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National Institute of Economic and Social Research
2 Dean Trench St
London SW1P 3HE
T: +44 (0)20 7222 7665
E: enquiries@niesr.ac.uk
W: niesr.ac.uk
Registered charity no. 306083

The National Institute of Economic and Social Research is an independent research institute, founded in 1938. The vision of our founders was to carry out research to improve understanding of the economic and social forces that affect people's lives, and the ways in which policy can bring about change. And this remains central to NIESR's ethos. We continue to apply our expertise in both quantitative and qualitative methods and our understanding of economic and social issues to current debates and to influence policy. The Institute is independent of all party political interests.

Contents

Foreword

The new year has started with the same old debate about how much fiscal space there is for tax cuts in the next Budget. It entirely misses the point about objectives of economic policy and the instruments to achieve them. If the objective is strong, sustained, and balanced growth to generate shared prosperity and greater well-being, then the focus should be on instruments that help to bring it about. While lower taxes can be part of the answer, the first-order question for policy is the right fiscal and monetary policy mix and the necessary levels and path of investment.

NIESR has consistently argued that over much of the past decade monetary policy was too loose and fiscal policy too tight. While the former has significantly tightened and dealt with the inflationary shock, the latter remains constrained by arbitrary fiscal rules that curtail capital investment as growth and potential future growth remain low. And this is the fundamental state of the UK economy. In our Winter Outlook, we project sluggish GDP growth of 0.9 per cent this year and a new trend rate of just under 1 per cent – compared with more than 2 per cent prior to 2008. This is combined with levels of both public and business investment that are low by historical and international comparison.

In turn, productivity growth continues to flatline and real wages, despite recent growth, have not risen much since the financial crash. As a result, we expect living standards – as measured by real household disposable income – to remain below pre-pandemic levels until 2027-28. What is worse, our projection for people in the bottom half of the income distribution is that their living standards are some 12 per cent below pre-Covid levels. And the living standards of households in the bottom income decile are lower by some 18 per cent compared with pre-pandemic levels, with a fall in real income since 2019-20 of about £4,500 in current prices.

Our Winter Outlook also shows that inflation will return to the Bank of England's 2 per cent target by April 2024 as a result of higher interest rates and significantly lower energy prices. Against this backdrop, the expectation is that the Bank's Monetary Policy Committee will start cutting rates as early as May and bring them down to 4.5 per cent by the end of the year.

With the normalisation of monetary policy, it is time to recalibrate fiscal policy, so that greater public investment can help boost growth and productivity. The parlous state of public services, exacerbated by the funding crisis engulfing local government, and crumbling infrastructure show the results of years of chronic underinvestment. While public investment is set to reach over 4 per cent of GDP in 2024, what is missing is a credible long-term plan to address the shortfalls (e.g. housing investment linked to land use and planning reform) and unlock greater business investment.

We live in an age of upheaval characterised by growing geopolitical instability, national polarisation and deeply entrenched regional and local disparities of power, wealth, health, and well-being. Instead of boosterism or declinism, we need greater realism about where the country is and where it could and should go. The United Kingdom has shown some resilience to cope with external shocks, but it lacks productive capacity and high-quality economic policymaking to achieve important goals such as enhancing energy security or reverse widening inequality.

In a year that will be dominated by the General Election, the budget on 6 March offers the first important opportunity for the Government and the opposition to put forward ideas for sustained economic renewal. How to break out of the cycle of low growth, low productivity and low investment that has left millions poorer? Given all the national assets, transformative policies and responsible leadership are in short supply. Will the new government bring about the meaningful change the country desperately needs?

Adrian Pabst
Deputy Director for Social and Political Economy
National Institute of Economic and Social Research
February 2024

National Institute UK Economic Outlook – Winter 2024

Summary

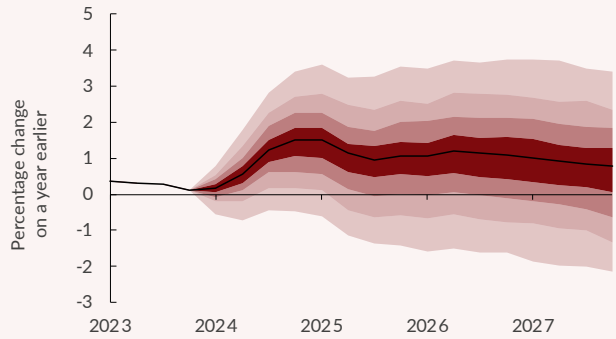
- **UK GDP growth will likely remain sluggish into the medium term.** We now think the United Kingdom was in recession in the second half of 2023 and that GDP grew by only 0.3 per cent in 2023. We expect GDP to grow by 0.9 per cent in 2024 and at a similar rate throughout the rest of the forecast.
- **Inflation is set to fall below the Bank of England's 2 per cent target in April.** We project that inflation will fall to 1.5 per cent in April as Ofgem reduce the energy price cap by 14 per cent and the high inflation in early 2023 'drops out' of the headline measure.
- **We expect the Bank of England to start cutting interest rates in May.** However, we expect further cuts to happen more slowly than is currently implied by market expectations given persistent core inflation, elevated wage growth and geopolitical challenges.
- **On current plans the government meets its fiscal targets.** But, it is simply not credible that the next government – whichever party may form it – will feel itself bound to the large fiscal tightening planned for 2025 and beyond. NIESR continues to stress the need to increase public investment, rather than put in place tax cuts that will have to be reversed in the not-too-distant future.
- **The main risks to our forecast are geopolitical.** Shipping costs between China and Europe have risen by around 150 per cent since the beginning of October. An escalation of the conflict in Gaza could lead both shipping costs and oil prices to rise further, pushing down on GDP and up on inflation.

Table 1.1 Summary of the forecast (percentage change unless otherwise stated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028
GDP	-10.4	8.7	4.3	*0.3*	*0.9*	*1.2*	*1.1*	*0.9*	*0.9*
Per capita GDP	-10.7	8.5	3.4	*-0.3*	*0.4*	*0.7*	*0.7*	*0.5*	*0.6*
CPI Inflation	0.8	2.6	9.1	*7.4*	*2.2*	*2.0*	*2.2*	*2.4*	*2.1*
RPIX Inflation	1.7	4.2	11.5	*8.6*	*2.7*	*2.6*	*2.9*	*3.1*	*2.8*
RPDI	-0.5	1.5	-1.4	*2.0*	*1.1*	*1.8*	*2.0*	*1.8*	*1.8*
Unemployment, %	4.6	4.5	3.7	*4.2*	*4.7*	*4.9*	*4.9*	*5.0*	*5.1*
Bank Rate, %	0.2	0.1	1.5	*4.7*	*4.9*	*3.9*	*3.3*	*3.3*	*3.3*
Long Rates, %	0.3	0.8	2.4	*4.0*	*3.8*	*3.5*	*3.4*	*3.4*	*3.3*
Effective exchange rate	0.5	4.7	-2.2	*1.2*	*2.3*	*-0.3*	*-0.1*	*0.1*	*0.1*
Current account as % of GDP	-2.8	-0.5	-3.1	*-3.8*	*-5.6*	*-4.3*	*-3.4*	*-3.0*	*-2.9*
Net borrowing as % of GDP	15.2	5.6	5.2	*4.2*	*4.8*	*3.8*	*2.7*	*2.3*	*3.4*
Net debt as % of GDP	101.5	99.3	97.6	*93.8*	*94.7*	*93.6*	*92.2*	*90.9*	*90.7*

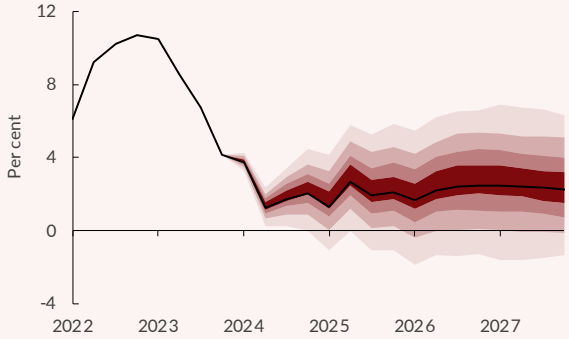
Note: Numbers reported are yearly averages except for net borrowing, which is reported for the full fiscal year, and net debt, which is reported for the end of the fiscal year.

Annual GDP growth



Note: The shades within the fan chart represent a 10 per cent chance that GDP growth will lie within the boundary of that shade. There is a 20 per cent chance that GDP growth will lie outside the shaded area of the fan. The black line represents our central forecast for GDP growth.
Source: NiGEM database, NIESR forecast and NiGEM stochastic simulations.

CPI inflation



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Source: NiGEM database, NIESR forecast and NiGEM stochastic simulations.

1. The Macroeconomic Outlook for the United Kingdom

By Paula Bejarano Carbo, Ben Caswell, Huw Dixon, Hailey Low, Stephen Millard and Max Mosley

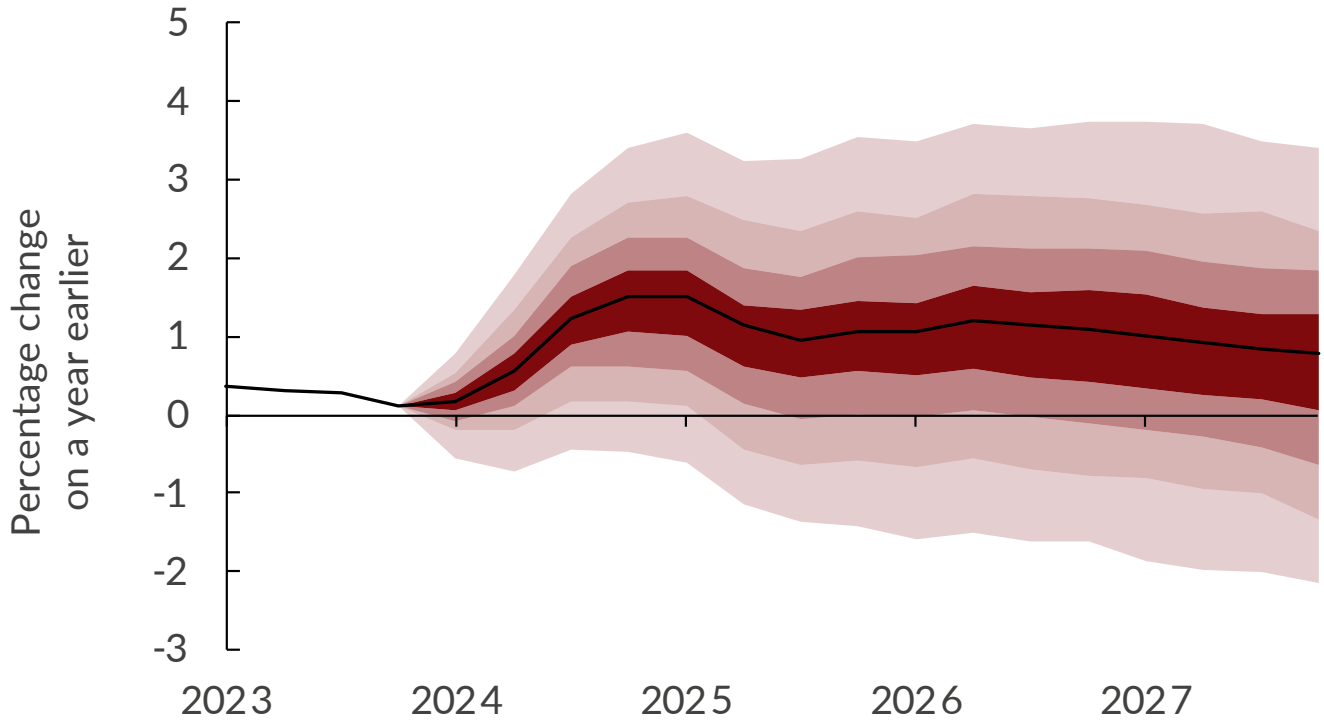
Economic Background and Forecast Summary

As we publish our Winter Economic Outlook, we face the possibility that the United Kingdom was in recession at the end of 2023. Specifically, GDP fell in the third quarter of 2023 by 0.1 per cent and we expect it to have fallen by a further 0.1 per cent in the fourth quarter of 2023. Regardless of whether or not fourth-quarter GDP growth was negative, the overall picture of flatlining output in the United Kingdom, which we have seen now for almost two years, continues. Momentum remains weak as the war in Ukraine continues and events in Israel and Gaza, together with the Houthi attacks on shipping in the Red Sea, raise the possibility of a wider conflict in the Middle East. The labour market continues to loosen, with vacancies falling and unemployment rising, while high inactivity on account of long-term sickness remains an issue. On the bright side, it is beginning to look like the aggressive policy rate hikes have resulted in inflation coming down towards its target and, as a result, real incomes continue to rise as wage inflation remains higher than price inflation.

Against this background, the outlook for growth remains subdued. Our January GDP Tracker (Bejarano Carbo, 2024a) suggests GDP was flat in the fourth quarter of 2023 but will grow by 0.2 per cent in the first quarter of 2024, consistent with our short- to medium-run view of low economic growth in the United Kingdom. Overall, we expect growth in 2023 of 0.3 per cent. For 2024, we expect GDP growth of 0.9 per cent (figure 1.1). Figure 1.1 plots a probabilistic range of values for GDP growth against our central forecast (the black line). Throughout the forecast period, we see the risks to GDP growth being on the downside. This means that there is roughly 20 per cent chance of an annual fall in GDP in 2024 and a roughly 30 per cent chance of an annual fall in GDP in 2025.

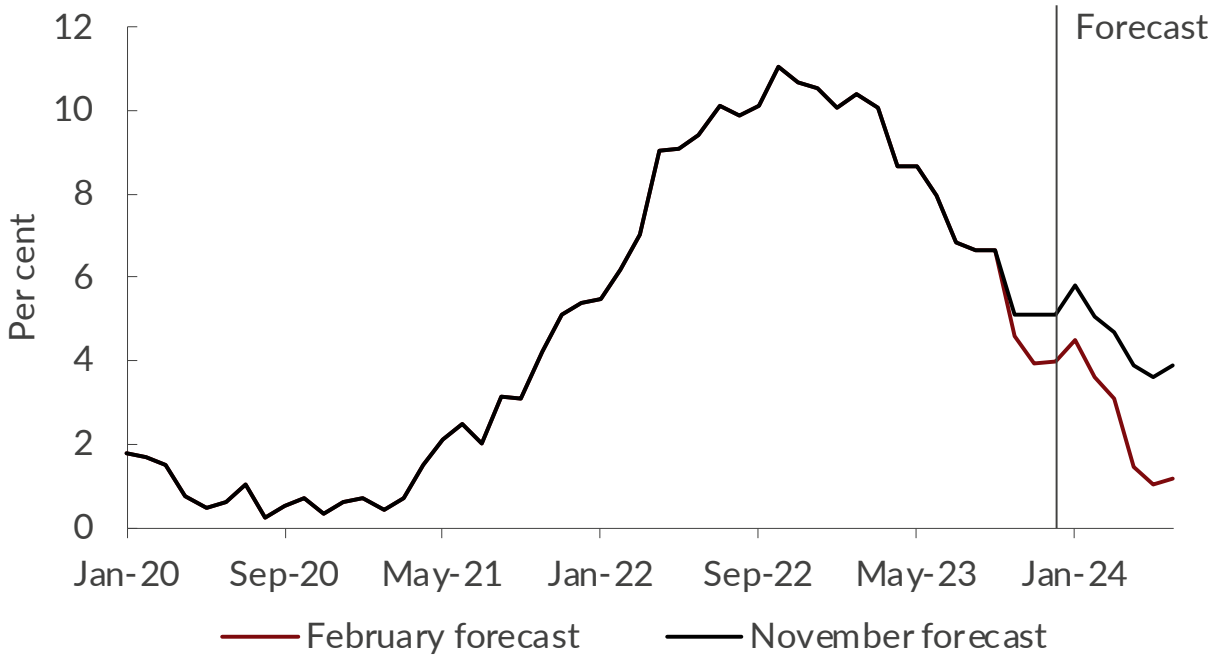
Twelve-month Consumer Price Index (CPI) inflation was 4.0 per cent in December, up from 3.9 per cent in November, core inflation was unchanged at 5.1 per cent. As shown in figure 1.2, this is 1.1 percentage point lower than we were expecting in our November forecast. We have carried this through into our forecast for the first three months of 2024. Following Cornwall Insights (2023), we also expect Ofgem to announce a 14 per cent fall in their energy price cap for April 2024 onwards. Together these changes to our forecast mean that we now expect the headline rate of CPI inflation to fall to below its target of 2 per cent by April 2024, as the large monthly inflation observations in early 2023 drop out. However, for CPI inflation to remain around its 2 per cent target, core inflation needs to start falling more quickly than it has done to date, which we expect in our central case scenario. Given the recent falls in inflation, we now think the Monetary Policy Committee (MPC) of the Bank of England is likely to start cutting interest rates earlier than we previously expected. Specifically, we expect interest rates to start falling in May of this year and reach 4.5 per cent by the end of 2024.

Figure 1.1 GDP growth



Note: The shades within the fan chart represent a 10 per cent chance that GDP growth will lie within the boundary of that shade. There is a 20 per cent chance that GDP growth will lie outside the shaded area of the fan. The black line represents our central forecast for GDP growth.
Source: NiGEM database, NIESR forecast and NiGEM stochastic simulations

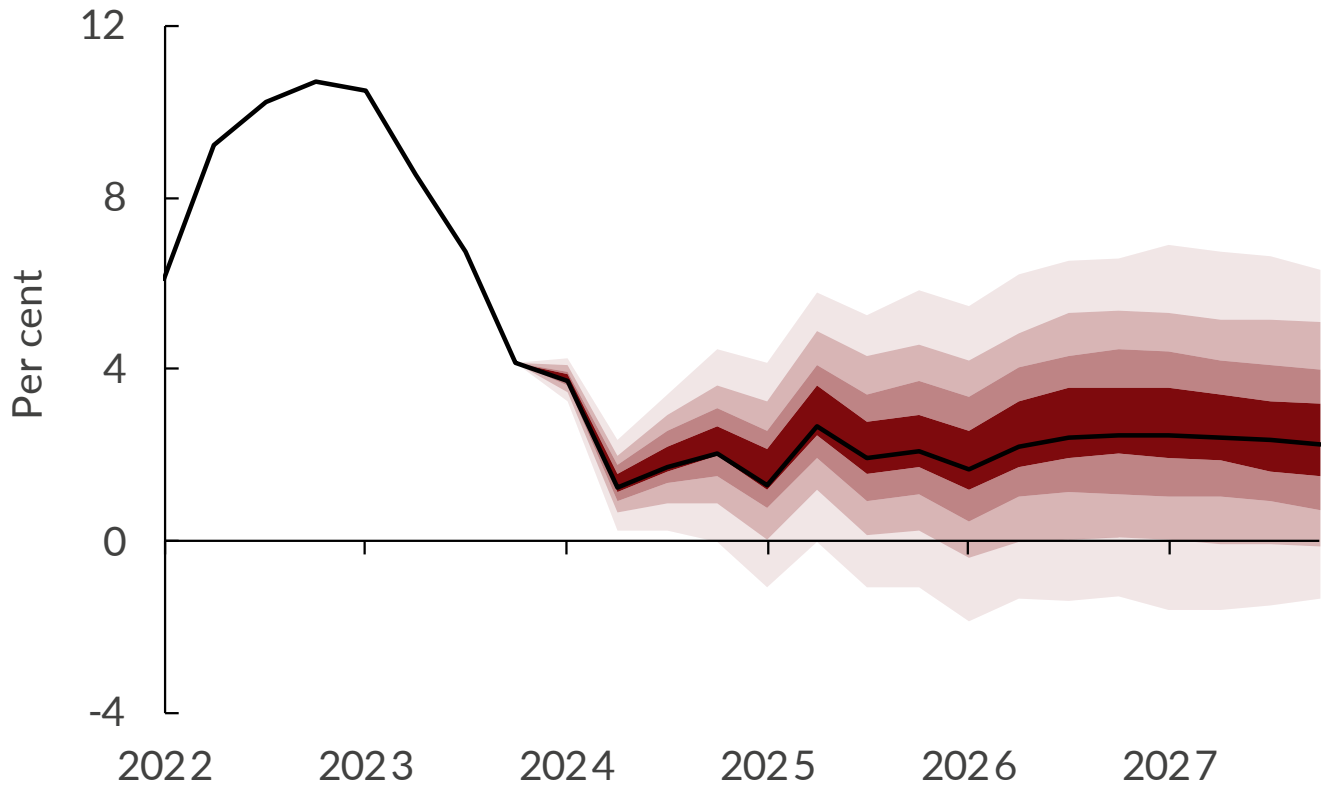
Figure 1.2 Annual consumer price index inflation



Source: ONS, NIESR calculations.

The ongoing fall in inflation means that we expect CPI inflation to be around 3.7 per cent in the first quarter of 2024 and around 1.2 per cent in the second quarter (figure 1.2), before returning to the Bank of England's 2 per cent target by the end of 2024. Looking further out, we expect CPI inflation to be volatile, but staying within the range of 1 to 3 per cent. Figure 1.3 plots a probabilistic range of values for inflation against our central forecast (the black line). Given the ongoing war in Ukraine and events in the Middle East, we see the risks to inflation to be on the upside. Our stochastic simulation suggests that there is a 20 per cent chance that the annual rate of CPI inflation will be above 4 per cent in the fourth quarter of 2025.

Figure 1.3 CPI inflation fan chart



Note: The shades within the fan chart represent a 10 per cent chance that inflation will lie within the boundary of that shade. There is a 20 per cent chance that inflation will lie outside the shaded area of the fan. The black line represents our central forecast for inflation.
Source: NiGEM database, NIESR forecast and NiGEM stochastic simulations.

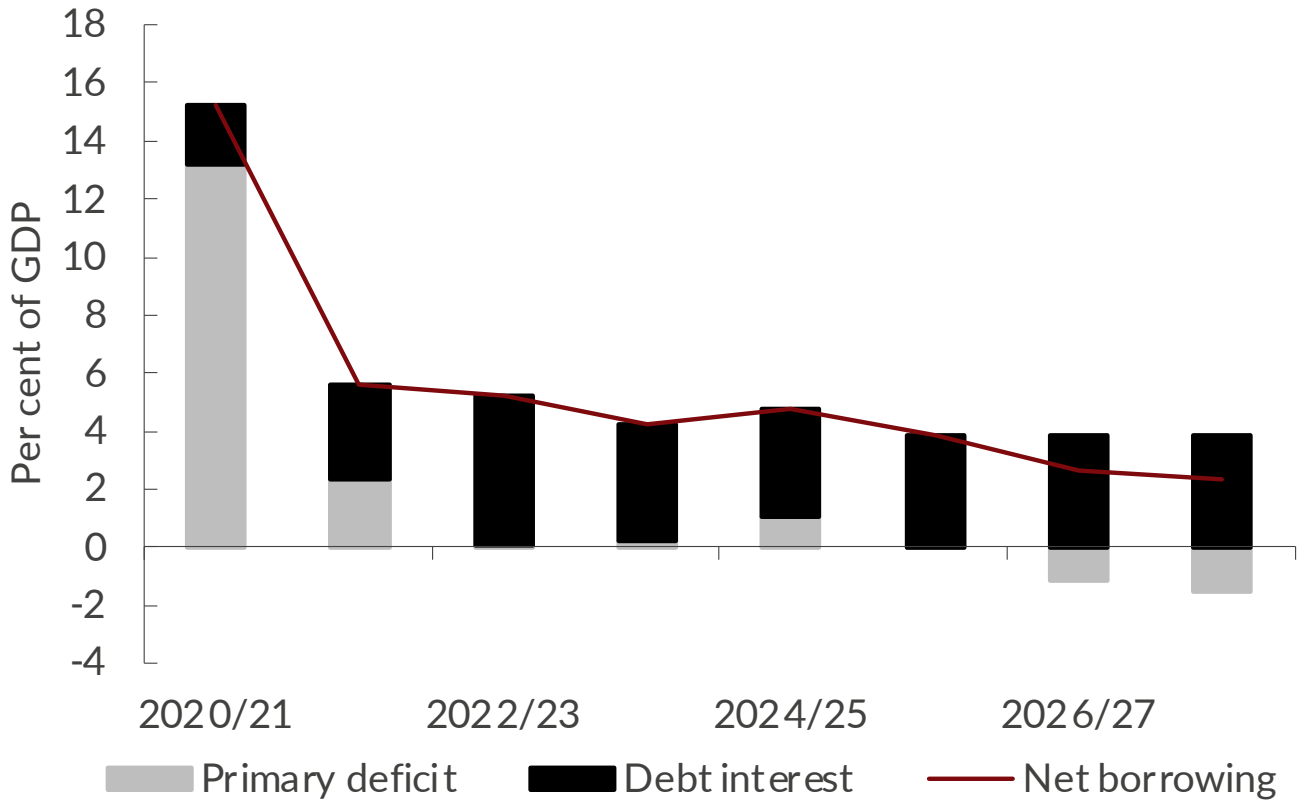
Policy

Fiscal Policy

The medium-term fiscal situation is one where the debt to GDP ratio is slowly falling. Despite low growth in real GDP and large budget deficits, this was made possible by the high inflation during 2022 and 2023, which led to an 'inflation tax' that reduced the real value of government debt, as discussed in Dixon et al. (2022). This fiscal space enabled major fiscal interventions such as the Energy Price Guarantee to be funded without major tax increases. Inflation also benefitted the public finances by reducing real wages in the public sector and increasing tax revenues with the freezing of tax thresholds.

The last quarter of 2023 saw a rapid fall in inflation, and we expect CPI inflation to fall even further to 1.2 per cent in the second quarter of 2024. This means that the fiscal space provided by the inflation tax will disappear and fiscal choices become tougher as we move into 2025 and beyond. The only way for the debt to GDP ratio to continue to fall is for the deficit to GDP ratio to fall and/or GDP growth to revive. Our forecast – based on the government's spending and taxation plans announced in the Autumn Statement in November – is that whilst the deficit to GDP ratio remains high in 2024-25 at 4.8 per cent, it falls to 3.8 per cent in 2025-26 and 2.7 per cent in 2026-27, with these falls being driven by a rising structural budget surplus (figure 1.4), in turn driven by increases in the effective rate of labour income tax resulting from the freezing of income tax thresholds.

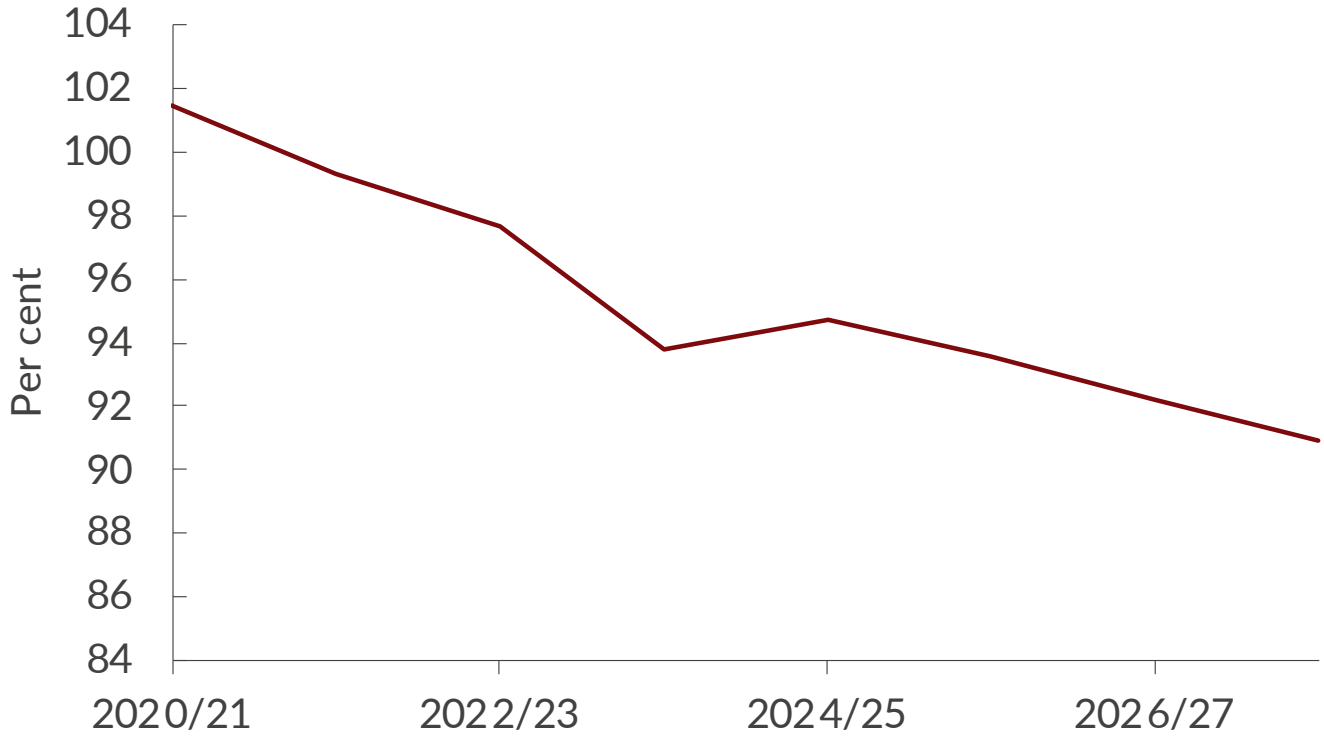
Figure 1.4 Public sector deficit to GDP ratio and its components



Source: NiGEM database and NIESR forecast.

Although real GDP growth remains sluggish throughout the forecast period, this fall in the deficit to GDP ratio is sufficient to keep the debt to GDP ratio on a downward track from 2025-26 onwards (figure 1.5).

Figure 1.5 Public sector net debt to GDP ratio



Source: NiGEM database and NIESR forecast.

For the fiscal year up to December, Public Sector Net Borrowing stood at £119.1 billion, £4.9 billion below the path the Office for Budget Responsibility (OBR) had forecast in their November Economic and Fiscal Outlook (OBR, 2023) with the difference driven by lower-than-expected debt interest payments. At the same time, Public Sector Net Debt stood at 97.7 per cent of GDP, roughly in line with what the OBR were expecting.

For some time now, and most recently in our analysis of the Chancellor's Autumn Statement (Bejarano Carbo et al., 2023a), we have argued that fiscal targets set by the government are completely arbitrary, and policy should not be constrained by them (Chadha et al., 2021). And, as we look forward to the March budget, the fiscal rules currently look even more arbitrary than usual. The current rule, which will affect what the Chancellor can do in the March budget, is that the debt to GDP ratio needs to be falling by 2029. For most of that time, fiscal policy will be set by the winners of this year's election. So, any constraint on fiscal choice will not bind this year but will only affect the spending and taxation decisions of the next Government. In principle, this means that the Chancellor will have 'free reign' in the March budget to cut taxes without worrying about the consequences.[1] Ironically, it is precisely to stop such situations occurring that led to the introduction of fiscal rules in the first place. This will create quite a challenge for the OBR, which will need to provide an assessment of the fiscal policy stance while acknowledging that the tax and spending plans for 2025-29, which it has to take as given in this assessment, are, essentially, fictional.

1 Of course, there is some limit to this as a completely non credible budget would result in a severe adverse reaction in the financial markets as was seen as the time of the Kwasi Kwarteng Mini Budget of October 2022.

Having said all that, we forecast there is some fiscal space left for modest tax cuts against the current fiscal rules. In our Autumn UK Economic Outlook (Bejarano Carbo et al., 2023b), we argued that, if the Chancellor decides to cut taxes, he should do so by raising tax thresholds to partly compensate for past inflation. However, in a pre-election budget the focus might be on more populist cuts, and cuts to inheritance tax and further reductions in National Insurance Contributions (NICs) are much talked about in the press. However, without corresponding expenditure cuts, any tax cuts would have to be relatively minor to avoid reversing the decline in the debt to GDP ratio. The November 2023 Autumn Statement already set in place a new era of austerity with the introduction of significant and sustained cuts in expenditure across a range of departments. As discussed in Box C in Chapter 2, this has led to a looming crisis in local government funding in England with many councils likely to become insolvent in the near future, and with Birmingham and Nottingham already having declared bankruptcy. The devolved nations are also complaining of a dire fiscal situation. These factors will make it difficult for further cuts in expenditure to be made, and hence large tax cuts are unlikely to be feasible.

It would be more prudent - as NIESR has previously suggested – to use fiscal space to increase public investment rather than to cut taxes. Years of underinvestment in public-sector infrastructure and service provision have led to a situation where our public services are stretched to the limit. As a result, taxes are higher than they otherwise might be to cover the need to 'patch up' our struggling public services. Taxes represented 36.3 per cent of GDP in 2022-23, higher than at any point since 1949-50, and the OBR expect this to rise to 37.7 per cent in 2028-29, higher than at any point since World War II. Until the government reverses the underinvestment trend and returns public service provision to an efficient level, taxation will have to remain high to cover necessary spending increases.

Monetary Policy

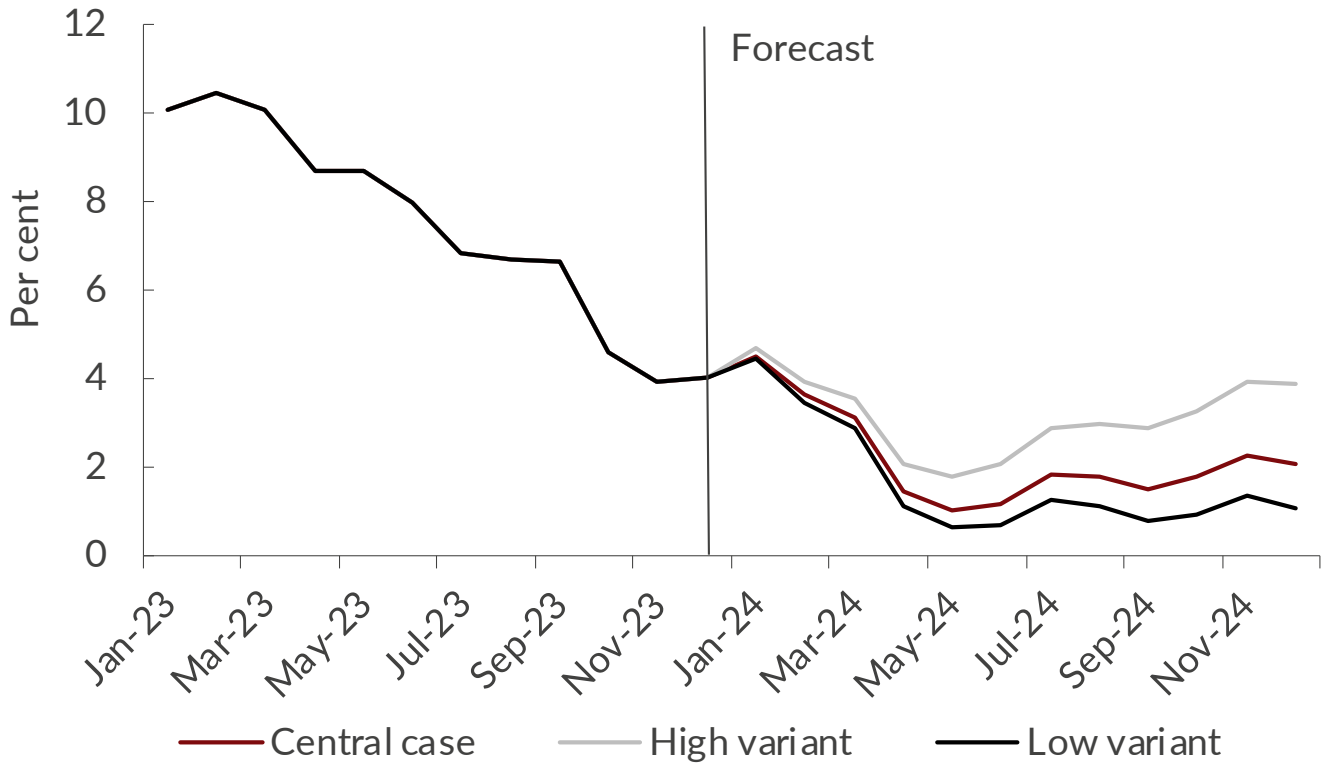
The headline CPI inflation figure measures the change in prices over a 12-month period. As we move on through time, our reference period changes, so if month on month (MoM) inflation was high twelve months ago, it will drop out from the headline figure. In the first three quarters of 2023, inflation was high: the average MoM inflation was 0.42 per cent (equivalent to an annualised rate of 5.2 per cent). As we move through the first three quarters of 2024, this inflation will 'drop out' and provide strong downward pressure in the headline CPI inflation rate. In the last quarter of 2023, in contrast, inflationary pressure was much less, with two consecutive months (October and November) with almost zero MoM inflation. Hence changes in inflation in the last quarter of 2024 will reflect primarily the new inflation occurring in those months.

The key issue for our forecast is how much new inflation will we see as we move through 2024? This combined with the old inflation dropping out from 2023 will determine the path of inflation in 2024. Following Dixon (2024), we take the view that inflation will moderate in 2024 and that new inflation will come in (on average) at 0.25 per cent per month (an annualised rate of 3 per cent). In addition, based on Cornwall Insights (2023), we assume a fall in Ofgem's energy price cap of 14 per cent. These assumptions, combined with the drop out of inflation from 2023 implies a fall in inflation to around 1.2 per cent in the second quarter of 2024 and then a rebound to the inflation target of 2 per cent in the last quarter of 2024 where it settles over the medium term.

We show this in figure 1.6, which gives a month-by-month prediction of inflation in 2024 under three hypotheses: one is new inflation each month at 0.25 per cent (our central forecast), the second is that new monthly inflation remains very high at its 2023 level of 0.4 per cent (annualised 5 per cent), and last that new inflation comes in at 0.17 per cent MoM. We have included a high

scenario because of the upside uncertainty for 2024 from geopolitical risks. We already have a war in Ukraine which might expand to open conflict between Russia and NATO. The conflict in the Middle East is already expanding to affect trade in the Suez Canal and Red Sea and may well expand to impact the Persian Gulf. Lastly, the election of the pro-independence President Lai Ching-te makes conflict between China and the United States more likely. All of these could have a significant effect on UK inflation.

Figure 1.6 CPI inflation projections



Source: ONS and NIESR forecast.

Looking further ahead, for CPI inflation to remain close to target, core inflation will need to fall. Given that labour costs are a large part of total costs, particularly in services, for core inflation to fall, wage inflation needs to come down. In our January Wage Tracker (Bejarano Carbo, 2024b), we estimated that total and regular average weekly earnings grew at 5.7 and 6.2 per cent, respectively, in the year to the fourth quarter of 2023. Given the loosening labour market, we expect wage growth to fall, averaging 3.7 per cent in 2024, and remaining around 4 per cent thereafter (figure 1.7).

