when it was not even clear whether the UK would vote to leave the EU. The main short-term impact of the Brexit vote is increased uncertainty. Its usual effects are greater financial market and exchange rate volatility, higher risk premia on credit and capital markets, lower business confidence and deferred investment.

[9] More precisely its oldest predecessor, the European Coal and Steel Community. Two additional organisations – the European Economic Community and the European Atomic Energy Community – were established by the Treaties of Rome in 1957. The three communities were integrated in 1967 and were thereafter referred to as the European Communities. The term European Union was not introduced until the Maastricht Treaty of 1992 (effective from 1993).

[10] In 1960, therefore, it founded the European Free Trade Association (EFTA) together with Denmark, Sweden, Norway, Switzerland, Austria, Portugal and Finland. EFTA aimed to allow free trade between its member countries, but with no need for common institutions.

3 The British economy a year after the referendum

Most of these predictions materialised. The British pound weakened for some time before the referendum on concerns that the vote could be for Brexit.[11] Market uncertainty rose sharply following the announcement of the result. During the first day after the referendum, the pound dropped by 10.9% against the euro (see Chart 1). The fall of the pound-dollar currency pair was rather more moderate (7.8%). In effective terms, the pound lost 6.8% of its value overnight. It continued to weaken until the end of 2016 (by which time it was 14.1% weaker against the euro than on the eve of the referendum). Only after that did the exchange rate more or less stabilise.

By contrast, the forecasts that government borrowing costs would increase did not materialise. After the referendum, the ten-year government bond yield continued to trend downwards until August 2016, when it reached 0.6% (see Chart 2). It seems that despite the uncertainty surrounding the future arrangements between the UK and the EU, British government bonds were regarded as a highly credible and safe asset attracting investors seeking less risky investments at a time of fevered sentiment. Later last year, however, the negative effect of the weakening pound, a portent of higher inflation, became predominant. Yields on British gilts therefore started to rise, although not until October, a quarter of a year after the referendum. Yields fluctuated around 1.5% during the winter and then fell gradually towards 1% in the spring. The path followed by the UK's FTSE 100 stock index was also surprising. It shot up after the result of the referendum was announced and has been rising steadily since then. However, the FTSE 100 does not seem to be an appropriate measure of market sentiment in the UK owing to the high representation of international firms generating most of their income outside Britain.[12]

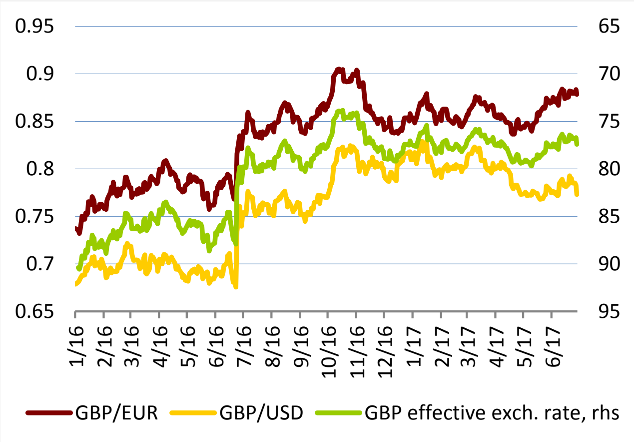

Chart 1 The exchange rate of the British pound

Source: WM/Reuters, BoE

Note: Higher GBP/EUR and GBP/USD rates mean depreciation of the pound. The opposite is true for the effective exchange rate: lower values signify a weakening (inverted scale). Rhs – right-hand scale.

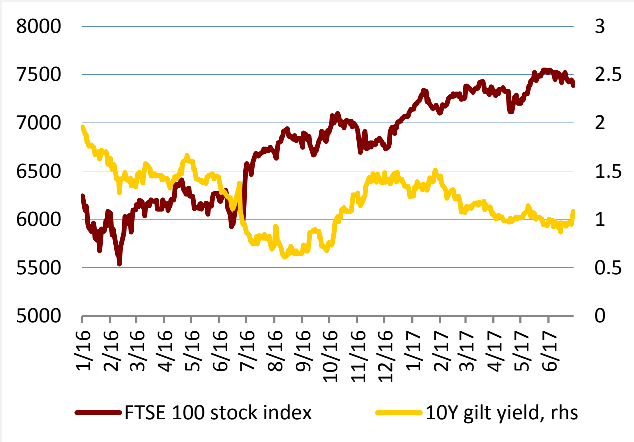

Chart 2 The financial market

Source: FTSE, Thomson Reuters Datastream

Note: FTSE – Financial Times Stock Exchange, an index comprising the 100 companies with the highest market capitalisation among those established in the UK (about 80% of the overall UK stock market); gilt – British government bond, rhs – right-hand scale; in %

