28. THE UNITED KINGDOM

Slowdown in growth expected to continue

Economic growth in the UK has been slowing since the start of the year, as higher consumer prices constrained private consumption growth. Based on a purely technical assumption of status quo in terms of trading relations between the EU27 and the UK, growth is still expected to remain subdued over the forecast horizon. Consumption growth is projected to be modest, in line with weak real wage growth, while uncertainty continues to weigh on business investment. However, net exports are expected to provide some support to growth, and the labour market is projected to show continued resilience.

Growth has slowed markedly in 2017

Annual GDP growth moderated from 2.3% in 2015 to 1.8% in 2016, despite initial resilience following the 23 June 2016 vote to leave the EU. The pace of growth has slowed further since the start of this year, from 0.6% in 2016-Q4 to 0.3% in both 2017-Q1 and 2017-Q2. This moderation has been driven primarily by a decline in private consumption growth, which fell to 0.2% in 2017-Q2, mainly due to the squeeze on real disposable incomes as nominal wage growth fell below consumer price inflation. Consumer prices have risen sharply in 2017 following the 2016 depreciation of sterling.

Following negative growth of 0.4% in 2016, business investment remains relatively subdued. In 2017-H2, it grew by just 0.9% compared to 2016-H2. Surveys suggest that heightened uncertainly is weighing on business investment.

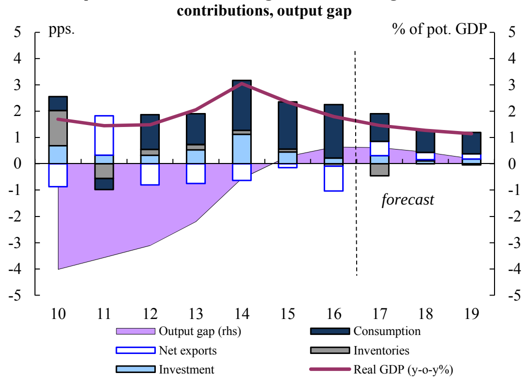
Supported by the earlier depreciation of sterling, net exports contributed 0.3 pps. to year-on-year growth in 2017-H1. Surveys of export order books and official data suggest that net trade should continue to make a modest contribution in 2017-H2. Despite the expected support from net exports, however, other survey and outturn data suggest a continuation of modest growth in 2017-H2. Consequently, annual GDP growth is projected to fall to 1.5% in 2017.

Growth set to slow further in 2018 and 2019

Private consumption growth is expected to remain subdued in 2018 as modest growth in nominal wages continues to be outpaced by elevated consumer price inflation. Nonetheless, households are expected to continue to smooth consumption by further reducing savings. The household savings rate is projected to fall to 4.8% in 2017 and to reach a low of 4.2% in 2018.

Investment growth is forecast to weaken in 2018, as many firms are likely to continue deferring investments in the face of uncertainty. Net exports are forecast to make a smaller contribution to growth, as the growth in export markets will be partially offset by the waning boost from sterling's past depreciation. A reduced contribution from net exports and slower domestic demand means that GDP growth in 2018 is expected to ease to 1.3%.

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



Given the ongoing negotiation on the terms of the UK withdrawal from the EU, projections for 2019 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. Under this assumption, GDP growth is still expected to remain subdued at 1.1%. Lower consumer price inflation in 2019 is expected to support private consumption but this may be partially offset by a marginal increase in the household savings rate. Business investment is projected to remain subdued following a period of heightened uncertainty, while net export growth is forecast to moderate marginally, in line with export markets.

Continued labour market resilience while inflation remains elevated

Employment is expected to continue growing, though more slowly than in recent years, as productivity growth remains subdued.

Unemployment is projected to remain low despite the moderation in GDP growth. The unemployment rate is projected to rise gradually from 4.5% in 2017 to 4.7% in 2018 and to 4.8% in 2019. After peaking at 2.7% in 2017, inflation is expected to remain elevated in 2018 at 2.6%. Inflation is projected to ease to 2.1% in 2019, still marginally above the Bank of England's inflation target of 2%.

General government deficit to rise in 2017-2018

Following several years of improvement, the UK's general government deficit is expected to rise to 2.5% of GDP in the 2017-2018 fiscal year. The deficit fell from 4.0% of GDP in 2015-2016 to 2.3% of GDP in 2016-2017. The fall in 2016-2017 was partly due to a temporary boost to revenues arising from a number of factors. The most significant was an increase in income tax revenues in the final quarter of the fiscal year due to changes in taxation for self-assessed (non-wage) incomes. This boost to tax receipts will not be repeated in the final quarter of the 2017-2018 fiscal year, contributing to a slight increase in the deficit. Interest payments are also expected to rise in 2017-2018, following a similar increase in 2016-2017, primarily due to higher interest payments on inflation-linked bonds. In line with the increase in the general government deficit, the structural deficit is expected to rise to 2.9% of GDP in 2017-2018, from 2.7% of GDP in 2016-2017.

