Economic Insight: The 2016 Autumn Statement

A response from the International Longevity Centre – UK

Nov 2016

Partners Programme
International Longevity Centre - UK

The International Longevity Centre - UK (ILC-UK) is an independent, non-partisan think-tank dedicated to addressing issues of longevity, ageing and population change. It develops ideas, undertakes research and creates a forum for debate.

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International Longevity Centre (ILC-UK) Comments

Autumn Statement 2016: What does it all mean for UK savings?

Summary

About this note

Yesterday's Autumn Statement outlined the state of the UK's economy and public finances in the wake of the vote to leave the EU. In this note we briefly analyse what this means for savings and conclude with a short discussion about UK savings policy.

Key facts and figures based on ILC-UK analysis

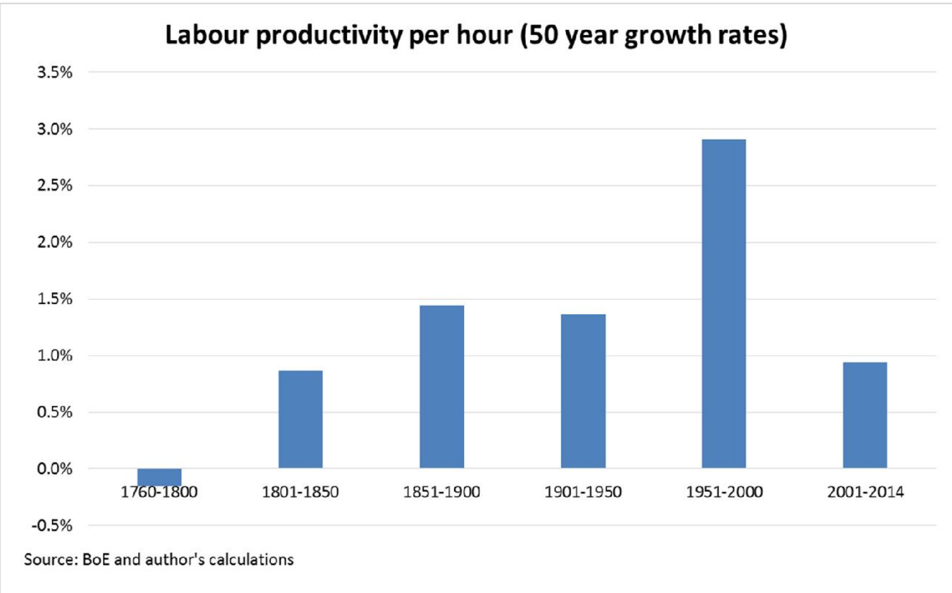
- By 2022, economic output per person will be over 25% smaller than we would have expected it to be before the crisis. This economic weakness has impacted on household finances**.**
- Real wages will be £11,600 (or 31%) below what we would have expected them to be before the crisis. This has made it harder to save.
- Bank Rate is expected to remain firmly in the zero lower bound, while returns on long dated government bonds are likely to remain at historically low levels. This means savings will not go as far.
- The household savings ratio has been falling and is expected to remain low up to 2022. This is despite the continued roll out of automatic enrolment.

