"Project Fear" was groundless: the UK economy has been remarkably resilient

*"Project Fear" has been proved pretty groundless, argues **Ruth Lea**, CBE (Arbuthnot Banking Group). Since the Brexit vote, the UK economy has been more robust than expected. This cannot, however, be attributed to "better-than-predicted" world growth, she maintains. The world economy's performance in 2016 and 2017 was, in reality, much as the IMF expected.*

Former Commercial Secretary to the Treasury Lord O'Neill has recently conceded that the UK economy has been more robust than he had expected, given the Brexit vote. He has been quoted as saying, "I certainly wouldn't have thought the UK economy would be as robust as it currently seems", reportedly attributing the resilience to better-than-predicted global growth.[1] Of course, I welcome his honesty, but I do question whether the "better-than-predicted" world growth has had as much effect on the UK economy as O'Neill implies. In the run-up to the Brexit vote (and in its aftermath) the IMF, for example, was expecting a pick-up in both global GDP growth and world trade growth. Granted, they have raised their projections a tad recently compared with pre-Brexit vote times, but not dramatically.

At this point, it is worth reminding ourselves of the Treasury's paper concerning the immediate impact of a Brexit vote, released in May 2016. May I quote some highlights of "Project Fear":[2]

> "The analysis in this document comes to a clear central conclusion: a vote to leave would represent an immediate and profound shock to our economy. That shock would push our economy into a recession and lead to an increase in unemployment of around 500,000, GDP would be 3.6% smaller, average real wages would be lower, inflation higher, sterling weaker, house prices would be hit and public borrowing would rise compared with a vote to remain".
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> "The analysis also presents a downside scenario, finding that the shock could be much more profound, meaning the effect on the economy would be worse still. The rise in uncertainty could be amplified, the volatility in financial markets more tumultuous, and the extent of the impact to living standards more acute. In this severe scenario, GDP would be 6% smaller, there would be a deeper recession, and the number of people made unemployed would rise by around 800,000 compared with a vote to remain. The hit to wages, inflation, house prices and borrowing would be larger. There is a credible risk that this more acute scenario could materialise".

Fortunately, "Project Fear" has been proved pretty groundless. Briefly, growth has not collapsed, there has not been a recession. Unemployment has not shot up. On the contrary, it has continued to fall in, and in the three months to October 2017 the unemployment rate was 4.3%, the joint lowest since 1975. The economy has been remarkably resilient.

More specifically, GDP growth in 2016 is now estimated to have been 1.9% in 2016 and may have been around 1.8% in 2017. (The ONS releases the first estimate for 2017 on Friday, 26 January.) Granted sterling weakened after the Brexit vote, with knock-on effects for inflation and real earnings and hence household consumption growth. But having said, that household consumption probably grew around 1.5% last year. Whilst, this was markedly slower than in 2016 it was still reasonable. Gross fixed capital formation (GFCF) may have risen by around 3% last year, thus confounding expectations in some quarters that it would "collapse" in the wake of a Brexit vote. And the growth of exports of goods and services (as a component of GDP) may have risen by around 6% compared with a more modest (around 3%) increase in imports, contributing to an improved trade balance.

The improvement in the balance of trade has, of course, contributed to GDP growth in 2017. It may have contributed about 0.7% of the estimated total GDP growth (1.8%), with the other components contributing over 1%. How much of this improvement reflected the UK's (much-needed) boost to competitiveness following sterling's depreciation (part of which has now been reversed, incidentally) and how much reflected a stronger world economy is difficult to say at this stage. But, let us for the sake of argument, say it is roughly 50/50. Under these circumstances, the improved performance of the world economy may have contributed 0.35% to GDP growth in 2017. But this is not the end of the matter.

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In the months running up to the Brexit vote, major forecasting institutions expected the world economy would improve. In April 2016, the IMF, for example, projected world GDP growth of 3.2% in 2016 and 3.5% in 2017, compared with 2015’s 3.1%. They expected, too, an improvement in world trade growth to 3.1% in 2016 and 3.8% in 2017, compared with 2015’s 2.8%. Granted these were not stellar projections, but there was some confidence matters would improve.[3-4]

Fast-forwarding to the IMF’s latest analysis (January 2018), the IMF estimated that world GDP growth was indeed 3.2% in 2016 and probably around 3.7% in 2017 (modestly higher than the April 2016 forecast).[5] They expect growth of 3.9% for this year, so no major acceleration. Turning to world trade, the IMF estimated in January that growth was 2.5% in 2016 (weaker than expected in April 2016) but probably around 4.7% in 2017 (before easing to 4.6% in 2018). Trade growth was, therefore, about 1% stronger in 2017 than expected in April 2016. In reality, the world economy has behaved much as the IMF expected then, with relatively modest upsides.

Again, we cannot say at this point how much the better-than-expected world trade growth in 2017 contributed to the UK’s improving trade balance but, given an expectation of 3.8% in April 2016 and an outturn nearer to 4.7%, it would be extraordinary if it were very great. If indeed the improved world economy did contribute 0.35% to GDP growth in 2017 (see above), it can be argued that much of this should have been anticipated prior to the Brexit vote, given the IMF forecasts. And the world economy’s better-than-expected performance may only have contributed 0.1%-0.2% to GDP growth – if that. In conclusion, therefore, I find it difficult to accept the notion that a better-than-expected world performance has been a game-changer, as implied by Lord O’Neill. A contributing factor, yes, a game changer, no.

The key issue now is to address the factors, not least of all concerning domestic policies, that will support the British economy in future, given that Brexit is happening. Granted, we do not yet know the eventual terms of our new relationship with the EU, but I am optimistic there will be a positive UK-EU trade deal because makes economic sense for both sides. But, even if there is no deal and we trade with the EU under WTO rules, this is far from being a disaster. As we know, trade is driven by commercial reality and growing markets, as shown by the fact that our exports to non-EU markets have grown significantly quicker in recent years than to EU markets and the share of our trade to EU is in secular decline. Trade with the EU would continue. And growth would continue.

The article gives the views of the author, and not the position of LSE Brexit, nor of the London School of Economics.

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References

1. *BBC,* “UK growth upgrade could ‘dwarf’ Brexit hit”, 22 January 2018.

2. *HM Treasury*, “The immediate economic impact of leaving the EU “, May 2016.
3. *IMF*, “World Economic Outlook: too slow for too long”, April 2016.
4. *IMF, “*Subdued demand: symptoms & remedies”, October 2016, revised world GDP growth to 3.1% (from 3.2%) for 2016 and 3.4% (from 3.5%) for 2017 and world trade growth to 2.3% (from 3.1%) for 2016 and 3.8% (no change) for 2017.
5. *IMF*, “World Economic Outlook, Seeking sustainable growth: short-term recovery, long-term challenges”, October 2017.