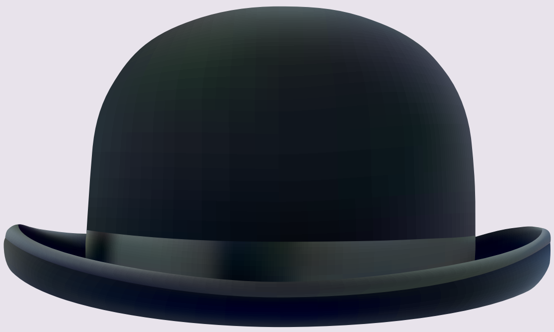

The UK and the International Economy

2015

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Contents

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Background

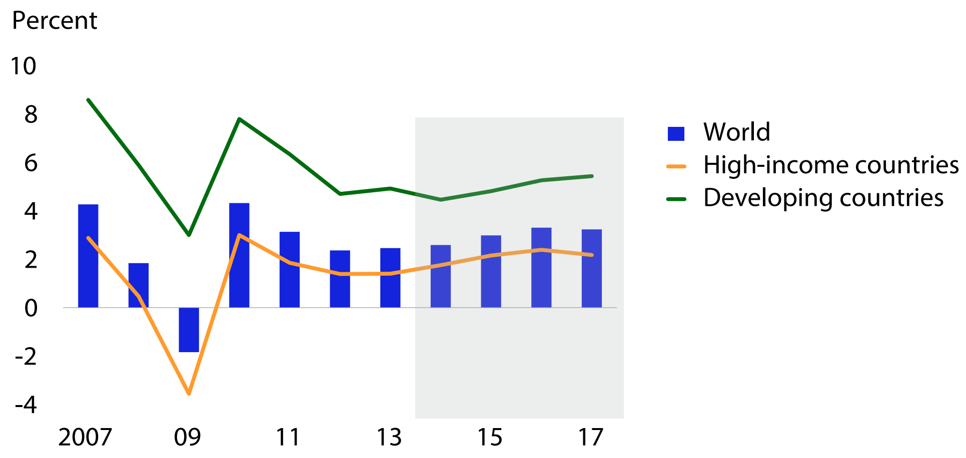
Global growth has been disappointing over the past year. According to the World Bank global growth only saw a very marginal increase during 2014, with a rise to 2.6% from the 2.5% recorded in 2013. The World Bank had initially forecast stronger growth figures but the recovery in high income countries has been particularly mixed.

Although growth in both the US and the UK was strong, with both countries showing output exceeding pre-crisis levels, this has not been the universal case. Problems in the Euro Area and Japan have accounted for the biggest mark-down in forecasts. The International Monetary Fund (IMF) shows the US recording growth of 2.4% in 2014 and the UK 2.6%, but on the other hand the Euro Area only achieved 0.8% and Japan was 0.1%.

In fact, Japan, which is the world's third largest economy was in recession during the 2nd and 3rd quarters of 2014, but came out of recession in the final quarter, although at a level which was below forecasts.

The recent trends in global growth rates can be seen in Figure 1.

Figure 1: GDP growth: Actual and Projected



Source: World bank, Bloomberg.

The World Bank expects global growth to settle at 3.0 to 3.3% between 2015 and 2017. High-income countries are expected to see growth of 2.2% in 2015-2017, which would be a rise from 1.8% in 2014. By contrast, growth in developing countries is expected to rise from 4.4% in 2014 to 4.8% in 2015 and 5.4% in 2017.

The IMF has projected very similar figures to the World Bank and expects global growth to rise moderately in 2015-16 from 3.3% in 2014 to 3.5% in 2015 and 3.7% in 2017. The IMF points out that although there have been factors supporting growth such as lower oil prices and the depreciation of the euro and the yen, these are more than offset by 'persistent negative forces', including the continuing after effects of the previous global crisis coupled with weak investment.

Overall there is a complicated picture and Olivier Blanchard, Director of Research at the IMF summed it up by saying: "It means good news for oil importers, bad news for oil exporters. Good news for commodity importers, bad news for exporters. Continuing struggles for the countries which show scars of the crisis, and not so for others. Good news for countries more linked to the euro and the yen, bad news for those more linked to the dollar."

The IMF World Economic Outlook suggests that all countries need to make a decisive push for structural reforms, even where there are different macroeconomic priorities. While the boost to growth of lower oil prices is welcomed, this will also push down inflation expectations, and this may result in deflation which is a distinct danger for future growth.

UK Economic Growth

In February 2015 the OECD launched a Survey of the UK economy. The Survey pointed out that annual growth in the UK rose by 2.6% in 2014, which was the fastest among G7 countries, and was forecast to stay at this level during 2015.

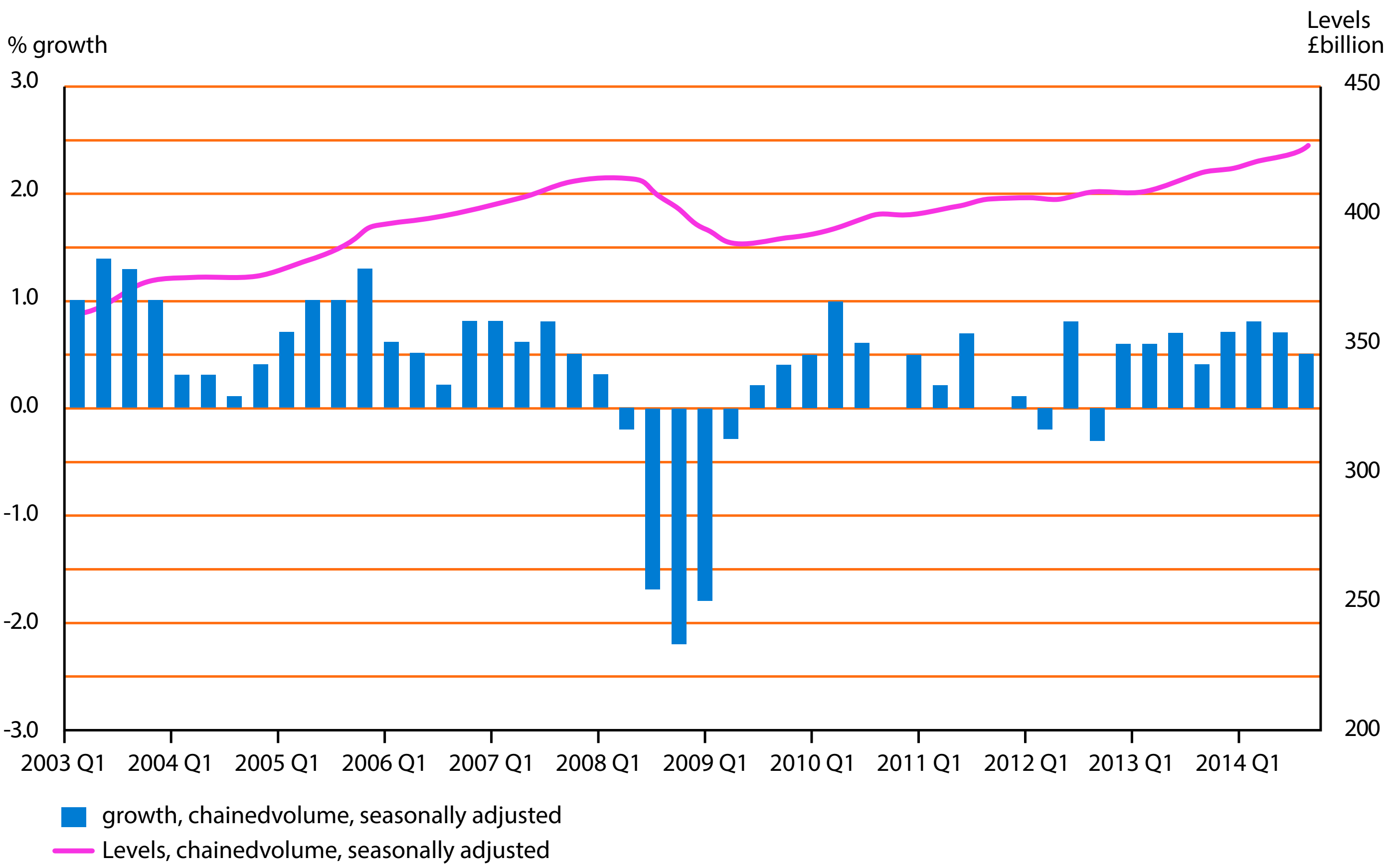
OECD Secretary-General, Angel Gurria said: "The United Kingdom has made tremendous progress exiting from the worst economic crisis of our lifetime. Job creation is remarkable and growth is strong, but the UK has to finish the job. Boosting productivity is essential to making this recovery durable and to ensuring that the benefits are shared by all. This requires further efforts to improve infrastructure, enhance access to finance for sound businesses and promote skills."

