



UK Economic Outlook

Special features on:

- UK economic prospects after Brexit
- UK housing market outlook
- The Northern Powerhouse: past performance and future potential



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Highlights and key messages for business and public policy

- UK economic growth had already slowed from around 3% in 2014 to around 2% before the EU referendum due to slower global growth, but the vote to leave the EU is likely to lead to a significant further slowdown.
- In our main scenario, we now project UK growth to slow to around 1.6% in 2016 and 0.6% in 2017, largely due to the increased political and economic uncertainty following the 'Brexit' vote. The UK would, however, narrowly avoid a recession in this main scenario.
- There are particularly large uncertainties around any such projections after the Brexit vote. We have therefore also considered alternative scenarios in which UK growth in 2017 could vary from around -1% if downside risks materialise to around 1.5% if there is an early recovery.
- We expect the Bank of England to loosen monetary policy over the summer to support the economy through this period of uncertainty, while public borrowing is allowed to rise to take the strain of slow

lowdown will be a decline in business investment, particularly from overseas in areas like commercial property. This is being driven by political instability in the short term, as well as uncertainty about the UK's future trading relationships with the EU in the longer term.

- Consumer spending growth is projected to hold up better, but will still slow from previous strong rates, dropping to around 1.3% in 2017 in our main scenario. This reflects the impact of a weaker pound in pushing up import prices and squeezing the real spending power of households, as well as lower consumer confidence levels and slower jobs growth.

Key projections

	2016	2017
Real GDP growth	1.6%	0.6%
Consumer spending growth	2.5%	1.3%
Inflation (CPI)	0.7%	1.8%
House price growth	3.1%	0.9%

Source: PwC main scenario projections

- The weaker pound should also boost net exports, however, which should move from being a drag on GDP growth in 2015 to a positive contributor in 2017. This should also see the UK current account deficit begin to shrink from recent high levels.
- Service sector growth will slow but should remain positive in 2016-17, but construction will suffer from lower investment levels. Capital goods manufacturers will suffer for the same reason, but some manufacturing exporters will benefit from the weaker pound.
- London may be particularly hard hit due to the weakening of international investor demand, with the impact of Brexit being to reduce average London house prices in 2018 by around £60,000 relative to a scenario where the UK voted to remain in the EU.
- Despite this moderation of house price growth, first time buyers still face a tough challenge to get on the property ladder, with a potential average savings period for a deposit of around 19 years for young people without family assistance. This remains a major barrier for generation rent to get on the housing ladder, emphasising the need both to build more homes and to increase the quality of rented accommodation in the UK.

Housing market will be hit by Brexit, but first time buyers still face tough challenges

- House price growth is likely to slow due to uncertainty relating to Brexit. We do not expect a major house price crash, but average UK prices by 2018 could be around 8% lower than if the UK had voted to stay in the EU in our main scenario.
- However, we still expect average UK house prices to rise in our main scenario even with the effects of Brexit. W t prices could be around 8% higher on average in 2018 than they were in 2015, although there is a broader than usual range of uncertainty around this central estimate.

All regions hit by Brexit, with increased focus needed on boosting growth outside London

- We project that London will remain the fastest growing region, but its pace of expansion could slow markedly to just over 1% in 2017 following the Brexit vote. Other regions are likely to see growth slow to below 1% next year.
- If future jobs growth in the North could be raised to the levels seen in the South East, we estimate that almost 200,000 extra jobs could be created by 2025 in the North of England. But this will require a sustained period of higher investment in infrastructure, housing and skills in these regions.

1 – Summary

Recent developments

The UK economy grew by just over 3% in 2014, the fastest rate seen since 2006, but then slowed to around 2% in the year to Q1 2016 as global growth moderated. The available data for the second quarter suggest that UK growth held up reasonably well in the run up to the EU referendum, particularly as regards consumer spending, but business investment weakened.

