Global economic outlook and the UK economy

The UK

B.3.1. GDP growth surged during 2013 and the first half of 2014. Since then it appears to have subsided somewhat but still remains strong by developed economy standards and is expected to continue likewise into 2015 and 2016. There needs to be a significant rebalancing of the economy away from consumer spending to business and manufacturing investment and exporting in order for this recovery to become more firmly established.

B.3.2 One drag on the economy has been that wage inflation has only recently started to exceed CPI inflation, so enabling disposable income and living standards to start improving. The plunge in the price of oil brought CPI inflation down to a low of 1.0% in November 2014, the lowest rate since September 2002. Inflation is expected to stay around or below 1.0% for the best part of a year and this will help to improve consumer disposable income and so underpin economic growth during 2015.

B.3.3 However, labour productivity needs to improve substantially to enable wage rates to increase and further support consumer disposable income and economic growth. In addition, the encouraging rate at which unemployment has been falling should feed through into pressure for wage increases, though current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen early in 2015.

The US

B.3.4 The US, the biggest world economy, has generated stunning growth rates of 4.6% (annualised) in Q2 2014 and 5.0% in Q3. This is hugely promising for the outlook for strong growth going forwards and it very much looks as if the US is now firmly on the path of full recovery from the financial crisis of 2008. Consequently, it is now confidently expected that the US will be the first major western economy to start on central rate increases by mid 2015.

The Eurozone

B.3.5 The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- Greece: the general election on 25 January 2015 is likely to bring a political party to power which is anti EU and anti austerity. If this results in Greece leaving the Euro, it is unlikely that this will destabilise the Eurozone as the EU is regarded as having put in place adequate firewalls to contain the immediate fallout to just Greece. The indirect effects of the likely strengthening of anti EU and anti austerity political parties throughout the EU is very difficult to quantify.

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- As for the Eurozone in general, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, worries over the Ukraine situation, the Middle East, and the Ebola crisis have led to a resurgence of those concerns, with increased risk of prolonged deflation and weak growth. Sovereign debt difficulties (especially Greece) have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done).

- It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods.