

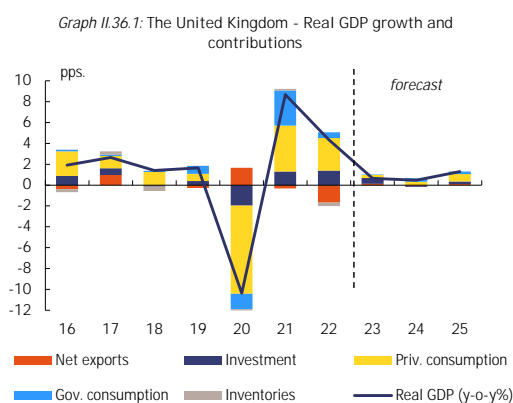
36. THE UNITED KINGDOM

The UK economy is expected to see subdued growth this year and next, as the impact of high interest rates and tighter fiscal policy offsets gains to households from lower energy prices. A modest pick-up is projected into 2025, with growth rising closer to potential, as the drag from the ongoing monetary and fiscal policy tightening fades. Inflation is expected to continue to fall in coming quarters, though remain above the Bank of England's 2% target until 2025.

Soft growth in coming quarters as fiscal and monetary policy bite

The UK economy surprised on the upside in early 2023, growing by 0.3% q-o-q in 2023-Q1 and 0.2% q-o-q in 2023-Q2. The main driver was growth in private consumption, which expanded by 0.7% in 2023-Q1 and 0.4% in 2023-Q2, contributing 0.4pp and 0.2pp to growth respectively. Gross fixed capital formation also rose in both quarters, contributing positively to growth for the first time since the first quarter of 2022.

However, GDP growth is facing headwinds and is expected to be softer in the second half of 2023 and into 2024. Recent PMI data point to weakening activity, with the services PMI at 49.2 and the manufacturing PMI at 45.2 in October. Retail sales volumes fell in September, while consumer confidence retrenched markedly in October. Although the Bank of England paused rate hikes in September, rates are at 5.25%, up from 0.25% in early 2022. Meanwhile, fiscal policy is tightening, with taxes rising and government expenditure projected to fall back further in real terms from pandemic era levels.



Accordingly, consumption is set to grow only slowly in 2023 and 2024, before picking up in 2025. Households are seeing lower energy prices reducing electricity bills but are also facing a rising tax burden and much tighter credit conditions, and house prices are falling. Some pick-up is expected from mid-2024 as the drag from the current tightening of monetary and fiscal policy eases. While Brexit related uncertainty has dissipated and firms' balance sheets are solid, firms face weak near-term prospects for demand growth, and much higher borrowing costs. Investment is projected to edge down in 2024, then recover only tepidly in 2025. Export and import volumes are both set to fall in 2023, adjusting from anomalous levels in 2022 and to grow only slowly over the rest of the forecast horizon. Overall, GDP in the UK is expected to grow by 0.6% in 2023, 0.5% in 2024, before growing moderately in 2025 by 1.2%, with the protracted weakness reflecting structural impediments to growth such as low public and private investment and skills gaps.

The labour market is softening, but the extent of slack is unclear

The labour market showed rapid employment growth in early 2023 but this has eased in recent months, with employment falling since April, vacancies declining, and the unemployment rate edging up from 3.8% in April to 4.3% in August. However, the extent of slack is unclear due to specific labour market developments and sizeable measurement issues. A rise in long-term illness, a decline in participation, and a pause in international migration in 2020, have slowed growth of the workforce which is almost unchanged from end 2019 levels. The reliability of Labour Force Survey data has however been put in doubt by a sharp fall in response rates, muddying the picture. Unemployment is expected to rise further in 2024 as employment growth remains slow, and then edge down in 2025 as employment growth picks-up.

Inflation to continue to moderate, but with upside risks

Inflation rose to a peak of 11.1% (y-o-y) in October 2022 and has since slowed, at a faltering pace, reaching 6.7% in September 2023. Lower energy prices are set to reduce CPI inflation in coming quarters, but underlying inflation may prove stickier, given the high pace of wage inflation at close to 8%. The Bank of England concluded in early November that recent high wage growth suggested that the unemployment rate consistent with the 2% inflation target had risen to around 4.5%. At the same time, significant uncertainty remains around wage formation processes. Headline inflation is projected to continue easing over the forecast horizon to stand at 2.5% in 2025, still somewhat above the 2% inflation target.

