UK Outlook

Insights into the UK economy

June 2024

Improved Economic Outlook

We have revised up our forecasts for GDP growth to 0.8% in 2024 (from 0.4% in our February Outlook) and to 1.4% in 2025 (from 1.2% previously), slightly above consensus expectations and Bank of England forecasts. We expect growth to accelerate further to 1.6% in 2026. The unemployment rate is likely to continue edging higher over coming quarters, before a recovery in employment growth sees it stabilising at about 4.7%. More positively, inflation pressures are likely to continue to ease, though it will likely be late 2025 before both headline and core inflation are back to the 2% inflation target. Declining inflation and a softer labour market means the Bank of England is likely to commence cutting interest rates in a matter of months.

Election campaign underway

Perhaps the most notable news since our last UK Outlook in February has been the calling of a general election by Prime Minister Rishi Sunak, to be held on July 4th. This took most observers somewhat by surprise as it was assumed the PM would hold off until later this year. The macroeconomic backdrop may have played a small role in his decision - the economic outlook has brightened a bit lately.

Growth to strengthen

After a disappointing performance in 2023 growth has picked up in 2024 to date. We have revised up our forecasts and anticipate growth will increase towards the economy's potential growth rate (c. 1.5%) by early next year. A strengthening of consumer spending will be the key driver. Business capital spending is likely to pick up a bit next year. Exports are likely to remain a weak spot in the near term as firms continue to adjust to Brexit, but should improve later in the forecast horizon.

Labour market cooling and inflation easing

The labour market has softened a bit of late – likely a lagged response to weaker growth and higher interest rates. A loosening of conditions has been a goal of monetary policy and will contribute to bringing wage inflation back down to sustainable levels. We expect unemployment to rise to about 4.7% before levelling off. Inflation should continue to trend lower, though it will be a bumpy process and both headline and core inflation are unlikely to be back to 2% on a sustained basis before the end of next year.

Fiscal policy on a tightening path

Whoever wins the election – and the polls clearly favour Labour – OBR analysis indicates that they will not have a huge amount of room for manoeuvre on fiscal policy. Ongoing consolidation will be the order of the day. Of course, should Labour win there would likely be a change of emphasis and they would almost certainly opt for a different balance between spending cuts and tax rises.

Monetary policy easing imminent

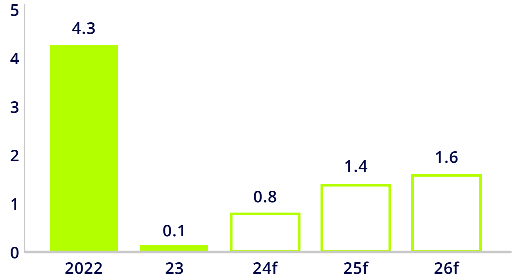
It now looks as if the Bank of England will be in a position to start easing policy in a matter of months, though still quite high wage growth and services inflation means they will proceed cautiously. We expect two 25bp cuts by year end, with Bank Rate eventually being cut to 3.50% by end 2025. This easing is likely to eventually feed through to lower mortgage rates, which should be supportive of ongoing – though fairly moderate – increases in house prices.

Downside risks dominate

The improved outlook is subject to some obvious downside risks – the geopolitical situation has not looked as fraught for a number of years (Ukraine/Russia, the Middle East, US/China relations). A deterioration in any or all of these flashpoints could lead to rising inflation and slower world growth and the UK would clearly not be immune to the economic fallout. Whoever forms the new government will certainly be hoping that this doesn't come to pass.

