UNITED KINGDOM

Economic growth is projected to continue at a robust pace over the coming two years, driven by domestic demand. House prices have continued to rise, although housing supply is edging up. The unemployment rate has stabilised at around 5.5%, and recently wage growth has picked up. Projected increases in labour productivity should underpin real wage growth. The trade deficit has remained contained, but weak global trade and past currency appreciation are holding back exports. Inflation is expected to increase towards the 2% inflation target as pressures on capacity emerge.

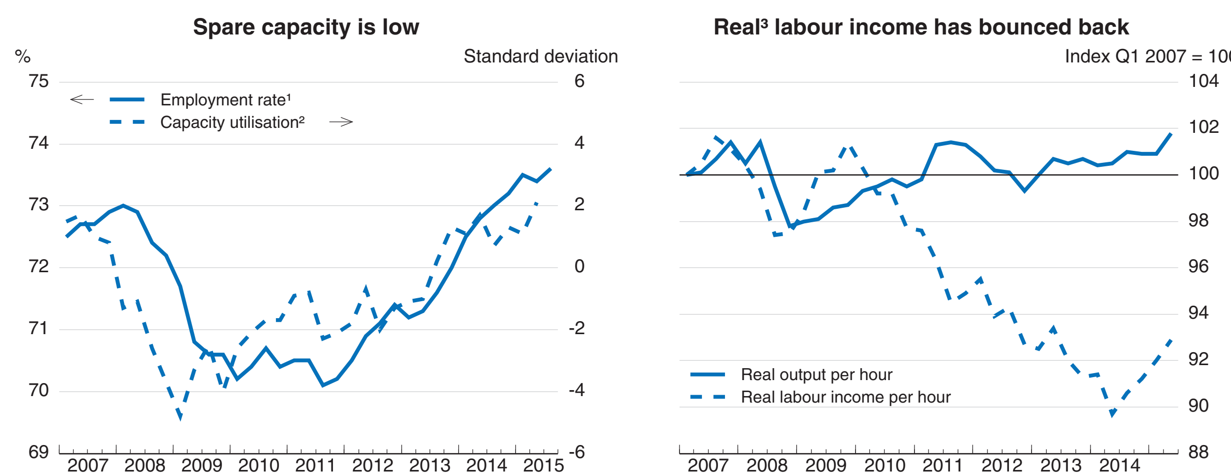
This projection assumes the Bank of England will begin to raise its policy rate in early 2016, and then raise it gradually through 2017 to ward off excess demand pressures. The pace of fiscal consolidation has appropriately been smoothed to around 1% of GDP per year and now involves smaller reductions in spending on public services than earlier planned. However, the decision to significantly lift the minimum wage will increase labour costs, possibly lowering the contribution of employment to GDP growth.

The United Kingdom has made significant progress in its climate-change mitigation efforts. It has established a long-term framework with a unilateral commitment to reduce greenhouse gas emissions to 80% of their 1990 level by 2050, delivered through five-yearly reduction targets. To help reach this ambitious objective at low cost, carbon emissions could be taxed more uniformly by increasing the low implicit rates now faced by some sectors.

Economic growth is robust

Solid GDP growth continued in 2015, driven by domestic demand. Private consumption continues to grow rapidly due to record-high employment, the acceleration in nominal

United Kingdom



1. Population aged between 16 and 64. Last data point for Q3 2015 refers to Jun - Aug 2015.
2. Difference from Q1 1999 - Q3 2007 average. The surveys are adjusted to have a mean of zero and a variance of one over Q1 1999 to Q3 2007. Aggregate indicator of capacity utilisation of the Confederation of British Industry refers to manufacturing, financial services, business, commercial and professional services and distributive trades.
3. Real output per hour deflated by the GDP deflator. Real labour income per hour deflated by the CPI.

Source: Office for National Statistics; and Bank of England.

StatLink http://dx.doi.org/10.1787/888933296551

United Kingdom: **Employment, income and inflation**

Percentage changes

	2013	2014	2015	2016	2017
Employment	1.2	2.3	1.2	0.7	0.6
Unemployment rate[1]	7.6	6.2	5.6	5.7	5.8
Compensation per employee[2]	1.5	0.8	2.4	3.4	3.8
Unit labour cost	0.6	-0.6	1.6	1.9	2.5
Household disposable income	1.1	0.8	6.1	3.2	3.4
GDP deflator	2.0	1.7	1.1	1.2	1.5
Harmonised index of consumer prices[3]	2.6	1.5	0.1	1.5	2.0
Core harmonised index of consumer prices[4]	2.0	1.6	1.0	1.2	1.9
Private consumption deflator	2.3	1.5	0.3	1.1	1.6