Government deficit expected to fall, though pressures on public finances remain

The public sector deficit is set to narrow through 2023 to 2025, from 3.7% of GDP in 2023 to 2.9% of GDP, due to a combination of tax rises and lower spending. The tax burden is expected to have risen by over 0.5 pps. of GDP during 2023. Government spending plans assume almost no rise in nominal spending in the fiscal years 2023-24 and 2024-25, which will prove challenging given the acute pressures on the public sector, including for higher wages. High bond yields have also significantly pushed up debt interest payments. Government gross debt is projected to edge down slightly over the forecast horizon, from 97.4% of GDP in 2023 to 96.5% in 2024 and 2025.

Risks arise on both demand and supply side, and appear balanced

Persistence in inflation is a major risk factor while uncertainties remain about the extent of slack. On the demand side, private consumption may prove stronger than expected if nominal wages continue to grow at a fast pace, but with a risk of prompting further monetary tightening. Conversely, Investment demand remains low and could pick-up more rapidly than projected in 2024 and 2025 if disinflation occurs in a relatively benign manner and sentiment improves.

Table II.36.1:

Main features of country forecast - UNITED KINGDOM

	2022		Annual percentage change							
	bn GBP	Curr. prices	% GDP	04-19	2020	2021	2022	2023	2024	2025
GDP	2506.2	100.0		1.6	-10.4	8.7	4.3	0.6	0.5	1.3
Private Consumption	1552.4	61.9		1.6	-13.2	7.4	5.2	0.5	0.5	1.2
Public Consumption	525.0	21.0		1.6	-7.9	14.9	2.5	0.2	1.6	1.2
Gross fixed capital formation	459.7	18.3		1.9	-10.8	7.4	7.9	3.0	-0.5	1.3
Exports (goods and services)	833.9	33.3		3.1	-11.5	4.9	8.6	-1.3	0.9	1.7
Imports (goods and services)	901.8	36.0		3.4	-16.0	6.1	14.1	-1.5	1.0	1.3
GNI (GDP deflator)	2518.9	100.5		1.5	-12.2	11.6	4.3	0.6	0.4	1.2
Contribution to GDP growth:										
Domestic demand				1.7	-11.9	9.1	5.1	0.9	0.6	1.2
Inventories				0.0	-0.1	0.2	-0.3	-0.1	0.0	0.0
Net exports				-0.1	1.7	-0.3	-1.7	0.1	-0.1	0.1
Employment				0.9	-0.9	-0.3	1.0	-0.2	0.1	0.6
Unemployment rate (a)				5.9	4.6	4.5	3.7	4.3	4.7	4.6
Compensation of employees / head				2.9	0.3	4.6	6.1	6.2	4.4	2.9
Unit labour costs whole economy				2.3	11.0	-4.1	2.8	5.3	4.0	2.1
Saving rate of households (b)				8.0	16.7	12.5	8.1	7.4	7.9	7.8
GDP deflator				2.1	5.1	-0.1	5.2	6.4	3.6	1.7
Consumer price index (CPIH) (e)				2.1	1.0	2.5	7.9	7.3	3.6	2.5
Terms of trade goods				0.7	-1.0	-1.5	-1.6	2.1	0.3	-0.4
Trade balance (goods) (c)				-6.3	-6.1	-7.2	-8.8	-7.2	-7.0	-7.0
Current-account balance (c)				-3.5	-2.9	-0.5	-3.1	-2.1	-2.3	-2.4
General government balance (c)				-4.9	-13.0	-7.9	-4.6	-3.7	-2.9	-2.9
Structural budget balance (d)				:	:	:	:	:	:	:
General government gross debt (c)				70.6	105.8	105.3	100.4	97.4	96.5	96.5

(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. (e) CPIH is consumer price index which includes costs of owner-occupied housing