United Kingdom

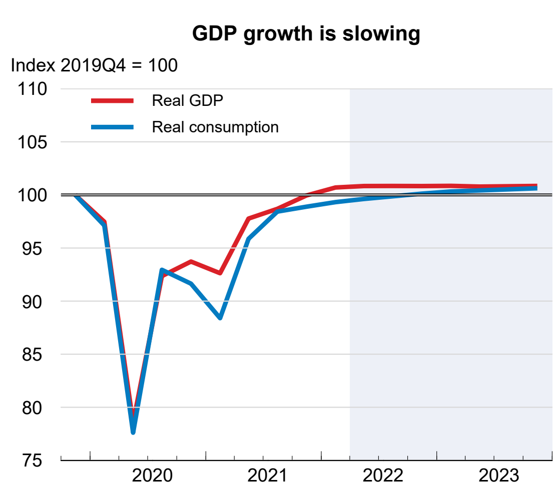
GDP is projected to increase by 3.6% in 2022, before stagnating in 2023. Inflation will keep rising and peak at over 10% at the end of 2022 due to continuing labour and supply shortages and high energy prices, before gradually declining to 4.7% by the end of 2023. Private consumption is expected to slow as rising prices erode households' income. Public investment will weaken in 2022 as supply bottlenecks hamper the implementation of planned investment, but is set to rise again in 2023 as these effects subside. A tight labour market will help to keep unemployment low.

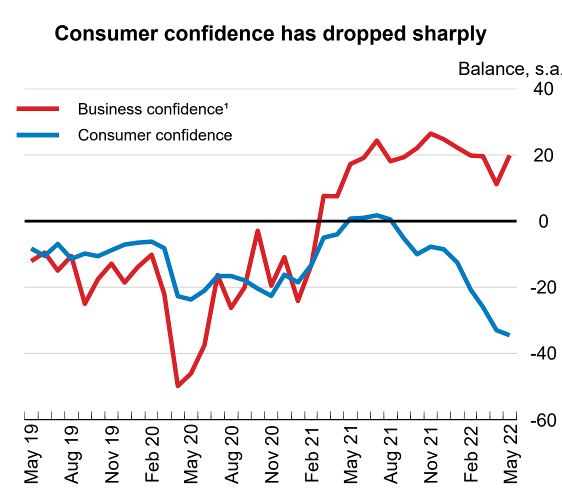
Monetary policy should continue to normalise gradually to help bring inflation to target. Fiscal policy has to balance gradual fiscal tightening with well-targeted support to protect vulnerable households from the rising cost of living and significant spending and investment needs to support productivity. Government programmes should focus on providing certainty about the transition to net zero to support investment and accelerate the reduction of fossil fuel dependence.

Growth is slowing amid persisting supply shortages and rising inflation

Output exceeded pre-pandemic levels in November 2021, but high frequency data indicate a slowing of the economy. Monthly GDP declined by 0.1% in March 2022, down from 0.7% in January and no growth in February. The easing of COVID travel restrictions early 2022 led to a sharp recovery in holiday bookings, but manufacturing slumped due to global supply chain disruptions. The labour market continues to tighten, with the number of vacancies rising to about 1.3 million in March 2022. The unemployment rate fell to 3.7% in the first quarter of 2022, below its pre-pandemic lows, but the inactivity rate remains above pre-pandemic levels. Inflation continues to rise, reflecting elevated energy and goods prices due to global supply shortages and strong pent-up demand for goods. Average weekly earnings have increased steadily since mid-2020, but real wages in January-March 2022 were 1.2% weaker than a year earlier. Inflation pressures have been aggravated by surging energy prices following Russia's invasion of Ukraine, hitting confidence. Business confidence remains well above pre-pandemic levels, but consumer confidence remains subdued, reflecting concerns related to the rising cost of living.

United Kingdom 1





1. Business confidence refers to the manufacturing sector.
Source: Economic Outlook 111 database; and OECD Main Indicators database.

