Summary Report – March 2018

UK Economic Outlook

Special features on:

- The outlook for consumer spending and the impact of automation
- Regional growth trends and prospects

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Key projections

	2018	2019
Real GDP growth	1.5%	1.6%
Consumer spending growth	1.1%	1.3%
Inflation (CPI)	2.7%	2.3%

Source: PwC main scenario projections

Recent UK developments and prospects

- UK economic growth slowed in 2017 as inflation rose sharply, squeezing household spending power.
- In our main scenario, we project UK growth to remain modest at around 1.5% in 2018 and 1.6% in 2019. This is due to continued subdued real consumer spending growth and the drag on business investment from ongoing economic and political uncertainty relating to the outcome of the Brexit negotiations.
- The stronger global and Eurozone economies, and the competitive value of the pound particularly against the euro, should also boost exports, however, which will offer some support for overall UK GDP growth.
- Service sector growth should remain modest but positive in 2018-19, while manufacturing retains momentum after ending 2017 strongly. But the construction sector has fallen back due to the weakness of commercial property investment and this looks set to continue this year.
- The Bank of England could raise interest rates once or twice this year, though the pace of increase will remain limited and gradual.

What are the longer term prospects for consumer spending?

- We project households will spend over 30% of their budget on housing and utilities by 2030, up from around 27% in 2017. Spending on financial services and personal care will also tend to increase relatively rapidly over time, while the share of total spending on food and clothing will tend to decline in the long run.
- Automation could have a major impact on retail jobs in the long run, but will also bring benefits to consumers in lower prices. This will allow consumers to increase their real spending levels, potentially creating new jobs in less automatable services sectors such as health and personal care. Emerging technologies like artificial intelligence (AI) could also bring great competitive advantage to businesses that deploy them effectively.

Regional trends and prospects

- London has grown significantly faster than other UK regions for most of the past two decades, but recently there have been signs from both the labour and housing markets that London's relative performance has been less strong.
- We expect this to continue in 2018-19, with London growing at close to the UK average rate.
- As manufacturing has bounced back recently on the back of a stronger global economy and a more competitive value of the pound, this has helped parts of the UK with stronger industrial bases in the North and the Midlands.

1 – Summary

Recent developments

The UK economy held up well in the six months after the EU referendum, but growth slowed markedly from early 2017 as consumer spending growth moderated.

A key factor behind that moderation was the increase in the rate of consumer price inflation (CPI) from around zero on average in 2015 to 3% in the year to January 2018, as global commodity prices have picked up from lows in early 2016, and the effects of the weak pound after the Brexit vote have fed through supply chains. Higher inflation has squeezed real household incomes and this has taken the edge off consumer-led growth. Brexit-related uncertainty has also dampened business investment growth.

On the more positive side, UK exports have been boosted by the upturn in global growth over the past year, notably in the Eurozone. The weaker pound, although bad for UK consumers, has been helpful to exporters and inbound tourism.

Table 1.1: Summary of UK economic growth and inflation prospects

Indicator (% change on previous year)	OBR forecasts (March 2018)		Independent forecasts (February 2018)		PwC Main scenario (March 2018)	
	2018	2019	2018	2019	2018	2019
GDP	1.5	1.3	1.6	1.5	1.5	1.6
Consumer spending	0.9	0.9	1.2	1.3	1.1	1.3
Inflation (CPI)	2.4	1.8	2.6	2.2	2.7	2.3

Source: Office for Budget Responsibility (March 2018), HM Treasury survey of independent forecasters (average value of new forecasts made in February 2018 survey) and latest PwC main scenario.

Future prospects

As shown in Table 1.1, our main scenario is for UK GDP growth to remain moderate at around 1.5% in 2018 and 1.6% in 2019. Our views on growth and inflation are broadly similar to the latest consensus and OBR forecasts (see Table 1.1).

Consumer spending growth is expected to moderate to only around 1% in 2018 but may pick up slightly next year as real wages recover. Longer term trends and prospects for consumer spending are discussed further below.

