



# *UK Economic Outlook*

Special features on:

- UK economic prospects after Brexit
- Outlook for the public finances and options for the Autumn Statement
- UK trade prospects after Brexit



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# Highlights and key messages for business and public policy

- UK economic growth held up better than expected following the Brexit vote, particularly as regards consumer spending and services. For 2016 as a whole, growth now looks likely to be around 2%.
- In our main scenario, we project UK growth to slow to around 1.2% in 2017 due to the drag on investment from increased political and economic uncertainty following the 'Brexit' vote. But we don't expect the UK to suffer a recession next year.
- We expect the Bank of England to keep monetary policy on hold in the short term, looking through an expected rise in headline inflation to well above its 2% target rate by late 2017 as the effects of a weaker pound feed through to consumer prices.
- The main reason for the slowdown will be a decline in business investment, driven in particular by 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 2% 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 expected slower jobs growth.
- The weaker pound should also boost net exports, however, which should see the UK current account deficit begin to shrink gradually from recent high levels.
- Service sector growth will slow but should remain positive in 2017, 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.

## Key projections

	2016	2017
Real GDP growth	2.0%	1.2%
Consumer spending growth	2.9%	2.2%
Inflation (CPI)	0.6%	2.3%

Source: PwC main scenario projections

## Public borrowing to overshoot OBR forecasts, but still scope for more investment

- In our main scenario we project that public borrowing will, in the absence of policy changes, be persistently higher than the OBR forecast back in March before the Brexit vote.
- In particular, we project a continuing budget deficit of around £67 billion this year falling to around £18 billion in 2019/20 on unchanged policies rather than a £10 billion budget surplus in that year. In total, we project a cumulative borrowing overshoot of over £100 billion by 2020/21 compared to the OBR's March forecasts.
- This would, however, still leave the Chancellor with a current budget surplus (excluding net investment) of around £14 billion in 2019/20 and it seems likely that he will want to add to planned public investment in priority areas such as housing, transport infrastructure and NHS capital budgets in his Autumn Statement.

## UK trade prospects after Brexit: risks and opportunities

- The Brexit votes poses clear risks to Britain's trading position with the EU, but there are also opportunities arising from the UK's strength in tradable services and its relatively strong performance in exporting to non-EU countries since 2007.
- The challenge for UK policymakers is to maximise these opportunities through securing good access to the Single Market even if it is no longer a member; focusing on trade promotion in key non-EU markets like North America, Asia, the Middle East and Africa rather than waiting for free trade deals with these regions; and boosting competitiveness by pursuing supply side reform at home linked to increased investment in housing, infrastructure and vocational skills.

# 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 Q2 2016 as global growth moderated. Preliminary data for the third quarter suggest that UK growth held up well in the immediate aftermath of the EU referendum, particularly as regards consumer spending and services.

The pound stabilised during the summer after an initial sharp fall after the Brexit vote, but fell back again in October due to heightened fears that the UK could suffer a significant loss of access to the EU Single Market after Brexit. Equity prices bounced back after the initial shock of the Brexit vote, however, and financial markets generally remained stable through the summer and early autumn. The housing market has also remained reasonably robust over this period.

UK growth continues to be driven by services, with manufacturing and construction both seeing falling output in the third quarter.

The rate of consumer price inflation (CPI) has picked up from around zero on average in 2015 to 1% in the year to September 2016, as commodity prices have picked up somewhat from lows in early 2016 and the effects of the pound have started to feed through the supply chain.

Table 1.1: Summary of UK economic prospects

Indicator (% change on previous year)	OBR forecasts (March 2016)		Independent forecasts (October 2016)		PwC Main scenario (November 2016)	
	2016	2017	2016	2017	2016	2017
GDP	2.0	2.2	1.9	1.0	2.0	1.2
Consumer spending	2.4	2.2	2.7	1.2	2.9	2.2
Investment	2.9	4.5	0.0	-2.1	1.1	0.0

Source: Office for Budget Responsibility (March 2016), Consensus Economics survey (average values in October 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 from around 2% in 2016 to around 1.2% in 2017 as the effects of the vote to leave the EU feed through. Expected growth next year 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 1.9% in 2016 and 1% in 2017 (see Table 1.1).