StatLink https://stat.link/tcx50w

United Kingdom: Demand, output and prices

United Kingdom	2018	2019	2020	2021	2022	2023
	Current prices GBP billion	Percentage changes, volume (2019 prices)				
GDP at market prices	2 174.4	1.7	-9.3	7.4	3.6	0.0
Private consumption	1 412.3	1.3	-10.6	6.2	4.5	0.7
Government consumption	399.0	4.2	-5.9	14.3	1.4	0.8
Gross fixed capital formation	386.5	0.5	-9.5	5.9	8.0	2.1
Final domestic demand	2 197.8	1.7	-9.5	7.9	4.5	1.0
Stockbuilding[1]	4.9	-0.1	-0.6	0.6	3.5	0.0
Total domestic demand	2 202.7	1.6	-10.2	8.3	8.0	0.9
Exports of goods and services	663.3	3.4	-13.0	-1.3	0.9	1.5
Imports of goods and services	691.6	2.9	-15.8	3.8	15.7	3.6
Net exports[1]	- 28.3	0.1	1.0	-1.4	-4.2	-0.7
Memorandum items						
GDP deflator	_	2.0	5.1	0.3	5.7	4.9
Harmonised index of consumer prices	_	1.8	0.9	2.6	8.8	7.4
Harmonised index of core inflation[2]	_	1.7	1.4	2.4	6.4	5.9
Unemployment rate (% of labour force)	_	3.8	4.5	4.5	3.8	4.3
Household saving ratio, gross (% of disposable income)	_	4.6	14.0	10.4	5.1	1.7
General government financial balance (% of GDP)	_	-2.3	-12.8	-8.3	-5.3	-4.1
General government gross debt (% of GDP)	_	118.5	149.1	143.1	139.2	138.6
Current account balance (% of GDP)	_	-2.7	-2.5	-2.6	-7.2	-7.6

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 111 database.

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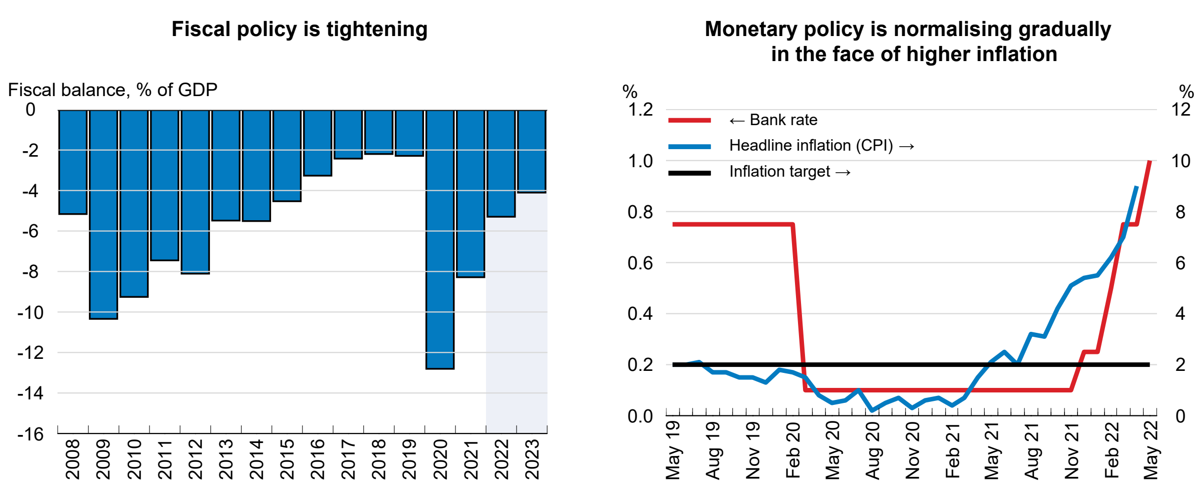
United Kingdom 2



Source: Economic Outlook 111 database; and Bank of England.

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The UK economy is susceptible to economic spill-over effects from Russia's invasion into Ukraine through rising energy prices and supply chain disruptions. The United Kingdom has limited direct trade and financial linkages with Russia and Ukraine, but higher global energy prices add to the squeeze on household incomes, which are now declining in real terms. Special visa schemes for Ukrainian refugees have been introduced allowing Ukrainian nationals to either stay with a sponsor in the United Kingdom, or be brought in by an immediate family member that is of British nationality or is settled in the United Kingdom.

Monetary and fiscal policy are becoming restrictive

The Bank of England has responded to rising inflationary pressures by increasing its policy rate four times since December 2021 from 0.1% to 1% and by starting 'quantitative tightening' of its balance sheet by no longer reinvesting the proceeds of gilt redemptions into new gilt purchases. As announced in February 2022, its holdings of sterling corporate bonds are also being reduced gradually, including through sales up to the end of 2023. As the policy rate reached 1% in May, the Bank announced that it would discuss a strategy for active gilt sales at the August 2022 monetary policy meeting. Monetary policy is expected to continue normalising, with the bank rate set to increase to 2.5% by 2023.

