

**National Institute Economic Review No. 245 August 2018**

**Prospects for the UK economy**

**EMBARGOED until 00.01am Wednesday 1 August**

- The UK economy is facing an unusual level of uncertainty because of Brexit. This uncertainty primarily stems from the yet to be defined relationship between the UK and the EU but also from the economy's response to the new framework once it emerges. The UK government's White Paper, which set out its preferences for that new relationship, has failed to unite the government or Parliament, leaving open an entire spectrum of possible outcomes.
- Our central forecast under a 'soft Brexit' scenario is that the economy will grow at a pace that is consistent with its potential. This translates to annual GDP growth of 1.4 per cent this year and 1.7 per cent next year, which is broadly unchanged from our previous forecast. The risks to our GDP growth forecast are wider than before and tilted to the downside.
- As before, we condition our forecast on a gentle path of monetary policy normalisation with the next 25 basis point rate increase this month. On the fiscal side, we recommend that the government maintains its current level of spending (as a share of GDP) and raises the quality of public services.

The UK government published a White Paper on 12 July with an outline of its preferred relationship with the EU. Both sides are looking to reach an agreement by October 2018 to allow the European Parliament to approve the withdrawal agreement and ensure that a deal is in place ahead of Brexit on 29 March 2019. In it the government has prioritised a free trade area for goods trade and an ambitious arrangement for services trade while taking back control of immigration and budgetary contributions. In our view the government will have to make significant concessions to the EU.

As before, the central forecast has been conditioned on a 'soft' Brexit assumption where the UK achieves close to full access to the EU market for goods and services. If instead of this soft Brexit scenario we assume that the government achieves the somewhat more restrictive White Paper proposals, the output loss will amount to £500 per person per year over time compared with the soft Brexit scenario. The loss would be around £800 under a 'no deal' Brexit. These estimates do not include the likely impact on productivity which could, on some estimates, double the size of the losses.

The Bank of England will take account of this uncertainty when setting policy and also weigh the consequences of 'getting it wrong'. With the economy growing in line with potential, we recommend that the MPC raises Bank Rate gradually but also stand ready to move in either

direction should circumstances change. The committee should emphasise the uncertainty (rather than the certainty) of its future policy stance in its communications and its willingness to reverse its decisions

The pressure to end fiscal consolidation is high. The government faces pressures to increase spending in a number of areas to maintain the quality of public services. Consistent with our view, the government has very recently promised new spending on the NHS and partially lifted the wage cap on public sector employees. Consistent with that, our central forecast assumes that government spending (as a share of GDP) will not fall as forecast by the OBR. As a result, the budget deficit remains close to 2 per cent of GDP over the next five years instead of the OBR's forecast of 1 per cent.

Summary of the forecast						Percentage
	Real GDP	CPI <sup>(a)</sup>	ILO unemployment	Bank Rate	External current balance	PSNB <sup>(b)</sup>
	annual growth	Q4/Q4	Q4	end-year	% of GDP	
2017	1.7	3.1	4.4	0.50	-3.9	1.9
2018	1.4	1.8	4.1	0.75	-3.3	1.8
2019	1.7	1.9	4.3	1.25	-3.5	1.7

Notes: Calendar years unless otherwise stated. (a) Consumer price index. (b) Public sector net borrowing, fiscal years, excludes public sector banks.

## ENDS

### Notes for editors:

The forecast for the UK economy is published in the National Institute Economic Review no. 245 August 2018. Details of NIESR's previous UK economic forecast can be found [here](#).

For a full copy of the world economic forecast or to arrange interviews, please contact the NIESR Press Office: Paola Buonadonna on 020 7654 1923 / [p.buonadonna@niesr.ac.uk](mailto:p.buonadonna@niesr.ac.uk)

For technical questions related to the forecast, please contact:

- Garry Young on +(44) 0207 6541916 [g.young@niesr.ac.uk](mailto:g.young@niesr.ac.uk)
- Amit Kara on +44 (0)20 7654 1943 / [a.kara@niesr.ac.uk](mailto:a.kara@niesr.ac.uk)

The National Institute Economic Review is the quarterly journal of the National Institute of Economic and Social Research (NIESR). Published in February, May, August and November, it is available from Sage Publications Ltd (<http://ner.sagepub.com/>) at [subscription@sagepub.co.uk](mailto:subscription@sagepub.co.uk).

Further details of NIESR's activities can be seen on <http://www.niesr.ac.uk> or by contacting [enquiries@niesr.ac.uk](mailto:enquiries@niesr.ac.uk) Switchboard Telephone Number: +44 (0) 207 222 7665