In fact UK growth of 2.6% in 2014 was the fastest pace of growth since 2007 and was considerably up on the 1.7% growth of 2013. According to the Office for National Statistics (ONS) the UK economy grew by 0.5% in the final quarter of 2014, although this was a slower growth rate than the 0.7% recorded in the previous three months.

Whether this slowdown is a 'one-off' or part of a possible ongoing trend has split economics commentators. According to the ONS's chief economist, Joe Grice it was '"too early to say" if this slowdown would persist. He said: "The dominant services sector remains buoyant while the contraction has taken place in industries like construction, mining and energy supply, which can be erratic."

In fact, the services sector grew by 0.8% in the quarter but this was offset by a decline in construction of 1.8%. At the same time the manufacturing sector only managed to grow by 0.1% which is its worst performance since the beginning of 2013.

Figure 2: Quarterly growth and levels of GDP

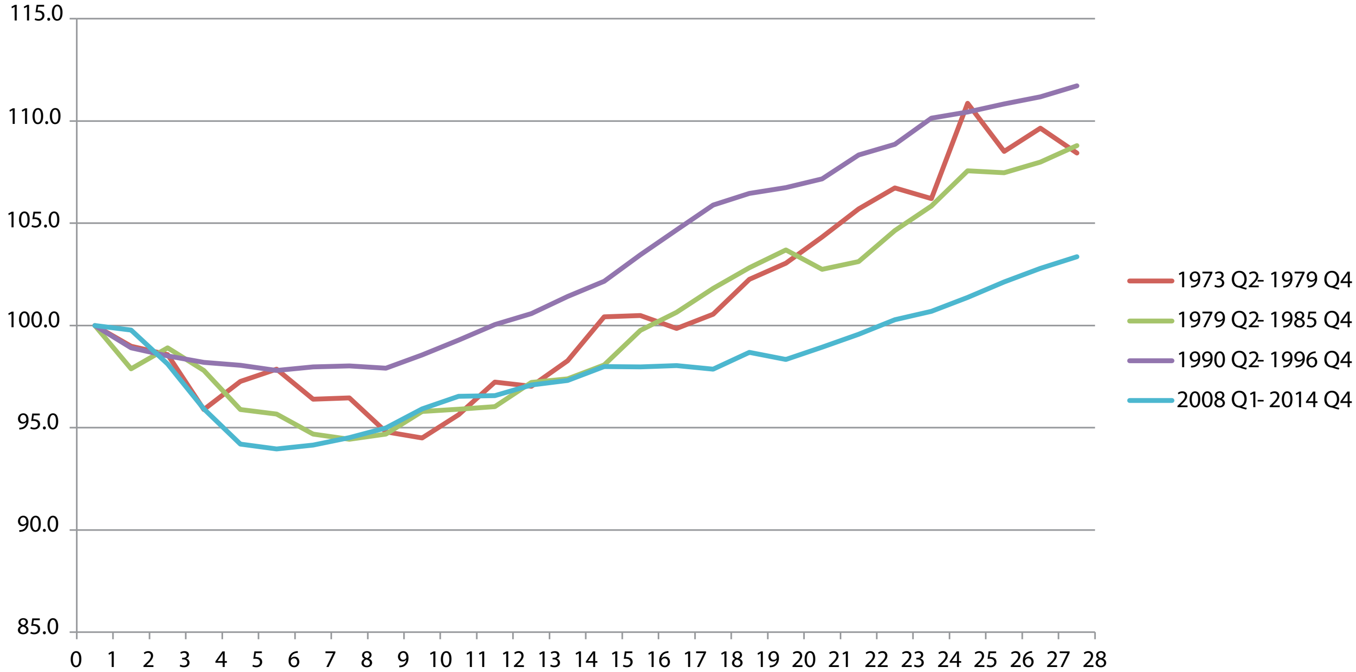


Source: ONS.

Figure 2 shows the steady growth of GDP in the UK during the 2000s until the worldwide financial crash hit in 2008 and 2009, where you can see the five consecutive quarters of negative growth. The figure also shows economic growth resuming at the end of 2009, but growth in the next few years tended to be lower than that seen in the years immediately before the global crash.

From the peak in the first quarter of 2008 to the trough in quarter two of 2009, overall GDP fell by 6.0%. Figure 3 below shows how previous economic downturns saw less severe impacts upon GDP.

Figure 3: GDP quarter-on-quarter growth from peak for previous and latest economic downturns



Source: Office for National Statistics.

Figure 3 shows that in the downturn in the early 1990s GDP only fell by 2.2% from the peak in the second quarter of 1990 to the trough in the third quarter of 1991. Similarly, in the downturn in the early 1980s there was a fall in GDP of 5.6% from the peak in the second quarter of 1979 to the trough in the first quarter of 1981.

Looking back at Figure 2 we can see that during 2010 to 2012 the recovery in GDP was very mixed with two quarters of economic decline, but since then we have seen fairly steady growth during the last eight quarters. This also meant that the UK economy saw economic growth exceed its peak level before the downturn in the third quarter of 2013.

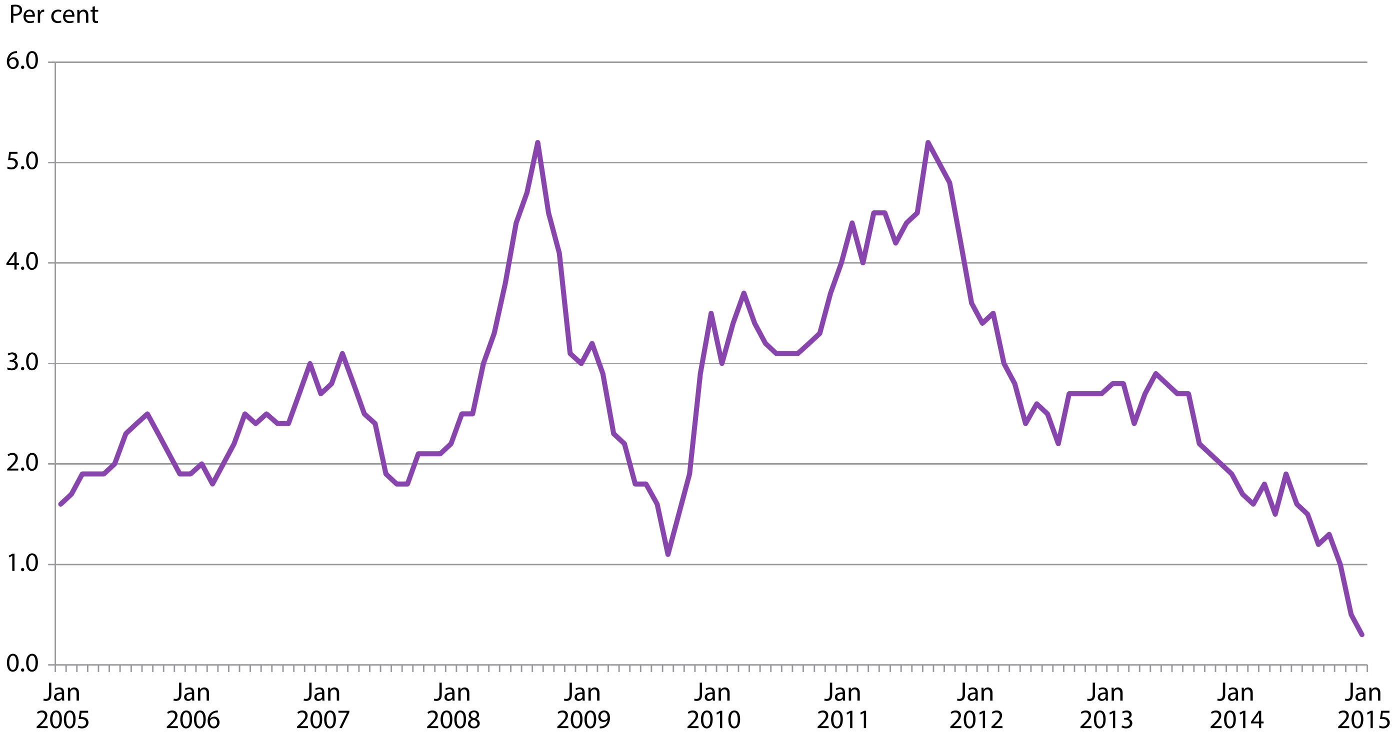
Monetary Policy and Interest Rates

The Bank of England has been given an inflation target of 2% expressed in terms of an annual rate of inflation based on the Consumer Prices Index (CPI). The objective is not to ensure that inflation is at its lowest possible rate, because the judgement is that inflation below this target is just as bad as inflation above it. In other words the inflation target is a symmetrical one.