The vote to leave the EU on 23rd June has added considerable political and economic uncertainty to the UK outlook, with the pound down sharply and the domestically-focused FTSE 250 index also declining (although the globally-focused FTSE 100 has been much stronger). Many commercial property funds have had to suspend trading in response to capital outflows. Gilt yields fell to record lows on expectations that monetary policy would be loosened in response to the Brexit vote.

UK growth continues to be driven primarily by services, with manufacturing growth having stalled over the past year and construction weakening markedly in June.

The rate of consumer price inflation (CPI) has remained low at around 0.3% as commodity prices have generally remained relatively weak, partly due to relatively subdued global demand growth. The latter has also been a factor in causing the Federal Reserve to hold off from interest rate rises in recent months.

Table 1.1: Summary of UK economic prospects

Indicator (% change on previous year)	OBR forecasts (March 2016)		Independent forecasts (July 2016)		PwC Main scenario (July 2016)	
	2016	2017	2016	2017	2016	2017
GDP	2.0	2.2	1.4	0.4	1.6	0.6
Consumer spending	2.4	2.2	n/a	n/a	2.5	1.3
Investment	2.9	4.5	n/a	n/a	-1.4	-4.6

Source: Office for Budget Responsibility (March 2016), Consensus Economics survey (average values in early July 2016 survey) and latest PwC main scenario

Future prospects

As shown in Table 1.1, our main scenario is for UK GDP growth to decline to around 1.6% in 2016 and around 0.6% in 2017 as the effects of the vote to leave the EU feed through¹. This is well down on pre-referendum forecasts, such as that by the OBR in March, but similar to the latest average of independent forecasts of around 1.4% in 2016 and 0.4% in 2017.

The largest short-term effect of the vote to leave the EU is likely to be on investment growth, which we now expect to be pushed into negative territory in 2016 and 2017. This reflects major projects being deferred or even cancelled due to uncertainties surrounding Brexit, particularly by foreign investors in commercial property and in sectors needing guaranteed access to the EU single market. These uncertainty effects should fade eventually, but it will take time before clarity emerges on future UK-EU trading arrangements.

Consumer spending growth is projected to remain stronger than overall GDP growth at around 2.5% in 2016 and 1.3% in 2017, but is nonetheless likely to slow significantly as real income growth is squeezed (in part due to the weaker pound pushing up import prices) and the job market weakens.

There should be some potential offset from a positive contribution to GDP growth from net trade next year, helped by the fall in sterling. This should also help to reduce the UK current account deficit somewhat next year. But this will fall some way short of fully offsetting the hit to domestic demand growth.

There are always uncertainties surrounding our growth projections and these are particularly marked following the vote to leave the EU, as illustrated by the alternative scenarios in Figure 1.1 (all of which see some short-term growth shortfall relative to our projections before the Brexit vote). There are still considerable downside risks relating to international developments and the fallout from Brexit, but there are also upside possibilities if these problems can be contained. In our main scenario, we expect the UK to narrowly avoid a recession, but businesses need to monitor and make contingency plans for this as a downside risk.

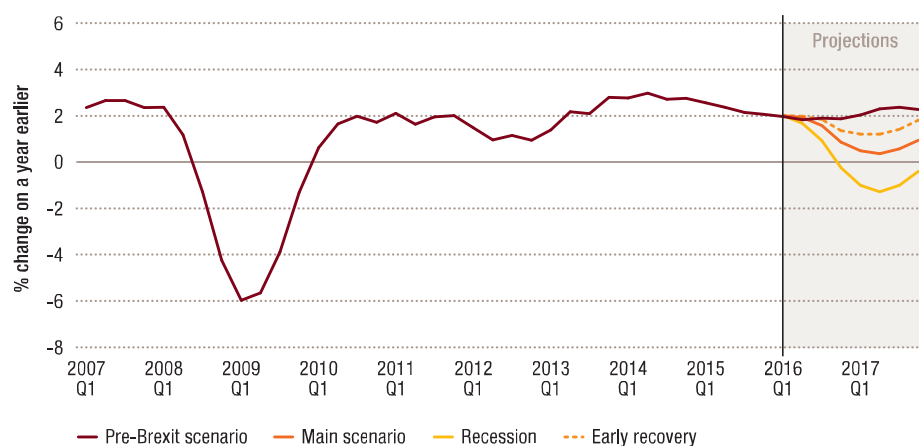
Inflation could rebound to close to its 2% target by the end of 2017 assuming the pound remains relatively weak and there is no repeat of past falls in global energy and food prices. There could be upside risks to this inflation outlook in the longer term if higher import prices feed through into domestic wages and prices more strongly than we expect, but also downside risks if domestic growth slows faster than we expect.