Forecasts	2024f	2025f	2026f
GDP Growth	0.8%	1.4%	1.6%
Employment Growth	-0.5%	0.4%	0.7%
Unemployment Rate	4.5%	4.7%	4.7%
Inflation Rate	2.6%	2.3%	2.0%

Output



GDP (annual % change)
Source: ONS & Bank of Ireland

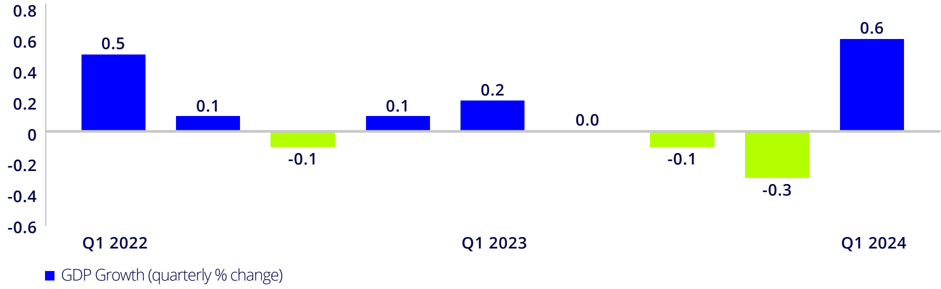
Economy

Growth to strengthen

Activity recovers in Q1 after weak 2023

After a weak patch through the second half of last year, when the UK was in a 'technical recession' (GDP was down in quarterly terms in both Q3 and Q4), the economy has rebounded a bit so far this year. Output expanded by 0.6% quarter-on-quarter in Q1, above consensus expectations, though perhaps boosted somewhat by a rebound following strikes in the health sector in Q4. The expansion was driven by healthy investment growth (in turn due to business capital spending) and a moderate expansion of consumer spending and government consumption, while exports were weak, as they have been for some time. On the output side growth was driven by manufacturing and services sectors (both consumer and business oriented), while construction lagged.

Output Growth



Source: ONS

High frequency indicators over recent months have been somewhat mixed. GDP was flat in April in month-on-month terms, though bad weather likely contributed to this (the retail and construction sectors underperformed). The PMIs have oscillated a bit but overall remain above 50 and point to ongoing, though fairly moderate growth – the same can be said for the Confederation of British Industry surveys of businesses. Retail sales data has been on the weak side (though May saw an improvement), while the labour market data has been, on balance, soft. Business confidence has been quite robust, and though consumer confidence remains subdued in absolute terms, it has improved significantly over the past six months. As such it looks like output will expand again in Q2, albeit likely at a more subdued pace than Q1.

However, standing back and looking at the big picture indicates that the UK economy has lagged international peers over recent years, though perhaps not to the extent that is sometimes portrayed. The difference is most notable versus the US – though the US is arguably the real outlier amongst major economies in terms of just how strong its economic expansion has been. Compared to other G7 economies excluding the US, UK GDP per capita and employment growth have been towards the low end, though it is not the worst performer. The obvious explanation for this slight underperformance is Brexit, which has imposed significant adjustment costs on the British economy.

Turning now to the outlook – a number of factors should support an improved economic performance over the coming couple of years, though growth rates will likely remain moderate relative to history.

Growth to strengthen, led by consumption

Firstly, consumer spending should strengthen. Household incomes have actually grown quite robustly over the past few years – this has been driven by a number of factors including strong wage and self-employed income growth, a significant increase in investment income and sizeable gains in welfare rates and pensions. Unfortunately, that strong growth has been offset by elevated inflation. However, with inflation having now declined significantly, disposable income gains, although somewhat lower than during the past couple of years, are set to exceed inflation. Furthermore, the household savings rate has risen over the past few years and there is now scope for this to decline back towards its long run average. Both these factors, along with fairly healthy household balance sheets, point to stronger consumer demand in the next few years. We are forecasting consumption growth of 0.4% this year (depressed somewhat by negative base effects – the Q4 over Q4 increase will likely be close to 1%), accelerating to 1.4% in 2025 and 1.6% in 2026.

