THE UK ECONOMY
Forecast summary

We have revised lower our GDP forecast for 2018 to just under 1.5 per cent mainly due to weak performance in the first quarter. But the slowdown is likely to be temporary.

The Commentary in this *Review* builds a case for higher government spending. We have, as a result, allowed for higher total managed expenditure resulting in a somewhat slower fiscal adjustment than presently planned.

Following the exchange rate depreciation of June 2016, annual consumer price inflation peaked at 3.1 per cent in November 2017 and is forecast to ease back to the target rate of 2 per cent over the next eight quarters.

Because of the dip in economic performance we expect the timing of our next increase in Bank Rate to be delayed to August but reiterate that the MPC should remain on a gentle path of monetary policy normalisation.

Economic growth slowed sharply in the first quarter of this year. Preliminary data published by the ONS show quarterly growth of 0.1 per cent which compares with the downwardly revised 0.4 per cent outturn for the final quarter of 2017. We do not believe that this weak outturn represents a prolonged period of slow growth. But our forecasts do suggest that UK growth will fall behind the Euro Area in 2018 as well as 2019.

As before, the central forecast has been conditioned on a 'soft' Brexit assumption where the UK achieves close to full access to the EU market. Although the UK government and the EU have made progress with a transition agreement, there is still a risk that talks fail and the UK ends up trading under WTO rules. The possibility of these events represents a downside risk for our GDP growth forecast and an upside risk for our inflation forecast.

The pressure to end fiscal consolidation is high. Public sector wages are lagging behind the private sector resulting in recruitment difficulties and at the same time concerns about the quality of public services is building. The government will struggle to resist lifting public sector wages and extra funding would be needed to stop the fall in public service quality. We therefore deviate from our standard practice of taking official spending plans as given and assume a pick-up in government spending from 2019.

On the positive side, there have been some welcome and tentative signs of a recovery in hourly labour productivity in the second half of last year. We have treated this recovery with caution and assumed the productivity growth remains at a subdued level of less than 1.5 per cent each year over the medium term, but the risk to that view is tilted to the upside. The outlook for real wages depends most critically on productivity.

Summary of the forecast – UK economy

	Real GDP(a)	Unemployment(b)	CPI(c)	RPIX(d)	External current balance(e)	PSNB(f)
2018	1.8	4.1	2.1	4.0	–83.2	48.9
2019	1.4	4.2	2.0	3.7	–84.3	48.8
2020	1.7	4.6	2.0	3.6	–88.1	56.3

(a) Percentage change, year–on–year. (b) ILO definition, fourth quarter, rate. (c) Consumer prices index, percentage change, fourth quarter on fourth quarter. (d) Retail price index, excluding mortgages, percentage change, fourth quarter on fourth quarter. (e) Year, £ billion. (f) Public sector net borrowing, fiscal year, £ billion. Includes the flows from the Bank of England's Asset Purchase Facility.

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