We expect an early loosening of monetary policy through some combination of lower official rates, assets purchase and credit easing. As indicated by record low gilt yields, it seems that a UK rate rise has been pushed well into the future by the Brexit vote.

Housing market will be hit by Brexit, but first time buyers still face tough challenges

In Section 3 of the report, we review recent trends in the housing market and present projections for house price growth in the UK and its regions. We also present new research that outlines the dramatic changes in the affordability of housing for 20-39 year olds (who we refer to as “generation rent”).

Figure 1.1 – Alternative UK GDP growth scenarios



Source: PwC based on latest ONS data

Our key findings are:

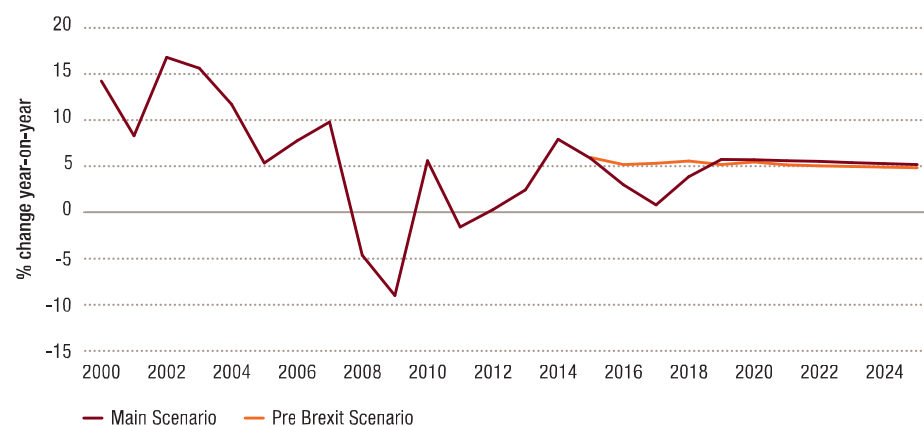
- The decision by the UK public to leave the EU has shaken the property market. W
lowdown as a result, with house price growth decelerating to 3% in 2016 and 1% in 2017 in our main scenario. But we are not projecting a major house price crash, and the downturn in house price growth due to the Brexit vote is expected to be only temporary with a gradual upturn resuming from 2018 onwards (see Figure 1.2).
- After this initial dip in UK house price growth, our main scenario projects a gradual recovery, with price growth picking up again to around 4% in 2018 and 6% in 2019. Thereafter, we expect growth to average around 5-6% per annum from 2020 to 2025 as persistent supply shortages keep house prices rising faster than earnings on average.
- The impact of Brexit will vary by region, but we expect it to be most acute in the London market. By 2018, we estimate house prices in London could be around £60,000 lower than if the UK had voted to remain; this contrasts to a difference of around £10,000 in Scotland and just £8,000 in the North East. Of course, there are many uncertainties around these central estimates so these projections can only be taken to be illustrative at this early stage.
- But we would stress that these are estimated differences from an expected steady upward path for regional house prices without Brexit. In our main scenario, the absolute level of house prices should still be higher in all regions in 2018 than in 2015 despite the dampening effect of the Brexit vote.

