UK economic outlook 2023

Predictions for the year ahead
January 2023

pwc

UK Predictions for 2023

As we usher in the new year, our clients and the wider business community will be refreshing their business plans in the hope that the year ahead is less eventful than the last. In this pack we set out ten predictions for 2023 to help provide some clarity into what next year has in store for households, businesses and wider society. The predictions cover a number of different topics, ranging from economics trends like the effects of inflation to the less serious but equally important (football).

In previous years we have had mixed success with our predictions. We correctly predicted that lockdowns would result in a 'baby bust' rather than a 'baby boom', in contrast to received wisdom at the time. But we wrongly predicted that there would be a sharp rise in unemployment following the end of the furlough scheme (due to an unexpected extension to the scheme). As always, there remains considerable economic uncertainty and our predictions should be considered in this light.

Our predictions for 2023

1 French workers will overtake British workers as the fourth-best paid workers in the G7, as British real wages fall back to their 2006 levels.

2 The weekly food shop will cost the average household around £100—more than twice as much as it cost at the start of the century.

3 UK house prices will decline by around 8% in 2023 – the second sharpest annual decline in house prices over the past seventy years.

4 The number of house sales will fall below 1 million for the first time in a decade as buyers and sellers adopt a wait-and-see approach.

5 More than three-hundred thousand British workers will rejoin the UK labour market in 2023.
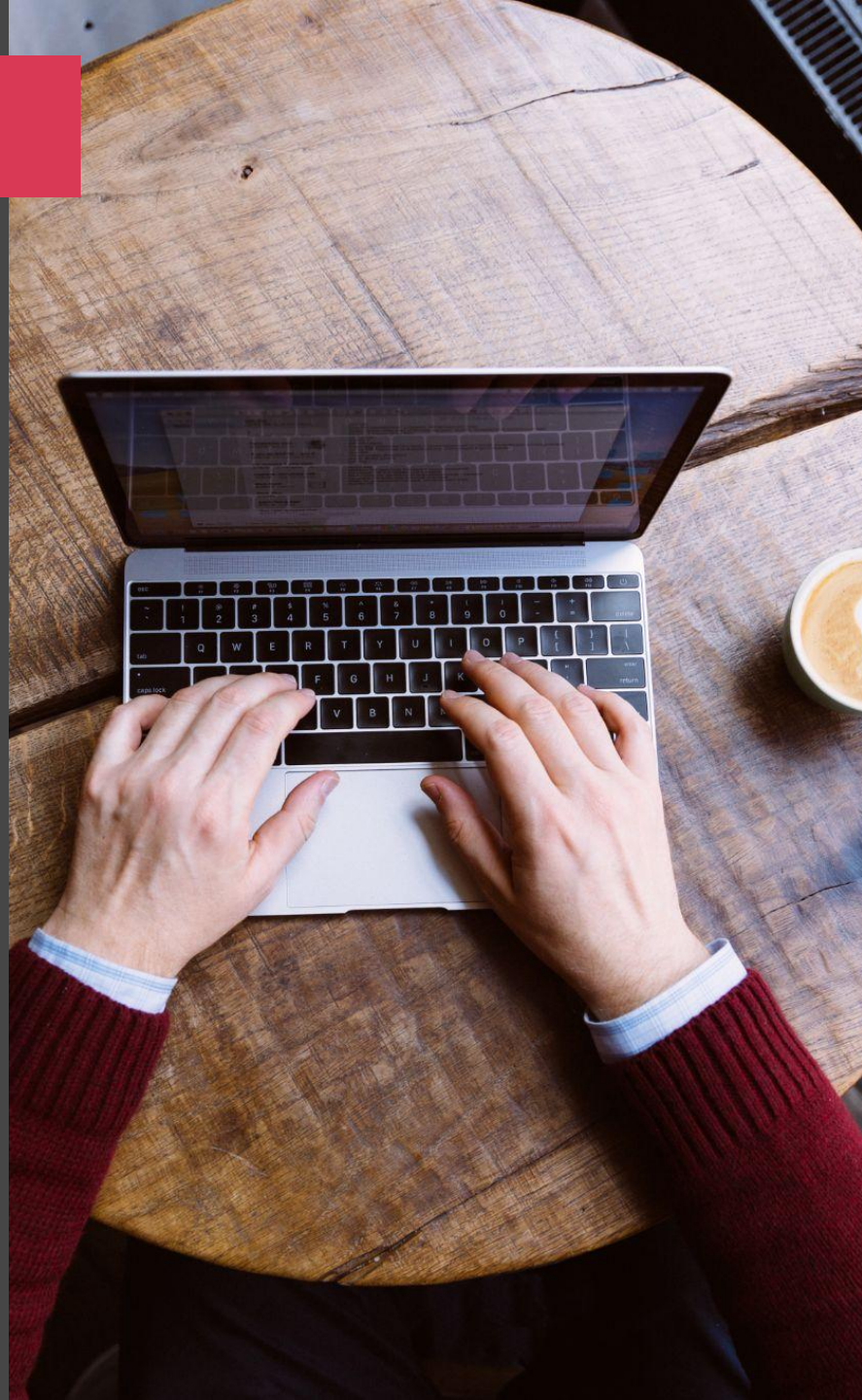
6 New immigrants will directly contribute £19bn to the UK economy, equivalent to around 1% of GDP.

7 London and Northern Ireland will be the only two UK regions with above pre-pandemic levels of economic activity.

8 The average Brit will be the unhappiest they've been since records began a decade ago.

9 The total number of divorces will spike by one-fifth to almost 140,000 in England and Wales, equivalent to 16 divorces every hour.

10 … it's coming home! The England Women's team will succeed where the men failed and bring home the World Cup in Summer 2023.

1. French workers will overtake British workers as the fourth-best paid workers in the G7, as British real wages fall back to their 2006 levels

The average British worker is expected to see their pay in real terms remain virtually unchanged over the 2006 to 2023 period. This follows almost five decades of positive real wage growth from the early 1960s to late 2000s.