Overall verdict

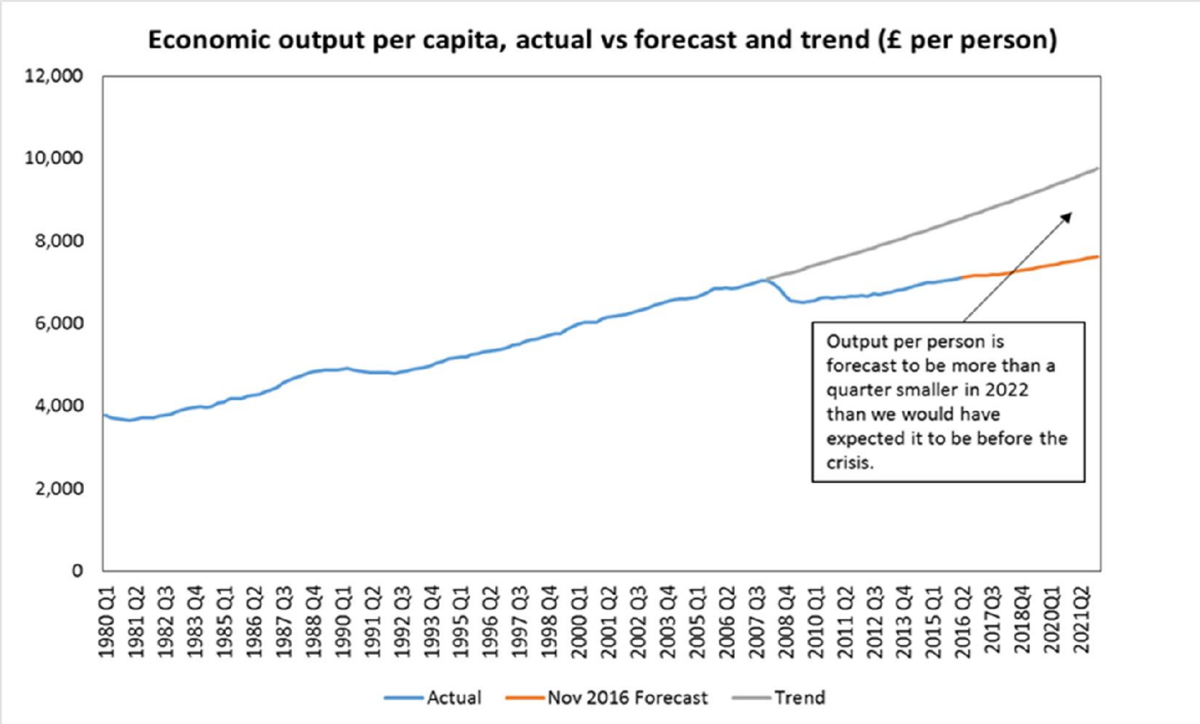
Generally bad economic news for savers, but this does not mean the government should shy away from its long run objective of supporting private savings through automatic enrolment. Government needs to think carefully about how to square the circle and deliver savings policy which is aligned to its economic and fiscal objectives.

Overall economic and fiscal outlook

Irrespective of the vote to leave the EU, UK economic growth and productivity has looked very weak for some time – more akin to 19th century rates of productivity growth than what we've been used to since the Second World War. Since the turn of this Millennium, average annual UK productivity growth has fallen to just below 1%. In contrast, between 1951 and 2000, productivity growth was almost 3% per annum (see chart).