- Our new research into housing affordability

(assuming the deposit has to be raised entirely from their own savings without family assistance). In 2000, the same group would have been able to buy after saving for just 6 years; in 1990, it took only around 2 years.

- The affordability analysis shows a huge disparity in outcomes between renters and those 20-39 year olds who have already managed to get a foot on the housing ladder. This group has been largely insulated from the deterioration in affordability due to capital gains made on their existing homes.
- The good news for generation renters is that Brexit may actually help them get on the property ladder slightly sooner as we expect it to slow the pace of house price growth. However, the effect is small, as we estimate a generation renter starting to save in 2016 without family assistance might now be able to buy in 2035, rather than 2037 if the UK had voted to remain. This also assumes that they do not lose their job as a result of a Brexit-related slowdown (though it does allow for some reduction in their real income growth).

Figure 1.2 – UK house price inflation: main scenario projections with and without Brexit



Source: ONS historic data, PwC analysis

The Northern Powerhouse – even more of a priority after Brexit

As we discuss in detail in Section 4 of this report, average income levels in the Northern regions of England have lagged behind the UK average for decades, in part reflecting relatively low average levels of skills and R&D spending in these areas. But employment growth has been stronger in the North West in the past two years and inward investment levels have been relatively high in Northern regions in some recent periods.

Uncertainties relating to Brexit could dampen growth in all UK regions over the next few years, but the EU vote has also focused renewed attention on the need for increased investment in the Northern Powerhouse to boost infrastructure, skills and innovation. Such investment would be of particular value in promoting the world class business clusters which already exist in sectors such as advanced manufacturing and services or in the promotion of new clusters.

There also need to be measures to reduce inequalities within the North, with some rural areas and smaller towns doing less well than major cities like Manchester. Connectivity is of vital importance; within the Northern Powerhouse, between the North and London and between the North and the rest of the world.

Given this additional investment, we think the North of England could resume positive employment growth after the initial Brexit shock fades. Our analysis suggests the potential for almost 200,000 extra jobs in the Northern Powerhouse regions by 2025 relative to 2015 levels.

Appendix A

Outlook for the global economy

Table A.1 presents our latest main scenario projections for a selection of economies across the world.

Growth in leading developed economies remained modest in 2015 and this seems set to continue in 2016-17, with the US as the fastest growing G7 economy despite relatively modest growth of only around 2% per annum in those two years. The UK, which has vied with the US for top place in the G7 league table in recent years, is set to fall back due to the impact of Brexit as discussed in detail in the main text of this report. The overall Eurozone growth rate has also been revised down slightly by around 0.1-0.2% per annum following the Brexit vote, with Ireland seeing the largest revisions due to its close trading links with the UK. Overall, however, the Eurozone economy is not expected to be too badly affected, continuing to grow at a modest but steady rate of around 1.5% per annum.

Growth in emerging markets has lost momentum with a slowdown in China and continuing recessions in Brazil and Russia. The growth outlook continues to be strong at present in India, which continues to benefit from low oil prices. Global GDP projections remain moderate but slightly brighter on average for 2017, at around 3.4% using PPP weights – estimated global growth is lower at around 2.8% in 2017 using MER weights as this gives less weight to China and India in particular.

Global inflation is expected to pick up somewhat in 2017 as past commodity price decreases gradually fall out of 12-month inflation rate calculations. But underlying inflationary pressures remain relatively subdued by historical standards, particularly in the advanced economies.