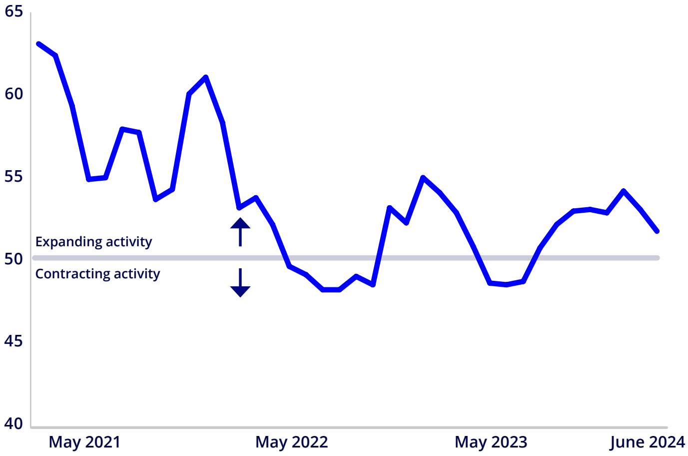
Secondly, investment, though likely flat in the near term, should pick up. It held up somewhat better over the past year than feared given strong headwinds including weak output growth, rapid rises in business costs and tight monetary policy. Business investment in particular has proved fairly resilient, offsetting weakness in housing investment (as builders have scaled back house construction in the face of rising mortgage rates). Government investment has also been healthy. Surveys of business capital spending plans point to broadly unchanged levels over coming quarters. Further out, in 2025 and 2026, capital spending is likely to resume moderate growth, with lower interest rates proving supportive. Overall we expect total investment to decline 0.3% in 2024, before expanding by 0.7% in 2025 and 1.7% in 2026.

Thirdly, although likely a drag in the near term, exports should eventually benefit from growth in the UK's trading partners. While obviously there are a number of significant risk factors (more below) the international environment looks set to be one of ongoing growth in output and trade over the next couple of years, with both the US and Chinese economies continuing to expand solidly. The Euro Area – still the UK's largest trading partner – is expected to see a rebound in growth, albeit a modest one, following a weak performance in 2023. While this environment should eventually translate into a pick-up in UK exports this may take some time and is complicated by the ongoing adjustment to the UK's new trading relationship with the EU. We are forecasting that exports will decline by 1.5% this year, before recovering to register growth of 0.8% in 2025 and 1.5% in 2026.

Consensus expectations for growth have been marked up somewhat over recent months – with expectations for 2024 GDP growth rising from 0.2% at the start of the year to 0.5% now. The Bank of England also recently pushed up their growth projections and now expect growth of 0.5% this year, 1.0% next year and 1.25% in 2026. NIESR are similar, at 0.8% this year and roughly 1% in 2025 and 2026. The OBR are more optimistic for 2025 and 2026 and see growth at close to 2% in those years.

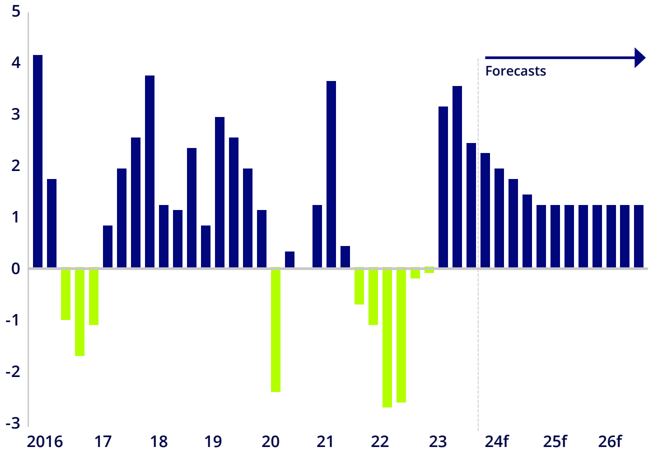
Our macro forecasts are summarised in the table below – overall we are projecting GDP growth of 0.8% this year (revised up from 0.4%), 1.4% next year (revised up from 1.2%) and 1.6% in 2026 - broadly in line with the economy's potential growth rate and slightly higher than the Bank of England or NIESR forecasts (also a bit above consensus expectations as well).

Composite PMI



Composite PMI (50 = no change)
Source: S&P Global

Household Incomes



Household Income Growth, Adjusted for Inflation (annual % change)
Source: ONS, Bank of Ireland

Geopolitical situation presents downside risks

However, there are clearly a range of significant risks to the outlook, centring on geopolitics. The war in Ukraine is ongoing, there has been an escalation of conflict in the Middle-East, and tensions between the US and China remain heightened. A deterioration in any of these conflicts could see rising energy and other commodity prices, supply chain disruptions, reduced trade, volatility in financial markets and ultimately a decline in global growth, with negative effects for the UK. Other risks – for example that overly tight monetary policy would tip the UK and key trading partners into recession – have thankfully retreated.

