

37. THE UNITED KINGDOM

The UK economy grew marginally in 2023, under the impact of tighter fiscal and monetary policy and with weak consumer confidence constraining demand. The outlook for 2024 is a little brighter, with inflation continuing to fall back, and momentum is expected to pick-up into 2025 as monetary policy eases and the pace of fiscal consolidation slows. At the same time, investment is set to remain weak, and trade to show only modest improvement. Risks to the growth outlook are broadly balanced.

A modest pick-up in 2024, gaining some momentum into 2025

The UK economy weakened further in the second half of 2023 as it contracted by 0.3% q-o-q in the fourth quarter of 2023, more than the 0.1% decline in the third quarter. Overall GDP grew by just 0.1% in 2023. Household incomes in 2023 were boosted by lower energy prices, offset to some extent by a withdrawal of temporary fiscal support measures and a higher tax burden, and grew by over 1%. Consumption was muted by a rise in the savings ratio and grew by just 0.3%. Gross fixed capital formation rose 2%, despite a steep fall in residential investment, with tax changes on depreciation likely having pulled some private investment forward, while public investment grew by over 5%. A large fall in inventories contributed negatively to growth. Goods imports and exports both contracted sharply in 2023, while trade in services grew strongly. In aggregate, a larger decline in imports in 2023 led to a small positive contribution from net exports to growth.

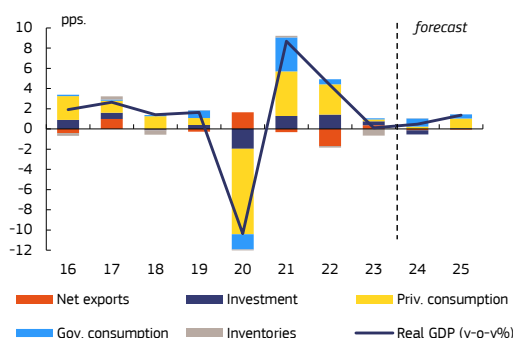
UK economic data improved in early 2024, with the services PMI moving well into expansionary territory, though the manufacturing PMI still indicates contraction. Monthly GDP data suggest a modest expansion in 2024Q1. Consumer confidence has improved over the past six months, though from very low levels. Household consumption is expected to remain sluggish in 2024, with slow employment growth and some tightening in fiscal policy, picking up gradually into 2025 as the pace of fiscal consolidation slows and monetary policy eases. Public consumption is projected to grow strongly in 2024 and then to moderate somewhat in 2025.

Investment is expected to contract in 2024 given the ongoing weakness in manufacturing and a fall in public investment, and to remain subdued in 2025, with a further fall in public investment and residential investment remaining weak. The slowdown in goods trade seen in 2023, when volumes contracted by around 8%, is expected to bottom out, while the rapid growth in services trade seen in 2023 is expected to level off in 2024 and resume a modest pace in 2025. Overall, trade volumes are expected to contract marginally in 2024 and then recover a little in 2025. In total, UK GDP is forecast to expand by 0.5% in 2024 and by 1.4% in 2025.

The labour market has loosened, but the extent of slack remains hard to assess.

Labour market indicators have softened in recent months - by February 2024 vacancies had fallen to 30% below the peaks reached in early 2022 - though remaining well above pre-pandemic levels. Employment growth was negative over the 3 months to February 2024, while the unemployment rate rose from 3.8% in December 2023 to 4.2% in February. Growth in average weekly earnings has also moderated, though remained high at 6.2% in February. High levels of immigration, largely from non-EU countries, have added to the labour force and eased pressures for wage growth. Nevertheless, the high pace of recent immigration, falling Labour Force Survey response rates, and the impact of the pandemic on levels of long-term illness, have made the

Graph II.37.1: The United Kingdom - Real GDP growth and contributions



extent of labour market slack hard to assess. A small rise in employment is projected for 2024, but with a rise in labour force implying a limited further increase in the unemployment rate, which is set to stabilize in 2025 as growth in demand and employment picks up.