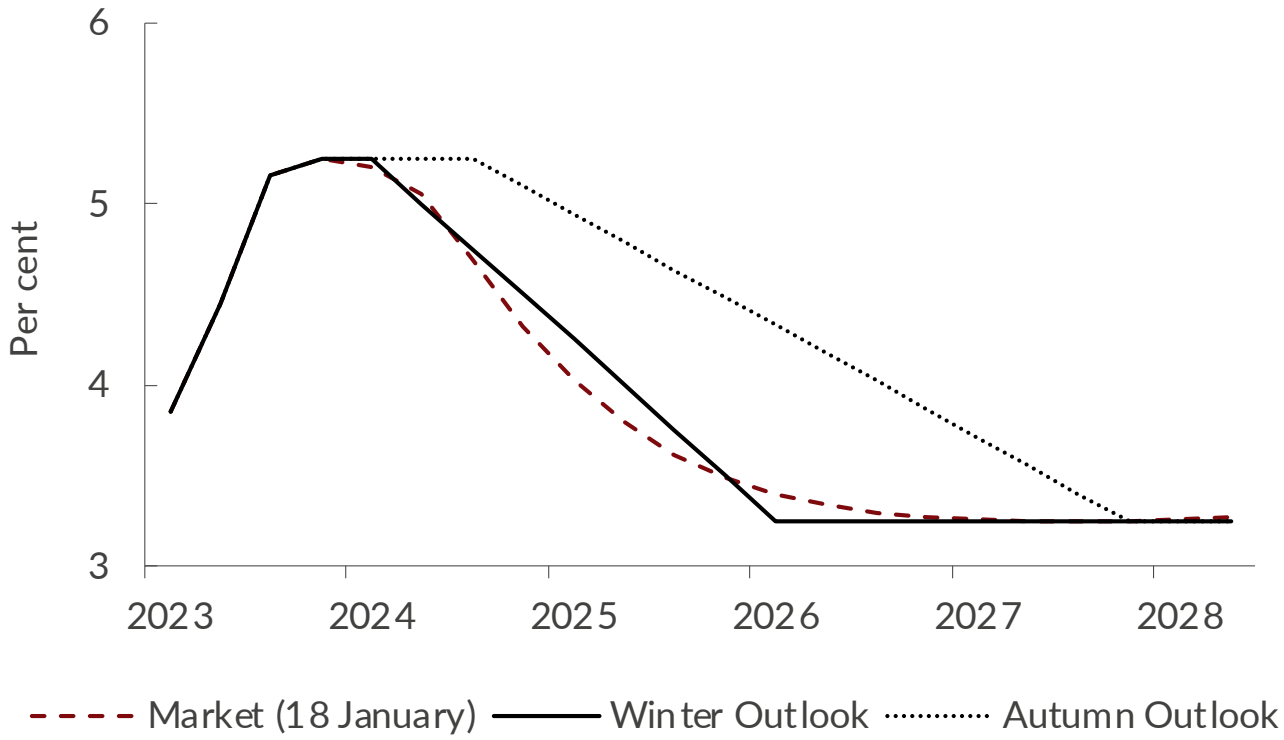
Figure 1.7 Nominal and real wage growth

Source: NiGEM database and NIESR forecast.

With CPI inflation expected to fall below the Bank of England's target of 2 per cent in April, there will be increased pressure on the MPC to start reducing rates soon and this has been reflected in changes in both our view of the future path of interest rates and that of the financial markets (figure 1.8). We and the market both predict a rapid decline in interest rates during 2024. However, as shown in figure 1.8, we take the view that the Bank of England will be more cautious than expected by the market, moderating interest rate cuts until it is sure that inflation will not increase again. In particular, MPC members will not want to have to raise interest rates after they have cut them, as this may raise questions of their judgement in the market. Given the geopolitical uncertainties, there should be no rush to cut interest rates quickly in 2024. 'Slow and steady' will win the day.

Such an approach may cause political problems. If the election should take place in the second quarter of 2024, there could be additional pressure on the MPC to cut interest rates in March and/or by a larger amount in May. However, as shown in figure 1.6, although inflation may well fall below target in April, it will also 'rebound' soon after, so some caution is required. However, small interest rate cuts in mid-2024 could signal the future path of interest rates to 3.25 per cent, our view, and now the view of the financial markets, of the long-term level of the nominal interest rate (figure 1.8). Indeed, some forward guidance on the longer-term level of interest rates would be very valuable and provide a stable framework for the savings and investment decisions of household and firms (not to mention mortgages and the housing market).

Figure 1.8 Bank rate forecast comparison



Source: Bank of England, NiGEM database and NIESR forecast.

The Forecast in Detail

Conditioning Assumptions

In line with the evolving nature of the whole forecasting process, the approaches used for setting the underlying assumptions are continually reviewed. Our current projections are conditioned on:

- The path for **short-term policy interest rates** shown in figure 1.8. We believe that interest rates have peaked at 5.25 per cent and will fall slowly from the second quarter of 2024 onwards. Given our view that the equilibrium real interest rate is around 1.25 per cent, we expect nominal rates to level off at around 3.25 per cent.

- A path for the **sterling effective exchange rate** index that is roughly 3.5 per cent higher on average than in our Autumn 2023 UK Economic Outlook. However, in the medium term, exchange rates are assumed to converge in line with the uncovered-interest parity condition based on interest rate differentials relative to the United States.

- **Fiscal policy** evolving in line with announced government policies to date. In particular, we imposed the paths for nominal government consumption, nominal government investment, nominal investment by public corporations, general government subsidies and miscellaneous government spending and tax revenue found in OBR (2023). We set the rate of income tax to 23.8 per cent for the fiscal year 2024-25, rising to 24.4 per cent for the fiscal year 2028-29 as the freeze in personal allowances raises the effective tax rate. These rates are in line with the implied rates suggested by the OBR forecasts for income tax revenue and personal income. Similarly, we set the rate of VAT to 18 per cent, the rate implied by the OBR forecasts for VAT revenue and nominal consumption. Finally, we set the rates of corporation tax for non-oil producers and oil producers to 25 per cent and 75 per cent, respectively, implying an average

rate of corporation tax of 26 per cent, the rate implied by the OBR forecasts for corporation tax revenue and the gross operating surplus of corporations.

- Our **oil price assumptions** for the short term generally follow those of the US Energy Information Administration (EIA), published in January 2024, and updated with daily spot price data available up to 18 January 2024. The EIA uses information from forward markets as well as an evaluation of supply conditions. Oil prices, in US dollar terms, have decreased since our last forecast in October by about 8 per cent, with the expectation for the oil price at the end of 2024 being around 14 per cent lower than three months ago.

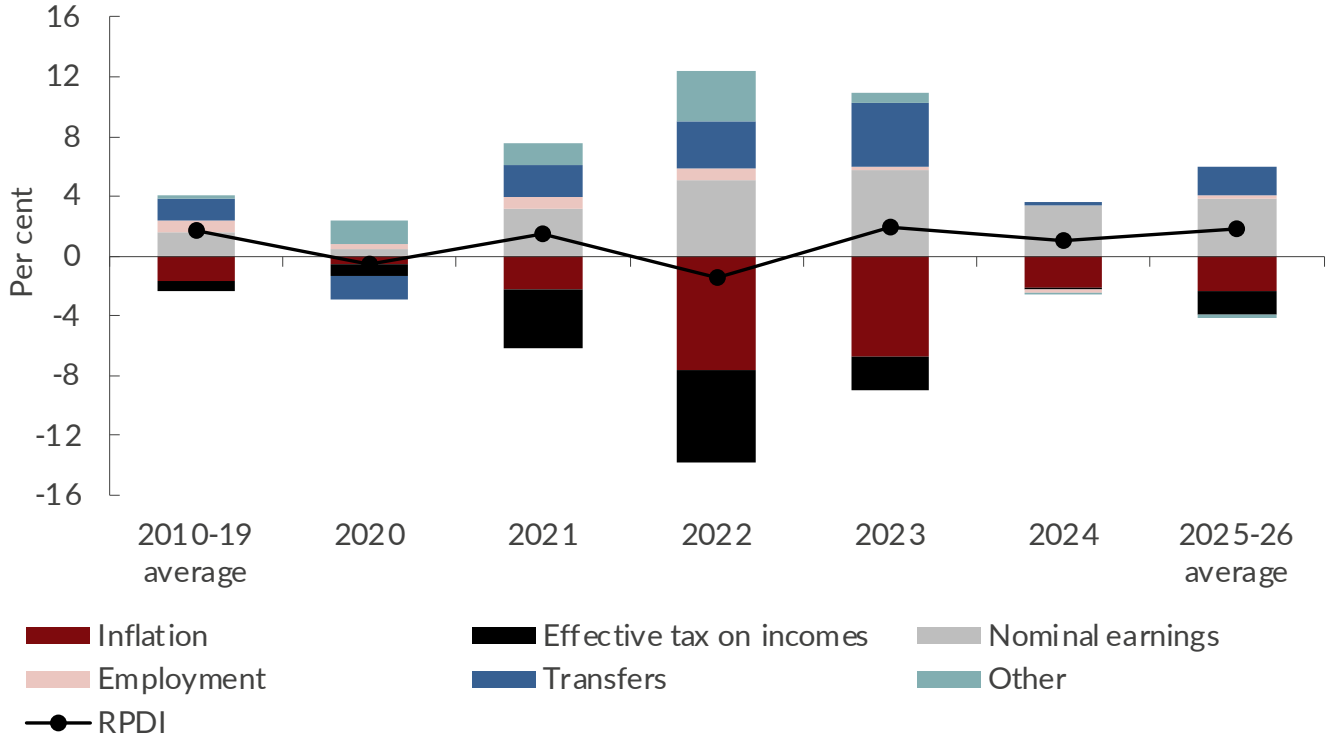
- The working-age **labour force participation rate** staying flat over the course of the next few years. Given the uncertainty around the participation data, and the ongoing issue of the large increase in long-term sickness, this seemed the most sensible neutral assumption we could make. Given demographic trends in the United Kingdom, we would expect the participation rate for the 16-plus population to fall over the medium run as the baby boomer generation retires.

Demand and Output

In terms of output, the overall theme of our forecast is the ongoing sluggish GDP growth, which we expect to persist into the medium term. We now think that the UK economy went into recession last year with GDP contracting in both the third and fourth quarters of 2023. This means we now think that GDP grew by only 0.3 per cent in 2023. Looking forward, we expect GDP to grow by 0.9 per cent in 2024 and at a similar rate throughout the rest of the forecast.

The 'cost of living' crisis led to a fall in aggregate real personal disposable income of 1.4 per cent in 2022 but the energy price guarantee and other one-off support payments in 2023, together with a smaller increase in average tax rates, mean that we now think aggregate real personal disposable incomes rose in 2023 by 2.0 per cent (figure 1.9). And with much lower inflation and ongoing high wage growth in 2024, we expect aggregate real personal disposable income to continue increasing, though by only 1.1 per cent. Other things equal, this rise in real incomes will act to push up on consumption.

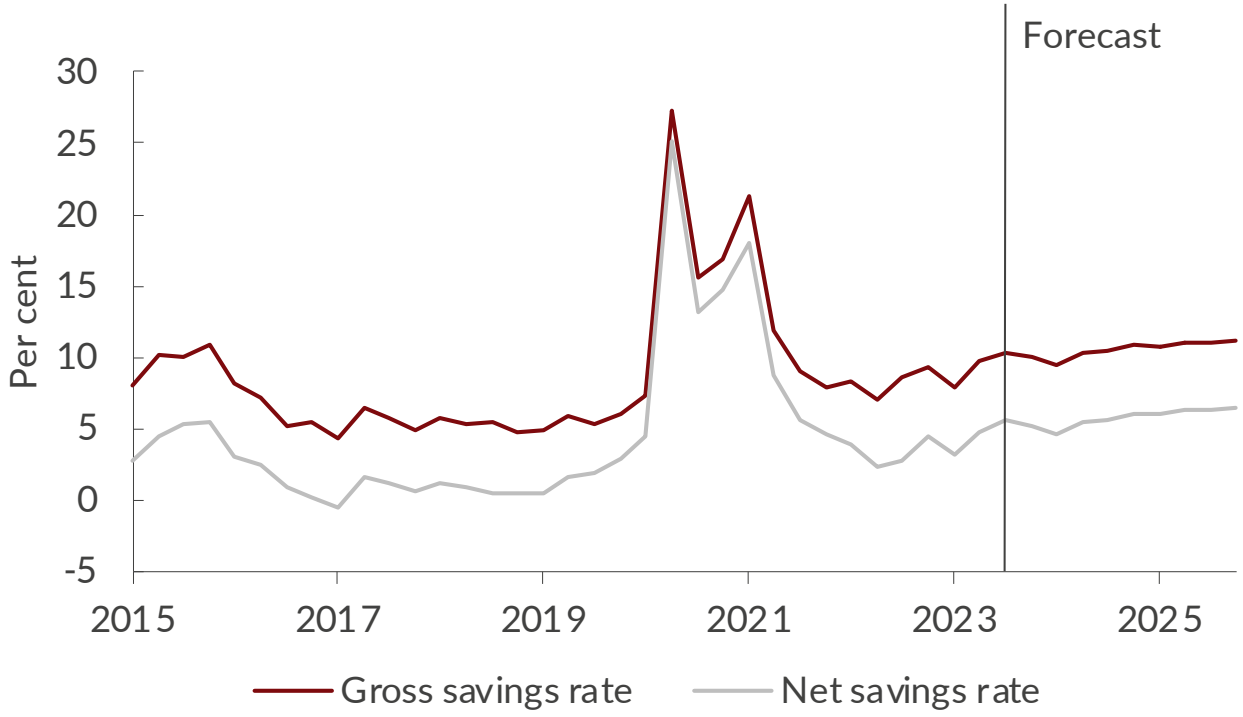
Figure 1.9 Contributions to growth in real personal disposable income



Note: 2023 onwards are NIESR forecasts.
Source: NiGEM database and NIESR forecast.

Against this good news, the large increases in interest rates over the past year have fed into lower consumption growth by increasing monthly mortgage payments – for those households on variable rates or whose fixed rate has come up for renewal over the past year – and encouraging savings. Figure 1.10 shows the net and gross savings rates. As interest rates have risen, so have the net and gross savings rates. Between the second quarter of 2022 and the third quarter of 2023, the net savings rate rose from 2.3 per cent to 5.5 per cent and the gross savings rate from 7.1 per cent to 10.3 per cent. Moving forward, we expect the net and gross savings rates to continue rising to around 6 ½ and 11 per cent, respectively, by the end of 2025.

Figure 1.10 Gross and net savings rates



Notes: The net savings rate is defined simply as 1 – real consumption/real personal disposable income. The gross savings rate accounts for revaluation effects in household financial wealth (ie, the change in the value of net equity in pension funds held by the household sector).
Source: NiGEM database and NIESR forecast..

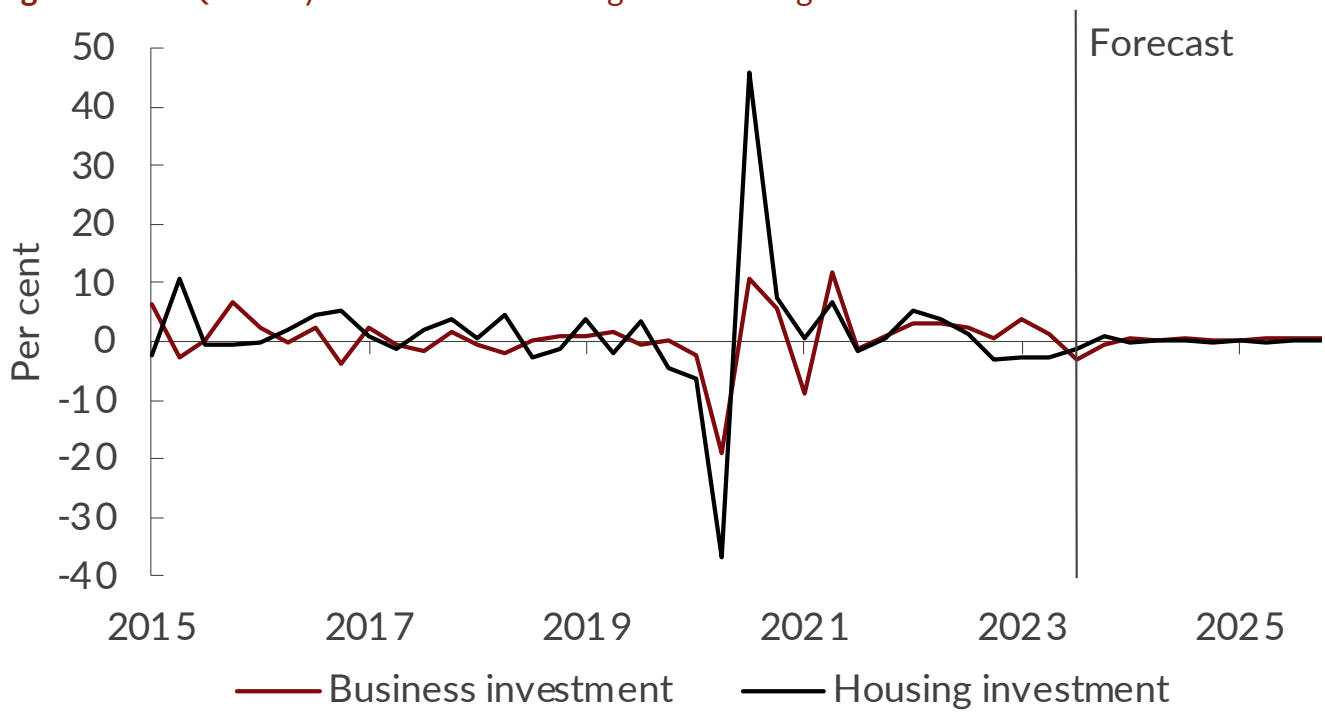
The result of higher savings rates has been sluggish consumption growth (figure 1.11). We expect consumption to have grown by 0.6 per cent in 2023 relative to 2022 and to grow by only 0.3 per cent in 2024 relative to 2023.

Figure 1.11 Annual consumption growth

Source: NiGEM database and NIESR forecast.

The monetary policy tightening we have seen since February last year has raised the cost of capital and born down on both business and housing investment. We think that business investment rose in 2023, by 5.3 per cent, but given the monetary tightening over 2023, we now expect business investment to fall by 0.8 per cent in 2024 (figure 1.12). NIESR has consistently said that to increase productivity growth in the United Kingdom, we need to raise business investment as a proportion of GDP. This view was also voiced in much of the evidence presented to the Productivity Commission (established by NIESR) and written up in its evidence review (NIESR, 2022). Last year, the Productivity Commission took evidence on the underperformance of business investment and this evidence is summarised in NIESR (2023b). We think housing investment contracted by 5.8 per cent in 2023 and will contract by a further 0.5 per cent in 2024 (figure 1.12).

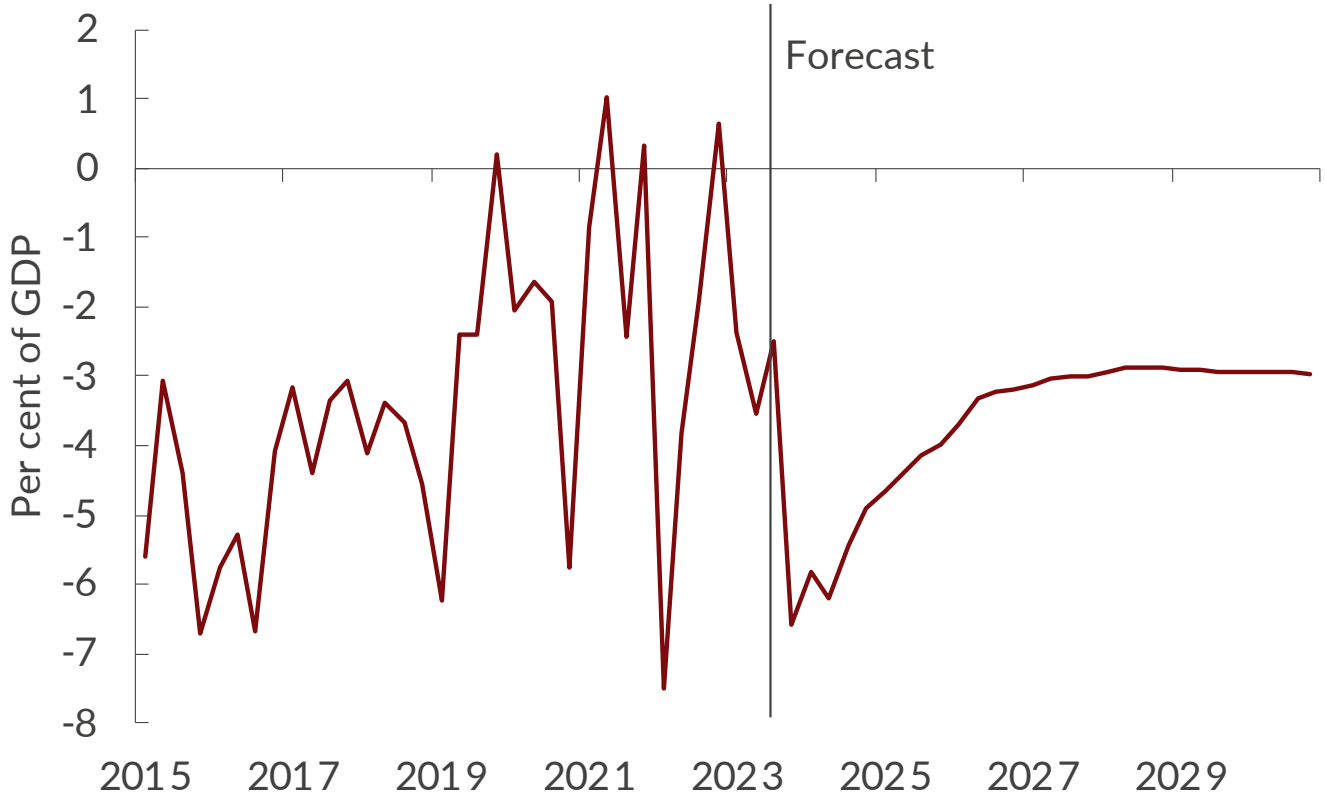
Figure 1.12 Quarterly business and housing investment growth



Source: NiGEM database and NIESR forecast

Turning to trade, we expect an improvement in both the trade and current account balances over the next three years. Having fallen in 2023 by 0.3 per cent, we expect exports to grow by 0.5 and 0.8 per cent in 2024 and 2025, respectively. At the same time, we expect the sluggish growth in output to lead to falls in imports of 0.9 and 0.5 per cent in 2024 and 2025, respectively. Beyond 2025, both exports and imports grow at around 1 per cent, in line with GDP. As a result, the trade deficit falls from £25.4 billion (at 2019 prices) in 2023 to around £1 billion in 2028. This improvement, coupled with an improvement in net IPD flows, leads to an improvement in the current account balance: the deficit falls from 5.6 per cent of GDP in 2024 to 2.8 per cent of GDP by 2028 (figure 1.13).

Figure 1.13 Current account balance



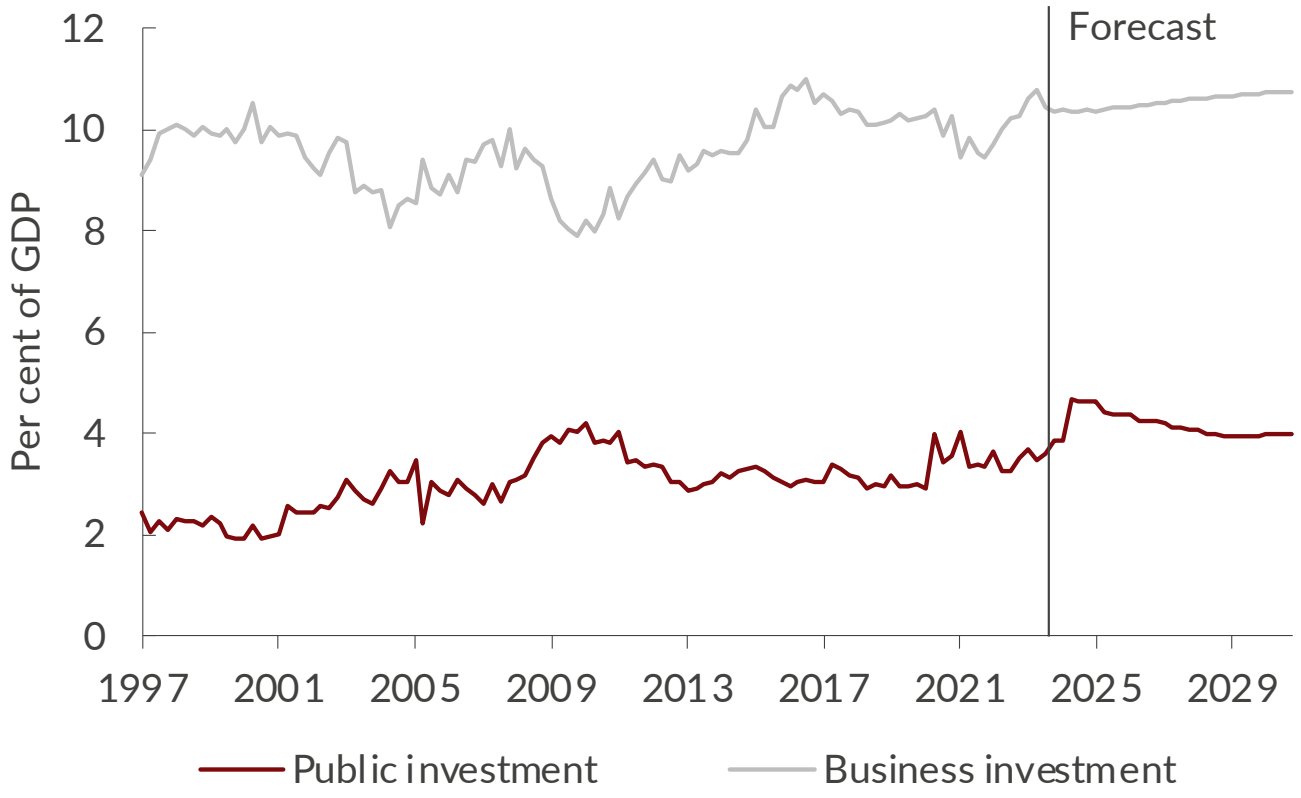
Source: NiGEM database and NIESR forecast.

Supply

In this section, we consider the determinants of the long-run supply potential of the UK economy: the capital stock, labour supply and labour-augmenting technology.

NIESR has often made the point that the United Kingdom suffers from a lack of investment, both business investment and public investment. Indeed, the UK Productivity Commission, hosted by NIESR, took the view that this lack of investment has been a major cause of the low productivity growth in the United Kingdom (NIESR, 2022). Figure 1.14 shows business and public investment as a proportion of GDP. Since the Global Financial Crisis (GFC), business investment has averaged only 9.7 per cent of UK GDP and public investment only 3.4 per cent. For business investment, this compares with an average of around 13-14 per cent in the 1960s and 1970s and 12 per cent in the 1980s. Looking forward, we expect business investment to pick up to around 10.7 per cent of GDP by the end of 2028, raising the business capital to output ratio from 4.22 to 4.29, but still not enough to lead to a noticeable improvement in UK productivity growth.

Figure 1.14 Investment to GDP ratios

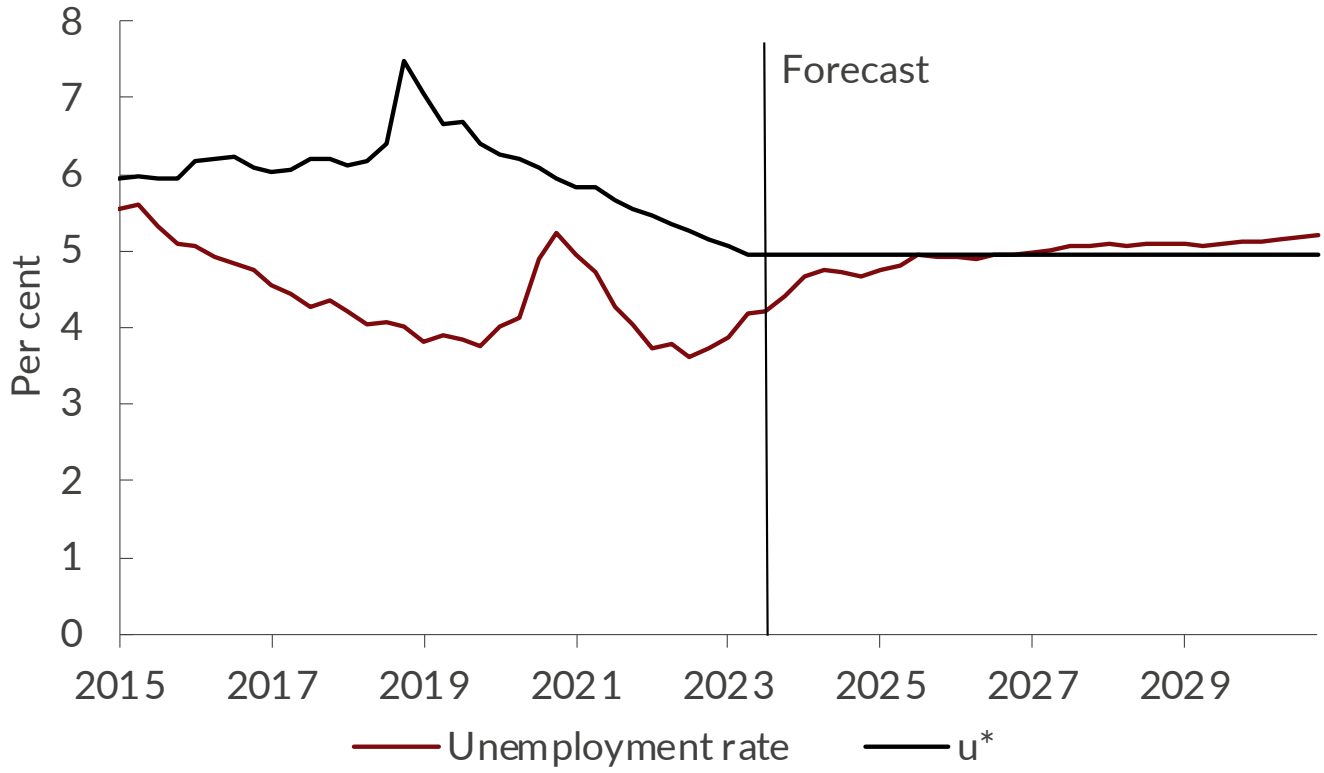


Source: NiGEM database and NIESR forecast.

Labour force growth depends on the growth in the working-age population and the participation rate. We expect the working-age population to grow by 0.4 per cent in 2024. Looking further forward, we expect the growth rate of the working-age population to average 0.2 per cent over the period from 2025-30. As we said above, we expect the participation rate to remain unchanged over this period, implying labour force growth of 0.2 per cent in the medium term. At the same time, the increase in longevity will lead to a rise in the proportion of the population aged over 65, increasing the burden on the working age population of financing 'pay as you go' state pensions. As argued in, e.g. Goodhart and Pradhan (2020), this will have serious implications for both monetary and fiscal policy.

Whether this increase in labour supply results in higher output in the medium run will also depend on the evolution of the unemployment rate. As discussed in the section on Current Economic Conditions below, the UK labour market remains tight, but there is evidence that it is loosening. Vacancies fell by 49,000 in the fourth quarter of 2023 relative to the third quarter and the new 'experimental estimates' suggest that the unemployment rate remained around 4.2 per cent in the fourth quarter of 2023. Given our forecast for output growth slightly below trend over the coming years, we expect to see a slow rise in the unemployment rate, which reaches its 'natural rate' of around 5 per cent in the fourth quarter of 2026 (figure 1.15).

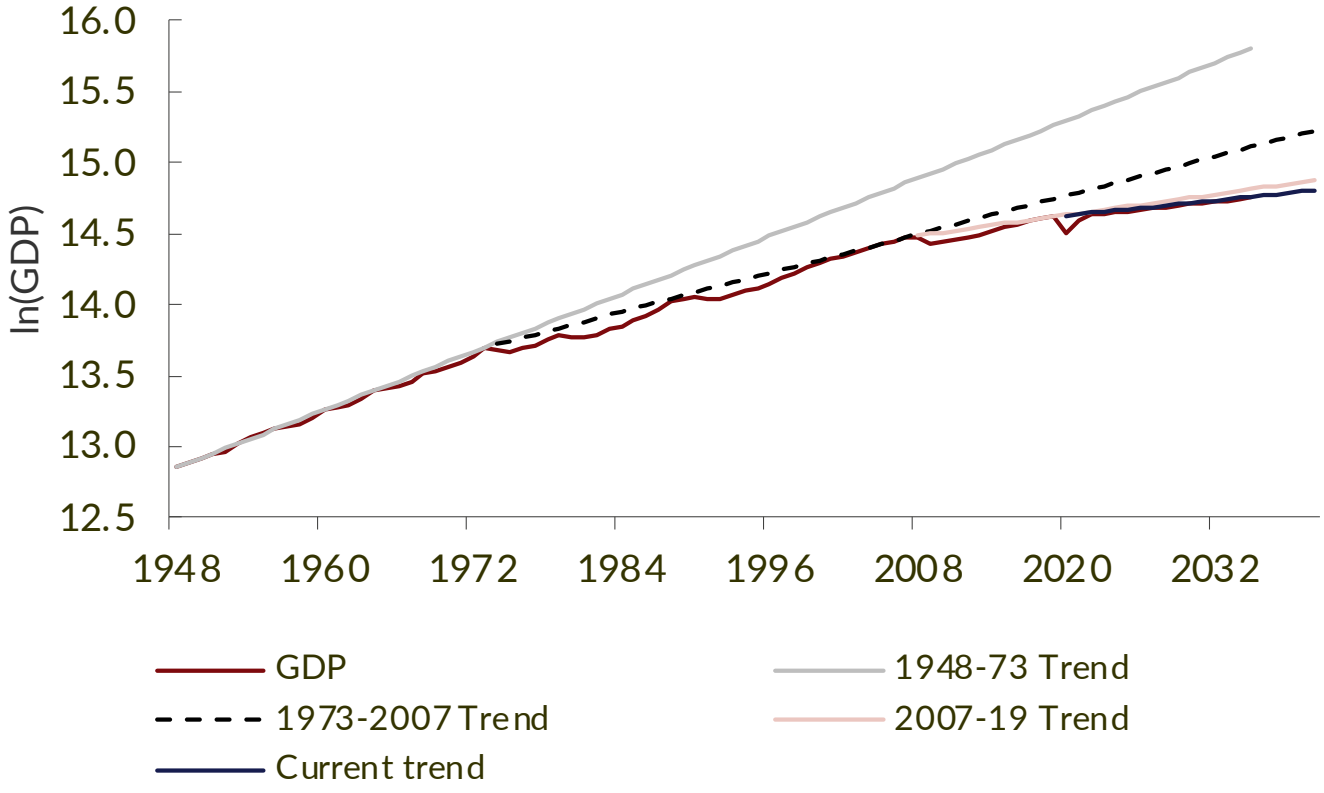
Figure 1.15 Unemployment rate and the natural rate of unemployment, u*



Source: NiGEM database and NIESR forecast.

Since 2019, the annual growth rate of labour-augmenting technological progress has averaged only 0.1 per cent. We expect this to pick up over the forecast period towards 0.4 per cent, our current estimate of its trend growth rate. Combining this with our current estimates for capital deepening and labour supply growth gives our current estimate for the trend rate of UK economic growth of around 0.9 per cent. This trend rate of output growth is low relative to the past. Looking at GDP growth over the period since World War II suggests that the trend rate of growth for the UK economy has been falling over time. Figure 1.16 suggests that the trend growth rate was around 3.4 per cent from 1947 to 1973 but that this then slowed to 2.3 per cent up to the GFC. Between the GFC and the Covid shock, the trend growth rate was around 1.2 per cent, still higher than our estimate of the current trend rate of growth. As we argued in our response to the Autumn Statement (Bejarano Carbo et al., 2023a), raising this trend rate of growth should be at the top of the government's priorities for economic policy.

Figure 1.16 GDP (log scale) and trend GDP



Source: ONS and NIESR forecast.

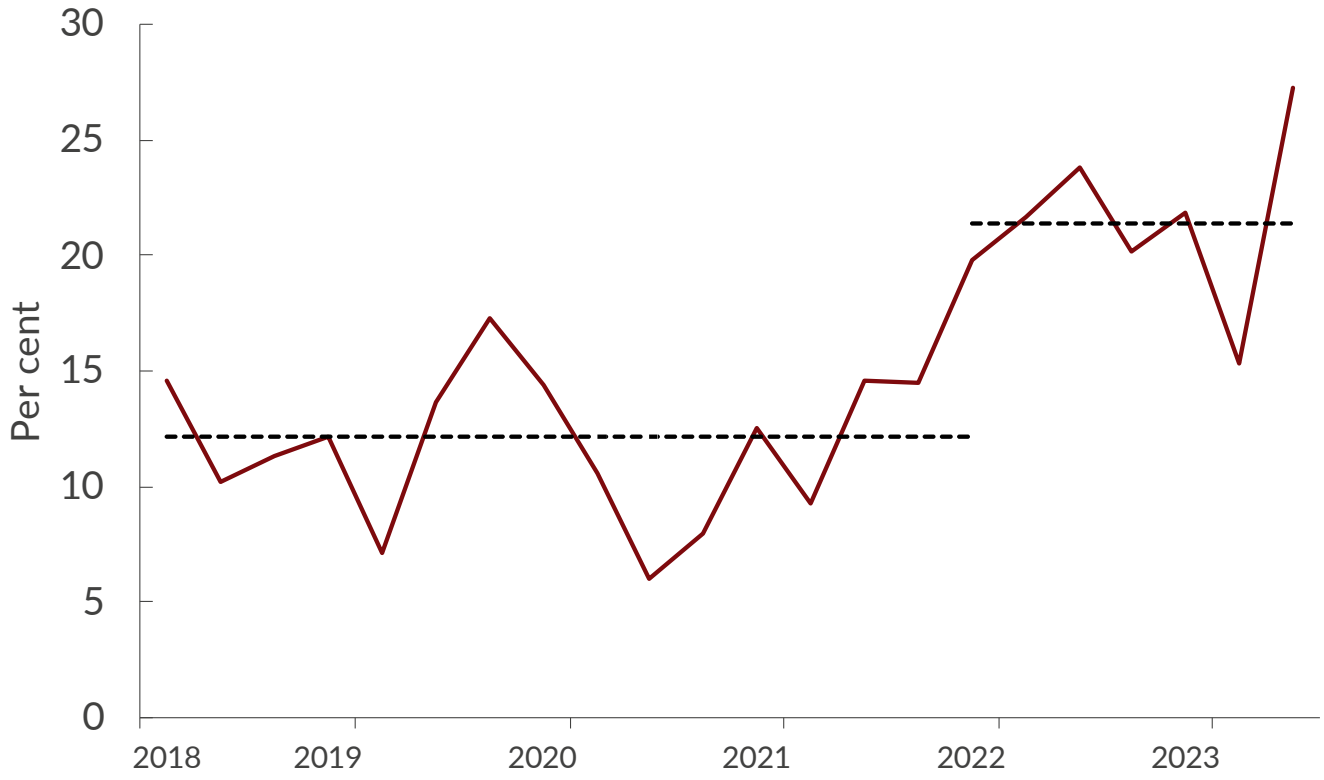
Key Risks

The main risks to both GDP growth and inflation over the coming year are geopolitical, in particular, the ongoing Russia-Ukraine war and the events in Gaza and the Gulf of Aden. For inflation, there is also the risk that wage inflation is higher than we expect over the next couple of years and, as a result, core inflation remains well above target.