On the positive side, the stronger global economy should continue to have some offsetting benefits for net exports (though there are downside risks here if recent US tariff policy changes were to lead to a wider trade war). Brexit-related uncertainty may continue to hold back business investment, but this should be partly offset by planned increases in public investment and some easing of austerity over the next two years as announced in the November 2017 Budget.

There are always uncertainties surrounding our growth projections, as illustrated by the alternative scenarios in Figure 1.1. There are still considerable downside risks relating to possible pitfalls on the road to Brexit, but there are also upside possibilities if these problems can be contained and global growth continues to pick up. In our main scenario, we expect the UK to continue with moderate but steady growth in 2018-19, but businesses need to monitor and make contingency plans for potential alternative scenarios related to Brexit and other factors.

Inflation should fall back gradually over the course of 2018 and 2019 assuming no major shifts in exchange rates or global commodity prices. Given continued uncertainties around Brexit, we expect the Monetary Policy Committee to be cautious about the pace of future interest rate rises, but one or two increases seem possible this year.

Longer term outlook for consumer spending and the impact of automation

As shown in Table 1.1, we expect consumer spending growth to slow to only around 1% this year and pick up only modestly to around 1.3% in 2019, but in the longer term it should return to an estimated trend rate of around 2% per annum on average in the 2020s.

As discussed in detail in Section 3 of this report, we project that households will spend over 30% of their budget on housing and utilities by 2030, up from around 27% in 2017 (see Table 1.2). Spending on financial services and personal care (classified under 'miscellaneous services' in Table 1.2) will also tend to increase relatively rapidly over time, while the share of total spending on food and clothing will tend to decline in the long run.

Automation could have a major impact on retail jobs in the long run, but will also bring benefits to consumers through lower prices. This will allow consumers to increase their real spending levels, potentially creating new jobs in less automatable services sectors such as health and personal care. Technologies like artificial intelligence (AI) could also bring great competitive advantage to businesses that deploy them effectively.

Figure 1.1 – Alternative UK GDP growth scenarios

Sources: ONS, PwC scenarios

Table 1.2: Household budget share projections to 2030 and implied average annual real growth rates by household spending category in main scenario

	Shares of total spending			Implied average real growth rates	
	2018p	2020p	2030p	2018-20p	2021-30p
Alcohol and tobacco	3.5%	3.4%	2.9%	0.6%	0.3%
Clothing and footwear	5.5%	5.3%	4.3%	-0.4%	-0.2%
Communications	2.0%	2.0%	2.0%	1.3%	2.3%
Education	1.8%	1.8%	1.7%	1.5%	2.0%
Food	7.9%	7.5%	5.5%	-1.2%	-1.1%
Furnishings	5.0%	5.0%	4.9%	1.8%	1.7%
Health	1.8%	1.8%	2.0%	1.6%	2.6%
Housing and utilities	27.1%	27.5%	30.8%	2.5%	3.1%
Miscellaneous services	13.4%	13.7%	14.9%	2.7%	2.8%
Recreation and culture	9.6%	9.7%	9.9%	2.0%	2.3%
Hotels and restaurants	9.3%	9.3%	9.4%	1.4%	2.1%
Transport	13.1%	13.0%	11.8%	0.6%	1.1%
Total spending	**100%**	**100%**	**100%**	**1.5%**	**2.0%**

Sources: ONS data for Q1-Q3 2017 and PwC estimates and main scenario projections for later periods

Regional growth trends and prospects

As analysed in detail in Section 4 of this report, London has consistently outperformed other UK regions for most of the past two decades in terms of economic growth, both before and after the global financial crisis.

