UK Outlook

Insights into the UK economy

September 2024

Bank of Ireland

Improved short term outlook, longer term challenges remain

We have revised up our GDP forecast for this year to 1.1%, from 0.7% previously, on foot of the robust rebound in activity in the first half of the year. Our forecasts for 2025 and 2026 are unchanged at 1.4% and 1.6%, broadly in line with the UK's potential growth rate. In relation to the labour market we are forecasting broadly unchanged employment this year, with jobs growth picking up to 0.6% in 2025 and 0.8% in 2026. We have pulled down our unemployment projections slightly, to 4.2% this year and 4.4% in 2025 and 2026. Inflation and wage growth are continuing to ease. We expect core inflation to drop to the BoE's 2% target by the end of 2025. Monetary easing is set to continue, supporting demand amidst an ongoing fiscal adjustment - we expect the BoE to cut the policy rate to 3.50% by the end of next year.

Solid growth outlook

While PM Starmer's new Labour government no doubt faces many challenges ahead, they have at least been greeted by a somewhat improved near term economic outlook. Following a technical recession in the second half of last year growth has picked up this year so far. We have revised up our GDP growth outlook for the year to 1.1% (from 0.7%) and continue to expect solid trend like growth of 1.4% in 2025 and 1.6% in 2026.

Consumer spending the driver

We expect a strengthening of consumer spending to be the key driver of this improved performance. Lower inflation should boost household spending power, while there is scope for the savings rate to decline. Investment growth should also strengthen somewhat as business and housing investment benefit from lower interest rates. Export growth remains a weak spot – particularly goods, weighed down by Brexit – though with trading partners continuing to grow a gradual pick up seems likely.

Employment growth to pick up

Recent labour market data has been volatile, with conflicting signals from different indicators, making it hard to interpret. In our view, looking through the statistical fog the data seems to point to ongoing quite moderate jobs growth, which is being outpaced by labour force growth, leading to a gradual tick up in unemployment. We expect jobs growth to strengthen into next year, eventually leading to unemployment stabilising just under 4 ½%.

Declining inflation

Price pressures continue to ease. While both core and services sector inflation rose in August, this was expected - both by market participants and the Bank of England - and was partly due to temporary factors influencing some of the more volatile components of the CPI index. Wage growth on the other hand has continued to decline fairly steadily. Furthermore, forward looking indicators of inflation continue to point downwards. Therefore, while there is still some work to do to get back to the 2% inflation target, and there are obviously some risks, things continue to move in the right direction.

Fiscal tightening ahead

The new government has made it clear it intends to adhere to the fiscal rules, which are overseen by the OBR, and continue to cut the deficit. However, a change in the mix of spending cuts and tax rises seems likely – with less of the former and more of the latter. This process of fiscal adjustment will weigh somewhat on growth in the coming years. The government also faces challenges to address a range of structural challenges, including increasing labour force participation, boosting business investment and innovation, investing in infrastructure and reforming public services - this will be challenging given the fiscal constraints.

Monetary policy to soften the blow

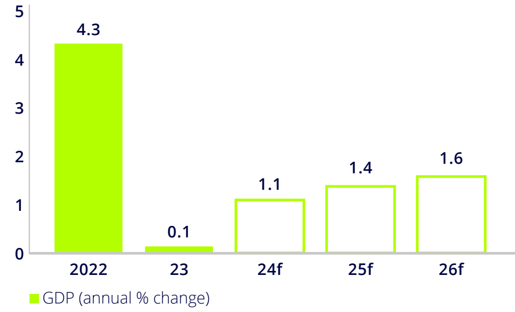
While fiscal policy is likely to be a drag on activity, there is scope for monetary policy to provide an offset and support demand. With inflation easing we expect the BoE to cut the policy rate to 3.50% by end 2025. Lower interest rates should support a pick-up in consumer spending and business investment. Should fiscal consolidation have a more detrimental effect on growth than anticipated the BoE has scope to ease policy further.