With respect to events in the Middle East, we can think of two separate risks. First, there is the risk that the Houthi attacks on shipping in the Red Sea result in all sea trade in this area being diverted around the Cape of Good Hope, rather than passing through the Red Sea and the Suez Canal. this would result in a large increase in the time taken to transport goods from Asia to Europe and, given that around 12 – 15 per cent of international trade passes through the Red Sea, lead to a large increase in shipping costs. As discussed in the Current Economic Conditions section below, the cost of shipping goods from Asia to Europe, as measured by the Shanghai Containerised Freight Index (SCFI), has already increased dramatically, by 153 per cent from the beginning of October 2023 to 22 January 2024. But there is clearly a risk that, if the attacks on shipping continue and the situation in that area escalates, shipping costs could increase much further. Since the United Kingdom currently imports around 33 per cent of its GDP, increases in import costs resulting from increases in shipping costs are likely to have a significant negative effect on output. In addition, since imports account for around 36 per cent of UK consumption, increases in import prices resulting from increases in shipping costs will also have a significant positive effect on UK inflation. Carriere-Swallow et al. (2022) suggest that a doubling in the cost of shipping leads to an increase in headline inflation of around 0.7 percentage points.

The second risk is that the conflict in Gaza, the Houthi attacks on shipping and, possibly, a widening of the conflict to other Middle Eastern countries leads to a significant rise in oil prices. Around 10 per cent of global oil and petroleum products pass through the Red Sea and, so, the Houthi attacks could have a direct effect on oil supply. More specifically, around 32 per cent of UK oil imports go through the Gulf of Aden, a share which has risen since sanctions were placed on Russian energy imports following Russia's invasion of Ukraine (figure 1.17). A large increase in oil prices will, again, have a significant negative effect on output and a positive effect on inflation. Millard and Shakir (2013) showed that the impact of a given oil shock on UK GDP growth and inflation changes over time but, when the United Kingdom was last an oil importer, it was between 0.2 and 1.0 per cent on the level of GDP, and between 0.2 and 1.5 percentage points on the level of CPI, after 1 year for a 10 per cent rise in oil prices.

Figure 1.17 UK imports of oil and petroleum products via the Gulf of Aden



Source: Department for Energy Security and Net Zero and Eurostat

Putting this all together, we judge that the risks are downside for GDP growth and upside for inflation. These judgements are reflected in our GDP fan chart (figure 1.1) and our CPI inflation fan chart (figure 1.3).

Current Economic Conditions

Demand and Output

Output Growth

As illustrated in Figure 1.1, we expect weak economic growth for the UK economy to persist into the medium run. GDP fell by 0.1 per cent in the third quarter of 2023, driven primarily by a contraction in demand for services. Moreover, GDP growth is expected to fall by 0.1 per cent in the fourth quarter of 2023, putting the UK growth rate for 2023 at just 0.3 per cent and implying that the UK economy was in recession in the second half of 2023. As NIESR has long emphasised, whether or not the United Kingdom is technically in a recession is almost beside the point: UK output growth has been sluggish for a long time now and is likely to remain so over the coming years. That said, the occurrence of a recession – and the press coverage that would go with it – may pose a risk to market sentiments, which may feed through to dampened business investment. Looking forward to 2024 and 2025, our forecasts suggest output growth of 0.9 per cent and 1.2 per cent, respectively. This indicates a general improvement in economic conditions as inflationary pressures ease and real wage growth remains firmly positive.

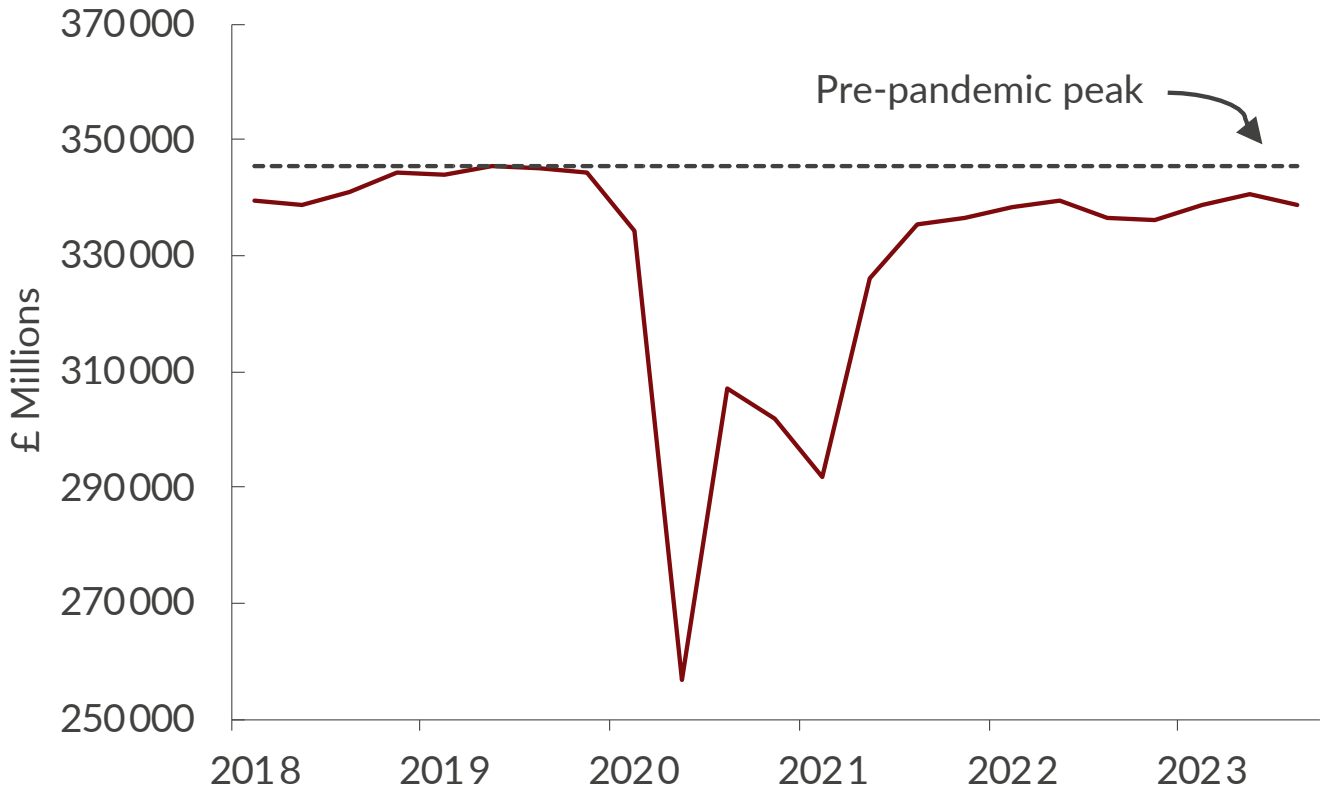
Consumer Spending

Household spending growth slowed notably in the third quarter of 2023, falling by 0.5 per cent, after rebounding earlier in the year. Moreover, as illustrated by figure 1.18, total household consumption continues to remain markedly below its pre-pandemic level. Specifically, in the third quarter of 2023, household consumption was 1.9 per cent below its pre-pandemic peak.

This trend reflects findings in the Public Opinions and Social Trends survey, published by the ONS, which found that 63 per cent of adults reported spending less on non-essentials in the previous quarter due to the increases in the cost of living, and the GfK Consumer Confidence Index, which fell sharply in October 2023, returning to levels observed in July. Low consumer confidence is also corroborated by the low retail sales volumes observed in December 2023. Retail sales volumes fell 3.2 per cent in the final month of last year, the largest monthly fall seen since January 2021.

Despite the two percentage point cut in the rate of national insurance, which came into effect at the start of the year, we only forecast a modest increase in household spending of 0.2 per cent in 2024. This is driven by diminished demand for services in the face of continued service-sector price inflation.

Figure 1.18 Total household spending

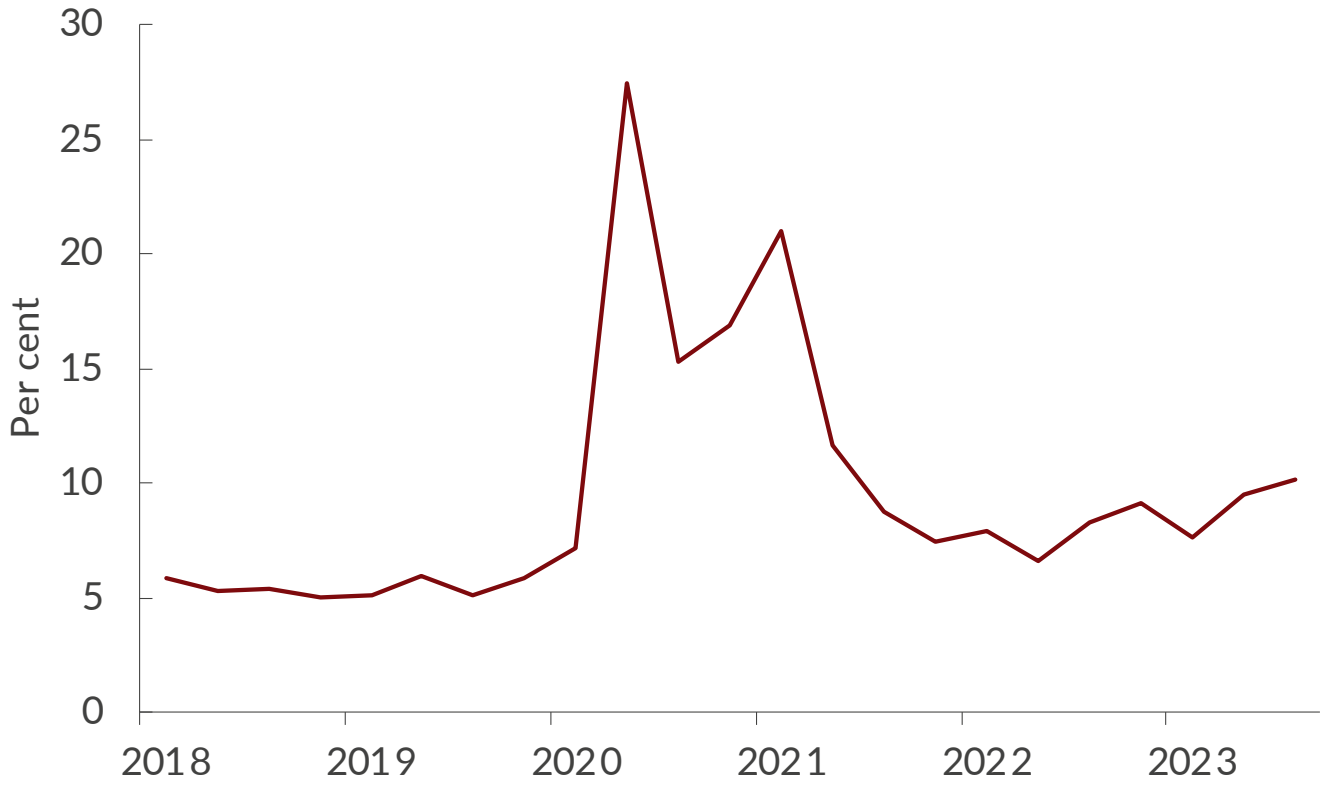


Source: ONS.

Household Savings

Building on strong growth in the household gross savings ratio in the previous two quarters, the portion of household income being saved rose to 10.1 per cent in the third quarter of 2023. The sustained rise in interest rates has heightened household's demand for savings and brought about the highest household savings ratio in almost a decade (excluding the involuntary spike in savings arising during the pandemic) as illustrated by figure 1.19. Moreover, the elevated levels of savings among households, coupled with average fixed term mortgage rates remaining lower for longer, relative to previous interest rate cycles, have led to a net gain in interest income accruing to households.

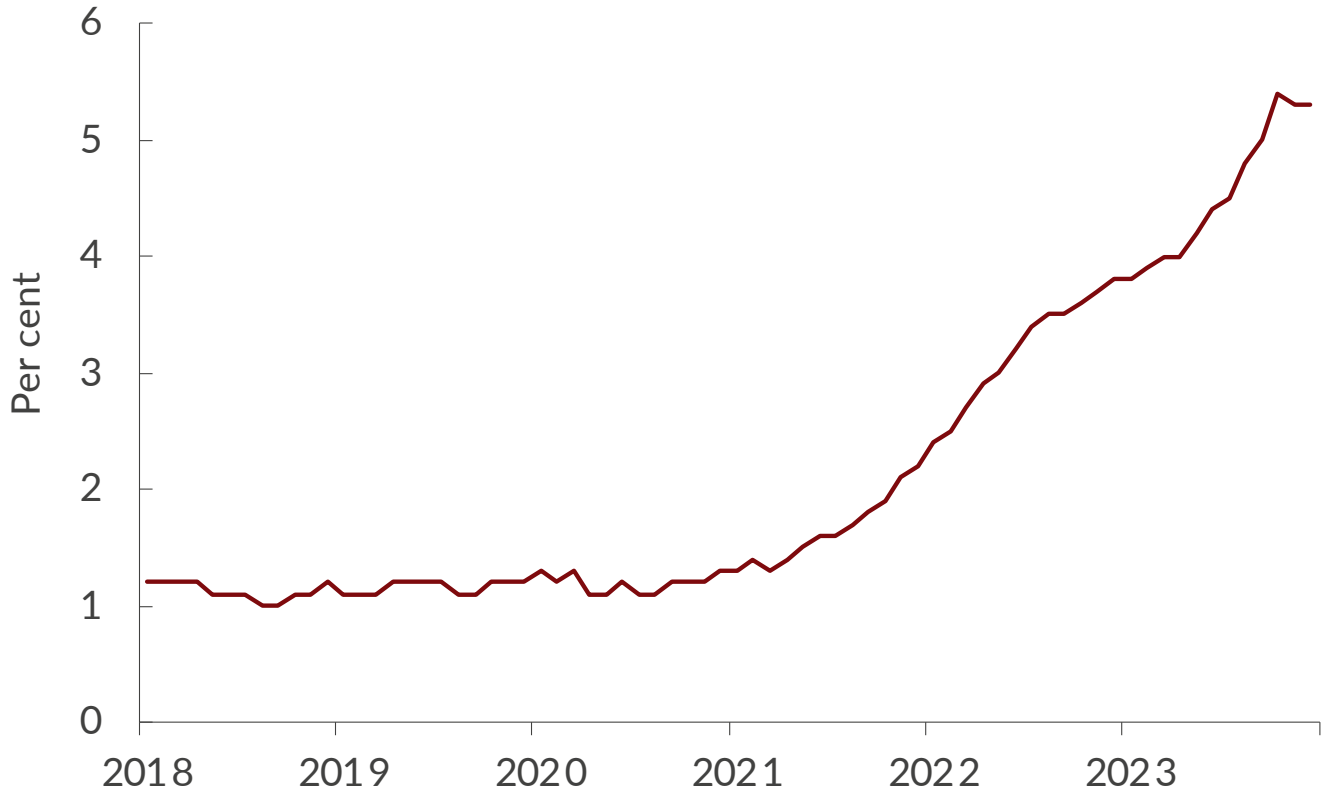
Figure 1.19 Household savings ratio



Source: Indeed.

Moreover, these accrued savings are likely to act as a welcome buffer for those households that need help absorbing increases in debt service payments associated with their having to remortgage at a higher fixed rate. The increase in these debt service payments is largely captured by owner occupiers' housing costs. Figure 1.20 suggests that owner occupiers' housing costs have seen rising growth rates since early 2021.

Figure 1.20 Growth rate of owner occupiers' housing costs



Source: ONS.

Investment Environment

The third quarter of 2023 saw a 4.3 per cent fall in business investment, the largest contraction in over a decade, excluding the large dip in investment during the pandemic. This is also reflected in total gross fixed capital formation, which also saw negative growth in the previous quarter. In line with the most recent CPI Industrial Trends Survey, we expect business investment to fall in 2024.

NIESR has long argued that business investment needs to be higher in the United Kingdom if the country is to solve its productivity problem. (See, for example, NIESR (2023).) One reason for perennially low business investment is that UK businesses face considerable policy churn. Recent examples of this include the further postponement of custom checks for agricultural goods entering into the United Kingdom from the European Union and the axed northern leg of HS2. Significant changes in public policy have engendered caution among investors in an already uncertain economic environment.

As we said in our response to the Chancellor's Autumn Statement (Bejarano Carbo et al., 2023a), while we welcome the permanent full expensing measure announced in the 2023 Autumn Statement, which is a clear positive for business investment, we think this measure is unlikely to boost total gross fixed capital formation significantly as full expensing is only available for expenditure on plants and machinery. Another measure that may help increase business investment is the proposed pensions reform, also announced in the Autumn Statement, that aims to redirect pension fund investment from foreign capital to domestic capital. Some of the issues around the links between pension fund regulation and business investment and the move from defined benefit to defined contribution pension schemes are discussed in Box A.

Box A: Implications of the transition from Defined Benefit to Defined Contribution pensions in the UK

By Francisco Sebastian

This box discusses the ongoing shift in the UK funded occupational pension landscape from Defined Benefit (DB) to Defined Contribution (DC) schemes, which carries significant implications for financial markets and the broader UK macroeconomic environment. Within the cyclical horizon, this transition is anticipated to result in a decline in real pension savings and a redirection of capital away from domestic use. The financial repercussions extend to funding pressures on the UK central government and to corporate sectors involved with infrastructure, such as utilities and housing. Additionally, it makes long-term interest rates more volatile and fosters a procyclical relationship with sterling. The key macroeconomic repercussion is an erosion of resources and willingness to invest domestically, from both private and public sources.

Recent policy attempts to induce domestic investment from private pension funds are well intentioned. The bigger opportunity for the UK Government to nurture investment lays with occupational pensions in the public sector.

UK funded occupational pensions to shrink

The size of the funded pensions balance sheet changes directly with the value of financial assets and inversely with interest rates. The decline in total assets in 2022 from £2.7 trillion to £2.1 trillion due to the sharp increase in interest rates was widely broadcast. However, the bulk of that loss has been recovered in 2023 as long-term interest rates have backed down.

The £5.4 billion net outflows in the UK funded occupational pensions sector observed in 2022 is far more indicative of the sector's health than any eye-catching headlines. These outflows are estimated as the difference between contributions into pension schemes for active and deferred members, and benefits paid out to retirees. The outflows first emerged in 2021 at £4.4 billion, reversing the inflows in previous years.

When we break the data down by type of scheme, we can see that DB schemes experienced net outflows of £28.7 billion whereas DC schemes experienced net inflows of £23.3 billion. The negative balance arises from the benefits that DB schemes pay to their 4.9 million retirees, which surpasses the contributions that DC and public sector schemes receive from their 13.75 million active and 20.64 million deferred members.[1]

The outflow trend from excess benefits over contributions is expected to intensify over the next five years due to the demographics of pension membership. Furthermore, the total balance sheet size of funded UK DB pensions is expected to decline due to buy-in/out

1 Source: Own calculations based on ONS data.

transactions. In April 2023, the Bank of England stated that the UK life insurance industry is expected to absorb over £500 billion of pension liabilities and assets in the coming decade.

Why does this matter?

DB schemes are significant domestic lenders, while DC schemes are predominantly investors in foreign assets. DB schemes allocate almost 70 per cent of their investment portfolios to bonds, of which, 65 per cent is lent to the UK Government and 18 per cent to domestic corporations.[2] In DC schemes, sampling from the UK Government-sponsored National Employment Savings Trust (NEST, the country's largest DC workplace scheme with £33 billion assets under management), the estimated total exposure to UK assets is less than 30 per cent, in contrast with the largest exposure (44 per cent) in Global equities.

The UK Government relies heavily on DB schemes for long-term financing. The pensions and insurance industries own about 40 per cent of total UK government bonds. Corporations also benefit from the long-term capital provided by DB schemes and insurers, especially infrastructure owners. However, corporations typically benefit from a more diversified lender base than the Government, in which UK life insurers feature prominently.

Demand for duration in investments declines as the pension system matures and longevity gains diminish. DB scheme net outflows reduce the duration of liabilities by around 0.6 years per annum. Furthermore, ongoing declines in longevity gains could further reduce duration by 1.5 years, bringing the total down by 4 years through 2027.[3] This has knock-on effects on demand for long-dated debt, which DB schemes typically use to hedge their 15-25 years of liability duration. Long-dated debt is often issued by the UK government and infrastructure-heavy corporates. Consequently, the financial stability that long-term borrowing provides will decline in the absence of a lender able to replace DB schemes in enabling such borrowing. This negative effect is likely to be more severe on the public finances than on corporate finances, as insurers are often willing lenders to the latter but less so to the former.

Financial implications

The result of the adverse dynamics in UK DB pensions explained above over the next 5 years is a cumulative outflow of £160 billion. This is approximately 6 per cent of current GDP, 12 per cent of total assets in private DB schemes, 13 per cent of the market value of nominal and index-linked Gilts (excluding Bank of England holdings through the Asset Purchase Facility as of the third quarter of 2023) or 30 per cent of sterling non-Gilts. The large size of the outflow has a two-fold negative impact: firstly, because liquidating existing investments, especially government bonds, will likely be needed to accommodate the outpayments; secondly, because retirees are unlikely to reinvest the funds received in long-term UK government or corporate debt, but, rather, to spend it.

Diminishing structural demand for government bonds creates government financing challenges and headwinds to the Bank of England's quantitative tightening plans. Private DB schemes are expected to sell £40 billion of UK government bonds over the next five

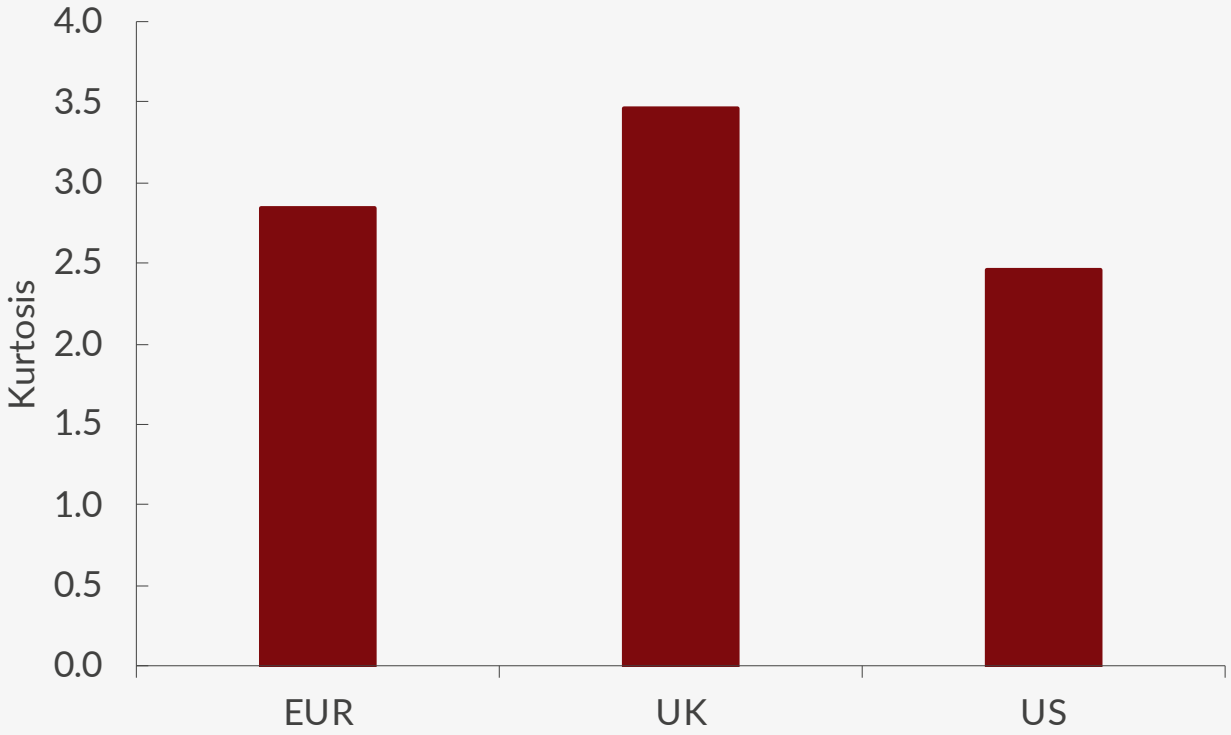
2 Source: Own estimates based on Pension Protection Fund (2023 Purple Book)
3 Source: Own calculations based on data from the Continuous Mortality Investigation, Institute & Faculty of Actuaries.

years to accommodate outflows. Annualised, this is about 10 per cent of the planned long-term nominal and index-linked Gilt issuance in 2023-24 as reported in HM Treasury (2023), and 8 per cent of the expected sales from the Bank of England's unwinding of the Asset Purchase Facility over 12 months as reported in Bank of England (2023). Paired with weak economic growth and a lower inflation environment, these events make it reasonable to expect the Gilt curve to steepen.

Elevated probability of large shifts in long-term rates. In the 2000s, the structural internal demand for long-dated UK government bonds from DB schemes helped stabilise yields and reduced the probability of large shifts in long-term interest rates. The decline in internal demand for government bonds in the 2020s, alongside the weakened position of the United Kingdom as a net recipient and a funnel of foreign investment, increase the probability of large movements in long-term rates.

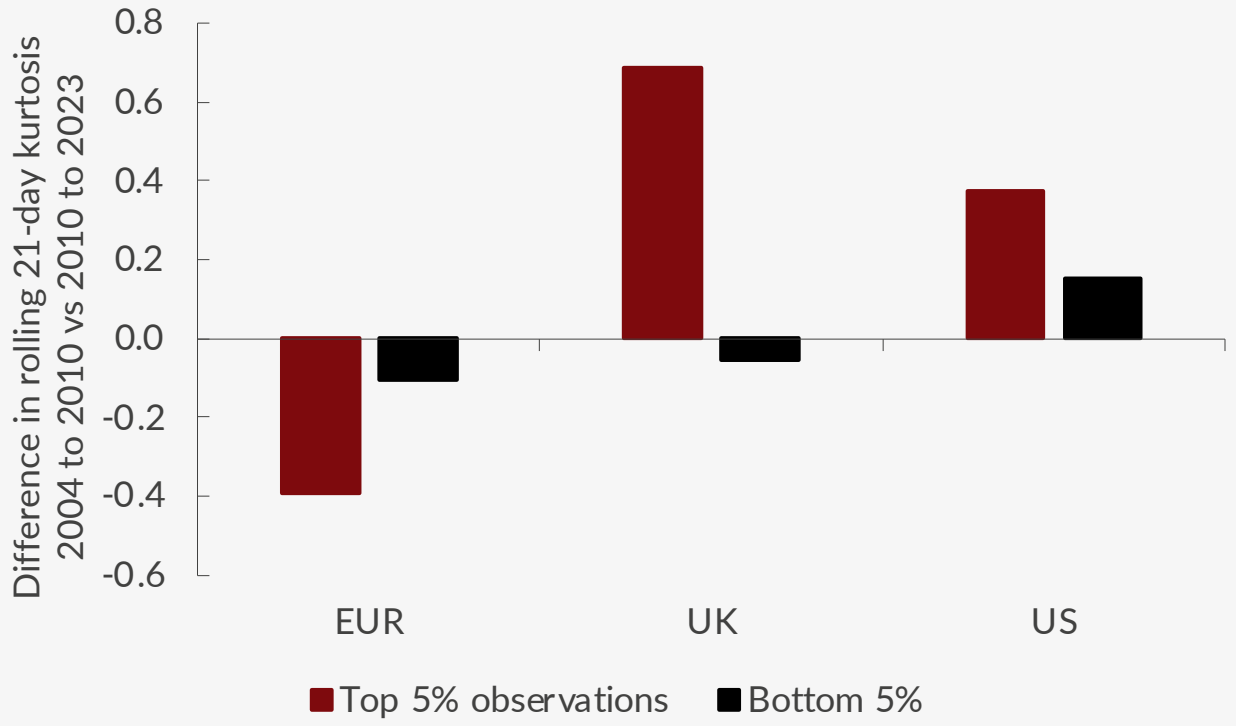
Figure A1 shows that, in the case of large changes in long-term yields, the abruptness of such changes among UK bonds, as measured by the kurtosis in long-term yields, has become larger than in comparable US or euro-area bonds. And figure A2 shows that kurtosis in long-term UK government bond yields has also increased more over the past 13 years than that of US or euro-area AAA-rated government bonds.

Figure A1 Kurtosis in 20-year bond yields (2017 – October 2023)



Source: Author's calculations based on yield curve data from the ECB, Bank of England and Federal Reserve Economic Data.

Figure A2 Change in kurtosis in 20-year Government bonds between 2004-2010 and 2017-Oct 2023



Source: Author's calculations based on yield curve data from the ECB, Bank of England and Federal Reserve Economic Data.

Reinforcement of the relationship between long-term yields and sterling. Historically, the relationship between sterling and long-term rates was weak because investors in long-dated UK government bonds were largely domestic. As DB pensions run off, in the absence of other significant domestic buyers, the gap between the demand and supply of long-term debt must be filled by (more price-sensitive) foreign investors. This leads to reinforcing relationships between sterling and long-term government bonds: as foreign investors flock to UK bonds, long-term rates decline and buying pressure on sterling grows, and vice versa.

The LDI crisis of 2022 was partly due to this phenomenon and can serve as a template for future shocks, which may become more frequent.

Macroeconomic and policy implications

The shrinking pool of domestic long-term investment capital negatively affects government financing, expenditure, and public capital formation. Furthermore, growing uncertainty from the financial implications described here hampers private investment projects and investor willingness to put capital to work in the United Kingdom. Both effects combined dampen both current economic growth and potential future growth.

The government's proposed policies in the Autumn Statement Pensions Reform 2023 aim to redirect investment capital from foreign to domestic uses but fail to address the root causes of the lack of domestic capital, including demographic changes and the transition from DB to DC schemes.

Policies around occupational pensions could be better utilised by policymakers to strengthen domestic investment. For example, the Government could consider migrating unfunded state pensions to a partly funded status, potentially strengthening domestic investment, which could even be directed towards public services like healthcare and education.

References

Bank of England (2023), Monetary Policy Summary and minutes of MPC meeting, 21 September 2023.

HM Treasury (2023), Debt Management Report 2023-24.

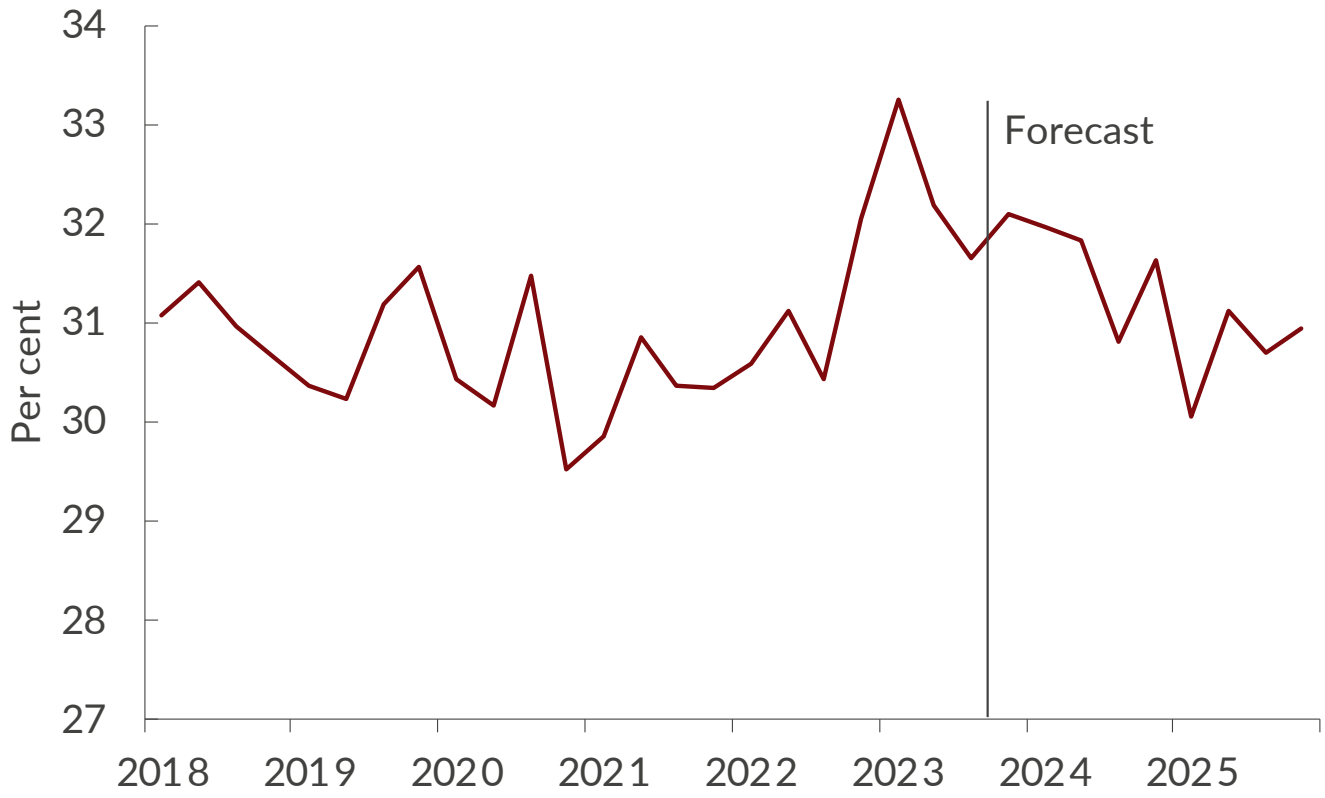
Bank of England (2023), Speech by Charlotte Gerken "Moderation in all things", 27 April 2023

Firm Margins

As illustrated in figure 1.21, in the first quarter of 2023 the share of value-added accruing to firms in the corporate sector was at its highest in almost a decade, indicating elevated profit margins for firms. However, there has been a significant erosion of margins over the second half of 2023 as workers have bargained for higher wages as they aim to restore real earnings back to pre-pandemic levels. This is partly due to the domestic shortfall in the supply of workers coupled with buoyant labour demand, which created a tight labour market and upward pressures on average wages in 2023.

This trend can be observed by the notable fall in the corporate sector profit share. A one percentage point decrease in the second quarter of 2023 followed by a half a percentage point decrease in the third quarter. As illustrated in figure 1.21, our forecasts for 2024 and beyond suggest a modest decrease in the corporate sector profit share as it returns to its long run equilibrium value of around 31 per cent. This rise is expected to be modest as the vacancy to unemployment ratio falls as the labour market softens and is in line with the views expressed by participants at NIESR's Business Conditions Forums, who suggested that recruitment difficulties for businesses have eased, relative to the previous year.

Figure 1.21 Corporate sector profit share



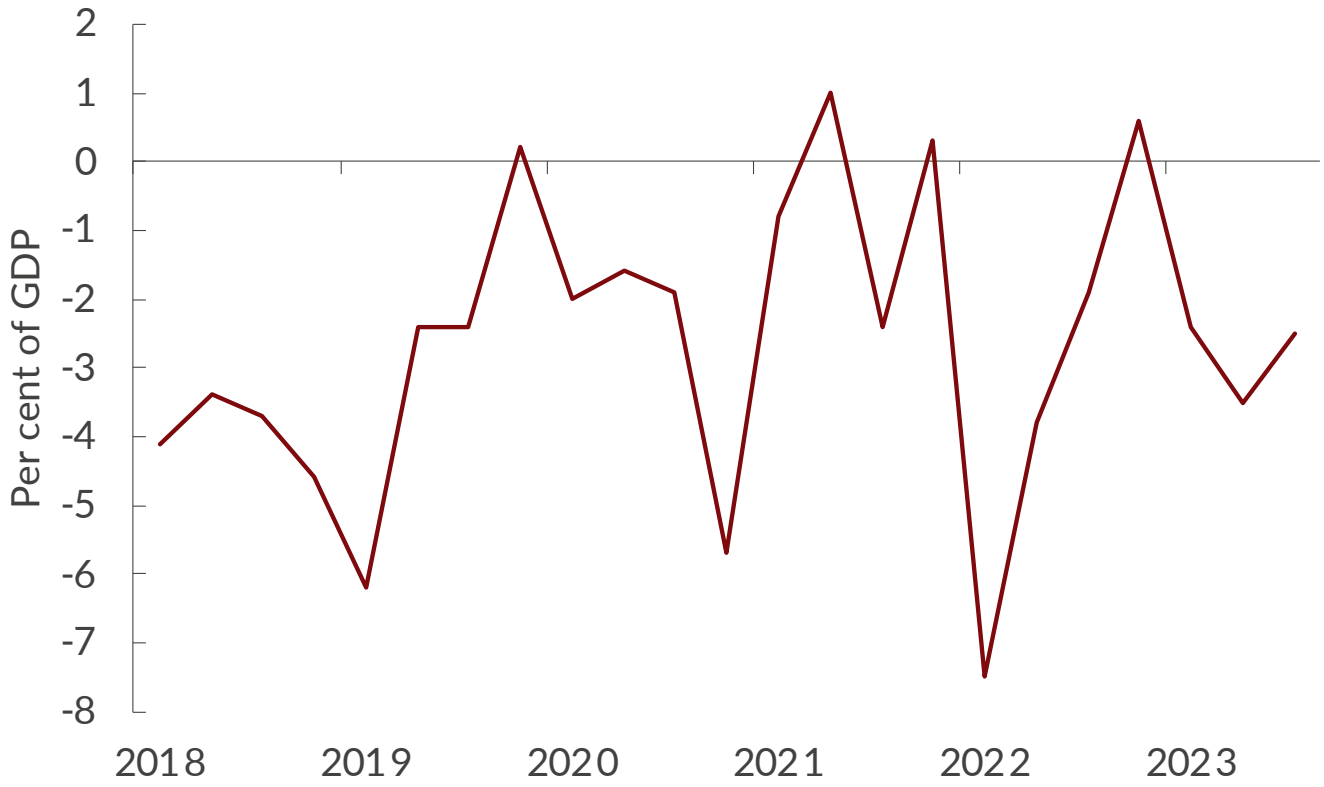
Source: ONS, NiGEM.