This is due in part to the UK's ongoing challenge of flatlining productivity following the Global Financial Crisis (GFC). However the current inflation crisis is also a factor – which could see real wages fall by as much as 3% in 2022 (the second largest fall on record), 2% in 2023 and <1% in 2024. Real wages in most of the other major economies are also expected to take a hit – but as the UK has been hit harder by inflation pressures, France could overtake the UK as the fourth-best paid workers in the G7.
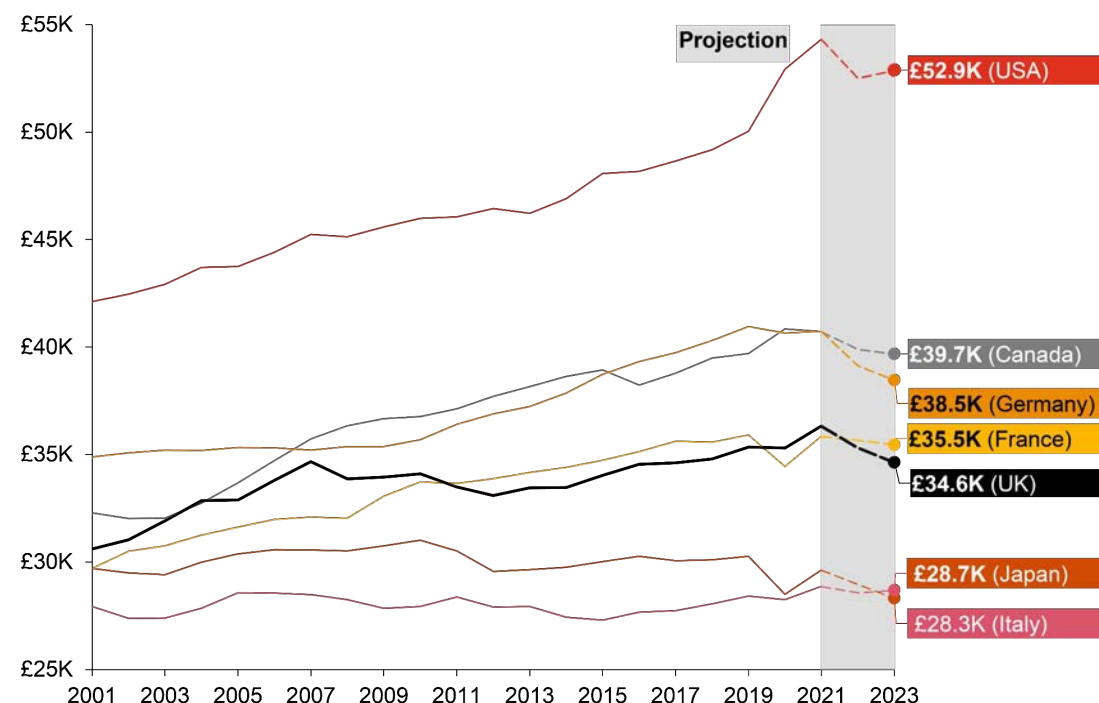
High inflation rates could see real wages in the UK fall back to their 2006 levels
Real average weekly earnings, deflated by CPI inflation (2021 prices)
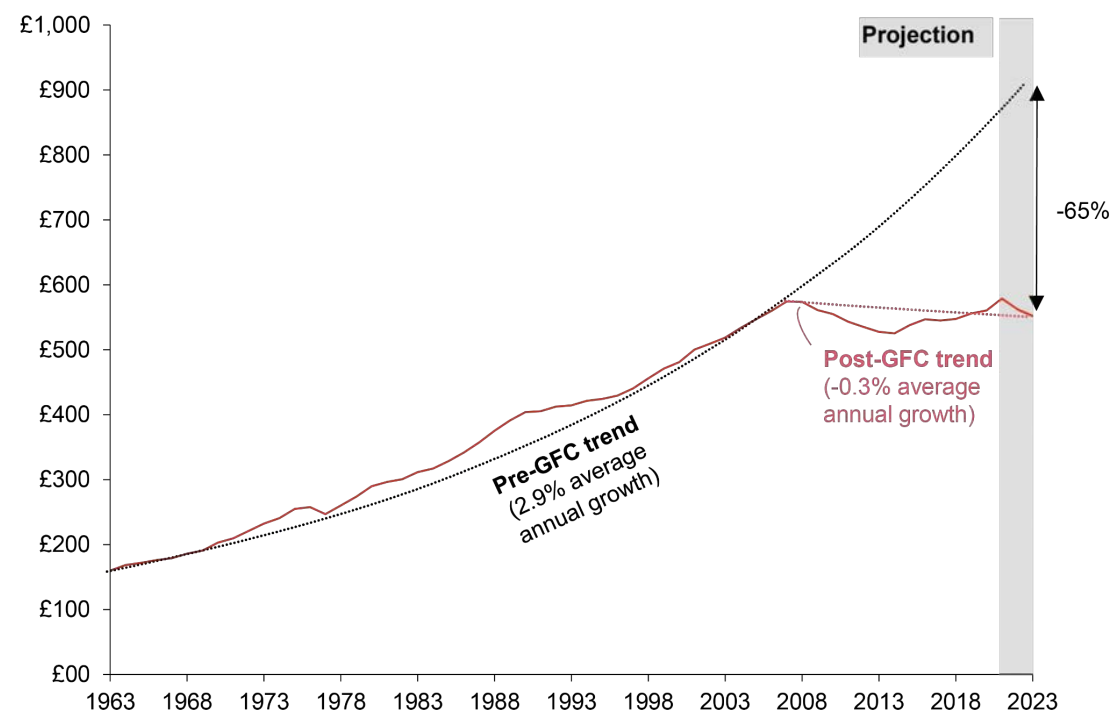
This could see French workers overtake British workers as the fourth-best paid G7 workers
Average annual wages, constant prices (2021 GBP PPPs), actual and projections (2022 & 2023)


Sources: PwC analysis, OECD, ONS. Notes: Average annual wage projections for the UK are developed in-house. For the other economies, we use the OECD forecasts for labour compensation per employee as a proxy for nominal wage growth (labour compensation also includes employers' social security contributions, but the two series are highly correlated) and deflate it by the OECD's forecasts for CPI inflation. This analysis implicitly assumes that purchasing power parities (PPPs) are unchanged over the forecast horizon.

2. The weekly food shop will cost the average household around £100—more than twice as much as it cost at the start of the century

One major driver of inflation pressures over the past year has been food prices, with food price inflation reaching a record high of 16.6% in November 2022. As a result the weekly shopping bill could cost the average household around £100 by 2023-24, more than double the £49 it cost at the beginning of the century (assuming they purchase the same quantities of goods). This is expected to be close to 15% of the average household disposable income of individuals in 2023-24. In some parts of the UK the average food shop could cost even more, potentially reaching £109 in Northern Ireland and London. While this will squeeze living standards for all households, low-income households will be the most affected as they spend proportionally more on food than higher-income households.

We expect that the average weekly food shop could cost £100 by 2023-24
Average weekly expenditure on food, beverages and tobacco, estimates & projections (FY 23-24)
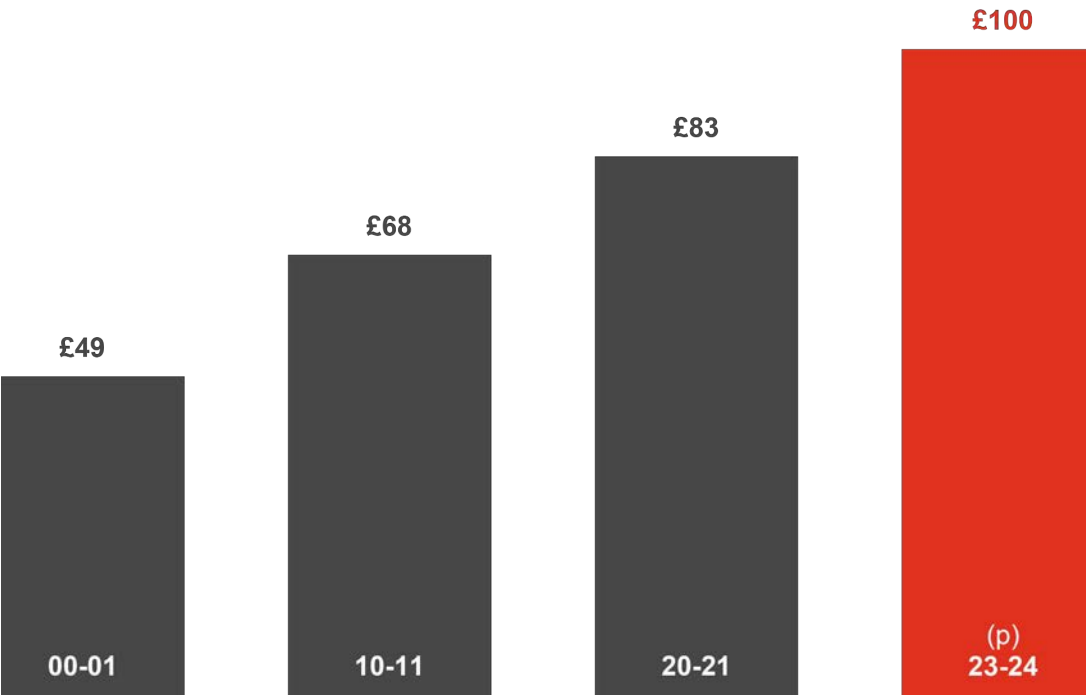
Households in Northern Ireland & London are expected to spend the most
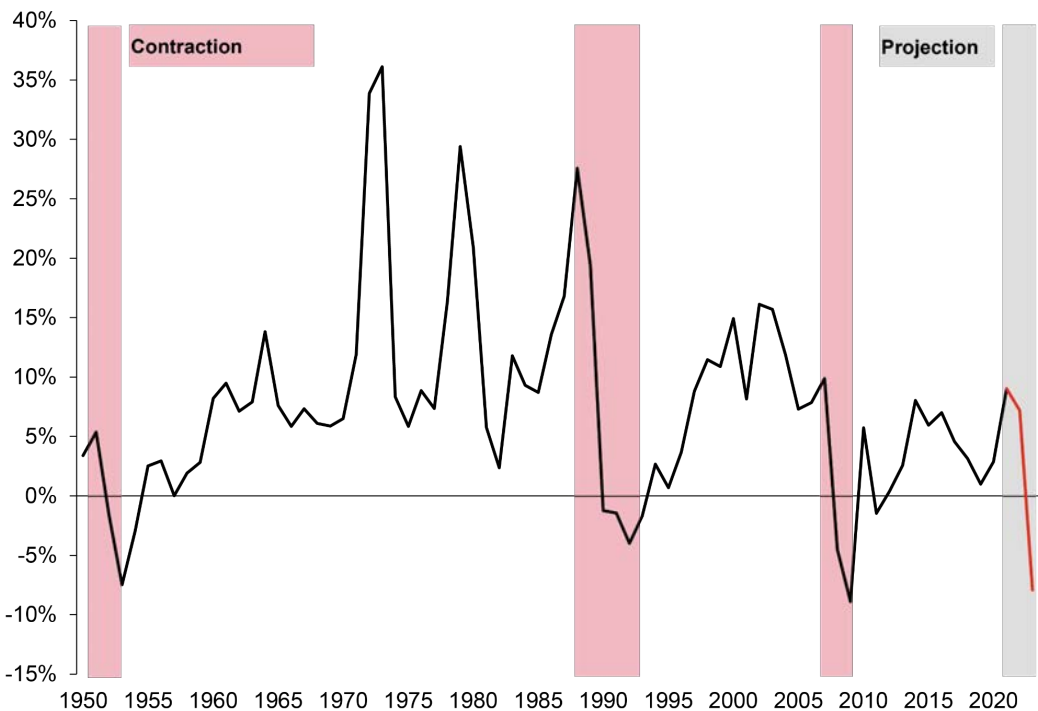Average weekly expenditure on food, beverages and tobacco, projections (FY 23-24)