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 down to around zero in 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. As discussed further below, the overall investment figures in Table 1.1 also allow for some increase in public investment to offset the expected downturn in business investment.

Consumer spending growth, by contrast, is projected to remain stronger than overall GDP growth at around 2.9% in 2016 and 2.2% in 2017, but is nonetheless likely to slow next year 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, supported 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 in 2017.

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 growth shortfall relative to our projections before the Brexit vote). There are still considerable downside risks relating to international developments (including uncertainty about the economic and trade policies of the incoming US President) 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 avoid a recession, but businesses need to monitor and make contingency plans for potential downside risks.

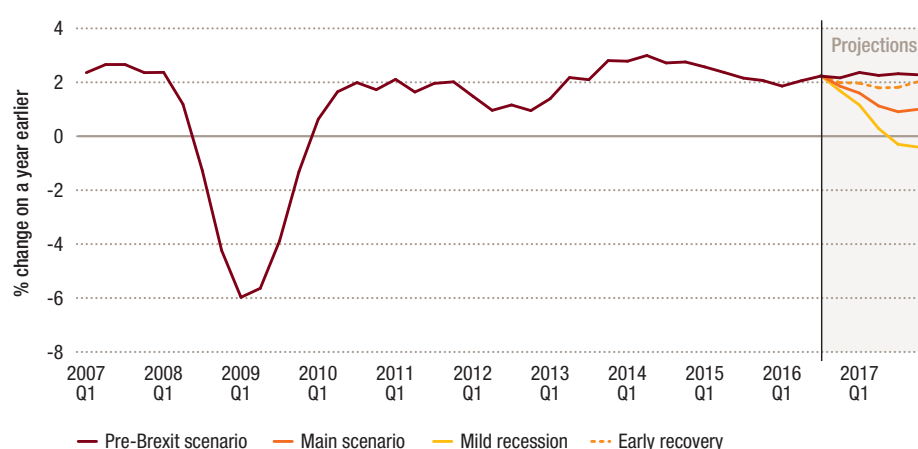
**Public borrowing could overshoot by over £100 billion over the next five years, but there is still room for additional public investment if fiscal rules are revised**

In Section 3 of the report, we present a revised outlook for the public finances following the Brexit vote. We find that:

- In our main scenario we project that public borrowing will, in the absence of policy changes, be persistently higher than the OBR forecast back in March before the Brexit vote. In particular, we project a continuing budget deficit of around £67 billion this year falling to around £18 billion in 2019/20 on unchanged policies, rather than a £10 billion budget surplus in that year. In total, we project a cumulative borrowing overshoot of over £100 billion by 2020/21 as compared to the OBR's March forecasts (see Figure 1.2).
- This would, however, still leave the Chancellor with a current budget surplus (excluding net investment) in 2019/20 and it seems likely that he will want to add to planned public investment in priority areas such as housing, transport infrastructure and NHS capital budgets in his Autumn Statement.
- Assuming an additional £20 billion (c. 1% of GDP) of net public investment spread over the period between 2017/18 and 2019/20, we estimate that the public debt to GDP ratio would still be on a downward trend from 2018/19 onwards, as well as retaining a current budget surplus of around £16 billion in 2019/20. This would meet a revised set of fiscal rules more similar to those initially adopted by George Osborne in 2010, as opposed to his later more ambitious budget surplus target.