Significant downside risks remain

The improved outlook remains subject to some clear downside risks. Geopolitical tensions (Ukraine/Russia, the Middle East, US/China relations) remain elevated and a deterioration in any of these flashpoints could negatively impact the UK economy through a range of channels (lower world growth, supply chain disruptions, higher energy prices). In addition, the forthcoming US Presidential election has increased uncertainty, while slower growth in key trading partners is also a downside risk that warrants monitoring.

Forecasts	2024f	2025f	2026f
GDP Growth	1.1%	1.4%	1.6%
Employment Growth	0.0%	0.6%	0.8%
Unemployment Rate	4.2%	4.4%	4.4%
Inflation Rate	2.6%	2.4%	2.0%

Output



Source: ONS & Bank of Ireland

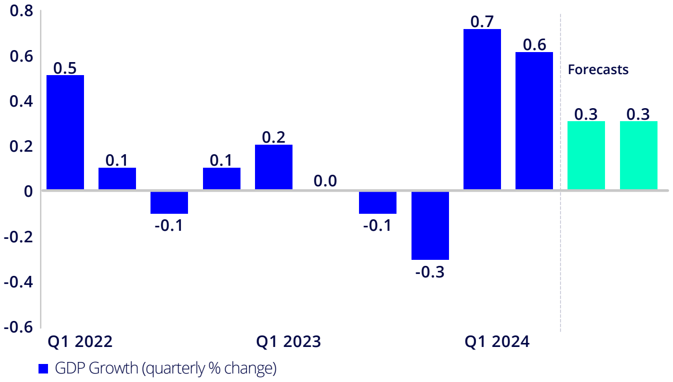
Economy

Growth Rebounds

Economic activity rebounds in H1

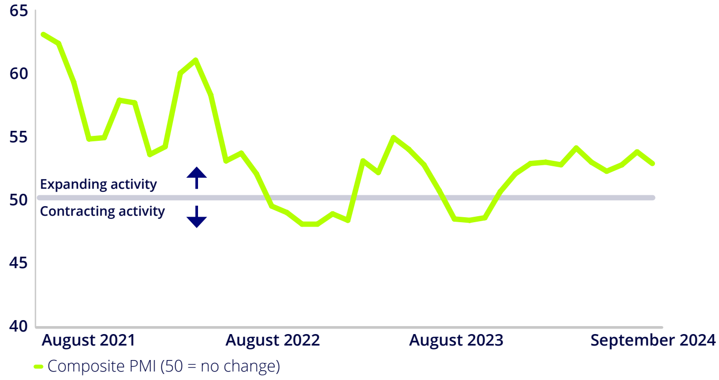
The government has been greeted by an improved short term economic outlook, though significant challenges remain in relation to the public finances and longer term structural issues. Following a strong rebound in Q1, with GDP up 0.7% quarter-on-quarter, output also expanded at a healthy clip in Q2, up 0.6% on a quarterly basis. The improvement in growth has been driven by a number of factors, including a strengthening of household and government consumption along with public sector capital spending. On the output side of the national accounts it is clear growth has been driven by services sectors, with business services, consumer services and public services all up solidly. On the other hand the performance of industry and construction has lagged.

Quarterly GDP



Source: ONS

Composite PMI



Source: S&P Global

The signs for Q3 growth are also fairly positive, most high frequency indicators have continued to trend up, albeit pointing to more moderate growth than seen in H1. The PMIs remain above 50, with the Composite PMI for September coming in at 52.9. Business confidence is strong, and consumer sentiment has improved, though it softened a bit in September. Retail sales volumes have continued to fluctuate somewhat, though the latest readings for July and August showed an improvement. However, monthly GDP was flat in July, below expectations. Overall, we expect GDP to expand by about 0.3% in Q3 and at this juncture a similar outturn for Q4 seems possible (however, quarterly growth is volatile and so projections are quite uncertain).

Solid growth looks set to continue

Our outlook for the next few years is broadly unchanged. We believe the UK economy has now fully digested the twin shocks of the past few years – higher energy prices and tighter monetary policy - and is now likely to expand at a roughly trend like rate (0.3%-0.4% per quarter) going forward.

