National Institute of Economic and Social Research

Press Release

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Prospects for the UK economy

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- GDP is expected to grow by 1.7 per cent in 2016, slowing to just 1 per cent in 2017. GDP is likely to decline by 0.2 per cent in the third quarter of this year and there is a risk of a further deterioration.
- Inflation is forecast to increase significantly, peaking at just over 3 per cent at the end of 2017. The MPC is expected to 'look through' this temporary rise and ease monetary policy substantially in the coming months.
- Government announcements have effectively 'over-ridden' the Fiscal Charter and borrowing is expected to increase by an additional £47 billion over the period 2016–17 to 2020–21.

Simon Kirby, Head of Macroeconomic Modelling and Forecasting at NIESR, said "*We expect the UK to experience a marked economic slowdown in the second half of this year and throughout 2017. There is an evens chance of a 'technical' recession in the next 18 months, while there is an elevated risk of further deterioration in the near term. In light of the downturn underway and the downside risks to the outlook, a decision by the MPC to provide monetary stimulus would be welcome and we look forward to assessing the new Chancellor's plans at the Autumn Statement."*

He also said *"We expect the rate of inflation to peak at over three per cent at the end of 2017, induced mainly by the recent depreciation of sterling. The MPC should 'look through' this temporary rise in inflation and ease monetary policy substantially in the coming months Indeed, the slowdown we are projecting is conditioned on the assumption that the MPC will cut interest rates to just 10 basis points, starting with a 25 basis point cut at their August meeting. The effects on the economy from these interest rate reductions are relatively modest, but our analysis suggests that the reduction in combination with a further round of quantitative easing (of around £200 billion) could boost the size of the economy by as much as 1½ per cent over the next two years."*

Following the vote to leave the EU, we have seen heightened uncertainty and a depreciation of sterling. In the near term, we also expect a tightening of financial conditions and a spike in inflation. These factors will slow GDP growth from 1.7 per cent in 2016 to just 1 per cent in 2017. The unemployment rate is expected to rise from 4.8 per cent in the second quarter of this year to a peak of around 5¾ per cent in the middle of 2017.

Both consumer spending and private sector investment are expected to decline in 2017. This is partially offset by a positive contribution from net trade as the fall in sterling improves the competitiveness of UK exporters. The downturn is expected to be temporary, with growth prospects ameliorating in 2018 and beyond. We estimate that the economy will shrink in 2016Q3. There is an elevated risk of further deterioration in the near term. The probability of such a recession occurring has increased significantly since our previous forecast. We estimate that there is around an evens chance of a recession at some point during the period 2016Q3 to 2017Q4, inclusive.

This forecast is based on a significantly looser path for monetary policy than we had assumed in May. We now expect a 25 basis point reduction in Bank Rate at the August meeting of the Monetary Policy Committee, and a further 15 basis point reduction at their November meeting. This conventional response could well be combined with further quantitative easing. Our analysis suggests these policy instruments could offset a negative shock to the economy of up to approximately 1½ per cent of GDP. A more extreme downturn than this would require the use of additional policy instruments.

Our forecasts for government borrowing have changed substantially from those published just three months ago. We now expect an absolute surplus to be achieved only in 2021–22. The economic downturn will generate a significant increase in the magnitude of borrowing between 2016–17 and 2020–21, amounting to at least a cumulative £47 billion (an annual average of £9.5 billion or 0.5 per cent of GDP). Gross government debt, as a percentage of GDP, is expected to increase from 89 per cent at the end of 2015 to just over 90 per cent of GDP by the end of 2017.

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)
2015	2.5	2.2	5.1	0.1	1.1	−100.3	77.4
2016	1.2	1.7	5.2	0.8	1.7	−114.5	70.9
2017	0.4	1.0	5.7	3.1	3.5	−62.4	65.3

(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.

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Notes for editors:

The forecast for the UK economy is published in the National Institute Economic Review no. 237 August 2016. Details of NIESR's previous UK economic forecast can be found here and here.

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