These projections (including those for the UK) are updated monthly in our Global Economy Watch publication, which can be found at www.pwc.com/gew

Table A.1: Global economic prospects

	Share of world GDP	Real GDP growth (%)		Inflation (%)	
	2015 at MERs	2016e	2017p	2016e	2017p
US	24.5%	1.9	2.2	1.2	2.2
China	15.0%	6.5	6.5	1.8	1.8
Japan	5.6%	0.7	0.5	0.2	1.4
UK	3.9%	1.6	0.6	0.7	1.8
France	3.3%	1.4	1.5	0.3	1.2
Germany	4.6%	1.6	1.4	0.3	1.5
Greece	0.3%	-1.4	0.3	-0.3	0.5
Ireland	0.3%	4.5	3.3	0.8	1.8
Italy	2.5%	0.9	1.0	0.2	1.1
Netherlands	1.0%	1.6	1.6	0.8	1.5
Portugal	0.3%	1.3	1.3	0.7	0.9
Spain	1.6%	2.6	2.3	-0.4	1.3
Poland	0.6%	3.5	3.4	-0.3	1.0
Russia	1.8%	-1.7	1.0	7.3	6.8
Turkey	1.0%	3.8	3.7	7.7	7.5
Australia	1.7%	2.4	2.5	2.3	2.5
India	2.9%	7.7	7.7	4.1	4.3
Indonesia	1.2%	4.8	4.8	6.1	6.1
South Korea	1.9%	2.7	2.7	1.1	1.7
Argentina	0.8%	-0.8	2.1	25.0	25.0
Brazil	2.4%	-3.8	0.0	9.0	6.5
Canada	2.1%	1.6	1.9	1.5	1.8
Mexico	1.6%	2.3	2.7	2.9	3.1
South Africa	0.4%	0.4	1.0	6.0	5.5
Nigeria	0.7%	1.0	2.5	14.0	13.5
Saudi Arabia	0.9%	1.3	1.5	3.9	3.2
World (PPP)		3.1	3.4		
World (Market Exchange Rates)	100%	2.6	2.8	2.1	2.6
Eurozone	15.8%	1.6	1.5	0.2	1.3

Source: PwC main scenario for 2016 and 2017; IMF for GDP shares in 2015 at market exchange rates (MERs)

Appendix B

UK economic trends: 1979 – 2015

Annual averages	GDP growth	Household expenditure growth	Manufacturing output growth*	Inflation (CPI**)	3 month interest rate (% annual a)	Unemployment (% of GDP)	PSNB*** (% of GDP)
1979	3.7	4.8			13.7	-0.6	4.3
1980	-2.0	0.1			16.6	0.5	3.9
1981	-0.8	0.3			13.9	1.5	3.1
1982	2.0	1.2			12.2	0.6	2.3
1983	4.2	4.4			10.1	0.2	3.0
1984	2.3	2.5			10.0	-0.5	3.3
1985	4.2	5.1			12.2	-0.3	2.6
1986	3.2	6.1			10.9	-1	2.0
1987	5.4	5.1			9.7	-1.6	1.3
1988	5.8	7.4			10.4	-3.6	-0.6
1989	2.6	3.9		5.2	13.9	-4.1	-0.6
1990	0.7	1.0		7.0	14.8	-3.1	0.6
1991	-1.1	-0.6		7.5	11.5	-1.3	2.6
1992	0.4	0.9		4.3	9.6	-1.5	5.6
1993	2.5	2.8		2.5	5.9	-1.3	6.8
1994	3.9	3.2		2.0	5.5	-0.5	5.8
1995	2.5	2.1		2.6	6.7	-0.7	4.7
1996	2.5	3.9		2.5	6.0	-0.6	3.3
1997	3.1	4.5		1.8	6.8	-0.2	1.6
1998	3.2	3.9	0.4	1.6	7.3	-0.4	-0.1
1999	3.3	4.9	0.6	1.3	5.4	-2.4	-1.1
2000	3.7	4.9	2.2	0.8	6.1	-2.1	-1.4
2001	2.7	3.5	-1.5	1.2	5.0	-1.9	-0.7
2002	2.4	3.7	-2.2	1.3	4.0	-2	1.7
2003	3.5	3.8	-0.6	1.4	3.7	-1.7	2.7
2004	2.5	3.3	1.8	1.3	4.6	-1.8	3.0
2005	3.0	3.0	0.0	2.1	4.7	-1.2	3.4
2006	2.5	1.8	2.2	2.3	4.8	-2.2	2.5
2007	2.6	3.0	0.6	2.3	6.0	-2.4	2.7
2008	-0.6	-0.8	-2.8	3.6	5.5	-3.5	4.8
2009	-4.3	-3.5	-9.4	2.2	1.2	-3	10.1
2010	1.9	0.7	4.6	3.3	0.7	-2.7	9.2
2011	1.5	-0.7	2.2	4.5	0.9	-1.8	7.2
2012	1.3	1.9	-1.5	2.8	0.8	-3.7	7.7
2013	1.9	1.6	-1.0	2.6	0.5	-4.4	6.0
2014	3.1	2.1	2.9	1.5	0.5	-4.7	5.5
2015	2.2	2.6	-0.2	0.0	0.6	-5.4	4.2
Average over economic cycles****							
1979 - 1989	2.8	3.7			12.2	-0.8	2.2
1989 - 2000	2.3	3.0		3.3	8.3	-1.5	2.3
2000 - 2007	2.9	3.4	0.3	1.6	4.8	-1.9	1.7