We expect consumer spending to be the key driver of growth. Household income growth remains solid, and with inflation declining this should translate into healthy growth in real incomes. Furthermore, there is scope for the household savings rate to fall back, boosting consumption. Both of these factors, along with healthy household balance sheets, and interest rate cuts from the Bank of England, which should ease debt servicing costs, point to stronger consumption growth ahead. While fiscal tightening may weigh a little on disposable income growth and consumer confidence, we don't think the effect will be strong enough to derail the consumer recovery. We expect consumption growth of 0.5% this year (depressed by negative base effects, the Q4 over Q4 increase will be close to 1%), with growth accelerating to 1.4% in 2025 and 1.6% in 2026.

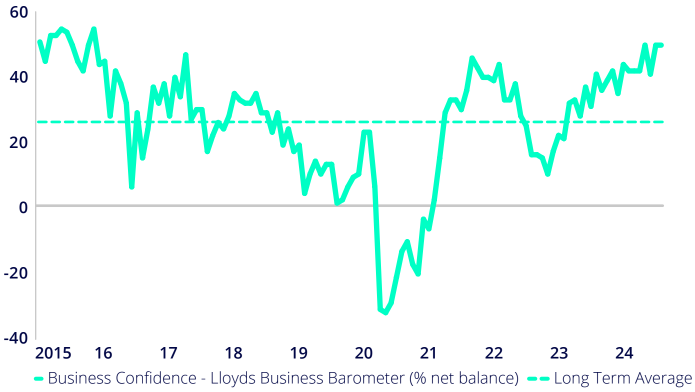
The outlook for investment is fairly solid, while exports may lag a bit in the near term. Business investment has proven relatively resilient over recent years, but has been dampened somewhat by higher interest rates. Housing investment has also no doubt been negatively impacted, with starts and completions on the weak side - however investment in existing dwellings (repair, maintenance, upgrade) has been quite robust. Government investment has risen steadily over recent years. Going forward we expect business and housing investment to pick up as interest rates decline. Government investment however may level off a bit, partly due to fiscal tightening - the new chancellor has already announced the cancellation of some projects. Overall we expect total investment to rise by 1.2% this year, before expanding by 1.5% in 2025 and 2.0% in 2026. The short term outlook for exports remains muted. Exports were down about 1 ½% year-on-year in the first half of the year – services exports were actually up, but goods exports, which have been more acutely impacted by Brexit, were down sharply. We expect growth to improve next year, led by services, with a less negative contribution from goods as firms adjust to Brexit. Overall we expect exports to expand by 1.2% in 2025 and 1.6% in 2026.

In terms of the output side of the economy, growth is likely to be driven by services sectors over the next 18 months, particularly business services (professional & admin, finance, ICT) and consumer services (hospitality, retail, transport), while manufacturing and construction lag somewhat (the former weighed down by weak goods exports), though we expect growth in these sectors to recover over time.

Monetary and fiscal policy are discussed in more detail later. As regards the overall macro outlook it is clear that fiscal policy is likely to act as drag on growth – Chancellor Reeves has made it clear that the adjustment in the public finances will continue. However, unlike during the period after the GFC, the BoE policy rate is now at 5.00% and there is therefore ample scope for interest rate cuts to support growth. As such, the negative impact on demand from tighter fiscal policy should be reduced.

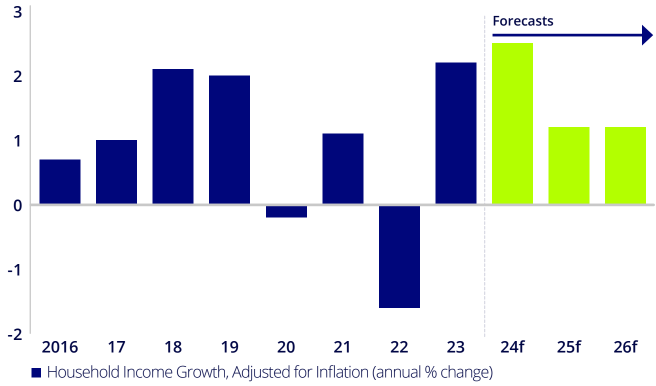
For this year we are projecting GDP growth of 1.1%, revised up from 0.7% previously, reflecting the stronger outturn in the first half of the year. We expect growth to pick up to 1.4% next year and 1.6% in 2026. These projections are broadly in line with the official sector forecasters for this year and are a touch higher for 2025 and 2026. The Bank of England is forecasting growth of 1.25% this year, 1.0% next year and 1.25% in 2026. NIESR are at 1.1% this year and 1.3% in 2025 and 2026.