Sources: PwC analysis, ONS, OBR. Notes: This prediction is made for the financial year 2023-24 (covering 9 months in 2023) to align it to the data reporting for the ONS' Living Costs and Food Survey. Average weekly expenditure on food, beverages and tobacco in the financial year 2020-21 is sourced from the ONS' Living Costs and Food Survey. All other years are estimated using actual or projected inflation rates for the respective CPI components, with the projections sourced from the OBR. This analysis does not account for changes in the quantities of food, beverages and tobacco consumed by households over time.

3. UK house prices will decline by around 8% in 2023 – the second sharpest annual decline in house prices over the past seventy years

We expect that the UK housing market will enter a downturn in 2023 as higher interest rates and a challenging macroeconomic outlook starts to take its toll on the sector. Our central expectation is that house prices will decline by around 8% in 2023, though there remains uncertainty around the macroeconomic outlook and its effect on the sector. House price contractions in the UK are relatively rare - this would only be the fourth period that house prices have fallen in the UK over the past 70 years. It would also be the second sharpest annual decline over that period, with only the fall during the GFC (-9%) exceeding it. Our analysis suggests that the UK is more exposed than most of its peers in the G7, owing in part to higher rate rises by the Bank of England. However the UK is less exposed than some other economies (e.g. New Zealand, Sweden, Australia), where rate rises have been even more pronounced and price-to-income ratios are more elevated.

Our expectation is that house prices will contract by around 8% in 2023

Annual growth in UK house prices, historical (1950-2021) and projections (2022-23).

The UK is in the middle-of-the-pack for its exposure to a housing market downturn

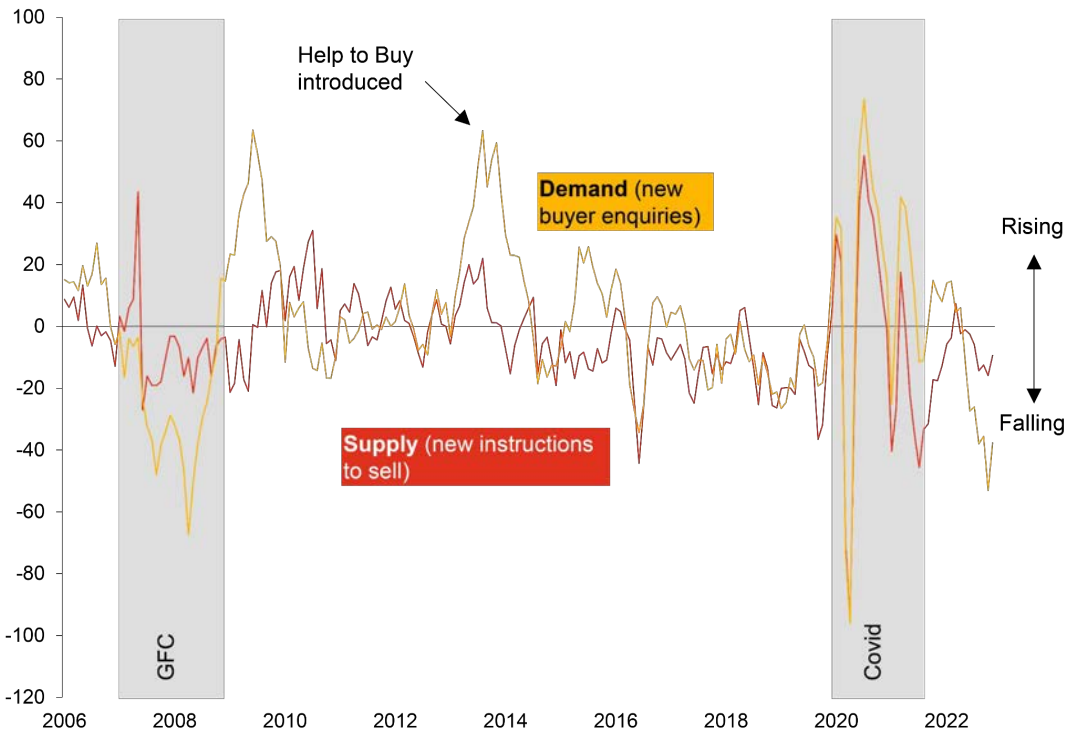Housing market risk indicators, high exposure = red and low exposure = green.

Region (1 = most exposed, 19 = least exposed)	House prices		Household finances			Lending
	House prices, % change, Q4-19 to Q2-22	Price-to-income ratio, latest vs long-run	Household debt as a % of income, '21 or latest	% of variable rate mortgages issued, '19 & '20 average	% of homeowners with a mortgage, '20 or latest	Policy rate, ppt change, Q4-19 to Q3-22
New Zealand (1)						
Sweden (2)						
Australia (3)						
Canada (4)						
Netherlands (5)						
Luxembourg (6)						
Portugal (7)						
Norway (8)						
Korea (9)						
UK (10)						
US (11)						
Germany (12)						
Denmark (13)						
Finland (14)						
Ireland (15)						
Spain (16)						
France (17)						
Italy (18)						
Japan (19)						

Sources: PwC analysis, HM Land Registry, ONS, Bank of England, UK Finance, OECD, BIS. Notes: For the RHS table, we calculate standardised scores for each of the metrics to estimate the exposure of each region to a housing market downturn, relative to the other regions in the sample. Shading is then assigned based on the standardised scores, with red indicating highest exposure and dark green indicating lowest exposure. Rankings are then calculated using a weighted average of these standardised scores.