The Monetary Policy Committee (MPC) of the Bank of England acknowledges that it is not possible to achieve a constant interest rate, but tries to ensure that an interest rate will be set which can bring inflation to its target within a 'reasonable time period without creating instability in the economy". There is a time lag between any change in interest rates being made and the impact upon the real variables in the economy, which can be as much as 18 months. So if the MPC thought that a current surge in inflation was caused by temporary factors, then they would be reluctant to raise interest rates, which could then have an unwanted effect of choking off economic growth at the very time that the inflation rate has sunk back down to its 2% target.

So, what has been happening to inflation and interest rates? The recent trend can be seen in Figure 4 below.

Figure 4: CPI 12-month inflation rate for the last 10 years: January 2005 to January 2015



Source: Office for National Statistics.

The rate of UK inflation has fallen to its lowest level on record. The CPI increased by 0.3% in the year to January 2015, which was down from 0.5% in December 2014. On a month to month basis the CPI fell by 0.9% between December 2014 and January 2015, which was the largest monthly fall since January 2001.

The main reason for this was that transport prices fell by 2.0% between December 2014 and January 2015 with most of this downward pressure coming from the fall in petrol prices which fell by 8.5p a litre between these two months. There was also a fall in food prices of 0.7% over the same period.

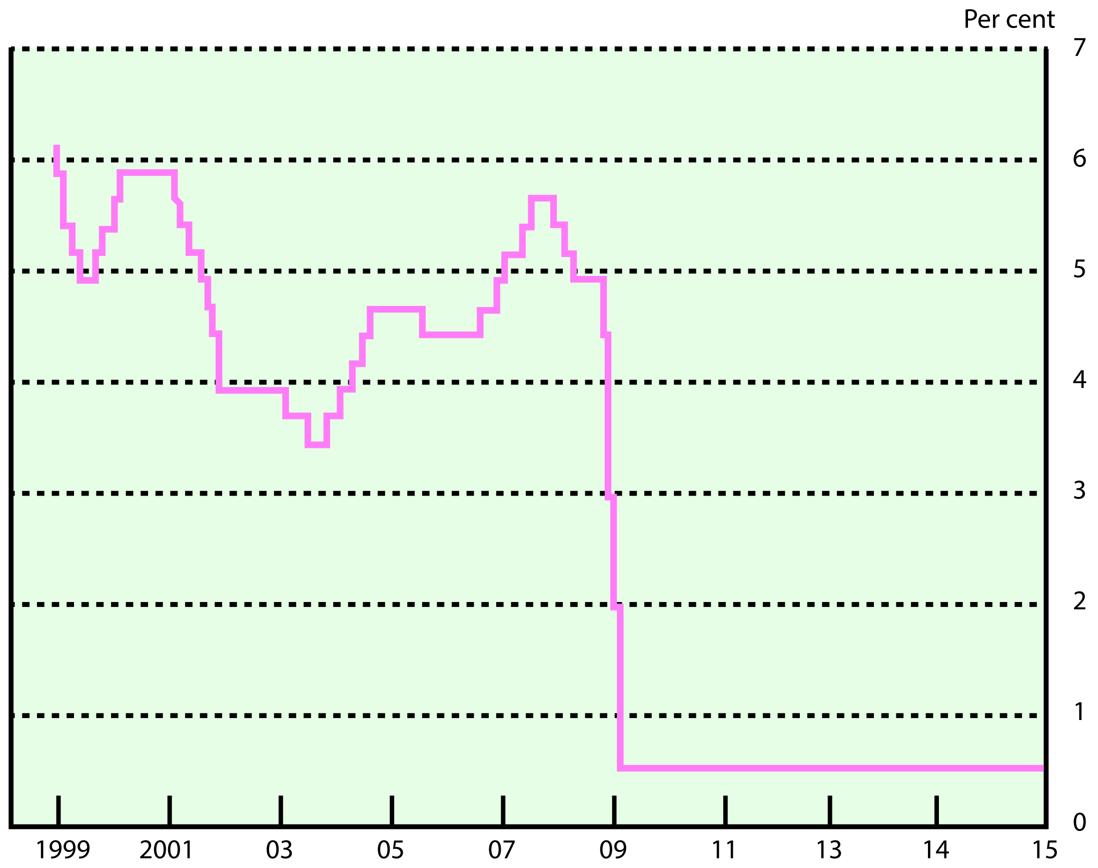
If the CPI continues to fall and moves into negative territory, then we have a situation called 'deflation'. You might think that negative price rises were a good thing but the Japanese economy has experienced a 20-year cycle of deflation from the mid 1990s. What tends to happen when prices are falling is that it makes rational sense for consumers to put off purchases. Why buy a new television now if it is going to be 5% cheaper in three months time? When economies get into this sort of downward spiral it means that if consumers are not buying then firms will reduce production, and if firms produce less they will employ fewer people.

In early February 2015 Mark Carney, governor of the Bank of England, did warn that inflation might temporarily turn negative in the spring, largely as a result of falling oil prices. But he did point out that if this were to happen it would not mean that the country had entered deflation as prices would be expected to rebound later in the year.

According to Mr Carney: “On the assumption that energy and food prices stabilise, CPI inflation should pick up notably once earlier declines start to drop out of the annual comparison towards the end of this year.”

The Bank is now forecasting that CPI inflation will return to its 2% target rate by the middle of 2017, without the Bank having to take any action. Mr Carney has argued that the falling oil price was “unambiguously good” for the economy. He said that: “The combination of rising wages and falling energy and food prices will help household finances and boost the growth of real take-home pay this year to its fastest rate in a decade. This will support solid growth in consumer spending.”

Figure 5: UK Base Rates



Source: Bank of England.

Figure 5 shows that as a result of the credit crisis in 2007-08 the Bank of England reduced interest rates from 5.75% in December 2007 to 0.5% in March 2009, in nine separate reductions. The resulting 0.5% base rate has been the lowest level in the Bank of England’s 315 year history. However, even this was not enough to stimulate the economy as banks became very wary of lending and wanted to make sure that they had sufficient funds available to stay solvent.

To overcome this, In March 2009 the Bank started to inject money directly into the economy. This became known as ‘Quantitative Easing’ (QE). Because the price of money (bank rate) was not working sufficiently, the MPC started to concentrate on increasing the quantity of money available.

So to encourage greater spending and avoid the risk of economic stagnation, the Bank eventually injected the equivalent of £375 billion into the economy through QE.

But in February 2015 Mr Carney did look at the possibility of deflation becoming more persistent than forecast. If this were to be the case he said that the Bank would be ready to cut interest rates further – although at 0.5% there is not much scope for further significant cuts – or the Bank would increase QE to stimulate the economy.

Mr Carney also said that: "It's pretty clear in terms of our central expectation that the most likely next move in monetary policy is an increase in interest rates." Currently markets are factoring in the possibility of an interest rate rise in early 2016.

