28. THE UNITED KINGDOM
Growth to moderate and inflation to rise

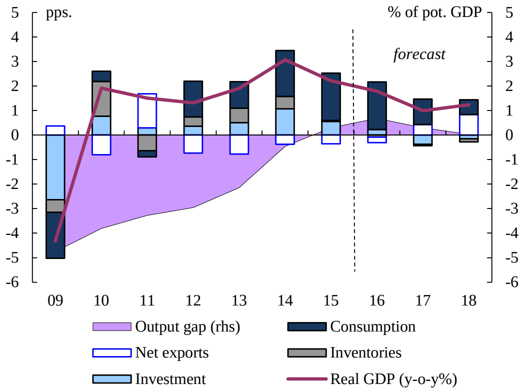
Growth is projected to moderate in 2016 as the economy reaches a mature phase in its cycle. In 2017, growth is projected to almost halve reflecting the impact on confidence and uncertainty of the vote to leave the EU in the referendum on 23 June 2016. However, growth is expected to pick up somewhat in 2018 as net exports continue to rise sharply and partially shield the economy from continued weakness in domestic demand. Inflation is projected to rise rapidly to over 2%. The impact on the labour market of the fall in demand is likely to be muted. The pace of fiscal consolidation looks set to slow.

Healthy growth in 2016

After moderating to 2.2% in 2015, growth is projected to soften further to 1.9% in 2016 as the economy enters a mature phase in its business cycle. Robust growth of 1.1% in 2016-H1 was driven by strong growth in domestic demand. Private consumption continued to support growth, boosted by buoyant growth in household disposable income and a decline in saving; the household saving ratio fell to 5.1% in 2016-Q2.

However, growth remains unbalanced. Exports declined in 2016-H1 while brisk import growth exceeded strong domestic demand growth. Consequently, net exports detracted from growth, continuing the pattern of the past four years.

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



On 23 June 2016, the UK voted, in a referendum on continued EU membership, to leave the EU. The impact on near-term growth of the vote in the referendum has been muted. Growth in 2016-Q3 was 0.5% - in line with the average of the preceding six quarters. The resilience of growth in 2016-Q3 was driven by continued growth in the services sector. Although quarterly growth is projected to decline in 2016-Q4, overall growth in 2016 is projected at 1.9%, slightly above that in the spring forecast.

Growth to soften markedly in 2017

Nevertheless, growth is projected to almost halve in 2017, to 1.0%, reflecting the impact of heightened uncertainty following the referendum and its impact on business confidence and broader economic conditions. Consistent with the results of recent surveys of businesses' investment intentions, business investment is expected to decline sharply throughout 2017 and fall by 2.2%.

Growth in private consumption is projected to slow, by from 2.9% in 2016 to 1.5% in 2017. The decline reflects the response of households to a sharp fall in real household disposable income growth in 2017, itself a reflection of rising price inflation eroding real earnings growth. In response to the drop in income growth, households are expected to smooth consumption, resulting in a fall in the household saving ratio.

In contrast to the pattern of previous years, a significant boost to net exports, of 0.4 pps., is projected in 2017. Exports are projected to be supported by the substantial depreciation of sterling in 2016 to date and underpinned by modest growth in major trading partners. Moreover, import growth is expected to fade, as domestic demand wanes and import prices rise following the depreciation. The boost to net exports should partly alleviate the negative impact on GDP of the fall in growth in domestic demand.

A mild recovery in 2018

Growth is projected to rise in 2018 to 1.2%. A further and stronger rise in net exports is projected to underpin growth in 2018. Domestic demand is, however, expected to remain subdued. Uncertainty is likely to remain high as negotiations on the future relationship between the UK and EU continue, impeding the extent of the rise in growth in 2018.

Labour market to remain resilient and inflation to rise sharply

The impact of increased uncertainty on employment is expected to be muted, partly because modest nominal wage growth is expected to cushion the impact of the fall in GDP growth on employment. Nonetheless, the unemployment rate is to rise to 5.6% in 2018 from 4.9% in 2016.

Inflation is expected to rise rapidly, and significantly, to 2.5% in 2017 and 2.6% in 2018, above the Bank of England's inflation target of 2%. The rise in inflation reflects the impact of the depreciation of the exchange rate which raises import prices, in the first instance, and then flows more widely to other sectors.

Fiscal consolidation to continue more slowly

The general government deficit fell to 4.1% of GDP in 2015-16 from 5.1% in 2014-15, driven both by cuts to the public wage bill and robust revenues, the latter linked to strong domestic demand. The structural deficit decreased to 4.3% of GDP in 2015-16, from 4.9% in 2014-15.