4. The number of house sales will fall below 1 million for the first time in a decade as buyers and sellers adopt a wait-and-see approach

During housing market downturns, homeowners tend to hold off on selling rather than accept a lower price if they are able to. As a result, downturns are typically associated with a sharper fall in transactions than prices. For instance, during the GFC, housing transactions fell by 69% while house prices declined by 19%. Fast-moving indicators suggest that housing market activity has already started to moderate - new buyer enquiries are falling to their lowest levels since the pandemic, while new instructions to sell are also falling back. Our expectation is that the total number of residential transactions (with a value above £40k) will fall from 1.2m in 2022 to 0.8m in 2023 (almost a third). This would be the lowest number of housing transactions since 2009 and the first time they have dipped below 1m in a decade.

The deteriorating macroeconomic climate is starting to weigh on housing activity

Housing market supply and demand indicators, RICS Housing Survey, net balance

Our expectation is that the number of transactions will fall to 0.8m in 2023

Annual residential property transactions (above £40,000) in the UK, actual and projections (2022-23)
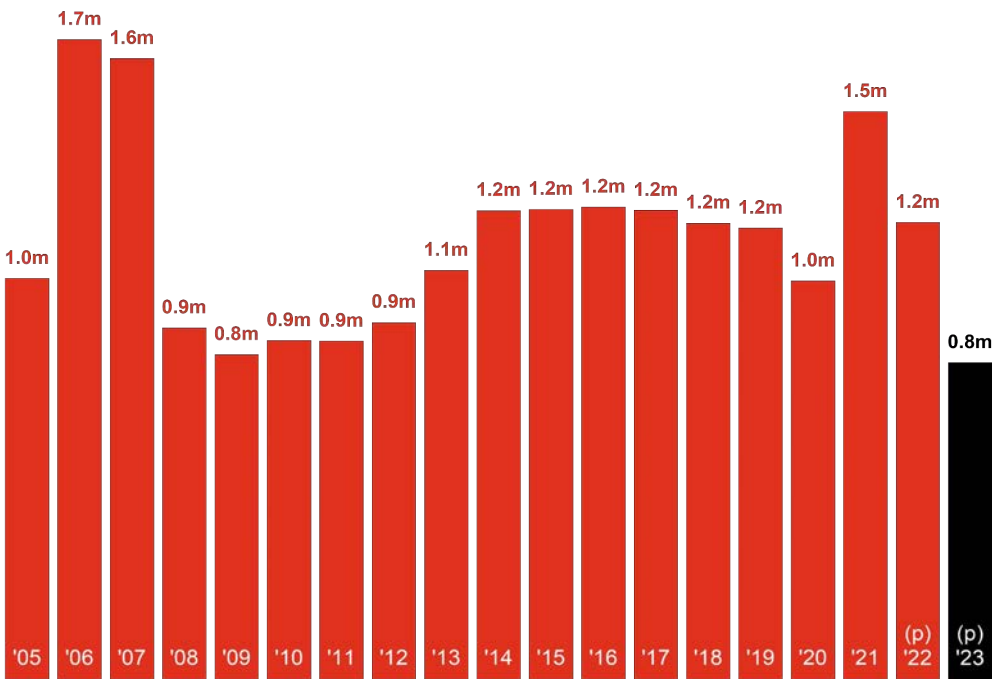
Sources: PwC analysis, RICS, HM Land Registry, ONS, Bank of England, UK Finance. Net balance = proportion of respondents reporting an increase over the past month minus those reporting a fall (e.g. if 30% reported an increase and 5% reported a fall, the net balance will be 25).

5. More than three-hundred thousand British workers will rejoin the UK labour market in 2023
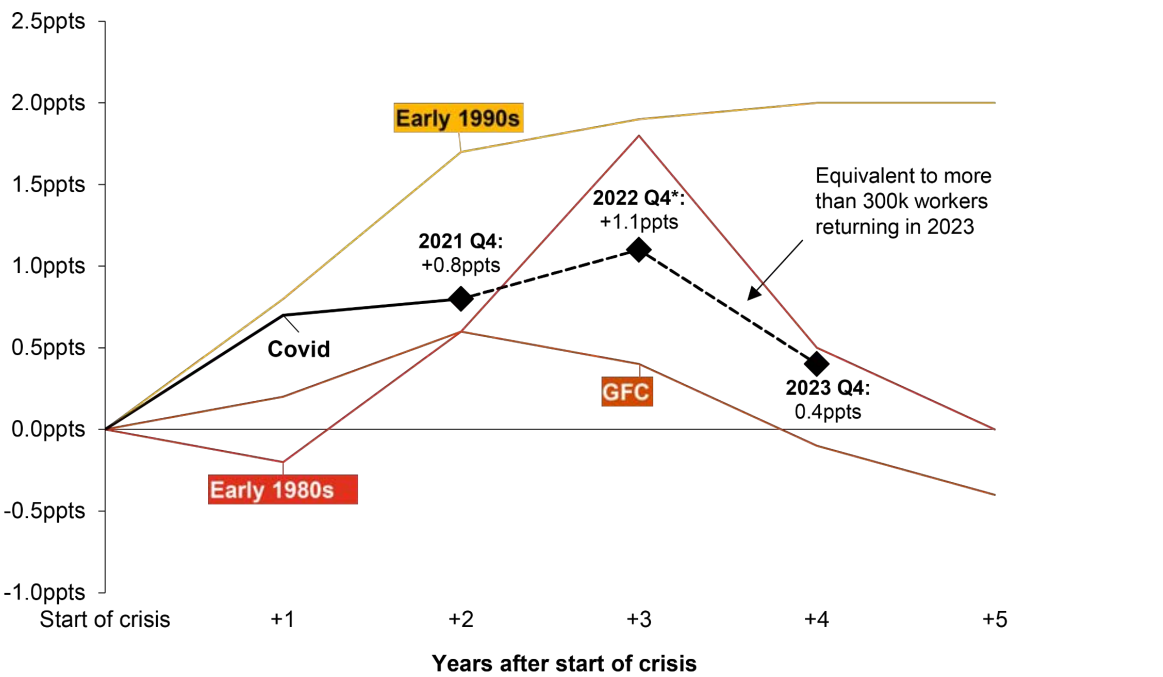
High levels of economic inactivity continues to be a defining feature of the UK labour market in the aftermath of the pandemic. The inactivity rate for working-age adults was 21.6% in 2022 Q3, 1.1ppts higher than the pre-pandemic rate and equivalent to 521,000 additional inactive working-age Brits. This sets the UK apart from most of its peers – the US is the only other major economy where inactivity remains elevated despite most economies seeing a pick-up during the pandemic. However most recessions result in a rising inactivity rate and then typically return to pre-recession levels within a few years (see chart below). Our expectation is that the inactivity rate will decline in 2023 – following its peers and the historical pattern – and the UK will at least close the gap with the US. This would be equivalent to more than 300k British workers returning to the workforce in 2023 and should help to ease some of the labour shortages in highly skilled sectors.

The UK and the US are the only two economies where inactivity rates remain elevated
Change in economic inactivity rates for working-age adults from pre-pandemic (Q4 2019), ppts

		Pandemic high-point (2020 max vs. Q4 2019)	Recent (Q2 2022 vs. Q4 2019)
	UK	+0.7	+0.9
	US	+2.4	+0.4
	Mexico	+4.9	-0.1
	OECD	+3.2	-0.3
	Italy	+3.6	-0.4
	Japan	+0.5	-0.8
	Canada	+4.1	-0.8
	Turkey	+5.2	-1.0
	Korea	+1.3	-1.1
	France	+1.7	-1.1
	EU	+1.6	-1.7
	Germany	+0.9	-1.8
	Australia	+2.4	-2.0

Inactivity rates typically spike during recessions and then fall back
Change in UK economic inactivity rates for working-age adults, from start of crisis.

Early 1990s

Equivalent to more than 300k workers returning in 2023

2022 Q4*: +1.1ppts

2021 Q4: +0.8ppts

Covid

GFC

2023 Q4: 0.4ppts

Early 1980s

Years after start of crisis

Sources: PwC analysis, OECD, ONS. Notes: *For 2022 Q4, we assume that the inactivity rate will stay constant at 2022 Q3 levels (21.6%).

