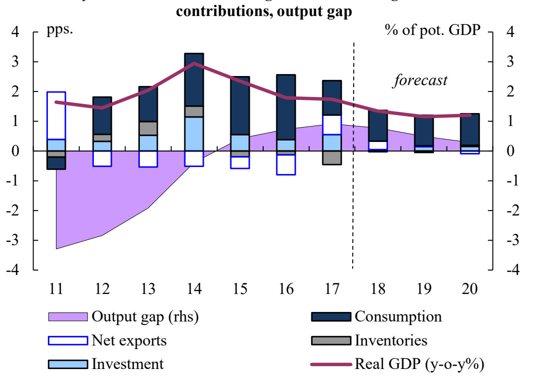
28. THE UNITED KINGDOM
Outlook remains subdued as slowdown persists

UK GDP growth is currently subdued and expected to remain so over the forecast horizon. Private consumption growth is forecast to remain weak as real wages grow modestly and households look to maintain savings. Heightened uncertainty means that business investment growth is likely to remain constrained. The net trade contribution to growth is projected to decrease in-line with a moderation in external demand. Employment growth is expected to slow significantly, leading to a modest rise in unemployment. Inflation should ease as the impact of sterling's 2016 depreciation unwinds.

Weather related effects have impacted the pace of growth in 2018

The pace of UK economic growth this year has been uneven to date, partly due to weather-related effects. GDP growth slowed significantly to 0.1% (q-o-q) in 2018-Q1, down from 0.4% in 2017-Q4. This slowdown was in part due to severe bad weather disruption in March. While the pace of GDP growth in Q2 (0.4%) was in-line with recent trends, growth in the first part of Q3 was boosted by strong private consumption (retail sales) due to warmer than usual summer weather. High frequency indicators suggest that both GDP and private consumption growth will ease back towards the subdued underlying growth rates recently seen.

Graph II.28.1: **The United Kingdom - Real GDP growth and contributions, output gap**



Business investment growth was negative in both 2018-Q1 (-0.7%) and 2018-Q2 (-0.5%). Various business surveys indicate that this subdued performance is largely due to ongoing uncertainty over the UK's future trading relationship with the EU.

The contribution of net exports to GDP growth has also reduced in 2018, as the impacts of the 2016 depreciation of sterling faded and external market growth moderated. Net trade made a negative contribution in Q1 (-0.1 pps.) and Q2 (-0.6 pps.). The large decrease in goods exports in Q2 was mainly due to lower car exports. The most recent official trade data suggests that net trade made a positive contribution to growth in Q3. GDP growth over 2018 as a whole is expected to be 1.3%, down from 1.7% in 2017.

Moderate increase in domestic demand to offset slower external demand in 2019 and 2020

Given the ongoing negotiation over the terms of the UK's withdrawal from the EU, projections for 2019 and 2020 are based on a purely technical assumption of status quo in terms of trading relations between the EU27 and the UK. This is for forecasting purposes only and has no bearing on the talks underway in the context of the Article 50 process.

Consumer confidence surveys suggest that savings intentions of consumers are high, reflecting weak overall consumer confidence. Private consumption growth is therefore assumed to remain weak in 2019 as households take the opportunity from modest real wage growth to maintain savings. Business investment growth is projected to rebound slightly in 2019 but to remain relatively subdued following a prolonged period of heightened uncertainty. The net trade contribution to growth is expected to deteriorate further alongside slowing external demand. Reflecting these factors and the technical assumption, GDP growth is expected to remain weak at 1.2% in 2019, marginally lower than in 2018. GDP growth is expected to be stable at 1.2% in 2020.

As this purely technical assumption implies a relatively benign scenario, the risks to the 2019 and 2020 baseline forecast are large and predominantly to the downside.

Employment growth expected to slow alongside easing inflation

Over the forecast horizon employment growth is expected to slow in a context of subdued GDP growth. This is projected to lead to a modest rise in the unemployment rate to 4.7% in 2020. As the impact of sterling's earlier depreciation on consumer prices unwinds fully, inflation is expected to ease to 2.0% in 2019 and to 1.9% in 2020.

General government deficit to stabilise over the forecast horizon

For the current fiscal year (2018-2019) to date, borrowing has been significantly lower than official projections. This over-performance is due to both lower spending as well as higher revenues. Consequently the general government deficit is now projected to fall to 1.3% of GDP in 2018-19 as a whole. The structural deficit is expected to fall to around 1¾ % of GDP in 2018-2019.