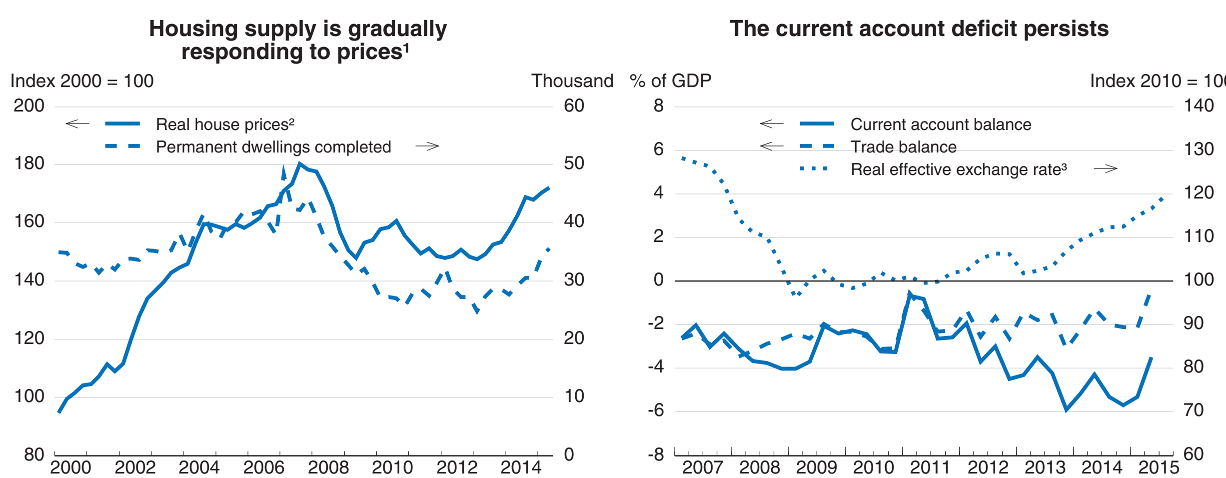
1. As a percentage of labour force.
2. In the total economy.
3. The HICP is known as the Consumer Price Index in the United Kingdom.
4. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 98 database.

StatLink http://dx.doi.org/10.1787/888933296884

wages, wealth effects from rising house prices and easier credit conditions. Stronger demand, falling spare capacity and higher credit availability have supported business investment. The number of residential dwellings completed has been trending upwards, but housing supply remains tight because of a backlog from the recession and rapid increases in population.

United Kingdom



1. Data refer to England.
2. Based on mortgages completed and adjusted for the mix of dwellings sold. Deflated by CPI.
3. Competitiveness indicator based on relative consumer prices.

Source: Office for National Statistics; Department for Communities and Local Government; and OECD Economic Outlook 98 database.

StatLink http://dx.doi.org/10.1787/888933296566

United Kingdom: **Financial indicators**

	2013	2014	2015	2016	2017
Household saving ratio, gross[1]	6.3	4.9	4.3	3.9	4.0
General government financial balance[2]	-5.7	-5.7	-3.9	-2.6	-1.5
General government gross debt[2]	106.4	116.8	116.4	115.5	114.1
General government debt, Maastricht definition[2]	86.2	88.2	87.8	86.9	85.5
Current account balance[2]	-4.5	-5.1	-4.0	-3.4	-3.0
Short-term interest rate[3]	0.5	0.5	0.6	1.1	2.1
Long-term interest rate[4]	2.4	2.6	1.9	2.3	3.1

1. As a percentage of disposable income (gross saving).
2. As a percentage of GDP at market value.
3. 3-month interbank rate.
4. 10-year government bonds.

Source: OECD Economic Outlook 98 database.

StatLink http://dx.doi.org/10.1787/888933296895

International competitiveness, as measured by the real effective exchange rate, has weakened, but the trade deficit has so far been contained. Although volatile, high frequency trade data point to weaker exports to non-EU countries, including China. Also, the primary income deficit has remained large.

The unemployment and participation rates have stabilised, but hours worked have continued to increase. Disappearing slack in the labour market and a revival in labour

United Kingdom: **Demand and output**

	2014	2015	2016	2017	Fourth quarter 2015	Fourth quarter 2016	Fourth quarter 2017
	Current prices livre billion	Percentage changes from previous year, volume (2012 prices)					
GDP at market prices	1 816.4	2.4	2.4	2.3	2.2	2.3	2.2
Private consumption	1 175.7	3.0	2.6	2.0	3.2	2.2	2.0
Government consumption	357.3	1.7	0.4	0.3	1.6	0.3	0.3
Gross fixed investment	306.1	4.0	6.4	6.7	5.6	6.8	6.6
Public[1]	49.6	2.9	0.6	0.9	3.4	0.2	1.2
Residential	87.5	0.7	6.4	7.0	2.2	7.5	6.8
Non-residential	169.0	6.0	8.0	8.0	7.9	8.2	7.9
Final domestic demand	1 839.1	2.9	2.8	2.6	3.3	2.7	2.5
Stockbuilding[2]	11.9	-1.0	-0.4	0.0			
Total domestic demand	1 851.0	1.9	2.5	2.6	1.9	2.7	2.5
Exports of goods and services	515.2	3.0	2.1	2.4	1.2	2.1	2.5
Imports of goods and services	549.7	1.1	2.3	3.4	-0.6	3.3	3.5
Net exports[2]	- 34.5	0.5	-0.1	-0.3			

Note: Detailed quarterly projections are reported for the major seven countries, the euro area and the total OECD in the Statistical Annex.