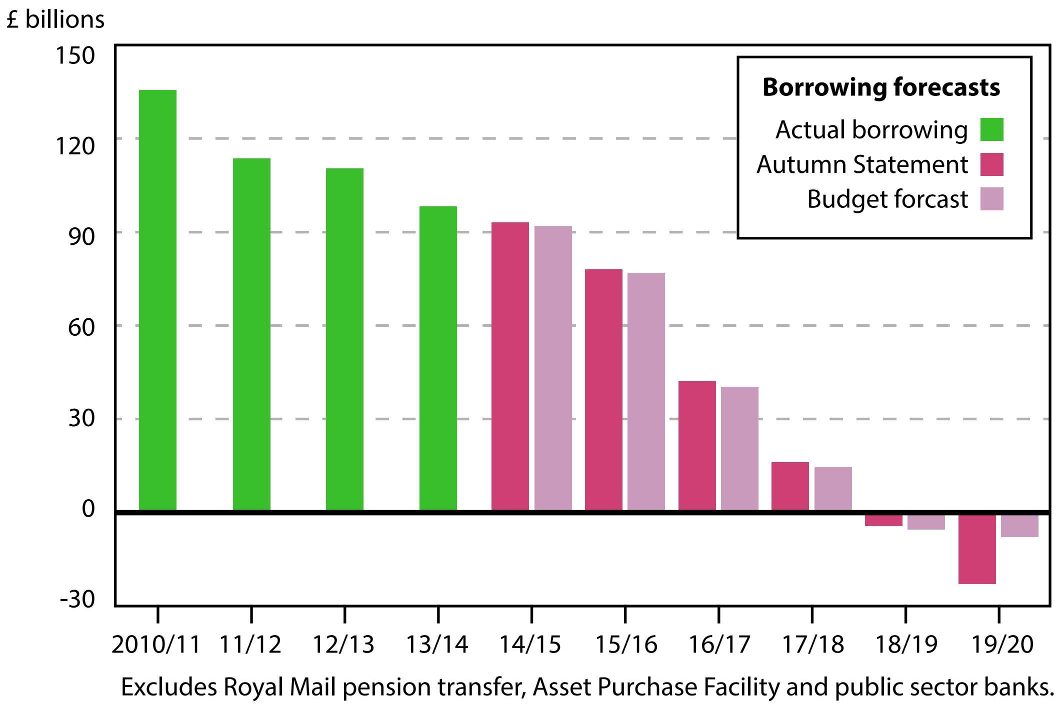
Fiscal Policy

We have seen already how monetary policy has been constrained by the record low interest rate which effectively has been at its lowest level possible, and the fact that the Bank of England has had to resort to measures such as quantitative easing to gain any traction in policy. To a certain degree fiscal policy has also been constrained in its flexibility by the decision of the coalition government from its first Budget in June 2010 to go for a so-called austerity policy. This involved the raising of taxes and the slashing of government spending.

The government committed itself to reducing borrowing as it considered that the country had been 'living beyond its means'. Although there has been a lot of domestic opposition to public sector job cuts and increased taxation, there was support from international bodies such as the IMF. The government has been able to point to the turnaround in economic growth, at a faster rate than many other advanced economies, as a justification for the measures taken.

The Chancellor, George Osborne, announced his Budget on 18th March 2015 and outlined government spending and borrowing plans for the next five years, should they be re-elected. The government borrowing forecasts can be seen in Figure 6 below.

Figure 6: Government Borrowing forecasts to 2019-20.



Source: BBC based on ONS and OBR figures.

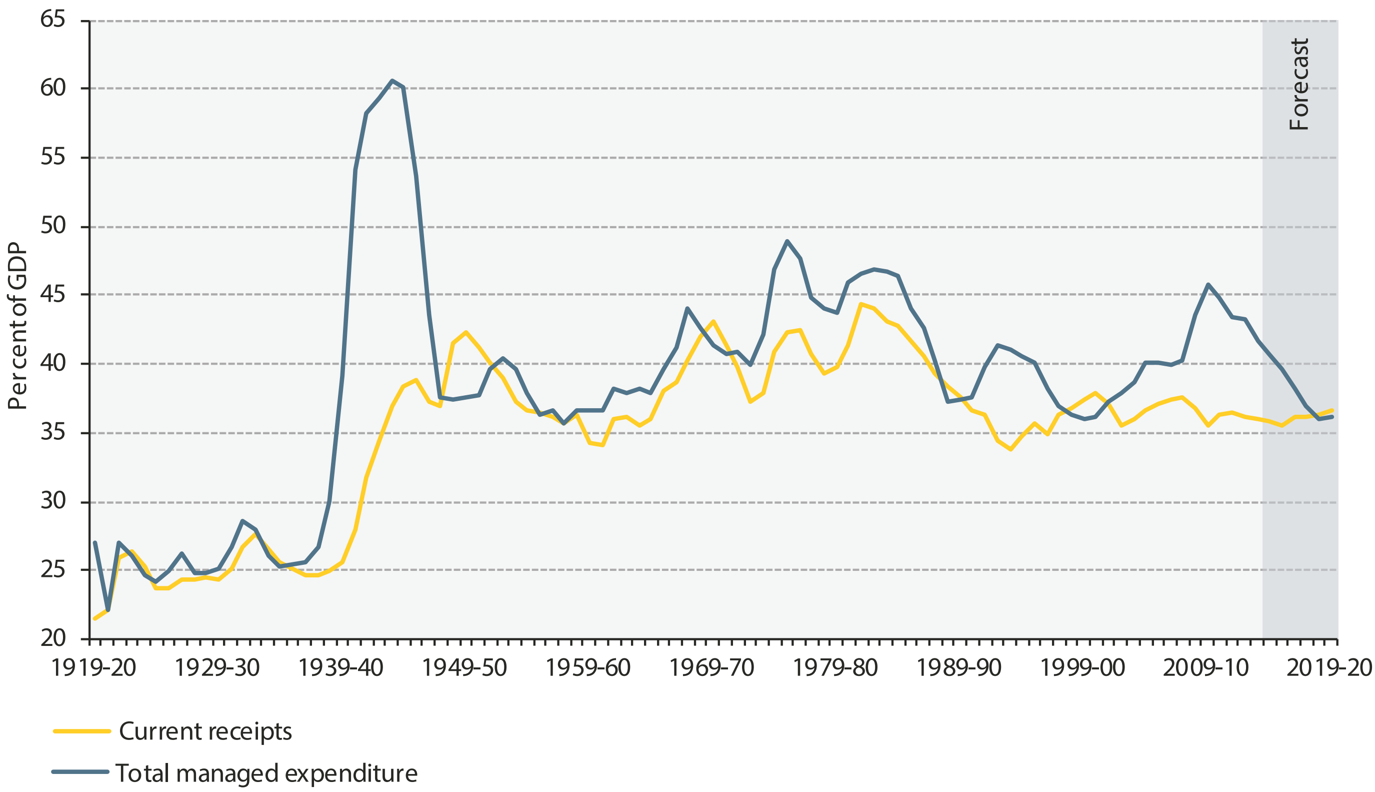
One major factor in the figures is that the government has reduced the amount of the Budget surplus which it had been aiming for by 2019-20. The Office for Budget Responsibility (OBR) had been predicting a £23bn surplus but that has now been reduced to a surplus of £7bn.

The analysis of the government figures by the OBR says that the government has left "a rollercoaster profile for implied public services spending through the next Parliament: a much sharper squeeze on real spending in 2016-17 and 2017-18 than anything seen over the past five years followed by the biggest increase in real spending for a decade in 2019-20."

The OBR estimates that public sector net borrowing has fallen to £90.2 billion or 5.0% of GDP in this current financial year – which is down 41% in cash terms and 51% as a share of GDP relative to the post-crisis peak in 2009-10.

According to the OBR between 2009-10 and 2019-20, the budget balance is forecast to move from a post-war record deficit of 10.2% of GDP to a small surplus of 0.3% - a turnaround of 10.5% of GDP – which amounts to £172 billion in today's terms. They say that by 2014-15, the end of this current fiscal year, around half of that planned reduction – 5.2% of GDP (£79 billion) – will have been completed.

Figure 7: Total public sector spending and receipts



Source: Bank of England, ONS, OBR.

Figure 7, produced by the OBR, shows an interesting picture of public spending current receipts and total managed expenditure over the century until the end of the next Parliament.

The OBR has also summarised the main factors which contribute both positively and negatively to the planned removal of the current deficit and the move into budget surplus over the five years to 2019-20. These include: a relatively small increase in debt interest amounting to 0.4% of GDP; a small reduction in capital spending of 0.1% of GDP; a small reduction of 0.3% in annually managed expenditure (not part of departmental budgets); a 0.5% of GDP rise in receipts; a 1.3% of GDP fall in welfare spending; and a 3.6% of GDP – or £65 billion in today's terms – cut in day-to-day spending on public services and administration.

The OBR refers to this as a "sharp acceleration in the pace of implied real cuts to day-to-day spending on public services and administration in 2016-17 and 2017-18."

So if a Conservative government returns to power later this year we can expect more huge cuts in departmental budgets and welfare spending. This should lead to a budget surplus – with the country living within its means – in a further five year period. But the question for voters will be whether the 'pain is worth the gain'.

We will see in this snapshot of employment and unemployment that there has been a remarkable recovery in the UK labour market but the situation on the world stage is still quite negative.

A recent publication by the International Labour Organisation (ILO) entitled World Employment and Social Outlook Trends 2015 said: "The world economy continues to expand at rates well below the trends that preceded the advent of the global crisis in 2008 and is unable to close the significant employment and social gaps that have emerged. The challenge of bringing unemployment and underemployment back to pre-crisis levels now appears as daunting a task as ever, with considerable societal and economic risks associated with this situation.