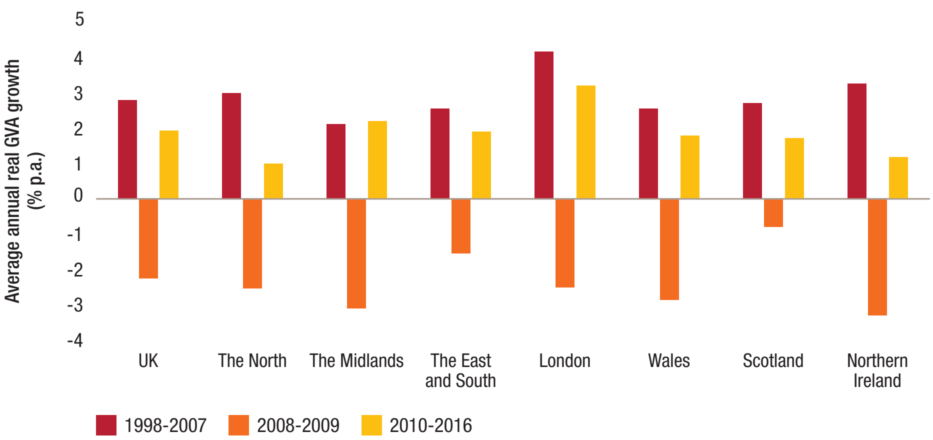
Outside London, there is less of a clear North-South divide in historical regional growth patterns. Some Northern regions and Northern Ireland did better than some Southern regions in the decade before the financial crisis, though they have performed less well since the crisis (see Figure 1.2).

The Midlands struggled before the crisis but has performed relatively better since 2010 when compared to other regions except London.

More recently, there have been signs that London's relative performance has been less strong and we expect this to continue in 2018-19, with London growing at close to the UK average rate.

As manufacturing has bounced back recently on the back of a stronger global economy and a more competitive value of the pound, this has helped parts of the UK with stronger industrial bases such as the North and the Midlands.

Figure 1.2 – London led the way on real GVA growth both before and after crisis



Sources: PwC analysis of ONS data

Appendix A
Outlook for the global economy

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

World economic growth strengthened through 2017 and this is expected to continue, increasing the global weighted average real growth rate to over 3% in both 2018 and 2019 (using GDP at market exchange rates as weights). This growth is expected to be driven by the large emerging economies with continued strong growth of around 7.5% in India and around 6.5% in China. The outlook for emerging markets has also brightened as a result of somewhat improved economic conditions in Russia and Brazil, which are now moving gradually out of recession. Indonesia is also expected to continue to grow strongly at over 5% in 2018-19.

There has been a clear upswing in Eurozone economic activity over the past two years, increasing projected growth to over 2% this year. Relative to the rest of the G7, strong US growth of just under 3% is projected in 2018 as fiscal stimulus strengthens an already recovering economy. But this could be offset by gradual rises in US interest rates to keep inflation under control, causing some slowing of growth next year. Any shift towards greater protectionism by the US could be a longer term downside risk to growth both in that economy and in the world more generally.

These projections are updated regularly in our Global Economy Watch publication, which can be found at www.pwc.com/gew