Annual % Change	2023	2024 F	2025 F	2026 F
Consumer Spending	0.3%	0.4%	1.4%	1.6%
Government Consumption	0.5%	2.5%	1.5%	1.5%
Investment	2.2%	-0.3%	0.7%	1.7%
- Business Investment	5.5%	0.3%	1.5%	2.0%
- Government Investment	7.7%	4.0%	2.0%	2.0%
- Housing Investment	-6.1%	-4.5%	-2.0%	1.0%
Exports	-0.5%	-1.5%	0.8%	1.5%
Imports	-1.5%	-0.7%	1.3%	1.6%
GDP	0.1%	0.8%	1.4%	1.6%

Labour Market

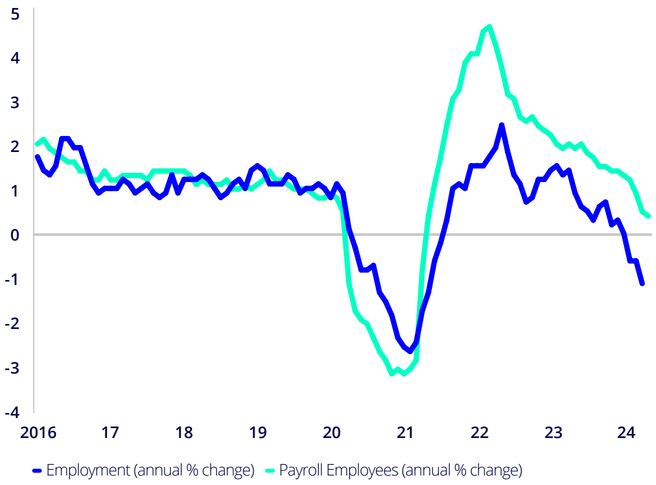
Continues to cool

Unemployment to rise further before stabilising

The labour market has proved quite resilient over the past number of years, with unemployment remaining low through 2022 and 2023 despite a number of significant negative shocks to the economy. However, the latest data points to a softening of conditions. The ONS's survey data (which is the principal official data on the labour market, though the ONS themselves note it is subject to greater uncertainty than pre-Covid due to lower response rates) indicates employment declined by 0.4% in the Feb-Apr period versus the prior three month period (Nov-Jan), and while alternative payrolls data based on income tax receipts shows employment still expanding on an year-over-year basis, it too has fallen slightly over recent months. Furthermore, the KPMG/REC survey also points to a softening of labour demand of late. As a result unemployment has risen recently, from 3.8% in late 2023 to 4.4% in the three months to April. The increase would have been larger were it not for the fact that labour force growth was also soft over this period.

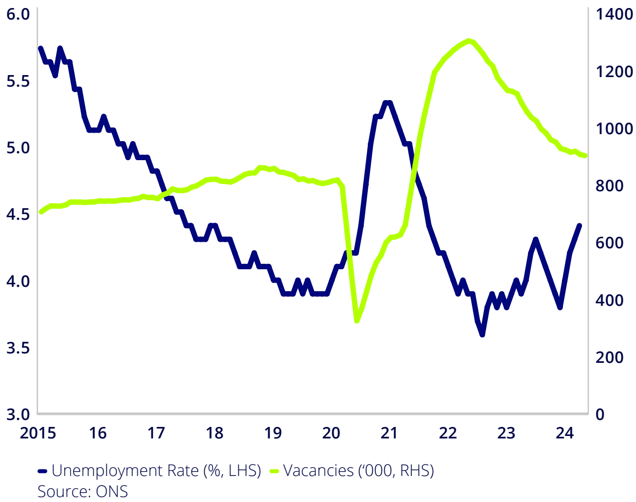
The number of vacancies has also declined, though they remain above average (service sectors such as retail, hospitality and healthcare have the most openings). We expect employment growth to recover gradually starting in the second half of this year as GDP growth strengthens. However, we anticipate that labour force growth will also rebound, partly due to robust inward migration flows, and as a result unemployment is likely to tick up a bit further, from an average of 4.5% this year to an average of 4.7% next year. We expect the unemployment rate to then stabilise as employment growth starts to match labour force growth (with both expanding by about 0.7% on an annual basis by 2026).

