The Prospects Service

LEADING ECONOMIC ANALYSIS, FORECASTS AND DATA

UK Prospects, December 2023

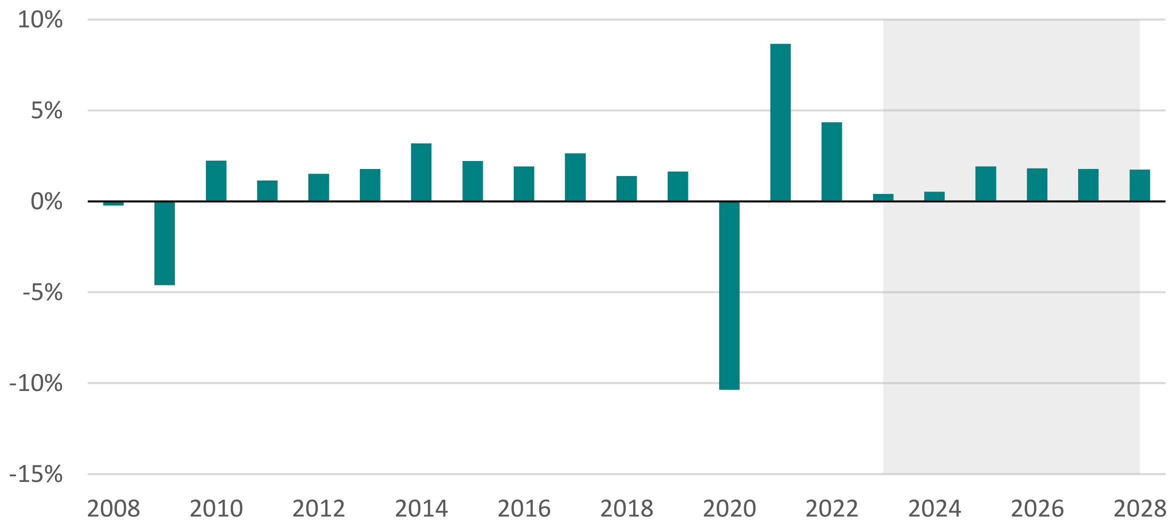
Making Business Sense

UK economy facing ongoing growth slowdown

Toplines

- Across Q3, UK GDP was stagnant relative to the previous quarter. **Looking ahead, this feeble growth trajectory is set to persist. Indeed, Cebr expects the economy to experience a technical recession across Q4 2023 and Q1 2024.**
- **In annual terms, Cebr projects weak growth rates of just 0.4% and 0.5% across 2023 and 2024, respectively.**
- Inflation slowed sharply in October, reaching 4.6%, driven predominantly by annual falls in energy prices. **Cebr expects inflation to decelerate further in the months ahead, as the effects from lower energy prices persist and broader slowdowns in other consumption categories continue.**
- However, inflation is expected to linger above target for a protracted period. **We do not expect inflation to be sustainably below 3.0% until 2025. Meanwhile, a return to target is not forecasted until the late 2020s.**
- **As a result of the expected recession, Cebr projects an uptick in the unemployment rate, peaking at 5.0% in Q2.**
- **The Bank of England base rate is expected to remain at its current rate of 5.25% until mid-2024 due to persistently above-target inflation. Beyond this point, the Monetary Policy Committee is expected to commence a gradual cutting process**.

UK GDP growth



Source: ONS, Cebr analysis

GDP and policy

- UK GDP grew by 0.2% in September, marking a second consecutive month of expansion. Across Q3, the economy was stagnant relative to the previous quarter.
- September's monthly growth was supported by the services sector, for which output was up by 0.2% relative to August.
- There was mixed experience amongst services subsectors, however. For instance, professional, scientific, and technical activities saw strong monthly growth of 1.0%, while human health and social work activities reported growth of 0.8%.
- At the other end of the scale, consumer-facing services saw output decline by 0.2% on the month. This largely reflects the ongoing effects of living cost pressures, with elevated inflation and curtailed spending power discouraging consumer activity.
- The broader picture of stagnant activity in Q3 highlights the economy's ongoing weak growth performance. Such weak growth reflects several economic headwinds, including the aforementioned pressures on consumers, as well as supply chain difficulties and the tighter monetary policy environment.
- Looking ahead, this feeble growth trajectory is set to persist. Indeed, Cebr expects the economy to experience a technical recession across Q4 2023 and Q1 2024.
- In annual terms, Cebr projects weak growth rates of just 0.4% and 0.5% across 2023 and 2024, respectively.

