United Kingdom

GDP growth is projected to remain sluggish at 0.4% in 2024 before improving to 1.0% in 2025, reflecting the waning drag from past monetary tightening. Stronger real wage growth will support a modest pick-up in private consumption. Headline inflation is expected to continue moderating towards target as energy and food prices have eased substantially, but persistent services price pressures will keep core inflation elevated at 3.3% in 2024 and 2.5% in 2025. Unemployment will continue increasing and reach 4.7% in 2025 as the labour market cools, although the actual degree of slack remains uncertain.

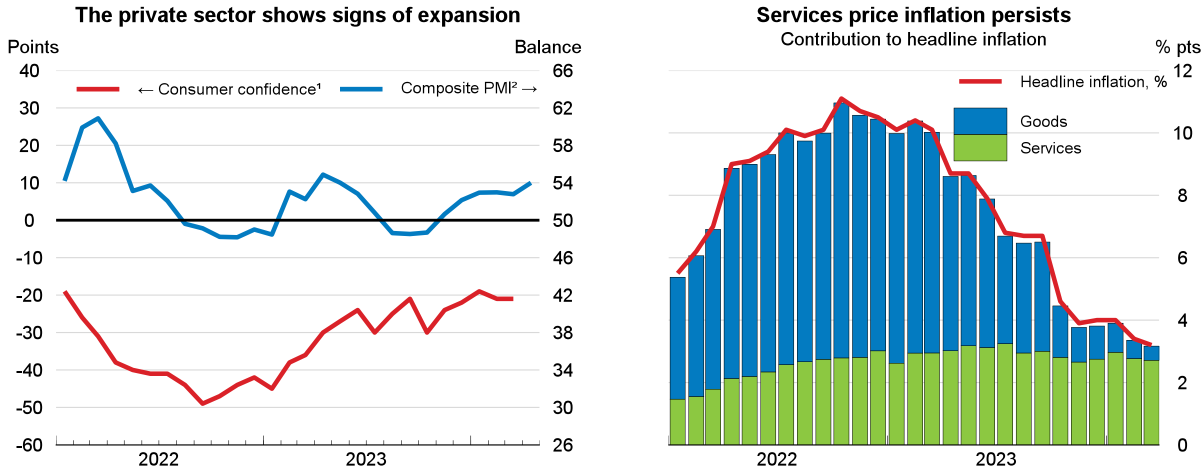
The fiscal and monetary policy mix is adequately restrictive and should remain so until inflation returns durably to target. Fiscal policy should remain prudent and focus on productivity-enhancing public investment when the monetary stance normalises. Reforming property taxation can help rebuild fiscal buffers and promote both efficiency and progressivity. Further advancing supply-side reforms while avoiding policy churn is essential to increase potential growth, especially by continuing to address economic inactivity and stagnant investment.

Momentum is improving

Monthly GDP grew by 0.1% in February after a 0.3% rebound in January, foreshadowing a moderate pick-up in the first quarter of 2024 following the shallow technical recession in the second half of 2023. Retail sales volumes show signs of stabilisation after a three-year long decline, with a modest increase of 0.8% in March compared to the same month last year, while consumer confidence remains on an upward, albeit unsteady, trend from historically depressed levels. Mortgage lending has started to recover as mortgage rates have eased slightly in recent months, edging up towards pre-pandemic levels with over 60 000 new approvals for house purchase in February. Business sentiment is also improving, pointing to private sector expansion since November. Lending to businesses has nearly stabilised since January after contracting for 12 months in a row.

Lower wholesale, energy and imported food inflation have tamed headline price pressures, with annual consumer price inflation at 3.2% in March. The 12% cut in the Ofgem energy price cap in April 2024 will further lower inflation. The labour market is cooling, with the stock of vacancies in the three months to March about 30% lower than its recent peak and close to pre-pandemic levels. Yet, wage-driven underlying price pressures persist, with services price inflation at 6.0% in March. Annual nominal wage growth remains robust despite a marked slowdown since the summer of 2023, with an increase of 6.0% in the three months to February.