Employment



Source: ONS

Unemployment and Vacancies



Source: ONS

Despite the cooling evident in the labour market in the year so far wage growth remains quite robust, though it has eased a bit – from 7%-8% late last year to just under 6% now. While this remains higher than is consistent with the Bank of England's 2% inflation target (wage growth of about 3.0% to 3.5%) it is on a declining trend and, given the labour market loosening we have seen, this is likely to continue over the rest of the year. We expect wage growth to average about 4.5% this year, easing to about 3.3% next year and 3.0% in 2026.

A challenge facing the new government, whoever it may be, will be reversing the rise seen in the past few years in the numbers who are economically inactive (i.e. outside the labour force), particularly due to long term illness – doing so could boost labour supply and help modestly raise the economy's potential growth rate.

	2023	2024 F	2025 F	2026 F
Labour Force Growth	0.9%	0.0%	0.6%	0.7%
Employment Growth	0.7%	-0.5%	0.4%	0.7%
Unemployment Rate	4.0%	4.5%	4.7%	4.7%
Wage Growth	6.6%	4.5%	3.3%	3.0%

Inflation

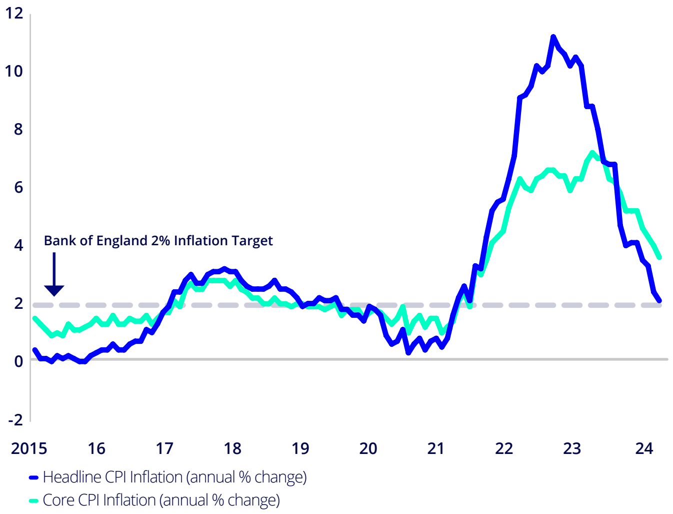
Inflation trending lower

Price pressures continue to gradually ease

Headline inflation has declined sharply over recent quarters, from a high of about 11% in late 2022, and 7% as recently as summer 2023, to 2.0% in May this year. This steep decline has been driven mainly by two factors. Firstly, a fall in household energy bills – in turn due to the fact wholesale gas prices have dropped sharply (down over 85% from their summer 2022 peak), easing costs for energy suppliers and allowing OFGEM to reduce the household energy price cap. Secondly, there has been a significant fall in goods price inflation as the global supply chain bottlenecks which emerged in the wake of the pandemic and the Russia/Ukraine war have eased. As a result inflation in a range of internationally traded goods (such as food, clothes, furniture, electronics, cars etc.) has dropped considerably.

