United Kingdom

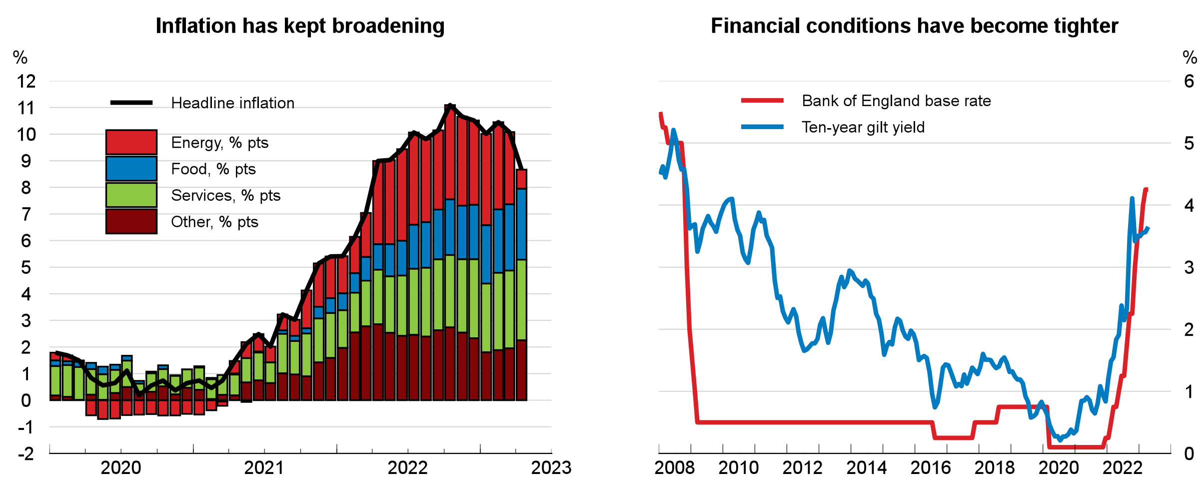
GDP growth is expected to be modest at 0.3% in 2023 and to improve moderately to 1.0% in 2024. Government consumption and investment will continue to prop up the economy, before a gradual strengthening of private expenditure due to falling wholesale gas prices and improved global conditions. Headline inflation is projected to slow on the back of declining energy prices and to come down close to target by the end of 2024. Core inflation is set to be more persistent due to strong services inflation, only receding to 3.2% in 2024. Unemployment will rise, reaching 4.5% in 2024.

Monetary policy will remain tight, increasingly weighing on output and lowering inflation, and the fiscal stance will be restrictive over 2023-24. However, little fiscal space is left, leaving the government significantly exposed to movements in interest rates. Swiftly implementing the spring budget's supply-side measures to increase labour supply, and providing certainty for investment and trade are key to strengthening potential growth.

Price pressures persist despite slowing activity and tighter financial conditions

Private consumption and housing investment weakened in the latter half of 2022. The first quarterly estimate for 2023 points to lacklustre real GDP growth of 0.1% in the three months to March. Retail sales volumes were 3.0% lower in April than in the same month last year, and consumer confidence remains depressed, although improving. Business sentiment is mixed, with a robust pick up in services but continuing weakness in manufacturing. Net mortgage borrowing continued to fall in March, while the average cost of bank loans to firms remains elevated at almost 5.8%, significantly above the rate of about 2.0% when the monetary tightening cycle started in December 2021.

United Kingdom 1



Source: Office of National Statistics; and OECD Economic Outlook 113 database.