International Trade

Both import and export volumes fell in the third quarter of 2023. However, imports experienced a proportionally greater fall, leading to a small improvement in the trade balance as a share of GDP (figure 1.22). This may reflect relatively weak domestic demand for international goods.

However, we anticipate an overall deterioration in the trade balance as a share of GDP in 2024. This could reflect weak productivity and output growth in the UK economy coupled with rising trade costs associated with geopolitical uncertainty in the Middle East. Seven out of the ten largest shipping companies have suspended their operations in the Red Sea as of December 2023 and this has led a large spike in the SCFI as well as the Drewry World Container Index, both of which have more than doubled in the past two months. This presents a significant downside risk to international trade volumes.

Figure 1.22 Trade Balance as a percentage of GDP



Source: ONS.

Supply and Costs

Labour market data is particularly uncertain just now…

As a result of declining survey response rates, the ONS has suspended publication of the Labour Force Survey. They expect to publish data for employment, unemployment and participation based around a reweighted, and larger, Labour Force Survey soon. As discussed in Box B, different measures of employment – those based on surveys of employers and those based on surveys of employees – have been suggesting alternative views as to the strength of the UK labour market over the past few years, making interpreting recent labour market movements particularly difficult.

Box B: Job boom or job bust? The effect of the pandemic on actual and measured job and employment growth.

By Bill Wells

Introduction and background

Normal life was put on hold for many during the lockdowns in 2020 and 2021 as society focused on addressing the health crisis. In the labour market, many fewer people started a new job ('hires') and, partly due to the use of the Coronavirus Job Retention Scheme, some people stayed longer in work than they would in 'normal' times. Their job 'separation' was delayed. Other parts of society saw a similar stalling in 'normal' turnover. Fewer people moved into new homes and/or households either in the United Kingdom or abroad with consequent disruption to trends in housing and internal and international migration.

So, as the health crisis subsided, this stalling of 'normal' turnover left behind a major imbalance of resources. All sorts of people and things were in the wrong place. In many cases this misallocation of resources was wrongly considered to be a 'shortage' – an absolute lack of people to do a job – as in the case of lorry drivers as the economy re-opened. But in a relatively short period this disequilibrium unwound and there is now little discussion of a permanent 'shortage'. Where did all the lorry drivers come from?

Not only that, but the pandemic caused many people to reconsider where the 'right place' was. Their experience during the pandemic and also changes in their household and community situation caused them to reconsider their priorities. It caused behavioural changes to their plans, hopes and expectations for the future.

What is the best way to measure these developments? And how and when can we judge if disequilibrium has returned to a new 'normal'?

As different parts of the job market have been affected differently by the pandemic, the ability to measure what is happening is also made more difficult. The tools used to measure developments – the statistics – are themselves affected by the disruption to normal life on top of their different strengths and weaknesses. Perhaps even more important, different statistics provide different perspectives on the situation. And these different perspectives have been affected differently by the disruption of the pandemic.

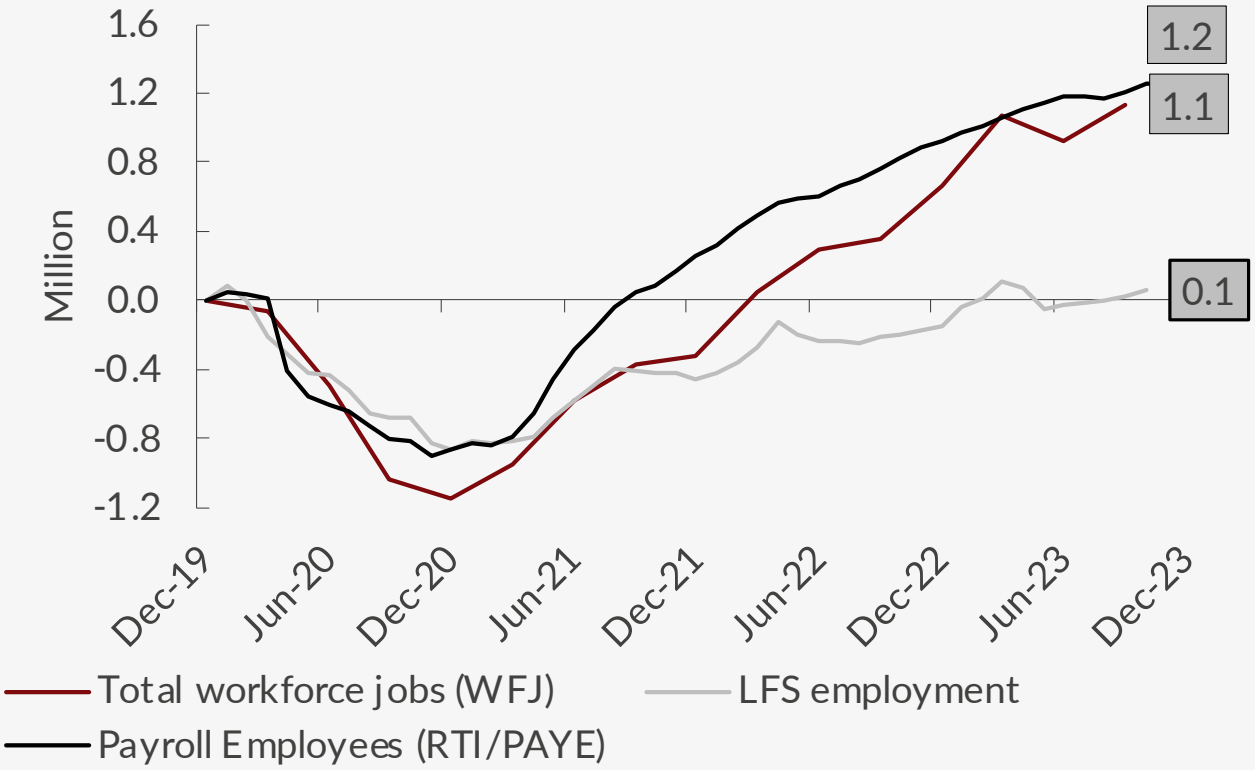
The Office for National Statistics (ONS) provides three headline statistics on the job/employment market. Of the two official statistics that provide estimates, one does so from an individual perspective – Labour Force Survey (LFS) employment – and the other from a business/firm perspective – Workforce Jobs (WFJ), which at its core (the Employee Jobs estimate) is based on the Short-Term Employment Survey (STES) of private-sector firms and the Quarterly Public-Sector Employment Survey (QPSES).

The third (experimental) measure is the Real-Time Information/Pay As You Earn (RTI/PAYE) employee estimates which is a by-product from the tax system. So, although it is more of a census than the other two estimates, it is a census of the people it measures. Not everyone. Self employment and employees not covered by PAYE are the main areas not included in the estimates. Also, as it is a by-product of the tax system, the RTI/PAYE system suffers from a substantial degree of missing values each month as information on new jobs (hires) and separations do not get to the tax system in time to feed into the estimates. Therefore, imputation to compensate for these missing values is required, which is either confirmed or revised in the months and years that follow as the information comes in. Little information of the extent of this imputation is available or whether it varies over time. But when the RTI/PAYE was set up, 20 per cent was the figure mentioned for imputation. The crisis caused measurement problems for all three of the main job market measures. But perhaps the biggest uncertainty is about the sampling frames – the overall population of individuals or firms - from which both the individual-based (LFS) and firm-based (WFJ) survey samples were drawn.

The nature of the crisis and other recent developments has had a differential effect on the different measures. The estimates, projections, and composition of the overall population – the LFS source – have been much more affected by the crisis than the overall measure of the number of businesses in the economy (the Inter-Departmental Business Register (IDBR)) - the WFJ source. So, in the annual IDBR review (DBT, 2023) there is no mention of measurement problems associated with the pandemic. Whereas the LFS was completely reweighted because of identified problems with population estimates and the relationship with LFS estimates (ONS, 2022). Unfortunately, the LFS reweighting seems to introduce a discontinuity. From mid-2021 it seems to have broken the link between business-based job (WFJ and RTI/PAYE) and population-based (LFS) estimates. This would seem to imply that the LFS reweighting made LFS-based estimates less accurate, and that more reliance should be given to business-based estimates.

In summary, if the WFJ estimate is used to provide the overall picture, there are likely to be around one million more jobs than at the start of the pandemic instead of an LFS-based picture of employment stagnating since mid-2021 and even now only just attaining pre-recession levels (figure B1). Workforce Jobs have also, on a comparable basis (employees only), grown faster than the other business-based estimate (RTI/PAYE). Workforce Employee Jobs are up by 1.8 million compared to the RTI/PAYE estimate of 1.2 million, while total Workforce Jobs are up by 1.1 million, with the difference due to the inclusion of self-employment jobs in the more complete WFJ estimate. Self-employment is down significantly during this period, one of the major features of the labour market in the crisis.

Figure B1 Change in employment since December 2019



Source: ONS.

However, such uncertainty about what statistics to use and what they mean is unsustainable. It needs to be resolved. Particular attention needs to be paid to the estimates and projections of population and not just how the LFS sample is drawn from this sample frame. In addition, the standard reconciliation between LFS and WFJ estimates needs to be restored as soon as possible. On RTI/PAYE employee estimates further review of the effect of imputation on revisions is needed, especially to consider its usefulness as a leading indicator given the large amount of imputation.

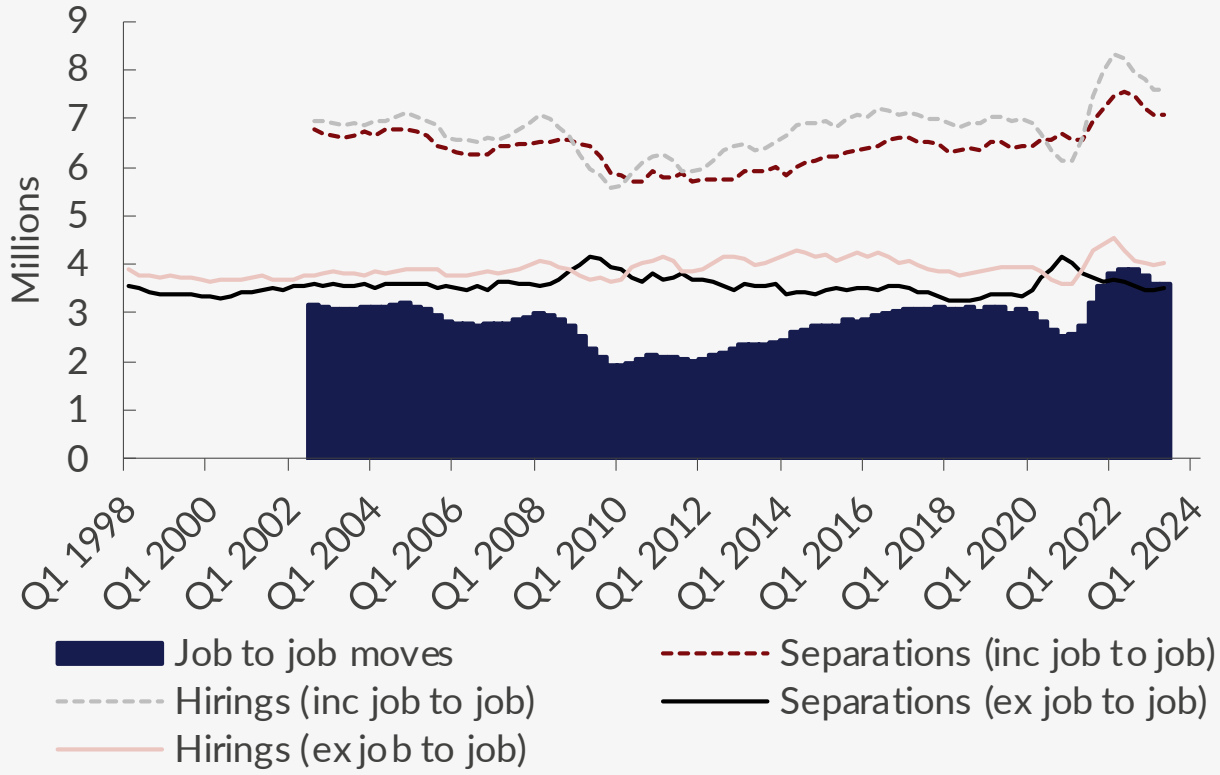
From roundabout back to roller-coaster

If, as argued here, WFJ provides the most accurate picture of the job market, the strong job growth it is currently signifying would seem to be at odds with some other recent labour market developments that have been interpreted as a softening of the labour market. The chief signs of softening are that vacancy and hiring numbers have slowed and the number of out of work benefits has begun increasing again.

A major factor that might help to resolve this conundrum – which is also evident in the United States – is the unwinding of the labour market disequilibrium caused by the stalling of turnover during the pandemic. In 'normal' times around 7 million people per year take up a new job - 'hires' – but in the year to the first quarter of 2021 there were only 6.1 million. Within a year 'hires' had soared to 8.3 million – a record high – and although it has fallen back (around 7 ½ million in the latest, LFS-based, information) it is still likely to be well above 'normal' levels. Firms had to advertise record vacancies to achieve these record hires.

However, initially overall job growth (net change) took some time to pick up. The reason is the share of hires taken up by job-to-job moves has risen while the share of hires taken up by moves from worklessness (both inactivity and unemployment) to work fell. (That said, moves from worklessness to work are also at historic highs.) The 'roundabout' of job-to-job moves does not add to overall employment. A vacancy is filled but by someone already in a job. So, a gap appears elsewhere and is likely to spark another vacancy. This 'roundabout' from job to job seems to be slowing with more vacancies being filled by jobless people and firms reporting fewer labour 'shortages.' So, vacancies and hires are falling back whilst employment is continuing to grow rapidly.

Figure B2 Hirings and separations



Source: Labour Force Survey.
Notes: Rolling four-quarter total. Age 16-64. Not seasonally adjusted.

The job market has also been affected by similar pandemic-induced trends in population – particularly international migration. Using issues of National Insurance Numbers (NINos) as a rough indicator, there was initially a major stalling of turnover. In the decade before the pandemic, NINos issued varied between 600 and 800 thousand. Whereas in the year to the first quarter of 2021, it had fallen to less than ¼ million. As society re-opened this rose rapidly to 1.1 million in early 2023 but had fallen back to 800 thousand in the third quarter. Not all this volatility is due to the pandemic. For example, the Ukrainian war has seen a (temporary) surge in NINos issued to Ukrainians. Also, there are signs of changes in migration policy that are likely to have been a significant factor in the record job 'hires.' One of the major factors in the growth in net migration has been that resident migrants are remaining in the UK longer. Extensions of temporary visas – many for work – have risen from less than 200 thousand in 2016 to nearly 700 thousand in the latest year.

Unfortunately, these new and changing demographic trends make it more difficult to interpret the jobs market using the LFS. Even if the statistical and sampling problems are resolved, the sampling frame – UK population estimates – from which the sample is drawn is very uncertain. And it is likely to take some time and require a lot of effort to get a clearer and more certain picture of the number and composition of the population.

Finally, not all societal and policy changes have led to the increase in 'hires.' Generally, the record hires have been taken up by people not on out-of-work benefits, both job-to-job moves and the workless who move directly into work. But, if anything, the success of people moving from welfare to work has worsened since 2015. This was a reversal of previous trends with out-of-work benefits falling from over 5 million to 3 ½ million between 1999 and 2015 despite the 2008 recession. Since 2015 out-of-work benefits have risen and are now back above 5 million again. And this reversal started before the pandemic with, for example, claimant unemployment rising ½ million in 3 years from February 2017. With fewer people moving into work from welfare, the increased duration of benefits has driven the rise. And so, amongst the total population who are without work the share taken up by people on benefits for a very long time has increased substantially.

In conclusion, having successfully identified previously in Wells (2002) that the second quarter of 2022 would be when Workforce Jobs would pass the pre-pandemic peak, this box sets out that there has been very rapid growth of over one million jobs in the following five quarters, continuing the United Kingdom's record as a 'successful employment performer'. At the time, there were similar trends in LFS employment, and the expectation was also of continued rapid growth. But then it came to a sudden stop, and it is only in the last few months that LFS employment has reached its pre-pandemic peak. Here it is suggested that the trends in Workforce Jobs are more accurate and that the stagnation in LFS employment was largely due to statistical measurement problems, with the effect of the reweighting seemingly playing a major role. But major statistical uncertainties remain and need to be resolved.

Although the United Kingdom has continued to be a strong job generator the nature of the people who are taking up the jobs has changed since around 2015. After a long period of 'levelling up' when the employment rates of the most disadvantaged in the labour market increased disproportionately and out-of-work benefits fell substantially, these trends have now been reversed. A major factor during the crisis was the unwinding of the disequilibrium caused by the lockdowns. This led to the 'roundabout' of record job-to-job moves which sparked record vacancies and 'hires' but did not contribute to job growth. What did contribute to job growth was the moves from the workless who were not on benefits into work. A large component of this seems to be due to a change in recruitment policy/strategy, with many of the jobs being taken up by resident migrants whose initial temporary visas were extended. By contrast, despite the strong job growth, fewer people are moving from welfare to work. And so, despite record jobs the United Kingdom also has record numbers on out-of-work benefits.

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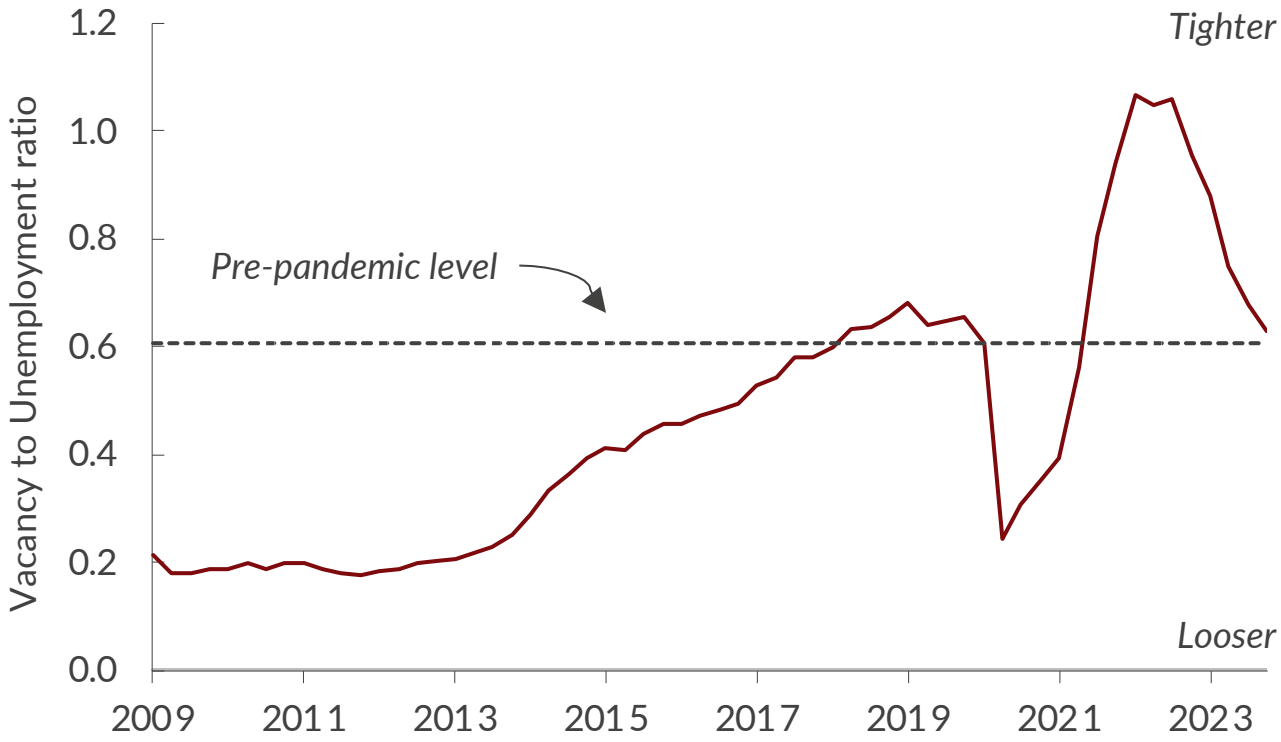
...but we think the labour market is set to cool over 2024...

We estimate that headline measures of the labour market have broadly loosened to pre-pandemic levels but remain tight by historical standards. Using a reconstructed vacancy to unemployment ratio (due to the ONS suspending updates to this measure), we have found that this measure of labour market tightness has broadly returned to its pre-pandemic level of 0.67 vacancies to unemployed people, or 1.5 unemployed people per vacancy (figure 1.23). We expect this loosening to continue over 2024 as employers cool their demand for new employees and the supply of available workers expands mostly due to future immigration.

Figure 1.23 Vacancies to domestic job seekers

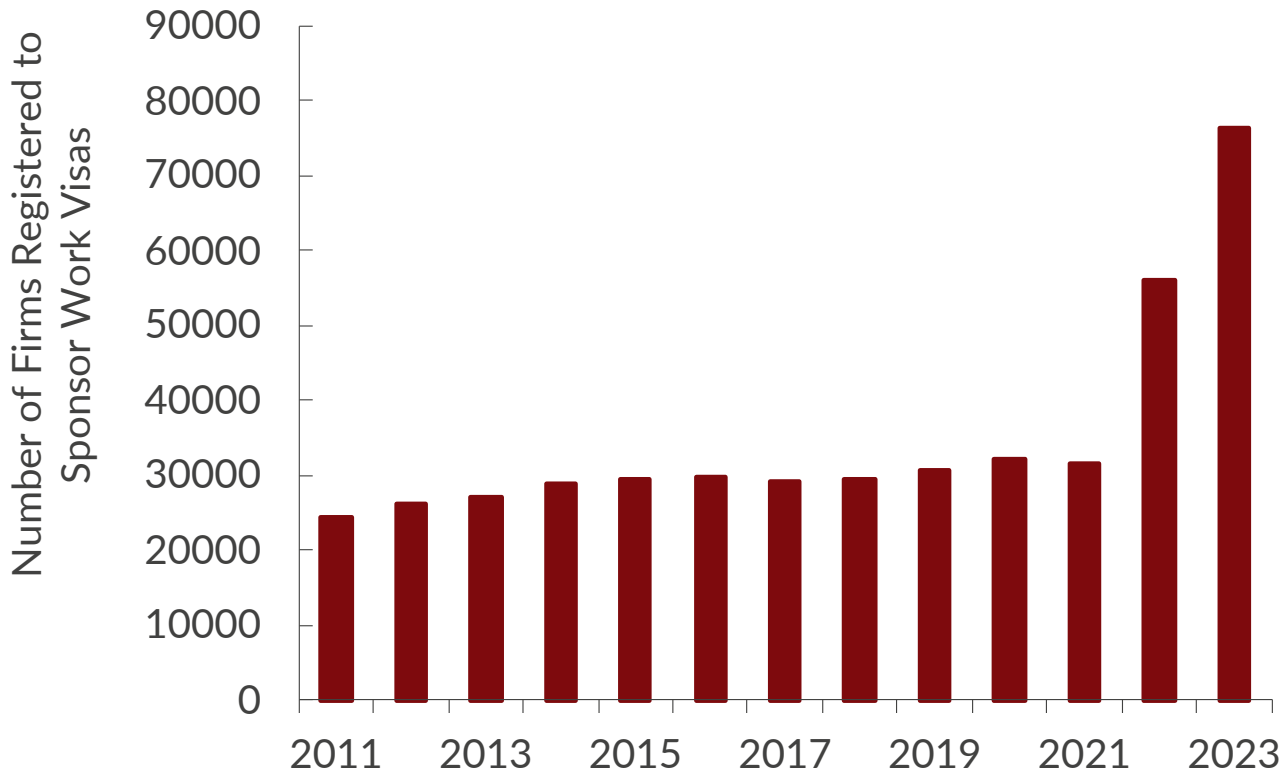


Source: ONS and NIESR calculations

...as employers begin to favour international workers ...

The supply of international workers is having a notable influence on the supply of labour while unemployment remains largely unchanged on the quarter. The 169,000 new work visas granted over 2023 represents a rise of 50 per cent relative to pre-pandemic levels (Home Office, September 2023). The increased favourability towards international labour is also reflected in the sharp rise in firms registered to sponsor work visas which has doubled since 2021 (figure 1.24).

Figure 1.24 Number of organisations registered to sponsor work visas



Source: Home Office (2023)

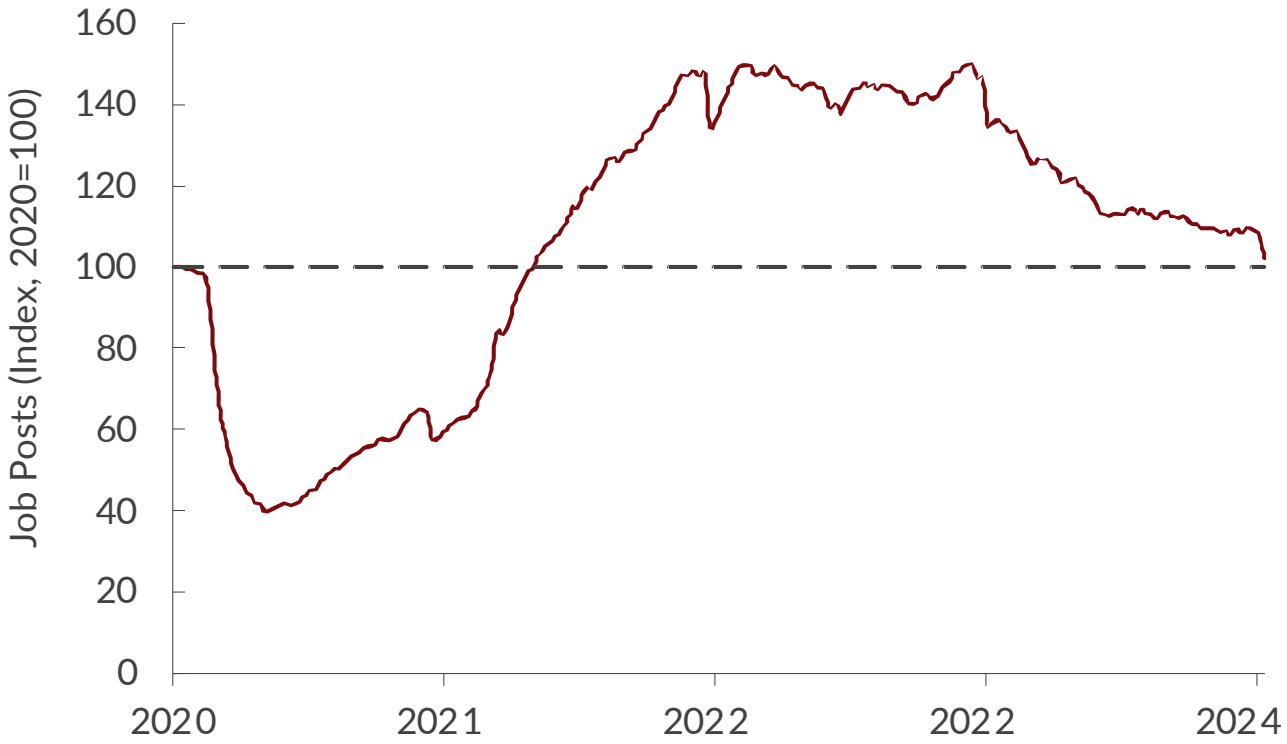
This trend toward employment visas is driven mostly by a rise in non-temporary placements (such as skilled worker visas). Seasonal or temporary work visas have remained stable despite the rise in employment visas. Through the 2010s, the proportion of non-temporary work visas to seasonal visas was broadly similar, whereas just 19 per cent of the work visas granted in 2023 were temporary. Skilled Worker visas rose by 9 per cent in the year to September 2023. This, coupled with historically high level of foreign jobseeker interest (Kennedy, 2024) and projections of further increases in net migration (OBR, 2023), suggests this trend will continue, contributing to a rising UK labour force and further cooling the labour market.

Of those work visas, 144,000 were granted to people applying to work in Health and Social Care occupations (Home Office, November 2023), representing over half of the 203,000 increase in health and social care workers in 2023 (ONS, 2023a). Part of this sharp rise could be driven by the increase in wages, with both social care and healthcare roles showing the strongest rise in advertised salaries (at around 11 per cent for the former) across a range of sectors in December 2023. And these were the most searched for occupations as of April 2023 (Adzuna, June 2023).

…and demand for workers cools as hiring activity slows down to pre-pandemic levels.

As discussed in Box B, the pandemic led to a stalling in labour market turnover. As a result, once the lockdowns had been lifted, hiring picked up substantially in the United Kingdom, initially associated with a large increase in job-to-job moves, but later with an increase in workforce jobs. However, hiring has now returned close to its pre-pandemic level. As of the beginning of 2024, aggregate job postings were 23 per cent lower than at the same point in 2023 (Kennedy, 2024). This is consistent with Adzuna insights, which show that hiring activity across a range of sectors is around 20 per cent lower than at the same point in the previous year (Adzuna, December 2023).

Figure 1.25 Job posting index, seasonally adjusted

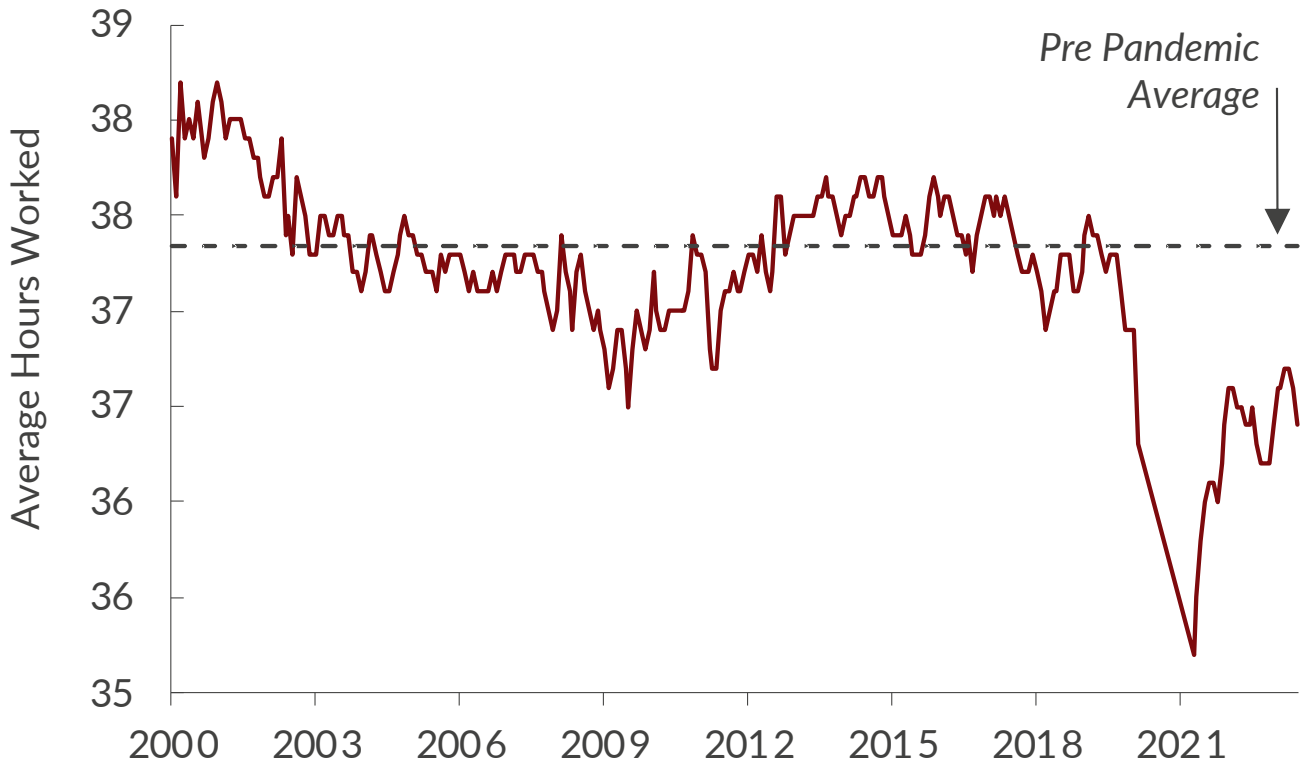


Source: Indeed.

However, falling hours worked suggest the labour market has changed since the pandemic.

Despite the positive news for employers of labour market tightness being closer to what could be considered 'normal', attendees at NIESR's latest Business Conditions Forum highlighted that the labour market today is notably different to that in 2019. In particular, hours worked have not recovered to their pre-pandemic average (Figure 1.26) and the ONS has recently calculated that this is equivalent to 310,000 fewer workers (ONS, 2024b).

Figure 1.26 Average hours worked

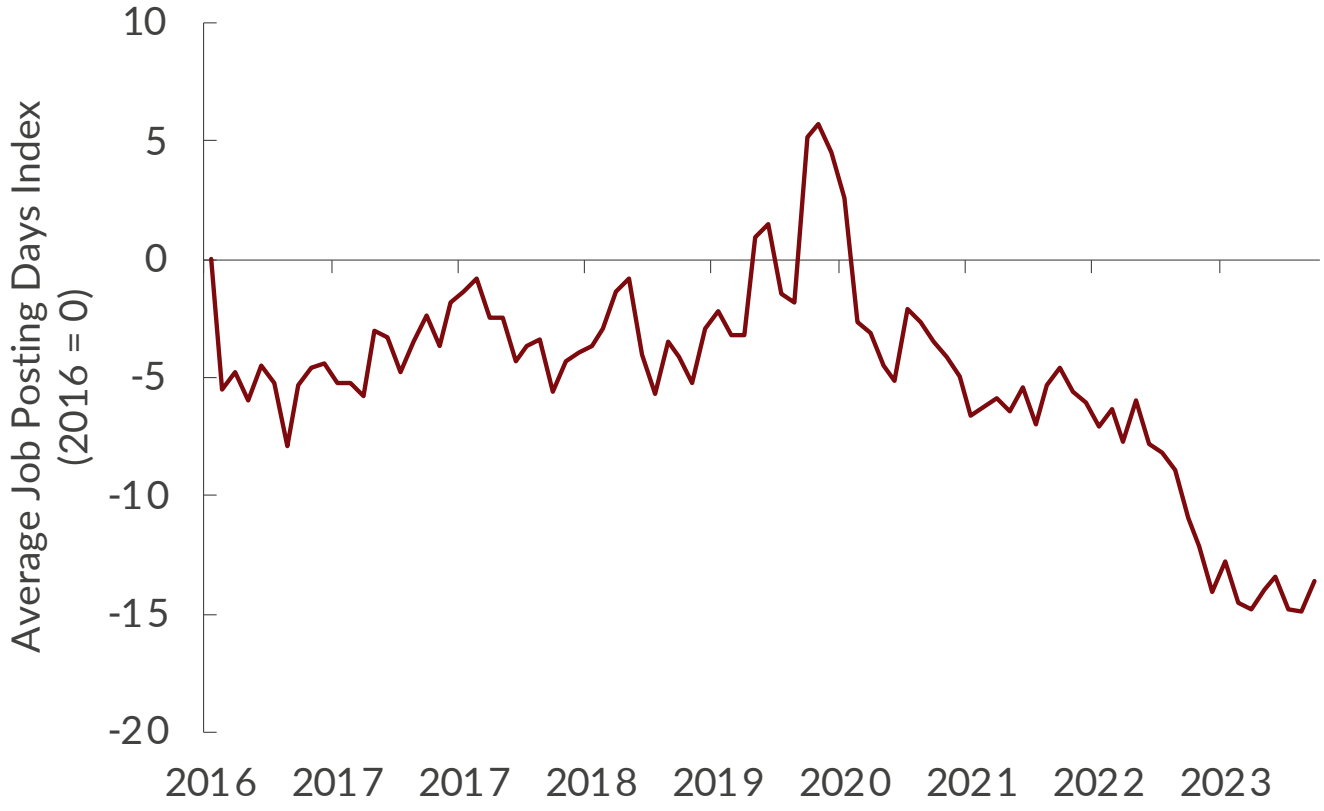


Notes: data in 2020 is omitted due to being a large (negative) outlier.
Source: ONS.

New vacancies are being filled in a historically short amount of time

The time it takes firms to fill vacancies has fallen to its lowest level over the past few years. Whereas in 2016, a new vacancy would on average take around 50 days to be filled, this is now around 35 days at the end of 2023 (Adzuna, December 2023). This confirms hiring conditions have become increasingly favourable over the past year, a suggestion backed up by respondents to the Bank of England's Decision Maker Panel, where there has been a notable growth in the number of respondents experiencing hiring conditions 'about normal' (Bank of England, 2024).

Figure 1.27 Average time to fill vacancies (index, 2016=100)



Source: Adzuna and NIESR calculations.

Wage growth is still elevated…

The latest ONS estimates show the annual growth rate of average weekly earnings was 6.5 per cent in the three months to November 2023. Despite some slowdown, this remains particularly strong. We forecast earnings growth to fall as the labour market continues to cool with economy-wide total pay and regular pay projected to grow at 5.6 per cent and 6.0 per cent, respectively, in the first quarter of 2024 (Bejarano Carbo, 2024b).

