

## THE UK ECONOMY

### Forecast summary

GDP is forecast to grow by 1.7 per cent this year and by 1.9 per cent next year.

Annual consumer price index inflation peaks at 3.0 per cent in the last quarter of this year before easing back to the target rate of 2 per cent in the final quarter of 2019.

We have brought forward the timing of the rate hike from the second quarter of 2019 to the first quarter of next year.

In our forecast, the fiscal deficit is eliminated in 2022 and the debt-to-GDP ratio peaks in 2018/19.

The main political news over the past three months has been the result of the general election held on 8 June. The incumbent Conservative Party lost seats in what was a surprise result and the party had to enter into a confidence and supply arrangement with the Northern Irish Democratic Unionist Party. This has raised political uncertainty just as formal negotiations for the withdrawal from the European Union have started. According to the major betting companies, there is an 80 per cent probability of another early general election.

The economy expanded by 0.3 per cent in the second quarter of 2017 according to official statistics. The outturn was in line with the Institute's nowcast and slightly faster than the 0.2 per cent growth in the previous quarter. Our forecasts for GDP growth for this year and next remain unrevised at 1.7 per cent and 1.9 per cent, respectively. The economy has slowed each year since 2014 and according to our forecast, 2017 will mark the trough for GDP growth. Thereafter, we envisage a modest recovery that takes economic growth to a level that is close to potential. Inflation, as measured by the consumer price index, is set to increase further, from 2.7 per cent in the second quarter of 2017 to 3 per cent in the final quarter, before easing back to the target rate of 2 per cent in the final quarter of 2019.

Our forecast for CPI inflation however, is lower compared with that in our *May Review* because the outturn for the second quarter was weaker than our forecast.

Notwithstanding the downward revision to the inflation forecast, we have brought forward the timing of the Bank Rate hike from the second quarter of 2019 to the first quarter of next year. This will be the first policy rate increase in nearly eleven years. This rate increase should not be seen as a tightening in policy, but instead as a modest withdrawal of some of the additional stimulus that was injected into the economy after the 2016 EU referendum.

Developments in the labour market remain puzzling. The employment rate has risen to a record high of 74.9 per cent in the three months to May 2017, the unemployment rate has dropped to 4.5 per cent, the lowest since 1975, yet wage growth remains muted. Average weekly earnings adjusted for inflation dropped by 0.7 per cent in the three months to May compared to the same period last year.

Our forecasts are conditioned on a return to meaningful productivity growth from 2018 onwards. Failure of such growth to materialise presents a downside risk to our forecast.

#### Summary of the forecast – UK economy

	Real gross national income <sup>(a)</sup>	Real GDP <sup>(a)</sup>	Unemployment <sup>(b)</sup>	CPI <sup>(c)</sup>	RPIX <sup>(d)</sup>	External current balance <sup>(e)</sup>	PSNB <sup>(f)</sup>
2016	2.5	1.8	4.8	1.2	2.5	-84.5	55.2
2017	1.8	1.7	4.9	3.0	3.7	-76.2	61.6
2018	2.1	1.9	4.7	2.4	3.1	-56.0	40.8

(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.