According to the report the global employment outlook will deteriorate in the coming five years. Over 201 million were unemployed in 2014 around the world, which was over 31 million more than before the start of the global crisis. On top of this global unemployment is expected to increase by 3 million in 2015 and by a further 8 million in the following four years.

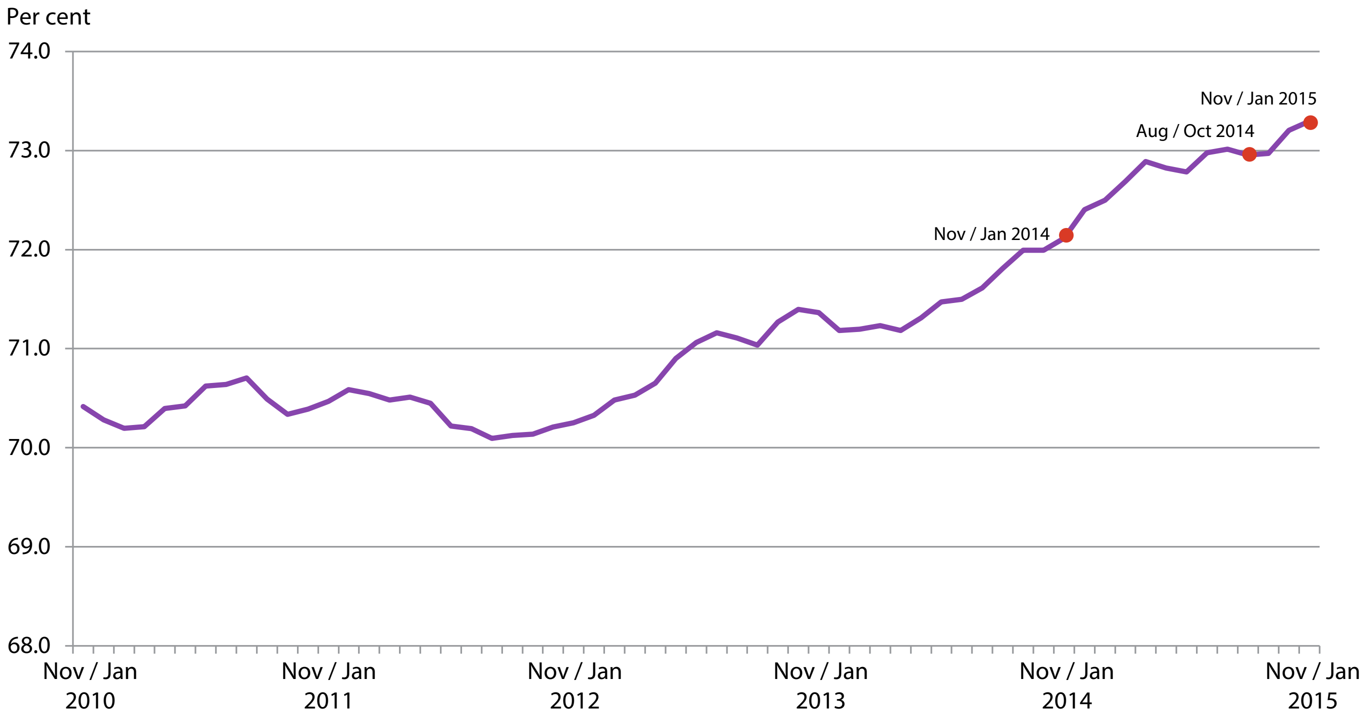
The report adds that the global employment gap, which measures the number of jobs lost since the start of the crisis, currently stands at 61 million. On top of this, if new labour market entrants over the next five years are taken into account, an additional 280 million jobs need to be created by 2019 to close the global employment gap caused by the crisis.

However, the latest figures in the UK show that employment is continuing to rise and unemployment to fall. In the three months to the end of January 2015 there were 30.94 million people in work, which was 143,000 more than the previous quarter and 617,000 more than a year earlier. There were 1.86 million unemployed people, 102,000 fewer than the previous quarter and 479,000 less than a year earlier.

The proportion of the economically active population who were unemployed (the unemployment rate) was 5.7%, lower than the 6.0% recorded in the previous quarter and 7.2% for a year earlier.

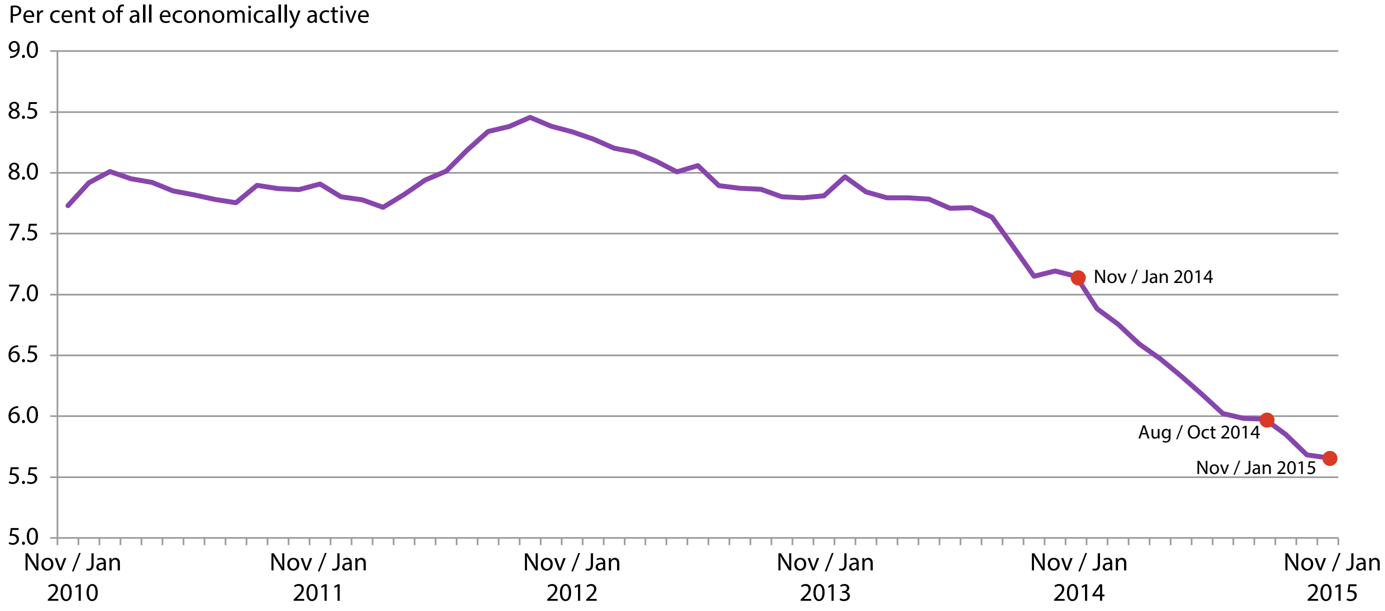
Figures 8 and 9 show the changes in the employment and unemployment rates in the UK over the past five years.

Figure 8: Employment rate (aged 16-64), seasonally adjusted



Source: Labour Force Survey - Office for National Statistics.

Figure 9: Unemployment rate (aged 16 and over), seasonally adjusted



Source: Labour Force Survey - Office for National Statistics.

As can be seen in Figure 8 73.3% of people aged 16 to 64 were in work for the three months ending January 2015. This was not only higher than a year earlier (72.1%) but it was higher than the pre-downturn peak recorded for early 2008 which was 73%. In fact this figure is the highest employment rate since comparable records began in 1971.

However, the record employment levels the UK is currently seeing are because the falls in public sector employment are being more than offset by increases in private sector employment. The government's austerity cutbacks have meant that public sector employment has been falling since March 2010.

Between December 2013 and December 2014 public sector employment fell by 42,000 and private sector employment increased by 659,000. In December 2014 there were 5.40 million people employed in the public sector which was the lowest figure since comparable records began in 1999. In fact in December 2009 21.9% of all people employed were working in the public sector and by December 2014 this figure had fallen to 17.4%.