6. New immigrants will directly contribute £19bn to the UK economy, equivalent to around 1% of GDP

Immigration to the UK hit a record high of 1.1m in the year to June-2022, as COVID-19 restrictions were unwound and targeted schemes for Ukrainians, Afghans and Hong Kong residents added around 140k to the total. Our analysis considers two scenarios for immigration in 2023: A high scenario, which assumes immigration remains at approximately 2022 levels in 2023 (assuming there is not the same level of immigration via temporary schemes) and a low scenario, based off the 2020-based interim ONS population projections. In both scenarios, we find that immigration to the UK will boost the UK's growth prospects in 2023, adding between £19bn to £30bn to real GDP in 2023, even though the whole economy is expected to contract. This is approximately equivalent to around 1% of real GDP.
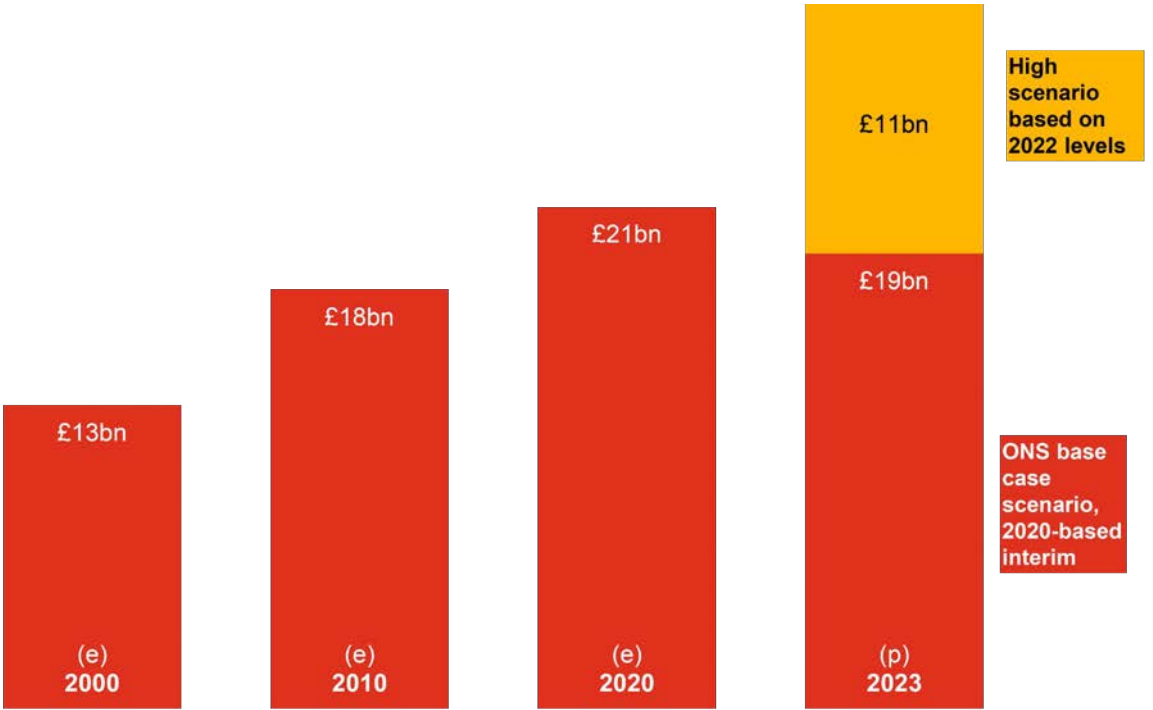
Immigration to the UK remains at high levels compared to historical standards

Estimated and projected total international immigration, UK, years ending mid-1997 to mid-2023
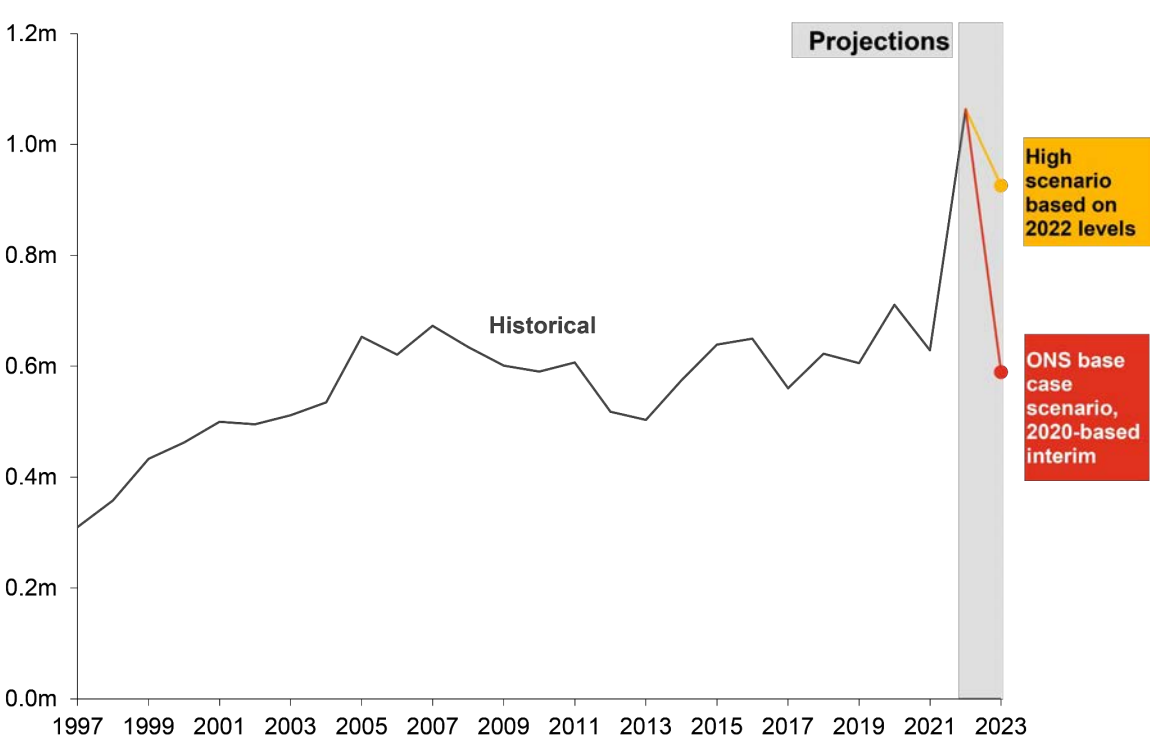
We expect that immigrants to the UK in 2023 could contribute £19bn to £30bn to real GDP

Total direct economic impact of immigration to UK, constant 2021 prices, projections from 2023
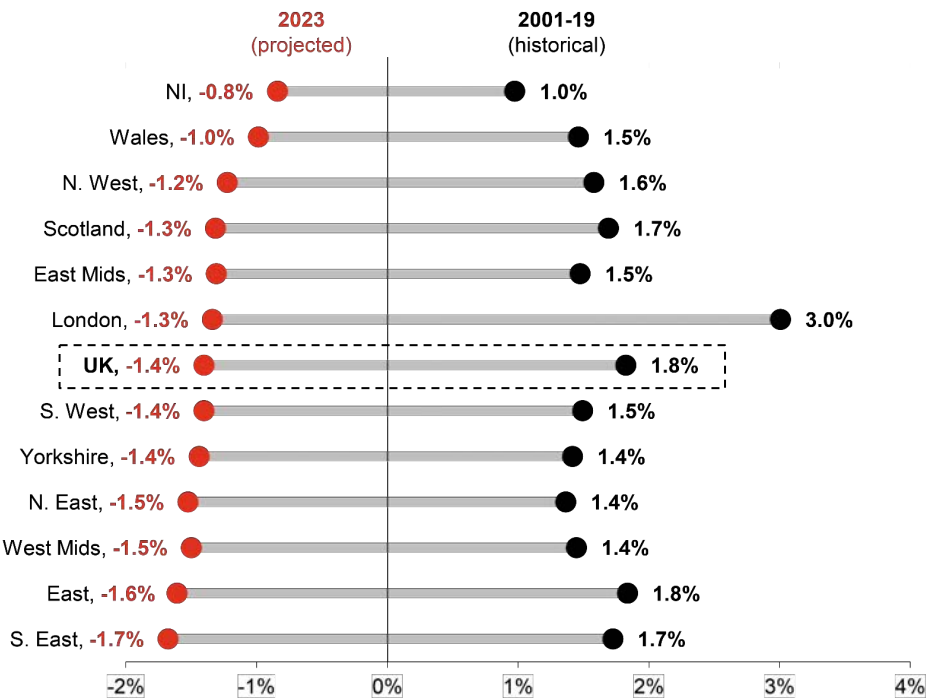