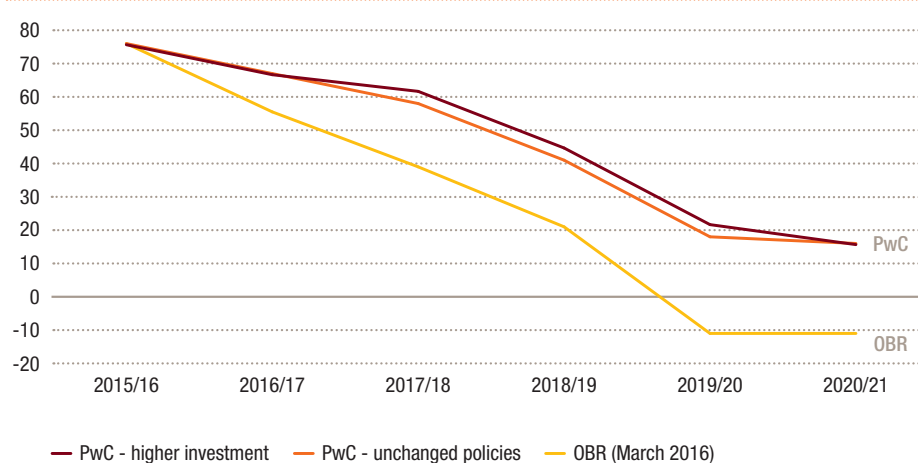
- While the Chancellor may boost public investment, he does not have the money for large net tax cuts and is likely to continue to bear down on non-investment spending by both central and local government.

**Figure 1.1 – Alternative UK GDP growth scenarios**



Source: ONS, PwC

**Figure 1.2 – Alternative public borrowing projections vs OBR's pre-Brexit forecasts (£bn)**



Source: ONS, OBR, PwC

## UK trade prospects after Brexit

One of the most important potential impacts of the Brexit vote is on the UK's longer term trade relationships both with the EU and other countries. Our senior economic adviser, Andrew Sentance, looks in detail at these implications in Section 4 of this report.

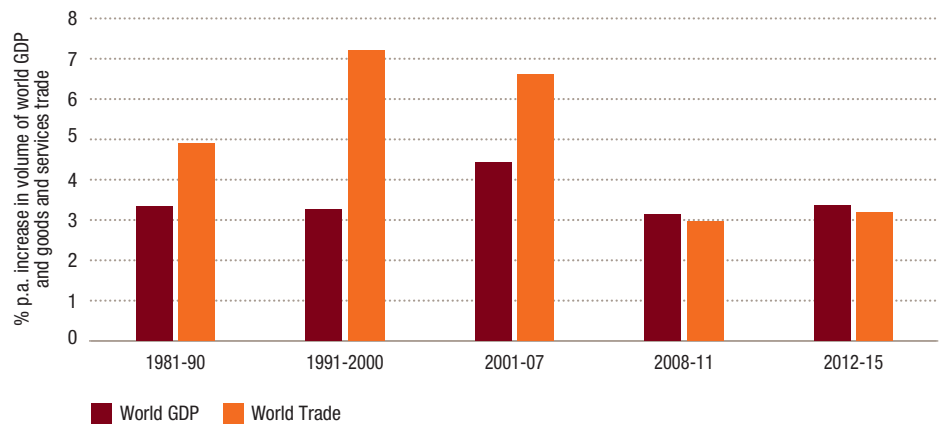
The background to this is that world trade growth has slowed relative to global GDP growth since the financial crisis (see Figure 1.3). This slowdown has been exacerbated recently by weaker growth in emerging markets and the commodity trade cycle.

Focusing on the UK, its relative export performance since 2007 actually appears to have been stronger outside the EU than within the EU Single Market (see Figure 1.4). This could reflect an advantage to euro area members from using a common currency or the inflexibility of trade linked to European supply chains. The UK also has a strong comparative advantage in services trade, which is growing more strongly globally than trade in goods.

Looking ahead, medium-term growth prospects remain strong in key emerging market regions, including Asia, Africa and the Middle East. That suggests that the recent downturn in trade growth outside the developed economies should prove temporary, and that UK export growth to markets outside the EU should soon resume momentum.