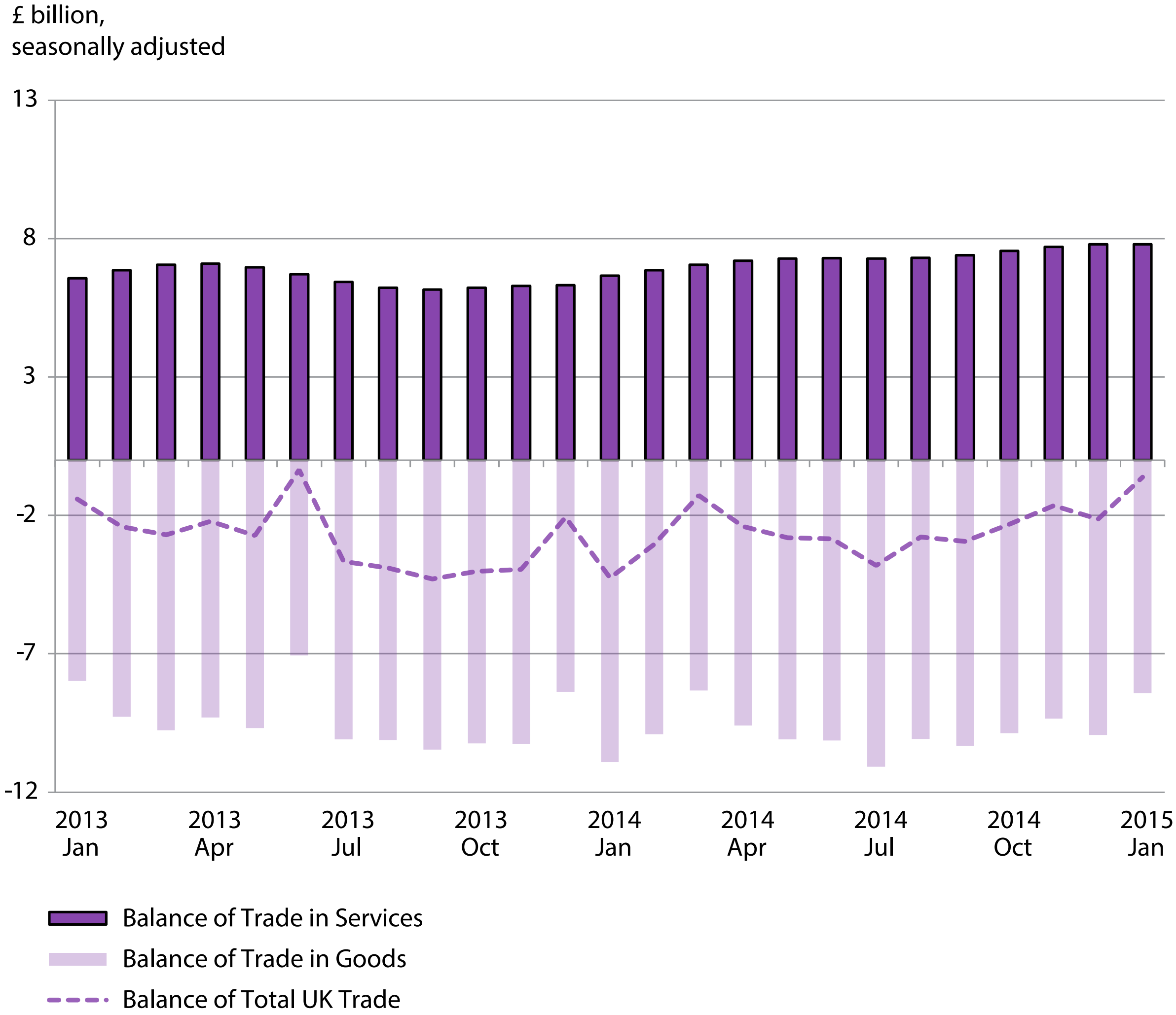
UK Trade

Let's look at the good news first. In January 2015 there was a major improvement in the UK's balance of trade in goods and services. Seasonally adjusted, the UK's deficit was £0.6 billion in January 2015, compared with a deficit of £2.1 billion in December 2014, and a much larger deficit of £4.3 billion in January 2014.

Between January 2014 and January 2015 the deficit on our balance of trade in goods fell from minus £10.9 billion to minus £8.4 billion. At the same time our balance of trade in services, which is the UK's strongest trading area, increased from a positive £6.7 billion to £7.8bn over the same period.

This can be seen in Figure 10 below.

Figure 10: Balance of UK Trade



Source: Office for National Statistics.

According to the analysis by the ONS the sharp narrowing of the deficit reflects a fall of £2.5 billion in imports. Almost half of this fall (£1.2 billion) was due to oil imports, where the price has been falling sharply in recent months. Also, in the three months to January 2015 the UK's deficit on trade in goods and services was estimated to have been £4.4 billion which is the smallest deficit since the three months to October 2000. This mainly reflects a 7.3% rise in exports of goods to countries outside the EU and falls in imports of goods from both EU and non-EU countries.

However, very little notice seems to have been taken concerning what is happening to the UK's overall current account on the balance of payments. This includes not only the balance of trade in goods and services but also net transfers, and, more importantly, net investment income.

Net investment income has fallen from a peak of plus 3% of GDP in 2005 quarter two to minus 2.8% in the latest figures. This has ‘helped’ the current account deficit to reach a total of 6% of GDP, which is a level which was last seen in the 1980s in the middle of a boom period. This could mean that the faster the economy recovers the bigger the likely deficit on current account.

An article in The Economist on 10th January 2015 entitled “The current account: Britain’s biggest export: wealth” argued that: “Ultimately, a current-account deficit represents a country flogging its assets or incurring debts to finance spending. That makes sense if the spending is on investments that will pay off in future. But Britain is on a consumption binge. The household savings rate is negative, according to one estimate, and household debt is forecast to balloon in the next five years. If that happens, Britain will grow as forecast, but at the cost of running down its wealth. It will be heading for a crisis.”

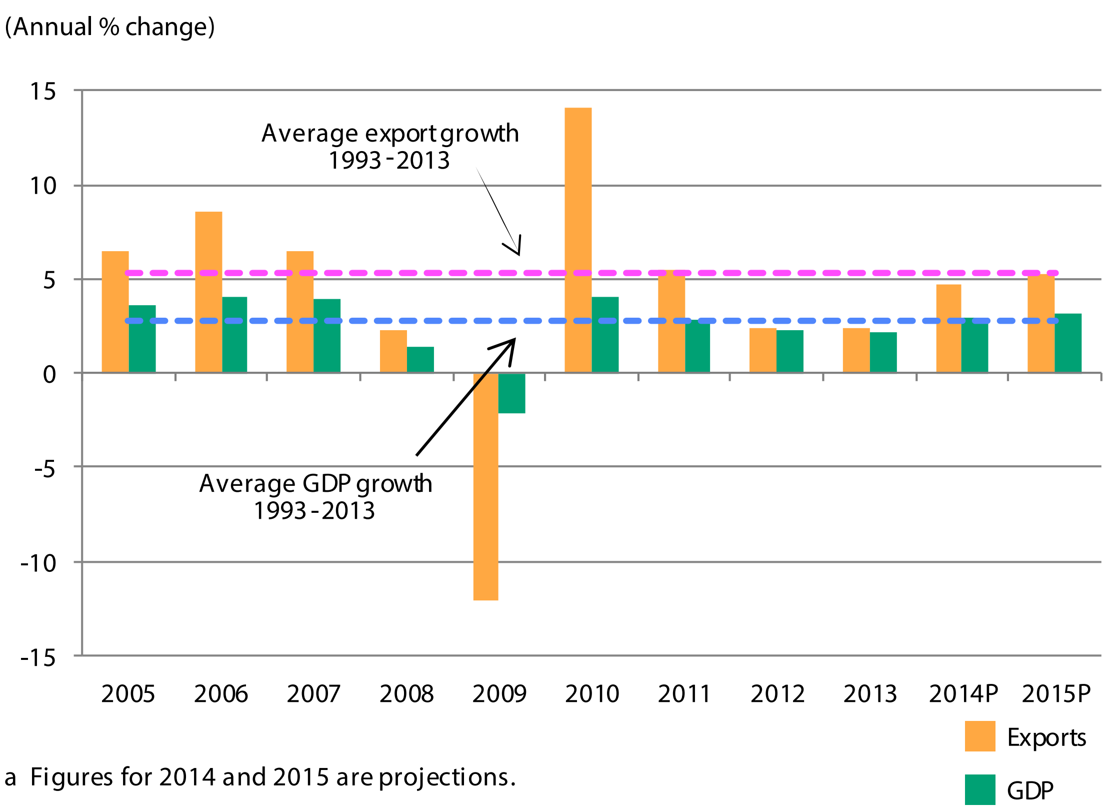
It is clear that the UK cannot just rely on having the strongest services balance of any major economy as this alone is not sufficient to overcome the negative balance of trade in goods. And, as far as net exports are concerned, the Office for Budget Responsibility in its Economic and Fiscal Outlook December 2014 said: “... UK export markets are expected to grow slightly more slowly than world trade due to the higher weight of slower-growing advanced economies in the UK’s export markets. For example, China makes up around 10 per cent of world trade but only 3.4 per cent of the UK’s export markets.”