Source: ONS, Cebr analysis

- The Bank of England's Monetary Policy Committee (MPC) kept interest rates on hold at its November meeting. The base rate is expected to remain at its current rate of 5.25% until mid-2024, due to persistently elevated inflation. Beyond this point, the MPC is expected to commence a gradual cutting process.
- At the recent Autumn Statement, the Chancellor unveiled a number of fiscal policy developments. One key focus was the labour market, with policies such as the cut to National Insurance contribution rates and the uplift to the National Living Wage implemented with the dual purpose of improving the spending power of workers and encouraging higher rates of labour force participation.
- Other key policies announced in the Autumn Statement include changes to the expensing of capital allowances and planning reform. All else equal, these policies are expected to boost investment. Accordingly, Cebr has adjusted its growth forecast for this variable in the long run.

Inflation and labour market

- The rate of inflation on the Consumer Prices Index (CPI) measure stood at 4.6% in October. This represented a sharp deceleration from September's price growth of 6.7% and represented the weakest inflation rate for two years.
- Core inflation slowed to 5.7% in October, down from 6.1% in September.
- October's slowdown in headline inflation was predominantly driven by energy prices, with the Ofgem price cap falling this October and standing considerably short of its value a year ago. This contributed to sharp deflation in categories such as electricity and gas, at annual rates of 15.6% and 31.0%, respectively.
- Cebr expects inflation to continue decelerating in the months ahead, with the effect from lower energy prices set to persist for some time and broader slowdowns in other consumption categories likely to continue.
- However, there is a risk that inflation will decelerate relatively slowly in 2024. The continually elevated rate of core inflation suggests that price pressures remain embedded in the economy, while above-average wage growth presents a further upside risk to inflation.
- Price pressures from elevated wage growth will likely feed more strongly into services inflation than goods inflation, given the former's greater exposure to rising labour costs. There is evidence that inflation is already shifting towards services, with price growth for this category amounting to 6.6% in October, compared to goods inflation of 2.9%.

Consumer price inflation

Source: ONS, Cebr analysis

- Experimental labour market figures showed that the unemployment rate stood at 4.2% in Q3.
- Broader indicators point to a loosening of the labour market. For instance, the number of vacancies is on a firm downward trajectory, falling by 257,000 annually in the three months to October.
- Earnings growth has slowed recently. Annual growth in total pay slowed from 8.4% in Q2 to 7.9% in Q3. This is still significantly stronger than historical averages, however. Cebr expects the trend of slowing but historically elevated earnings growth to persist into 2024.
- As a result of the expected recession, Cebr projects an uptick in the unemployment rate, peaking at 5.0% in Q2.