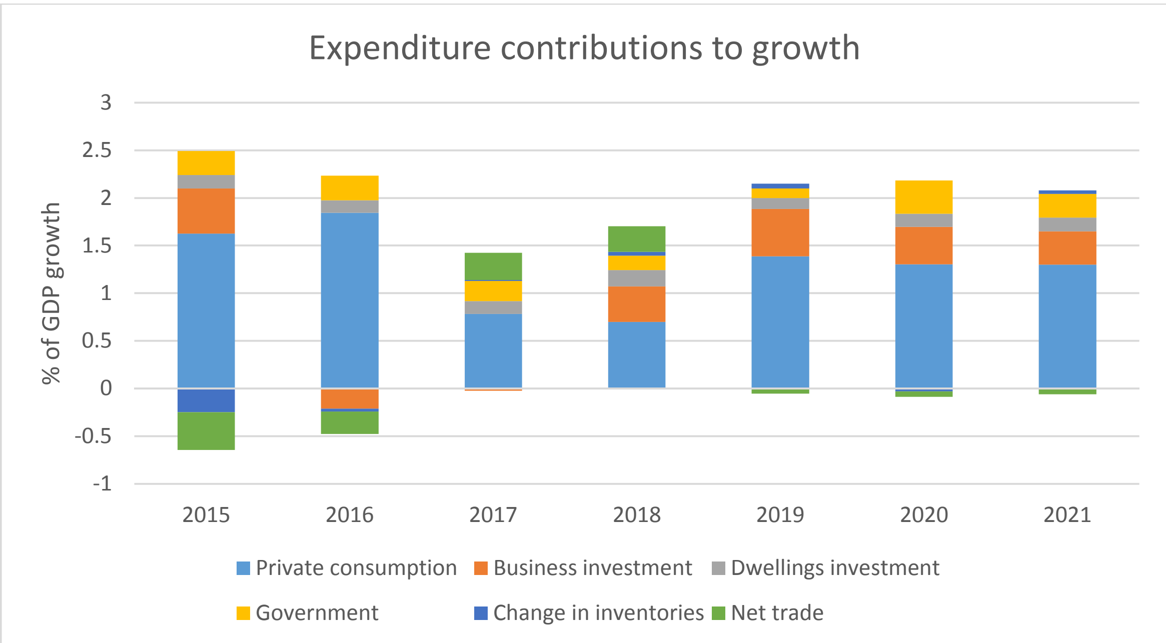


Peoples' expectations are conditioned on recent economic performance and there remains a widely held view that we will return to the bumper growth rates seen in the latter half of the twentieth century soon. But this may not be the case as was underlined by the latest forecasts from the OBR. In short, we have calculated that by 2022, **economic output per person will be over 25% smaller** than we would have expected it to be before the crisis.



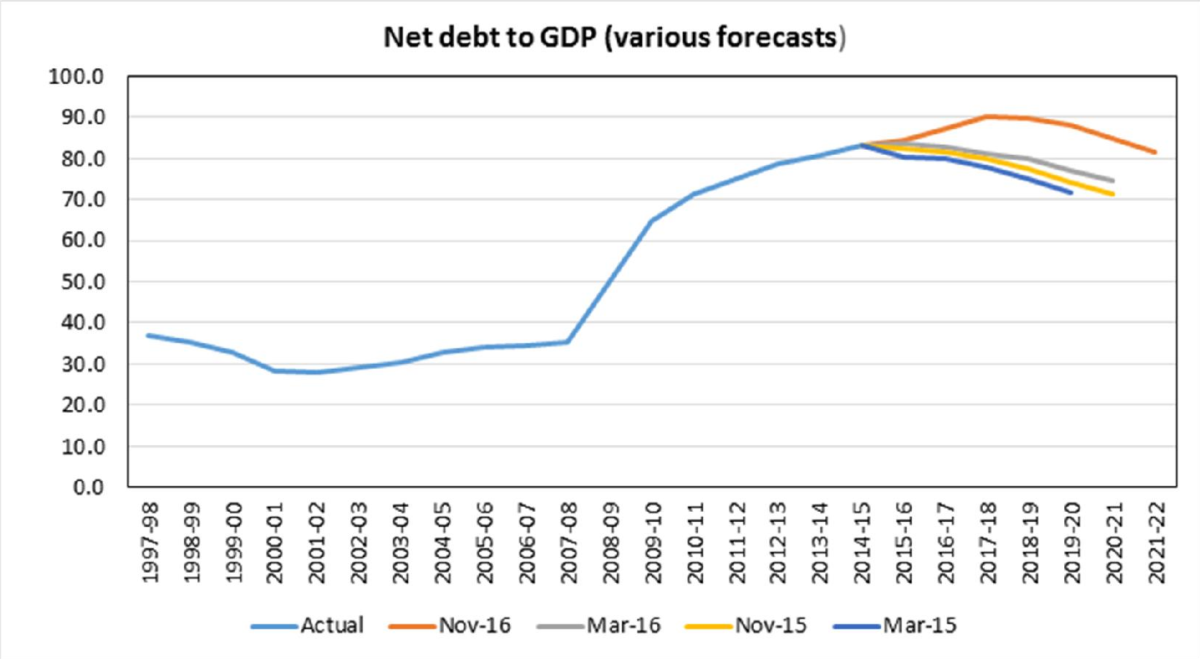
Source: OBR, ONS and authors calculations

Underpinning this fall in output growth, is an expected decline in business investment and consumption growth - **particularly in the years 2017 and 2018** - given the uncertainty surrounding Brexit and rising prices caused by the falling Sterling.



Source: OBR

But even before the Brexit vote, the UK economy had been performing worse than expected, which meant the Chancellor missed his spending targets again and again. As our chart below shows, net debt to GDP just kept on rising and is now expected to **peak at nearly 90% of GDP in the year 2017-18**.



Source: OBR

Household finances continue to stagnate

Sustained income growth will be key to supporting increased savings over the coming years. Yet, the persistently bleak economic outlook continues to put pressure on household finances. Today, real wages remain below their peak achieved 9 years ago. The prognosis for wages continues to look dire, particularly when pitted against the rate of wage growth we were accustomed to before the crisis. Even in 2021, wages are forecast to remain below where they were in 2007, and more dramatically, we have calculated that wages will be **£11,600 (or 31%) below** what we might have expected them to be given trend wage growth before the recession.