The marked depreciation of the pound very soon started to push up consumer prices via higher import prices. Inflation, which had been below 0.5% before the referendum, started to rise apace in the summer (see Chart 3). This was due in part to the British central bank's August decision to support an economy grappling with a wave of negative sentiment by lowering its policy rate to an all-time low (0.25%). In addition, the Bank of England (BoE) strengthened its quantitative easing programme by increasing its government bond purchases by GBP 60 billion. By easing monetary policy, it calmed market nervousness and partly dampened the impacts of higher uncertainty on the real economy. However, it also fostered a rise in consumer price inflation. Since then, inflation has been increasing steadily. In February 2017 it exceeded the BoE's target, and it is now fast approaching 3%. The BoE has so far held back from reacting as it weighs up the conflicting interests (relaxed rates to support the slowing economy versus higher rates to dampen inflation). However, it is increasingly likely to raise rates at its August meeting.[13]

[11] Between the start of 2016 and the referendum date (23 June 2016) it weakened by 4% against the euro. In effective terms, using a weighted average of the pound's currency pairs weighted by trade flow size, it depreciated by 2.7% (this figure is lower mainly because the US dollar, which has a weight of about 20% in the index, was also depreciating at the time).
[12] According to analysts, three-quarters of the aggregate income of FTSE corporations is generated outside the UK.
[13] As early as June, three of the seven members of the BoE's Monetary Policy Committee voted to increase rates.

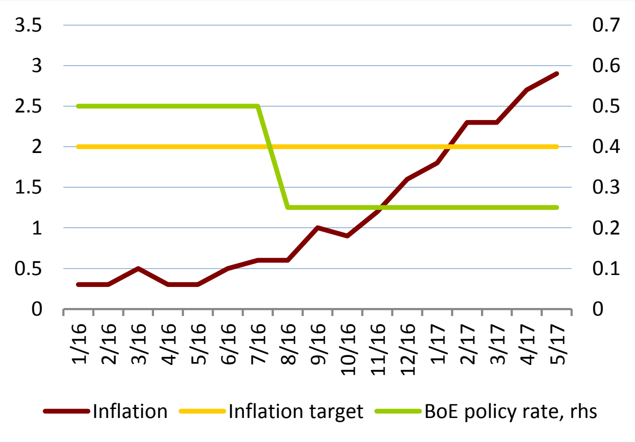

Chart 3 Inflation and the BoE's policy rate

Source: ONS (Office for National Statistics), BoE
Note: rhs – right-hand scale, in %