Sources: PwC analysis, ONS, OBR. Notes: To calculate the estimated contribution of international immigration to the UK we multiply the number of immigrants in each scenario by the OBR's projections for GDP per capita in 2023. This analysis implicitly assumes that newly arrived immigrants produce the same output per person as the existing resident population.

7. London and Northern Ireland will be the only two UK regions with above pre-pandemic levels of economic activity

High inflation combined with a tightening of financial conditions is expected to see all twelve regions in the UK contract in 2023. As a result, by the end of 2023 we expect that there will only be two regions where economic activity exceeds pre-pandemic levels: London and Northern Ireland. In the case of Northern Ireland, this in part reflects the region's strong export performance relative to the rest of the UK, owing largely to its continued membership in the EU's single market and customs union. While at the other end of the spectrum, the West Midlands is expected to remain the furthest from pre-pandemic levels. This is in large part due to the importance of the automotive sector in the region, which has struggled with Brexit and COVID-related disruptions.
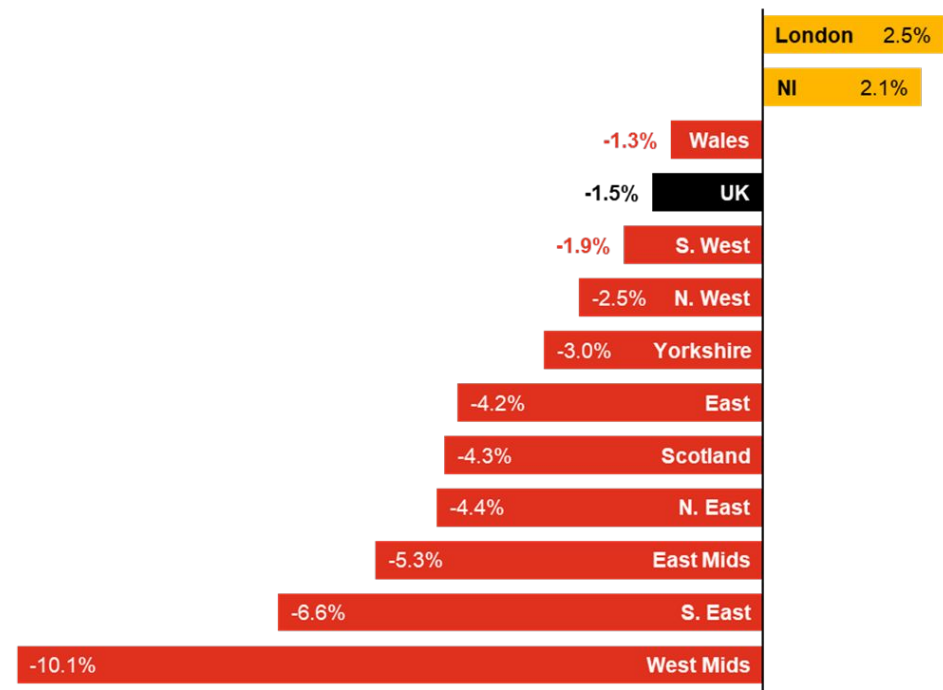
We expect that all twelve UK regions will shrink in 2023
Annual GVA growth, actual (2001-19 annual average) and projections (2023), by UK region.

London & Northern Ireland could be the only two regions that exceed pre-pandemic levels
Projected GVA in 2023 relative to pre-pandemic levels.

2023 (projected)   **2001-19** (historical)

Region	2023	2001-19
NI	-0.8%	1.0%
Wales	-1.0%	1.5%
N. West	-1.2%	1.6%
Scotland	-1.3%	1.7%
East Mids	-1.3%	1.5%
London	-1.3%	3.0%
UK	-1.4%	1.8%
S. West	-1.4%	1.5%
Yorkshire	-1.4%	1.4%
N. East	-1.5%	1.4%
West Mids	-1.5%	1.4%
East	-1.6%	1.8%
S. East	-1.7%	1.7%

|	
London	2.5%
NI	2.1%
Wales	-1.3%
UK	-1.5%
S. West	-1.9%
N. West	-2.5%
Yorkshire	-3.0%
East	-4.2%
Scotland	-4.3%
N. East	-4.4%
East Mids	-5.3%
S. East	-6.6%
West Mids	-10.1%

Sources: PwC analysis, ONS, OBR, IHS Markit. Notes: Our analysis uses the OBR's forecasts for UK-wide growth in 2022 and 2023, alongside sectoral forecasts produced by IHS Markit, to develop regional projections for 2022 and 2023.

8. The average Brit will be the unhappiest they've been since records began a decade ago

Over the past decade economists and policymakers have started to use wellbeing as an indicator for societal performance alongside more traditional economic metrics such as gross domestic product (GDP). Despite this, there remains a strong relationship between economic conditions – as measured by the sum of unemployment and inflation rates – and happiness indices. We use this relationship, which is well documented in the academic literature, to develop projections for average UK life satisfaction. Our analysis suggests that happiness could fall to its lowest level ever recorded in FY 2023, as household living standards take a hit due to high inflation rates and the expected rise in unemployment, and then start to improve along with economic conditions.