Business Confidence



Source: Lloyds

Household Incomes



Source: ONS, Bank of Ireland

Significant downside risks remain

However, there are clearly a range of significant downside risks to the outlook. Geopolitical tensions remain elevated, with the conflicts in Ukraine and the Middle-East ongoing. Tensions between the US and China persist. A deterioration in any of these could see rising energy and other commodity prices, supply chain disruptions, reduced trade, volatility in financial markets and ultimately a decline in global growth. Uncertainty regarding the outcome of the upcoming US Presidential Election is also now a factor – a change of administration could usher in significant and potentially disruptive policy changes. In addition, some recent macroeconomic data from the US and Europe has been a touch softer, while the outlook for the Chinese economy remains uncertain. Should growth in these major economies slow more sharply than currently anticipated, and/or financial conditions deteriorate – perhaps due to a correction in equity markets - then the UK economy would clearly not be immune to the fallout.

Finally, while an improved short to medium outlook is welcome, the economy continues to face a range of longer term challenges. These include an aging population, a rise in inactivity in the labour force, a lack of business dynamism (particularly compared to the US), insufficient investment in infrastructure and housing and stretched public services. Addressing these challenges, particularly in the context of tightening public finances, will not be easy, though it could contribute to raising productivity and boosting growth in the longer term.

Annual % Change	2023	2024 F	2025 F	2026 F
Consumer Spending	0.3%	0.5%	1.4%	1.6%
Government Consumption	0.5%	2.3%	1.3%	1.3%
Investment	2.2%	1.2%	1.5%	2.0%
- Business Investment	5.5%	0.5%	1.8%	2.2%
- Government Investment	7.7%	5.0%	1.0%	1.0%
- Housing Investment	-7.4%	0.0%	1.3%	2.2%
Exports	-0.5%	-1.5%	1.2%	1.6%
Imports	-1.5%	-0.2%	1.2%	1.5%
GDP	0.1%	1.1%	1.4%	1.6%

Labour Market

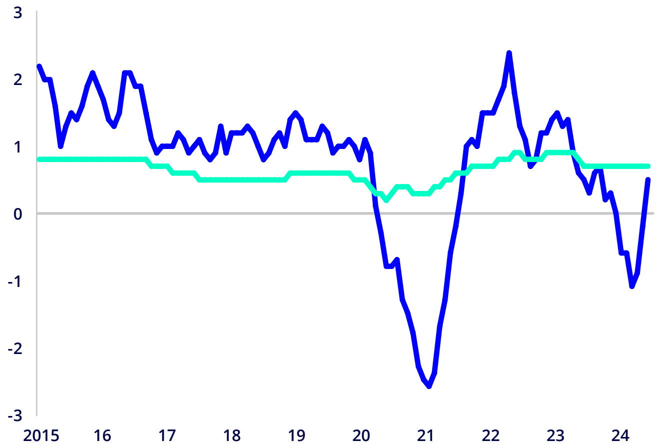
Unemployment Remains Low

Employment growth to pick up gradually

Getting a clear picture of developments in the UK labour market has not been straightforward of late. The ONS have noted that their key Labour Force Survey (LFS) data is now subject to greater uncertainty than normal due to lower post-Covid survey response rates. This has led to heightened volatility in the LFS data and at times conflicting signals relative to other labour market indicators. The Q1 data showed a fairly sharp drop in employment, and a rise in unemployment, which was reversed in Q2 as employment rebounded and unemployment fell back. Averaging across these two quarters, and cross checking with other indicators, in our view points to stable or moderately rising employment levels through the first half of the year, along with a modest uptick in unemployment. The data we have for Q3 points to a continuation of these trends.

