

THE UK ECONOMY

Forecast summary

GDP growth is expected to slow from 2 per cent in 2016 to 1.7 per cent in 2017 and 1.9 per cent in 2018.

We forecast consumer price inflation to average 3.3 per cent in 2017 and 2.9 per cent in 2018.

We expect the MPC to 'look through' this temporary period of above target inflation.

The new fiscal mandate is for the government to reduce cyclically adjusted public sector net borrowing to below 2 per cent of GDP by 2020–21. We expect the government to meet this target with relative ease.

The economy grew by 0.6 per cent in the final quarter of 2016, implying growth of 2 per cent for the year as a whole. The resilience of the economy has largely been supported by robust expansion in real consumer spending. We expect the composition of growth to rebalance towards net trade, as the headwinds facing households from the erosion of their real incomes weigh on consumer spending while the depreciation of sterling supports net trade. Overall, we forecast growth of 1.7 and 1.9 per cent this year and next.

Consumer price inflation is expected to rise throughout the year due to the sharp depreciation of sterling against a broad basket of currencies as a result of the referendum outcome. Sterling has regained ground against a broad basket of currencies and is around 4 per cent higher than forecast three months ago. This should help moderate some of the impact on inflation. Nonetheless, we forecast inflation to average 3.3 per cent this year and 2.9 per cent in 2018, returning back to the Bank of England's mandated target in 2020. We expect the Bank of England to look through the temporary period of above target inflation and to keep interest rates unchanged until the middle of 2019, increasing gradually at around 50 basis points per year thereafter.

As a result of the mild slowdown of the economy, we expect the unemployment rate to edge up to 5.1 and 5.4 per cent this year and next, respectively. The corollary of softening output growth and nearly constant unemployment rate is weak growth of labour productivity in both years, implying that real wages will be broadly flat.

The current account balance deficit is expected to shrink through 2017 and 2018, as the depreciation of sterling leads to a reduction in import volumes, a modest increase in export volumes and a positive contribution from the primary income balance. We forecast the current account deficit to be 2.7 per cent of GDP this year and ½ per cent next year.

In the *Autumn Statement* the government announced a new fiscal charter, scrapping the previous target of reaching an absolute surplus by 2020–21, replacing it with an overall objective for government to "return the balance back to surplus at the earliest date in the next parliament" and a target to reduce cyclically-adjusted public sector net borrowing to below 2 per cent of GDP by 2020–21. We expect this target to be met with relative ease.

Summary of the forecast – UK economy

	Real gross national income ^(a)	Real GDP ^(a)	Unemployment ^(b)	CPI ^(c)	RPIX ^(d)	External current balance ^(e)	PSNB ^(f)
2016	3.0	2.0	4.8	1.2	2.5	–92.0	71.3
2017	1.1	1.7	5.4	3.7	4.2	–54.5	70.5
2018	2.1	1.9	5.1	2.7	3.3	–9.8	48.6

(a) Percentage change, year-on-year. (b) ILO definition, fourth quarter, rate. (c) Consumer prices index, percentage change, fourth quarter on fourth quarter. (d) Retail price index, excluding mortgages, percentage change, fourth quarter on fourth quarter. (e) Year, £ billion. (f) Public sector net borrowing, fiscal year, £ billion. Includes the flows from the Bank of England's Asset Purchase Facility.