National Institute of Economic and Social Research

Press Release

National Institute Economic Review No. 247 February 2019

Prospects for the UK economy

EMBARGOED until 00.01am Wednesday 6 February

- The UK's future relationship with the European Union (EU) remains undecided even though the Article 50 exit date is less than two months away. Brexit uncertainty has intensified since our last forecast and is now evident in various indicators.

- Our main forecast is conditional on a 'soft' Brexit scenario. Under this scenario, GDP growth stabilises at around 1.5 per cent this year before recovering to 1.7 per cent in 2020. CPI inflation eases to the target level of 2 per cent over this period.

- We expect the Bank of England to raise Bank Rate by 25 basis points in August. We also expect the Chancellor to spend more than the latest OBR forecast. That, together with the reclassification of student loans in public deficit data, will mean that the Chancellor is set to breach the fiscal mandate.

- There is a chance that the UK exits the EU without a deal at the end of March. Policymakers will have more room to inject stimulus if inflation expectations remain anchored.

The UK economy has lost momentum since our last forecast because Brexit-related uncertainty has intensified and also because global economic growth has slowed. As a result, we have revised lower our forecast for UK GDP for 2019 from 1.9 per cent to 1.5 per cent. GDP growth is likely to be driven by domestic demand and consumer spending more specifically. With global growth softening over the forecast horizon and the tailwinds from the weaker exchange rate fading, we do not expect net trade to make a material positive contribution to UK economic growth. The risk to our GDP growth forecast is tilted materially to the downside because of Brexit.

This slowdown must be placed in the context of record levels of employment, rising wage growth and public finance data that continues to surprise to the upside. We note that annual unit labour cost growth has remained stable at around 2.8 per cent in the third quarter of last year. CPI inflation however, is likely to fall below the target in the short run because of lower oil prices.

Compared with our November forecast, we now expect the next 25 basis point Bank Rate increase to be delayed until August this year. Thereafter, we envisage a similar 25 basis point rate increase every six months until end-2020 when Bank Rate would reach 1.5 per cent. In the event that the UK slips into a no-deal Brexit, the MPC should lower Bank Rate if inflation expectations remain anchored.

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The Chancellor announced higher public spending in the 2018 Budget. In our view, the Chancellor will have to go further to better cater to the needs of an ageing population and to maintain the quality of public services. That, together with the new and more realistic treatment of student loans in the fiscal deficit measure implies a breach of the fiscal mandate on our forecasts.

There is still a chance that the UK exits the EU at the end of March without a deal. Policymakers will respond to that scenario by activating contingency plans and inject stimulus into the economy if possible. We present two alternative scenarios, one where medium-term inflation expectations and wage growth remain stable and the other where expectations are dislodged and the labour market displays real wage resistance. We show that policymakers will have more room to inject stimulus and stabilise short term economic growth if inflation expectations and wages remain anchored.

Summary of the forecast (based on a soft Brexit scenario) *Per cent*

	Real GDP	CPI[(a)]	ILO unemployment	Bank Rate	External current balance	PSNB[(b)]
	annual growth	Q4/Q4	Q4	end-year	% of GDP	
2018	1.4	2.1	4.0	0.75	−4.4	1.5
2019	1.5	2.0	4.3	1.00	−4.0	1.7
2020	1.7	2.0	4.4	1.50	−3.8	1.9

Notes: Calendar years unless otherwise stated. No deal scenario in brackets. (a) Consumer price index. (b) Public sector net borrowing, excludes public sector banks.

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Notes for editors:

The full forecast for the UK economy will be published in the National Institute Economic Review no. 247 on Wednesday 6 February. Details of NIESR's previous UK economic forecast can be found here.

For a full copy of the UK economic forecast or to arrange interviews, please contact the NIESR Press Office: Paola Buonadonna on 020 7654 1923 / p.buonadonna@niesr.ac.uk

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