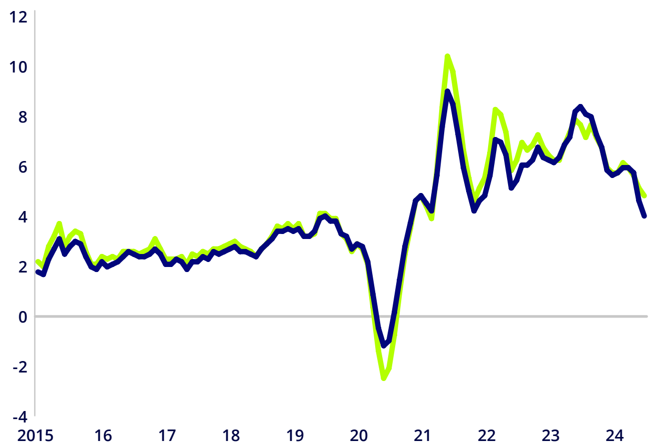
While we have not changed our outlook for the labour market materially and continue to expect employment growth to strengthen gradually over coming quarters as the pick-up in GDP growth flows through to the labour market with its usual lag, the latest data have led us to recalibrate our forecasts somewhat. Both employment growth and labour force growth now look likely to be a bit stronger than previously projected this year, as the weakness evident in the Q1 data has not persisted. We expect employment growth to be close to flat or marginally positive this year, and for unemployment to average about 4.2% for the year as a whole (revised down from 4.5%). Next year we expect employment to expand by about 0.6%, though with labour force growth also accelerating, unemployment may tick up to about 4.4% (revised down from 4.7%).

Employment



Employment (annual % change) Population 16+ (annual % change)
Source: ONS

Wage Growth



Total Wages (annual % change) Private Sector Wages (annual % change)
Source: ONS

Wage growth, which has been well above levels consistent with the Bank of England's 2% inflation target for several years, is continuing to gradually trend down. Average weekly earnings rose by 4.0% year-on-year in July, down from 5.6% at the start of year. Furthermore, more forward looking indicators, such as wage expectations from Bank of England surveys, continue to point to further deceleration ahead. We continue to expect wage growth to average about 4.5% this year, before declining to about 3.3% next year.

A challenge facing the new Chancellor and her colleagues at cabinet will be reversing the rise in the numbers who are economically inactive (i.e. outside the labour force), particularly due to long term illness. Doing so will be challenging and will take some time, but it could boost labour supply somewhat and help modestly raise the medium term potential growth rate of the UK economy.

	2023	2024 F	2025 F	2026 F
Labour Force Growth	0.9%	0.2%	0.8%	0.8%
Employment Growth	0.7%	0.0%	0.6%	0.8%
Unemployment Rate	4.0%	4.2%	4.4%	4.4%
Wage Growth	6.6%	4.5%	3.3%	3.0%

Inflation

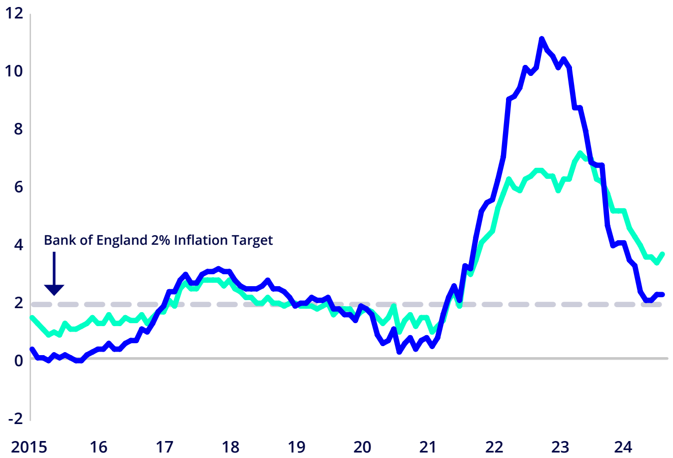
Price Pressures Continue to Ease

Core inflation and wage growth to trend lower

Headline inflation registered 2.2% in August, the same as July and up from 2.0% in June. However, the rise over the past couple of months was largely anticipated and likely reflects temporary factors rather than a change in the underlying trend. Perhaps of more note was the rise in core inflation, to 3.6% in August from 3.3% in July, while services sector inflation picked up to 5.6% from 5.2%. However, these increases were largely as expected and services inflation was actually a touch below Bank of England projections from the August Monetary Policy Report (5.8%). Furthermore the pick-up was partly due to the very volatile airfares component, which may well unwind fairly quickly. Overall, the latest inflation data will in our view not change the Bank of England's broad view that price pressures are abating as hoped.