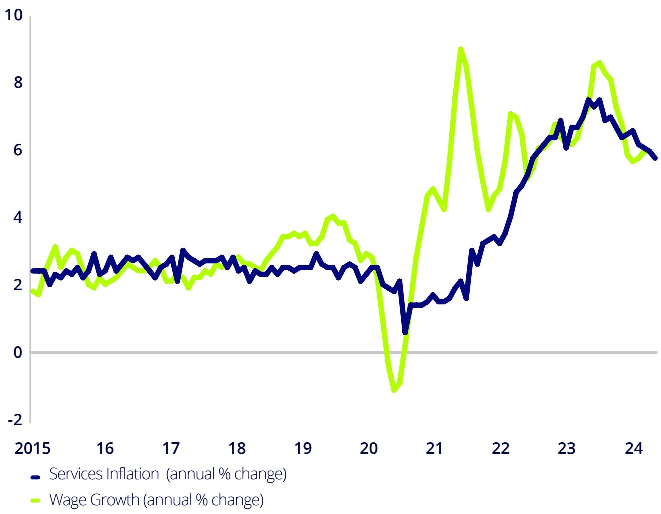
However, inflation in a range of services sectors, for which wages are the largest input cost (entertainment, hotels, restaurants etc.), has not eased as much and remains elevated. There has also been a sizeable increase in rental inflation, running at 7.0% in May. Overall, services inflation is running at 5.7% currently versus a high of about 7 ½% in mid-2023. This is reflected in the fact that core inflation, which strips out energy prices, was 3.5% in May, considerably higher than headline inflation and still quite a bit above the Bank of England's 2% inflation target. Getting core inflation back down to 2% in a sustainable manner will require services inflation to fall further.

Headline and Core Inflation



Source: ONS

Services Inflation and Wages



Source: ONS

Turning to our forecasts - we expect headline inflation to remain a little above 2% over coming quarters and into next year (it is likely to be volatile though, due to base effects arising because of the large swings in energy prices). Core inflation is likely to continue to gradually decline as wage growth eases but probably won't get back to close to target until late next year.

Nonetheless, with the direction of travel for both headline and core inflation relatively clear – and subject to no further shocks which push energy or internationally traded goods prices back up, or which stalls the declining trend in wage inflation – the Bank of England is likely to be satisfied with progress on the journey back to price stability and will be comfortable gradually easing monetary policy over the next 18 months. Our projections foresee that both headline and core inflation should both be back to around 2% by late 2025 or early 2026. However, the risks to this outlook lie to the upside – geopolitical tensions could push energy prices back up for example – and the BoE will be carefully watching the data month to month.

	2023	2024 F	2025 F	2026 F
Inflation Rate (CPI)	7.3%	2.6%	2.3%	2.0%
Core Inflation Rate (CPI ex-Energy)	7.3%	3.8%	2.8%	2.0%

Fiscal Policy

Fiscal tightening ahead

Deficit reduction likely to remain the priority

While fiscal policy was able to offer critical support to the economy through Covid and the start of the Russia-Ukraine war, the result is that both the fiscal deficit and the government debt-to-GDP ratio are now materially higher than pre-Covid. Under the UK's fiscal rules, which are monitored by the OBR, and are supported by both major parties, this necessitates a period of fiscal tightening ahead to bring the deficit down and put the debt-to-GDP ratio on a downward trajectory. So while the forthcoming election may usher in a new government, the fiscal parameters under which they will be operating are unlikely to change much. Of course, a new government could change the emphasis in terms of specific policy choices and the balance between tax rises and spending cuts.

This outlook is reflected in the OBR's most recent forecasts for government spending and taxation (shown in the table below), with growth in the former likely to be moderate. This will present significant challenges in terms of maintaining public services and meeting other priorities such as increased defence spending. Overall, fiscal policy is likely to be a drag, albeit a small one, on growth in the next few years.

OBR Projections	2024/25 F	2025/26 F	2026/27 F
Revenue Growth	3.4%	3.1%	4.1%
Expenditure Growth	0.8%	2.1%	3.0%
- Current Spending Growth	0.6%	2.8%	3.4%
- Capital Spending Growth	1.9%	-2.9%	0.1%
Fiscal Balance (% GDP)	3.1%	2.7%	2.3%
Government Debt-to-GDP (% GDP)	91.7%	92.8%	93.2%

