

UK Economic Outlook

UK economic trends and prospects

The impact of lower oil prices on the UK economy

New job creation in the UK: which regions will benefit most from the digital revolution?

Global economic outlook



Highlights and key messages for business and public policy

- The UK economy has been recovering at a relatively strong rate since early 2013, although there were signs of a slight slowdown in growth in late 2014 due to problems in the Eurozone and other geopolitical uncertainties.
- In our main scenario we expect GDP growth to average around 2.5% in 2015, supported by recent oil price falls, before easing slightly to around 2.3% in 2016.
- We judge that risks to UK growth are weighted somewhat to the downside in the short term due to international risks, but there are also upside possibilities in the medium term if the global economic environment improves.
- We expect the services sector to remain the main engine of UK growth for both output and employment. Manufacturing and construction growth have slowed recently, but should remain positive contributors to overall UK growth in 2015-16.

Lower oil prices are positive for the UK economy

- The sharp fall in oil prices since mid-2014 should boost most sectors of the economy except for those directly involved in oil and gas production.
- In our central scenario, where oil prices rise gradually to around \$73 per barrel in 2020, total UK employment could be around 37,000 higher in 2020 than in a baseline scenario where oil prices remained at their mid-2014 levels of around \$108 per barrel through to 2020.
- Lower oil prices should also benefit consumers significantly in the short term, as well as boosting government revenues and narrowing the trade deficit slightly.

Key projections

	2015	2016
Real GDP growth	2.5%	2.3%
Inflation (CPI)	0.3%	1.8%

Source: PwC main scenario projections

Low inflation in the short term may not prevent interest rate rises from late 2015

- Consumer price inflation is likely to be close to zero on average in 2015 due to lower global energy and food prices, but could return to target by the end of 2016.
- We expect the MPC to keep interest rates on hold in the short term, but then to increase them gradually from late 2015 or early 2016 onwards, returning to around 3.5-4% by 2020. Businesses and households should start to prepare for this upward trend now.

London continues to lead the recovery, but growth has diffused to other regions

- London and the South East are continuing to lead the recovery, as has been the pattern for many years, but other UK regions should also register positive real growth of around 1.7-2.5% in 2015.
- Detailed analysis in this report shows that London has been a key source of new job creation associated with the digital revolution of the past 25 years. But the benefits of this have started to diffuse to other regions over the past ten years and we expect this to continue.

- We think greater regional balance would be good for the long-term future of the UK economy, but this should not be at the expense of weakening the London economy. London needs increased investment in affordable housing and transport infrastructure to support potential continued strong jobs growth over the next decade.
- There should also be an emphasis on building up successful manufacturing and service sector clusters outside London and the South East, which requires long-term investment in transport infrastructure, skills and knowledge hubs linked to top regional universities.

1 – Summary

Recent developments

The UK economy grew by 2.6% in 2014 as a whole, which was the fastest rate seen since 2007 and the strongest growth rate in the G7.

However, UK quarter-on-quarter GDP growth slowed somewhat to 0.5% in the fourth quarter of 2014, which appears to reflect the drag from sluggish growth in the Eurozone as well as wider global geopolitical risks related to the situation in Russia/Ukraine and the Middle East in particular. But lower global oil prices have been a positive factor from the perspective of UK consumers.

UK growth has been driven primarily by services over the past five years, but manufacturing and construction have also been on an upward trend since early 2013 despite some slowdown in late 2014.

The slowdown in the Eurozone has been partly offset by stronger growth in the US since the second quarter of 2014, but more generally international risks have increased over the past nine months. As such, UK growth remains heavily dependent on domestic demand.

UK employment has continued to rise strongly, which has supported consumer spending growth despite relatively subdued rates of average real earnings growth until recent months. Rising house prices have also supported consumer confidence and spending, but have moderated since mid-2014.

Business investment had been showing signs of a stronger recovery in recent years, though this fell back somewhat in late 2014 according to the latest preliminary official estimates. Public spending cuts have slowed down over the past year, but will remain a drag on growth for many years to come and could accelerate again after the general election.

The rate of consumer price inflation (CPI) has fallen sharply over the past year to record lows as import price inflation has dropped due to global energy and food price declines.