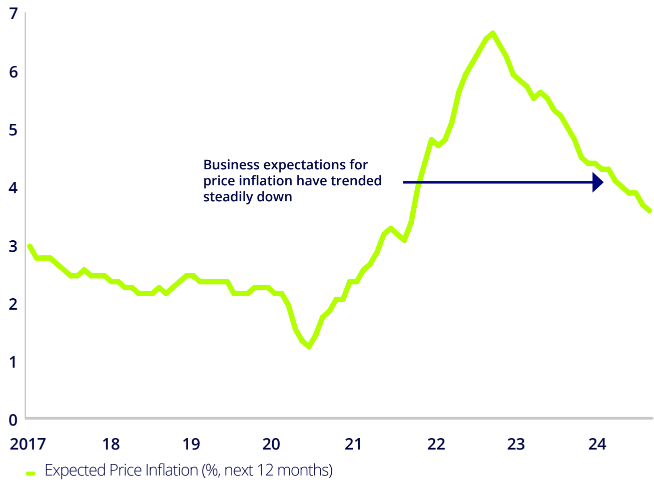
However, a few risks do remain with regard to the inflation outlook. Most importantly, wage growth remains elevated and, while it is easing, it is doing so rather gradually - any stalling or reversal in this process would likely concern the members of the Bank of England Monetary Policy Committee. Furthermore, while the general trend in inflation clearly seems to be downwards, a few factors are likely to push upwards on headline inflation over the coming few quarters, including still quite elevated rental inflation and an increase in the energy price cap of 10% due in October (a rise in fuel duty in October's budget, which would push up petrol/diesel prices, is also a possibility).

Headline and Core Inflation



Source: ONS

Price Expectations



Source: Bank of England

Nonetheless, while some of these factors may push up on inflation over coming months, we doubt they will derail the general disinflationary trend and we still expect core inflation to decline fairly steadily.

Forward looking indicators continue to point to lower price pressures ahead. Bank of England surveys show that firms expect both wage growth and prices charged to continue to decline over the next 12 months (expectations for the former are now at 4%, while for the latter they are at 3 ½%). While natural gas prices have trended up over recent months, they have eased a bit in the past couple of weeks, while the price of Brent crude oil has declined and now stands at $74. Producer input and output price inflation remains low (input prices were down 1.2% year-on-year in August, with output prices up 0.2%). Global food price inflation has also slowed significantly, with the UN global food price index down 1% on an annual basis in August.

Overall, We expect headline inflation to average 2.6% this year, easing to 2.4% in 2025 and declining further, to 2.0%, in 2026. For core inflation we are projecting a rate of 3.8% this year on average. We expect core inflation to decline steadily through the course of 2025, reaching 2% by December. On an annual average basis core inflation should come in at 2.5% next year and 2.0% in 2026.

	2023	2024 F	2025 F	2026 F
Inflation Rate (CPI)	7.3%	2.6%	2.4%	2.0%
Core Inflation Rate (CPI ex-Energy)	7.3%	3.8%	2.5%	2.0%

Fiscal Policy

Significant Challenges Ahead

Deficit reduction to remain the priority

Both the PM and the new Chancellor have been quick to outline their assessment that the UK's public finances are "worse than they thought". While some of the comments are likely political in nature, both to prepare the public for difficult choices ahead (such as the recently announced cuts to the winter fuel payment), and to put as much of the blame as possible on the previous government, there is no doubt that the public finances are in difficult position.