StatLink https://stat.link/s83bzk

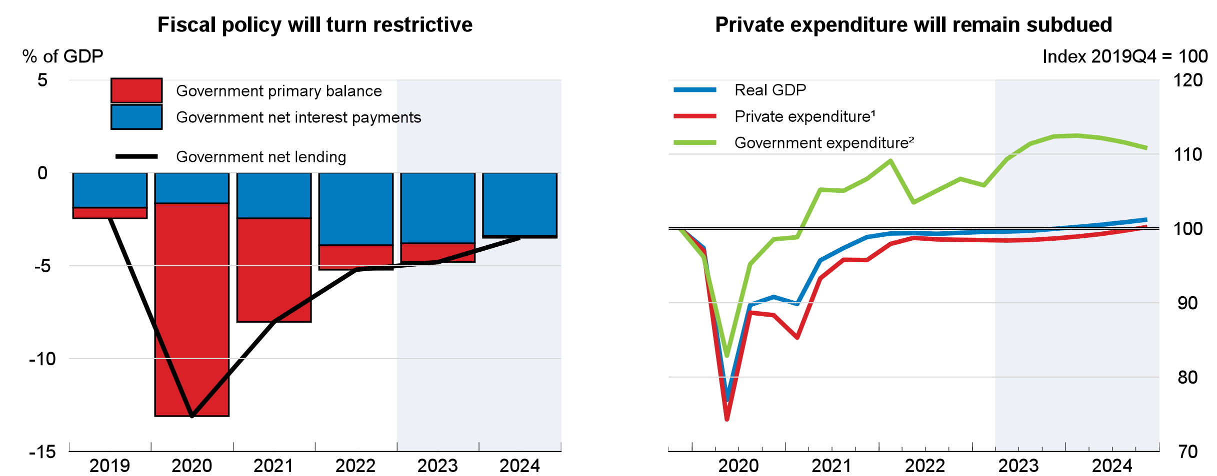
United Kingdom: Demand, output and prices

United Kingdom	2019	2020	2021	2022	2023	2024
	Current prices GBP billion	Percentage changes, volume (2019 prices)				
GDP at market prices	2 238.3	-11.0	7.6	4.1	0.3	1.0
Private consumption	1 440.0	-13.2	6.3	5.6	0.5	1.3
Government consumption	425.6	-7.3	12.5	1.8	1.7	1.7
Gross fixed capital formation	403.4	-10.5	6.1	8.6	1.0	0.6
Final domestic demand	2 269.0	-11.6	7.6	5.3	0.8	1.2
Stockbuilding[1]	5.5	-0.7	1.3	-0.9	-1.7	0.0
Total domestic demand	2 274.5	-12.3	8.8	4.3	-0.8	1.3
Exports of goods and services	699.7	-12.1	2.2	9.9	-3.4	1.1
Imports of goods and services	735.8	-16.0	6.2	13.3	-6.6	1.9
Net exports[1]	- 36.1	1.5	-1.1	-1.1	1.3	-0.3
Memorandum items						
GDP deflator	_	5.9	0.0	5.4	4.8	2.3
Harmonised index of consumer prices	_	0.9	2.6	9.1	6.9	2.8
Harmonised index of core inflation[2]	_	1.4	2.4	5.9	5.3	3.2
Unemployment rate (% of labour force)	_	4.6	4.5	3.7	4.2	4.5
Household saving ratio, gross (% of disposable income)	_	15.8	12.6	8.5	7.9	7.6
General government financial balance (% of GDP)	_	-13.1	-8.0	-5.2	-4.8	-3.5
General government gross debt (% of GDP)	_	105.6	105.9	101.0	102.5	103.8
Current account balance (% of GDP)	_	-3.2	-1.5	-3.8	-3.9	-3.7

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 113 database.

StatLink https://stat.link/mxuzoh

United Kingdom 2



1. Private consumption, housing investment and business investment.
2. Government consumption and government investment.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/xi6puj

Annual nominal wage growth in the three months to March was 5.8%, lower than both headline and core inflation. Vacancies posted a tenth consecutive quarterly fall in April, and unemployment is picking up. Yet, annual headline inflation remains high at 8.7% in April, despite the drop in the contribution of energy prices. Both rising services prices and elevated goods prices contribute to the persistence of core inflation, which at 6.8% in April, is the highest rate observed since March 1992. Imported food materials inflation continues to push up producer prices and headline consumer prices, with the food and non-alcoholic beverages annual inflation rate at 19.0% in April, the second highest observed for over 45 years after that in March 2023. By contrast, a fall in wholesale energy prices has eased the cost-of-living squeeze, and the steady appreciation of sterling against the US dollar attenuates imported inflation overall.