Industry outlook

	Real output, year-on-year change			
Industry	2022	2023*	2024*	Comment
Manufacturing	-3.3%	1.2%	1.1%	Output in the manufacturing sector grew by just 0.1% on the quarter in Q3, a significant slowdown from Q2's expansion of 1.9%. Looking ahead, Cebr has revised its long-term forecast for manufacturing growth upwards. The sector is expected to be one of the main beneficiaries of the policies announced at the recent Autumn Statement, notably the permanent full expensing of capital allowances.
Construction	6.5%	2.8%	-0.4%	Activity in the housing market remains subdued as high mortgage rates reduce affordability and deter potential buyers. Cebr expects construction sector growth to slow to 2.8% in 2023, down from 6.5% in the previous year. For 2024, the sector is expected to see falling output, at an annual rate of 0.4%. This is expected to be accompanied by a house price correction, driven by similar factors.
Financial & Business Services	2.6%	0.5%	0.9%	The financial and business services sector saw a stagnation in output in Q3. This marked a second consecutive quarter without growth, following a contraction in Q2. The sector is expected to show continually weak growth for a number of quarters. The main headwind affecting financial and business services is the tighter monetary policy environment, which impacts several operational streams amongst financial businesses, including lending, borrowing, and investment.
Wholesale & Retail	0.6%	-1.1%	0.6%	Output in the wholesale and retail sector was stagnant in Q3. This marked a third consecutive quarter without growth, having experienced contractions in the earlier quarters of 2023. Such weak performance reflects the ongoing effects of living cost pressures, which have reduced activity amongst consumers. Cebr's forecast for the sector has been revised upwards since the last edition of this report. Recent policy changes announced at the Autumn Statement, including the cut to National Insurance contribution rates and uplifts to the National Living Wage and social securities will boost households' disposable income. This will likely impact demand for retail and other consumer-facing services more broadly.