Table A.1: Global economic growth and inflation prospects

	Share of world GDP	Real GDP growth (%)		Inflation (%)	
	2016 at MERs	2018p	2019p	2018p	2019p
US	24.7%	2.8	2.3	2.3	2.2
China	14.9%	6.5	6.3	2.3	2.4
Japan	6.6%	1.0	0.8	0.5	1.1
UK	3.5%	1.5	1.6	2.7	2.3
France	3.3%	2.1	1.9	2.6	2.1
Germany	4.6%	2.4	2.3	2.1	1.7
Greece	0.3%	2.7	2.4	1.0	1.4
Ireland	0.4%	3.5	3.0	1.0	1.2
Italy	2.5%	1.2	1.0	1.3	1.3
Netherlands	1.0%	2.6	2.3	1.6	1.9
Portugal	0.3%	2.0	1.7	1.4	1.4
Spain	1.6%	2.8	2.5	1.6	1.6
Poland	0.6%	3.4	3.2	2.2	2.7
Russia	1.7%	1.8	1.6	4.1	4.1
Turkey	1.1%	3.2	3.8	8.4	8.1
Australia	1.7%	2.9	3.0	2.2	2.5
India	3.0%	7.4	7.6	4.5	5.0
Indonesia	1.2%	5.3	5.4	4.0	3.8
South Korea	1.9%	2.9	2.7	1.8	2.0
Argentina	0.7%	3.0	3.2	19.5	n/a
Brazil	2.4%	1.8	2.1	4.1	4.2
Canada	2.0%	2.1	2.0	1.8	1.9
Mexico	1.4%	2.1	2.2	4.2	3.9
South Africa	0.4%	1.3	1.5	5.3	5.6
Nigeria	0.5%	2.0	3.4	12.1	10.7
Saudi Arabia	0.8%	1.3	1.9	3.7	3.0
World (PPP)		3.8	3.7	3.0	2.9
World (Market Exchange Rates)	100%	3.3	3.1	2.6	2.5
G7	47.1%	2.2	1.9	2.0	1.9
Eurozone	13.9%	2.2	2.0	1.9	1.7

Source: PwC main scenario for 2018 and 2019; IMF for GDP shares in 2016 at market exchange rates (MERs).

Appendix B
UK economic trends: 1979 – 2017

Annual averages	GDP growth	Household expenditure growth	Manufacturing output growth*	Inflation (CPI**)	3 month interest rate (% annual average)	Current account balance (% of GDP)	PSNB*** (% of GDP)
1979	3.7	4.8			13.7	-0.6	4.2
1980	-2.0	0.1			16.6	0.5	3.9
1981	-0.8	0.3			13.9	1.5	3.0
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	2.5
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	-3.5	-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	6.7
1994	3.9	3.2		2.0	5.5	-0.5	5.8
1995	2.5	2.1		2.6	6.7	-0.7	4.6
1996	2.5	3.9		2.5	6.0	-0.6	3.3
1997	6.6	8.7		1.8	6.8	-0.1	1.9
1998	3.1	4.0	0.4	1.6	7.3	-0.7	0.2
1999	3.2	4.9	0.5	1.3	5.4	-2.6	-0.8
2000	3.7	4.8	2.3	0.8	6.1	-2.4	-1.5
2001	2.5	3.6	-1.5	1.2	5.0	-2.1	-0.2
2002	2.5	3.8	-2.2	1.3	4.0	-2.2	2.0
2003	3.3	3.6	-0.5	1.4	3.7	-1.9	3.4
2004	2.4	3.2	1.8	1.3	4.6	-2.4	3.3
2005	3.1	3.1	0.0	2.1	4.7	-2.1	3.2
2006	2.5	1.8	2.1	2.3	4.8	-3.1	2.8
2007	2.4	2.7	0.6	2.3	6.0	-3.8	2.6
2008	-0.5	-0.6	-2.8	3.6	5.5	-4.6	5.4
2009	-4.2	-3.3	-9.4	2.2	1.2	-3.9	10.1
2010	1.7	0.7	4.6	3.3	0.7	-3.8	9.1
2011	1.5	-1.0	2.2	4.5	0.9	-2.4	7.1
2012	1.5	1.8	-1.5	2.8	0.8	-4.2	7.6
2013	2.1	1.9	-1.0	2.6	0.5	-5.5	5.7
2014	3.1	2.2	2.9	1.5	0.5	-5.3	5.3
2015	2.3	2.7	0.0	0.0	0.6	-5.2	4.1
2016	1.9	3.1	0.9	0.7	0.5	-5.8	2.9
2017 (est.)	1.7	1.8	2.8	2.7	0.3	-4.6	1.8
Average over economic cycles****							
1979 - 1989	2.8	3.7			12.2	-0.8	2.2
1989 - 2000	2.5	3.3		3.3	8.3	-1.6	2.4
2000 - 2014	1.8	1.9	-0.2	2.2	3.3	-3.3	4.4

* 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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