So, there are few positive reasons for expecting an improvement in the UK trade figures any time soon.

World Trade

World trade growth fell to a 2.1% figure in 2013 in volume terms, which was down from a 2.3% increase in the previous year, according to the World Trade Organisation (WTO). The WTO said that the factors which contributed to the weakness of both trade and output in 2013 included the lingering impact of the EU recession, high unemployment in euro area countries, and uncertainty about the timing of the winding down of the monetary stimulus in the United States. Growth in both world merchandise trade and GDP can be seen in Figure 11.

Figure 11: Growth in volume of world merchandise exports and GDP, 2005-15.



a Figures for 2014 and 2015 are projections.

Source: WTO Secretariat.

The figures for 2013 were lower than the WTO had previously forecast. They put this down to a combination of flat import demand in developed economies (-0.2%) and moderate import growth in developing economies (4.4%). As far as exports were concerned both developed and developing economies only managed to record small, positive increases (1.5% for developed economies, 3.3% for developing economies). This meant that for the second consecutive year, world trade grew at roughly the same rate as world GDP. In the past world trade has tended to grow at about twice the rate of GDP.

The WTO has forecast that growth will have been 4.7% in 2014 and will be 5.3% in 2015, which would take it back to its 20-year average.

Overseas aid and development

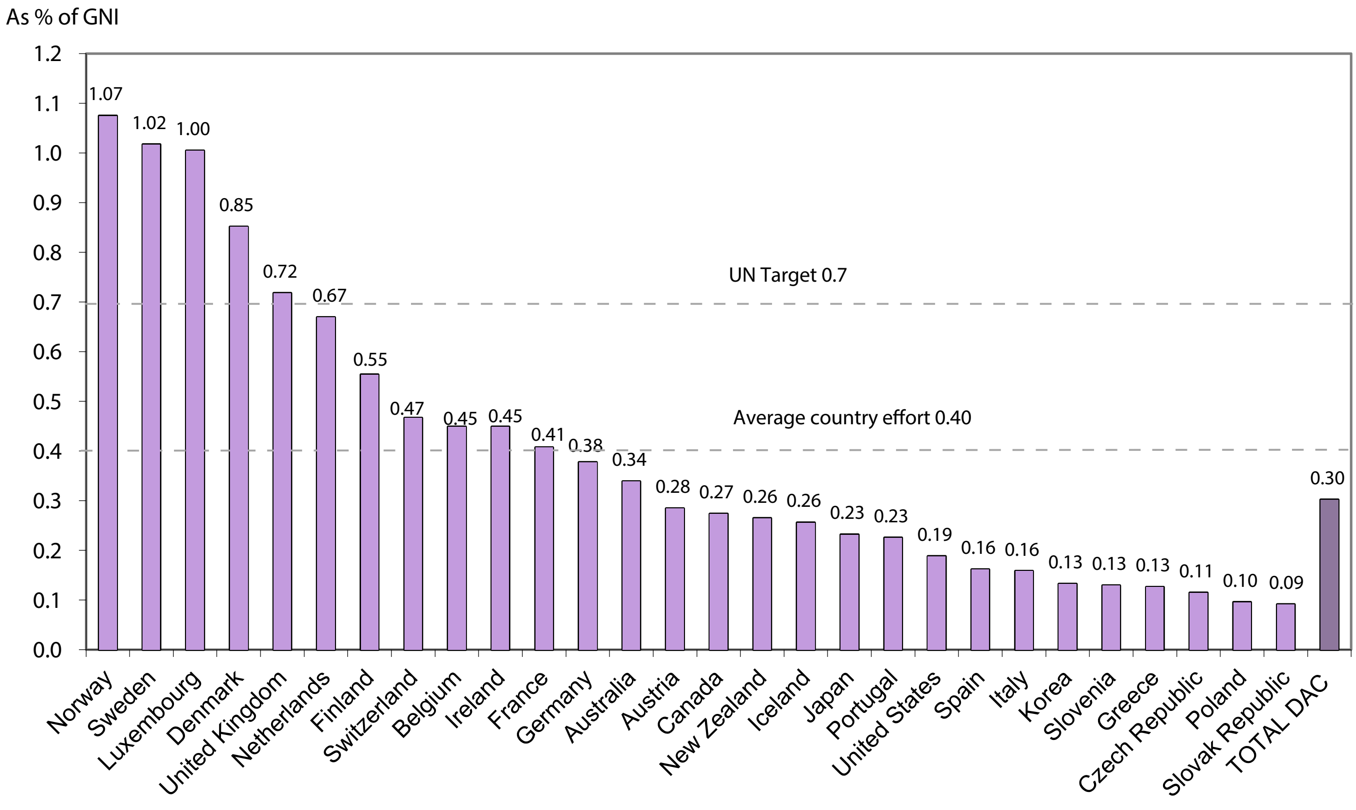
Development aid rose by 6.1% in real terms in 2013 to reach the highest level ever recorded according to the OECD. This was perhaps somewhat surprising given the squeeze on budgets in many OECD countries as a result of the global financial crisis. In fact international donors provided $134.8 billion in net official development assistance (ODA) which followed two years of falling spending.

"It is heartening to see governments increasing their development aid budgets again despite the financial constraints they are currently facing," said OECD Secretary-General Angel Gurria. "However, assistance to some of the neediest countries continues to fall which is a serious concern."

The OECD also noted that an annual survey of donor spending plans by the OECD Development Assistance Committee (DAC) indicated that aid levels could increase again in 2014.

The full picture of aid by DAC members in 2013 can be seen in Figure 12.

Figure 12: Net Official Development Assistance in 2013 as a percentage of Gross National Income



Source: OECD, 8 April 2014.

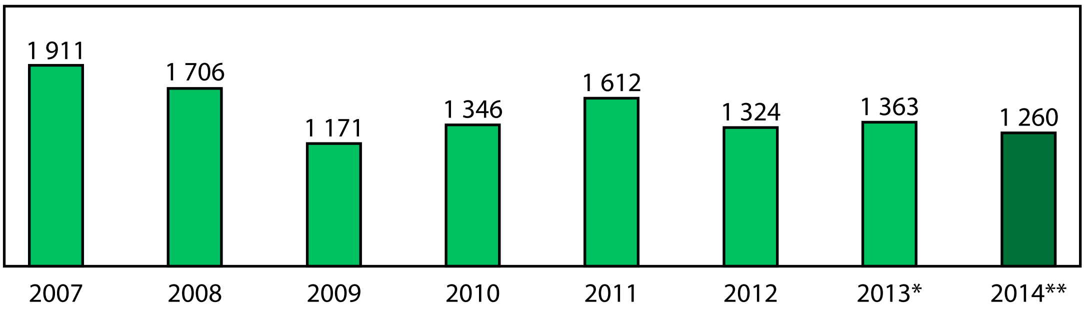
Overall, 17 of the DAC's 28 member countries increased their ODA in 2013, while 13 reduced their aid. For some time the United Nations has set a target for countries to give 0.7% of their Gross National Income (GNI) each year. In fact the net ODA from DAC countries only stood at 0.3% of GNI. Figure 12 shows that only Norway, Sweden, Luxembourg, Denmark and the UK actually achieved the 0.7% target in 2013. In fact, the UK increased its ODA by 27.8% to reach the 0.7% target for the first time.

Bilateral net ODA to the Least Developed Countries rose by 12.3% in real terms in 2013. However, aid to Africa as a whole fell by 5.6% and aid to sub-Saharan Africa was down 4% in real terms compared with 2012.

Global Foreign Direct Investment (FDI)

Global foreign direct investment (FDI) inflows declined by 8% in 2014 to an estimated $1.26 trillion in 2014, according to the Global Investment Trends Monitor produced by the United Nations Conference on Trade and Development (UNCTAD) published in January 2015. The reason for the fall was put down to the fragility of the global economy, policy uncertainty and geopolitical risks. This can be seen in Figure 13.