Monetary Policy

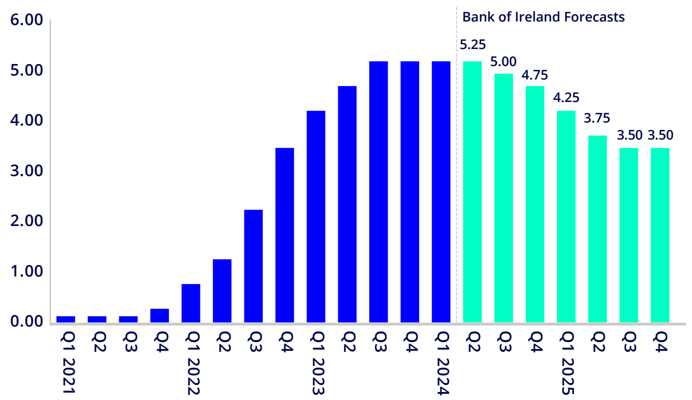
BoE set to ease

BoE to commence lowering interest rates soon

On the other hand, while fiscal policy can't offer much support to growth, monetary policy can partly pick up the slack. Policy has been tight over the past year following rapid Bank of England rate rises to combat elevated inflation. With inflation now lower and trending in the right direction the Bank of England is likely to start cutting interest rates in the coming months. While the pace of the easing cycle is likely to be fairly moderate, given that services sector inflation and wage growth are still frothy, this should moderately boost economic activity. We expect the BoE to start lowering rates in August, with a 25bp cut, followed up with another cut in Q4, taking Bank Rate to 4.75% at the end of this year. Further easing in 2025 may take Bank Rate to 3.50% by year end.

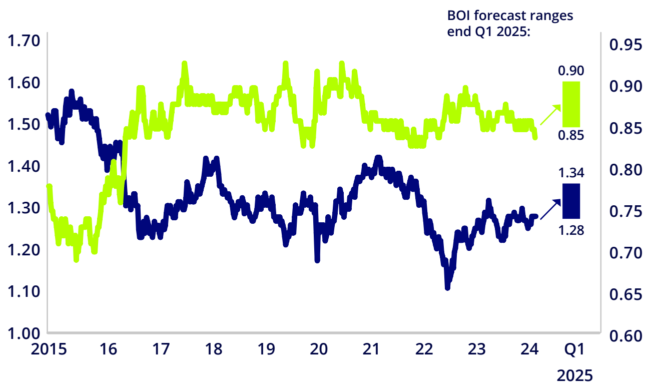
UK 10 year government bond yields are trading at around 4.1% currently, above the level at the start of this year. Sterling has been trading fairly steadily in a $1.24 to $1.28 range versus the dollar of late. It has appreciated a bit versus the euro, moving below the low end of an £0.85 to £0.87 trading range in recent weeks.

Bank of England Rate Outlook



■ BoE Bank Rate (end period, %)
Source: Bloomberg, Bank of Ireland

Exchange Rate Forecasts



- GBPUSD (LHS) - EURGBP (RHS)
Source: Bloomberg, Bank of Ireland

Housing Market

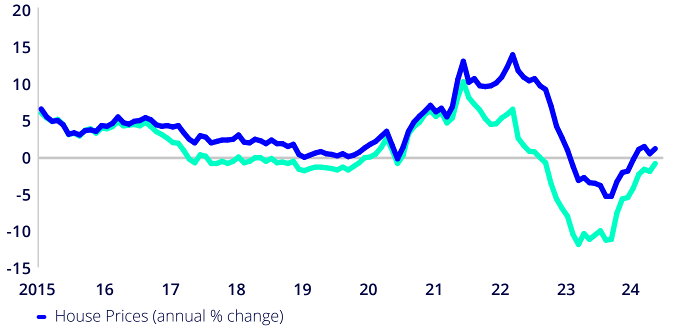
Mortgage rates to fall

Moderate house price growth in prospect

Following a period of weakness between summer 2022 and summer 2023, when house prices declined by about 5 ½% in total (Nationwide measure), likely mainly due to the cost of living squeeze and the rise in mortgage rates, the housing market has stabilised since, with prices up marginally. However, when house prices are adjusted for inflation, the picture is a little different - the decline in 'real' house prices has been notably larger and it is still ongoing. This is also the case if house prices are compared to incomes, which have grown fairly rapidly. Also of note is a fairly sharp rise in rental inflation of late.