The twin shocks of Covid and the Ukraine War have left the UK with a large fiscal deficit and higher government debt. Given that starting position, and the challenges ahead such as an aging population, a period of fiscal consolidation is almost inevitable - as was already evident from the OBR's March projections (shown below). While the overall quantum of tightening is not likely to differ all that much from what was planned by the previous government, Chancellor Reeves is likely to put more emphasis on tax increases and less on spending cuts. We will know more about the specifics after the forthcoming budget, due Oct 30th. Tax raising measures may focus on capital taxes such as CGT and inheritance tax, while spending cuts will likely be recalibrated. Overall, fiscal policy is likely to be a drag on economic activity over the coming few years, with tight 'barely above inflation' spending envelopes for most government departments bar health and defence. However it should be borne in mind that, in contrast to the period after the GFC, monetary policy has significant scope to partly offset this drag via interest rate cuts.

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%
Departmental Spending Growth***	0.5%	0.0%	0.0%

*Public Sector Net Borrowing
**Public Sector Net Debt Ex-Bank of England
***Adjusted for inflation and population growth

Monetary Policy

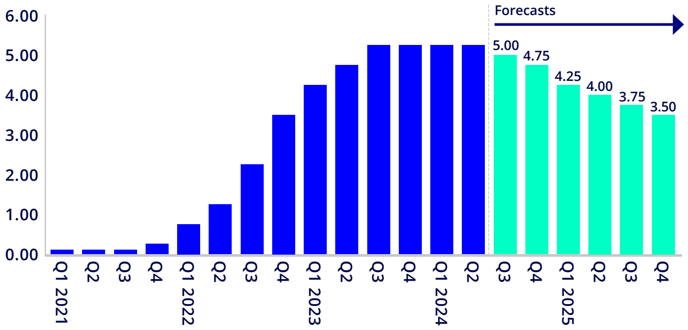
BoE set to ease

Further BoE rate cuts should support growth

The Bank of England cut rates by 25bp on August 1st, following a close 5-4 vote, taking Bank Rate down to 5.0%, but left rates unchanged at their meeting on September 19th. With inflation pressures likely to continue to ease, and wage growth trending down, albeit gradually, we feel the required conditions for further rate cuts will fall into place in the coming months and we expect another 25bp cut by year end. With – as noted above – fiscal policy tightening coming down the tracks and price pressures continuing to ease there are likely to be further cuts through the course of next year. We expect the BoE to cut by 125bp over the course of the year, taking the policy rate down to 3.5%. Should fiscal tightening exert a bigger drag on demand than anticipated, policy could be eased further.

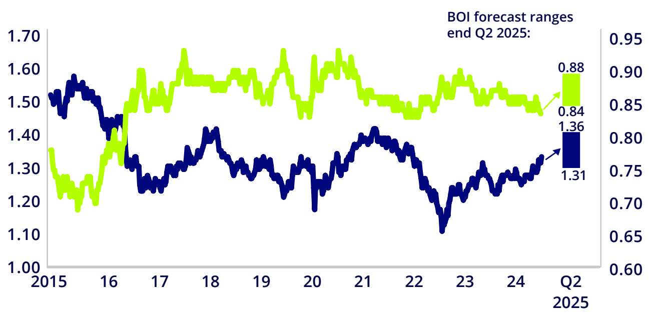
UK 10 year government bond yields have trended down over the past few months, from roughly 4.2% at the time of the last Outlook in June to 3.9% now. Sterling has made some gains of late against the dollar, up to about $1.33. Sterling has fluctuated in a broad £0.84-0.87 range versus the euro, though it has been testing the low end of that 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

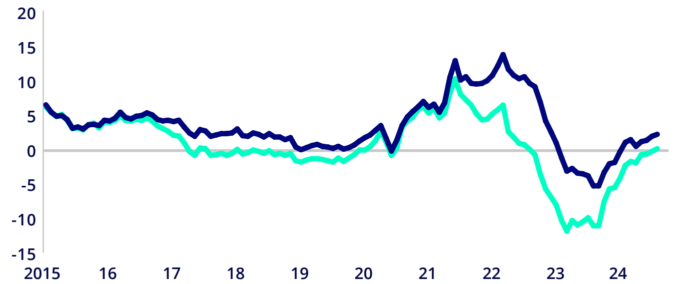
Improving Conditions

Mortgage rates to decline further

House prices rose 2.4% year-on-year in August on the Nationwide measure, though growth was a bit stronger according to the Halifax index. House price growth is therefore now broadly matching inflation, though it remains below wage growth, meaning affordability is continuing to improve, albeit only marginally at this stage. The RICS survey of property professionals paints a picture of gradually improving market conditions. New buyer enquiries and vendor instructions are now close to long run average levels, while sales expectations have increased steadily. House price growth expectations have strengthened.