* After the revisions to the national accounts data, pre-1998 data is not currently available ** Pre-1997 data estimated *** Public Sector Net Borrowing (calendar years excluding public sector banks)

**** Peak-to-peak for GDP relative to trend

Sources: ONS, Bank of England

Contacts and services

Economics and policy

Our macroeconomics team produce the UK Economic Outlook three times a year.

The present report was written by John Hawksworth, Esmond Birnie, Richard Snook, Thomas Fisher, Rebecca McDonald, Lucy Rimmington and Paula Gallego Marquez.

For more information about the technical content of this report please contact:

John Hawksworth

john.c.hawksworth@uk.pwc.com
or 020 7213 1650

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Competition Economics	Tim Ogier	+44 (0)20 7804 5207
	Daniel Hanson	+44 (0)20 7804 5774
	Luisa Affuso	+44 (0)20 7212 1832
Economic Regulation	David Armstrong	+44 (0)28 9041 5716
	Dan Burke	+44 (0)20 7212 6494
	Alastair Macpherson	+44 (0)20 7213 4463
	Stuart Cook	+44 (0)20 7804 7167
Economic Appraisal	Nick Forrest	+44 (0)20 7804 5695
	Jonathan Gillham	+44 (0)7714 567 297
	Richard Boxshall	+44 (0)20 7213 2079
	Andrew Sentance	+44 (0)20 7213 2068
Total impact measurement and management	Mark Ambler	+44 (0)20 7213 1591
	Mark Graham	+44 (0)131 260 4054
Sustainability and climate change	Andrew Thurley	+44 (0)20 7212 6503
Health industries	Tim Wilson	+44 (0)20 7213 2147
	Kalee Talvite-Brown	+44 (0)20 7213 4372
	Dan Burke	+44 (0)20 7212 6494
	Andy Statham	+44 (0)20 7213 1486
Education and skills	Christopher Kirk	+44 (0)20 7213 3275
	Michael Kane	+44 (0)28 9041 5303
	Sean Hughes	+44 (0)20 7212 4194
International development	David Armstrong	+44 (0)28 9041 5716
	Sheetal Vyas	+44 (0)7730 146 352
	Zlatina Loudjeva	+44 (0)20 7213 4815
Financial services	Nick Forrest	+44 (0)20 7804 5695
	Darren Pigg	+44 (0)20 7774 9989
Telecommunications	Alastair Macpherson	+44 (0)20 7213 4463
Media and entertainment	David Lancefield	+44 (0)20 7213 2263
Water	Richard Laikin	+44 (0)20 7212 1204
Power and utilities	Stuart Cook	+44 (0)20 7804 7167
Transport	Daniel Hanson	+44 (0)20 7804 5774

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