Future prospects

As shown in Table 1.1, our main scenario is for UK GDP growth to average around 2.5% in 2015 and around 2.3% in 2016. This is similar to the latest consensus and OBR forecasts.

Consumer spending growth is projected to be broadly similar to GDP growth, with a boost from lower oil prices this year but some moderation in growth in 2016.

We expect continued investment growth in 2015, but at a slower rate than in 2014 as business confidence could be affected by increased international risks and possibly also temporary uncertainty around the general election outcome.

Net exports have been erratic, but we do not expect them to make a significant positive contribution to growth in 2015 and 2016 given ongoing problems in the Eurozone in particular. UK growth will therefore remain heavily dependent on domestic demand.

As always there are many uncertainties surrounding our growth projections, as illustrated by the alternative scenarios in Figure 1.1. There are still considerable

downside risks relating to trends in the Eurozone and emerging markets (including Ukraine and the Middle East), and these have increased since mid-2014. But there are also upside possibilities if these problems can be avoided and a virtuous circle of rising confidence and spending can be established as in past economic recoveries.

Inflation will remain very low this year, but could rebound to close to target in 2016 if past falls in global energy and food prices do not continue. There could be upside risks to this inflation outlook in the longer term if domestic wages start to recover without a corresponding rise in productivity.

We do not expect any immediate rise in official UK interest rates, but a gradual upward trend seems likely to begin in late 2015 or early 2016. In the long term, however, we would still expect official rates to return very gradually to a more normal level of around 3.5-4% by 2020.

Higher interest rates will help savers and reduce pension fund deficits, but borrowers (including businesses and the government) might gain from locking in funding now for long term investments such as infrastructure and housing. Households need to bear in mind likely future interest rate rises in any decisions on mortgages or other longer term loans.

Table 1.1 – Summary of UK economic growth prospects

Indicator (% change on previous year)	OBR forecasts (December 2014)		Independent forecasts (February 2015)		PwC Main scenario (March 2015)	
	2015	2016	2015	2016	2015	2016
GDP	2.4	2.2	2.6	2.3	2.5	2.3
Consumer spending	2.8	2.2	2.9	2.4	2.6	2.3

Source: Office for Budget Responsibility (December 2014), HM Treasury survey of independent forecasts (average values in February 2015 survey) and latest PwC main scenario.

Impact of lower oil prices on the UK economy

As discussed in detail in Section 3 of this report, we think that the fall in the oil price since mid-2014 should have a significant positive impact on the UK by increasing overall economic activity as the cost of production decreases for businesses, especially for those that are heavily dependent on oil inputs.

Although the oil and gas extraction sector is negatively affected by the reduction in the oil price, sectors such as agriculture, air transport, coke and refined petroleum manufacturing, and oil-intensive manufacturing sectors will benefit as the price of a key input falls.

Our modelling implies that water transport and other services sectors will enjoy a smaller positive impact. However, oil-intensive sectors are likely to benefit from the reallocation of capital and resources at the expense of less oil-intensive sectors.

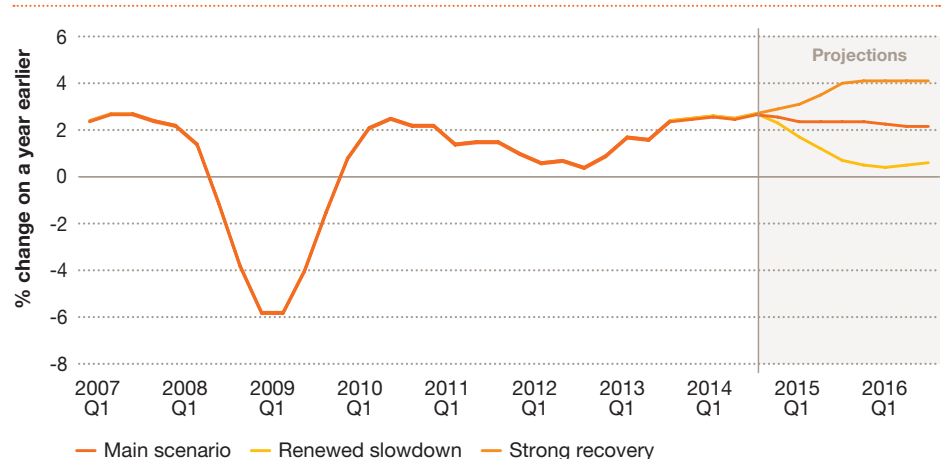
Future oil price trends remain highly uncertain, so we have looked at three alternative scenarios. In a case where the reduction in the oil price is persistent, the size of the UK economy increases by around 1% on average relative to the baseline between 2015 and 2020. Employment also increases by around 90,000 by 2020 in this case (Scenario 1 in Table 1.2).