Since the last Budget in November 2017, there have been notable public policy spending announcements, including additional funding for the National Health Service. In the absence of compensatory revenue measures, these will have a significant impact on the deficit over the forecast horizon. The UK authorities have announced that the 2018 Budget will be released on 29 October. Based on the publicly available information at the cut-off date for this forecast (22 October 2018) and under our no-policy-change assumption, over the forecast horizon the general government deficit is projected to stabilise at 1.2% of GDP in both 2019-2020 and 2020-2021. The structural deficit is expected to fall and stabilise close to 1½% in 2019-2020 and in 2020-2021, reflecting slightly below-trend GDP growth in both years. As additional spending and/or compensatory revenue measures may yet be announced in the Budget, the risks to the forecast seem balanced. The general government debt ratio is projected to fall from 85.0% of GDP in 2018-2019 to 83.7% of GDP in 2019-2020 and to 82.0% of GDP in 2020-2021.

Table II.28.1:

General government projections on a financial-year basis

ESA10	Actual		Forecast		
	2016-17	2017-18	2018-19	2019-20	2020-2021
General government balance~	-2.4	-2.0	**-1.3**	**-1.2**	**-1.2**
Structural budget balance	-2.8	-2.5	**-1.7**	**-1.5**	**-1.4**
General government gross debt	86.4	85.7	**85.0**	**83.7**	**82.0**

~APF transfers included

Table II.28.2:

Main features of country forecast - UNITED KINGDOM

	2017			Annual percentage change						
	bn GBP Curr. prices	% GDP	99-14	2015	2016	2017	2018	2019	2020
GDP	2044.5	100.0	1.9	2.3	1.8	1.7	**1.3**	**1.2**	**1.2**
Private Consumption	1343.8	65.7	2.0	2.6	3.1	1.8	**1.4**	**1.3**	**1.3**
Public Consumption	372.8	18.2	2.3	1.4	0.8	-0.1	**0.5**	**0.9**	**1.1**
Gross fixed capital formation	350.7	17.2	1.5	3.4	2.3	3.3	**-0.1**	**0.9**	**0.9**
of which: equipment	87.5	4.3	2.0	5.2	2.0	-2.6	**-3.2**	**0.4**	**1.0**
Exports (goods and services)	617.8	30.2	3.2	4.4	1.0	5.7	**2.1**	**2.9**	**2.0**
Imports (goods and services)	640.5	31.3	3.7	5.5	3.3	3.2	**1.1**	**2.8**	**2.2**
GNI (GDP deflator)	2011.7	98.4	1.7	2.1	1.5	2.7	**1.3**	**1.2**	**1.2**
Contribution to GDP growth:	Domestic demand		2.0	2.5	2.6	1.7	**1.0**	**1.2**	**1.2**
	Inventories		0.0	-0.2	-0.1	-0.5	**0.0**	**0.0**	**0.0**
	Net exports		-0.2	-0.4	-0.7	0.7	**0.3**	**0.0**	**-0.1**
Employment			0.9	1.7	1.4	1.0	**0.8**	**0.4**	**0.3**
Unemployment rate (a)			6.1	5.3	4.8	4.4	**4.3**	**4.5**	**4.7**
Compensation of employees / head			3.4	1.1	2.9	3.1	**3.0**	**3.1**	**3.2**
Unit labour costs whole economy			2.3	0.5	2.5	2.4	**2.5**	**2.3**	**2.3**
Real unit labour cost			0.3	0.1	0.4	0.3	**0.6**	**0.7**	**0.3**
Saving rate of households (b)			8.7	9.4	6.7	4.5	**4.0**	**4.5**	**4.7**
GDP deflator			2.0	0.4	2.1	2.0	**1.9**	**1.6**	**2.0**
Harmonised index of consumer prices			2.1	0.0	0.7	2.7	**2.6**	**2.0**	**1.9**
Terms of trade goods			0.3	-1.7	2.8	0.4	**0.4**	**0.4**	**0.9**
Trade balance (goods) (c)			-5.1	-6.2	-6.7	-6.7	**-6.4**	**-6.3**	**-6.2**
Current-account balance (c)			-3.1	-4.9	-5.2	-3.7	**-3.3**	**-3.2**	**-3.0**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-3.1	-5.0	-5.3	-3.8	**-3.4**	**-3.3**	**-3.1**
General government balance (c)			-4.1	-4.2	-2.9	-1.8	**-1.3**	**-1.0**	**-1.0**
Cyclically-adjusted budget balance (d)			-3.7	-4.5	-3.4	-2.3	**-1.8**	**-1.3**	**-1.1**
Structural budget balance (d)			-	-4.5	-3.4	-2.3	**-1.8**	**-1.3**	**-1.1**
General government gross debt (c)			54.2	87.9	87.9	87.4	**86.0**	**84.5**	**82.6**

(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.