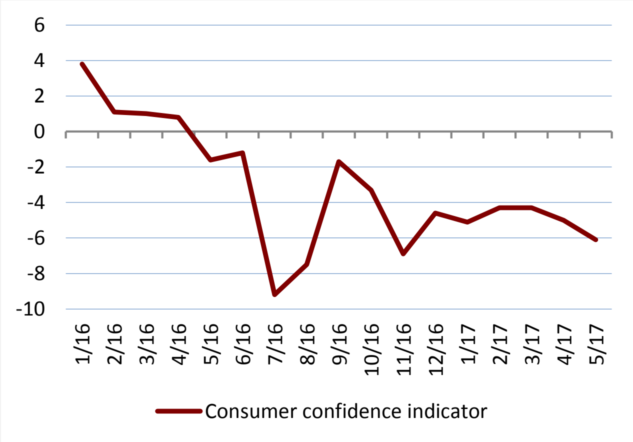

Chart 4 UK consumer confidence

Source: European Commission (Consumer Survey)
Note: index

Rising prices mainly affect consumers. The European Commission's survey-based sentiment indicator is showing a persistent decline in consumer confidence in the UK (see Chart 4). It slumped after the referendum result was announced and, despite rebounding last summer, is continuing to drop. Chart 5 (retail sales in the UK) shows why. While the volume of goods purchased stopped rising last autumn, the value of the purchases is continuing to go up due to rising inflation. To keep living standards at least flat, households had to dip into their savings. The saving rate thus dropped to a historical low at the end of 2016 (3.3%). The situation is even direr than during the global economic and financial crisis, when UK households saved more than 4% of their income (see Chart 6). Moreover, wages in the UK have been rising more slowly than consumer prices since April, so households have less money available for consumption in real terms.

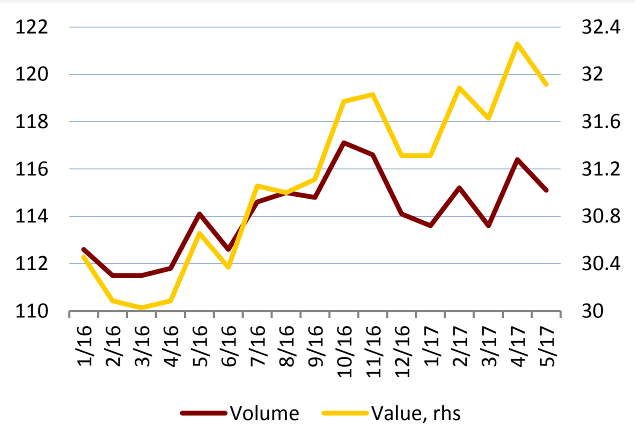

Chart 5 Retail sales

Source: ONS (Office for National Statistics)
Note: volume – 2013 index = 100, value – in GBP billions, rhs – right-hand scale

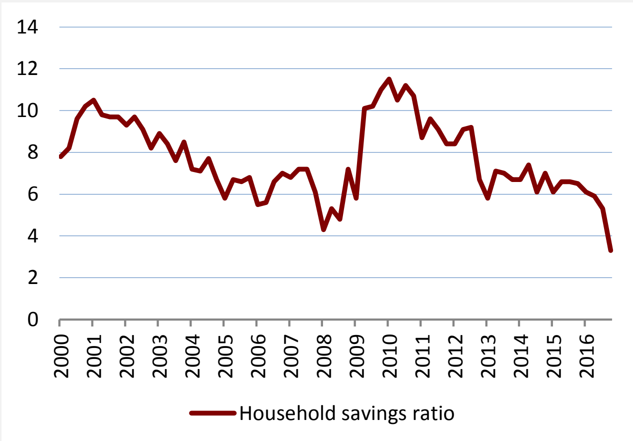

Chart 6 Household savings

Source: ONS (Office for National Statistics)
Note: in % of disposable income; the latest available data are for 2016 Q4

As soon as the adverse phenomena described above reach the point where households will be forced to reduce consumption and lower their living standards, the rate of growth of the UK economy will be affected. The short-term impacts of the Brexit vote, induced by a spike in uncertainty, will pass through the economy to the main macroeconomic indicators. This time may have come already. The growth of the British economy slowed to just 0.2% quarter on quarter in the first quarter of 2017[14] (see Chart 7), making the UK the slowest growing G7[15] economy. However, it is still possible that the slowdown seen at the start of the year was due to extraordinary seasonal effects, as UK GDP slowed in the same period of last year (also to 0.2%) and the year before (0.3%). More will be revealed by the data for Q2, the first estimate of which will become available at the end of July. Nevertheless, the National Institute of Economic and Social Research

[14] seasonally adjusted
[15] A group of the most advanced economies (in alphabetical order: Canada, France, Germany, Italy, Japan, the UK and the USA). The EU is also represented.

(NIESR) in London has estimated that the UK economy again grew by a mere 0.2% in the three months from February to May. The figure for Q2 may thus be disappointing. The June CF estimated it at 0.4%. As a result of the lower quarterly growth, the annual growth rate will gradually slow (see Chart 8). According to CF, it will drop below 1.5% and stay there until the end of 2018.