In contrast, the impacts are much smaller where the fall in the oil price is wholly or partially temporary: in these scenarios the average impact on the level of GDP is 0.2-0.5%, with employment effects in 2020 of around 3,000 to 37,000 depending on how far and fast oil prices rebound. The central case (Scenario 2) where output is 0.5% higher and employment in 2020 around 37,000 higher would be most consistent with our main scenario for the UK economy, but the other scenarios shown in Table 1.2 are also quite plausible outcomes.

Real household incomes also rise due to lower oil prices, which increases consumer spending. As a result of growing economic activity, we project that government tax revenues should also rise as the tax take from corporate and personal income taxes increases by more than the loss of North Sea oil and gas revenues.

In summary, lower oil prices should be positive for most sectors of the UK economy, households and the government. But the scale of these benefits remains highly uncertain depending on how oil prices evolve from here.

Figure 1.1: Alternative UK GDP growth scenarios



Source: ONS, PwC scenarios

Table 1.2: Increase in total UK employment relative to baseline: 2016 and 2020

Oil price scenarios (\$ per barrel)	2016	2020
Scenario 1 (settling at \$50)	121,000	91,000
Scenario 2 (rising to \$73 by 2020)	53,000	37,000
Scenario 3 (rising back to \$108 by 2020)	11,000	3,000

Source: PwC analysis (the effects shown are relative to employment levels in a baseline case where oil prices remained at their mid-2014 level of around \$108 per barrel through to 2020).

Which UK regions will benefit most from digital job creation?

The digital revolution has both created and displaced many types of jobs since 1990. In a special article in Section 4 of this report by Dr Carl Benedikt Frey of Oxford University and John Hawksworth of PwC, we focus on the new types of jobs created since 1990 and assess how this has affected total national and regional employment in the UK since 2004. We highlight the key role of London as an incubator for the digital revolution, but also find some signs of catch up in other regions such as the North, Wales and Northern Ireland.

We examined new job titles that emerged only after 1990 and found that 5.5% of the UK workforce had shifted into these new types of jobs by 2004. But by 2014 this proportion had risen only slightly further to around 6%. Eight of the ten occupational categories where these new job titles arose were related to computers, so this can largely be linked to the digital revolution.

London has been the greatest motor for the creation of new types of jobs, outperforming the rest of the UK economy: for example, new types of jobs in Central London increased from 8.6% to 9.8% of total employment between 2004 and 2014.

But we also find some evidence of regional convergence over the past decade. While London continues to lead in terms of the proportion of workers in new types of jobs, regions like Yorkshire, Tyne & Wear, Wales and Northern Ireland with low initial employment shares in new types of jobs in 2004 experienced higher growth rates of these new job types on average between 2004 and 2014.

