Summary Report – November 2018

UK Economic Outlook

Special features on:

Paying it down: past trends and future prospects for UK debt

UK economic growth: long-term trends and prospects for the 2020s

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Highlights and key messages for business and public policy

Key projections

	2018	2019
Real GDP growth	1.3%	1.6%
Consumer spending growth	1.7%	1.5%
Fixed investment growth	-0.5%	0.8%
Inflation (CPI)	2.5%	2.2%

Source: PwC main scenario projections

Recent UK developments and prospects

- In our main scenario, we project UK growth to remain modest at around 1.3% in 2018 and 1.6% in 2019. This reflects the drag on business investment from ongoing economic and political uncertainty relating to the outcome of the Brexit negotiations, which remain a major source of downside risk to our main scenario at the time of writing. But the higher government spending and short-term tax cuts announced in the Budget will provide some support for growth in 2019.

- The stronger global economy, and the competitive value of the pound, have boosted UK exports and inbound tourism, offering some support to the economy over the past two years. But the Eurozone economy has slowed recently and any escalation of international trade tensions could dampen global growth in 2019 and beyond.

- Service sector growth should remain modest but positive in 2019, but manufacturing growth has slowed markedly recently from the relatively high rates seen in 2017. Construction sector output has fallen back since early 2017 due to the weakness of commercial property investment in particular and looks set to remain relatively weak in the short term, given the uncertainty around Brexit.

- London has grown significantly faster than other UK regions for most of the past three decades, but recently there have been signs from both the labour and housing markets that London's relative performance has been less strong. We therefore expect London to grow at only slightly above the UK average rate in 2018-19, with limited variations in growth across regions over this period.

- In our main scenario with a smooth Brexit, we assume that the Bank of England raises interest rates by a quarter of a percent to 1% in mid-2019. But the precise timing of this will be data-dependent and the pace of any subsequent rate increases are likely to remain limited and gradual.

Rising private sector debt likely to outweigh declining public debt over next five years

- Over the next five years we expect the government to reduce gradually the size of its debt relative to GDP, but households and companies are both likely to borrow at a faster rate than economic growth. The net effect will be a gradual rise in the UK economy's overall debt-to-GDP ratio from 252% in 2017 to around 260% in 2023.

- Assuming that the Bank of England gradually raises interest rates to 2% by 2023, we project that total debt servicing costs in the UK economy could rise from an estimated 7.7% of GDP in 2017 to around 9.6% of GDP in 2023. This will squeeze the discretionary spending power of both households and companies.

UK growth could average 1.75% in 2020s

- UK economic growth has averaged below 2% in each of the first two decades of this century, the weakest performance in any decade since the Second World War.

- Our central estimate is that average UK growth may remain relatively subdued at around 1.75% per annum in the 2020s, allowing for the effects of an ageing population.

- But there is scope for government, working with business, to boost UK growth to 2% or more by promoting artificial intelligence and other new technologies, reforming tax and regulation to support productivity growth, encouraging greater participation in the labour force by older workers, and retaining an open approach to EU and global trade after Brexit.

1. Summary

Recent developments

The UK economy held up well in the six months after the EU referendum, but growth slowed from early 2017 as higher inflation bit into household spending power. This slowdown continued into early 2018, but GDP growth picked up again in the second and third quarters of the year, helped by a recovery in consumer spending as the weather improved and inflation eased.

The jobs market has generally remained strong, with the employment rate at record levels and unemployment down to its lowest rate since 1975. In recent months, this has finally started to feed through into increased wage growth, which is one reason why the Bank of England raised interest rates in August.

Future prospects

As shown in Table 1.1, our main scenario is for UK GDP growth to remain moderate at around 1.3% on average 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), and indeed the latest Bank of England forecasts.

Consumer spending growth held up better than expected in 2018, but is expected to moderate to around 1.5% in 2019 in our main scenario as stronger real wage growth is offset by slower jobs growth, a gradual rise in interest rates and subdued house price growth.