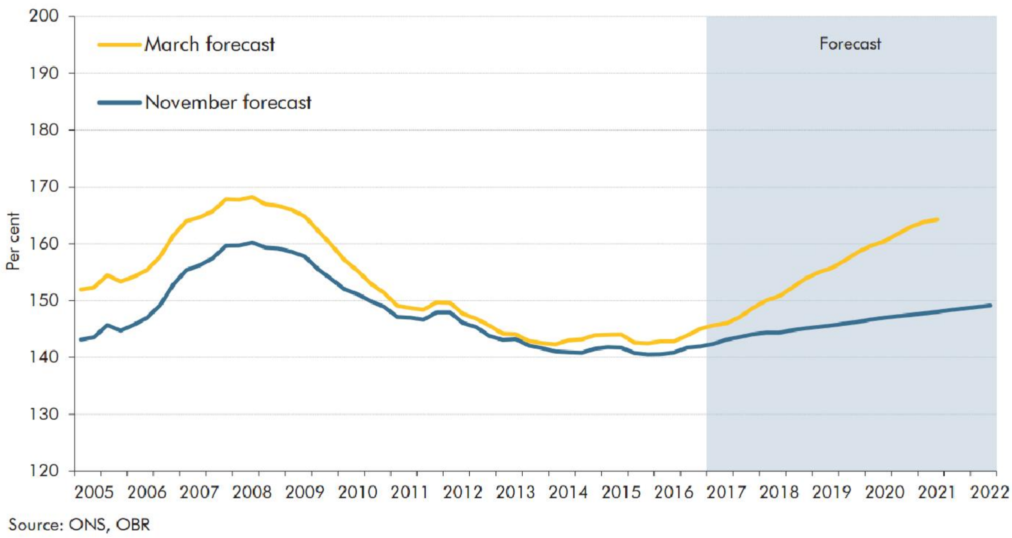
Source: ONS, OBR and author's calculations

Underpinning slow wage growth, is both higher expected inflation caused by the falling value of sterling as we look to leave the EU, but also continued stagnation in nominal pay growth. The latter is reflective of long term sluggish productivity growth which we mentioned earlier as well as continued evidence of some slack in the labour market – with underemployment still higher than it was before the financial crisis. Both of these two challenges would have remained prominent irrespective of our vote to leave the EU. But Brexit may exacerbate this situation by driving up imported inflation.

Source: OBR and author's calculations

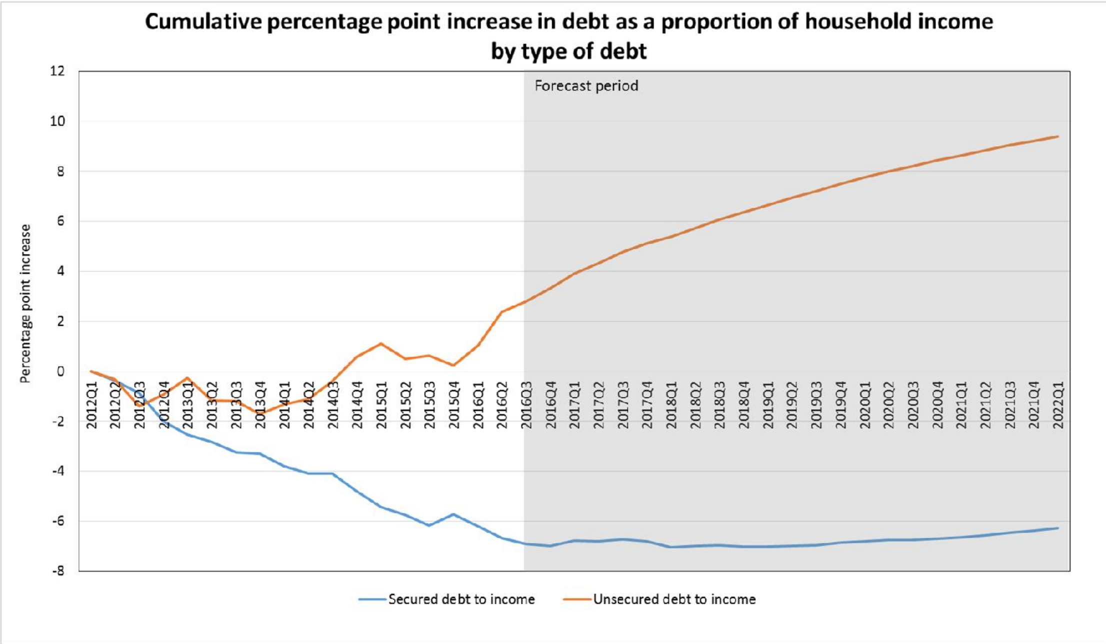
Unlike previous forecasts, the OBR does not expect such a dramatic debt filled rise in household consumption. Indeed, while debt as a proportion of household income is expected to rise, this rise is much flatter than was forecast in March.