Inflation has fallen back significantly, though services inflation is slowing more gradually

Headline inflation has fallen sharply over the past year from 10.1% in March 2023 to 3.2% in March 2024, driven largely by falling goods and food inflation and lower energy prices. Core inflation (i.e. excluding energy and food) has fallen more gradually and was at 4.2% in March, and services inflation at 6%. Base effects for energy are expected to push headline inflation lower in the coming months, which may in turn allow for further moderation in nominal wage growth, and a reduction in underlying inflationary pressures. However, the high pace of services inflation is projected to subside only gradually, potentially with some stickiness in core inflation ahead.

Deficit expected to fall, though pressures on public finances remain

The public sector deficit is set to narrow in 2024 and 2025 due to a combination of tax rises in the fiscal year 2024/5 of around 0.5pp of GDP, and a fall of around 0.5pp in overall spending in both 2024/5 and 2025/6. The March 2024 budget implies real terms cuts to public expenditure in 2024/25 and almost no rise in 2025/26, while public investment is set to fall in real terms over the forecast horizon. Due to acute pressures on public services, including high NHS waiting lists post-pandemic, meeting these projected spending plans is expected to prove challenging. Overall debt is forecast to rise from around 101% of GDP in 2023 to 105% in 2025.

Risks appear balanced

On the upside, there is scope for a fall-back in the savings rate and faster consumption growth. The household saving rate remains well above pre-pandemic levels and moved up further in 2023, possibly due to higher precautionary savings. Improving consumer sentiment, a falling saving rate and faster consumption growth could in turn lead to faster investment growth than projected. At the same time, stronger domestic demand could lead to weaker deflationary pressures – and given the still-high pace of services inflation and uncertainty over the extent of labour market slack, some persistence in inflation remains a risk.

Table II.37.1:

Main features of country forecast - UNITED KINGDOM

	2023		Annual percentage change							
	bn GBP	Curr. prices	% GDP	04-19	2020	2021	2022	2023	2024	2025
GDP	2687.2	100.0		1.6	-10.4	8.7	4.3	0.1	0.5	1.4
Private Consumption	1661.3	61.8		1.6	-13.2	7.4	5.0	0.3	0.4	1.5
Public Consumption	557.1	20.7		1.6	-7.9	14.9	2.3	0.5	3.9	1.9
Gross fixed capital formation	490.9	18.3		1.9	-10.8	7.4	8.0	2.2	-2.2	0.5
Exports (goods and services)	864.5	32.2		3.1	-11.5	4.9	9.0	-0.5	-0.6	1.3
Imports (goods and services)	897.9	33.4		3.4	-16.0	6.1	14.6	-1.5	-0.2	1.4
GNI (GDP deflator)	2652.3	98.7		1.5	-12.2	11.6	4.3	-1.7	0.6	1.5
Contribution to GDP growth:										
Domestic demand				1.7	-11.9	9.1	4.9	0.7	0.6	1.5
Inventories				0.0	-0.1	0.2	-0.1	-0.7	0.0	0.0
Net exports				-0.1	1.7	-0.3	-1.7	0.4	-0.1	-0.1
Employment				0.9	-0.9	-0.1	1.3	0.7	-0.1	0.6
Unemployment rate (a)				5.9	4.7	4.6	3.9	4.0	4.4	4.4
Compensation of employees / head				2.9	0.3	4.6	5.9	6.5	3.5	2.2
Unit labour costs whole economy				2.3	10.9	-3.9	2.9	7.2	2.9	1.4
Saving rate of households (b)				8.0	16.7	12.5	8.1	9.7	9.5	8.9
GDP deflator				2.1	5.1	-0.1	5.1	7.1	1.7	1.5
Consumer price index (CPIH) (e)				2.1	1.0	2.5	7.9	6.8	2.4	2.0
Terms of trade goods				0.7	-1.0	-1.5	-1.5	1.7	0.4	-0.4
Trade balance (goods) (c)				-6.3	-6.1	-7.2	-8.7	-6.9	-6.7	-6.8
Current-account balance (c)				-3.5	-2.9	-0.5	-3.1	-3.3	-3.3	-3.4
General government balance (c)				-4.9	-13.0	-7.9	-4.6	-5.9	-4.8	-4.1
Structural budget balance (d)				:	:	:	:	:	:	:
General government gross debt (c)				70.6	105.8	105.3	100.4	101.3	103.9	105.1

(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