After monetary policy, fiscal policy is becoming more restrictive

The Bank of England brought its base rate to 4.5% in May, close to the assumed terminal value of 4.75% for the current monetary tightening cycle. The Bank is also proceeding with quantitative tightening by gradually reducing its bond holdings by GPB 80 billion by September 2023, through a mixture of redemptions and active sales, and by decreasing its stock of sterling corporate bonds. Monetary policy is not expected to ease until the second half of 2024, with two cuts of 25 basis points in the Bank's base rate in the third and fourth quarters as core inflation converges towards target.

The fiscal stance will be restrictive over 2023-24, as the government complies with its national fiscal rule of decreasing public debt within a five-year horizon against the backdrop of significantly higher borrowing costs. The government's 2023 spring budget includes the continuation of energy support measures, some of which are expected to become obsolete by the third quarter of 2023 as energy prices fall. Cumulative costs across fiscal years 2022/23 and 2023/24 are estimated at about GBP 78 billion (about 3% of GDP), of which GPB 15 billion is recouped via windfall taxes on energy producers. The main measures are the energy price subsidies to households and businesses, extended until the end of March 2024 (GPB 47 billion, about 1.8% of GDP); targeted cost-of-living payments (GPB 25 billion, about 1% of GDP); and the fuel duty freeze, also extended until the end of March 2024 (GPB 5 billion, about 0.2% of GDP). The spring budget also includes childcare subsidies and pension tax allowances, which are expected to gradually increase labour market participation, and a new "full-expensing" investment allowance, which is meant to foster investment and compensate for the expiration of the "super deduction" and the increase in the corporate income tax rate from the second quarter of 2023. Higher defence expenditure is also planned. A freeze of income tax brackets will significantly increase fiscal pressure on households, pushing 1.7 million people to start paying income taxes and 1.2 million people to pay higher rates.

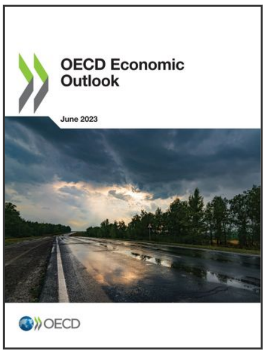
Private expenditure will remain subdued

GDP will grow by 0.3% in 2023 and 1.0% in 2024. The contribution of government expenditure to GDP growth in the second half of 2022 will carry over to the first quarters of 2023, owing in part to energy support measures. Private expenditure will strengthen moderately as energy prices recede, benefits such as pensions and universal credit are uprated, labour participation increases, and global economic conditions improve. However, weak household income growth will weigh on consumption despite the fall in inflation, monetary tightening will slow both housing and already sluggish business investment, and uncertainty will continue to reduce the contribution of trade to growth. Real wages will stagnate in 2023, as a gradual easing of labour market conditions limits nominal wage growth, before eventually increasing in 2024 thanks to lower inflation. Unemployment will increase steadily to about 4.5% as growth remains subdued. The government deficit will improve from 5.2% of GDP in 2022 to 3.5% of GDP in 2024, owing to both consolidation and higher growth.

Significant risks surround the outlook. The high interest burden on public debt and the recent drop in average debt maturity leave the public finances exposed to movements in bond yields. Renewed increases in wholesale energy prices due to Russia's war of aggression against Ukraine would further squeeze real incomes given the United Kingdom's high dependence on natural gas. Faster-than-expected resolution of uncertainty regarding future trade relationships is an upside risk.

Lifting labour supply is necessary and boosting investment is a top priority

Labour market participation remains weaker than before the pandemic, and women disproportionately work part-time because of care responsibilities. The childcare measure, which offers 30 hours a week of free childcare for working parents of nine-to-24-month-olds, should be implemented swiftly, as it will raise labour market participation and potential output while reducing gender inequalities in earnings. Energy support should be gradually withdrawn, except measures focused on households insufficiently protected against high energy prices through the regular social safety net. Providing certainty regarding investment conditions and future trade relationships is essential to boost productivity and accelerate the low-carbon transition.



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