

**EMBARGO 00.01 hours 5 May 2011**

## **Prospects for the UK economy**

- GDP will grow by 1.4 per cent in 2011 and 2 per cent in 2012.
- Consumer price inflation will reach 4.5 per cent in 2011 but fall to 1.9 per cent in 2012.
- Consumer spending will decline by 0.6 per cent this year.
- Net trade will drive growth both this year and next.
- Public sector net borrowing will amount to 3.6 per cent of GDP in 2015–16.
- House prices will fall in real terms by 4.5 per cent this year.

The expansion will continue but at a sluggish pace. Not until 2013 will the economy grow faster than its trend rate of 2.1 per cent. Growth this year will be constrained not just by the government's spending cuts but by the squeeze on households from higher taxes and rising inflation. Consumer price inflation will reach 4.5 per cent this year, up from 3.3 per cent in 2010 and the pressure will ease only in 2012, when inflation will subside to 1.9 per cent. Following a 0.8 per cent decline in 2010, real disposable incomes will fall by 1.3 per cent this year.

The squeeze on household incomes will contribute to the fall in consumer spending of 0.6 per cent in 2011 and it will rise by only 0.6 per cent in 2012. What modest growth there is over the next two years will come mainly from net trade; indeed it will contribute all the 1.4 per cent expansion in GDP this year. The support from the external sector reflects both strong exports, benefiting from growing overseas markets and the weaker pound, and weak imports, held back by slack domestic demand and greater competition from British producers. Exports will grow by 6.9 per cent this year and 4.3 per cent in 2012. Imports will rise by only 1.4 per cent this year and actually decline, by 1.1 per cent, in 2012.

The weak recovery will feed through to lower tax revenues. That will mean that even if the spending plans are met over the next four years, public sector net borrowing will fall only to 3.6 per cent of GDP in 2015–16 rather than the 1.5 per cent projected by the Office for Budget Responsibility. Likewise, the current budget will then run a deficit of 2.2 per cent of GDP compared with the OBR's deficit of 0.2 per cent. We do not expect the government to meet its target to balance the cyclically-adjusted current budget by 2015–16.

Real house prices will fall by 4.5 per cent in 2011 and by an average of 1½ per cent per annum in the subsequent four years as borrowing costs rise because of tighter monetary policy. Research by the Institute shows that higher loan-to-income ratios for new mortgage borrowers were a major reason for the house price boom of the 2000s that turned to bust in the financial crisis. Supply constraints were less important than is often argued since supply just about kept pace with household formation. This suggests that regulation should focus on limiting loan-to-income ratios and that increasing housing supply, as recently advocated by the OECD, would be less fruitful, although perhaps useful, and a housebuilding boom would stimulate growth.

**ENDS**

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**Notes:**

The forecast for the UK economy is published in the National Institute Economic Review, no. 216, April 2011

For a full copy of the UK Economy forecast, please contact the NIESR Press Office:  
Pat Shaw on 020 7654 1905/ [p.shaw@niesr.ac.uk](mailto:p.shaw@niesr.ac.uk) or  
Goran Stankov on 020 7654 1931/ [g.stankov@niesr.ac.uk](mailto:g.stankov@niesr.ac.uk).

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**For further information:**

National Institute of Economic and Social Research  
2 Dean Trench Street  
Smith Square  
London, SW1P 3HE  
United Kingdom

Switchboard Telephone Number: +44 (0) 207 222 7665  
Switchboard Fax: +44 (0) 207 654 1900

Contact:

Simon Kirby ([s.kirby@niesr.ac.uk](mailto:s.kirby@niesr.ac.uk)) on +44(0)20 7654 1916

Ray Barrell ([r.barrell@niesr.ac.uk](mailto:r.barrell@niesr.ac.uk)) on +44(0)20 7654 1925