*Forecast

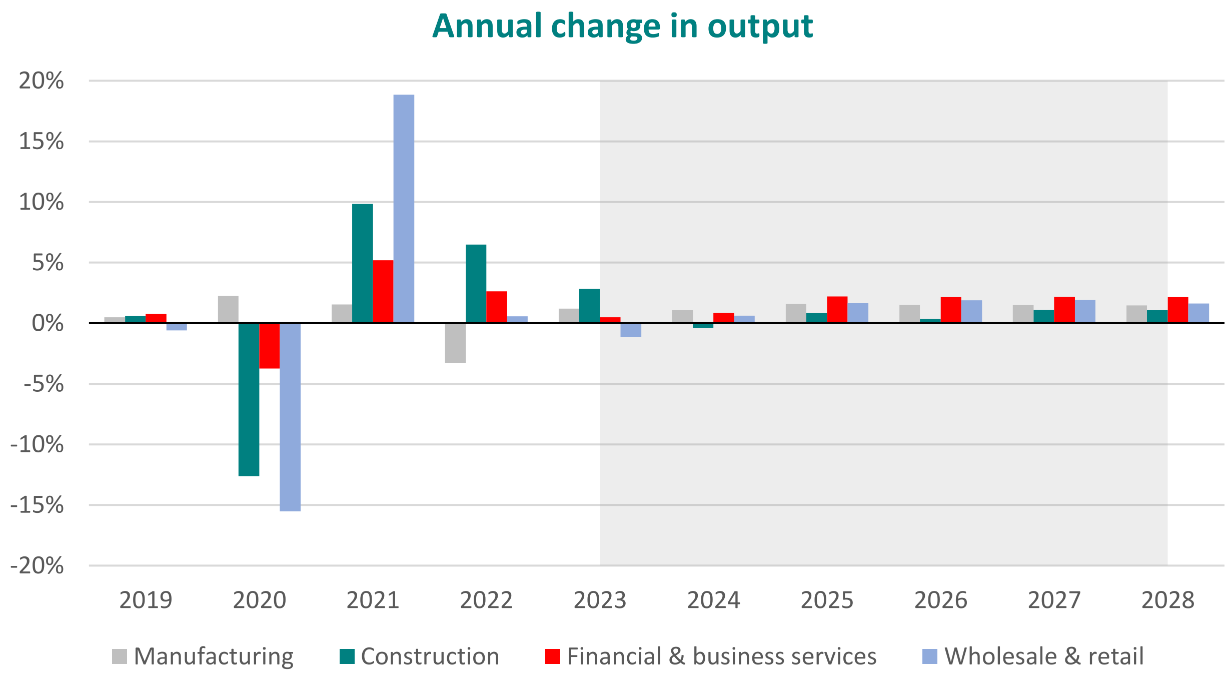
Forecast table

Year-on-year change, unless otherwise indicated	2020	2021	2022	2023	2024	2025	2026	2027
GDP	-10.4%	8.7%	4.3%	0.4%	0.5%	1.9%	1.8%	1.8%
Consumer spending	-13.0%	7.5%	4.9%	0.4%	0.6%	1.8%	2.1%	1.9%
Household disposable income	-0.1%	1.3%	-2.0%	2.6%	4.4%	1.7%	1.5%	1.5%
Business investment	-10.6%	2.0%	9.6%	5.6%	-0.7%	2.1%	2.0%	2.3%
Imports	-16.0%	6.1%	14.1%	-0.4%	3.9%	2.6%	2.7%	2.1%
Exports	-11.5%	4.9%	8.6%	-1.1%	1.2%	2.2%	1.9%	2.0%
Unemployment rate (%)	4.6%	4.5%	3.7%	4.2%	4.8%	4.5%	4.2%	4.0%
Average gross employee earnings (incl. bonuses)	1.8%	5.9%	6.1%	7.4%	5.4%	3.5%	3.0%	3.1%
CPI inflation	0.9%	2.6%	9.1%	7.4%	3.5%	2.8%	2.2%	2.1%
Bank rate	0.21%	0.11%	1.54%	4.73%	4.69%	3.21%	2.27%	2.08%
$/£	$1.28	$1.38	$1.24	$1.24	$1.20	$1.22	$1.23	$1.25
€/£	€ 1.13	€ 1.16	€ 1.17	€ 1.15	€ 1.13	€ 1.15	€ 1.15	€ 1.19
UK 10-year gilt yields, %	0.4%	0.8%	2.4%	4.2%	4.4%	3.3%	2.3%	2.0%
Real output, manufacturing	2.3%	1.5%	-3.3%	1.2%	1.1%	1.6%	1.5%	1.5%
Real output, construction	-12.6%	9.8%	6.5%	2.8%	-0.4%	0.8%	0.4%	1.1%
Real output, financial & business services	-3.7%	5.2%	2.6%	0.5%	0.9%	2.2%	2.2%	2.2%
Real output, wholesale & retail	-15.5%	18.9%	0.6%	-1.1%	0.6%	1.6%	1.9%	1.9%

More forecasts can be found by accessing the Cebr databank via the TPS Members' Area of our website.