The government's plans for expenditure-focused fiscal consolidation throughout the forecast period remain in place, at this time, with ongoing cuts to resource spending, including public sector wages. The headline deficit is forecast to fall to 3.2% of GDP in 2016-17. Reforms to national insurance raise social contributions but, to date, overall revenues have been slightly weaker than expected. The structural deficit is projected to fall by more than ½ pps. to 3.5% of GDP.

In 2017-18 and 2018-19, the headline deficit is expected to decline further - to 2.7% and 2.2% of GDP respectively. The pace of deficit reduction slows, however, as a result of lower GDP growth and subdued imports and private consumption. The structural deficit is expected to improve by at least ½ pps. per year, to about 2¾% of GDP in 2017-18 and about 2¼% of GDP in 2018-19. The government debt ratio is expected to have stabilised in 2015-16 at 87.9% of GDP and to remain almost flat in 2016-17 and 2017-18, before declining to 86.3% in 2018-19.

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

ESA10	Actual		Forecast		
	2014-15	2015-16	2016-17	2017-18	2018-19
General government balance~	-5.1	-4.1	**-3.2**	**-2.7**	**-2.2**
Structural budget balance	-4.9	-4.3	**-3.5**	**-2.8**	**-2.3**
General government gross debt	87.4	87.9	**87.9**	**87.6**	**86.3**

~APF transfers included

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

	2015		Annual percentage change						
	bn GBP Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP	1870.7	100.0	2.0	1.9	3.1	2.2	**1.9**	**1.0**	**1.2**
Private Consumption	1215.9	65.0	2.4	1.6	2.2	2.5	**2.9**	**1.5**	**0.7**
Public Consumption	363.0	19.4	2.3	0.3	2.3	1.5	**0.3**	**0.5**	**0.8**
Gross fixed capital formation	316.9	16.9	1.1	3.2	6.7	3.4	**1.3**	**-2.2**	**-0.9**
of which: equipment	74.6	4.0	0.7	2.5	6.8	4.3	**3.8**	**-1.3**	**-0.9**
Exports (goods and services)	508.8	27.2	3.6	1.1	1.5	4.5	**3.1**	**3.3**	**3.8**
Imports (goods and services)	547.4	29.3	4.3	3.4	2.5	5.4	**3.6**	**1.7**	**1.0**
GNI (GDP deflator)	1833.8	98.0	2.0	1.4	2.3	1.5	**2.2**	**1.3**	**1.5**
Contribution to GDP growth:	Domestic demand		2.2	1.6	2.9	2.5	**2.2**	**0.7**	**0.4**
	Inventories		0.0	0.6	0.5	0.0	**-0.1**	**-0.1**	**-0.1**
	Net exports		-0.2	-0.8	-0.4	-0.4	**-0.2**	**0.4**	**0.8**
Employment			0.8	1.2	2.4	1.8	**1.2**	**0.5**	**0.3**
Unemployment rate (a)			6.0	7.6	6.1	5.3	**4.9**	**5.2**	**5.6**
Compensation of employees / head			3.9	2.1	0.4	1.1	**2.3**	**2.2**	**2.1**
Unit labour costs whole economy			2.7	1.3	-0.3	0.6	**1.6**	**1.7**	**1.3**
Real unit labour cost			0.7	-0.6	-1.9	0.2	**1.0**	**-0.4**	**-1.3**
Saving rate of households (b)			8.4	6.7	6.8	6.1	**5.7**	**4.5**	**4.2**
GDP deflator			2.0	1.9	1.6	0.4	**0.6**	**2.0**	**2.6**
Harmonised index of consumer prices			2.1	2.6	1.5	0.0	**0.7**	**2.5**	**2.6**
Terms of trade goods			0.0	1.4	-0.4	-1.7	**-1.4**	**-0.5**	**0.5**
Trade balance (goods) (c)			-4.6	-6.9	-6.7	-6.8	**-8.0**	**-8.3**	**-7.8**
Current-account balance (c)			-2.1	-4.4	-4.7	-5.4	**-5.6**	**-4.9**	**-3.3**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-2.1	-4.4	-4.7	-5.4	**-5.6**	**-5.0**	**-3.4**
General government balance (c)			-3.6	-5.7	-5.7	-4.3	**-3.5**	**-2.8**	**-2.3**
Cyclically-adjusted budget balance (d)			-3.5	-4.4	-5.5	-4.5	**-3.9**	**-2.9**	**-2.3**
Structural budget balance (d)			-	-4.4	-5.4	-4.5	**-3.8**	**-2.9**	**-2.3**
General government gross debt (c)			49.1	86.2	88.1	89.1	**89.2**	**88.9**	**87.5**

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