

UNITED KINGDOM

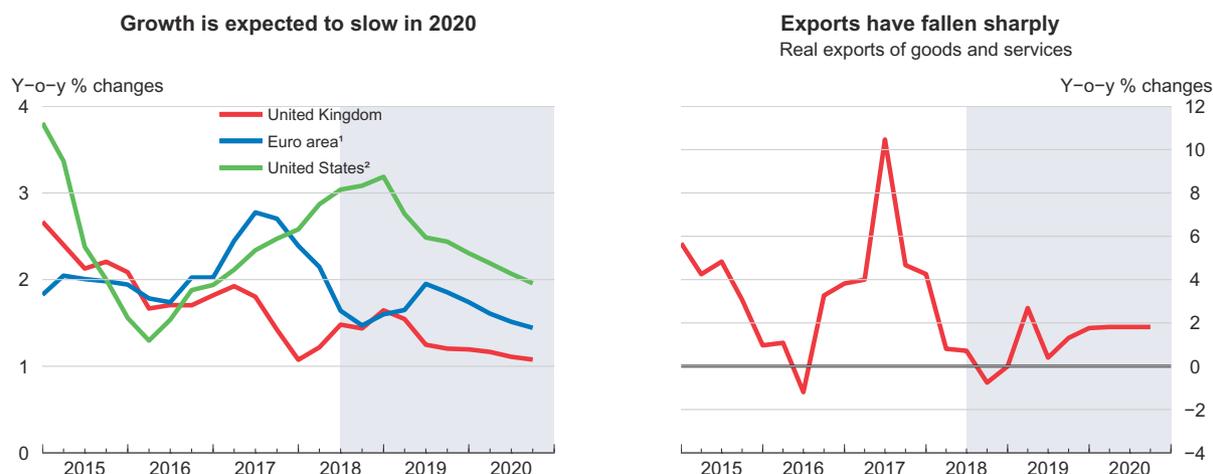
Economic growth is projected to increase slightly in 2019 before slowing in 2020, on the assumption that there is a smooth exit from the European Union. Some Brexit-related uncertainties will remain until there is clarity about future trading arrangements. An expansionary fiscal stance and a slow recovery in exports are expected to support growth, while the monetary stimulus will be gradually withdrawn. Inflation is projected to converge to 2% by the end of 2020.

With inflation above target and large uncertainties remaining, monetary policy should normalise at a very gradual pace. The fiscal impulse is expected to peak in 2019. The authorities should stand ready to respond further if demand weakens significantly as a result of Brexit. Economically, the preferred Brexit option should be to forge an agreement that will ensure the closest possible trading relationship with the European Union and high access for financial services to overseas markets. Temporary measures will be needed to cushion the economy and support displaced workers in the event of a no-deal exit.

Brexit-related uncertainties are holding back economic growth

Both private consumption and investment growth have slowed markedly since 2016, reflecting uncertainties and a decline in households' purchasing power. Activity in the housing market has been subdued. House price inflation has slowed since the start of 2016, although the weakness remains concentrated in London. After two years of buoyant export growth, boosted by the post-referendum depreciation, exports of goods and services have fallen sharply since the beginning of this year, reflecting to some extent one-off factors. Trade flows have rebounded recently and the current account deficit was at 3.2% of GDP in the third quarter of 2018.

United Kingdom



1. Covers 17 countries that are both euro area and OECD members.

2. Projections from 2018Q4.

Source: OECD Economic Outlook 104 database.

United Kingdom: **Demand, output and prices**

	2015	2016	2017	2018	2019	2020
	Current prices GBP billion	Percentage changes, volume (2016 prices)				
GDP at market prices	1 895.8	1.8	1.7	1.3	1.4	1.1
Private consumption	1 235.5	3.1	1.8	1.5	1.1	0.6
Government consumption	361.0	0.8	-0.1	0.8	1.9	2.0
Gross fixed capital formation	319.4	2.3	3.3	0.0	0.8	0.4
Final domestic demand	1 915.9	2.5	1.7	1.1	1.2	0.8
Stockbuilding ¹	6.9	-0.1	-0.5	-0.1	-0.1	0.0
Total domestic demand	1 922.8	2.5	1.2	1.0	1.1	0.8
Exports of goods and services	519.6	1.0	5.7	1.2	1.1	1.8
Imports of goods and services	546.6	3.3	3.2	0.2	0.1	0.7
Net exports ¹	- 27.0	-0.7	0.7	0.3	0.3	0.3
<i>Memorandum items</i>						
GDP deflator	—	2.1	2.0	1.9	1.7	1.8
Harmonised index of consumer prices	—	0.6	2.7	2.5	2.3	2.1
Harmonised index of core inflation ²	—	1.2	2.3	2.2	2.1	2.1
Unemployment rate (% of labour force)	—	4.9	4.4	4.1	4.0	4.1
Household saving ratio, gross (% of disposable income)	—	6.7	4.5	4.6	4.6	4.6
General government financial balance (% of GDP)	—	-2.9	-1.9	-1.3	-1.6	-1.3
General government gross debt (% of GDP)	—	119.5	117.0	115.6	114.6	113.6
General government debt, Maastricht definition (% of GDP)	—	87.9	87.4	87.3	87.0	86.9
Current account balance (% of GDP)	—	-5.2	-3.7	-3.4	-3.3	-2.9

1. Contributions to changes in real GDP, actual amount in the first column.

2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 104 database.