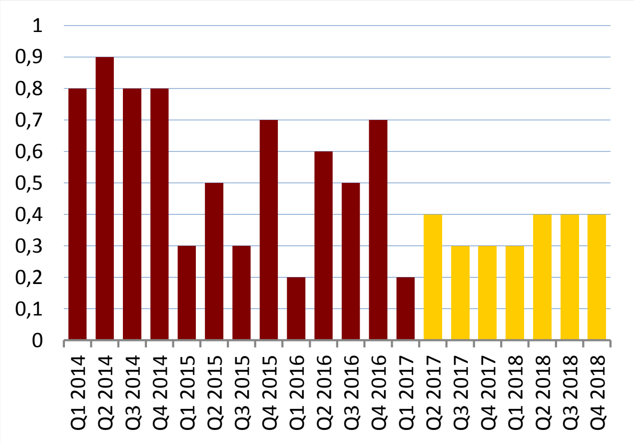

Chart 7 Quarterly GDP growth

Source: ONS (Office for National Statistics), CF
Note: in %; yellow columns show the CF forecast

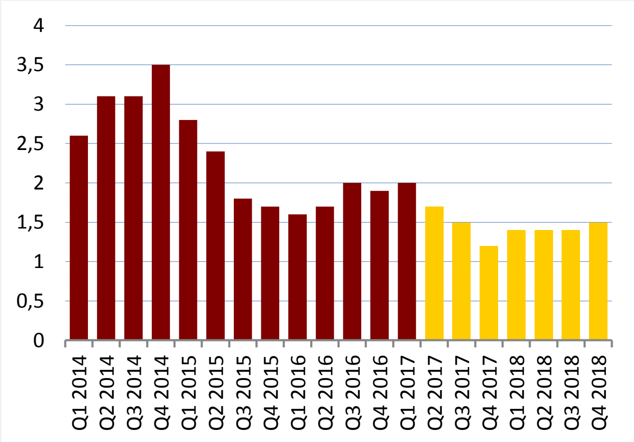

Chart 8 Annual GDP growth

Source: ONS (Office for National Statistics), CF
Note: in %; yellow columns show the CF forecast

4 Conclusion

Last June, the citizens of the UK voted by a slim majority for Britain to leave the EU. Not even the fact that most (UK and world) economists had agreed that this decision would do major harm to the UK economy convinced them to vote the other way.[16] Although the UK officially announced its intention to leave the EU this March and the negotiations on future mutual relations have yet to start properly,[17] the UK economy has been facing negative economic impacts of this decision for more than a year now. As correctly predicted by numerous empirical and theoretical studies, it all started with nervousness in financial markets. The consequences of the heightened uncertainty then began to spread across the economy. Whether, and to what extent, Brexit will damage the UK economy from the long-term perspective will be seen in the coming months, quarters and years. It will depend largely on the outcome of the negotiations on the future conditions of mutual trade between the UK and the EU.

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[16] A summary of the results of major studies quantifying the economic impacts of possible Brexit and a more detailed account of their forecasting considerations and techniques will be presented in a follow-up article by Pavla Břízová in the next issue of Global Economic Outlook (August).

[17] The negotiations were slowed, among other things, by the early elections called in June by Theresa May in the belief that they would increase her party's majority in Parliament and give her a stronger mandate for the Brexit negotiations. Instead, the Conservative Partly lost its parliamentary majority in this ill-considered election.