Brexit-related uncertainty will continue to hold back business investment in the UK in the short term, although we assume in our main scenario that this eases later in 2019 on the assumption of a relatively smooth Brexit. Total fixed investment in the economy is projected to fall by 0.5% in real terms in 2018, followed by a modest 0.8% recovery in 2019 in our main scenario.

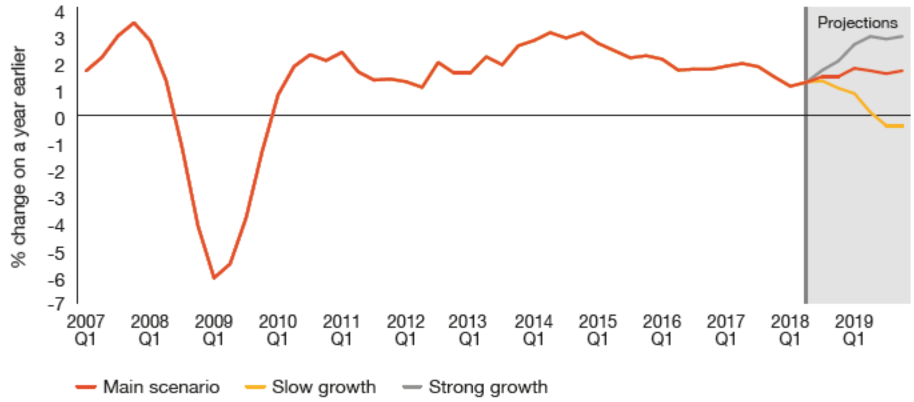
The Budget provided a significant boost to government spending, particularly on the NHS, and also some short-term tax cuts that will support growth in 2019.

Table 1.1: Summary of UK economic growth and inflation prospects

Indicator (% change on previous year)	OBR forecasts		Independent forecasts (October 2018)		PwC Main scenario (November 2018)	
	2018	2019	2018	2019	2018	2019
GDP	1.3	1.6	1.3	1.5	1.3	1.6
Consumer spending	1.3	1.2	1.4	1.4	1.7	1.5
Inflation (CPI)	2.6	2.0	2.5	2.1	2.5	2.2

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

Figure 1.1 – Alternative UK GDP growth scenarios



Source: ONS, PwC

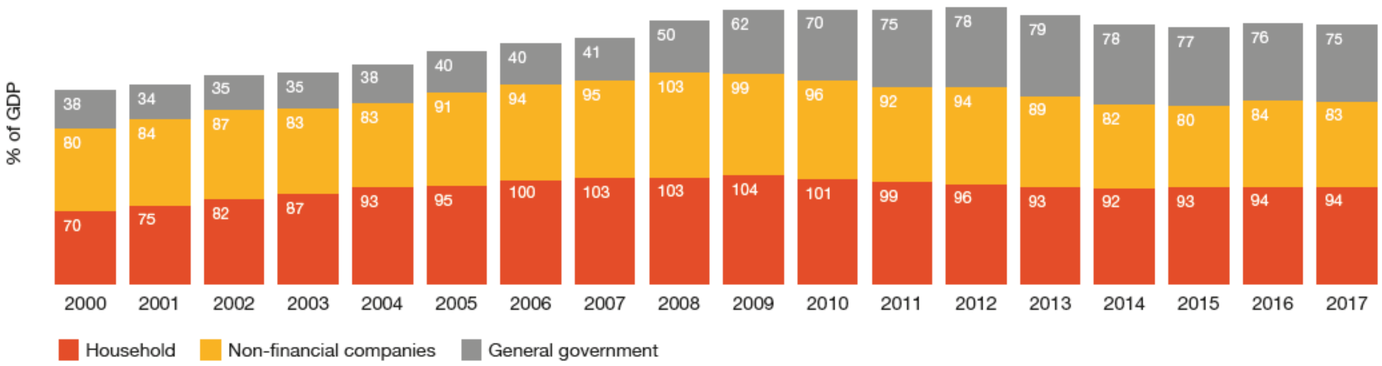
A fairly strong global economy should continue to have some offsetting benefits for net exports in the short term, but there are downside risks in 2019 and beyond from the effects of higher US interest rates and heightened international trade tensions. The Eurozone economy has also slowed recently, which will dampen UK export growth.