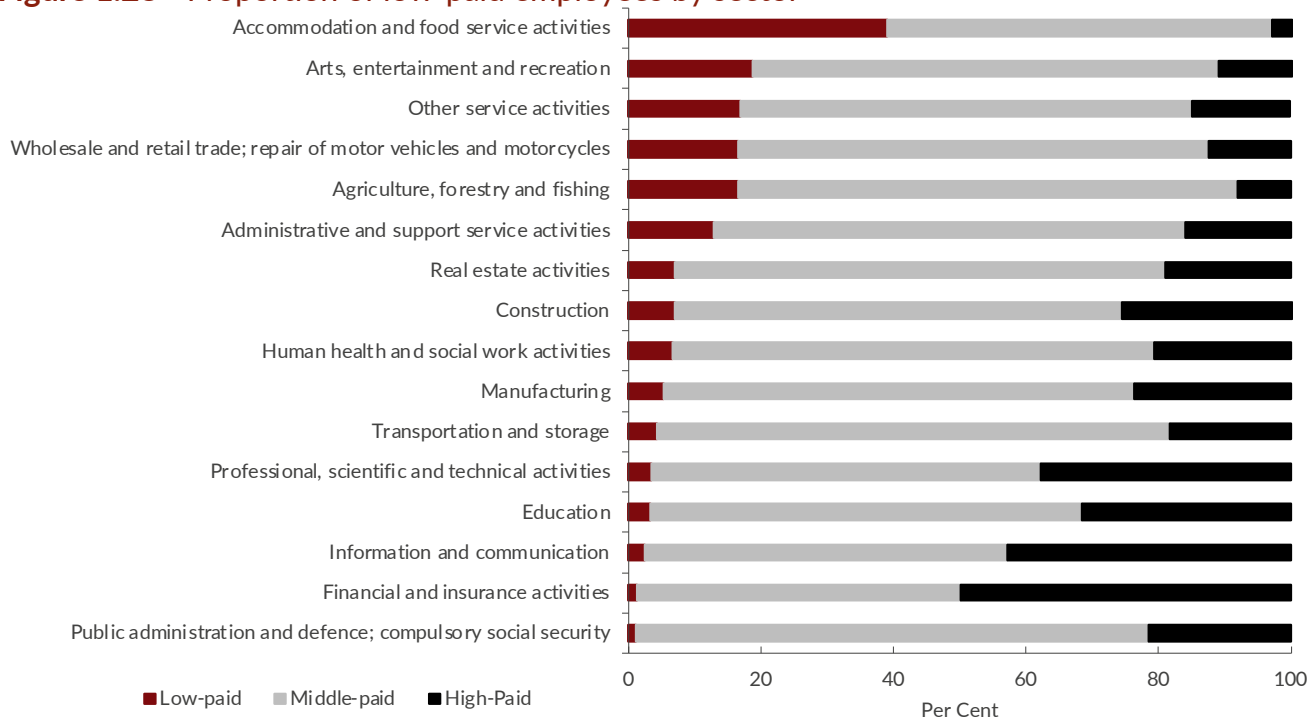
Wages are proving stickier than many expected, as although we forecast softening wage growth in the short term, the overall level remains elevated. This is likely driven by two factors. Firstly, the presence of contracts and defined pay review timetables is likely resulting in wages playing a delayed catch-up to rising prices. Secondly, workers are still recovering the real value of their wages, which has been eroded by inflation.

…with further upward pressure on the horizon from the forthcoming rise in the National Minimum Wage.

There is likely more upside risk to wage growth than downside given the effects of the forthcoming changes to the minimum wage. As of 1 April 2024, the national minimum wage (NMW) will increase from £10.42 per hour to £11.40. This 9.4 per cent increase comes after the previous 9.7 per cent increase in April 2023. It is likely that the forthcoming rise in the NMW will have a stronger influence on average wage growth than the previous rise, as firstly, firms will need to raise wages across the organisation to maintain the same pay differentials between different pay bands, and secondly, this historically large rise happens only one year after the last.

Firms may be less able to absorb the increased costs associated with the forthcoming rise in the NMW than the last, given both rises have been historically high, and therefore forced to pass the costs on with higher price rises. The hospitality, retail and agriculture sectors will likely be most impacted by this challenge, due to the strong presence of 'low-paid' employees. Forthcoming NIESR analysis for the Low Pay Commission on the experiences of employers in these same sectors found that, although larger organisations often absorb cost pressures from changes to the NMW (such as by reducing overheads), small organisations do not.

Figure 1.28 Proportion of low-paid employees by sector

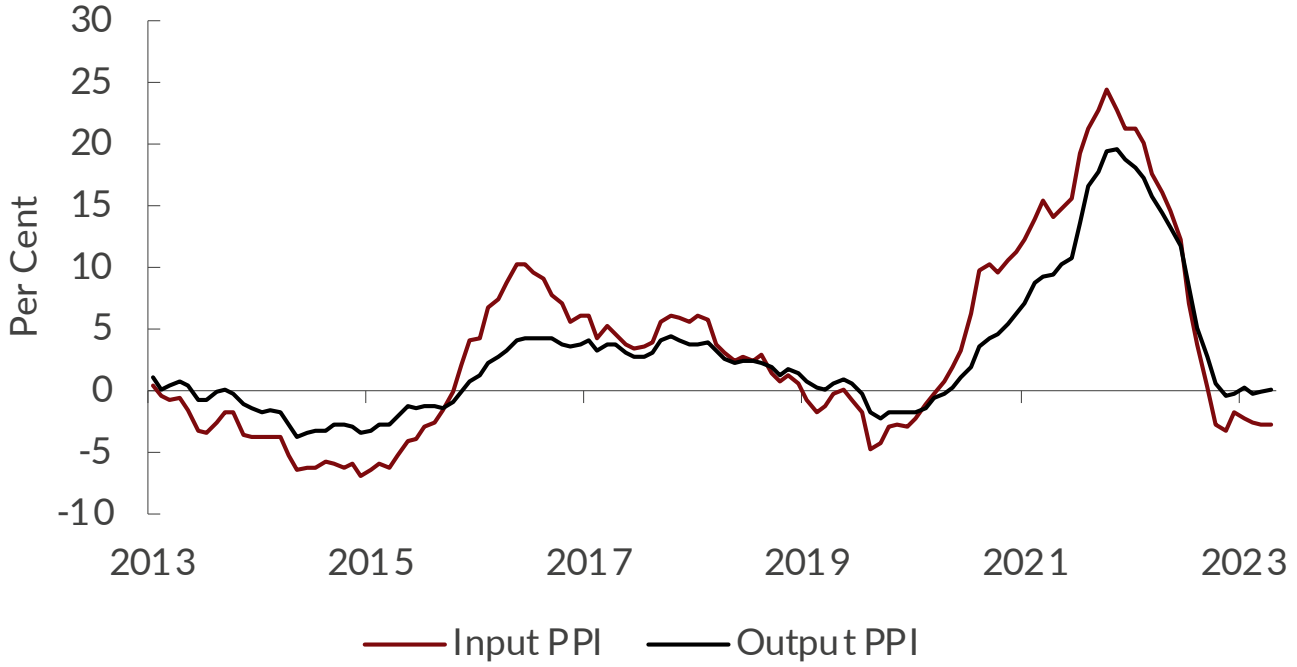


Notes: Low pay is defined as the value that is two-thirds of median hourly earnings and high pay is defined as the value that is 1.5 times median hourly earnings
Source: ONS.

Input and output costs stabilise…

Producer input and output prices have both broadly stabilised after three years of sustained increases (figure 1.29). Output prices remain stable with no meaningful changes since before the summer of 2023. Input costs have begun to contract and are 2.8 per cent lower than they were in the previous year.

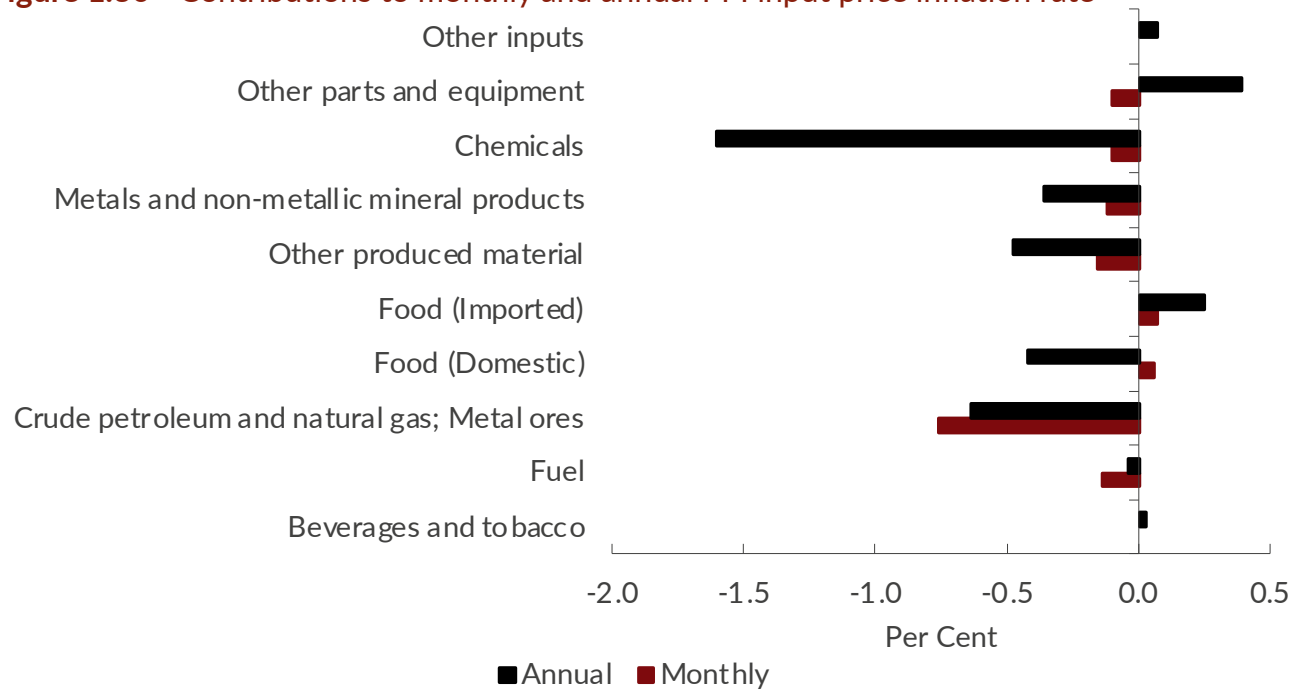
Figure 1.29 Producer Price Index annual inflation rates



Source: ONS.

The falls in input and output prices remain mostly driven by sharp falls in the costs of chemicals and crude oil (figure 1.30). The latter has recently fallen sharply, with a 0.8 per cent fall in one month. Almost all measures were providing downward pressure on the Producer Price Index, with just food (both imported and domestic) input costs slightly rising in December.

Figure 1.30 Contributions to monthly and annual PPI input price inflation rate



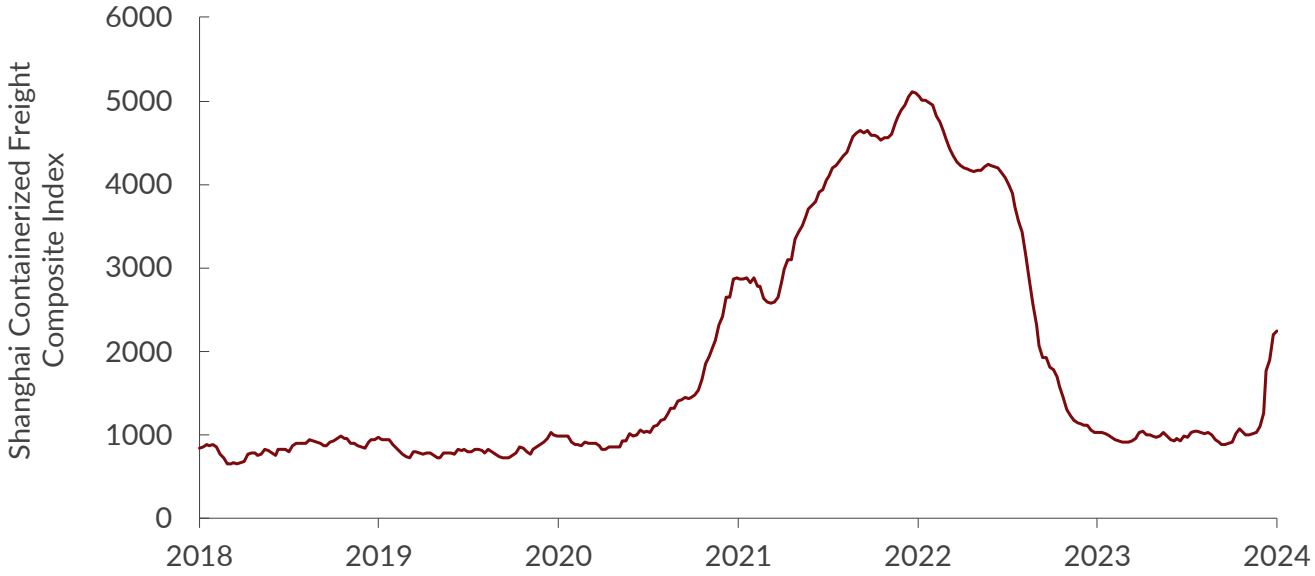
Source: ONS.

...although this could change with rising shipping costs resulting from the Houthi attacks on shipping in the Red Sea.

With around 10 per cent of the global seaborne oil trade sailing through the Red Sea, disruption to shipping routes as a result of the Houthi attacks on shipping in the Gulf of Aden could have a meaningful impact on the global economy in the near term. The United Kingdom and Europe will be disproportionately impacted as the Asia-Europe shipping routes, which transit the Red Sea, will be disrupted. The SCFI stood at 2,240 on 22 January 2024, a rise of 152 per cent relative to 9 October 2023. It should be noted, however, that other measures of shipping costs, such as the Baltic Dry Index, have not seen such an increase.

The increase in shipping costs, as measured by the SCFI, has been of a similar magnitude to the increase seen over 2020 as the Covid pandemic hit the world (figure 1.31). It is clearly too early to tell whether the current rise will continue, as happened in 2021, or if shipping costs will peak at the same level as in January 2022. However, our view at this stage is that this is unlikely given the challenge presented by the Houthi attacks in the Red Sea is more isolated than the global disruption caused by Covid restrictions. In addition, the increase in shipping costs appears to be slowing in the latest data.

Figure 1.31 Shanghai Containerised Freight Index



Notes: the index is based on the costs of shipping from China to a series of ports in Northern Europe.
Source: Shanghai Containerised Freight Index (Europe Service).

Given the PPI has not meaningfully increased, it is likely that the increase in shipping costs has not yet passed through to UK firms. It is currently unclear what proportion of price increases could be absorbed by UK firms. However, existing evidence suggests that when the cost of shipping doubles, around 0.7 percentage points is added to headline inflation (Carriere-Swallow et al., 2022). This, coupled with the fact that UK firms have only just begun to get over the economic challenges of the last few years, would suggest it is likely that a sustained increase in shipping costs would have a meaningful impact on future inflation.

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2. Outlook for UK Households, the Devolved Nations and the English Regions

By Arnab Bhattacharjee, Ben Caswell, Adrian Pabst, Robyn Smith and Tibor Szendrei

- **Living standards as defined by real household disposable income are projected to rise by 1.9 per cent on average in 2024-25 across all income deciles but will be below pre-pandemic levels:** for households in income deciles 1-4, living standards will be between 7 and 20 per cent lower in 2024-25 compared with 2019-20.
- **For the poorest 10 per cent, the fall in real income since 2019-20 is about £4,500 (in current prices):** their living standards are lower by some 18 per cent compared with the pre-pandemic levels.
- **Tighter monetary policy has considerably limited the hit to household finances from the inflation shock, but there are some distributional differences, with the bottom half of the income distribution sustaining a larger impact than the richest households:** the rise in the costs of mortgages and unsecured loans for people in income deciles 1-5 has been higher by some 2 per cent on average than people in the top income decile.
- **Recent strong wage growth has reduced the gap between the top income percentile and the bottom income percentile:** this is especially apparent in the North East where the bottom percentile has experienced the greatest year-on-year growth in average earnings of 17.1 per cent in 2022-23 compared to the UK average of 8.5 per cent growth (relative to 2021-22).
- **The ONS has revised down its UK-wide estimates of employment, but we find that this has a negligible spatial impact:** with respect to employment, there are no significant changes to the regional variation between the UK's top performing and worst performing areas.
- **The parlous state of local government finances threatens both the provision of basic public services on which the most vulnerable people depend and the prospect for a revival of struggling heartland communities:** Local Authorities have seen deep cuts in central government funding without being able to raise extra revenue, while facing increased demand for essential services whose costs are rising faster than inflation (Box C).
- **Urgent action is required to help Local Authorities in distress and regenerate the regions:** support local government finances, by plugging the funding gap of £4 billion including a reform of council tax, and a credible commitment to maintain public investment at 4 per cent of GDP per year and productivity beyond the next general election.

UK Distributional Analysis: the picture ahead of the Budget on 6 March

Living Standards

The essential backdrop is that living standards defined as real household disposable income (RHDI) have significantly fallen since the Covid-19 pandemic, and households in the bottom half of the income distribution have borne the brunt of this fall (Bhattacharjee et al., 2023a-d; OBR, 2023; Francis-Devine and Orme, 2023). The once-in-a-generation cost-of-living crisis had severe distributional effects and was met with robust monetary policy action to try and mitigate its consequences. Given our forecast that the UK economy will follow a path of sluggish growth in 2024, what are the distributional implications?

Against the backdrop of strong wage growth and the cut to the main rate of employee National Insurance Contributions (NICs), we project that living standards as measured by RHDI will rise by 1.9 per cent on average in 2024-25 (table 2.1). For the 'squeezed middle' who in percentage terms were hit hardest by the cost-of-living crisis, living standards are projected to rise by about 2 per cent on average in 2024-25 but will still be below pre-pandemic levels. The living standards of households in the second bottom tenth of the population (income decile 2) will still be about 12 per cent lower in 2024-25 compared with 2019-20.

Table 2.1 Household disposable income

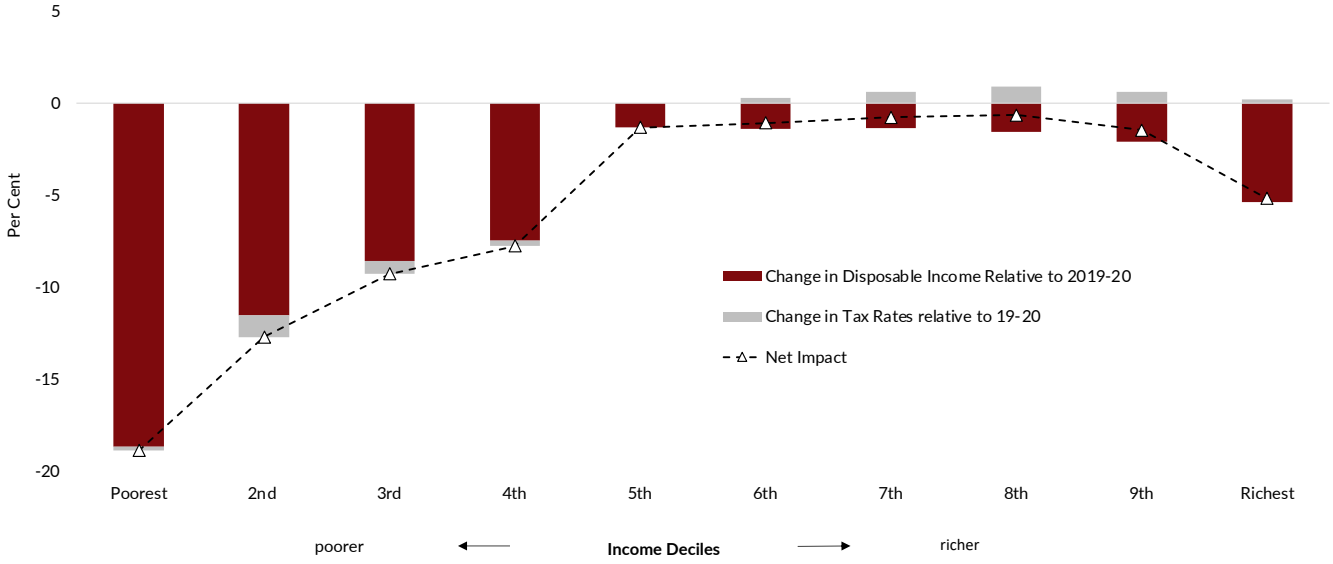
Fall in disposable income	Bottom decile	Decile 2	Decile 3	Decile 4	Decile 5	Decile 6	Decile 7	Decile 8	Decile 9	Top decile	Average
Household Disposable Income [nominal] , 2023-24	£15,400	£26,600	£29,900	£34,200	£41,500	£49,000	£56,400	£66,400	£80,500	£150,500	£55,100
[Relative to pre-Covid (19-20), real terms]	[-20.5%]	[-12.4%]	[-10.0%]	[-9.4%]	[-3.6%]	[-4.0%]	[-4.3%]	[-4.8%]	[-5.0%]	[-5.6%]	[-6.3%]
[Of which, NI rates & taxes, 2023-24]	£102	£169	£222	£180	£151	£123	-£43	-£292	-£773	-£1,972	-£213
[Share of Household Disposable Income Per Cent]	[0.7%]	[0.6%]	[0.7%]	[0.5%]	[0.4%]	[0.3%]	[-0.1%]	[-0.4%]	[-1.0%]	[-1.3%]	[-0.4%]
Household Disposable Income [nominal], 2024-25	£15,500	£28,600	£31,200	£37,500	£45,600	£53,800	£61,900	£73,000	£88,000	£162,600	£59,800
[Change in Income due to Inflation]	-£642	£874	-£21	£1,755	£2,279	£2,665	£3,086	£3,661	£3,981	£8,749	£2,639
[Change from 2023-24, real terms]	[1.8%]	[0.9%]	[1.4%]	[1.9%]	[2.3%]	[2.6%]	[2.9%]	[3.3%]	[2.9%]	[0.2%]	[1.9%]
[of which, NI rates & taxes, 2024-25]	-£46	-£362	-£236	-£126	-£15	£139	£334	£598	£478	£330	£109
[Share of Household Disposable Income Per Cent]	[-0.3%]	[-1.3%]	[-0.8%]	[-0.4%]	[0.0%]	[0.3%]	[0.6%]	[0.9%]	[0.6%]	[0.2%]	[0.2%]

Source: LINDA.

The living standards of households in the bottom income decile are lower by some 20 per cent compared with the pre-pandemic levels (figure 2.1), and this despite some targeted policy measures such as the uplift to Universal Credit during Covid-19 and the Cost-of-Living Payments worth up to £900 for the past year. For the poorest 10 per cent, this means that the shortfall in their disposable income since 2019-20 is about £4,500 (figure 2.2).

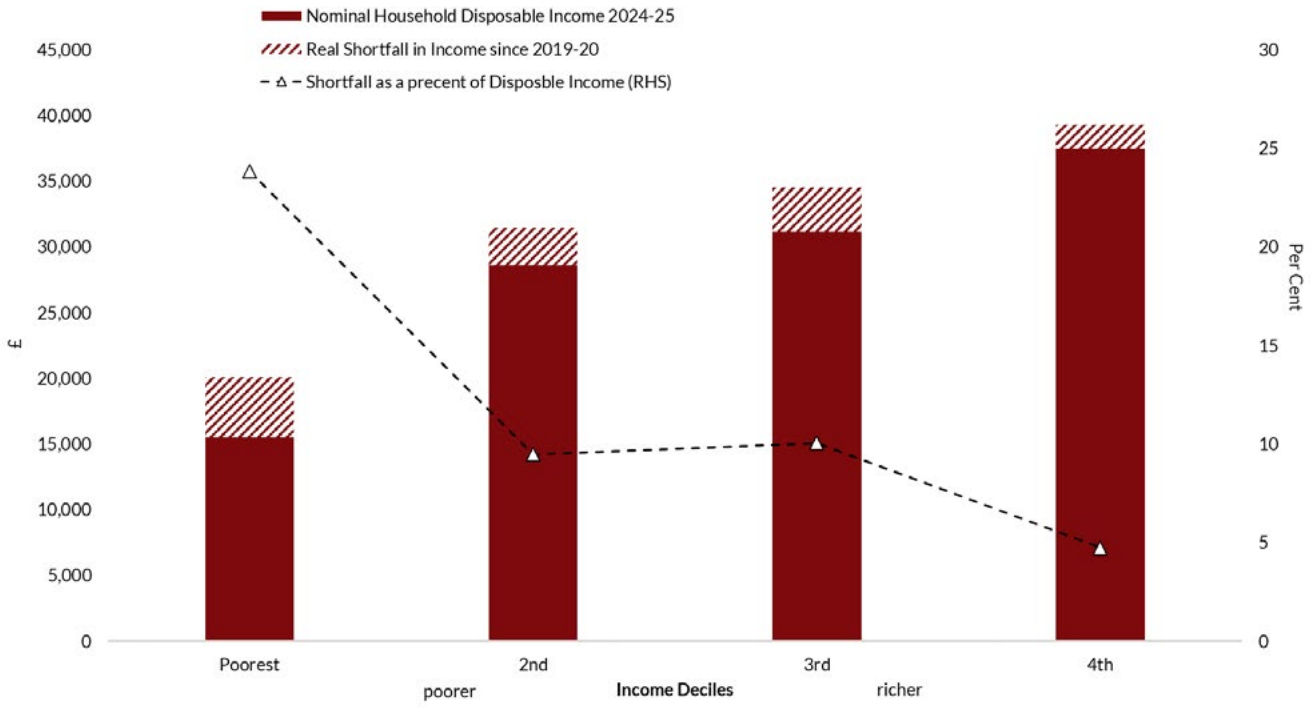
The 2 per cent reduction in NICs that came into effect in January 2024 will cost the Exchequer some £100 per household per year, totalling about £10 billion by 2027-28. However, because of the freeze in income tax thresholds, the net impact will be regressive, reducing average disposable incomes for the bottom half of the population while raising average disposable incomes for the top half (table 2.1 and figure 2.1).

Figure 2.1 Cumulative impact of price shocks and policy interventions relative to 2019-20



Source: LINDA.

Figure 2.2 Income shortfalls by decile (1-4) in 2024-25 relative to pre-pandemic (2019-20)



Source: LINDA.

Impact of Monetary Policy Tightening

In addition to falls in disposable income, persistent high inflation further eroded household budgets over the past two years. This, in turn, necessitated robust monetary policy responses, supported by fiscal policy measures to reduce cost-of-living challenges (Bhattacharjee et al., 2023d). An important question is whether monetary policy action has been tighter than necessary and what implications would have followed if a comparatively loose monetary policy response had been adopted. We examine this issue by considering the heterogenous impacts of tight monetary policy in two dimensions: first, across the distribution of households by income and, second, across the three devolved nations and the English regions.

In Table 2.2, we show the impact of tight monetary policy characterised by a series of sharp rises in interest rates to tackle inflation, as compared with a rather more moderate monetary policy response of maintaining the base rate at 3.5 per cent since the beginning of 2023 (Chadha et al., 2023). There are two main areas where the impacts of monetary policy would focus: (i) bringing inflation down and hence mitigating the cost-of-living effects, and (ii) higher interest rates payments, particularly on mortgages and unsecured debt at high rates. The two impacts affect household finances in opposite directions, and hence we need to consider net effects. Both impacts also have distributional implications, and these are also documented in Table 2.2 by deciles across the income distribution.

Table 2.2 The impact on household finances from tighter vs looser monetary policy

Household Finances	Bottom decile	Decile 2	Decile 3	Decile 4	Decile 5	Decile 6	Decile 7	Decile 8	Decile 9	Top decile	Average
Tight MP (monetary policy)											
Disposable Income, 2023-24	£15,400	£26,600	£29,900	£34,200	£41,500	£49,000	£56,400	£66,400	£80,500	£150,500	**£55,100**
Cost-of-living (inflation>3%)	**-£1,394.66**	**-£2,930.97**	**-£4,414.33**	**-£4,791.77**	**-£3,749.46**	**-£981.37**	**-£915.84**	**-£1,677.33**	**-£2,700.95**	**-£4,919.14**	**-£2,848**
[Hit: excess inflation]	[-9.0%]	[-11.0%]	[-14.7%]	[-13.9%]	[-9.0 %]	[-2.0%]	[-1.6%]	[-2.5%]	[-3.4%]	[-3.3%]	[-5.2%]
Mortgage/Loans (base rate>2%)	**-£1,192.96**	**-£1,956.93**	**-£2,350.15**	**-£2,764.94**	**-£3,405.56**	**-£4,027.01**	**-£4,407.98**	**-£4,658.62**	**-£5,317.13**	**-£6,953.41**	**-£3,703**
[Hit: high rates]	[-7.7%]	[-7.3%]	[-7.8%]	[-8.0%]	[-8.2%]	[-8.2%]	[-7.8%]	[-7.0%]	[-6.7%]	[-4.7%]	[-6.8%]
[Combined hit to HH finances]	[-16.7%]	[-18.3%]	[-22.5%]	[-22.0%]	[-17.2%]	[-10.2%]	[-9.5%]	[-9.6%]	[-10.1%]	[-8.0%]	[-12.0%]
Disposable Income, 2024-25	£15,500	£28,600	£31,200	£37,500	£45,600	£53,800	£61,900	£73,000	£88,000	£162,600	**£59,800**
Cost-of-living (inflation>3%)	**-£741.04**	**-£1,557.35**	**-£2,345.52**	**-£2,546.07**	**-£1,992.25**	**-£521.45**	**-£486.62**	**-£891.24**	**-£1,435.13**	**-£2,613.75**	**-£1,513.04**
[Hit: excess inflation]	[-4.8%]	[-5.5%]	[-7.5%]	[-6.8%]	[-4.4%]	[-1.0%]	[-0.8%]	[-1.2%]	[-1.6%]	[-1.6%]	[-2.5%]
Mortgage/Loans (base rate>2%)	**-£1,811.15**	**-£3,003.67**	**-£3,636.32**	**-£4,285.35**	**-£5,287.30**	**-£6,263.06**	**-£6,867.76**	**-£7,348.31**	**-£8,504.19**	**-£11,297.62**	**-£5,830.47**
[Hit: high rates]	[-11.8%]	[-10.5%]	[-11.7%]	[-11.4%]	[-11.6%]	[-11.6%]	[-11.1%]	[-10.1%]	[-9.7%]	[-7.0%]	[-9.8%]
[Combined hit to HH finances]	[-16.6%]	[-16.0%]	[-19.2%]	[-18.2%]	[-16.0%]	[-12.6%]	[-11.9%]	[-11.3%]	[-11.3%]	[-8.6%]	[-12.3%]
Relative to loose MP											
[Inflation: Tight - Loose MP]	[8.5%]	[11.3%]	[13.0%]	[10.8%]	[8.0%]	[1.8%]	[1.4%]	[2.2%]	[3.0%]	[3.3%]	[4.6%]
[Rates: Tight - Loose MP]	[-1.0%]	[-1.0%]	[-1.3%]	[-1.6%]	[-1.5%]	[-1.5%]	[-1.4%]	[-1.4%]	[-1.3%]	[-1.0%]	[-1.3%]
[Combined hit: Tight - Loose MP]	[3.7%]	[5.2%]	[5.9%]	[4.6%]	[3.2%]	[0.1%]	[0.0%]	[0.4%]	[0.8%]	[1.0%]	[1.7%]

Source: LINDA.

The top panel shows the impacts on household finances in the current financial year (2023-24). It is clear than across the distribution, household finances are squeezed by both effects. Together, the distributional impacts are substantial. The combined effect is highest in deciles 2-5, accounting for a hit of about 20 per cent of household incomes, the 'squeezed middle' (Bhattacharjee et al., 2023a).

However, by 2024-25 (second panel), tight monetary policy would bring inflation back to the 2 per cent target, mitigating much of the cost-of-living pressures. Together, moderate wage growth with falling inflation would mean larger household incomes and purchasing power. However, debt servicing costs still remain high until the Bank of England base rate starts to fall. The combined effect means that pressures on household finances will persist during the next year. Note that some households would have been saving and investing (as the savings rate has been rising, cf. Chapter 1), and they would benefit from the higher interest rates. Hence the distributional impacts also remain persistent.

How would household finances have been affected if the stance of monetary policy were comparatively loose (maintaining the base rate at 3.5 per cent), relative to the above tight monetary policy scenario? This is shown as a contrast between tight and loose monetary policy in the bottom panel of Table 2.2. Evidently, tight monetary policy was much more effective in reining in inflation as compared to what loose monetary policy would have achieved. Hence, with loose monetary policy, we see that households in the bottom half of the distribution would have suffered more, by about 10 per cent of their disposable incomes over 2023-25. This would cut against lower debt costs that households would have faced. However, since some households are saving and investing, this impact is much more moderate.

The overall impact therefore points to gains from the tight monetary policy stance adopted by the Bank of England. However, this too has distributional implications. Finances for households in the middle of the distribution would have been similar, while greater gains from tight monetary policy accrued to households at both ends of the distribution. This is yet more evidence of the return of the 'squeezed middle'. Overall, this counterfactual modelling exercise confirms that tight monetary policy has benefited more households than otherwise, and the benefits span across the entire distribution of households.

As evident from the above results, regional variation of impacts can also be induced by variation in debt and regional demand. Further, political economy considerations of optimal monetary policy suggest that variation in competitiveness can influence regional economic trajectories and hence choice of monetary policy responses to inflation and output (Waller, 1992). While regional dimensions of monetary policy is an understudied area, recent research has also suggested several alternate mechanisms (Beraja et al., 2017; Hauptmeier et al., 2020).

Following Chadha et al. (2023), we also examine regional variation in the impact of tight monetary policy across the devolved nations of the United Kingdom and English regions. Overall, compositional effects by regional variation in income distribution and sectoral composition are persistent but relatively moderate. Together, they imply a trajectory of about 0.1 to 0.2 per cent lower output relative to the UK average for London and the South of England, and correspondingly, about 0.3 per cent higher trajectory for the Midlands and regions in the north of England, and to a lesser extent Wales. While these variations are small relative to distributional effects, further investigation of regional monetary policy is planned for the future. Against flatlining employment and projected stable output growth public investment (Chapter 1), these findings appear to be driven by regional variation in mortgage and housing costs placing downward pressures on disposable income as well as a focus of Levelling Up investments – particularly the Midlands, the North and to some extent Wales rather than London and the South East.

Note on NIESR Household Distributional Projections Data

Since February 2022 (Bhattacharjee et al., 2022), NIESR's UK Outlooks have been publishing tables and charts documenting pressures upon household finances across the distribution of households by income decile. In the current Outlook, Tables 2.1 and 2.2 and Figures 2.1 and 2.2 refer to these projections. This short note documents conceptual elements and computations for these projection statistics.

For the purpose of these statistics, the definition and conceptual basis of household disposable income is the same as Household Below Average Income (HBAI) statistics published on behalf of HM Department of Work and Pensions (DWP) since 2011; for detailed discussion and definitions, see DWP (2023). Following HBAI, our primary measure is disposable household income adjusted for household composition (by equivalisation), estimated on a after housing costs basis. This includes contributions from earnings, state support, pensions, and investment income among others, aggregated across all members in a household, and is net of tax. We use this **net equivalised disposable household income** as a proxy for living standards. However, there are two main differences from DWP in the way we compute these statistics.

First, while the HBAI estimates are backward looking and computed based on the Family Resources Survey (FRS), our projections are based on a microsimulated representative sample of UK households projected forward through time. Individuals in each household receive incomes (wage, benefits and interest income, among others) that follow aggregate trajectories (from NiGEM projections) with regional variations (from NiReMS) modelled using NIESR's dynamic microsimulation model (LINDA). Changes in household composition over time are also accounted for; for further details, see Bhattacharjee et al. (2024) and Bhattacharjee and Szendrei (2021). These incomes are calculated on a nominal basis annually for each financial year, but corresponding real term computations account for distributional variation in experiences of inflation across income deciles (Francis-Devine and Orme, 2023; ONS, 2021) based on the Living Costs and Food Survey.

Second, to aid understanding of the impacts of recent inflation, high borrowing cost, changes to taxes and freeze on thresholds, these calculations are based on benchmarks for 2019-20 with regard to tax rates, tax thresholds and housing costs (rents and mortgages). In other words, tax thresholds are set to percentiles of personal income in 2019-20 and tax rates for 2019-20 are applied, and the balance of current taxes are shown as additional tax effects on household income. Likewise, rents and mortgage payments are calculated at 2019-20 rates, and deviations of current (and future) housing costs are reported as an additional hit to household finances.

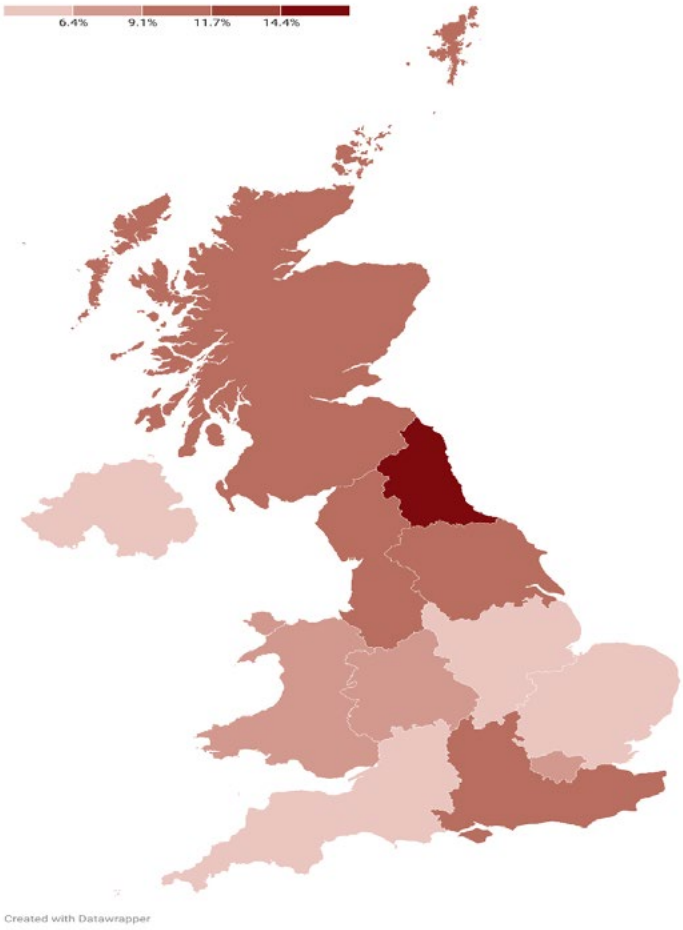
The statistics are not directly comparable with ONS personal income statistics, such as personal incomes and personal disposable incomes, nominal or real, and gross or net (of taxes); the same is true for projections published in Chapter 1 (Figure 1.9, for example). This is because personal income statistics are on per person (typically of working age, 16-64 years) while the distributional statistics are per household. Once adjusted for household composition and changes thereof, using LINDA for example, the two can be compared. Household sector national accounts statistics are not comparable, as the household sector includes not only households, but also third sector institutions serving households.

Distributional and Regional Analysis

Weekly Pay Growth by Devolved Nation and English Region

Total weekly earnings grew by 7.2 per cent in the first three quarters of 2023 (Chapter 1; Bejarano Carbo, 2024). The 10th percentile of wage growth is an important indicator of the economic circumstances of low paid workers and their households. The recent NIESR evidence to the Low Pay Commission (NIESR, 2023) documented that household incomes and labour market outcomes for the second decile (earning wages just above the 10th percentile) were positively affected by the recent increases in the National Minimum Wage and the National Living Wage, but those in the bottom decile (earning less than the 10th percentile) were not significantly affected.

