National Institute of Economic and Social Research

Press Release

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Prospects for the UK economy

- The economy will grow by 1.1 and 2.0 per cent over the next two years.
- After its recent pause, unemployment will rise again, to 9.2 per cent in 2011.
- The surge in inflation this year will be temporary and CPI inflation will average 1.7 per cent in 2011.
- Public borrowing in 2013–14 will be 1.3 percentage points higher than the Treasury is forecasting and net debt as a share of GDP will not start to fall in 2015–16.

Despite the disappointingly slow start to the recovery in the fourth quarter of 2009, we are expecting the economy to grow rather faster in the first three months of 2010 and beyond. But the expansion will be at a moderate tempo, both this year and next. Consumer spending will be weak, falling by 0.3 per cent this year and rising by 1.0 per cent in 2011. But by then government consumption will be falling by 1.5 per cent and fixed investment will still be falling. As a result, the recovery will rely on a turnaround in the inventory cycle, as companies first slow the pace of destocking and then start to rebuild inventories, together with net trade, which will contribute 1.3 percentage points to GDP growth in 2011.

Unemployment has risen by less than seemed likely given the severity of the downturn. But employment has fallen by more than expected once we take account of the adjustment of real wages and average hours worked. The unemployment rate stabilised in the second half of 2009. This will prove to be a hiatus rather than a turning-point and we expect unemployment to carry on rising over the next two years, from 7.8 per cent in late 2009 to 9.2 per cent in 2011. The jobless count will peak at 2.9 million in the third quarter of 2011.

CPI inflation will shortly rise to around 3.5 per cent, as the reversion of the standard rate of VAT from 15 to 17.5 per cent on 1 January feeds through to prices. Although the overshoot will require a public letter of explanation from the Bank of England, it will be short-lived. Underlying inflation has been raised by the depreciation of the pound, but the spare capacity that has opened up in the economy will bear down on prices, causing inflation to fall below the 2 per cent target by the start of 2011.

The plans for fiscal consolidation will not be sufficient to start bringing down net public debt as a share of GDP by the middle of this decade, as the Treasury expects. Instead it will carry on rising. Additional retrenchment will be needed, through either extra spending cuts or further tax increases or a mixture of both. Net borrowing at 6.8 per cent of GDP in 2013–14 depends on tighter public spending than the Government has currently planned, but still fails to meet the Government's aspirations for deficit reduction.

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Notes:

The forecast for the UK economy is published in the National Institute Economic Review, no. 211, January 2010

For a full copy of the UK Economy forecast, please contact the NIESR Press Office: Goran Stankov on 020 7654 1931/ 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) on +44(0)20 7654 1916

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

Martin Weale (m.weale@niesr.ac.uk) on +44(0)20 7654 1945