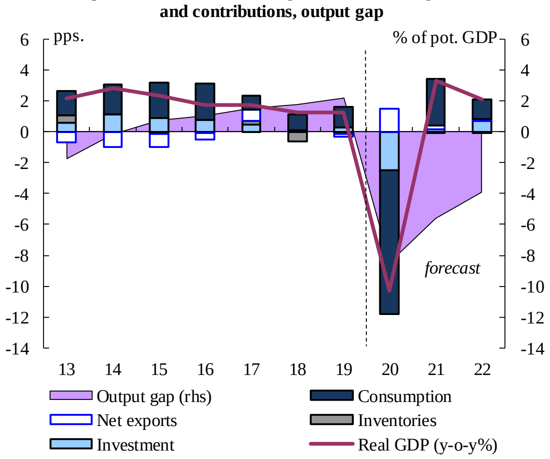
33. THE UNITED KINGDOM

As a consequence of the COVID-19 pandemic, UK GDP is projected to fall steeply in 2020, driven by a large drop in domestic demand. The recovery in 2021 is expected to be subdued, assuming in this forecast EU-UK trading relations based on WTO Most Favoured Nation (MFN) rules from the beginning of 2021. While private consumption drives most of the rebound in 2021, business investment is expected to take longer to recover due to the longer-term effects of the pandemic and the need to adapt to the new, significantly less beneficial trading relations with the EU. The general government deficit is forecast to increase in the current fiscal year above the levels seen in the global financial crisis, and debt is expected to remain well above 100% of GDP over the forecast horizon.

GDP fell steeply in the second quarter of 2020

After falling by 2.5% in the first quarter of 2020, UK GDP dropped sharply by 19.8% in the second quarter. As strict lockdown measures were only implemented towards the end of March, somewhat later than in other European countries, the GDP losses in the UK were concentrated in the second quarter. A fall in private consumption was the main driver of the fall, with investment also contributing negatively to growth.

Graph II.33.1: **The United Kingdom - Real GDP growth and contributions, output gap**



After a partial rebound in the third quarter of 2020, GDP growth is expected to slow down significantly in the last quarter of 2020. Overall, the government supported the economy with a fiscal package of about 10% of GDP and liquidity measures of about 16% of GDP in the fiscal year 2020-21 to counter the negative impacts of the pandemic. The winding down of the Coronavirus Job Retention Scheme at the end of October is expected to contribute to an increase in the unemployment rate, though the updated Job Support Scheme is expected to cushion the impact. In addition, an increase in the prevalence of COVID-19 cases and new restrictive measures to contain the pandemic are expected to weigh on private spending in the last quarter, and business investment expectations remain low. Overall, after growing 1.3% in 2019, GDP is forecast to contract by 10¼ % in 2020.

Output in the last quarter of 2022 is expected to still be well below pre-pandemic levels

Following the UK's withdrawal from the EU on 31 January 2020 and the entry into force of the Withdrawal Agreement, the UK entered a transition period during which EU law, with a few exceptions, continues to apply to the UK. This transition period lasts until the end of 2020. Without prejudice to the ongoing negotiations, projections over the forecast period are based on the assumption that the EU and the UK will trade on WTO MFN rules ('WTO assumption') from 1 January 2021 onwards.

The assumed move to this new trade relationship, which will be significantly less beneficial than the current situation, is expected to slow down the recovery considerably in 2021 and 2022. Business investment, which has already been weak in the past years, is expected to rebound only slowly as businesses have to deal with the consequences of the pandemic and the new trade relations with the EU. Job losses and lower real wages are expected to negatively affect private consumption. Government consumption is forecast to contribute positively to growth over the next two years. Overall, GDP is expected to increase by 3¼ % in 2021, and by 2% in 2022. In the fourth quarter of 2022, UK GDP is projected to still be 5% below the level of the fourth quarter of 2019. A potential trade agreement between the EU and the UK constitutes an upside risk for the forecast, whereas a less smooth transition to the new trade relationship would additionally weigh on growth.

Unemployment to increase sharply in 2021

Due to government policies supporting employees and the self-employed, unemployment is expected to increase only moderately in 2020, to 5.0% on average. However, due to the slow recovery in 2021 and government support terminating, unemployment is expected to increase sharply in 2021 to 7.3%. In 2022, the unemployment rate is projected to fall again to an average of 6.2%.

Consumer price inflation is forecast to ease to 0.9 % in 2020, mainly due to lower energy and service prices. Inflation is projected to increase to 2.3% in 2021 and 2.9% in 2022, partly as a result of higher prices for imports resulting from the new trade barriers.