1. Including nationalised industries and public corporations.
2. Contributions to changes in real GDP, actual amount in the first column.

Source: OECD Economic Outlook 98 database.

StatLink http://dx.doi.org/10.1787/888933296906

United Kingdom: **External indicators**

	2013	2014	2015	2016	2017
	USD billion				
Goods and services exports	814.5	848.6	805.7	835	863
Goods and services imports	868.4	905.4	841.2	870	907
Foreign balance	- 53.8	- 56.8	- 35.5	- 36	- 45
Invisibles, net	- 68.5	- 96.0	- 81.1	- 66	- 48
Current account balance	- 122.4	- 152.7	- 116.6	- 102	- 92
	Percentage changes				
Goods and services export volumes	1.2	1.8	3.0	2.1	2.4
Goods and services import volumes	2.8	2.8	1.1	2.3	3.4
Export performance[1]	- 1.1	- 2.5	- 1.1	- 1.8	- 2.4
Terms of trade	1.7	0.8	0.3	0.3	0.2

1. Ratio between export volume and export market of total goods and services.

Source: OECD Economic Outlook 98 database.

StatLink http://dx.doi.org/10.1787/888933296915

productivity have boosted wage growth, but real wage incomes are still well below pre-crisis levels. Past structural reforms have put the structural unemployment rate on a downward trend, although the recent decision to lift the minimum wage could work in the opposite direction. The Low Pay Commission should carefully consider the current and expected state of the economy and the labour market when making its recommendations about increases of the minimum wage to the government.

Macroeconomic policies are gradually being adjusted to ensure balanced growth

The government has amended its medium-term fiscal plan to bring the budget to a small surplus by 2020. Additionally, asset sales have been accelerated to reduce gross public debt. Adjusting for cyclical effects, the planned deficit reduction is about 1% of GDP per year between 2015 and 2019, which is a welcome smoothing of fiscal consolidation. The composition of fiscal consolidation has also been revised, with a commendable reduction in the downward pressure on public services that had contributed significantly to past consolidation. The authorities should also continue to review the distributional effects of budgetary adjustments to ensure growth is inclusive.

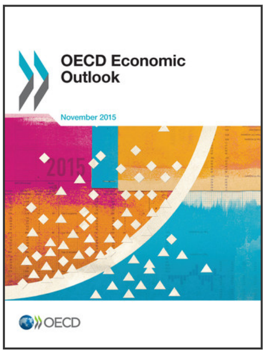
The United Kingdom has set ambitious targets for reducing greenhouse gas emissions. Five-year carbon budgets have been established until 2027. The fourth carbon budget (2023-2027) aims to cut emissions by half of the levels in 1990. The share of renewables in the energy mix has increased rapidly, with numerous policies aming to increase renewable electricity, heat and transport, despite the recent removal of the Climate Change levy exemption for renewable electricity for businesses. A move towards a more consistent pricing of carbon would include an alignment of taxation across sectors and, as a first step, raising low rates at least somewhat towards the level of taxation of energy in the transport sector. Diesel should also be more taxed than gasoline to reflect higher carbon emissions per litre (and higher emmissions of other pollutants).

Spare capacity is low and a gradual normalisation in interest rates, with the first hike in early 2016, would be prudent to contain excess demand pressures that now seem to be developing. Yet, since consumer price inflation has been very low and expectations are well anchored, the pace of monetary adjustment should be gradual. Higher interest rates should encourage greater economic restructuring thereby supporting productivity, which stronger infrastructure investment would further boost. Releasing more land for housing, as considered by the authorities in a recent Productivity Plan, would also support productivity by improving labour mobility and reducing skills mismatches.

Growth will moderate somewhat

GDP growth is expected to continue at a solid pace, with private domestic demand remaining a key driver. Employment is projected to continue to rise but more slowly, and wage growth should remain solid, reflecting the tighter labour market and further gains in labour productivity. Consumer prices should pick up in 2016 and 2017 with higher capacity pressures and the unwinding of temporary effects of weaker energy prices and the stronger exchange rate.

Labour resource utilisation could be lower than expected owing to measures increasing the costs of employing low-income earners. The magnitude of their impacts is uncertain, but a higher minimum wage could hurt employment by pricing out low productivity workers from the labour market and result in losses of competiveness if not matched by stronger productivity. House price buoyancy could restrict access to the rental market, reducing labour mobility, and boost household indebtedness, creating financial stability risks. Stronger growth in the euro area would boost exports and further narrow the current account deficit, but could be offset by weaker external demand from China and other emerging markets.



From:

OECD Economic Outlook, Volume 2015 Issue 2

Access the complete publication at:

https://doi.org/10.1787/eco_outlook-v2015-2-en

Please cite this chapter as:

OECD (2015), “United Kingdom”, in *OECD Economic Outlook, Volume 2015 Issue 2*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/eco_outlook-v2015-2-47-en