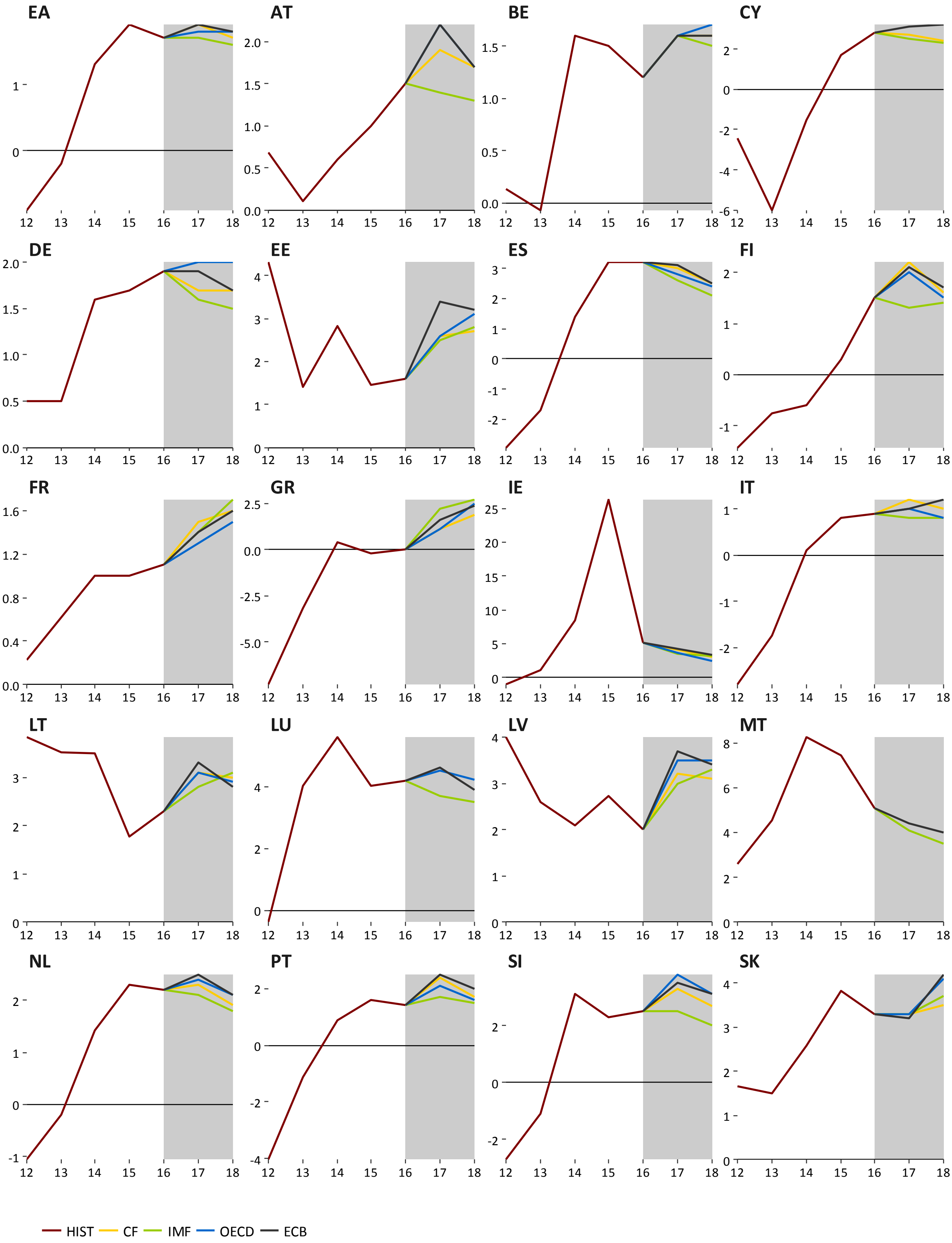
A1. Change in GDP predictions for 2017

	CF		IMF		OECD		CB / EIU	
EA	+0.1	2017/7 2017/6	+0.1	2017/4 2017/1	+0.2	2017/6 2017/3	+0.1	2017/6 2017/3
DE	+0.1	2017/7 2017/6	+0.1	2017/4 2017/1	+0.2	2017/6 2017/3	+0.1	2017/6 2016/12
US	0	2017/7 2017/6	0	2017/4 2017/1	-0.3	2017/6 2017/3	+0.1	2017/6 2017/3
UK	0	2017/7 2017/6	+0.5	2017/4 2017/1	0	2017/6 2017/3	-0.1	2017/5 2017/2
JP	0	2017/7 2017/6	+0.4	2017/4 2017/1	+0.2	2017/6 2017/3	+0.1	2017/4 2017/1
CN	0	2017/7 2017/6	+0.1	2017/4 2017/1	+0.1	2017/6 2017/3	0	2017/6 2017/6
IN	0	2017/7 2017/6	0	2017/4 2017/1	0	2017/6 2017/3	+0.1	2017/6 2017/5
RU	0	2017/6 2017/5	+0.3	2017/4 2017/1	+0.6	2017/6 2016/11	-0.2	2017/6 2017/4
BR	-0.1	2017/6 2017/5	0	2017/4 2017/1	+0.7	2017/6 2017/3	-0.3	2017/6 2017/5