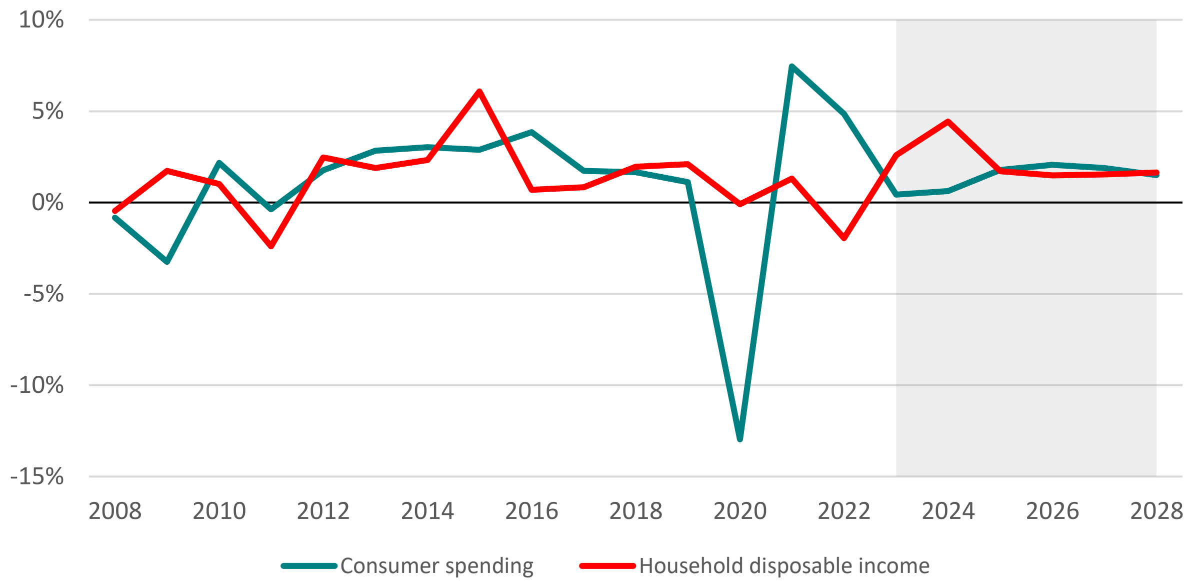
Key charts

Source: ONS, Cebr analysis



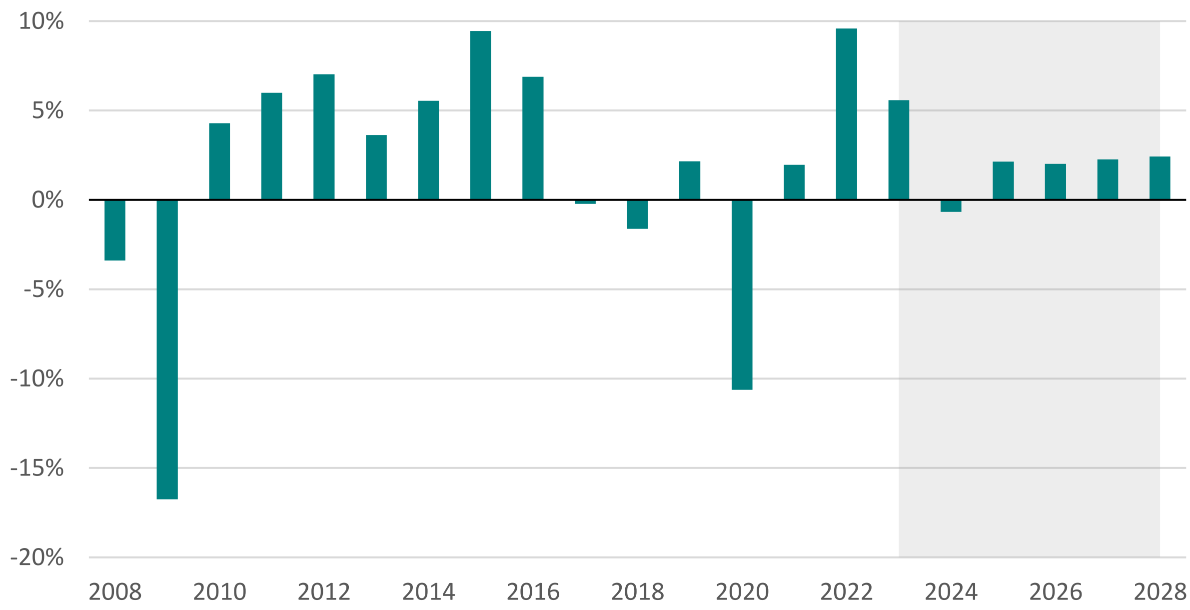
Source: ONS, Cebr analysis

Real consumer spending and household disposable income, annual % change



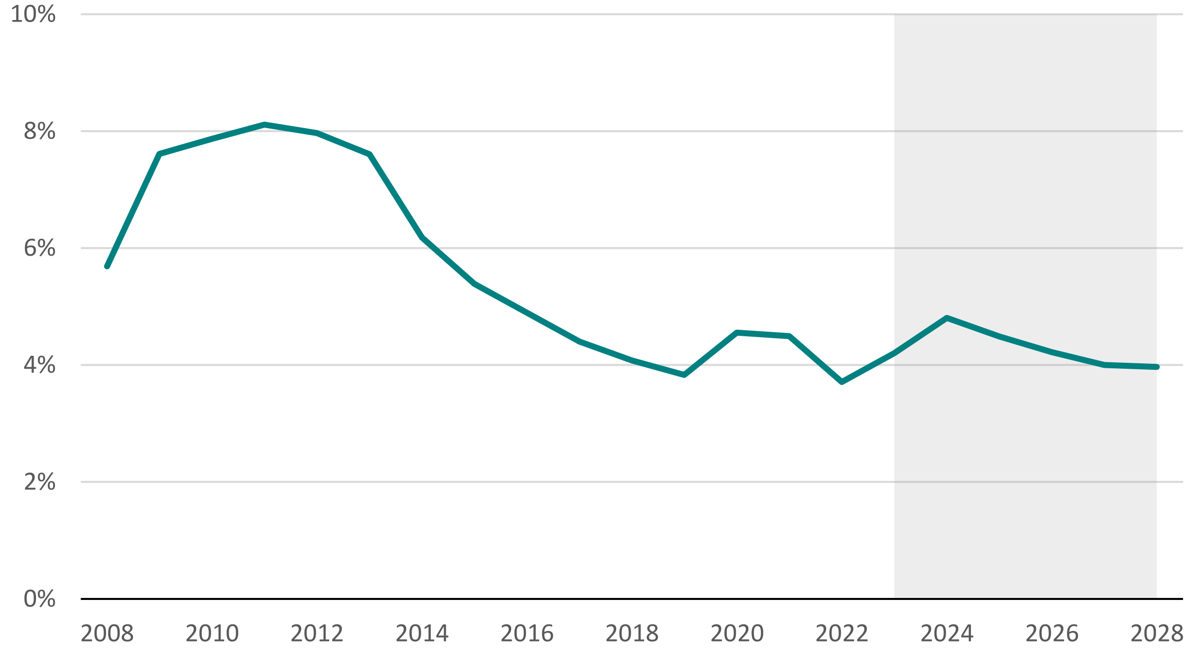