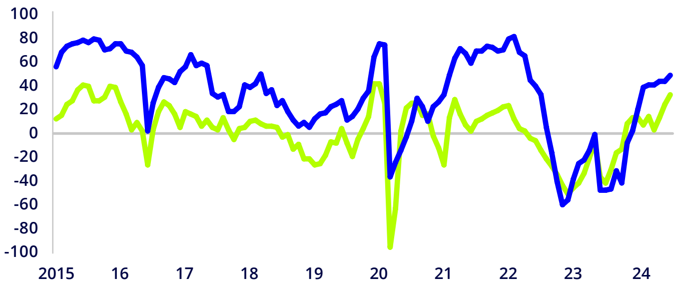
Our outlook is broadly unchanged. Mortgage rates are likely to decline somewhat over the balance of this year and into next as the BoE lowers rates. With the economy expanding and incomes rising, house price growth in a 3% to 5% range seems most likely, modestly above inflation and broadly in line with wage gains. Mortgage lending should strengthen a bit also – with monthly mortgage approvals rising towards 70k per month. The rental market is likely to remain tight. A longer term structural challenge that the new government must grapple with is increasing the supply of new housing, which remains far too low and is a constraint on growth.

House Prices



House Prices (annual % change) House Prices Adjusted for Inflation (annual % change)
Source: Nationwide, Bank of Ireland

House Price Expectations



House Price Expectations next 12 months (% net balance)
Sales Expectations next 3 months (% net balance)
Source: RICS

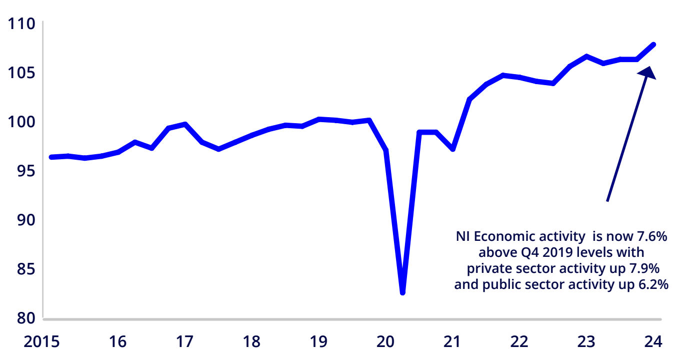
Northern Ireland

Continued Growth

Economy expanding, unemployment remains low

The latest Composite Economic Index data shows activity up 1.4% quarter-on-quarter and 1.1% year-on-year in Q1. The PMI data suggests growth continued into Q2 and Q3, with the Composite PMI well above the 50 level over this period. The sectoral PMIs showed significant growth for services and manufacturing, with retail close to flat and construction lagging – perhaps reflecting weakness in house building. The latest labour market data was also quite solid. In the three months to July employment expanded by 2.6% year-on-year, with unemployment remaining low at just 2.0%, and wages were up robustly. The Northern Ireland Executive has now published a draft Programme for Government for its remaining mandate but delivery of key reforms will remain, in large part, subject to securing additional resources within wider UK fiscal considerations. Nonetheless, this hopefully means some public sector current and capital spending which was stalled can proceed, providing a boost both to activity and confidence. This, combined with the effects of lower BoE interest rates, and solid growth in trading partners, should support continued output and employment growth ahead.

Economic Activity



Northern Ireland Composite Economic Index
Source: NISRA

Labour Market

Northern Ireland Unemployment Rate (%) UK Unemployment Rate (%)
Source: ONS

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