Fiscal policy has started to tighten, with the main pandemic support measures phased out at the end of 2021. Other measures, such as the temporary reduced VAT rates on hospitality and recreational services, ended on 31 March 2022. To return to a sustainable fiscal path, the government has committed to a gradual medium-term fiscal consolidation plan, with planned increases in tax revenues and increased investment. From April 2022, national-insurance contributions increased by 1.25 percentage points to fund health and social care spending while tax-free allowances and higher rate thresholds for income tax are frozen until 2025-26, a policy that now has a bigger positive impact on revenues than anticipated when introduced in early 2021 due to high inflation. From April 2023, the corporate income tax rate will increase from 19% to 25%. Due to rising energy prices, the UK government introduced a support package worth GBP 9.1 billion (0.4% of 2022-23 GDP) for 2022-23 before Russia's invasion of Ukraine, to help households with rising cost of living. Measures include a non-repayable council tax rebate, a repayable energy discount and discretionary funding for Local Authorities to support households who need support but are not eligible for the Council Tax Rebate. Following Russia's invasion into Ukraine, additional measures were taken, such as a 12-month cut in fuel duty. To reduce the burden on lower income households in face of increasing cost of living, the national insurance threshold is being raised in July from GBP 9 880 to GBP 12 570. An additional support package of GBP 15 billion (0.7% of GDP) was announced at the end of May, including a one-off GBP 600 payment to households on means-tested benefits, and one-off payments of GBP 300 to pensioner households and GBP 150 to individuals receiving disability benefits. Moreover, the energy discount was doubled to GBP 400 and turned into a grant. To help pay for the extra support, the government announced a new and temporary 25% energy profit levy for oil and gas companies, while also introducing an investment allowance of 80% to incentivise the oil and gas sector to invest in UK extraction. Overall, the fiscal stance will be contractionary and the underlying primary balance is set to improve by 1.8 percentage points of potential GDP between 2022 and 2023.

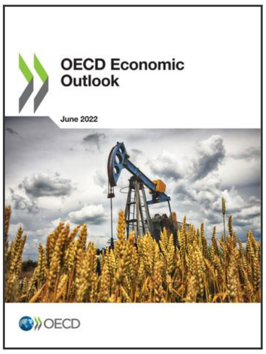
Economic growth is set to slow

Output is projected to grow by 3.6% in 2022 before stagnating in 2023 due to depressed demand. Private consumption will slow as rising prices erode households' incomes. Household savings will decline to below pre-pandemic levels, with some households taking on more debt to keep up with the rising cost of living. Inflation will continue to rise, peaking at just over 10% in the fourth quarter of 2022, driven by increasing global prices of tradable goods and services due to supply bottlenecks, transportation costs and energy prices. Inflation will moderate gradually through 2023 due to base effects, but will remain elevated due to the impact of the EU oil embargo on global energy prices. Continued tightness of the labour market is expected to feed through to higher wage growth over the projection period, but with wage growth remaining below inflation. Tighter monetary policy and easing supply constraints over 2023 are expected to help inflation to decline to 4.7% by the end of 2023. Unemployment is set to remain low, but will increase gradually to 4.5% by the end of 2023 due to weaker demand. Business investment will be damped by rising interest rates and lingering uncertainties. Public investment will be weakened by supply shortages in 2022, hindering planned investment, but is expected to pick up in 2023 with planned spending increases on infrastructure and climate. The general government deficit is projected to decline gradually to 5.3% of GDP in 2022 and 4.1% of GDP in 2023.

Risks to the outlook are considerable. Spill-overs from economic sanctions and higher than expected energy prices as the Ukraine war drags on, and a deterioration in the public health situation due to new COVID strains are significant downside risks. Higher than expected goods and energy prices could weigh on consumption and further lower growth. A prolonged period of acute supply and labour shortages could force firms into a more permanent reduction in their operating capacity or push up wage inflation further. A progress in trade deals could support trade and improve the outlook.

Supporting investment to raise productivity and advance the green transition

The government should consider slowing fiscal consolidation to support growth. The ambitious government "Plan for Growth" to support structural transformation towards greener and more inclusive growth through large scale public investment in infrastructure, skills and innovation should continue as planned, and be well targeted, with a special focus on improving productivity in lagging regions. Accelerating progress towards net zero is fundamental to enhance energy security and reduce dependence on fossil fuels. Policies in place are not yet sufficient to deliver the Net Zero target. The government can stimulate the necessary investment by being clearer about its approach to the transition to a net zero economy and developing an economy-wide plan with concrete deadlines, policies and priorities in line with a target-consistent emission pricing trajectory.



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