United Kingdom

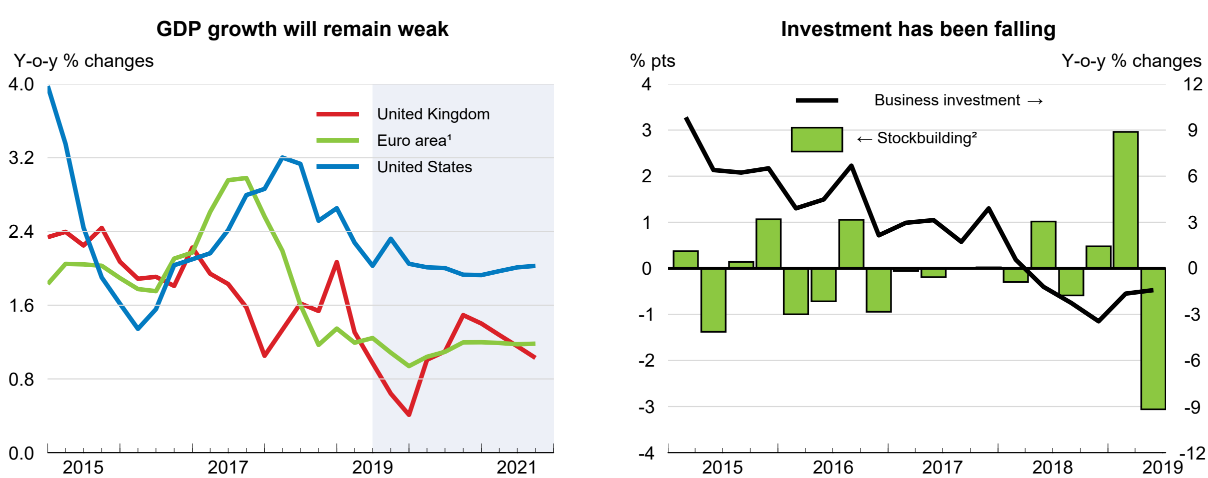
The economic outlook is unusually uncertain given the risks around exit from the European Union. Assuming there is a smooth transition ending after 2021, activity is expected to grow at around 1% in the next two years. Brexit-related uncertainty will keep holding back investment until there is clarity about future trading arrangements. Weak global economic prospects will slow the recovery in exports. Inflation is projected to slow to below 2%.

Monetary policy should continue to support activity and keep inflation close to target, but cannot fully address all shocks. The government should stand ready to intervene to address any Brexit-related disruption or a weakening of economic growth. The United Kingdom should strive to find an agreement that ensures the closest possible trading relationship with the European Union and high access for financial services to overseas markets.

Economic uncertainty has held back investment

Shifting expectations about the potential timing and nature of Brexit and a deteriorating international environment have weighed on trade and business investment. Persistent weakness in investment is starting to erode long-term prospects, and surveys point to weak investment intentions going forward. The accumulation of stocks in the first quarter of the year has been partially unwound, with little effect on growth as it essentially related to imported goods. Consumption growth has remained resilient, supported by continued growth in real household incomes. There are signs that the labour market is starting to cool. The unemployment rate has ticked upward and the number of vacancies has started falling. Net migration from the European Union has decelerated markedly since 2017 and has been only partly compensated for by more migrants from non-EU countries. Inflation has recently fallen below target.

United Kingdom 1



1. Covers 17 countries that are both euro area and OECD members.
2. Contribution to changes in real GDP.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046019

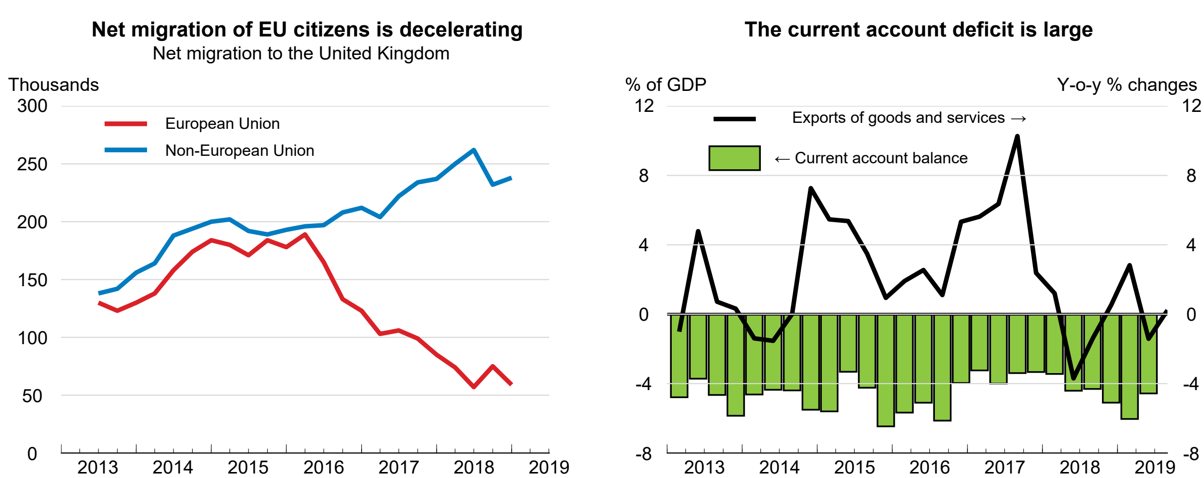
United Kingdom: Demand, output and prices