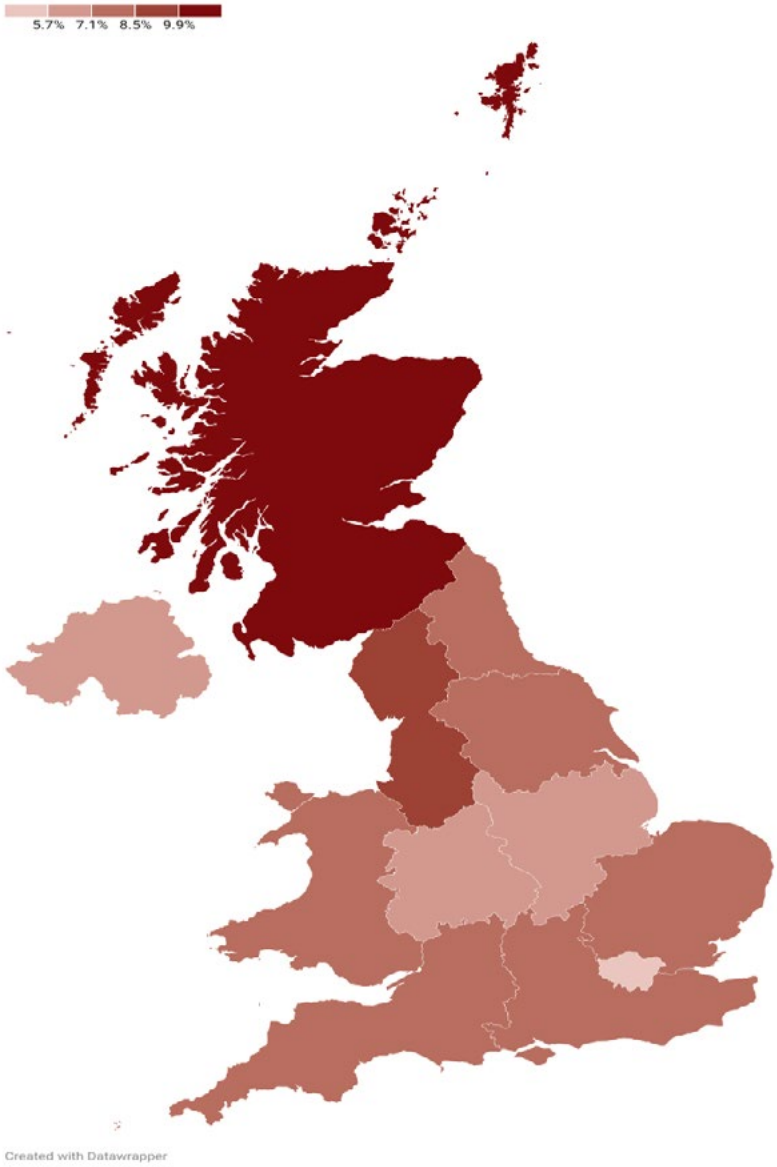
Figure 2.3 Weekly Gross Pay Year-on-Year Growth for the 10th Percentile (2022-23) by English Region and Devolved Nation



Source: ASHE, NIESR Calculations.

Figure 2.3 shows the regional distribution of year-on-year growth in weekly gross pay for the 10th percentile. Relatively poor workers on this percentile in the North East experienced the largest year on year growth compared to the other regions, with a 17.1 per cent increase compared to the 2022 weekly gross earnings. By contrast, similar workers in Wales, the East of England, the East Midlands and the South West experienced an increase of less than 6.4 per cent. This shows not just a high degree of inter-regional variation but also an uneven pattern of Levelling Up: while some regions like the North East are catching up, others are either stagnating or falling further behind the top performing areas.

Figure 2.4 Weekly Gross Pay Year on Year Growth for the Median Percentile (2022-23) by UK Region/Devolved Nation



Source: ASHE, NIESR Calculation .

As a contrast, figure 2.4 shows the year-on-year growth of weekly pay for the median wage worker across the devolved nations of the UK and English regions. The median percentile in Scotland experienced the highest year on year growth, which was around 11.3 per cent. By contrast, the median percentile in London experienced the lowest year on year growth (4.2 per cent). As growth in wages have started substantially slowing down (Bell, 2024), and in the face of large distributional outcomes, it remains important to continuously track socio-economic outcomes of the working families across different regions of the country – both the poor and the median wage earners.

The regions and devolved nations where the 10th percentile experienced a higher year-on-year growth than the median percentile are London, the North East, South East, West Midlands and Yorkshire & the Humber. These data suggest early signs that the gap between the median percentile and the bottom percentile may be closing somewhat in the short run, which represents tentative progress in relation to Mission 1 of Levelling Up (DLUHC, 2022). This is especially significant in the North East where the median percentile experiences a 7.8 per cent year on year growth as compared to 17.1 per cent growth at the 10th percentile. On the other hand, the regions and devolved nations where the gap between the median and 10th percentile have widened are Northern Ireland, East Midlands, East of England and South West.

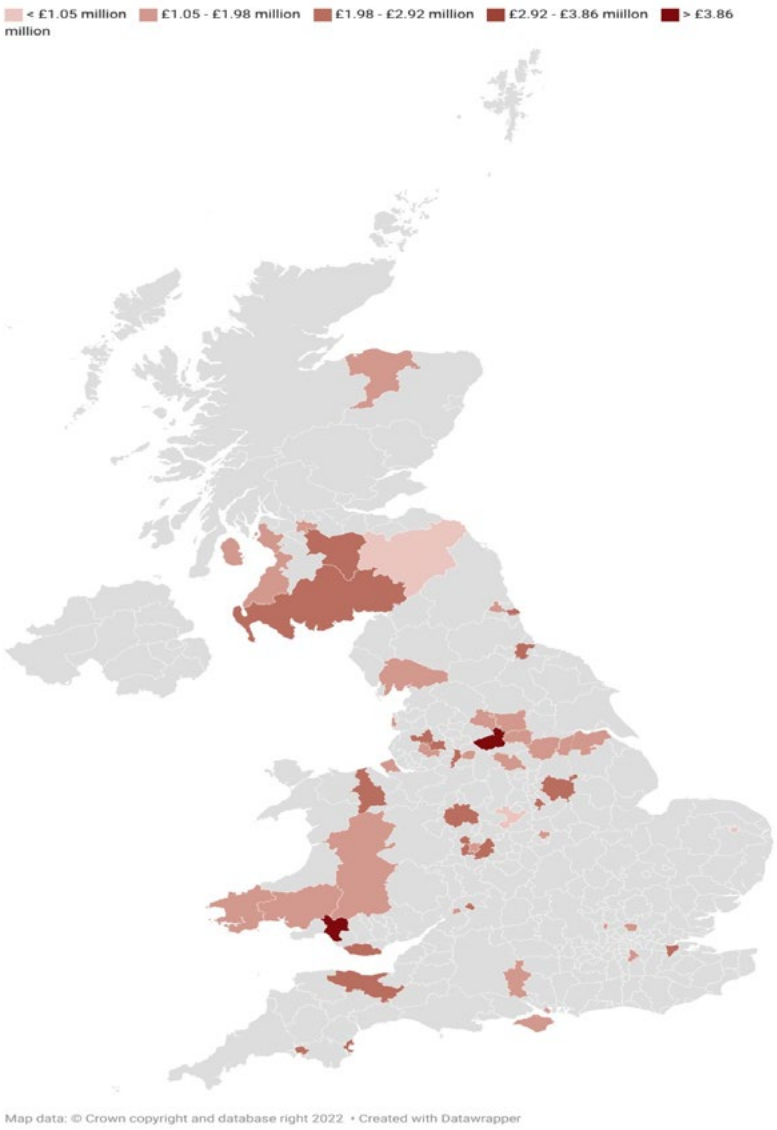
Levelling Up Funds Round 3

With public investment projected to rise more sharply in 2023-24 and 2024-25 compared to private investment (Chapter 1), there are tentative signs of government efforts to tackle regional disparities. While the extent to which this materialises is difficult to ascertain ex ante, Levelling Up funds offer an opportunity to explore what regions have been chosen to receive these public funds. Against this backdrop, we examine regional distribution in the allocation of round 3 of levelling up funds. We focus on Round 3 on account of these projects having potentially productivity enhancing and inequality reducing impacts in the near-term future. In conjunction with the current regional disparities, we analyse the extent to which the increased public investments might address persistent differences among the UK regions.

For Round 3, the allocation of Levelling Up funds was different compared with Round 2 (DLUHC, 2023a). Using new allocation measures as detailed under the Funding Simplification Plan (DLUHC, 2024a), the aim was to simplify the processes so as to reduce the costs of applying for local authorities. This is why in Round 3 the best unfunded bids from Round 2 were considered and £1 billion was allocated across the UK, with the exception of Northern Ireland where the devolved government in Stormont and its institutions was until last week suspended.

Figure 2.5 shows that the distribution of levelling up funds across the UK. The Department of Levelling Up, Housing and Communities (DLUHC) states that funding was targeted to places based on Levelling Up Need in regard to the following four metrics: NVQ Level 3+ levels, Healthy Life Expectancy, Median Gross Weekly Pay and GVA per hour worked. However, the main theme of Round 3 is to fund regeneration and transport projects. Whether these are adequate principles for the allocation of funds is a moot point.

Figure 2.5 Geographic distribution of Levelling Up Funds in Round 3



Source: DLUHC (2023b).

Some clear clusters in the allocation can be identified. The devolved nations of Scotland and Wales accumulate investments, as does Yorkshire & the Humber. This follows from Round 2 where the largest concentration of the total allocation worth £2.1 billion was in the North West. The allocation of £1.7 billion in Round 1 had somewhat larger shares for the North West and Scotland, but otherwise was more evenly spread across the country, with limited concentration in more deprived areas.

Outlook for the Devolved Nations and English Regions

Compared with NIESR's Autumn Outlook published last November (Bhattacharjee et al., 2023d), the key difference is a set of significantly lower employment projections. This is largely driven by new ONS employment data regarding the UK, which shows lower than expected employment growth over the past months, compounded by uncertainty surrounding recent employment data. In line with aggregate UK employment projections in the National Institute Regional Economic Modelling System NiReMs (Bhattacharjee et al., 2024), we see that there is a downward revision of employment projections across all devolved nations and English regions. As such, these updated employment patterns have a uniform regional impact.

By contrast, regional GVA projections are approximately in line with the last Outlook (Bhattacharjee et al., 2023d). Together, these imply that productivity is projected to grow in the near future for all regions. GVA projections remain stable even though employment is expected to be less dynamic, which may be viewed as a short run outcome of public investments, where Levelling Up funds also play an important role. As such, most regions are projected to recover their pre-pandemic levels of productivity by the end of 2024. The only part of the country where productivity is still below pre-2019Q4 is the Midlands.

Prospects of true levelling up are hampered by concerns surrounding the crisis of local government finances. Both Birmingham City Council and Nottingham City Council have issued section 114 (or bankruptcy) notices, bringing the total number of Local Authority section 114 notices to 7 since 2021 (Box C). This puts at risk both the provision of essential public services on which the some of the most vulnerable households depend and a more sustained and balanced regional recovery (HoC, 2024).

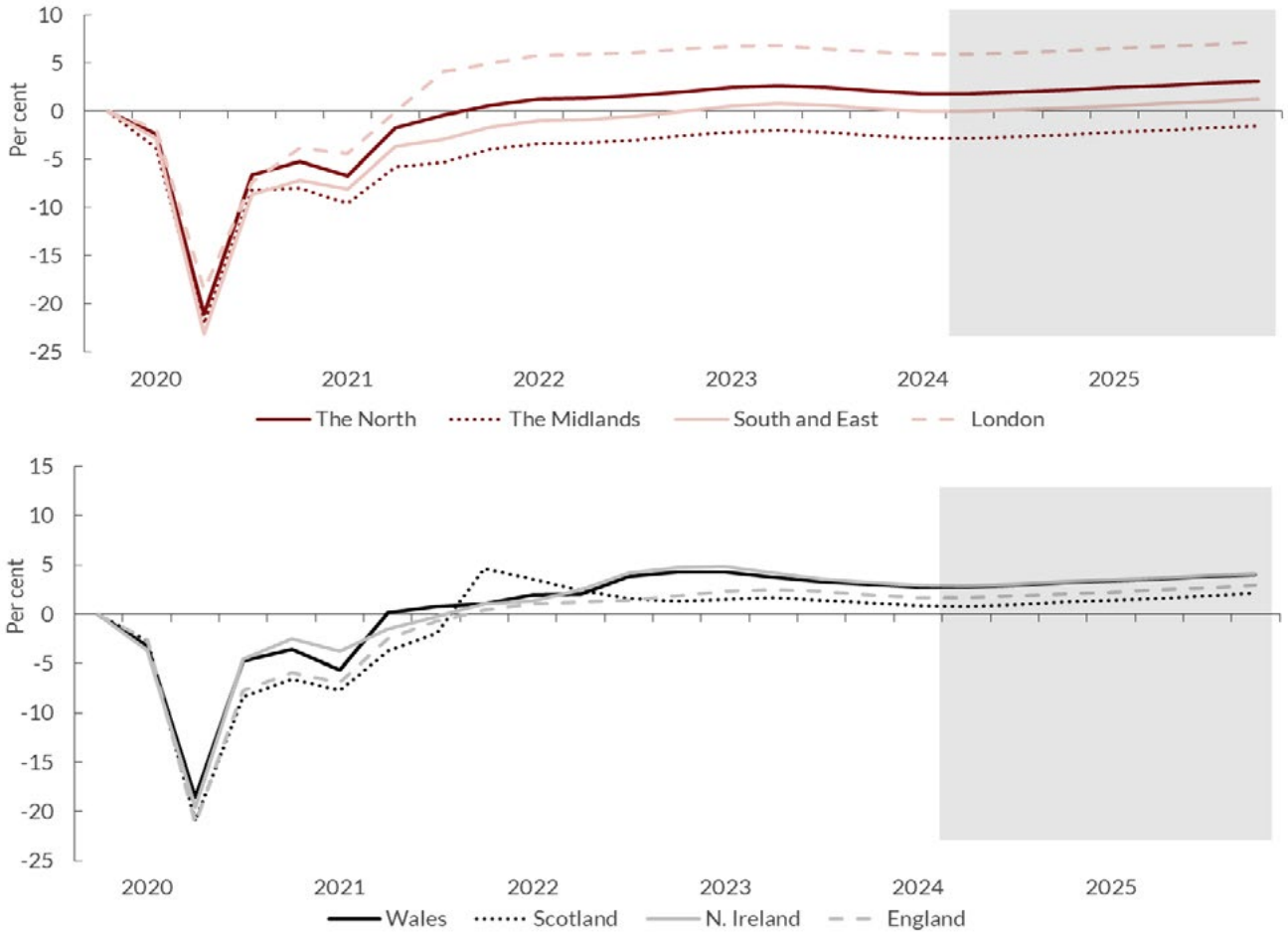
In light of this situation, we continue to project low economic growth for all devolved nations and English regions. While most parts of the country have now returned to pre-Covid levels of economic output as measured by GVA, the Midlands will not revert to pre-pandemic levels until 2025. As discussed above, employment growth is generally flatlining across all regions, which also implies that already existing substantial regional variation in levels persists. While London powers ahead, the Midlands lag behind, as do Northern Ireland and Wales.

For economic output, employment, inactivity and productivity, we find that:

Gross Value Added (GVA)

- With respect to economic output (as measured by GVA), all three devolved nations continue to be above pre-pandemic levels (figure 2.6).
- Output in the South and East as predicted in the previous Outlook is hovering around its pre-pandemic level and projected to exceed this level by the last quarter of 2024 (figure 2.6).
- The Midlands continues not to make any gains compared to the other English regions and is not predicted to reach its pre pandemic level of output in the next two years (figure 2.6).
- Note that these figures reflect the dynamics of regional GVA.

Figure 2.6 Regional GVA relative to the fourth quarter of 2019

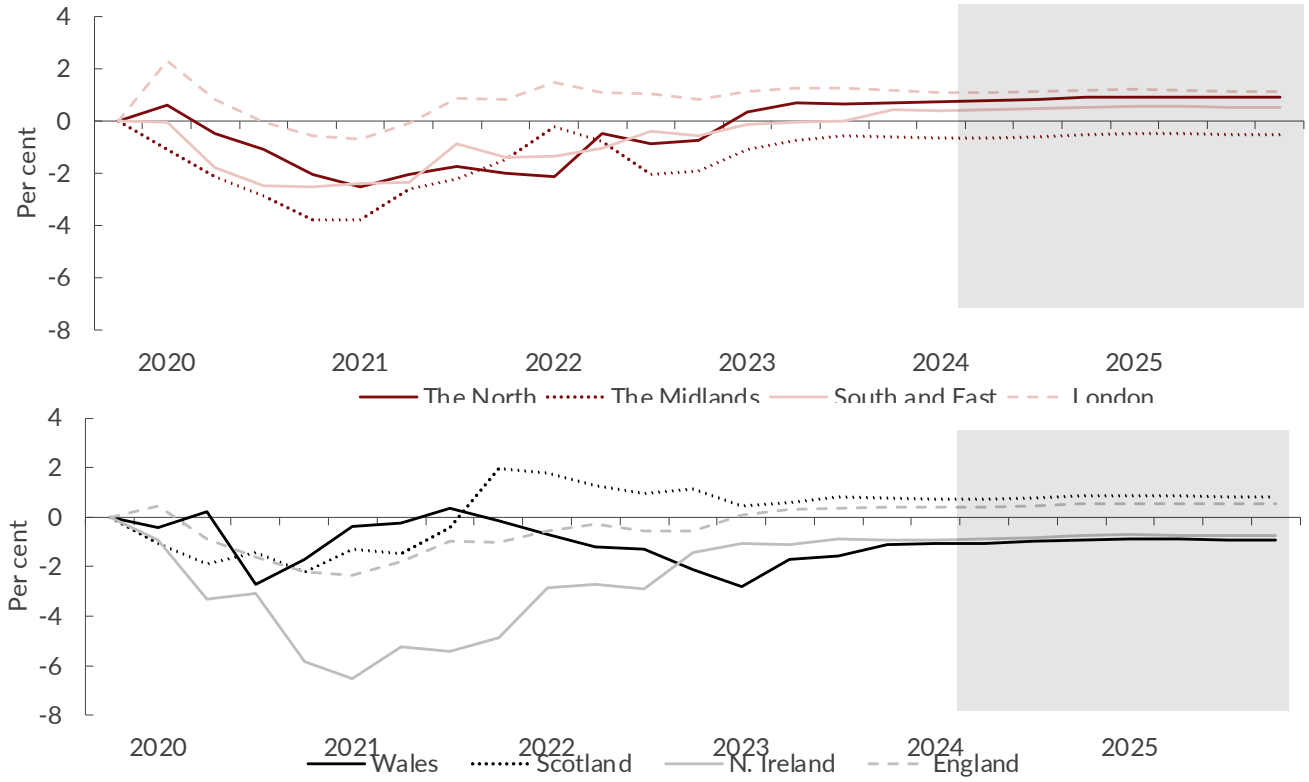


Source: NiReMS.

Employment

- This quarter the employment numbers received a significant downward projection in light of new UK employment data, which sees employment levels flatline in all regions over the next 2 years.
- In the previous Outlook, the Midlands were projected to be following a subdued upward path and projected to reach their pre-pandemic levels in late 2023 but the revisions see the Midlands experiencing stagnation with respect to their employment numbers below pre-pandemic levels (figure 2.7).
- After experiencing an upward trend in employment levels, Wales is expected to experience flatlining numbers below pre-pandemic levels (figure 2.7).
- Northern Ireland's employment is also expected to stagnate at below pre-pandemic levels over the next two years (figure 2.7).

Figure 2.7 Employment levels relative to the fourth quarter of 2019

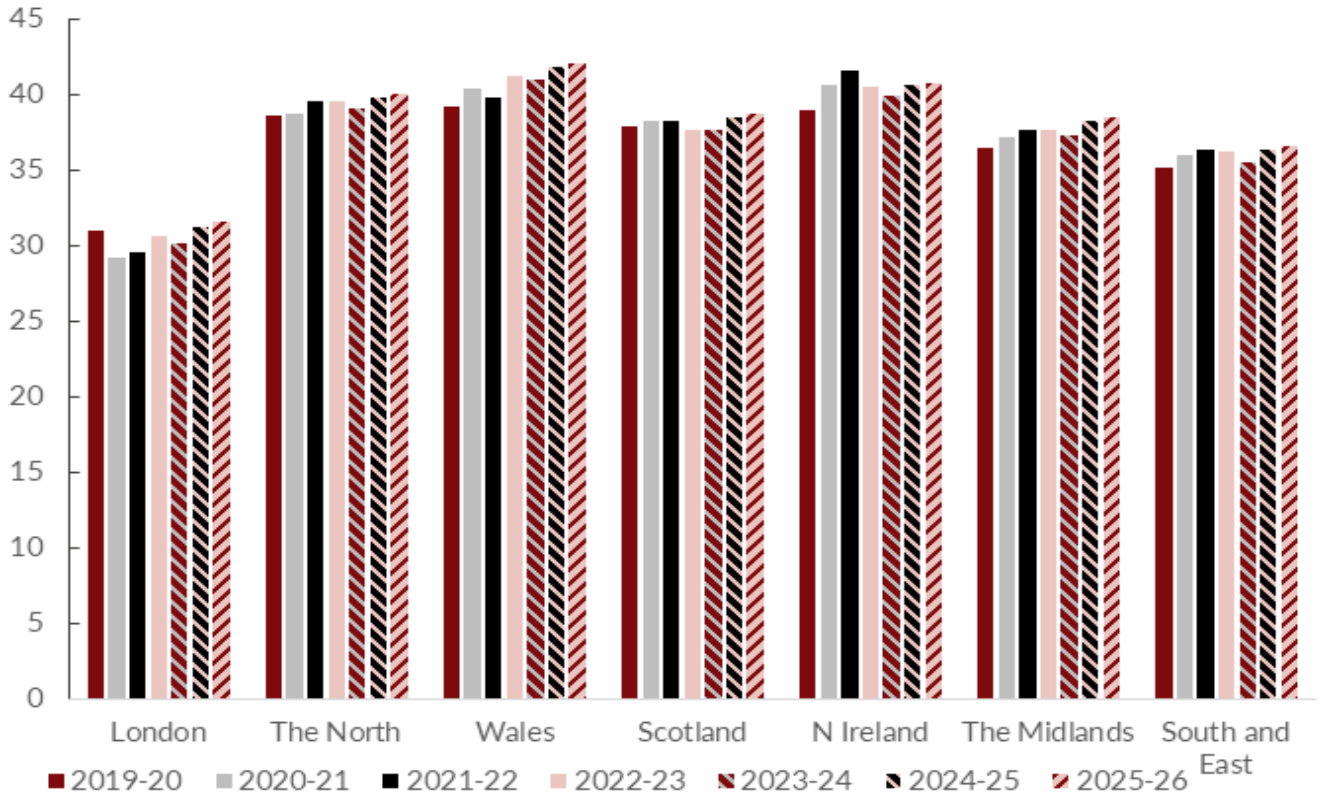


Source: NiReMS.

Inactivity

- London continues to have the lowest inactivity rate in 2023-24 while Wales continues to have the highest inactivity rate (figure 2.8). The North and Northern Ireland continue to have high inactivity rates relative to the UK average.
- The inactivity rate among the whole population aged over 16 is predicted to increase slightly by 2025-26 across all regions (figure 2.8).
- London and the South East remain below the UK average whereas Wales continues to have the highest activity rate relative to the UK average (figure 2.9).

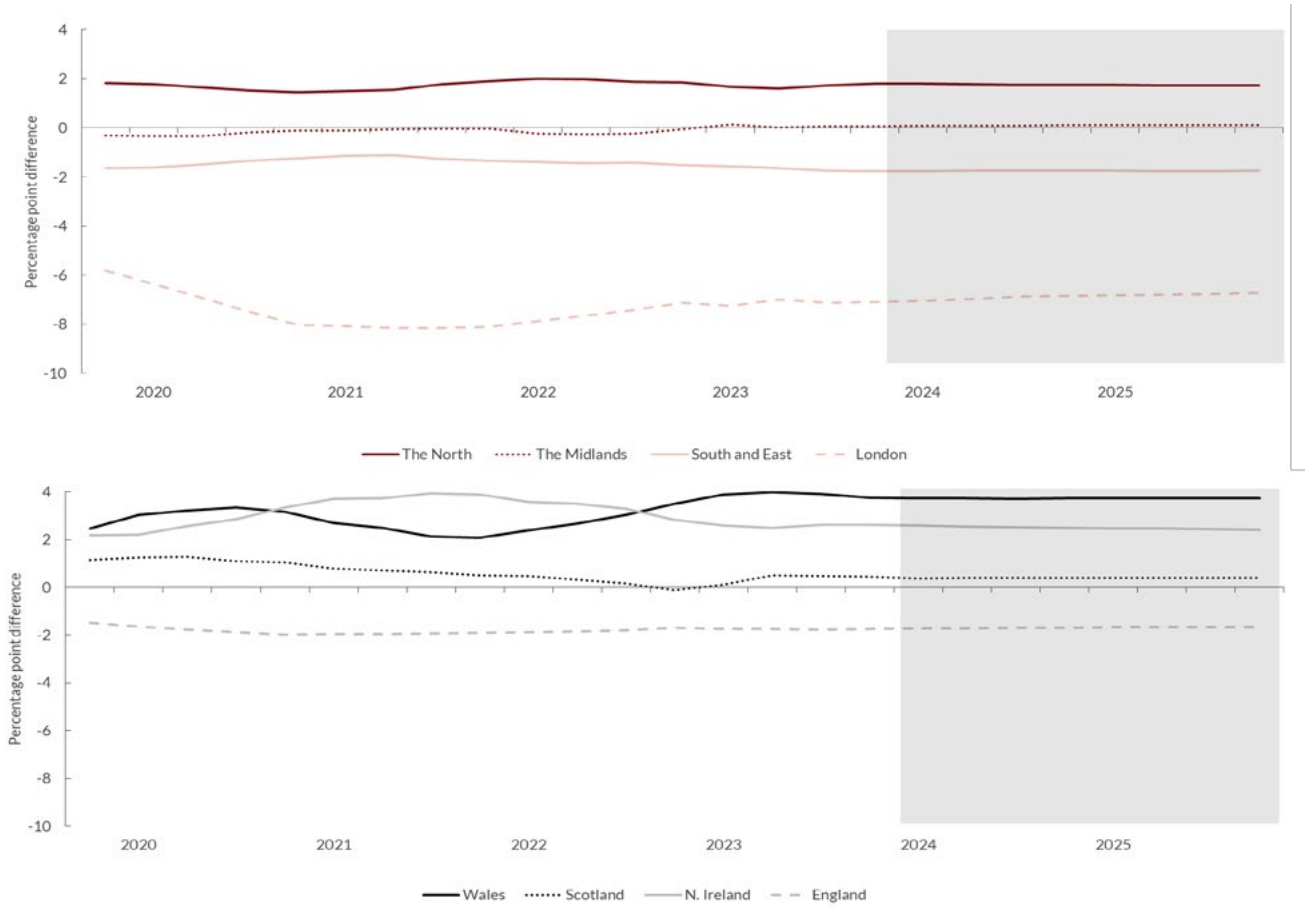
Figure 2.8 Devolved nation and regional inactivity rates (per cent)



Note: Inactivity rate defined as labour force/population aged over 16.

Source: NiReMS.

Figure 2.9 Regional inactivity rates relative to UK average

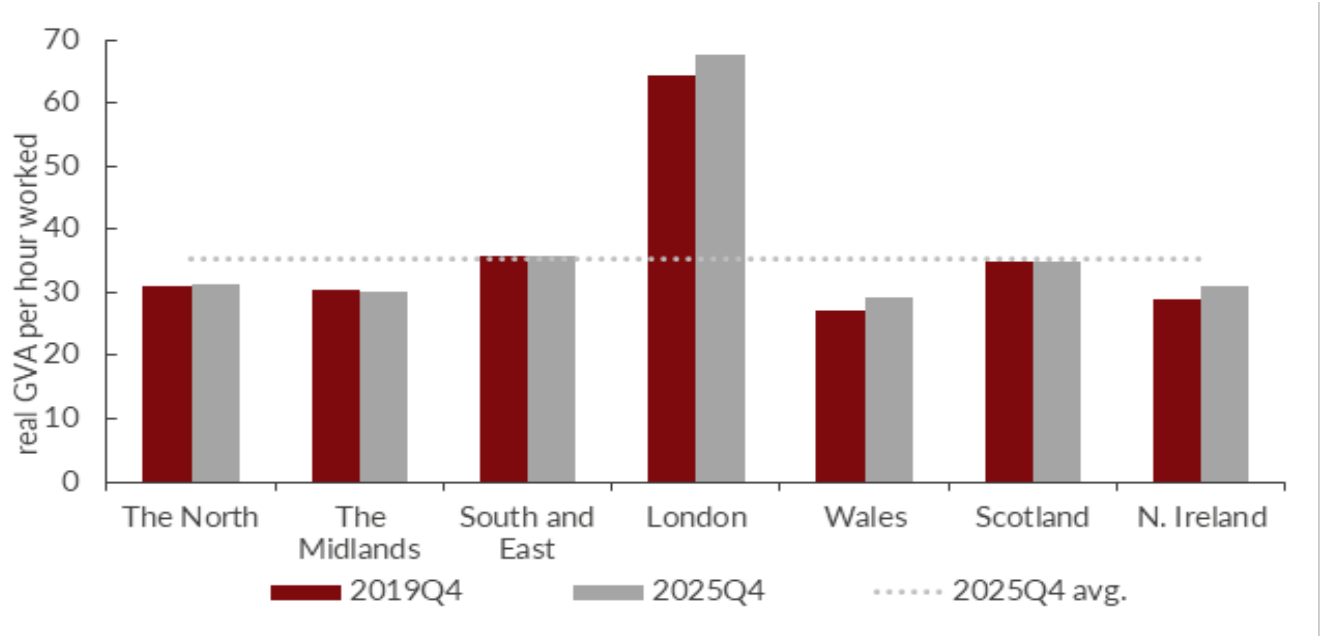


Note: Average Inactivity rate (as defined as labour force/population aged over 16) over the last four quarters, minus UK average inactivity rate.
Source: NiReMS.

Productivity

- Due to the changes in employment, productivity (as measured by real GVA per hour worked) is projected to grow in most regions of the UK.
- The only region which has pre-pandemic levels of productivity is the Midlands, although the new employment projections mean that in terms of productivity the region is not far off the level in 2019Q4.
- Of all the UK devolved nations and English regions, London exhibits the largest productivity growth.
- Overall, the productivity differentials between the more prosperous and the poorer region of the United Kingdom continue to persist (figure 2.10).

Figure 2.10 Devolved nation and English regional productivity



Source: NiReMS.

Scotland Economic Outlook

In our Summer and Autumn 2023 Outlooks (Bhattacharjee et al., 2023 c,d), we highlighted the potential for investments, particularly in the energy (oil and gas and green energy) and technology sectors. New data reveals that the renewables sector grew 50 per cent in 2021 and is continuing to create substantial jobs and attract investments (Spowage et al., 2023). For the first time, the Scottish economy in 2022 produced more renewable energy than its consumption (Scottish Government, 2024a). At the same time, the Westminster government has been allocating new licenses for drilling in the North Sea (Poynting, 2024). Together, Scotland's fintech sector has seen a 24 per cent increase in jobs from 2021 to 2023 (Digit News, 2024).

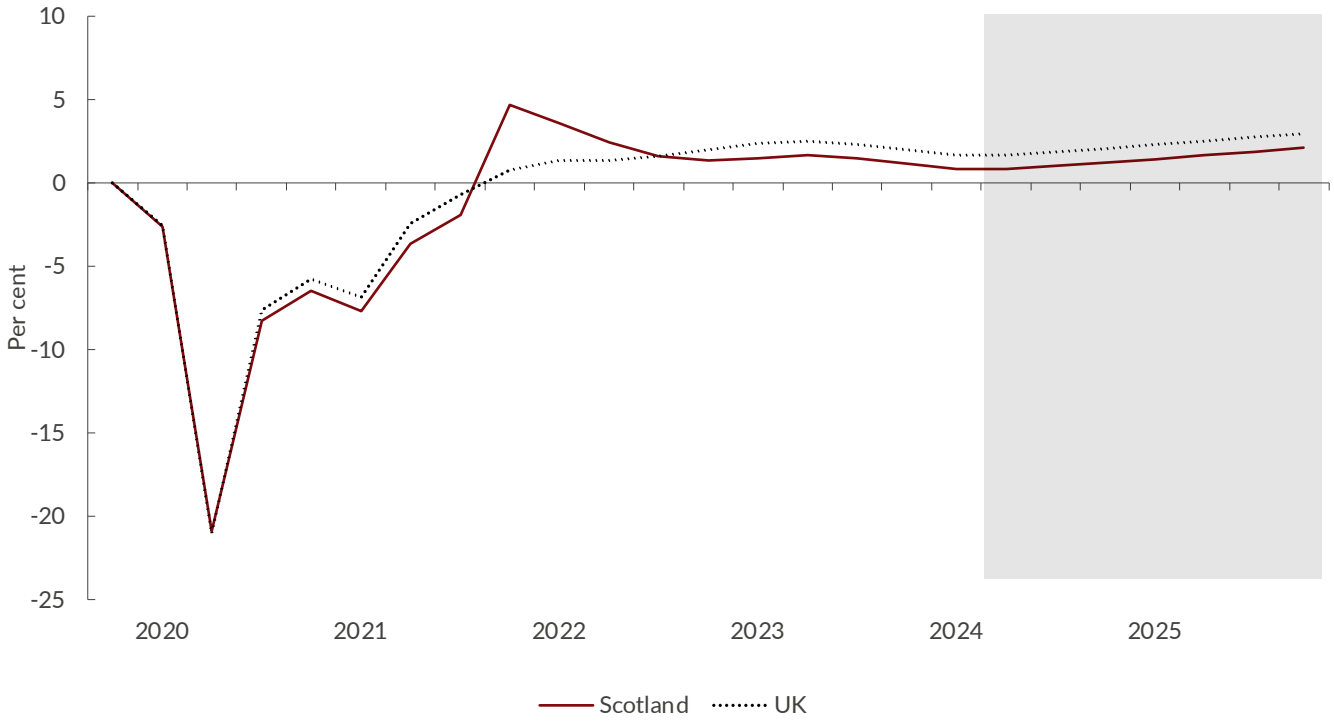
While the above developments hold considerable promise for the future, current economic conditions are mixed. While a recession was avoided in the third quarter of 2023, growth was still threadbare as prices and borrowing costs hit consumer and business confidence, inactivity remains high and global and EU trade is lower (Fraser, 2023). On the other hand, the Institute of Chartered Accountants in England and Wales (ICAEW) reported 5 per cent higher domestic sales in 2023Q4 and also a 5.3 per cent expected rise in profits for 2024; comparative figures for the UK were 3.6 per cent and 4.6 per cent respectively (Scottish Government, 2024b). Given tight public finances, the Scottish Government promise of fully funding local authorities for the freeze in council tax is likely to cost more than £300 million, of which only £40 million will be covered by the rise in top bracket income taxes (Sousa et al. 2023).

We find that

- Scotland's Gross Value Added (GVA) continues to be above its pre-pandemic levels (figure 2.11). Nevertheless, Scotland's GVA growth is projected to remain marginally below the UK average which could be a hurdle for future productivity growth.
- Employment in Scotland continues to be strong relative to the UK average (figure 2.12) and is projected to be above the UK average. Nevertheless, the medium-term employment dynamics are revised downward for Scotland too.
- Given the employment opportunities worsening, we expect Scotland's inactivity rate to rise marginally over the next two years (figure 2.8).
- With growth in Scottish employment projected to be lower than expected, Scotland's productivity is projected to rise. Nevertheless, this increase in projected productivity is lower than the productivity growth in the UK (figure 2.13).

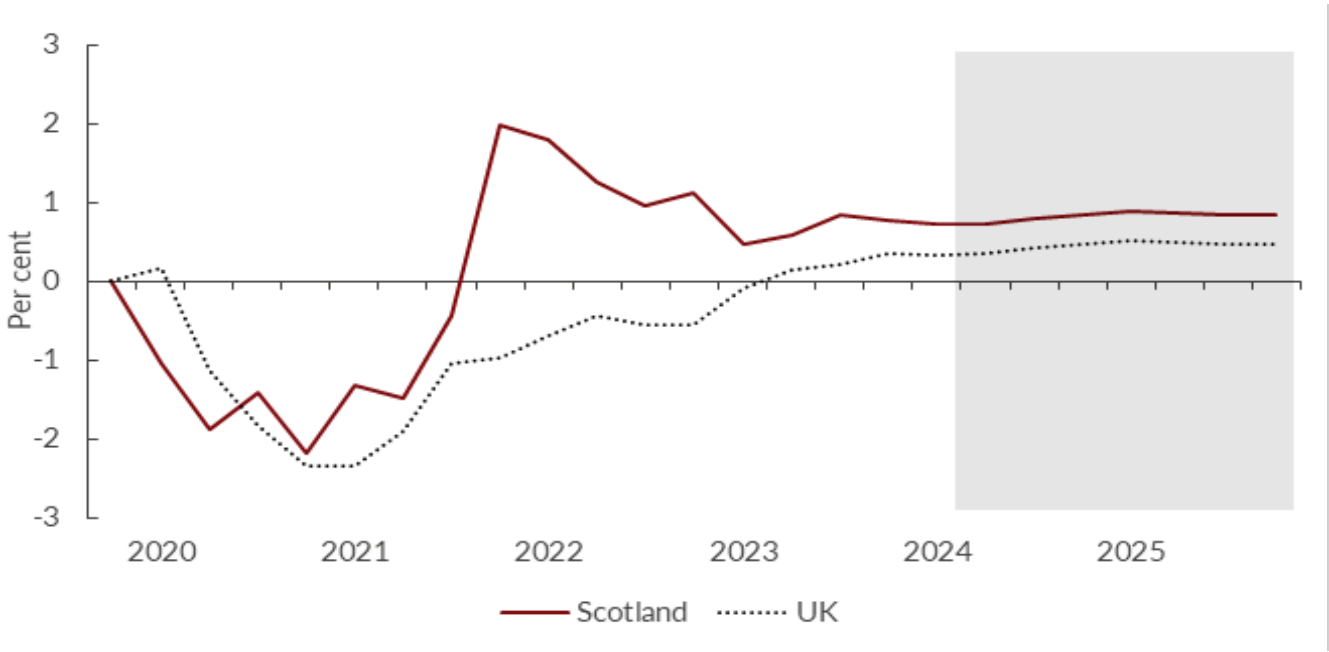
GVA

Figure 2.11 GVA in Scotland relative to the fourth quarter of 2019



Source: NiReMS.