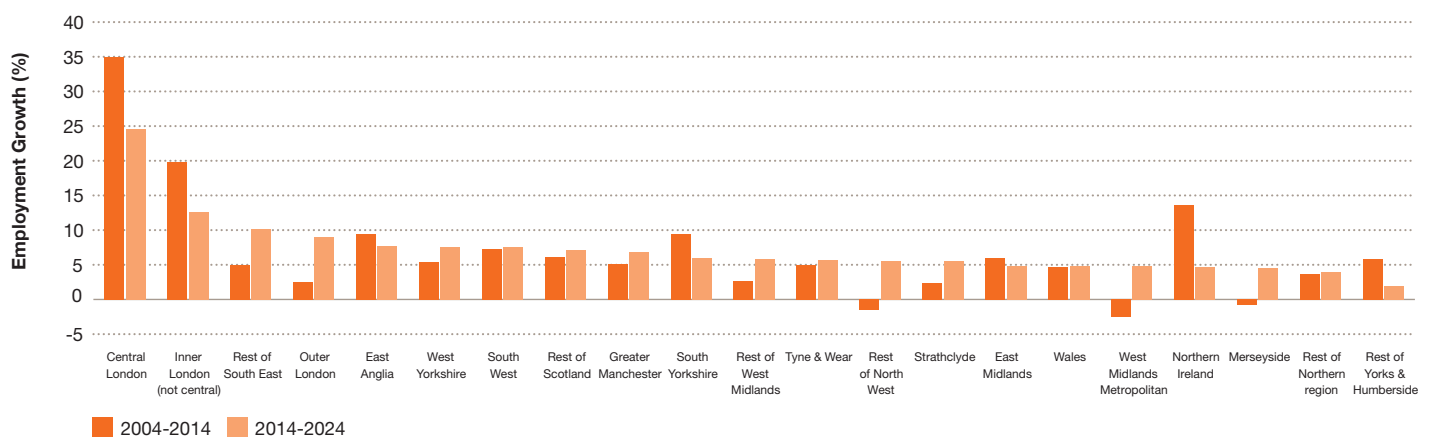
Our findings suggest that new types of jobs created since 1990 (linked mainly but not only to the digital revolution) initially appeared in areas like London where entrepreneurs, innovative firms and skilled workers were concentrated and then gradually diffused to other regions. These other regions will continue to catch up unless London's pace of new job creation is higher than the rate of regional diffusion.

Projecting patterns in regional employment growth over the next decade, we find that total employment in Central London could grow by around 25% between 2014 and 2024, but this would be down from around 35% total employment growth over the past ten years (see Figure 1.2).

By contrast, employment growth rates over the next decade in regions like West Yorkshire, Greater Manchester, the West Midlands, Scotland and the rest of the South East are projected to see some acceleration in job creation relative to the past decade as the digital revolution continues to diffuse.

Future UK and London governments need to make sure that the city's growth potential is not constrained by the supply of housing and transport infrastructure. But it also needs to support the diffusion of digital job creation to other UK regions by boosting transport links outside London, supporting leading regional universities, and building skills, which we find to be a key driver of economic success for cities.

Figure 1.2: Projected total employment growth in UK regions, 2014-2024, as compared to the past decade



Source: ONS Labour Force Survey; calculations by Carl Frey

Appendix A

Outlook for the global economy

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

We expect the US economy to achieve relatively strong growth in 2015 and 2016. The outlook for the Eurozone economies remains weak in comparison to both the US and the UK, although lower oil prices will help to give the Eurozone some modest upward momentum in 2015-16. In the emerging markets, China's economic growth is slowing down, but remains high in absolute terms. By contrast, the Russian economy is expected to experience a severe economic contraction this year due to a combination of lower oil revenues and sanctions. Significant uncertainties continue to surround global economic prospects with particular risks stemming from the recent problems in Greece and elsewhere in the Eurozone and possible escalation of geopolitical tensions in Russia/Ukraine and the Middle East.

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 (%)	
	2013 at MERs	2015p	2016p	2015p	2016p
United States	22.4%	3.2	3.1	0.3	1.8
China	12.7%	7.1	7.2	2.2	1.8
Japan	6.6%	1.1	1.4	1.4	2.3
UK	3.4%	2.5	2.3	0.3	1.8
France	3.8%	0.9	1.4	0.1	1.1
Germany	4.9%	1.5	1.9	0.1	1.8
Greece	0.3%	0.7	1.5	0.2	0.3
Ireland	0.3%	3.3	3.2	(1.3)	1.0
Italy	2.8%	0.4	1.1	0.4	1.8
Netherlands	1.1%	1.4	1.6	(0.1)	1.1
Portugal	0.3%	1.7	1.8	1.2	0.8
Spain	1.8%	2.2	2.2	0.1	0.7
Poland	0.7%	3.3	3.5	(0.3)	1.7
Russia	2.8%	(5.0)	(0.5)	0.1	8.0
Turkey	1.1%	3.5	3.8	15.0	6.5
Australia	2.0%	2.6	3.1	6.7	2.6
India	2.5%	7.0	6.9	2.5	5.2
Indonesia	1.2%	5.8	5.7	4.2	6.7
South Korea	1.7%	3.5	3.7	6.5	2.2
Argentina	0.8%	0.1	3.1	1.5	-
Brazil	3.0%	1.0	2.9	25.0	4.5
Canada	2.4%	2.3	2.2	5.5	1.9
Mexico	1.7%	3.2	3.5	0.9	3.5
South Africa	0.5%	2.0	2.3	3.2	5.6
Nigeria	0.7%	4.2	4.9	5.1	9.9
Saudi Arabia	1.0%	3.2	3.0	11.7	3.0
World (PPP)		3.5	3.9		
World (Market Exchange Rates)	100%	3.0	3.3	2.2	2.4
Eurozone	17.1%	1.2	1.7	0.1	1.4