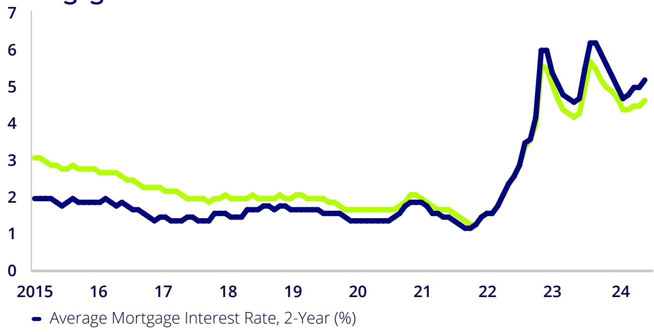
In terms of the outlook, with mortgage rates likely to decline gradually we expect house price growth to continue, with low to mid-single digit gains, modestly above inflation and broadly in line with income growth. This is supported by the RICS survey, which points to house price rises over the next 12 months. Looking at the big picture, new housing supply in the UK remains too low – increasing it will be a key challenge for the new government.

House Prices



Source: Nationwide, Bank of Ireland

Mortgage Rates



Source: Bloomberg, Bank of England

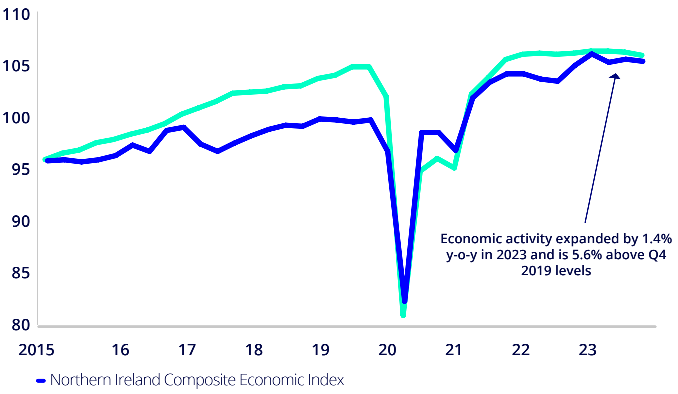
Northern Ireland

Economy expanding

Output is rising and unemployment is low

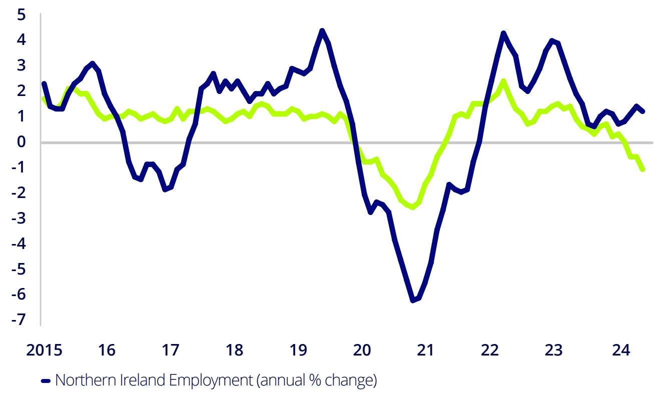
The Composite Economic Index increased by 1.4% in 2023, following growth of 2.5% in 2022, though it decelerated slightly into year end, with activity down marginally in Q4. However, the data in 2024 to date, such as the PMIs, indicates that was likely just a temporary blip and economic activity has continued to pick up. The labour market has continued to perform solidly as well, with the latest data showing employment up slightly on a year-over-year basis and the unemployment rate down to 2.2%. Inactivity does remain elevated however, a long running structural issue. Although no doubt the short term political focus is now turned to the upcoming general election, the fact that an Executive is in place is a positive and means that some public spending which was stalled can now hopefully proceed – this should help support continued economic expansion over the balance of this year and into 2025 and 2026.

Economic Activity



Source: NISRA, ONS

Labour Market



Source: ONS
NI Data smoothed in chart

Contact Us

economics@boi.com
+353 1 250 8900

Conall MacCoille
Group Chief Economist
+353 87 788 4264

Michael Crowley
Senior Economist
ext. 44268

Mark Leech
Head of Media Relations
+353 87 905 3679

Conn Creedon
Senior Economist
ext. 35134

Alan Bridle
UK Economist & Market Analyst
+44 77 3636 2138