Source: ONS, Cebr analysis

Real business investment, annual % change



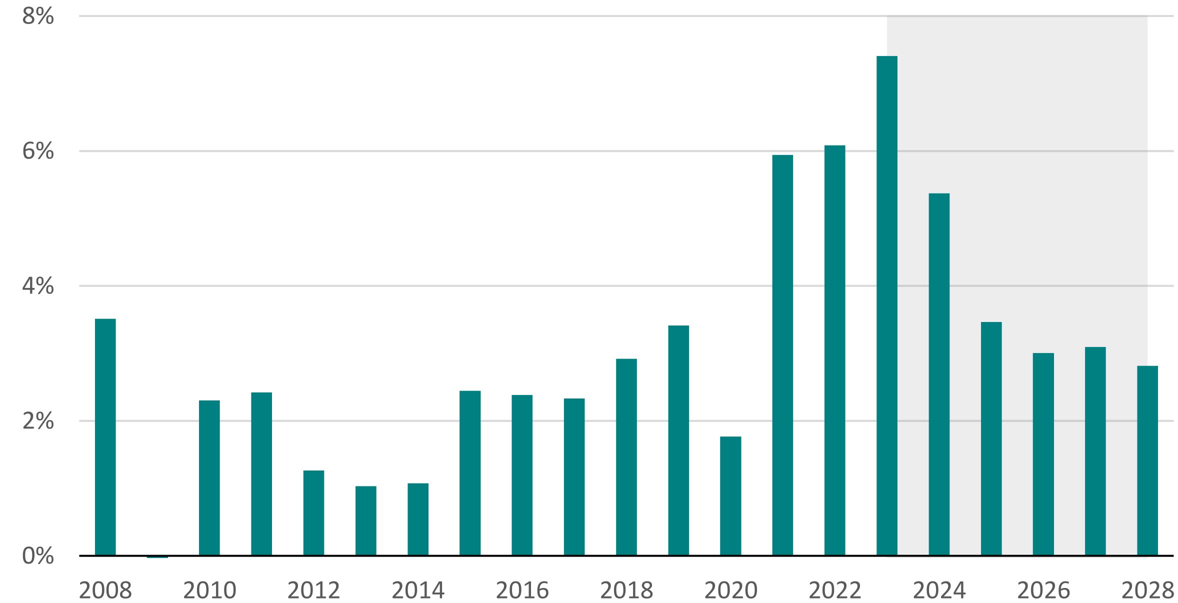
Source: ONS, Cebr analysis

Unemployment rate, %



Source: ONS, Cebr analysis

Average gross in total pay, annual % change

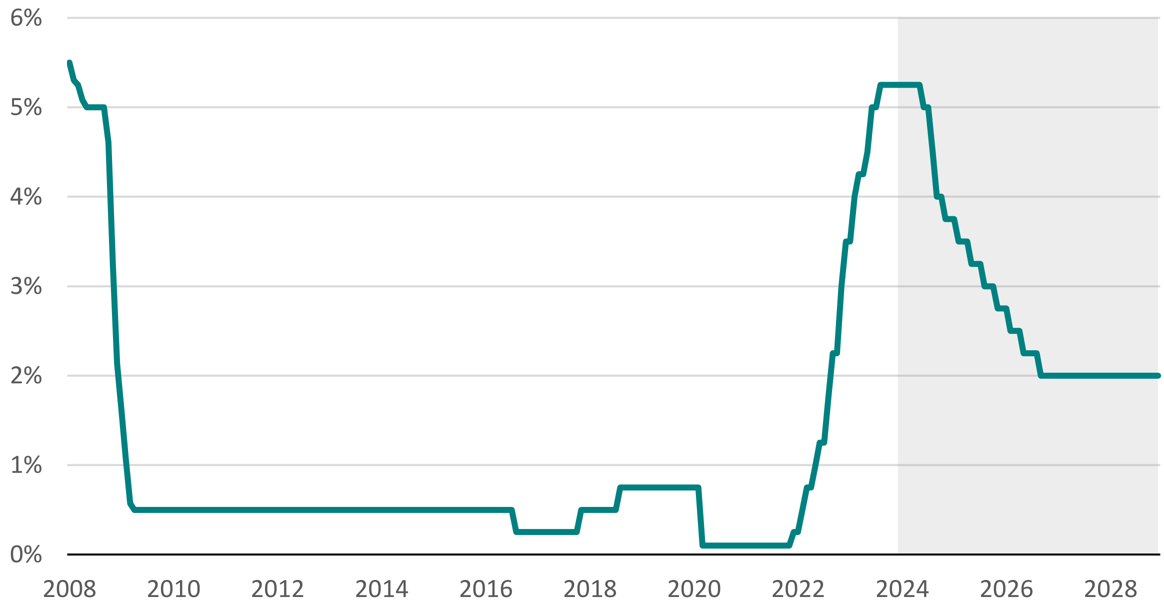