StatLink  <http://dx.doi.org/10.1787/888933878247>

Inflation has been above the 2% inflation target since 2017, pushed up by past currency depreciation and more recently higher commodity prices. The unemployment rate is at historically low level, at 4% in the second quarter of 2018, and labour shortages have emerged. Real average earnings have risen, but still remain below their pre-crisis levels. Migration from EU countries is falling, but the decline has been compensated by an increase in net migration from non-EU countries.

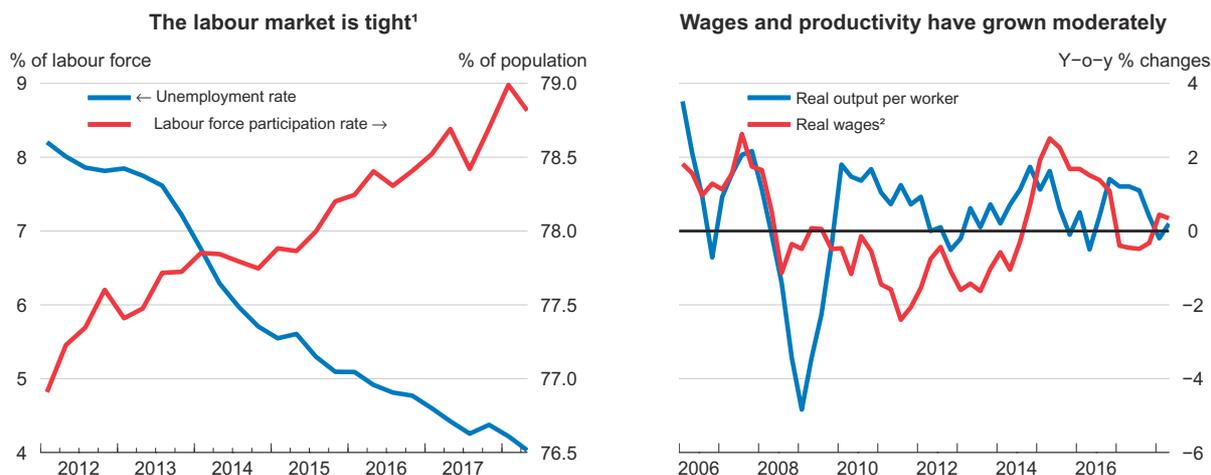
Policy measures will be needed to smooth the transition to a post-Brexit environment

The projection assumes that the United Kingdom and the European Union come to an agreement on the withdrawal conditions and the transition period in the near term, but only define the broad contours of the future trading relationships. This would dissipate some of the near-term uncertainties, but major uncertainties would nevertheless remain.

The Bank of England has suggested that further increases in the policy interest rate and a run-off of its balance sheet may be warranted in the case of smooth exit from the European Union. Given the prevailing uncertainties, the pace of normalisation should be gradual and clearly communicated.

After several years of consolidation, fiscal policy is set to become accommodative in 2019. Increases in health spending, infrastructure and defence, together with cuts in household income tax and other taxes amount to some 0.8% of GDP next year, adding some

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1. Data for the unemployment rate refer to the population aged 16 and over. Data for the labour force participation rate refer to the population aged between 16 and 64.
2. Real average weekly earnings excluding bonuses. Earnings have been deflated by the consumer price index including owner occupiers' housing costs.

Source: Office for National Statistics.

StatLink  <http://dx.doi.org/10.1787/888933877354>

0.3 percentage point to growth. Improvements in the outlook for government receipts mean that the authorities will still meet their fiscal targets.

The authorities should stand ready to react should the United Kingdom and the European Union fail to reach an agreement. Monetary policy conditions should remain accommodative if demand is depressed. In addition to letting the automatic fiscal stabilisers fully operate, the government should focus on measures that foster productivity and inclusive growth in the long term, such as greater spending on training and low-skilled workers.

The authorities should aim to sign a withdrawal agreement with the European Union that ensures the closest possible trade relationship, including for financial services. The government has published a set of technical notices to raise citizens and firms' awareness on the likely impact of a no-deal. It has put forward legislation that will allow UK households and businesses to continue to access financial services provided by EU companies. It will be important to pass legislation establishing temporary regimes to prevent disruption on financial and other markets if needed. Government policies should seek to support workers, not particular sectors or jobs, should trade and production shift as a result of Brexit, including through support for retraining.

Growth is projected to keep slowing

Economic growth is set to increase slightly next year, boosted by fiscal policy, before slowing in 2020, with demand growing below its trend. A tighter monetary stance and receding commodity price effects are expected to bring inflation closer to target. The unemployment rate is projected to edge up slightly. After a peak during the current fiscal year, the public debt-to-GDP ratio is projected to decrease gradually over the coming two years. The current account deficit would narrow as exports of goods and services grow.

The failure to come to a withdrawal agreement with the European Union is by far the greatest risk in the short term. OECD analysis suggests that a no-deal scenario could subtract over 2% from real GDP over two years. The lack of details on the future relationship between the United Kingdom and the European Union or the extension of the transition period, and the resulting uncertainties, could incite businesses to delay investment plans further. By contrast, prospects of maintaining the closest possible economic relationship with the European Union would lead to stronger-than-expected economic growth.