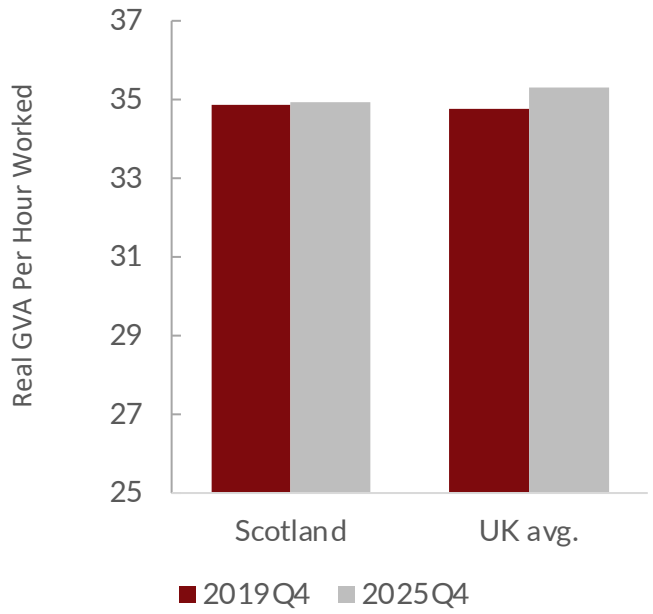
Figure 2.12 Employment in Scotland relative to the fourth quarter of 2019



Source: NiReMS.

Productivity

Figure 2.13 Productivity in Scotland



Source: NiReMS.

Wales Economic Outlook

As highlighted in our Summer 2023 Outlook (Bhattacharjee et al., 2023c), among others, the Wesh economy and society has been facing severe challenges of "global disruptions, inflation, interest rates and energy costs" (Welsh Government, 2023). This is in addition to historic and persistent challenges of low labour force participation and low productivity. In November 2023, the Welsh economy minister set out a four-pronged plan to tackle these challenges, the uncertainty thereof and explore new opportunities: (a) a just transition and green prosperity; (b) a platform for young people, fair work, skills and success; (c) stronger partnerships for stronger regions and Wales' everyday economy; and (d) investing for growth. At the same time, Wales feels let down by £1.3 billion in unreplaced EU structural and rural funding between 2021 and 2025 (Welsh Government, 2024).

The ambition to attract long term investments and better skills/jobs matches is welcome, even if the current prognosis in this respect appears more mixed. The EU funding shortfall has led, in particular, to suspended planned investments in the energy sector and R&D support for universities. On the other hand, Wales has attracted significant FDI (Tata Steel and Rolls Royce, for example) and some Levelling Up investments in the form of two new freeports and associated renewable energy initiatives. Part of this momentum has been disrupted by the recent suspension of Tata Steel's Port Talbot blast furnaces, leading to substantial job losses in the medium run, but a firmer commitment to net zero transition with additional investments towards electric arc furnaces in two years' time (Pigott and Price, 2024). Controversy surrounding the development continues, centred around fair and just transition towards net zero. Meanwhile domestic levelling up funds have been used to fund regeneration of town centre including the transformation of derelict buildings in centres of towns into green space and several projects on improving footpaths and cyclist routes.

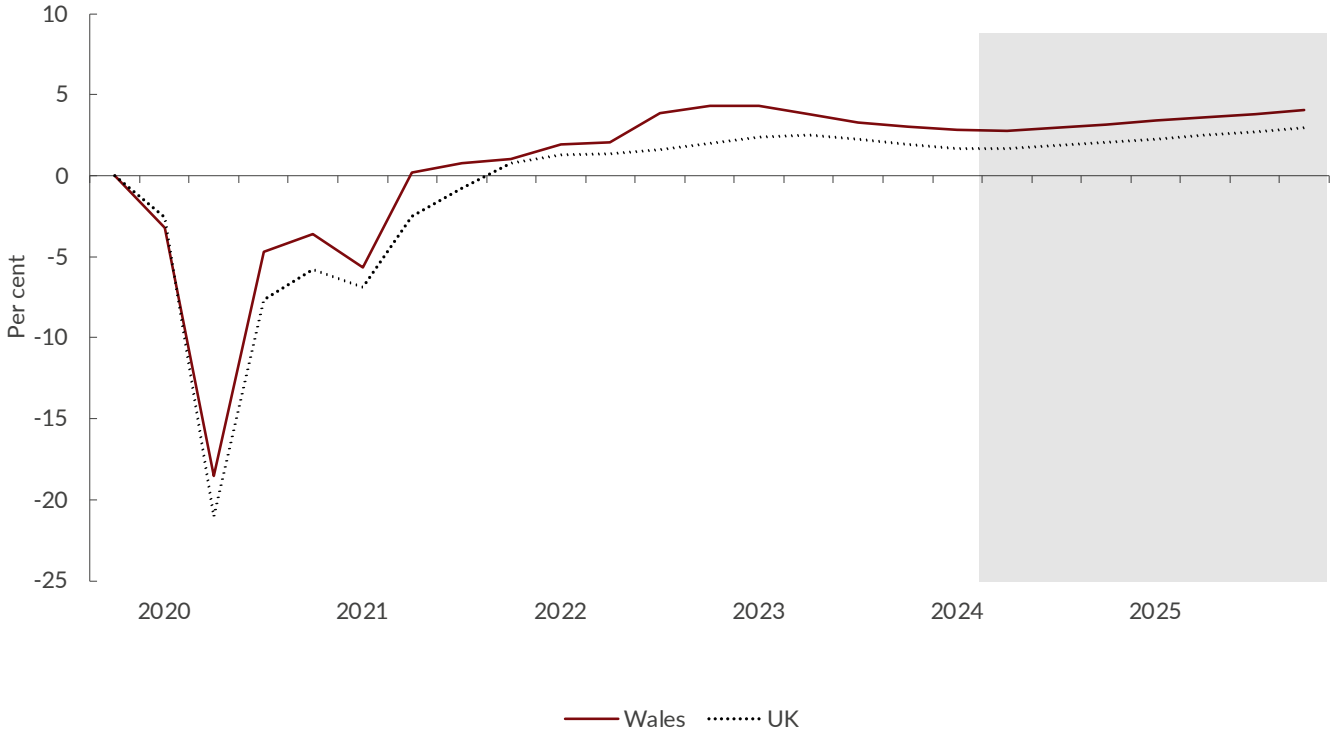
Together, the Welsh Government has also commenced public consultation on an ambitious approach to local government finances. Quite different from the Scottish Government subsidies reported above, the Welsh Government proposes to raise council taxes, which are usually highly regressive, sufficiently at the top end to achieve fiscal sustainability of local authorities. While the outcome of this proposed move to 12 council tax bands remains to be seen, the concern for fairness and innovation in public finances is noteworthy.

We find that

- Gross Value added (GVA) for Wales remains above its pre-pandemic levels and above the UK average. This is projected to continue over the next few years (figure 2.14).
- With the latest revisions in employment data, we have heavily adjusted the projected path of employment for Wales. In particular, with the latest projected paths for UK employment, we no longer expect Welsh employment to retain its pre-pandemic levels.
- Welsh inactivity rates continue to be above the UK average and with worsening employment projections, we expect inactivity rates to increase further (figure 2.8).
- Productivity in Wales is predicted to grow significantly by the fourth quarter of 2025 relative to its pre-pandemic levels (figure 2.16).

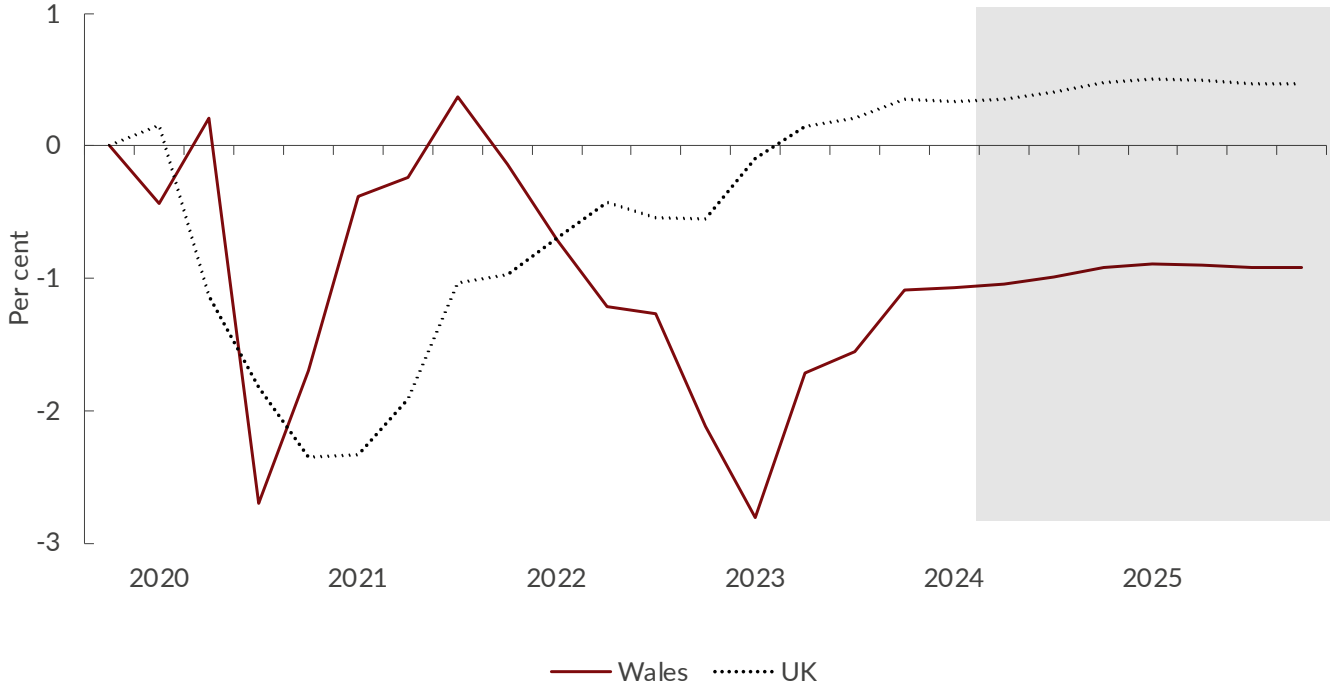
GVA

Figure 2.14 GVA in Wales relative to the fourth quarter of 2019



Source: NiReMS.

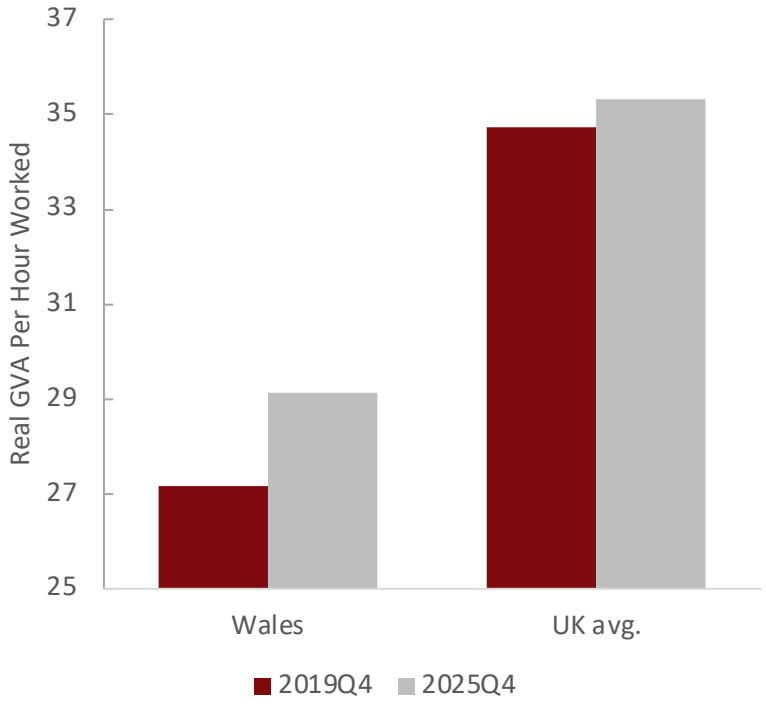
Figure 2.15 Employment in Wales relative to the fourth quarter of 2019



Source: NiReMS.

Productivity

Figure 2.16 Productivity in Wales



Source: NiReMS.

Northern Ireland Economic Outlook

In the early hours of 30 January 2024, the leadership of the Democratic Unionist Party (DUP) agreed a deal with Westminster on post-Brexit trade arrangements that will lead to the return of the Northern Ireland Assembly and the restoration of power-sharing government between the DUP and Sinn Féin. Subject to confirmation, the agreement will involve £3 billion in order to boost public services in Northern Ireland (NI). The other effect will likely be greater business investment as higher public spending (including higher public investment) help unlock private investment.

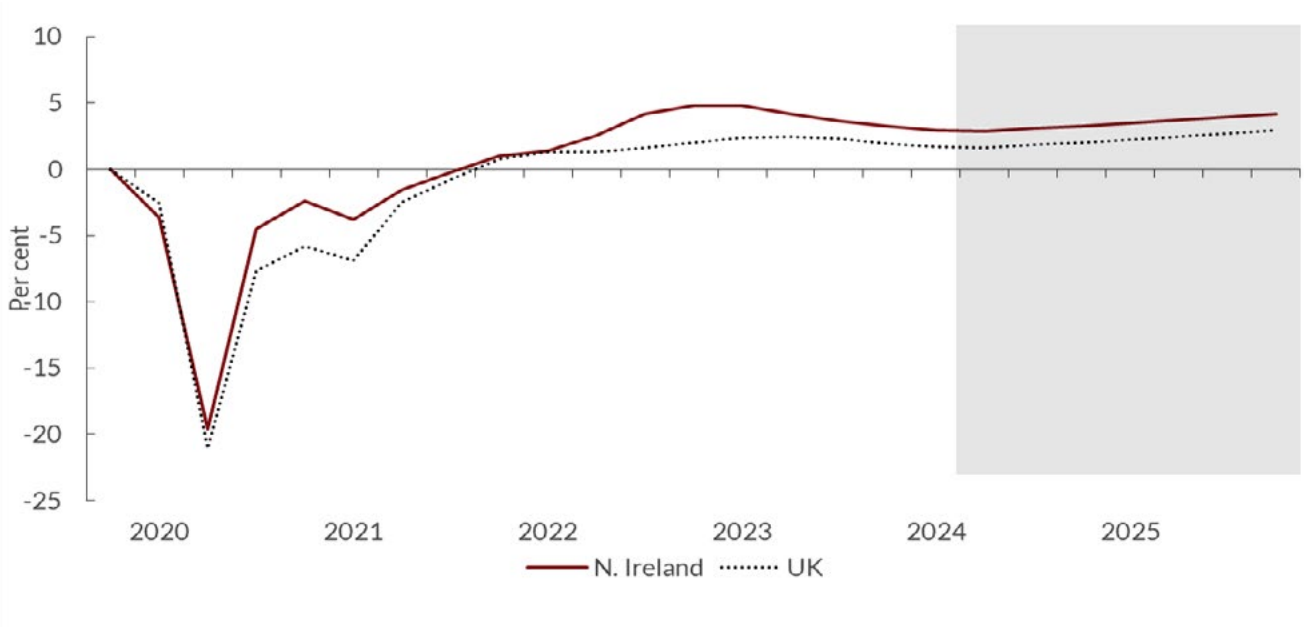
Prior to this hugely significant and long overdue development, political instability had held recovery back as well as negating future growth potential through investments (Belton, 2024). This is despite NI enjoying unique access to both UK and EU markets. While the medium- to long-run implications are positive, there remain many pressing problems in the short run, including stagnating employment and weak productivity growth, but also uncertainty about the viability of restored government and the ongoing tensions over trade arrangements between NI and Great Britain (GB, on the one hand, and the province, the Republic of Ireland and the rest of the EU, on the other hand. As part of restoring power-sharing, the Westminster government's proposal aims to reduce checks and paperwork on goods crossing from GB into NI, with no routine checks.

We find that

- Northern Irish economic output as measured by GVA relative to 2019Q4 is expected to remain above the UK average (figure 2.17).
- The latest employment figures put Northern Ireland's employment path much lower than last outlook. In particular, this means that Northern Ireland will not retain its pre-pandemic levels of employment in the next 2 years (figure 2.18).
- Given the output and employment dynamics, Northern Ireland's productivity rise remains one of the strongest. Nevertheless, overall productivity is still below the UK average (figure 2.19).

GVA

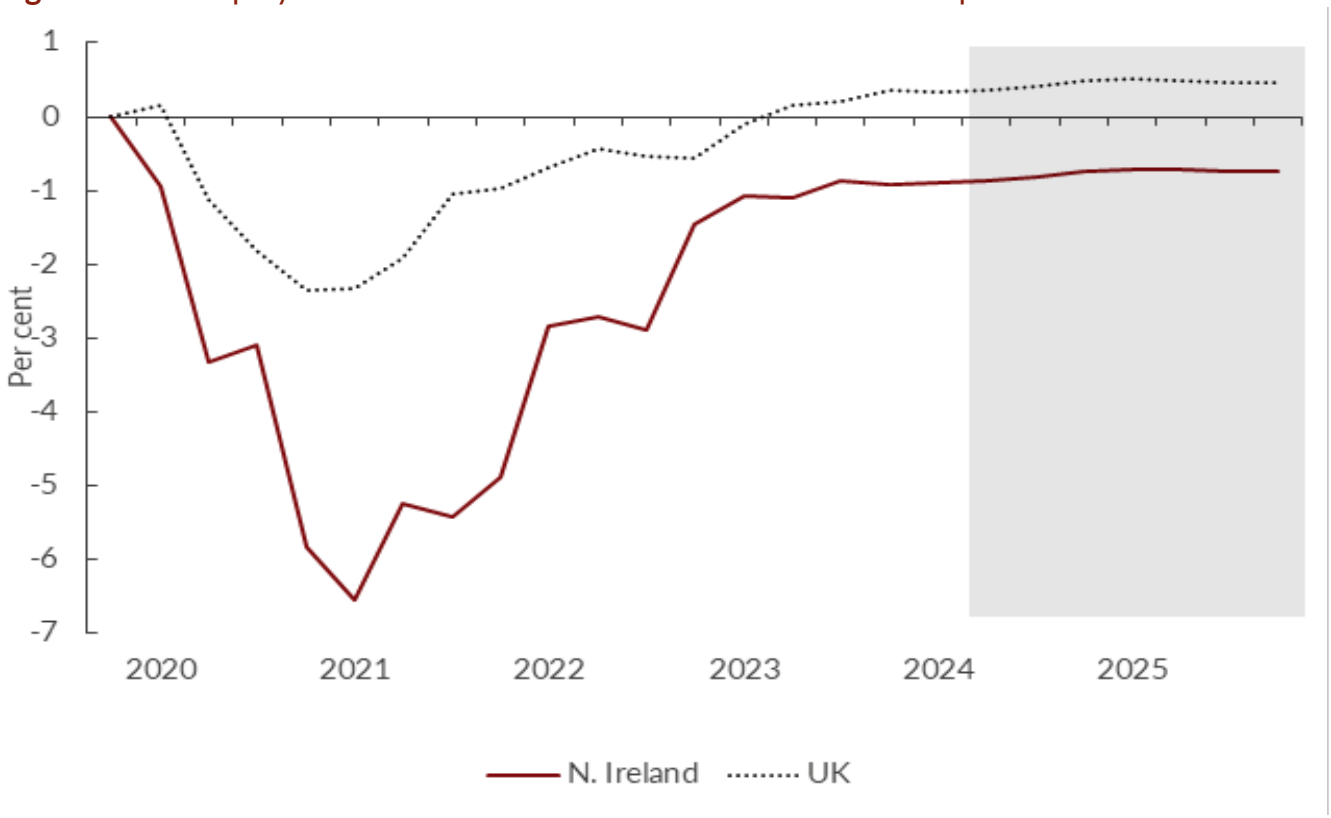
Figure 2.17 GVA in Northern Ireland relative to the fourth quarter of 2019



Source: NiReMS.

Employment

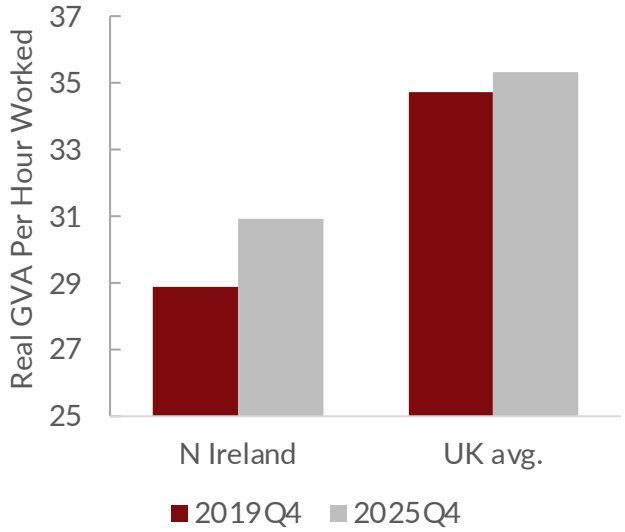
Figure 2.18 Employment in Northern Ireland relative to the fourth quarter of 2019



Source: NiReMS.

Productivity

Figure 2.19 Productivity in Northern Ireland



Source: NiReMS.

Economic Outlook for England's Regions

Since our Autumn Outlook (Bhattacharjee et al., 2023d), the situation in the English regions that are lagging behind London and the metropolitan parts of the South East has been dominated by two issues. First, the government's response to the precarious state of Local Authority (LA) finances and the danger that more LAs might issue section 114 notices and reduce essential service provision (Box C). The second issue concerns the distribution of Round 3 Levelling Up funds (DLUHC, 2023a).

On the first issue, the Government announced an injection of £600 million to help LAs that experience acute financial distress. As the Secretary of State for Levelling Up, Housing and Communities Michael Gove said in a statement to the House of Commons on 24 January, "this includes £500 million of new funding for councils with responsibility for adults and children's social care, distributed through the Social Care Grant. Further details on the exceptional provision of this funding will be set out at the upcoming Budget". This is a step in the right direction, as it will enable LAs to reduce the scale of planned cuts to social care in 2024-45. A further £100 million for core spending notwithstanding, the reductions will affect local communities, in particular some of the most vulnerable people as local councils face a combined deficit of £4 billion over the next two years (LGA, 2023; HoC, 2024). This approach contrasts sharply with policies adopted by the devolved governments in Scotland and Wales.

The other announcement by Michael Gove was in relation to efficiency and productivity:

> we are asking local authorities to produce productivity plans setting out how they will improve service performance and reduce wasteful expenditure to ensure every area is making best use of taxpayers' money. [...] The Department for Levelling Up, Housing and Communities will be establishing an expert panel to advise the Government on financial sustainability in the sector which will include the Office for Local Government and the Local Government Association. The panel will review local authority productivity plans and advise the Government on best practice in this area. The Government will monitor these plans and use them to inform funding Settlements in future years (DLUHC, 2024b).

Linked to this initiative is the disbursement of Round 3 of Levelling Up funds, which – as discussed earlier – is part of the Government's attempt to ramp up public investment in an attempt to boost growth and productivity. While this will take time, the question is how the current spending plans and the built-in fiscal contraction of about 15 per cent after the next election are compatible with the objective to raising the UK's growth rate and productivity performance. Uncertainty over fiscal plans and public investment post-election will hinder the unlocking of greater private investments on which a sustained recovery depends.

Specifically, we find that

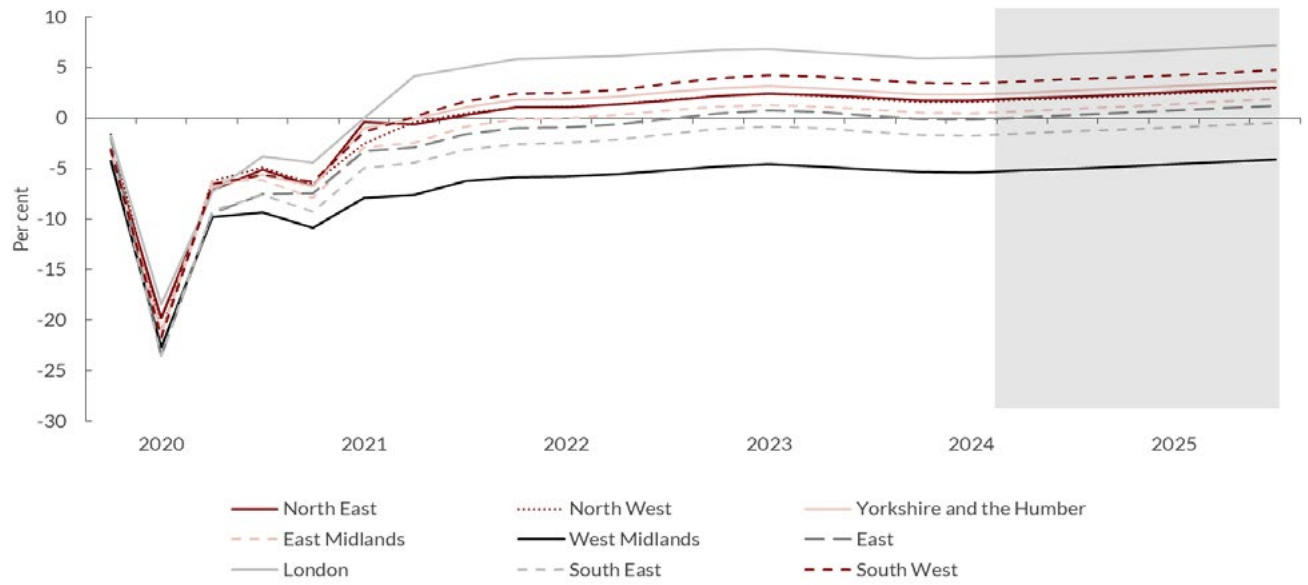
- With the revised employment numbers, the overall outlook for the English regions is worse than previously thought with all English regions projected to stagnate over the next two years (figure 2.21).
- The North East after experiencing a positive uptick in employment levels in early 2023 to a slight downward path towards the end of 2023 is now projected to follow a more flat trajectory at a significant level above its pre-pandemic level over the next two years (figure 2.21).
- The South East and the West Midlands are projected to continue to have lower output compared to their pre-pandemic levels. The South East is no longer projected to regain its pre-

pandemic output by the end of 2025 and is now projected to stay just below its pre-pandemic levels (figure 2.20).

- Unlike the stagnant employment projections, the GVA projections for all English regions follow a subdued positive path (figure 2.20).
- East Midlands and the North West continue to lag significantly below their pre-pandemic levels in regards to employment levels and are not expected to reach pre-pandemic levels over the next two years (figure 2.21).
- The East of England is projected to regain its pre-pandemic level of output during the second quarter of 2024 (figure 2.20).
- The inactivity rates are projected to follow a small upwards trend by similar amounts across all English region (figure 2.22).
- The North East, West Midlands, South East and East of England are projected to remain below their pre-pandemic levels over the next two years in terms of productivity as defined by GVA per hour worked (figure 2.23).

GVA

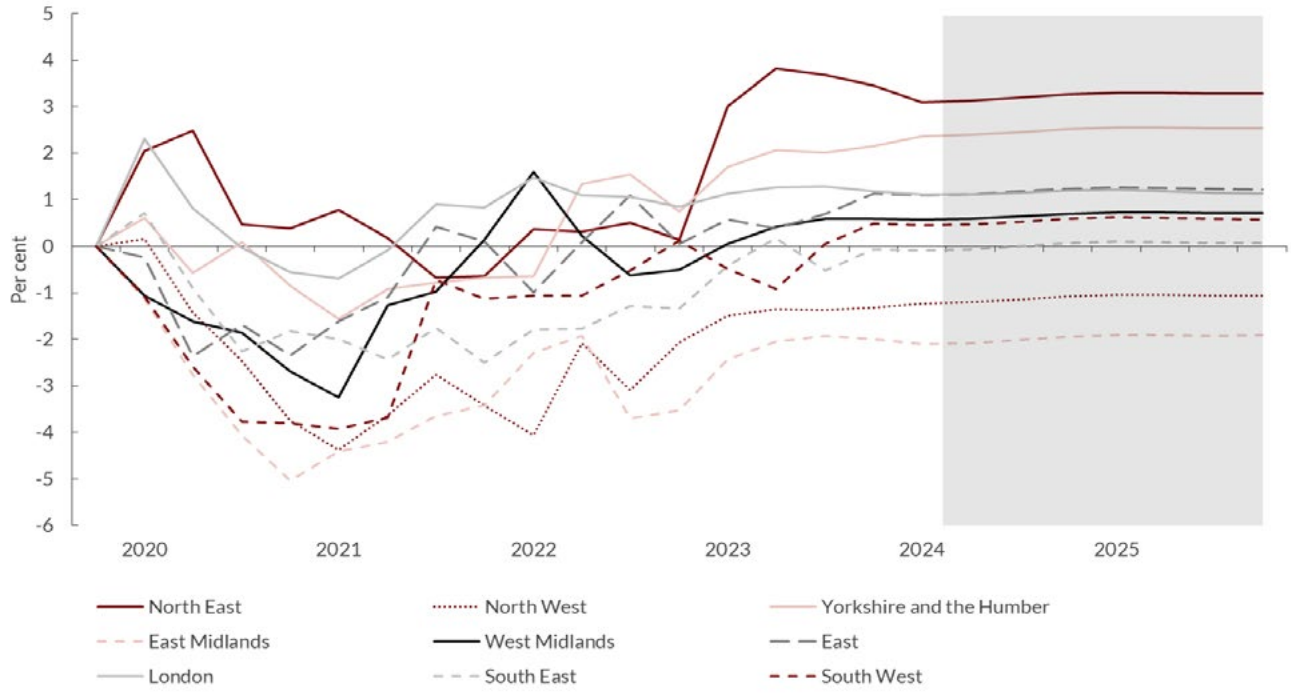
Figure 2.20 GVA in the English regions relative to the fourth quarter of 2019



Source: NiReMS.

Employment

Figure 2.21 Employment in the English regions relative to the fourth quarter of 2019



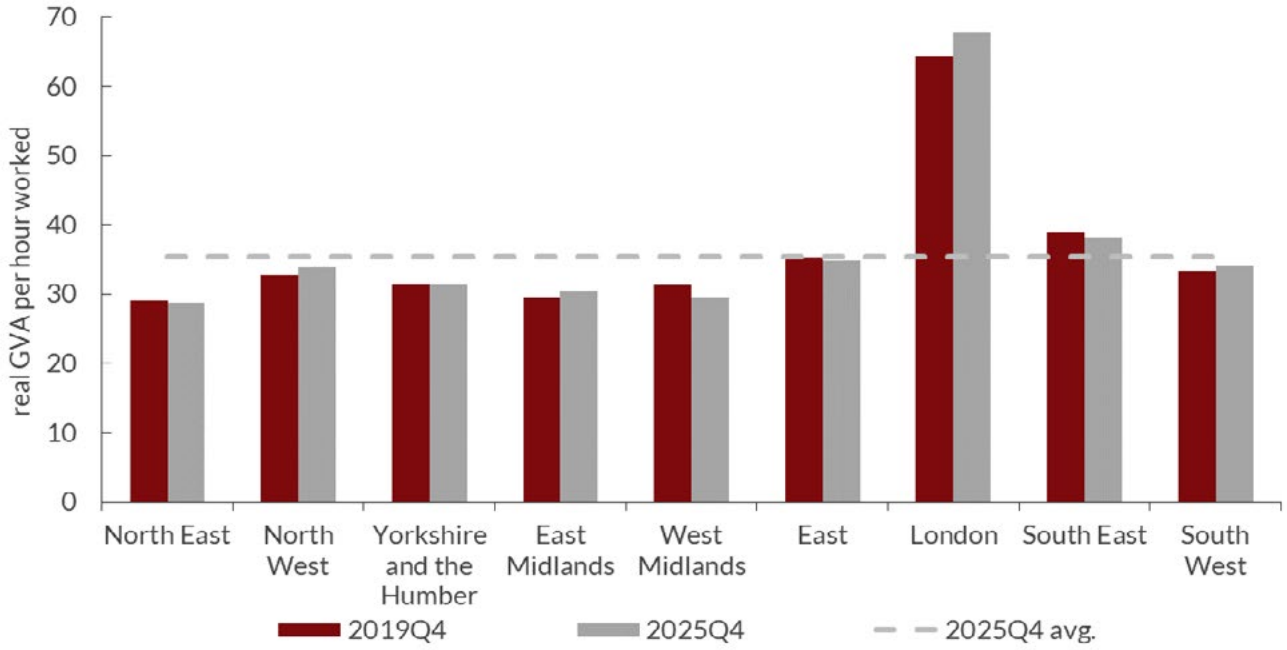
Source: NiReMS

Figure 2.22 Inactivity rates in the English regions

Source: NiReMS.

Productivity

Figure 2.23 Productivity in the English regions



Source: NiReMS.

Box C: The state of local government finances

By Jack Shaw

There is a crisis unfolding across local government which has far-reaching implications that are not fully understood. Since 2021, seven local authorities in England have issued what is formally known as a Section 114 but popularly dubbed a 'bankruptcy notice'. This is historically unprecedented.

The Government has explained these notices as examples of 'localised mismanagement' and cited either poor culture or governance. There is evidence that both poor culture and governance exist across a small number of England's 317 authorities, but the majority are well-managed. How did authorities which employ two million people in England, and are responsible for spending tens of billions on public services every year, get into this situation?

Diagnosis

In 2010, authorities received funding via three routes: council tax, business rates and grant funding from central government. As a result of the Government's programme of fiscal restraint, the grant funding made available to authorities fell sharply – from £46.5 billion in 2010 to £28 billion a decade later. This is the equivalent of a 40 per cent reduction in their 'spending power' (Atkins and Hoddinott, 2020).

In order to address the shortfall, authorities have adopted a series of strategies. In the first instance, they identified savings by 'trimming fat': reducing services and corporate costs, such as back office administration, pursuing digitalisation and introducing voluntary redundancies. The Government adopted a blunt approach when it decided where reductions were applied and, as a result, disadvantaged authorities were subject to more aggressive squeezes. Salami-slicing services gave way to more widespread service transformation as authorities were required to identify more substantial savings, including through redesigning and integrating services or sharing them with neighbouring authorities. Services continued to be reduced – or in some cases discontinued altogether – throughout the mid-2010s. Authorities also began to pursue income generation strategies: introducing a broad range of fees or increasing the amount charged for services, from burial and wedding ceremonies to waste collection and parking, and investing in commercial property, primarily retail and office space, were chief among them. In 2015-16, authorities invested £236 million in commercial assets (NAO, 2020). In 2016-17, that increased seven-fold to £1.8 billion.

Throughout the pandemic, relatively generous support from the Government combined with the temporary closure of services (e.g. leisure centres and libraries) reduced financial pressure and enabled the sector as a whole to increase its reserves. Not all authorities benefitted and in other cases the reduction in income had an adverse effect. Though nuanced, this increase in reserves during Covid-19 has bred scepticism in government that the financial challenges facing authorities are as acute as suggested. This has shaped the Government's response until now.

As authorities came out of the pandemic, service transformation, commercial investment and salami-slicing have increasingly become inadequate to address shortfalls. This is in part driven by post-pandemic pressure on services, with suppressed demand arising from the temporary closure of services increasing late-stage, costlier interventions across social care and public health.

The acuity of the challenge has also been driven by the macroeconomic environment. High inflation has increased the cost of delivering services. High interest rates have increased the cost of borrowing and in some cases revenue streams have become unviable. The cost-of-living crisis has continued to increase the demand for services, while the rise in council tax arrears has increased the debt owed to authorities. Pay awards set by the National Joint Council for the sector has also increased pressure on authorities.

These cost pressures are outpacing economy-wide inflation and by 2024-25 the pressure on authorities will increase by £15 billion, which is equivalent to a 29 per cent increase in the cost of delivering services relative to 2021-22 (LGA, 2023). The rising cost of homelessness and social care have been especially problematic. The cost of homelessness is 26 per cent higher and children's social care 16 per cent higher for the period of April-September 2023 compared with the same period in 2022 (IFS, 2023).

The culmination of over a decade of pressure has upped the ante on authorities. Voluntary redundancies have returned, and in many cases mandatory redundancies have replaced them. In Bradford, 113 employees are at risk of redundancy and in Birmingham that figure is 600. Emergency spending controls have been introduced in dozens of authorities in the last 24 months. And credit ratings agency Moody's has raised concerns about the debt held by authorities, downgrading Warrington Council in 2022.

Given the number of interdependent challenges facing authorities, there is no clear 'typology of failure'. Large urban authorities with high levels of deprivation and affluent suburban authorities are at risk in equal measure, often for different reasons.

How has the government responded?

While the Secretary of State for Levelling Up, Housing & Communities, Michael Gove, acknowledges the challenges facing authorities, the Government has expressed some doubt. Gove told the Levelling Up, Housing & Communities Select Committee that the number of authorities reported by the LGA at risk of failure is an "overestimate" and accused the sector of "crying wolf" (DLUHC, 2023c).

This may explain why the Local Government Finance Settlement (the annual funding allocation for authorities) will be less redistributive in 2024-25 than in 2022-23, with no additional funding for disadvantaged authorities (IFS, 2023). Though upper-tier authorities are entitled to increase council tax by 5 per cent, the Government has 'capped' them from increasing tax further without a referendum.

Curiously, the Government has given a small but growing number of authorities a 'dispensation' to increase council tax by more than 5 per cent without a referendum. This contravenes the spirit of the 'principle of excessiveness' enshrined in the Localism Act (2011) and amounts to a tacit recognition that the framework that underpins local

government finance is increasingly out of kilter with the acute challenges. From April 2024, Thurrock, Slough and Woking, which have all issued high-profile Section 114s, are able to raise council tax by up to 10 per cent without a referendum. Birmingham City Council, which supports over one million residents, has requested a dispensation to raise council tax by 21 per cent by April 2025.

An increasing number of authorities have also requested Exceptional Financial Support. These requests are under consideration by the Government. If approved, they will enable authorities to cover day-to-day spending through the sale of assets or by spreading expenditure over multiple years. Requesting this support is indicative of financial distress. In recent weeks Havering, Bradford, Stoke-on-Trent, Dudley, Middlesbrough and Somerset have announced that they are in this position. More are expected to follow and up to one in five authorities are at serious risk (LGA, 2023b).

Over the last 18 months the Government has adopted a wait-and-see approach. Beyond approving requests for Exceptional Financial Support, it has been non-interventionist prior to bankruptcy notices. When authorities have issued a Section 114, the Government has appointed Commissioners, but it has done so inconsistently. This has led to accusations that their appointment is politicised and Nottingham City Council recently appealed against the Government's decision to introduce Commissioners.

In the medium-term, the pressure on authorities is unlikely to recede. Under the current spending plans announced in the Autumn Statement, investment in public services is expected to fall by 1.4 per cent in real terms between 2024-25 and 2027-28 (Hoddinott, 2023). The Shadow Chancellor, Rachel Reeves, has similarly ruled out substantive investment in public services. Reducing investment in the criminal justice system and schools will also displace pressure, including onto local services.

What more can be done?