A2. Change in inflation predictions for 2017

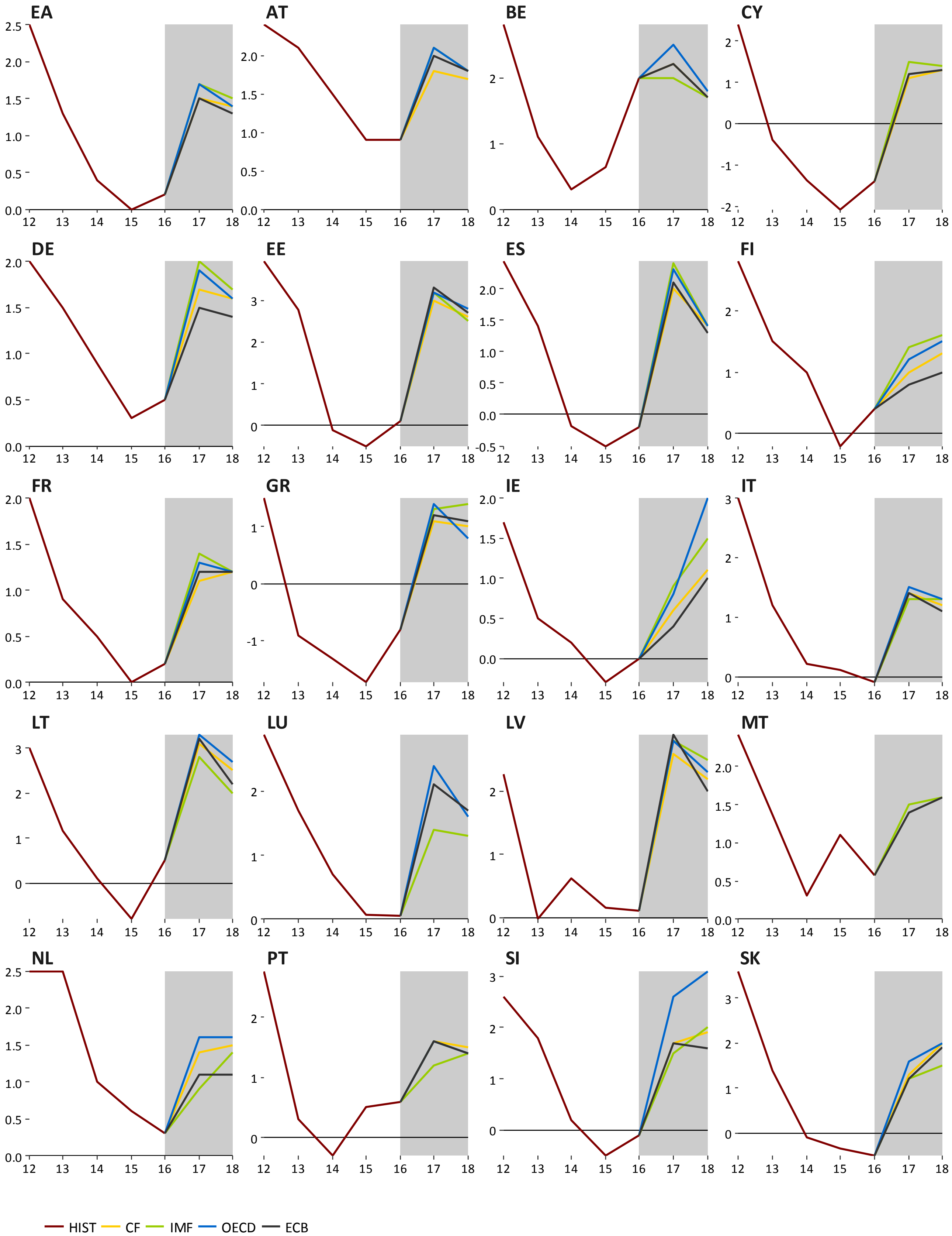
	CF		IMF		OECD		CB / EIU	
EA	-0.1	2017/7 2017/6	+0.6	2017/4 2016/10	+0.5	2017/6 2016/11	-0.2	2017/6 2017/3
DE	0	2017/7 2017/6	+0.5	2017/4 2016/10	+0.5	2017/6 2016/11	+0.1	2017/6 2016/12
US	-0.2	2017/7 2017/6	+0.4	2017/4 2016/10	+0.6	2017/6 2016/11	-0.3	2017/6 2017/3
UK	0	2017/7 2017/6	0	2017/4 2016/10	+0.4	2017/6 2016/11	+0.1	2017/5 2017/2
JP	-0.1	2017/7 2017/6	+0.5	2017/4 2016/10	+0.3	2017/6 2016/11	-0.1	2017/4 2017/1
CN	-0.1	2017/7 2017/6	+0.1	2017/4 2016/10	-0.7	2017/6 2016/11	+0.1	2017/6 2017/6
IN	-0.6	2017/7 2017/6	-0.4	2017/4 2016/10	-0.4	2017/6 2016/11	-0.6	2017/6 2017/5
RU	-0.2	2017/6 2017/5	-0.5	2017/4 2016/10	-1.7	2017/6 2016/11	+0.1	2017/6 2017/4
BR	-0.3	2017/6 2017/5	-1.0	2017/4 2016/10	-1.8	2017/6 2016/11	-0.1	2017/6 2017/5