Debt to household income (various forecasts)



The change between the two forecasts is largely because the OBR have revised down their expectations for rises in secured debt (i.e. property), though unsecured (i.e. credit cards and borrowing from payday lenders) is still expected to increase over the period. This is consistent with our recent analysis of data from the Bank of England for a presentation at the Building Societies Annual Conference, which showed that secured lending volumes remain subdued, while consumer credit lending continues to rise[1].

[1] Slides available on request

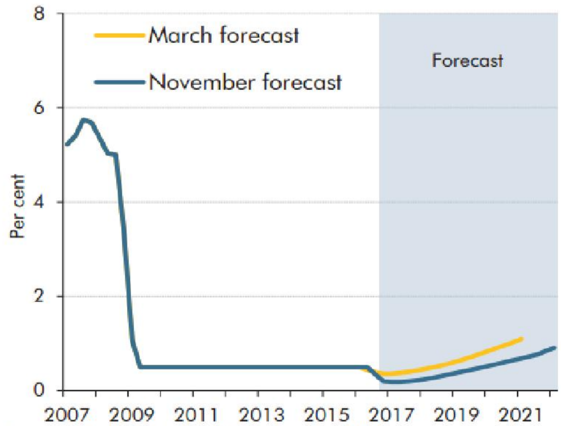


Source: OBR and author's calculations

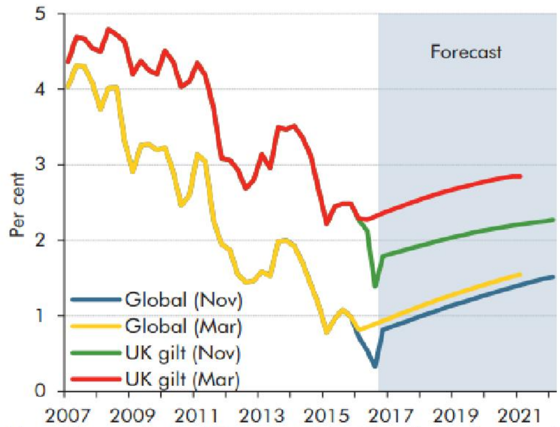
What about interest rates?

Since the 2008 financial crisis, interest rates have been persistently low – not just in the UK but around the world. Crucially, this reflects [weak underlying economic fundamentals] and is not simply the result of unconventional monetary policy. The Autumn Statement has not changed this outlook. While the UK may face higher than expected inflation, this is largely due to rising imported prices rather than being a sign of the UK economy overheating. Consequently, interest rates are unlikely to shift much over the forecast period. As the below charts show, Bank Rate is expected to remain firmly in the zero lower bound, while returns on long dated government bonds are likely to remain at historically low levels. In summary, returns on savings and investments are likely to remain subdued for some time to come.

Bank rate (left) Global and UK government bonds (right)