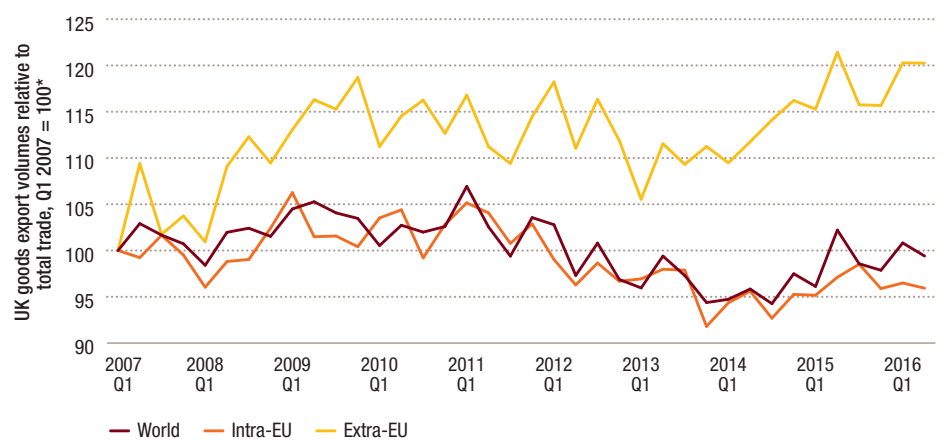
In this context, the key policy priorities for improving UK trade prospects after Brexit should be: securing the best possible access to the Single Market; a programme of trade promotion in non-EU markets; supply-side reform; and active engagement with other major international institutions – including the World Trade Organisation.

Figure 1.3 – World GDP and trade growth



Source: IMF World Economic Outlook, October 2016

Figure 1.4 – UK relative trade performance since 2007



Source: PwC calculations based on data from World Trade Organisation and ONS

Note\*: UK total exports relative to total world imports and UK intra-EU and extra-EU exports relative to EU totals

# 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 in 2017 despite relatively modest average growth of just over 2% next year. The UK, which has vied with the US for top place in the G7 league table in recent years, is set to fall back in 2017 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 this year. The growth outlook continues to be strong at present in India, which continues to benefit from relatively 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 2.9% 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](http://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%	1.5	2.2	1.2	2.2
China	15.2%	6.5	6.5	1.8	1.8
Japan	5.6%	0.6	0.5	0.1	1.3
UK	3.9%	2.0	1.2	0.6	2.3
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%	-1.3	0.3	-0.3	0.5
Ireland	0.4%	4.2	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%	3.2	3.5	8.2	7.8
Australia	1.7%	2.6	2.8	1.8	2.5
India	2.8%	7.7	7.7	4.1	4.3
Indonesia	1.2%	4.8	5.2	5.7	6.1
South Korea	1.9%	2.7	2.6	1.0	1.6
Argentina	0.9%	-0.8	2.1	30.0	
Brazil	2.4%	-3.0	1.0	9.0	6.5
Canada	2.1%	1.0	1.9	1.5	1.9
Mexico	1.6%	1.9	2.5	2.7	3.1
South Africa	0.4%	0.3	1.0	6.0	5.5
Nigeria	0.7%	-1.0	1.0	14.0	13.5
Saudi Arabia	0.9%	1.0	1.5	4.0	3.2
World (PPP)		3.0	3.4		
World (Market Exchange Rates)	100%	2.5	2.9	2.1	2.4
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 average)	Current account balance (% 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	-1.0	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	-1.5
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	-2.0	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	3.3
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	2.6
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	-3.0	10.2
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	7.1
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	5.7
2015	2.2	2.6	-0.2	0.0	0.6	-5.4	4.3
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, Andrew Sentance and Alan Shannon.

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

### John Hawksworth

john.c.hawksworth@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
	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
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	Michael Kane	+44 (0)28 9041 5303
	Peter Norriss	+44 (0)7525 298 726
	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
Telecommunications	Alastair Macpherson	+44 (0)20 7213 4463
Media and entertainment	David Lancefield	+44 (0)20 7213 2263
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