United Kingdom 1



1. GfK Consumer Confidence Barometer; values above 0 indicate optimism.
2. S&P Global Composite Purchasing Manager Index; values above 50 indicate expansion.
Source: Bloomberg; S&P Global; Office for National Statistics; and OECD calculations.

StatLink https://stat.link/wmjp7d

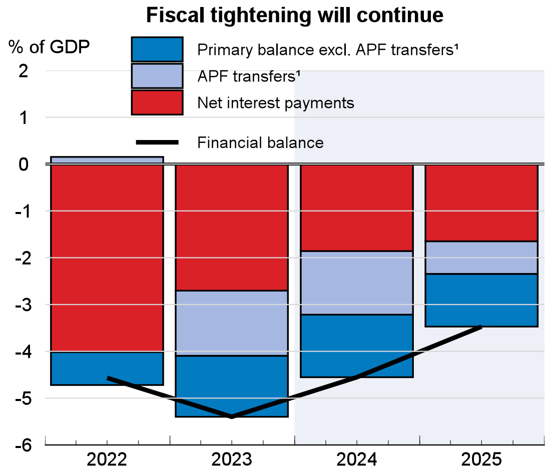
United Kingdom: Demand, output and prices

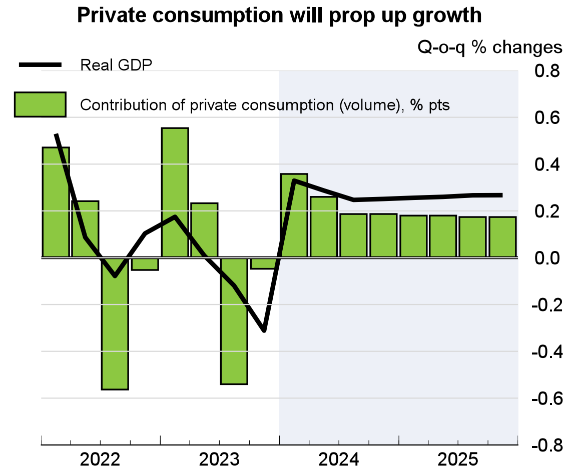
United Kingdom	2020	2021	2022	2023	2024	2025
	Current prices GBP billion	Percentage changes, volume (2019 prices)				
GDP at market prices	2 104.3	8.7	4.3	0.1	0.4	1.0
Private consumption	1 246.1	7.5	5.0	0.3	0.7	1.2
Government consumption	475.6	14.9	2.3	0.5	1.6	0.4
Gross fixed capital formation	367.5	7.4	8.0	2.2	-1.6	-0.2
Final domestic demand	2 089.2	9.1	4.9	0.7	0.5	0.8
Stockbuilding[1]	2.3	0.1	-0.3	-0.6	-0.2	0.0
Total domestic demand	2 091.5	9.1	4.6	0.1	0.3	0.8
Exports of goods and services	624.8	4.9	9.0	-0.5	0.6	1.9
Imports of goods and services	612.0	6.1	14.6	-1.5	0.0	1.1
Net exports[1]	12.8	-0.3	-1.7	0.4	0.2	0.2
Memorandum items						
GDP deflator	_	-0.1	5.1	7.1	2.6	1.9
Harmonised index of consumer prices	_	2.6	9.1	7.3	2.7	2.3
Harmonised index of core inflation[2]	_	2.4	5.9	6.2	3.3	2.5
Unemployment rate (% of labour force)	_	4.6	3.9	4.0	4.5	4.7
Household saving ratio, gross (% of disposable income)	_	12.5	8.1	8.4	8.5	8.9
General government financial balance (% of GDP)	_	-7.9	-4.6	-5.4	-4.6	-3.5
General government gross debt (% of GDP)	_	105.3	100.4	101.4	103.9	105.4
Current account balance (% of GDP)	_	-0.5	-3.1	-3.3	-1.6	-0.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 115 database.