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 in particular to possible pitfalls on the road to Brexit, but there are also upside possibilities if these problems can be contained and global growth remains strong in 2019.

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 such as global trade tensions.

Inflation should fall back gradually to around its 2% target rate by the end of 2019, assuming no major shifts in exchange rates or global commodity prices. Given continued uncertainties around Brexit and the UK economy, we expect the Monetary Policy Committee to remain cautious about the pace of future interest rate rises, but in our main scenario we assume a further quarter-point rate rise to 1% in mid-2019.

Figure 1.2 – Gross UK debt stock outstanding by sector as % GDP



Source: PwC analysis of ONS data from 2018 Blue Book

Table 1.2: Projected UK debt stock

Sectors	Debt in cash terms (£ trillion)		Debt as % of GDP	
	2017	2023	2017	2023
Households	1.9	2.6	94	100
General government	1.5	1.8	75	69
Non-financial companies	1.7	2.4	83	91
Total	**5.1**	**6.7**	**252**	**259**

Source: ONS data for 2017, PwC main scenario projections for 2023

“ Total debt interest costs could rise from 7.7% of GDP in 2017 to 9.6% of GDP in 2023”.

Paying it down: past trends and future prospects for UK debt

The total stock of debt held by UK households, non-financial companies and the government rose sharply during the 2000s, so that by the time of the global financial crisis in 2008, the economy's debt burden was equivalent to more than 250% of national income (GDP), up from less than 200% of GDP at the turn of the century (see Figure 1.2).

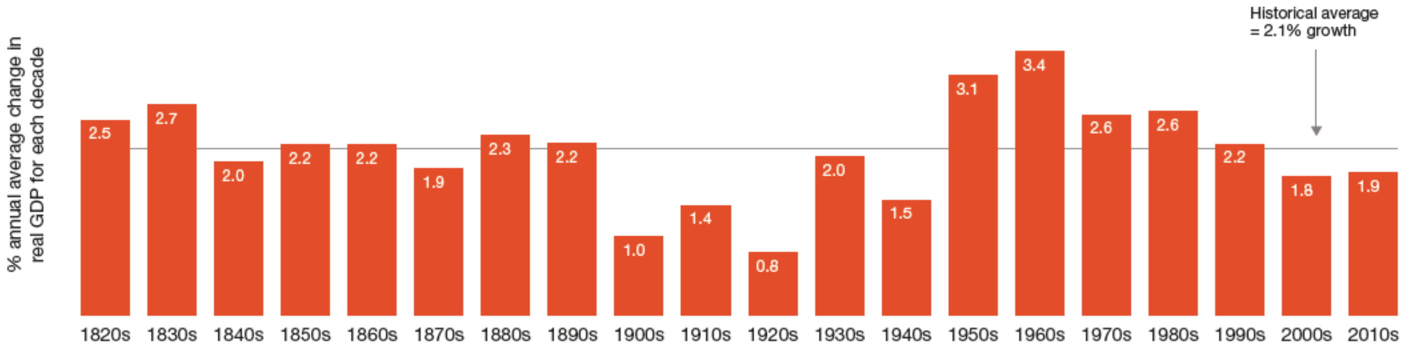
The onset of the crisis saw the private sector begin to pay down its debt, but the combination of higher government spending and falling tax revenue saw public debt double as a proportion of GDP between 2007 and 2013.

Several years of government austerity and private-sector deleveraging have brought down the total debt stock, but the economy remains much more indebted than it was before the crisis.

Over the next five years we expect the government to continue to reduce the size of its debt relative to GDP, but households and companies are both likely to borrow at a faster rate than economic growth. The net effect will be a gradual rise in the economy's debt-to-GDP ratio from 252% in 2017 to just under 260% in 2023 (see Table 1.2). In cash terms, the total debt stock might reach £6.7 trillion by 2023 in our main scenario.