United Kingdom	2016	2017	2018	2019	2020	2021
	Current prices GBP billion	Percentage changes, volume (2016 prices)				
GDP at market prices	1 995.5	1.9	1.4	1.2	1.0	1.2
Private consumption	1 299.1	2.2	1.6	1.2	1.0	0.7
Government consumption	381.5	0.3	0.6	3.3	3.1	2.1
Gross fixed capital formation	343.7	1.6	-0.1	0.0	0.0	1.3
Final domestic demand	2 024.3	1.7	1.1	1.4	1.2	1.1
Stockbuilding[1]	3.5	-0.6	0.3	0.3	-1.5	0.0
Total domestic demand	2 027.8	1.2	1.4	1.6	-0.3	1.1
Exports of goods and services	567.5	6.1	-0.9	0.2	1.2	1.6
Imports of goods and services	599.8	3.5	0.7	2.5	-2.8	1.2
Net exports[1]	- 32.3	0.7	-0.5	-0.7	1.3	0.1
Memorandum items						
GDP deflator	_	1.9	1.9	2.1	1.7	1.6
Harmonised index of consumer prices	_	2.7	2.5	1.9	2.0	1.8
Harmonised index of core inflation[2]	_	2.3	2.1	1.7	1.8	1.8
Unemployment rate (% of labour force)	_	4.4	4.1	3.8	4.0	4.1
Household saving ratio, gross (% of disposable income)	_	5.3	6.1	6.4	6.5	6.6
General government financial balance (% of GDP)	_	-2.4	-2.2	-2.6	-3.2	-3.2
General government gross debt (% of GDP)	_	115.1	111.8	111.8	112.9	113.9
General government debt, Maastricht definition (% of GDP)	_	86.2	85.9	85.2	85.4	85.6
Current account balance (% of GDP)	_	-3.5	-4.3	-4.5	-3.7	-3.6

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 106 database.

StatLink https://doi.org/10.1787/888934046950

United Kingdom 2



Source: Office for National Statistics.

StatLink https://doi.org/10.1787/888934046038

Policy action will be needed to smooth the exit from the European Union

The projections assume a smooth exit from the European Union, with a transition period ending after 2021. The UK authorities should clarify their position as soon as possible in terms of the nature of the relationship with the European Union to lower uncertainties, whose persistence is detrimental to long-term prospects. The government should strive to forge an agreement that will ensure the closest possible trading relationship with the European Union and high access for financial services to overseas markets. Given the high degree of trade integration with the European Union and its extensive trading relationships with third countries, exit will increase barriers to trade and damp UK exports.

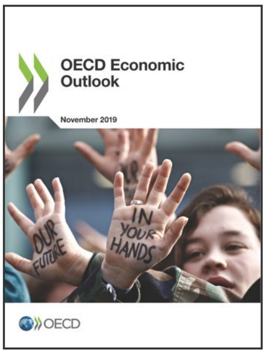
The monetary policy stance has appropriately remained accommodative in the context of high uncertainty. If there were to be a disruptive exit, the Bank of England should stimulate the economy by cutting interest rates and buying bonds, although this would be insufficient to fully offset the sizeable output loss in such an event. The Financial Policy Committee should be prepared to reduce the counter-cyclical capital buffer rate to preserve banks' capacity to lend to households and firms in case of financial turbulence.

The government has announced a significant increase in spending for the fiscal year 2020-21 in the Spending Round, which is set to add around 0.2 percentage point to growth. The government has also signalled future tax cuts and additional spending increases, which have not been included in the projections. Future fiscal policy is particularly uncertain in view of the general election in December. In case of exit from the European Union without an ageed trade deal or if the international environment deteriorates further, a temporary fiscal package would be warranted to manage the disruption. In addition to letting the fiscal automatic stabilisers operate fully, this could include increasing active labour market spending on training and services to displaced and low-skilled workers. Government policies should seek to support workers, not particular sectors or jobs, should trade and production shift as a result of Brexit. Temporary emergency measures, such as accelerating depreciation allowances, could also be envisaged.

Growth is projected to remain weak

Activity is expected to grow below trend, at just above 1% on average in the coming two years. Investment growth will recover as uncertainty regarding the nature of Brexit is assumed to diminish gradually, but it will remain low. With the continued weakness in world trade, exports are set to grow only very modestly. Inflation will slow to below 2% by 2021, in line with currency developments. The unemployment rate is anticipated to edge up slightly in the context of continued economic fragility. With the already announced increase in spending, the public deficit, corrected for the business cycle, is expected to increase to around 2.5% of GDP in the next two years, and the public debt-to-GDP ratio is set to increase moderately even before any additional stimulus measures. The current account deficit will remain large.

Exit from the European Union without an agreed deal would significantly damage the economy, especially if it triggers turbulence in financial markets. The UK economy is also exposed to global financial risks, a further slowdown in the world economy and rising protectionism. Leaving the European Union may exacerbate these vulnerabilities. By contrast, investment prospects could recover faster should the United Kingdom and the European Union agree on a future close economic relationship. Following the general election, fiscal policy might be eased more than assumed in the projections, which would strengthen growth in the short term.



From:

OECD Economic Outlook, Volume 2019 Issue 2

Access the complete publication at:

https://doi.org/10.1787/9b89401b-en

Please cite this chapter as:

OECD (2019), "United Kingdom", in *OECD Economic Outlook, Volume 2019 Issue 2*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/62f48ee1-en