MOMENT OF TRUTH

With Brexit edging ever closer, interest rates going up and a Budget coming this month, **Alex Wright** explains why these are defining times for the UK economy

These are tough economic times we are living in, with the uncertainty surrounding Brexit and what form a deal struck with the European Union (EU) will take, if indeed any at all.

There is also the 0.25% rise in interest rates to 0.5% announced by the Bank of England earlier this month – the first rise in a decade – increasing mortgage interest payments for almost four millions households. As if that wasn't bad enough, the Chancellor Philip Hammond admitted in last week's Budget that growth forecasts have been lowered and productivity is still poor.

The uncertainty following last year's EU referendum vote has resulted in a double whammy of lower inward investment and higher inflation, rising to 3%, fuelled by a weaker pound.

However, it has not all been doom and gloom. The UK economy was estimated to have grown 1.8% in 2016, second only to Germany's 1.9%, and it has continued to grow at almost the same rate this year, according to the Office for National Statistics.

Unemployment has also continued to fall, to a 42-year low of 4.3%. Annual house price increases, meanwhile, have fallen from 9.4% since the June 2016 vote, but were still at an inflation-beating 5% in the year to August 2017.

BREXIT QUESTION

The big question, however, remains whether Prime Minister Theresa May and her government can push through a hard Brexit, leaving both the single market and the customs union, or whether it is vetoed by parliament, or they fail altogether to reach a deal with the EU before the 29 March 2019 deadline. Despite Ms May insisting that "real and tangible progress" has been made in Brexit talks to date, "no deal" is still a real possibility.

Agreement has also yet to be reached on the size of Britain's divorce bill from the EU, before both parties can move on to discussing future trade deals. The EU is demanding €60bn in payment, whereas the UK has so far offered €20bn to cover the two-year transition period.

Should the worst happen and Britain gets no deal, it would have to rely on trading with the EU under World Trade Organisation (WTO) rules, meaning higher tariffs for businesses and consumers, companies losing passporting rights to operate across the EU, and soaring unemployment. Worse still, consultants Oliver Wyman estimate that 75,000 financial services jobs would be lost if WTO terms were imposed, not to mention the billions of pounds in lost tax revenue and investment.

"This is another reminder that a no-deal Brexit will be no good for the industry, for customers or the economies of the UK and the EU," says Miles Celic, chief executive of lobby group TheCityUK. "For our industry, the most urgent priority remains agreeing a timebound Brexit transition period."

INTEREST RATES

Amid all this was this month's announced interest rate rise – a double-edged sword. While it will raise the cost of borrowing on mortgages and other loans, it is good news for savers who have endured historically low rates for the past decade.

"The Bank of England seemingly sees the hike to 0.50% as more likely to be a case of 'one and a little more to come' rather than 'one and done'," says Howard Archer, chief economic adviser to the EY Item Club consultancy.

The 3.7 million households on variable and interest-only mortgages will be worst affected by the rise, with monthly mortgage payments increasing by about £12 per month based on an average outstanding balance of £89,000, according to UK Finance.

The rise may also force landlords to increase their rent. Consumer spending may also decline, having a knock-on effect on shops and retailers, particularly during the crucial Christmas and new year trading period.

On the flipside, Britain's 45 million savers stand to benefit most from increased interest earned on their accounts, as well as pensioners buying an annuity. Nationwide, Skipton, TSB and Yorkshire Building Society have all pledged to increase their variable savings rates after the announcement.

CRUCIAL TIME

In his Budget Mr Hammond slightly reduced the pace of repaying the country's debt and has stuck to his guns in terms of income tax pledges. Little emerged in his speech, however, in terms of good news for savers.

Whatever the outcome, the UK is now entering a significant time that will go a long way to determining its economic future. ●

1.8% estimated growth of the UK economy in 2016

4.3% UK unemployment figures – a 42-year low