Assuming that the Bank of England gradually raises its official bank rate to 2% by 2023, we estimate that total debt servicing costs in the UK economy could rise from an estimated 7.7% of GDP in 2017 to around 9.6% of GDP in 2023. This will squeeze the discretionary spending power of both households and companies.

Figure 1.3 – Two centuries of UK economic growth



Source: Bank of England (1830-1949), ONS (1950-2017) and PwC main scenario (2018-19)

"Our central estimate is for UK GDP growth in the 2020s to average around 1.75%".

Long term UK growth trends and prospects

Based on our main scenario for 2018-19, UK economic growth will average below 2% per annum in both of the first two decades of the 21st century. This period of sub-2% growth is the weakest since the end of the Second World War (see Figure 1.3).

The UK is not alone in suffering a drop in economic growth. G7 average growth is also projected to be below 2% in the current decade.

Shifts in productivity growth rates have been critical to variations in overall UK economic growth rates across the decades, and trade and technology appear to be the main drivers of productivity for the UK and other advanced economies.

Looking forward, these two key productivity drivers are giving mixed signals. We estimate that Artificial Intelligence (AI) and related technologies could boost UK GDP by up to 10% by 2030. But Brexit and global protectionism could be negative factors for the decade ahead.

Our central estimate is for UK GDP growth in the 2020s to average around 1.75% per annum, not far from the average in the first two decades of the 21st century. But there could be potential to boost this growth rate to around 2% through appropriate policies.

This would include measures which support the contribution of new technologies like AI to productivity, help to establish more efficient tax and regulatory systems, engage older people in the workforce and maintain open trading relations with the EU and the rest of the world. Government needs to work with business and other stakeholders to achieve these objectives.

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 has remained relatively strong this year. But we expect the global weighted average real growth rate to slow slightly from 3.2% in 2018 to 3.0% in 2019 (using GDP at market exchange rates as weights – global GDP growth using PPP weights might be around 3.8% in 2018 and 3.6% in 2019). This growth is expected to be driven by the large emerging economies with continued strong growth of around 7.6% in India in 2019 and only a modest slowdown to 6.3% growth in China next year. 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, with the ASEAN economies as a group also generally performing well.

There was a marked upswing in Eurozone economic activity in 2016-17, but growth has now started to slow again to just under 2% in 2018-19 in our main scenario. Compared to the rest of the G7, relatively strong US growth of around 2.8% is projected in 2018 as fiscal stimulus has strengthened an already robust economy. But this will be offset by gradual rises in US interest rates to keep inflation there under control, causing some slowing of growth to around 2.3% next year as the effects of the fiscal stimulus fade. Any further shift towards greater protectionism could also pose significant downside risks to growth in 2019 and beyond both in the US and China 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 (%)	
	2017 at MERs	2018p	2019p	2018p	2019p
US	24.3%	2.8	2.3	2.5	2.2
China	15.0%	6.5	6.3	2.3	2.4
Japan	6.1%	1.0	0.8	0.5	1.1
UK	3.3%	1.3	1.6	2.5	2.2
France	3.2%	1.6	1.7	1.7	1.5
Germany	4.6%	1.8	1.7	2.0	1.7
Greece	0.3%	2.0	2.1	0.8	1.2
Ireland	0.4%	5.1	3.3	0.9	1.3
Italy	2.4%	1.0	0.9	1.1	1.4
Netherlands	1.0%	2.7	2.3	1.6	1.9
Portugal	0.3%	2.1	1.9	1.1	1.7
Spain	1.6%	2.8	2.4	1.7	1.7
Poland	0.7%	4.5	3.5	1.9	2.5
Russia	1.9%	1.8	1.7	4.0	4.2
Turkey	1.1%	3.2	0.2	16.0	19.0
Australia	1.7%	2.9	3.0	2.2	2.5
India	3.3%	7.4	7.6	4.8	5.0
Indonesia	1.3%	5.2	5.3	3.8	3.9
South Korea	1.9%	2.9	2.8	1.6	1.9
Argentina	0.8%	-2.4	-1.3	33.0	-
Brazil	2.6%	1.6	2.5	3.7	4.2
Canada	2.1%	2.0	1.9	2.4	1.9
Mexico	1.4%	2.1	2.2	4.2	3.9
South Africa	0.4%	1.2	1.5	4.8	5.3
Nigeria	0.5%	2.0	1.6	11.9	10.8
Saudi Arabia	0.9%	1.7	2.2	3.2	2.5
World (PPP)	-	3.8	3.6	3.3	3.1
World (Market Exchange Rates)	100%	3.2	3.0	2.9	2.6
G7	46.0%	2.2	1.9	2.0	1.9
Eurozone	13.9%	2.3	2.0	1.7	1.6