Source: PwC main scenario for 2015 and 2016; IMF for GDP shares in 2013 at market exchange rates (MERs).

Appendix B

UK economic trends: 1979 – 2014

Annual averages	GDP growth	Household expenditure growth	Manufacturing output growth*	Inflation (CPI**)	Three month interest rate (% annual average)	Current account balance (% of GDP)	PSNB*** (% of GDP)
1980	(2.2)	0.1			16.6	0.7	4.1
1981	(0.8)	0.3			13.9	1.8	3.3
1982	2.1	1.2			12.2	0.7	2.5
1983	4.2	4.4			10.1	0.3	3.3
1984	2.3	2.5			10.0	(0.5)	3.6
1985	3.5	4.1			12.2	(0.3)	2.8
1986	3.2	6.5			10.9	(1)	2.2
1987	5.5	5.3			9.7	(1.6)	1.4
1988	5.9	7.8			10.4	(3.8)	(0.7)
1989	2.5	4.0		5.2	13.9	(4.3)	(0.7)
1990	0.5	0.7		7.0	14.8	(3.3)	0.7
1991	(1.2)	(0.7)		7.5	11.5	(1.4)	2.8
1992	0.4	1.2		4.3	9.6	(1.6)	6.0
1993	2.6	3.1		2.5	5.9	(1.4)	7.3
1994	4.0	3.3		2.0	5.5	(0.5)	6.2
1995	2.5	2.1		2.6	6.7	(0.7)	5.0
1996	2.7	4.2		2.5	6.0	(0.6)	3.6
1997	2.6	4.6		1.8	6.8	(0.1)	1.7
1998	3.5	4.4	0.4	1.6	7.3	(0.4)	(0.1)
1999	3.2	5.0	0.5	1.3	5.4	(2.6)	(1.2)
2000	3.8	5.3	2.3	0.8	6.1	(2.4)	(1.5)
2001	2.7	3.7	(1.6)	1.2	5.0	(2.1)	(0.7)
2002	2.5	4.0	(2.6)	1.3	4.0	(2)	1.8
2003	4.3	4.0	(0.6)	1.4	3.7	(1.6)	2.8
2004	2.5	3.6	2.0	1.3	4.6	(2)	3.1
2005	2.8	3.0	(0.1)	2.1	4.7	(1.3)	3.5
2006	3.0	2.2	2.2	2.3	4.8	(2.2)	2.5
2007	2.6	2.8	0.7	2.3	6.0	(2.7)	2.7
2008	(0.3)	(0.5)	(2.9)	3.6	5.5	(3.7)	4.8
2009	(4.3)	(3.3)	(9.4)	2.2	1.2	(2.8)	10.2
2010	1.9	0.5	4.7	3.3	0.7	(2.6)	9.1
2011	1.6	(0.1)	1.8	4.5	0.9	(1.7)	7.0
2012	0.7	1.5	(1.3)	2.8	0.8	(3.7)	7.6
2013	1.7	1.7	(0.7)	2.6	0.5	(4.5)	5.9
2014	2.6	2.1	2.7	1.5	0.5	n/a	5.2
Average over economic cycles****							
1979 – 1989	2.7	3.7		7.9	12.2	(0.8)	2.4
1989 – 2000	2.3	3.1		3.3	8.3	(1.6)	2.5
2000 – 2007	3.0	3.6	0.3	1.6	4.8	(2.0)	1.8

* 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

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

The present report was written by John Hawksworth, Priya Ravidran, Yong Jing Teow, Jonathan Gillham and Conor Lambe.

We would also particularly like to thank Dr Carl Benedikt Frey of Oxford University, who was the lead author of the research article in Section 4 of this report.

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