A3. GDP growth in the euro area countries



Note: The chart shows institutions' latest available outlooks of for the given country (in %).

A4. Inflation in the euro area countries



Note: The chart shows institutions' latest available outlooks of for the given country (in %).

A5. List of abbreviations

AT	Austria
bbl	barrel
BE	Belgium
BoE	Bank of England
BoJ	Bank of Japan
bp	basis point (one hundredth of a percentage point)
BR	Brazil
BRIC	countries of Brazil, Russia, India and China
BRL	Brazilian real
CB	central bank
CB-CCI	Conference Board Consumer Confidence Index
CB-LEII	Conference Board Leading Economic Indicator Index
CBR	Central Bank of Russia
CF	Consensus Forecasts
CN	China
CNB	Czech National Bank
CNY	Chinese renminbi
CY	Cyprus
DBB	Deutsche Bundesbank
DE	Germany
EA	euro area
ECB	European Central Bank
EC-CCI	European Commission Consumer Confidence Indicator
EC-ICI	European Commission Industrial Confidence Indicator
EE	Estonia
EIA	Energy Information Administration
EIU	Economist Intelligence Unit
ES	Spain
EU	European Union
EUR	euro
EURIBOR	Euro Interbank Offered Rate
Fed	Federal Reserve System (the US central bank)
FI	Finland
FOMC	Federal Open Market Committee
FR	France
FRA	forward rate agreement
FY	fiscal year
GBP	pound sterling
GDP	gross domestic product
GR	Greece
ICE	Intercontinental Exchange
IE	Ireland
IEA	International Energy Agency
IMF	International Monetary Fund
IN	India
INR	Indian rupee
IRS	Interest Rate swap
ISM	Institute for Supply Management
IT	Italy
JP	Japan
JPY	Japanese yen
LIBOR	London Interbank Offered Rate
LME	London Metal Exchange
LT	Lithuania
LU	Luxembourg
LV	Latvia
MT	Malta
NL	Netherlands
OECD	Organisation for Economic Co-operation and Development
OECD-CLI	OECD Composite Leading Indicator
PMI	Purchasing Managers' Index
pp	percentage point
PT	Portugal
QE	quantitative easing
RU	Russia
RUB	Russian rouble
SI	Slovenia
SK	Slovakia
TLTRO	targeted longer-term refinancing operations
UK	United Kingdom
UoM-CSI	University of Michigan Consumer Sentiment Index
US	United States
USD	US dollar
USDA	United States Department of Agriculture
WEO	World Economic Outlook
WTI	West Texas Intermediate (crude oil used as a benchmark in oil pricing)
ZEW-ES	ZEW Economic Sentiment