Source: PwC main scenario for 2018 and 2019; IMF for GDP shares in 2017 at market exchange rates (MERs).

Appendix B
UK economic trends: 1979-2017

Annual averages	GDP growth	Household expenditure	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	3.1	6.0			10.9	-1	2.0
1987	5.3	5.0			9.7	-1.6	1.3
1988	5.8	7.3			10.4	-3.5	-0.6
1989	2.6	3.8		5.2	13.9	-4.1	-0.6
1990	0.7	1.0		7.0	14.8	-3.1	0.6
1991	-1.1	-0.5	-4.9	7.5	11.5	-1.3	2.6
1992	0.4	0.9	-0.1	4.3	9.6	-1.5	5.6
1993	2.5	2.9	1.4	2.5	5.9	-1.3	6.7
1994	3.9	3.2	4.7	2.0	5.5	-0.5	5.8
1995	2.5	2.0	1.5	2.6	6.7	-0.7	4.6
1996	2.5	3.8	0.8	2.5	6.0	-0.6	3.3
1997	4.3	4.4	1.7	1.8	6.8	0	1.9
1998	3.3	4.0	0.4	1.6	7.3	-0.5	0.3
1999	3.2	4.8	0.5	1.3	5.4	-2.5	-0.7
2000	3.5	4.7	2.2	0.8	6.1	-2.4	-1.5
2001	2.8	3.6	-1.5	1.2	5.0	-2.2	-0.2
2002	2.5	3.8	-2.1	1.3	4.0	-2.3	2.0
2003	3.3	3.6	-0.5	1.4	3.7	-1.9	3.4
2004	2.3	3.1	1.8	1.3	4.6	-2.3	3.3
2005	3.1	3.1	0.0	2.1	4.7	-2	3.2
2006	2.5	1.8	2.1	2.3	4.8	-3	2.8
2007	2.5	2.6	0.6	2.3	6.0	-3.6	2.6
2008	-0.3	-0.6	-2.8	3.6	5.5	-4.2	5.4
2009	-4.2	-3.2	-9.4	2.2	1.2	-3.6	10.1
2010	1.7	0.8	4.6	3.3	0.7	-3.4	9.0
2011	1.6	-0.9	2.2	4.5	0.9	-2	7.1
2012	1.4	1.7	-1.4	2.8	0.8	-3.8	7.5
2013	2.0	2.0	-1.0	2.6	0.5	-5.1	5.7
2014	2.9	2.1	2.9	1.5	0.5	-4.9	5.3
2015	2.3	2.7	0.0	0.0	0.6	-4.9	4.1
2016	1.8	3.2	0.4	0.7	0.5	-5.2	2.9
2017	1.7	1.9	2.6	2.7	0.3	-3.7	1.8
Average over economic cycles****							
1979 - 1989	2.8	3.7			12.2	-0.8	2.2
1989 - 2000	2.4	2.9		3.3	8.3	-1.5	2.4
2000 - 2014	1.9	1.9	-0.2	2.2	3.3	-3.1	4.4

* Pre-1991 figures for manufacturing output growth are not currently available on a consistent basis ** Pre-1997 data estimate
*** 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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