Source: ONS, Cebr analysis

Consumer price inflation

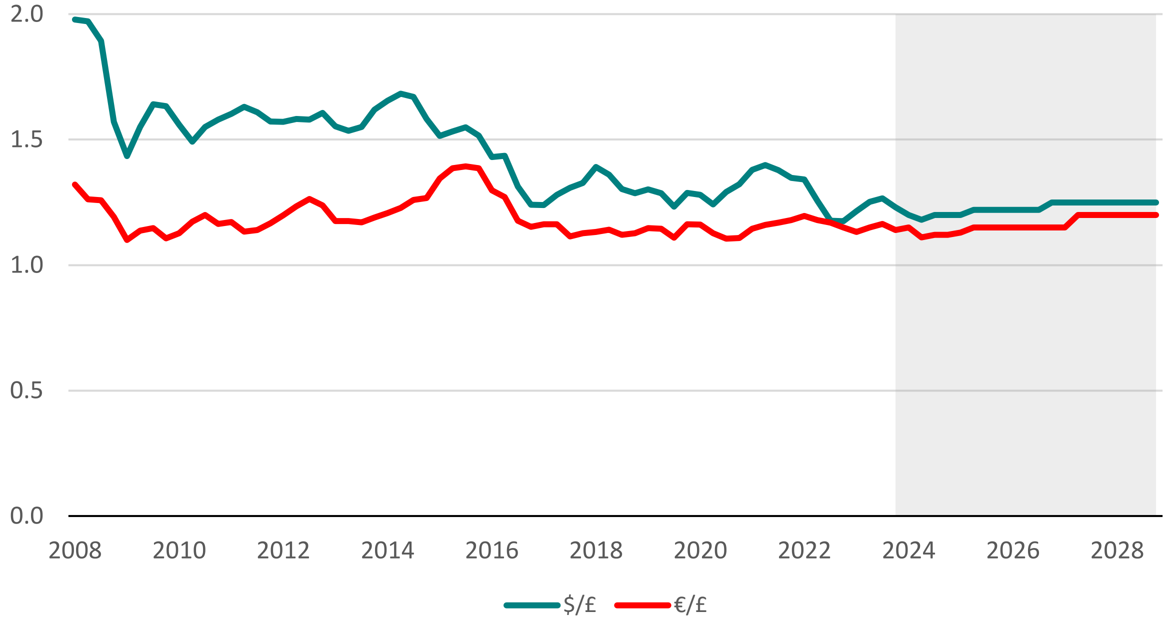
Source: ONS, Cebr analysis

Bank of England base rate



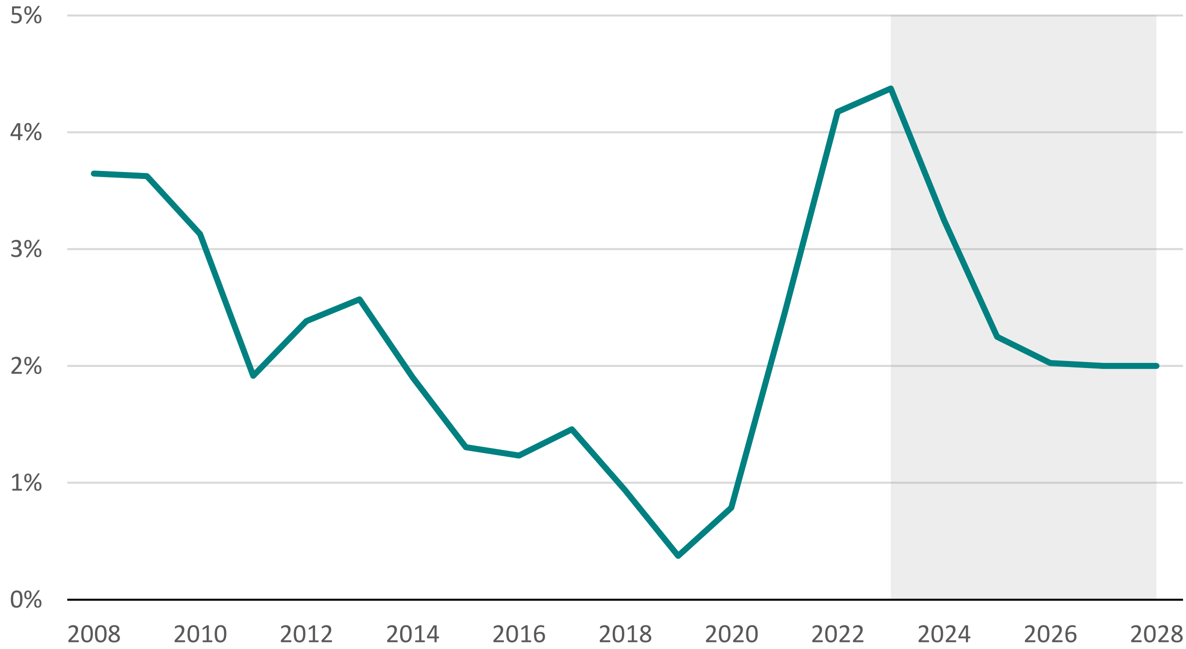
Source: Bank of England, Cebr analysis

Sterling exchange rate versus US dollar and euro



Source: Bank of England, Cebr analysis

10-year gilt yields



Source: Bank of England, Cebr analysis

More forecasts can be found by accessing the Cebr databank via the TPS Members' Area of our website.

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