Countries with poorer economic outcomes typically have lower levels of happiness
Economic misery index (unemployment + inflation rate) vs. happiness index, 2015-19 average
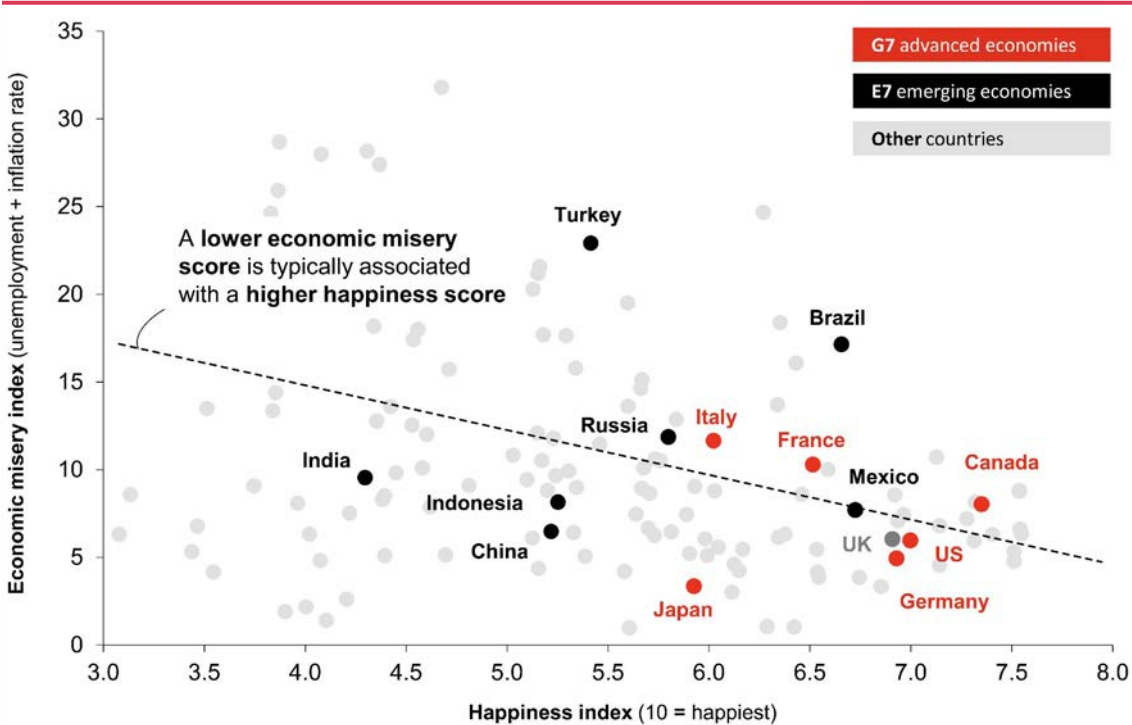
Happiness levels in the UK could decline as economic conditions deteriorate
Average UK life satisfaction rating, 0 to 10 (10 = happiest), projections from FY23
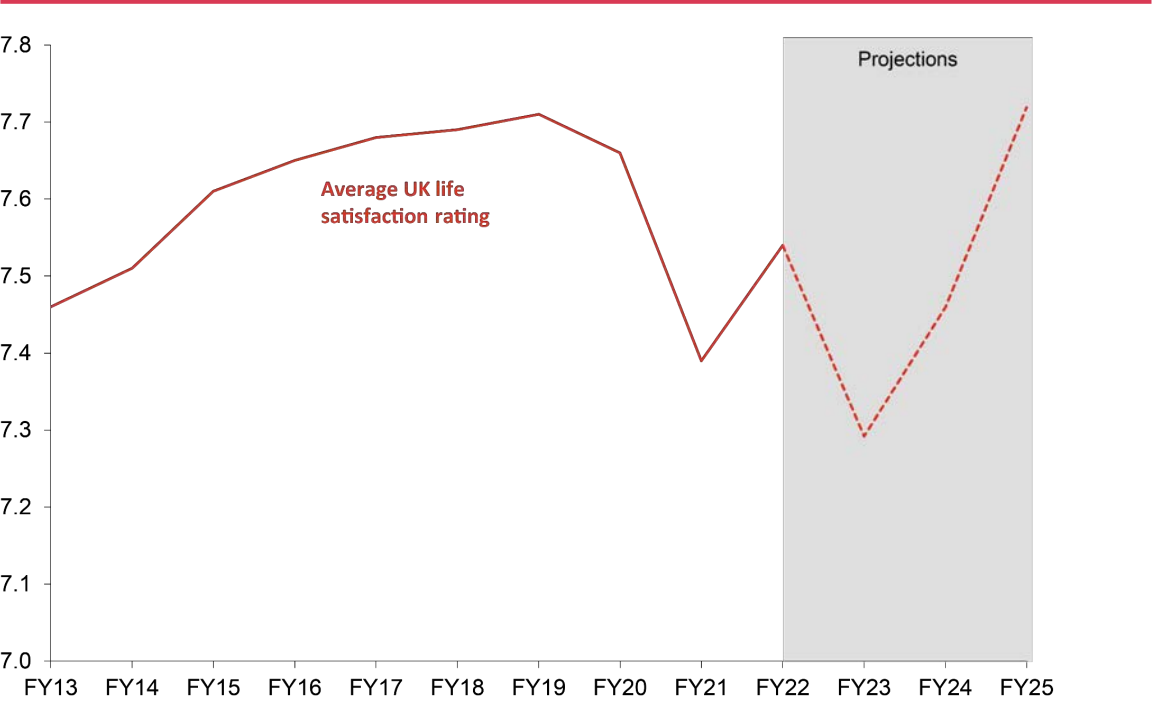

Sources: PwC analysis, ONS, OBR, World Bank, Gallup, Blanchflower et al.. Notes: This prediction is made on a financial year basis to align it to the ONS reporting on UK life satisfaction. FY refers to the calendar year in which the financial year ends (e.g. FY13 covers the period from April 2012 to March 2013). Our average UK life satisfaction rating prediction is based on the findings from a paper by Blanchflower et al. (2014), which uses econometric analysis to estimate the relationship between unemployment rates, inflation rates and life satisfaction indices. We also use projections for the unemployment rate and inflation rate from the OBR's Economic and Fiscal Outlook – November 2022 as an input in the analysis.

9. The total number of divorces will spike by one-fifth to almost 140,000 in England and Wales, equivalent to 16 divorces every hour

The total number of divorces has been on a downward trajectory for several decades, in large part due to the fact that fewer people are getting married in the first place. However, in recent years divorces have started to rise and our expectation is that they will spike by a further 20% over the 2022 to 2023 period. The main driver of this profile is the introduction of no-fault divorces in April 2022 - the biggest reform to Divorce Law in 50 years. When the change was first introduced divorce applications spiked by 22% in Q2 2022 compared to Q2 2021, and when a similar change to legislation was introduced in Scotland it resulted in a 20% rise. The key unknown is the impact of a deteriorating economic environment. One theory posits that recessions contribute to a rise in divorces due to increased financial strain, while another suggests that an unfavourable economic climate leads to increased family solidarity. Evidence from the GFC suggests the impact from a recession may be delayed by 1-2 years.