StatLink https://stat.link/eiqj1v

United Kingdom 2





1. Transfers to and from the Bank of England under the Asset Purchase Facility indemnification arrangement.
Source: OECD Economic Outlook 115 database; Office for Budget Responsibility; and OECD calculations.

StatLink https://stat.link/zhspbw

A shift in the macroeconomic policy mix is expected

Monetary policy is assumed to start easing from the third quarter of 2024, with Bank Rate gradually lowered from its current peak of 5.25% to 3.75% by the end of 2025, as inflation continues converging towards target. The Bank of England is also expected to proceed with the unwinding of the stock of assets held for monetary policy purposes in the Asset Purchase Facility at an unchanged pace, with the GBP 100 billion target for gilt stock reduction over the 12-month period to September 2024 renewed for another year.

Fiscal policy will remain restrictive, with assumed consolidation of about 1.3% of potential GDP between 2023 and 2025, in line with the government's self-imposed fiscal target of decreasing public debt within a five-year horizon. Tax receipts keep rising towards historic highs of about 37% of GDP, as the cumulated 4 percentage points cut in the rate of national insurance contributions since 2023 only partially offsets the ongoing fiscal drag from frozen personal income tax thresholds, and the permanent full-expensing investment allowance less than fully compensates the increase in the statutory corporate tax rate. Yet the measures are expected to increase potential output by providing stronger work and investment incentives and, together with supply-side initiatives such as the childcare expansion, could help to lower fiscal pressures in the longer run. However, public expenditure is expected to be 2.9% of GDP higher by fiscal year 2028/29 than before the pandemic. This is despite a consolidation-driven fall in real departmental spending per person, as welfare spending is set to increase by more than 1% of GDP, mainly due to the pension triple lock and rising caseloads for health-related benefits.

Growth will improve as the effect of past monetary tightening wanes

GDP is projected to grow by 0.4% in 2024 and 1.0% in 2025. Robust real wage growth will support activity in the first half of 2024, attenuating the strongly negative carry-over from the output decline in the second half of 2023. Monetary easing will then sustain the pick-up in private expenditure, including a modest increase in household investment as mortgage volumes start recovering. However, sticky services price inflation and fiscal drag will continue to weigh on consumers' purchasing power, soft external demand will constrain trade growth, and policy uncertainty will impede business investment. Unemployment is expected to continue rising, reaching 4.7% in 2025 as the labour market cools. The government deficit will improve from 4.6% of GDP in 2024 to 3.5% of GDP in 2025, owing to continued consolidation and despite the fiscal cost of the Asset Purchase Facility, but public debt is set to remain above 100% of GDP in 2025.

Uncertainty about the degree of slack in the labour market is a key risk to the outlook: overestimating the actual availability of labour resources and a faster reduction in Bank Rate would boost GDP but possibly entrench wage inflation, while underestimating actual availability would entail high interest rates for longer, slowing the economy. The limited fiscal space to confront possible shocks remains a downside risk, given exposure to potential further surges in wholesale energy prices if geopolitical tensions worsen. A rundown of excess household savings would boost growth but could limit the pace of disinflation.

Fiscal policy should remain prudent and focus on the supply side

Persevering with consolidation to rebuild fiscal buffers is a priority, given limited fiscal space, and necessitates detailed and credible plans on departmental allocation of fiscal efforts based on spending reviews. Reforming property taxation can contribute to the consolidation, and promote both progressivity, by re-evaluating council tax bands based on updated property values, and efficiency, by scrapping stamp duties. Fiscal prudence is required as inflation remains above target, and spending is to be directed towards supply-enhancing investment, including infrastructure, the National Health Service, and adult skills. Proceeding with the childcare reform will help tackle economic inactivity, but requires contingent planning to address potential bottlenecks, in particular likely staff shortages.

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