The general government deficit is expected to resume a declining trend over the remainder of the forecast horizon, falling to 1.8% of GDP in 2018-2019 and 1.3% of GDP in 2019-2020. In line with measures announced by the UK authorities, fiscal consolidation during this period is largely expected to be expenditure based, although the revenue-to-GDP ratio is also expected to increase slightly. The structural deficit is expected to fall to 2.0% of GDP in 2018-2019 and 1½% of GDP 2019-2020. Risks to the forecast point to upward pressure on the general government deficit, particularly in case of a Brexit-related trade shock during the forecast period. The government debt ratio is projected to fall to 82.9% of GDP in 2019-2020, after peaking at 86.8% of GDP in 2016-2017.

Table II.28.1:
General government projections on a financial-year basis

ESA10	Actual		Forecast		
	2015-16	2016-17	2017-18	2018-19	2019-20
General government balance~	-4.0	-2.3	**-2.5**	**-1.8**	**-1.3**
Structural budget balance	-4.2	-2.7	**-2.9**	**-2.0**	**-1.4**
General government gross debt	86.7	86.8	**85.6**	**84.6**	**82.9**

~APF transfers included

Table II.28.2:
Main features of country forecast - UNITED KINGDOM

		2016			Annual percentage change					
		bn GBP Curr. prices	% GDP	98-13	2014	2015	2016	2017	2018	2019
GDP		1961.1	100.0	1.9	3.1	2.3	1.8	**1.5**	**1.3**	**1.1**
Private Consumption		1290.3	65.8	2.1	2.1	2.6	2.8	**1.4**	**1.1**	**1.1**
Public Consumption		370.0	18.9	2.3	2.5	0.6	1.1	**0.6**	**0.5**	**0.4**
Gross fixed capital formation		322.4	16.4	1.3	7.1	2.8	1.3	**1.9**	**0.7**	**1.1**
of which: equipment		80.6	4.1	0.8	17.7	6.4	1.7	**-0.4**	**1.3**	**1.0**
Exports (goods and services)		547.5	27.9	3.2	2.7	5.0	1.1	**4.7**	**3.1**	**2.9**
Imports (goods and services)		590.5	30.1	4.0	4.5	5.1	4.3	**2.6**	**2.1**	**2.1**
GNI (GDP deflator)		1910.7	97.4	1.8	3.1	2.1	1.5	**1.5**	**1.3**	**1.2**
Contribution to GDP growth:	Domestic demand			2.1	3.0	2.2	2.3	**1.4**	**0.9**	**1.0**
	Inventories			0.0	0.2	0.1	-0.1	**-0.5**	**0.0**	**0.0**
	Net exports			-0.3	-0.6	-0.1	-0.9	**0.5**	**0.3**	**0.2**
Employment				0.8	2.4	1.7	1.4	**0.9**	**0.5**	**0.4**
Unemployment rate (a)				6.1	6.1	5.3	4.8	**4.5**	**4.7**	**4.8**
Compensation of employees / head				3.8	0.5	1.1	3.1	**2.1**	**2.2**	**2.5**
Unit labour costs whole economy				2.7	-0.1	0.4	2.8	**1.5**	**1.5**	**1.8**
Real unit labour cost				0.7	-1.8	0.0	0.7	**-0.7**	**-0.7**	**0.1**
Saving rate of households (b)				8.9	8.4	9.2	7.1	**4.8**	**4.2**	**4.5**
GDP deflator				2.0	1.7	0.5	2.0	**2.3**	**2.1**	**1.7**
Harmonised index of consumer prices				2.2	1.5	0.0	0.7	**2.7**	**2.6**	**2.1**
Terms of trade goods				0.1	-0.2	-1.6	2.8	**0.8**	**0.5**	**0.5**
Trade balance (goods) (c)				-4.9	-6.7	-6.3	-6.9	**-6.3**	**-5.8**	**-5.7**
Current-account balance (c)				-3.0	-5.3	-5.2	-5.9	**-5.1**	**-4.6**	**-4.4**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-3.0	-5.4	-5.3	-6.0	**-5.2**	**-4.7**	**-4.4**
General government balance (c)				-3.8	-5.5	-4.3	-2.9	**-2.1**	**-1.9**	**-1.5**
Cyclically-adjusted budget balance (d)				-3.6	-5.1	-4.4	-3.3	**-2.5**	**-2.2**	**-1.6**
Structural budget balance (d)				-	-5.0	-4.4	-3.3	**-2.5**	**-2.2**	**-1.6**
General government gross debt (c)				51.6	87.4	88.2	88.3	**86.6**	**85.3**	**84.2**

(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.