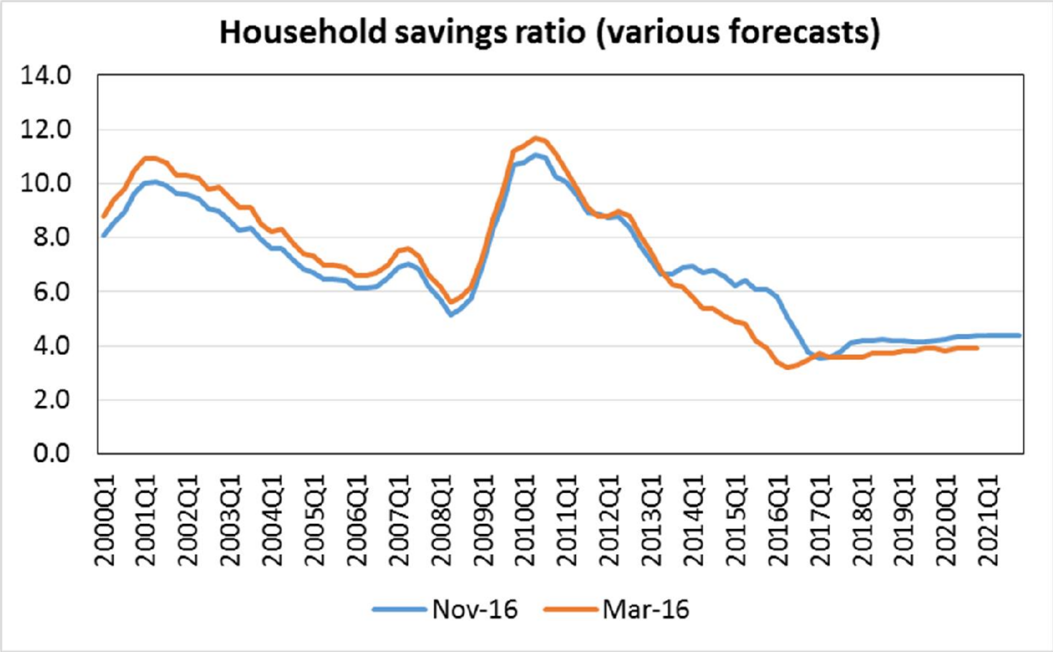
Source: Bank of England, Datastream, OBR



Note: 20-year gilts for UK, trade weighted bond rates for global.

What about the headline savings ratio?

While households are not anticipated to take on as much debt as they were in previous OBR forecasts, this does not translate into additional savings. Indeed, the household savings ratio – a critical measure of the amount saved as a proportion of disposable income - has been falling and is expected to remain low up to 2022. This is despite the continued roll out of automatic enrolment.



Source: OBR

Implications for savings policy

In response to the need to support savings and boost incomes of the poorest workers, the government announced an increase in the National Living Wage and a new NS&I savings bond with an interest rate of around 2.2% (with a maximum deposit of £3,000). While both measures are welcome, they do not change the overall picture of stagnating incomes and low savings.

In 2017, the government will have some big decisions to make about the future of long term savings, particularly with regard to the review of Automatic Enrolment. Automatic enrolment has been a real success in terms of driving up the number of people saving but not the amount being saved. Many have advocated autoescalation, whereby pension contributions automatically increase at regular intervals to boost savings levels. But against the economic picture painted by the OBR, of falling consumption growth, and stagnating real wages, the temptation for government to shy away from autoescalation may rise.

It is crucial government takes a long-term view. Private savings will need to play a large role in supporting future pension incomes, and over the long-run can be invested in a way to drive forward the productivity of the UK economy. In the context of the AE review, the government need to think carefully about how to square the circle and deliver savings policy which is aligned to its economic and fiscal objectives. Ultimately, this is the only way we will achieve sustainable growth. The chancellor said that as we look ahead to the next parliament, “we will need to ensure we tackle the challenges of rising longevity and fiscal sustainability”. We hope the AE review and related policy discussions fully reflect this view.

About the International Longevity Centre – UK (ILC-UK)

The International Longevity Centre – UK (ILC-UK) is an independent, research led, think-tank dedicated to addressing issues of longevity, ageing and demographic change. We develop ideas, undertake research and create a forum for action and debate.

The ILC-UK was established in 2000 to explore and address the new longevity revolution and its impact on the life-course and society. It provides the visionary approach needed for individual and societal planning to ensure a progressive, economically viable and socially inclusive tomorrow for all.

Based in Westminster, much of our work is directed at the highest levels of government and the civil service, in London, local government and Brussels. We have a reputation as a respected think-tank which works, often with key partner organisations, to inform important decision-making processes. We are aided in this work by our Chief Executive, Baroness Sally Greengross, former director-general of Age Concern and now a cross-bench peer.

Our policy and research remit is broad, and covers everything from pensions and financial planning, to health and social care, housing design, and age discrimination. We work primarily with central government, but also actively build relationships with local government, the private sector and relevant professional and academic associations.

Partners Programme

International Longevity Centre - UK

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