Figure 13: Estimated global FDI inflows, 2007-2014 (Billions of US dollars)

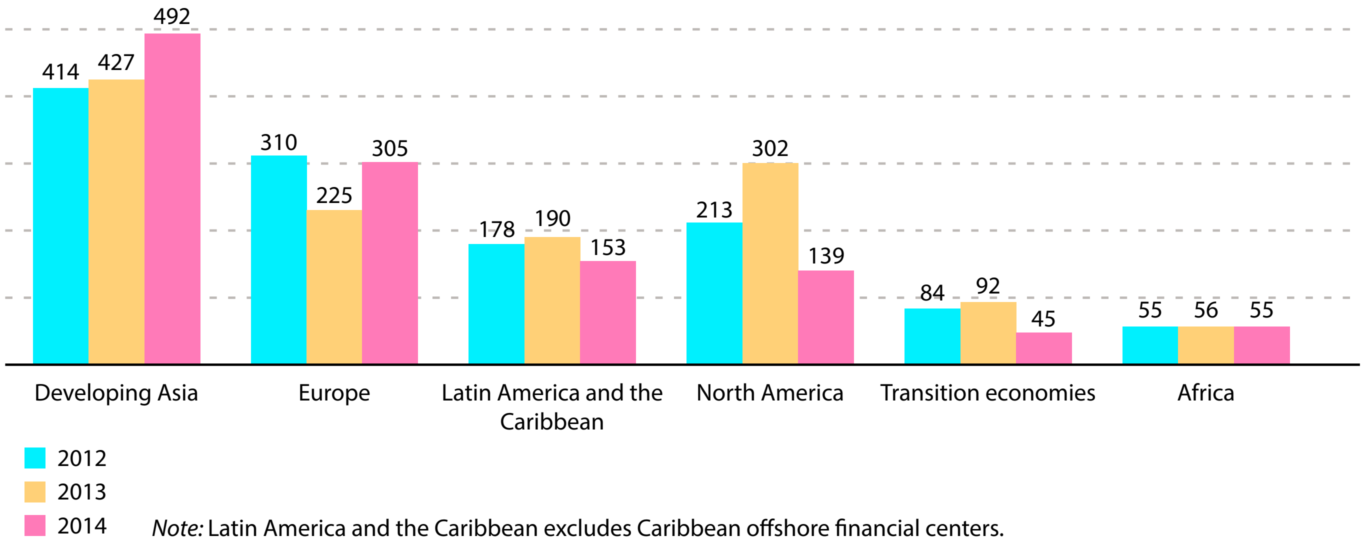


* Revised; ** Preliminary estimates.
Note: Excluding Caribbean offshore financial centres.

Source: ©UNCTAD.

FDI inflows into China, which included both financial and non-financial sectors, reached an estimated $128 billion in 2014, which made China the largest recipient of FDI in the world. Hong Kong was in second place, followed by the US, Singapore, Brazil and the UK in sixth place with an FDI inflow of $61 billion. Changes in FDI inflows on a regional basis over the past three years can be seen in Figure 14.

Figure 14: Estimated FDI inflows by region, 2012-2014 (Billions of US dollars)



Note: Latin America and the Caribbean excludes Caribbean offshore financial centers.

Source: ©UNCTAD.

The overall picture shows that FDI flows to developed countries as a whole fell by 14% in 2014 while flows in developing countries stayed strong, reaching more than $700 billion, which was the highest level ever recorded and accounted for 56% of global FDI flows.

When broken down by regions there was a 36% increase in flows to Europe and a 13% increase into the European Union. There was also an increase of 15% for developing Asia. But on the downside there were falls of 3% for Africa, 19% for Latin America and the Caribbean, 51% amongst the transition economies, largely due to sanctions in the Russian Federation and 54% in North America.

UNCTAD said that global FDI flows are uncertain for 2015. According to their Global Investment Trends Monitor this is due to the: “Fragility of the world economy, with growth tempered by hesitant consumer demand, volatility in currency markets and geopolitical instability which will act as a deterrent for investors. The decline in commodity prices will also lower investments in the oil and gas and other commodity industries. Among developed countries, the increasing divergence in economic growth between the United States and the euro area and Japan will lead to different patterns of FDI. In developing and transition economies, slower growth prospects in some emerging markets and regional conflicts are likely to affect investment negatively.

The UK and the European Union

We have seen earlier that UK CPI inflation fell to 0.3% in January 2015, but prices in the eurozone were minus 0.6% in January compared with a year ago, compared with minus 0.2% in December. This suggests that the eurozone is descending into a deflationary situation. But, is this a major cause for concern?

The main reason for the falling price level is the cost of energy, with prices falling 8.9% in January alone in the eurozone. But when both food and energy are removed from the calculation, prices are actually rising at a rate of 0.5% (although this was down from 0.7% in December). On top of this the European Central Bank (ECB) in January 2015, started its own system of 'quantitative easing' and injected about 1 trillion euros into the eurozone economy. Deflation can definitely be damaging, but the current evidence suggests that it may well be under control, especially given the aggressive action by the ECB.

But aside from deflation the largest question at the moment is will the UK remain in the EU? If the Conservatives are re-elected in the May 2015 General Election they are committed to holding a referendum by 2017 which will simply ask the British public whether we should stay in or leave. However, both Labour and the Liberal Democrats are opposed to a referendum and withdrawal, although UKIP is very much in favour.

But what are the pros and cons of leaving? We all know the problems of EU bureaucracy and whether we want to be told how straight our cucumbers should be and also the profligacy of the Common Agricultural Policy, which incidentally is in the process of being reformed, but probably the main issues are the cost of membership, trade and migration.

Figures published by the ONS in 2014 showed that the UK's contribution to the EU quadrupled between 2008 and 2013. Although the UK's rebate increased from £3.1bn in 2012 to £3.7bn in 2013 the net figures, taking into account the rebate, show that our contribution to the EU was £2.7bn in 2008, £3.8bn in 2009, £7.2bn in 2010, £7.5bn in 2011, £8.5bn in 2012 and £11.3bn in 2013. However, the most recent rise is mainly due to a £3bn increase in payment due to the rapid growth in the UK's total gross national income. So, it could be argued that our contributions were a result of our vastly improved economic growth, which is just like saying that if you earn more money you have to pay more tax.

Overall, this means that with a UK population of 63 million, we were paying about £179 per person to the EU in 2013. Is this too much for the benefits gained?

Another of the major arguments is related to trade with the EU. The latest figures show that the UK exports 50.5% of our total exports to the EU and we import 53.1% of our total imports from the EU. Some people suggest that we could leave the EU and join the European Free Trade Association (EFTA). But the European Politics and Policy Blog, produced by the London School of Economics and Political Science on March 24th 2015 suggests that: "EU member states trade 40 per cent more with other EU countries than they do with members of EFTA. Combining this with estimates that a 1 per cent decline in trade reduces income by between 0.5 per cent and 0.75 per cent implies that leaving the EU and joining EFTA will reduce UK income by 6.3 per cent to 9.5 per cent."

In addition it is noted that the EU is currently negotiating major new free trade agreements (FTA) with both the United States and Japan. Researchers at the Centre for Economic Performance have quantified the impact of recent EU FTAs on consumers in the UK. Consumer prices fell by 0.5% for UK consumers as a result of FTAs negotiated by the EU with trade partners that are not EU members, saving UK consumers £5.3 billion per year. Based on this, the FTAs with the US and Japan would save UK households £6.3 billion every year. The argument here is that the UK will be in a more powerful bargaining position from being within the EU than it could ever gain on its own.

The EU single market is based on what is generally known as the "four freedoms": the free movement of goods, services, capital and people. There is generally agreement on the first three of these, but the free movement of people raises a lot of controversy within the UK. It is concern about this that could well sway the vote in a referendum for the UK to leave the EU.

In an article in the Daily Telegraph by Raziye Akkoe on 28th November 2014 it is noted that data from the Department for Work and Pensions and HMRC show that in 2014, 4.9 million (92.6%) working age benefit claimants were British while only 131,000 (2.5%) were EU nationals. The number of recipients from outside the UK – but not from the EU – was 264,000 (5.0%).

The article concludes by asking: “What does this all mean? It suggests that whatever the arguments for and against reducing the number of EU migrants receiving British benefits, delivering such a reduction wouldn’t make a significant difference to the overall welfare bill which is estimated to be £208 billion for the year 2013-14. And seeing as the take-up of benefits among migrants is so small, it’s also worth asking how big of a draw Britain’s welfare system really is.”

In February 2014 the government published figures covering 2010 which showed that whilst there were 2.3 million EU citizens in the UK, it was estimated that 2.2 million Britons live in the other 26 EU countries. It was shown that just over 1 million British people live in Spain with 330,000 in France, 319,000 in Ireland, 65,000 in Cyprus, 48,000 in the Netherlands, 45,000 in Greece, 39,000 in Portugal and 37,000 in Italy. Of the total about 400,000 are British pensioners.

If the Conservatives win the election and a referendum on leaving the EU takes place then these are some of the contentious areas which will lead people to decide which way they vote.