General government deficit to rise above levels in the global financial crisis

Since the latest budget in March, the government announced several fiscal measures to deal with the consequences of the pandemic, amounting to around 10% of GDP. They include income support for employees and self-employed workers, support for businesses and increases in welfare spending.

Based on a no-policy change assumption, the measures are assumed to only have a temporary effect in 2020-2021. The government has also provided credit guarantees for bank loans of about 16 % of GDP, creating contingent liabilities. The general government deficit is expected to increase from 2.8% in 2019-2020 to 14¾ % in 2020-2021, significantly higher than at the height of the financial crisis. The deficit is forecast to fall to 8¼ % in 2021-2022 and to 7¼ % in 2022-23.

The additional fiscal measures and the expected fall in GDP lead to an expected general government debt-to-GDP ratio of 107½ % in 2020-2021, up from 84.5 % in 2019-2020. Debt is expected to increase further over the forecast period to 113½ %.

Table II.33.1:

General government projections on a financial-year basis

ESA10	Actual		Forecast		
	2018-19	2019-20	2020-21	2021-22	2022-23
General government balance~	-1.9	-2.8	**-14.7**	**-8.3**	**-7.3**
Structural budget balance	-3.0	-2.5	**-10.1**	**-5.4**	**-5.4**
General government gross debt	84.2	84.5	**107.4**	**110.0**	**113.4**

~APF transfers included

Table II.33.2:

Main features of country forecast - UNITED KINGDOM

		2019		Annual percentage change						
	bn GBP	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP		2214.4	100.0	1.7	1.7	1.3	1.3	**-10.3**	**3.3**	**2.1**
Private Consumption		1416.9	64.0	1.9	1.1	1.4	0.9	**-12.6**	**1.6**	**1.6**
Public Consumption		423.1	19.1	2.0	0.7	0.6	4.1	**-6.5**	**8.9**	**1.2**
Gross fixed capital formation		399.5	18.0	1.7	2.8	0.4	1.5	**-13.7**	**1.1**	**4.1**
of which: equipment		81.1	3.7	1.6	0.9	-5.5	-2.6	**-15.6**	**0.0**	**4.8**
Exports (goods and services)		690.8	31.2	2.5	5.4	3.0	2.8	**-9.8**	**-0.7**	**0.3**
Imports (goods and services)		721.3	32.6	3.1	2.6	2.7	3.3	**-14.0**	**-1.5**	**-0.1**
GNI (GDP deflator)		2177.0	98.3	1.6	3.0	1.2	0.9	**-10.4**	**3.3**	**2.1**
Contribution to GDP growth:	Domestic demand			1.9	0.8	1.8	1.6	**-11.8**	**3.2**	**1.9**
	Inventories			0.0	0.2	-0.6	-0.1	**0.0**	**0.0**	**0.0**
	Net exports			-0.2	0.7	0.1	-0.2	**1.5**	**0.2**	**0.1**
Employment				0.9	1.0	1.2	1.1	**-0.9**	**-1.7**	**1.9**
Unemployment rate (a)				6.0	4.3	4.0	3.8	**5.0**	**7.3**	**6.2**
Compensation of employees / head				3.1	3.0	2.6	4.0	**-0.6**	**1.1**	**1.4**
Unit labour costs whole economy				2.2	2.3	2.5	3.8	**9.8**	**-3.8**	**1.2**
Real unit labour cost				0.2	0.3	0.3	1.7	**4.8**	**-2.8**	**-1.1**
Saving rate of households (b)				8.9	5.7	6.1	6.5	**16.8**	**14.7**	**13.2**
GDP deflator				2.0	1.9	2.2	2.1	**4.8**	**-1.1**	**2.3**
Harmonised index of consumer prices				2.1	2.7	2.5	1.8	**0.9**	**2.3**	**2.9**
Terms of trade goods				0.4	-0.9	0.8	0.7	**0.0**	**0.0**	**0.0**
Trade balance (goods) (c)				-5.5	-6.5	-6.4	-5.9	**-4.7**	**-4.3**	**-4.2**
Current-account balance (c)				-3.3	-3.8	-3.7	-4.3	**-3.1**	**-2.9**	**-2.7**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-3.3	-3.8	-3.8	-4.3	**-3.2**	**-3.0**	**-2.8**
General government balance (c)				-4.7	-2.4	-2.2	-2.3	**-13.4**	**-9.0**	**-7.6**
Cyclically-adjusted budget balance (d)				-4.4	-3.3	-3.2	-3.5	**-8.7**	**-5.9**	**-5.4**
Structural budget balance (d)				-	-3.3	-3.2	-3.5	**-8.7**	**-5.9**	**-5.4**
General government gross debt (c)				59.9	86.3	85.8	85.4	**104.4**	**111.0**	**113.7**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.