Given criticism about Westminster's inaction, it is welcome that the Government is now exploring alternative financial instruments, having launched a new consultation that could give authorities the ability to capitalise day-to-day spending without having to request it (DLUHC, 2023a). This has been met with tentative opposition though following concern that the Government risks normalising an approach which it concedes is neither "prudent or sustainable". It is entirely legitimate to ask questions about the productive capacity of £23 billion in local assets, but there is a risk that if authorities are required to sell assets, it may provide short-term relief but erode their medium-to -long-term resilience (Shaw, 2024).

Financial instruments as yet unexplored are also available. While authorities are required to set a balanced budget every year, NHS Trusts are not. The NHS has greater autonomy over its finances and its 'breakeven duty' enables NHS Trusts to balance their books over three years (or, exceptionally, five). The NHS Act has given NHS Trusts this flexibility since 2006. Likewise, the re-introduction of multi-year settlements, which has been used by both Conservative and Labour governments, could help authorities with longer-term financial planning and enable them to make more strategic decisions. Neither of these alone address the root issues facing authorities, but they should be given consideration.

Announcing a clear set of priorities for local government as part of the Public Sector Productivity Programme is also warranted. While public sector productivity has increased by 0.7 per cent each year from 2010 to 2019, social care – the largest cost for most authorities – has stagnated or become less productive (TPI, 2022). This is not unconnected to the failure to address its inadequate funding model.

The crisis facing authorities also provides the opportunity for a more radical revision of the purpose they serve and the value they add. While a new constitutional settlement may appear distant from the lives of ordinary citizens, there have been issues arising from the lack of clarity over the statutory duties incumbent on authorities, of which not a single authority in England has a full understanding. This is no reflection on the sector. For example, social care is governed by at least 58 Acts of Parliament. Or take the more concrete example of the Public Libraries and Museums Act (1964), which places a statutory duty on authorities to "provide a comprehensive and efficient library service". Yet what 'comprehensive' and 'efficient' mean are subject to multiple interpretations. The number of libraries, their opening times, the services they run, the books they stock and the maintenance their buildings receive are at the discretion of authorities. And even when Birmingham issued a Section 114, it still could not identify its statutory duties. With public satisfaction and trust in authorities at its lowest since 2012, a national conversation is sorely needed (LGA, 2023a).

Despite the challenges with determining the contours of statutory and discretionary services, one option set out by Barnet Council in 2009 is to adopt an 'easyCouncil' model, based on airline EasyJet. Under this model, services could simply retrench to a minimum 'core service' with duties interpreted narrowly. This is undesirable for both authorities, who are at greater risk of judicial review, and citizens, who will receive a poorer service or be denied access to a service to which they are entitled. It will also adversely affect the most vulnerable, including homeless people and those with special educational needs.

The most impactful interventions are either unpalatable to Westminster or have repeatedly been kicked in the long grass. Additional investment for authorities is not likely – or will be limited in scope - given fiscal restraint exercised by central government. Even new tax-raising powers for authorities have failed to earn support from the Government or HMT.

The deeply regressive council tax, based on 1991 property values, requires reform. It has not been re-evaluated since it was introduced, though the Scottish and Welsh devolved governments have managed to do so. The Government should follow in the footsteps of the Welsh Government, which is currently consulting on making council tax fairer (Welsh Government, 2023).

And the long-awaited Review of Relative Needs and Resources (the Fair Funding Review) was designed to address the outdated funding formula that underpins the series of grants the Government allocates to authorities, though it will take place no earlier than 2026.

Though the options on the table might provide authorities with some relief, without both serious reform and substantive investment, more authorities are at risk of failure, confidence in public services will suffer and the public will be denied services which can enrich their lives, protect their health, and support local economies.

Further reading

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Department for Levelling Up, Housing and Communities (2023a) Local government call for views on capital measures to improve sector stability and efficiency

Department for Levelling Up, Housing and Communities (2023b) Local government finance policy statement, 2023-24 to 2024-25

Department for Levelling Up, Housing and Communities (2023c) Oral evidence given to the Levelling Up, Housing and Communities Select Committee by Michael Gove

Game. C. and Wilson, D. (2011) Local government in the United Kingdom

Hoddinott, S. (2023) The Government has abdicated responsibility for public services | Institute for Government

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Concluding reflections ahead of the Budget

For 2024-25, we project a small increase in living standards, with real household disposable income set to rise by 1.9 per cent on average across the income distribution, while still remaining substantially below pre-pandemic levels. However, there are some downside risks: lower than anticipated economic growth, a more persistent inflation rate than currently projected, lower nominal wage growth and cuts to benefits on top of the end of the Cost of Living Payments worth up to £900 which are due to expire in February 2024. The 10 percent rise in the National Minimum Wage and the Living Wage that will come into effect in April 2024 will provide some respite for households at the bottom of the distribution. On the other hand, the cut to the main rate of employee NICs is costly for the Exchequer, has regressive effects and thereby disadvantages households in the lower half of the distribution.

Those households face further strong headwinds over the coming year and beyond. First of all, wage growth is slowing down (Bell, 2024) and thereby holding back the recovery of living standards for households in income deciles 2-5 which tend not to have revenues from nonwage income such as interest income, dividends or bonus payments. Second, the sharp increase in housing costs (both mortgages and rents), coupled with weak wage growth in the period 2008-2022 means that only about one in five people aged 18-34 have their own property and a majority of this age group live with their parents (Burn-Murdoch, 2024). On the other hand, higher interest rates benefit savers and investors who are largely concentrated in the top half of the income distribution.

Third, energy prices are expected to fall by 14 per cent in April 2024, with a typical household bill dropping from £1,928 to £1,620 (Lowrey, 2023), but a return to levels prior to the war in Ukraine will not happen until the end of the forecast horizon (2028-29). There is also downside risk that the disruption in the Red Sea and wider tensions in the Middle East could exacerbate supply chains and raise costs once more. Fourth, the parlous state of local government finances threatens the provision of basic public services. The rise in demand for, and the rising costs of, providing help for homelessness, social care and home-to-school transport for pupils with special needs are inversely related to the fall in central government financial support and the ability for Local Authorities to raise revenue (Box C).

Absent support from Westminster, council taxes may need to rise by more than 5 per cent. Yet the growing burden of council tax on households in the bottom half of the income distribution highlights the fundamental problem: 33 years of differential house-price inflation have made the valuation bands on which council tax is calculated meaningless, leading to a situation where council-tax bills for households in the bottom income decile England represented about 10 per cent of earnings whereas for the wealthiest 10 per cent it is about 2 per cent. All of which makes a revaluation imperative and it raises questions about the need to consider other forms of taxation such as land tax (e.g. Kumhof et al., 2021).

As the Covid-19 and inflationary shocks recede, the policy debate has shifted from short-term firefighting to longer-term planning on how to boost growth and productivity in order to reduce persistent regional inequalities and bring about a sustained recovery of living standards. Both the Budget on 6 March 2024 and the general election, widely expected for autumn 2024, will not just shape the UK policy discussion but also offer opportunities to put forward alternative visions. In the short run, there is urgency to address the financial difficulties facing many local authorities across England, as many of the most vulnerable people depend on the provision of essential public services, such as help for the homeless, adult social care and transport for people with special needs.

In the medium- and long-run, the country needs a plan to raise productivity and consequently wages in line with productivity growth, which in turn requires an ambitious policy programme to boost both public and business investment, allied with institutional reform. The latter should include improving central government coordination of industrial policy (Pabst and Westwood, 2023), better finance for SMEs and a National Development Bank (Chadha, 2023 Bhattacharjee et al., 2023a) with a focus on channelling capital to regions and sectors as part of a more balanced growth strategy based on a new fiscal framework (Chadha et al., 2021). This is in line with the government's stated Levelling Up ambitions and the cross-party consensus on the need to reduce persistent inequalities between and within regions, even if consistent and continuous progress along these dimensions is yet to be evidenced.

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Forecast tables:

Table A1 Exchange rates and interest rates

	UK exchange rates			FTSE All-share index			
	Effective 2017=100	Dollar	Euro		10-year gilts	World[a]	Bank Rate[b]
2018	101.9	1.34	1.13	2937	1.40	2.00	0.75
2019	101.4	1.28	1.14	2898	0.90	2.10	0.75
2020	101.9	1.28	1.13	2537	0.30	0.90	0.10
2021	106.7	1.38	1.16	2900	0.80	1.10	0.13
2022	104.3	1.24	1.17	2953	2.40	2.20	2.83
2023	*105.6*	*1.24*	*1.15*	*3011*	*4.00*	*5.20*	*5.25*
2024	*108.0*	*1.27*	*1.16*	*3197*	*3.80*	*6.40*	*4.50*
2025	*107.7*	*1.27*	*1.16*	*3544*	*3.50*	*5.30*	*3.50*
2026	*107.7*	*1.27*	*1.16*	*3755*	*3.40*	*4.40*	*3.25*
2027	*107.8*	*1.27*	*1.16*	*3880*	*3.40*	*3.90*	*3.25*
2028	107.9	1.27	1.16	3969	3.30	3.70	3.25
2023Q1	*102.7*	*1.22*	*1.13*	*3076*	*3.40*	*4.20*	*3.85*
2023Q2	*105.6*	*1.25*	*1.15*	*3040*	*4.00*	*4.80*	*4.45*
2023Q3	*107.7*	*1.27*	*1.16*	*2969*	*4.40*	*5.70*	*5.16*
2023Q4	*106.6*	*1.24*	*1.15*	*2960*	*4.20*	*6.30*	*5.25*
2024Q1	*108.0*	*1.27*	*1.16*	*3026*	*3.90*	*6.60*	*5.25*
2024Q2	*108.1*	*1.27*	*1.16*	*3153*	*3.80*	*6.60*	*5.00*
2024Q3	*108.1*	*1.27*	*1.16*	*3250*	*3.70*	*6.40*	*4.75*
2024Q4	*108.0*	*1.27*	*1.16*	*3358*	*3.70*	*6.00*	*4.50*
2025Q1	*107.8*	*1.27*	*1.16*	*3445*	*3.60*	*5.70*	*4.25*
2025Q2	*107.7*	*1.27*	*1.16*	*3516*	*3.50*	*5.40*	*4.00*
2025Q3	*107.7*	*1.27*	*1.16*	*3581*	*3.50*	*5.10*	*3.75*
2025Q4	*107.6*	*1.27*	*1.16*	*3634*	*3.50*	*4.90*	*3.50*
Percentage changes							
2018/2017	1.9	3.6	-1.0	0.3			
2019/2018	-0.5	-4.4	0.9	-1.3			
2020/2019	0.5	0.5	-1.3	-12.5			
2021/2020	4.7	7.2	3.3	14.3			
2022/2021	-2.2	-10.1	0.9	1.8			
2023/2022	*1.2*	*0.5*	*-2.1*	*2.0*			
2024/2023	*2.3*	*2.0*	*1.3*	*6.2*			
2025/2024	*-0.3*	*0.2*	*-0.5*	*10.9*			
2026/2025	*-0.1*	*0.1*	*-0.2*	*6.0*			
2027/2026	*0.1*	*0.0*	*0.0*	*3.3*			
2028/2027	*0.1*	*0.0*	*0.0*	*2.3*			
2023Q4/2022Q1	4.3	5.7	0.1	2.5			
2024Q4/2023Q1	*1.3*	*2.2*	*0.8*	*13.4*			
2025Q4/2024Q1	*-0.3*	*0.2*	*-0.6*	*8.2*			

Notes: [a] Weighted average of central bank intervention rates in OECD economies. [b] End of period.

Table A2 Price indices (2019=100)

	Unit labour costs	Imports deflator	Exports deflator	World Oil Price ($)[a]	Consumption deflator	GDP deflator (market prices)	Consumer prices RPI[b]	CPI[c]	CPIH[d]
2018	97.4	98.8	98.1	70.4	98.5	97.9	97.5	98.2	98.3
2019	100.0	100.0	100.0	63.7	100.0	100.0	100.0	100.0	100.0
2020	113.0	98.6	99.8	43.0	100.6	105.3	101.5	100.8	101.0
2021	109.2	103.2	102.9	69.9	102.8	105.0	105.6	103.5	103.5
2022	112.5	119.6	116.3	97.2	110.9	110.4	117.8	112.8	111.7
2023	*120.0*	*118.3*	*120.3*	*82.0*	*118.6*	*119.2*	*129.6*	*121.2*	*119.5*
2024	*123.2*	*110.8*	*117.7*	*79.2*	*121.2*	*123.7*	*136.4*	*123.8*	*122.1*
2025	*127.0*	*111.9*	*118.8*	*77.6*	*124.1*	*126.7*	*140.3*	*126.3*	*125.0*
2026	*131.1*	*114.3*	*120.8*	*76.7*	*127.1*	*129.6*	*144.1*	*129.1*	*128.0*
2027	*135.6*	*116.9*	*123.5*	*77.7*	*130.4*	*132.8*	*149.2*	*132.1*	*131.3*
2028	*139.7*	*119.3*	*125.9*	*78.7*	*133.4*	*135.9*	*154.0*	*134.9*	*134.3*
Percentage changes									
2018/2017	2.8	2.5	2.5	30.5	2.1	1.9	3.3	2.4	2.3
2019/2018	2.7	1.3	1.9	-9.6	1.5	2.1	2.6	1.8	1.7
2020/2019	13.0	-1.4	-0.2	-32.5	0.6	5.3	1.5	0.8	1.0
2021/2020	-3.3	4.6	3.1	62.6	2.2	-0.3	4.1	2.6	2.5
2022/2021	3.0	15.9	13.0	39.0	7.9	5.1	11.6	9.1	7.9
2023/2022	*6.7*	*-1.1*	*3.4*	*-15.6*	*6.9*	*8.0*	*10.0*	*7.4*	*6.9*
2024/2023	*2.6*	*-6.3*	*-2.2*	*-3.5*	*2.2*	*3.8*	*5.2*	*2.2*	*2.2*
2025/2024	*3.0*	*1.0*	*0.9*	*-2.0*	*2.4*	*2.4*	*2.8*	*2.0*	*2.4*
2026/2025	*3.2*	*2.1*	*1.7*	*-1.2*	*2.4*	*2.3*	*2.7*	*2.2*	*2.4*
2027/2026	*3.4*	*2.3*	*2.2*	*1.3*	*2.6*	*2.5*	*3.5*	*2.4*	*2.6*
2028/2027	*3.1*	*2.0*	*2.0*	*1.3*	*2.3*	*2.3*	*3.2*	*2.1*	*2.3*
2023Q4/2022Q1	6.9	-7.1	-1.0	-4.1	4.2	7.1	6.6	4.2	4.5
2024Q4/2023Q1	*1.3*	*-2.9*	*-1.5*	*-6.3*	*2.0*	*2.5*	*4.2*	*2.0*	*2.0*
2025Q4/2024Q1	*2.6*	*1.7*	*1.3*	*-2.0*	*2.3*	*2.2*	*2.5*	*2.1*	*2.3*

Notes: [a] Per barrel, average of Dubai and Brent spot prices. [b] Retail price index. [c] Consumer price index. [d] Consumer prices index, including owner occupiers' housing costs.

Table A3 Gross domestic product and components of expenditure (£ billion, 2019 prices)

	Final consumption expenditure		Gross capital formation		Domestic demand	Total exports[c]	Total final expenditure	Total imports[c]	Net trade	GDP at market prices[d]
	H-Holds & NPISH[a]	General govt.	Gross fixed investment	Changes in inventories[b]						
2018	1413	410	398	4	2223	693	2916	718	-26	2198
2019	1428	427	406	4	2265	707	2972	738	-31	2234
2020	1239	393	363	2	1997	626	2622	620	6	2003
2021	1331	452	390	5	2178	657	2834	658	-1	2176
2022	1398	462	421	2	2282	715	2997	754	-39	2271
2023	*1406*	*456*	*432*	*-10*	*2283*	*713*	*2997*	*739*	*-25*	*2277*
2024	*1410*	*442*	*449*	*-7*	*2293*	*717*	*3009*	*732*	*-15*	*2296*
2025	*1423*	*442*	*453*	*-7*	*2310*	*723*	*3033*	*729*	*-6*	*2323*
2026	*1444*	*439*	*455*	*-7*	*2331*	*736*	*3067*	*737*	*0*	*2349*
2027	*1462*	*437*	*459*	*-7*	*2351*	*743*	*3095*	*744*	*0*	*2370*
2028	*1481*	*436*	*465*	*-7*	*2375*	*754*	*3129*	*755*	*-1*	*2393*
Percentage changes										
2018/2017	2.0	0.6	-0.5		1.4	3.1	1.8	3.1		1.4
2019/2018	1.1	4.0	2.2		1.9	2.0	1.9	2.7		1.6
2020/2019	-13.2	-7.9	-10.8		-11.9	-11.5	-11.8	-16.0		-10.4
2021/2020	7.4	14.9	7.4		9.1	4.9	8.1	6.1		8.7
2022/2021	5.0	2.3	8.0		4.8	9.0	5.8	14.6		4.3
2023/2022	*0.6*	*-1.3*	*2.6*		*0.0*	*-0.3*	*0.0*	*-2.0*		*0.3*
2024/2023	*0.3*	*-3.0*	*3.9*		*0.4*	*0.5*	*0.4*	*-0.9*		*0.9*
2025/2024	*0.9*	*-0.1*	*1.0*		*0.8*	*0.8*	*0.8*	*-0.5*		*1.2*
2026/2025	*1.5*	*-0.6*	*0.4*		*0.9*	*1.9*	*1.1*	*1.1*		*1.1*
2027/2026	*1.3*	*-0.5*	*1.0*		*0.9*	*1.0*	*0.9*	*1.0*		*0.9*
2028/2027	*1.3*	*-0.1*	*1.2*		*1.0*	*1.4*	*1.1*	*1.5*		*0.9*
Decomposition of growth in GDP (percentage points)										
2016	2.3	0.1	0.9	-0.3	2.3	0.7	3.1	-1.2	-0.4	1.9
2017	1.2	0.1	0.6	0.3	1.7	2.0	3.7	-1.0	1.0	2.7
2018	1.3	0.1	-0.1	-0.5	1.4	0.9	2.4	-0.9	0.0	1.4
2019	0.7	0.7	0.4	0.0	1.9	0.6	2.5	-0.9	-0.3	1.6
2020	-8.5	-1.5	-2.0	-0.1	-12.0	-3.6	-15.6	5.2	1.7	-10.4
2021	4.6	2.9	1.3	0.2	9.0	1.4	10.6	-1.8	-0.4	8.7
2022	3.2	0.5	1.4	-0.3	4.8	2.9	7.3	-4.6	-1.7	4.3
2023	*0.3*	*-0.2*	*0.4*	*-0.3*	*0.1*	*-0.8*	*-0.3*	*1.2*	*0.3*	*0.6*
2024	*0.1*	*-0.7*	*-0.6*	*0.0*	*-0.8*	*0.5*	*-0.3*	*0.8*	*1.3*	*0.5*
2025	*0.5*	*-0.5*	*-0.2*	*0.0*	*-0.2*	*1.1*	*0.9*	*0.1*	*1.2*	*1.0*
2026	*0.6*	*-0.2*	*0.2*	*0.0*	*0.6*	*1.1*	*1.7*	*-0.3*	*0.7*	*1.3*

Notes: [a] Non–profit institutions serving households. [b] Including acquisitions less disposals of valuables and quarterly alignment adjustment. [c] Includes Missing Trader Intra–Community Fraud. [d] Components may not add up to total GDP growth due to rounding and the statistical discrepancy included in GDP.

Table A4 External sector

	Exports of goods[a]	Imports of goods[a]	Net trade in goods[a]	Exports of services	Imports of services	Net trade in services	Export price competitiveness[c]	World trade[d]	Terms of trade[e]	Current balance
	£ billion, 2019 prices[b]						2019=100			% of GDP
2018	361	500	-140	332	218	114	101.1	95.7	99.3	-3.9
2019	368	513	-145	339	225	114	100.0	100.0	100.0	-2.7
2020	323	450	-127	303	170	132	99.7	92.4	101.2	-2.8
2021	327	476	-149	330	182	148	104.3	100.5	99.8	-0.5
2022	358	520	-161	357	235	123	104.8	107.6	97.2	-3.1
2023	*330*	*474*	*-144*	*383*	*265*	*119*	*106.4*	*108.0*	*101.7*	*-3.8*
2024	*351*	*484*	*-134*	*366*	*248*	*118*	*105.8*	*112.5*	*106.2*	*-5.6*
2025	*371*	*503*	*-132*	*352*	*226*	*126*	*104.6*	*119.1*	*106.2*	*-4.3*
2026	*386*	*524*	*-138*	*350*	*213*	*137*	*104.3*	*125.3*	*105.8*	*-3.4*
2027	*393*	*539*	*-146*	*351*	*205*	*146*	*104.5*	*130.6*	*105.6*	*-3.0*
2028	*400*	*555*	*-154*	*354*	*201*	*153*	*104.6*	*135.0*	*105.6*	*-2.9*
Percentage changes										
2018/2017	0.5	0.6		6.0	9.5		3.3	3.8	0.0	
2019/2018	2.1	2.6		1.9	3.0		-1.1	4.5	0.7	
2020/2019	-12.3	-12.4		-10.6	-24.2		-0.3	-7.6	1.2	
2021/2020	1.1	5.8		9.0	7.1		4.6	8.8	-1.4	
2022/2021	9.7	9.2		8.3	28.6		0.5	7.1	-2.5	
2023/2022	*-7.8*	*-8.7*		*7.2*	*12.8*		*1.5*	*0.3*	*4.6*	
2024/2023	*6.1*	*2.1*		*-4.4*	*-6.3*		*-0.6*	*4.2*	*4.4*	
2025/2024	*5.7*	*3.9*		*-3.9*	*-8.9*		*-1.1*	*5.9*	*0.0*	
2026/2025	*4.1*	*4.1*		*-0.5*	*-5.7*		*-0.3*	*5.2*	*-0.4*	
2027/2026	*1.8*	*2.9*		*0.1*	*-3.9*		*0.2*	*4.2*	*-0.2*	
2028/2027	*1.8*	*2.9*		*0.9*	*-2.0*		*0.1*	*3.4*	*0.0*	

Notes: [a] Includes Missing Trader Intra–Community Fraud. [b] Balance of payments basis. [c] A rise denotes a loss in UK competitiveness. [d] Weighted by import shares in UK export markets. [e] Ratio of average value of exports to imports.

Table A5 Household sector

	Average[a] earnings	Employee compensation	Total personal income	Gross disposable income	Real disposable income[b]	Final consumption expenditure	Saving ratio[c]	House prices[d]	Net worth to income ratio[e]
	£ billion, current prices				£ billion, 2019 prices		% of GDP	2019=100	
2018	96.4	1042	1809	1402	1424	1413	5.3	99.1	6.8
2019	100.0	1088	1881	1453	1453	1428	5.5	100.0	7.0
2020	100.3	1095	1887	1454	1445	1239	16.8	102.8	7.6
2021	104.9	1156	1988	1508	1467	1331	12.5	111.9	7.6
2022	111.6	1243	2136	1604	1446	1398	8.3	122.8	6.6
2023	*119.0*	*1330*	*2313*	*1750*	*1475*	*1406*	*9.5*	*123.7*	*6.1*
2024	*123.4*	*1377*	*2377*	*1806*	*1490*	*1410*	*10.3*	*120.4*	*6.0*
2025	*128.4*	*1436*	*2478*	*1883*	*1518*	*1423*	*11.0*	*119.1*	*6.0*
2026	*133.7*	*1499*	*2588*	*1967*	*1547*	*1444*	*11.4*	*120.6*	*5.8*
2027	*139.3*	*1564*	*2702*	*2054*	*1575*	*1462*	*11.8*	*123.3*	*5.7*
2028	*144.6*	*1628*	*2814*	*2139*	*1603*	*1481*	*12.2*	*126.3*	*5.6*
Percentage changes									
2018/2017	2.6	4.3	4.1	4.1	2.0	2.0		3.3	
2019/2018	3.8	4.4	4.0	3.6	2.1	1.1		0.9	
2020/2019	0.3	0.7	0.3	0.1	-0.5	-13.2		2.8	
2021/2020	4.6	5.6	5.3	3.7	1.5	7.4		8.8	
2022/2021	6.4	7.5	7.5	6.4	-1.4	5.0		9.7	
2023/2022	*6.6*	*7.0*	*8.3*	*9.1*	*2.0*	*0.6*		*0.7*	
2024/2023	*3.7*	*3.5*	*2.8*	*3.2*	*1.1*	*0.3*		*-2.7*	
2025/2024	*4.0*	*4.2*	*4.3*	*4.3*	*1.8*	*0.9*		*-1.1*	
2026/2025	*4.1*	*4.4*	*4.4*	*4.4*	*2.0*	*1.5*		*1.3*	
2027/2026	*4.2*	*4.4*	*4.4*	*4.4*	*1.8*	*1.3*		*2.3*	
2028/2027	*3.8*	*4.0*	*4.1*	*4.1*	*1.8*	*1.3*		*2.4*	

Notes: [a] Average earnings equals total labour compensation divided by the number of employees. [b] Deflated by consumers' expenditure deflator. [c] Includes adjustment for change in net equity of households in pension funds. [d] Office for National Statistics, mix–adjusted. [e] Net worth is defined as housing wealth plus net financial assets.

Table A6 Fixed investment and capital (£ billion, 2019 prices)

	Gross Capital Formation				User cost of capital (%)	Corporate profit share of GDP (%)	Capital stock	
	Business investment	Private housing[a]	General government	Total			Private	Public[b]
2018	224	108	66	398	12.7	24.8	3771	806
2019	229	110	68	406	12.9	24.6	3832	824
2020	204	89	69	363	13.0	24.3	3839	844
2021	208	105	77	390	10.8	24.3	3860	869
2022	228	115	78	421	10.3	25.1	3910	895
2023	*240*	*108*	*83*	*432*	*13.7*	*25.5*	*3950*	*924*
2024	*238*	*108*	*103*	*449*	*14.0*	*27.4*	*3986*	*970*
2025	*242*	*108*	*103*	*453*	*13.4*	*27.3*	*4022*	*1015*
2026	*247*	*108*	*101*	*455*	*13.2*	*27.0*	*4059*	*1054*
2027	*251*	*111*	*98*	*459*	*13.2*	*26.7*	*4101*	*1088*
2028	*254*	*115*	*96*	*465*	*13.2*	*26.5*	*4147*	*1118*
Percentage changes								
2018/2017	-1.6	6.0	-6.1	-0.5			1.6	2.0
2019/2018	2.1	1.5	3.2	2.2			1.6	2.2
2020/2019	-10.6	-18.8	1.8	-10.8			0.2	2.4
2021/2020	2.0	17.6	10.6	7.4			0.5	3.0
2022/2021	9.6	9.5	1.7	8.0			1.3	3.0
2023/2022	*5.3*	*-5.8*	*7.2*	*2.6*			*1.0*	*3.3*
2024/2023	*-0.8*	*-0.5*	*23.0*	*3.9*			*0.9*	*5.0*
2025/2024	*1.5*	*0.0*	*0.8*	*1.0*			*0.9*	*4.6*
2026/2025	*1.9*	*0.2*	*-2.8*	*0.4*			*0.9*	*3.8*
2027/2026	*1.6*	*2.5*	*-2.4*	*1.0*			*1.0*	*3.3*
2028/2027	*1.5*	*3.7*	*-2.4*	*1.2*			*1.1*	*2.8*

Notes: [a] Includes private sector transfer costs of non–produced assets. [b] Including public sector non–financial corporations.

Table A7 Productivity and the labour market (thousands unless otherwise stated)

	Employment		ILO unemployment	Labour force[b]	Population of working age[c]	Productivity (2019=100) per hour	ILO unemployment rate
	Employees	Total[a]					
2018	27494	32439	1380	33819	41260	99.6	4.1
2019	27652	32799	1306	34105	41344	100.0	3.8
2020	27752	32509	1551	34060	41362	100.6	4.6
2021	28023	32407	1525	33931	41392	102.3	4.5
2022	28324	32744	1262	34006	41532	102.7	3.7
2023	*28424*	*32946*	*1432*	*34378*	*41678*	*102.3*	*4.2*
2024	*28369*	*32923*	*1625*	*34547*	*41853*	*103.6*	*4.7*
2025	*28428*	*33000*	*1686*	*34685*	*41994*	*104.7*	*4.9*
2026	*28501*	*33088*	*1714*	*34802*	*42105*	*105.9*	*4.9*
2027	*28549*	*33149*	*1757*	*34906*	*42197*	*106.8*	*5.0*
2028	*28617*	*33231*	*1779*	*35010*	*42288*	*107.7*	*5.1*
Percentage changes							
2018/2017	1.6	1.2	-6.5	0.9	0.2	0.5	
2019/2018	0.6	1.1	-5.4	0.8	0.2	0.4	
2020/2019	0.4	-0.9	18.8	-0.1	0.0	0.6	
2021/2020	1.0	-0.3	-1.7	-0.4	0.1	1.7	
2022/2021	1.1	1.0	-17.2	0.2	0.3	0.4	
2023/2022	*0.4*	*0.6*	*13.5*	*1.1*	*0.4*	*-0.4*	
2024/2023	*-0.2*	*-0.1*	*13.5*	*0.5*	*0.4*	*1.2*	
2025/2024	*0.2*	*0.2*	*3.8*	*0.4*	*0.3*	*1.2*	
2026/2025	*0.3*	*0.3*	*1.7*	*0.3*	*0.3*	*1.1*	
2027/2026	*0.2*	*0.2*	*2.5*	*0.3*	*0.2*	*0.9*	
2028/2027	*0.2*	*0.2*	*1.3*	*0.3*	*0.2*	*0.9*	

Notes: [a] Includes self–employed, government–supported trainees and unpaid family members. [b] Employment plus ILO unemployment. [c] Population projections are based on annual rates of growth from 2018–based population projections by the ONS.

Table A8 Public sector financial balance and borrowing requirement (£ billion, fiscal years)

		2019–20	2020–21	2021–22	2022–23	*2023–24*	*2024–25*	*2025–26*	*2026–27*
Current receipts:	Taxes on income	495.7	567.1	633.0	690.2	*742.4*	*784.4*	*816.9*	*848.4*
	Taxes on expenditure	144.8	260.5	319.2	325.2	*292.2*	*302.6*	*315.1*	*327.0*
	Other current receipts	153.1	91.0	69.3	109.8	*116.5*	*115.9*	*116.9*	*121.4*
	Total	793.6	918.6	1021.5	1125.2	*1151.1*	*1202.8*	*1248.9*	*1296.8*
	(as a % of GDP)	36.9	38.0	39.0	39.9	*40.0*	*40.0*	*40.2*	*40.7*
Current expenditure:	Goods and services	495.8	512.9	526.3	544.7	*546.9*	*561.4*	*577.6*	*594.1*
	Net social benefits paid	262.9	261.6	280.7	314.8	*322.6*	*335.9*	*352.4*	*373.3*
	Debt interest	42.4	77.3	131.8	110.7	*107.6*	*113.8*	*118.2*	*122.1*
	Other current expenditure	180.9	84.5	108.8	66.9	*58.4*	*61.1*	*62.0*	*62.8*
	Total	982.0	936.2	1047.6	1037.1	*1035.6*	*1072.2*	*1110.1*	*1152.2*
	(as a % of GDP)	35.4	47.1	39.8	40.8	*40.0*	*38.8*	*38.2*	*37.5*
Depreciation		53.7	55.1	60.2	61.2	*63.1*	*65.3*	*67.6*	*69.9*
Surplus on public sector current budget[a]		-242.2	-72.8	-86.3	26.8	*52.4*	*65.3*	*71.1*	*74.7*
(as a % of GDP)		-11.8	-3.1	-3.3	0.9	*1.8*	*2.2*	*2.3*	*2.4*
Gross investment		123.3	114.0	109.1	209.5	*243.9*	*244.3*	*249.3*	*253.6*
Net investment		69.6	58.9	48.9	148.3	*180.8*	*179.1*	*181.6*	*183.7*
(as a % of GDP)		1.7	3.4	2.4	2.0	*3.8*	*3.3*	*3.1*	*2.9*
Total managed expenditure		1105.3	1050.2	1156.7	1246.7	*1279.5*	*1316.6*	*1359.4*	*1405.9*
(as a % of GDP)		39.4	53.0	44.5	45.2	*46.0*	*44.3*	*43.6*	*42.7*
Public sector net borrowing		311.8	131.7	135.3	116.5	*136.6*	*113.8*	*82.1*	*73.7*
(as a % of GDP)		2.5	14.9	5.5	5.2	*5.6*	*4.5*	*3.2*	*1.7*
Public sector net debt (% of GDP)		81.1	100.9	97.8	96.9	*95.2*	*94.5*	*92.6*	*90.7*
GDP deflator at market prices (2019=100)		106.2	105.4	112.5	121.2	*124.3*	*127.2*	*130.4*	*133.6*
Money GDP (£ billion)		2086	2354	2558	2760	*2865*	*2963*	*3071*	*3174*

Notes: These data are constructed from seasonally adjusted national accounts data. This results in differences between the figures here and unadjusted fiscal year data. Data exclude the impact of financial sector interventions, but include flows from the Asset Purchase Facility of the Bank of England. [a] Public sector current budget surplus is total current receipts less total current expenditure and depreciation.

Table A9 Accumulation (percentage of GDP)

	Households		Companies		General government		Whole economy		Finance from abroad[a]		Net national saving
	Saving	Investment	Saving	Investment	Saving	Investment	Saving	Investment	Total	Net factor income	
2018	3.6	4.8	9.3	10.8	1.3	2.6	14.3	18.2	3.9	1.3	-0.5
2019	3.7	4.7	10.8	11.0	1.1	2.7	15.7	18.4	2.7	0.0	0.8
2020	12.2	4.3	10.8	10.1	-8.4	3.1	14.7	17.5	2.8	2.1	-1.6
2021	8.7	4.4	12.5	10.5	-3.8	3.1	17.5	17.9	0.5	-0.5	2.1
2022	5.6	4.7	11.1	10.9	-1.2	3.0	15.5	18.7	3.1	-0.5	0.5
2023	*6.5*	*4.5*	*8.2*	*10.7*	*0.8*	*4.0*	*15.5*	*19.2*	*3.8*	*2.4*	*0.6*
2024	*6.9*	*4.8*	*5.3*	*11.7*	*3.9*	*5.1*	*16.0*	*21.6*	*5.6*	*5.6*	*1.2*
2025	*7.4*	*4.8*	*5.8*	*12.0*	*3.8*	*4.5*	*17.0*	*21.3*	*4.3*	*4.6*	*2.2*
2026	*7.8*	*4.8*	*5.4*	*12.2*	*4.8*	*4.3*	*18.0*	*21.3*	*3.4*	*3.8*	*3.2*
2027	*8.1*	*4.9*	*4.7*	*12.3*	*5.6*	*4.1*	*18.3*	*21.4*	*3.0*	*3.5*	*3.5*
2028	*8.4*	*5.1*	*6.0*	*12.4*	*4.1*	*4.0*	*18.6*	*21.5*	*2.9*	*3.3*	*3.8*

Notes: Saving and investment data are gross of depreciation unless otherwise stated. [a] Negative sign indicates a surplus for the UK.

Table A10 Medium– and long–term projections (percentage change unless otherwise stated)

	2022	2023	2024	2025	2026	2027	2028	2029-2033
GDP (market prices)	4.3	0.3	0.9	1.2	1.1	0.9	0.9	0.9
Average earnings	6.4	6.6	3.7	4.0	4.1	4.2	3.8	3.4
GDP deflator (market prices)	5.1	8.0	3.8	2.4	2.3	2.5	2.3	2.1
Consumer Prices Index	9.1	7.4	2.2	2.0	2.2	2.4	2.1	1.8
Per capita GDP	3.4	-0.3	0.4	0.7	0.7	0.5	0.6	0.6
Whole economy productivity[a]	0.4	-0.4	1.2	1.2	1.1	0.9	0.9	1.0
Labour input[b]	3.6	0.7	-0.2	0.0	0.1	0.0	0.1	-0.1
ILO Unemployment rate (%)	3.7	4.2	4.7	4.9	4.9	5.0	5.1	5.3
Current account (% of GDP)	-3.1	-3.8	-5.6	-4.3	-3.4	-3.0	-2.9	-3.0
Total managed expenditure (% of GDP)	44.5	45.2	46.0	44.3	43.6	42.7	41.2	42.6
Public sector net borrowing (% of GDP)	5.5	5.2	5.6	4.5	3.2	1.7	-0.7	2.8
Public sector net debt (% GDP)	97.8	96.9	95.2	94.5	92.6	90.7	86.9	82.2
Effective exchange rate (2011=100)	104.3	105.6	108.0	107.7	107.7	107.8	107.9	108.2
Bank Rate (%)	1.5	4.7	4.9	3.9	3.3	3.3	3.3	3.3
10 year interest rates (%)	2.4	4.0	3.8	3.5	3.4	3.4	3.3	3.3

Notes: [a] Per hour. [b] Total hours worked.

Table A11 Gross Value Added by sector percentage change

	2019	2020	2021	2022	2023	2024	2025	2026	2027
Utilities and agriculture	8.4	1.0	-14.4	-3.7	-1.2	1.3	2.1	3.0	2.5
Mining and quarrying	1.8	0.1	-23.4	-1.0	-12.8	-0.8	0.1	-0.1	-0.3
Manufacturing	0.5	2.2	1.6	-3.3	1.7	2.6	1.2	0.9	0.8
Construction	0.6	-12.6	9.8	6.8	2.5	-0.7	0.9	1.2	0.7
Public sector	2.1	-20.4	17.8	8.9	0.1	-0.4	0.0	0.3	0.5
Private non-traded services	1.0	-17.4	15.3	5.1	-2.8	-5.5	1.5	1.5	1.5
Financial services	-2.7	-1.6	5.4	1.0	-0.5	0.5	0.1	0.2	0.3
Imputed rent	1.4	0.3	1.4	1.1	0.9	0.2	0.5	0.6	0.6
Private traded services	4.0	-8.6	8.8	7.1	2.2	0.8	1.0	1.1	1.2
Total economy	1.8	-10.0	8.4	4.4	0.2	-0.7	0.8	0.9	1.0

Notes: NiSEM database and forecast. Public sector is composed of Public administration and defence, compulsory social security (O), Education (P) and Human Health and Social Work activities (Q). Private non-traded services sector is composed of Wholesale and Retail Trade, Repair of Motor vehicles and Motorcycles (G), Accommodation and Food services (I), Arts, Entertainment and Recreation (S), Real Estate Activities excluding imputed rent (L-68.2IMP) and Activities of Households as Employers (T). Private traded sector is composed of Professional, Scientific and Technical Activities (M), Transport and Storage (H), Information and Communication (J) and Administrative and Support Services Activities (N).

Notes

Notes

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National Institute of Economic and Social Research
2 Dean Trench St
London SW1P 3HE
T: +44 (0)20 7222 7665
E: enquiries@niesr.ac.uk
W: niesr.ac.uk