The number of divorces has been on a mostly downward trajectory since the start of the century but has started to rise in recent years
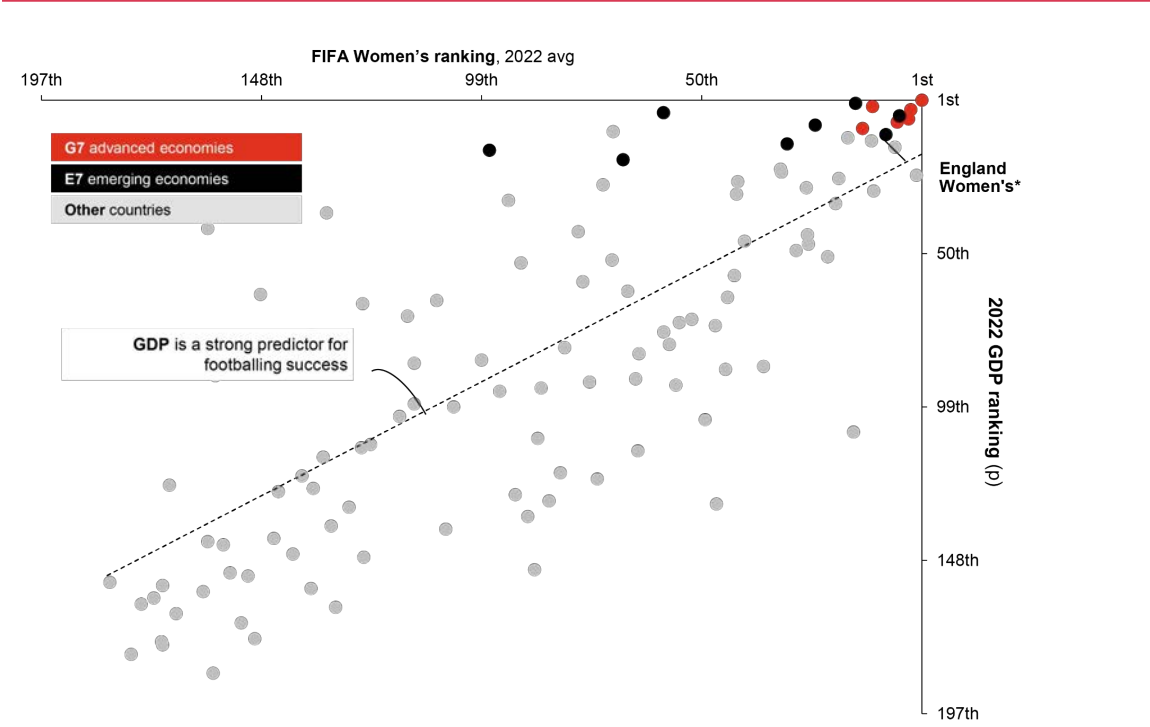Number of divorces, England and Wales, thousands.
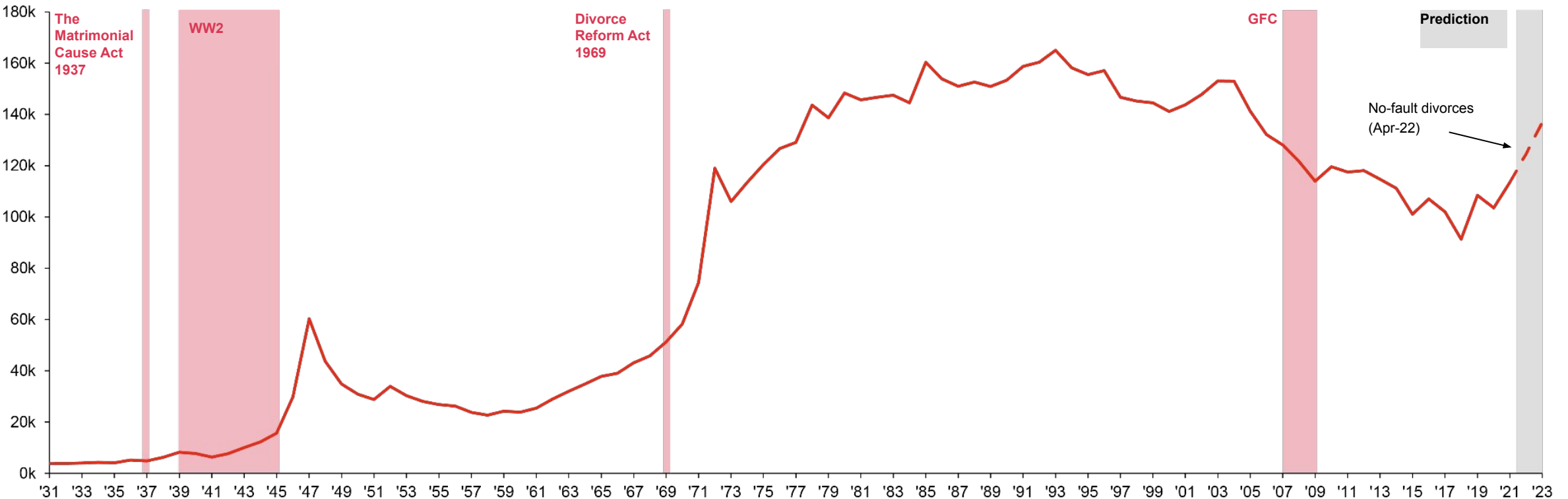
10. It's coming home! The England Women's team will succeed where the men failed and bring home the World Cup

The UK is currently the sixth largest economy in the world in market prices. If we assume that the size of an economy is a predictor of footballing success – and the data suggests there is a strong relationship – then we would expect the England Men's & Women's teams to be the sixth best in the world. But they are both doing better than this, with the Men's team in fifth place, and the Women's team in fourth place – behind only the US, Germany and Sweden. The England Women's team surpassed expectations in 2022 when they won the Euros despite being only the eighth highest ranking team in the world, which saw them jump four places in the rankings and overtake the Men's team for the first time since 2019. Our (somewhat biased) prediction is that the Women's team will continue to surpass expectations and bring home the World Cup in 2023. This would see the Women's team once again outperform the Men's team, who crashed out in the World Cup quarter finals in 2022.

Larger economies are typically more successful in Women's international football
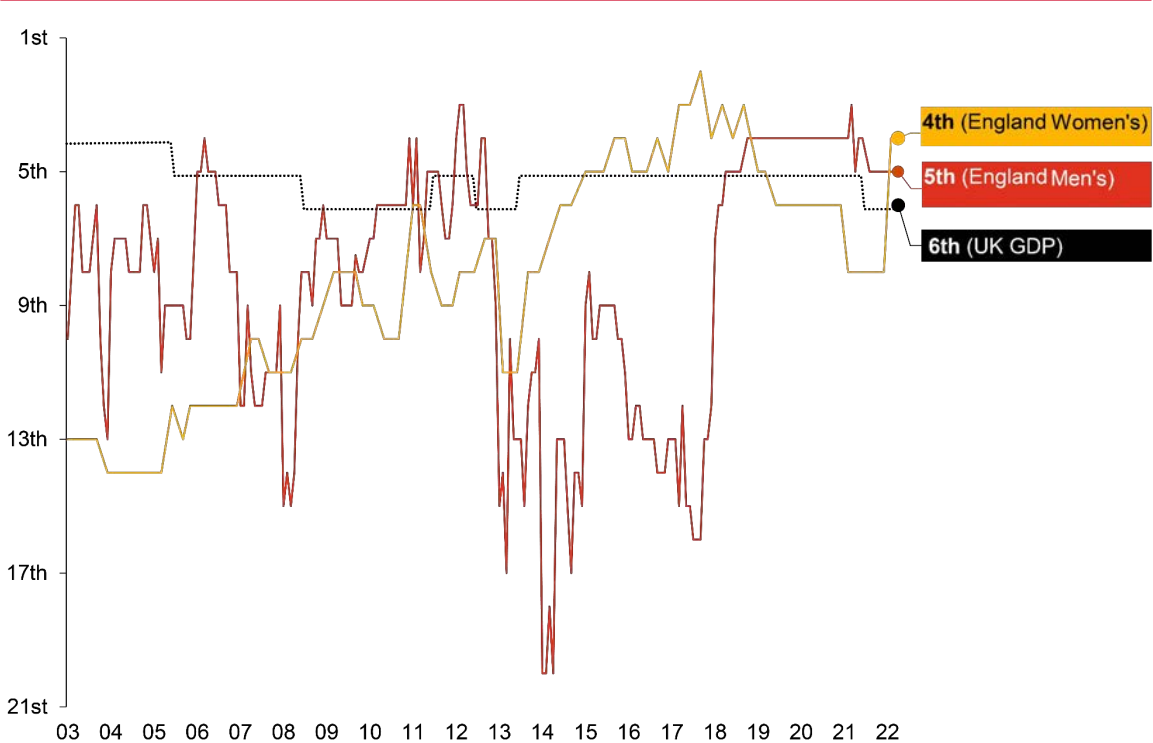FIFA women's team ranking (2022 average) vs. projected GDP ranking in market prices (2022)

The England Women's team are outperforming the Men's team & the UK's GDP ranking
World Cup Rankings (England Women's & Men's) vs UK GDP ranking in market prices

Sources: PwC analysis, FIFA, IMF. Notes: *UK GDP ranking used as a proxy for England's GDP ranking

Contacts and services

Nick Forrest
UK economics leader
nick.forrest@pwc.com

Barret Kupelian
Director
barret.g.kupelian@pwc.com

Jake Finney
Economist
jake.finney@pwc.com

Amaan Saroya
Economist
amaan.saroya@pwc.com

Archie Thackray
Junior economist
archie.thackray@pwc.com

Gabriela Grobelny
Junior economist
gabriela.grobelny@pwc.com

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Total impact measurement and management
Jason Calvert
+44 (0) 7501 538 370

Econometric modelling and data analytics
Mehdi Sahneh
+44 (0) 7483 380 165

Macroeconomic consulting and financial regulation
Barret Kupelian
+44 (0) 771 562 331

Competition economics
Saatvik Bansal
+44 (0) 7872 815 77

Policy and economic cases
Philip Dobson
+44 (0) 7825 318 386

International trade and development
David Armstrong
+44 (0) 7713 690 266

Economic regulation
Daniel Jacobson
+44 (0) 7803 455 617

Economic modelling and appraisal
Barret Kupelian
+44 (0) 7715 62 331

Behavioural economics
Suresh Natarajan
+44 (0) 7764 958 008

Thank you

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