

## UNITED KINGDOM

Growth has been propelled by high job creation and is set to continue at a strong pace in 2015 and 2016, underpinned by robust private consumption and investment. With slack narrowing, inflationary pressures are projected to pick up gradually. Accordingly, the stance of monetary policy is assumed to begin to normalise in mid-2015 to contain inflation.

This projection assumes that the government continues to implement its medium-term fiscal consolidation plan. Higher interest rates associated with the economic recovery could support stronger productivity growth by encouraging the selection of more profitable projects and the restructuring of loss-making companies. Labour productivity would also be strengthened by further structural reforms to improve loan availability, reduce mismatches in the labour market and further upgrade infrastructure.

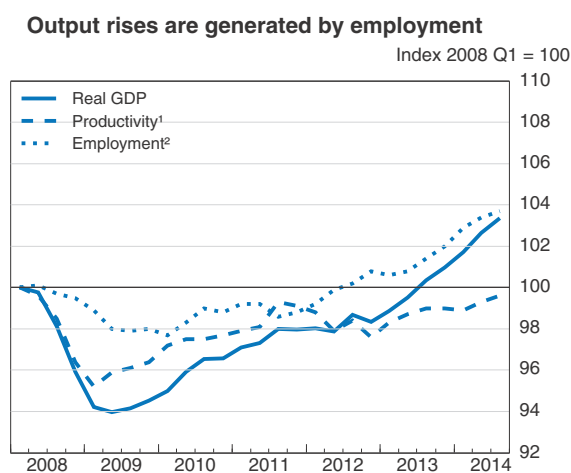
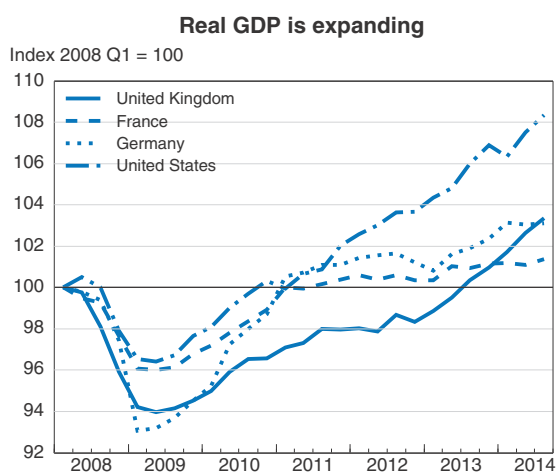
### Growth has continued at a robust pace

The economy has been growing at around a 3% annualised rate since the second quarter of 2013. Private consumption has been the main engine of the expansion, amid strong job creation, and business investment continues to recover strongly, supported by diminishing uncertainty, the accelerator effects of stronger demand and a low user cost of capital. However, export performance has been weak and the income balance has disappointed, pushing the current account deficit to close to 5% of GDP.

### The labour market is tightening

Labour supply has been strong as the labour force participation rate and the working-age population have been trending upwards. However, labour demand has been robust as well, as labour productivity has failed to recover. As a result, the unemployment rate has been falling rapidly, vacancies are rising, and there are increasing signs of skill shortages. Wage growth has been weak, although as the labour market tightens this


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1. Productivity is defined as real GDP divided by total employment.

2. Population aged 16 and over.

Source: OECD Economic Outlook 96 database; and Office for National Statistics (ONS).

StatLink  <http://dx.doi.org/10.1787/888933169485>

United Kingdom: **Employment, income and inflation**

Percentage changes

	2012	2013	2014	2015	2016
Employment	1.1	1.2	2.3	1.4	1.1
Unemployment rate <sup>1</sup>	8.0	7.6	6.2	5.6	5.4
Compensation per employee <sup>2</sup>	2.0	2.1	1.6	3.0	3.2
Unit labour cost	1.9	1.6	0.0	1.6	1.7
Household disposable income	4.6	2.0	4.3	4.0	4.0
GDP deflator	1.7	1.7	1.8	1.7	1.7
Harmonised index of consumer prices <sup>3</sup>	2.8	2.6	1.6	1.8	2.1
Core harmonised index of consumer prices <sup>4</sup>	2.2	2.0	1.7	1.9	2.1
Private consumption deflator	2.1	1.9	1.6	1.5	1.7

1. As a percentage of labour force.

2. In the total economy.

3. The HICP is known as the Consumer Price Index in the United Kingdom.

4. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 96 database.

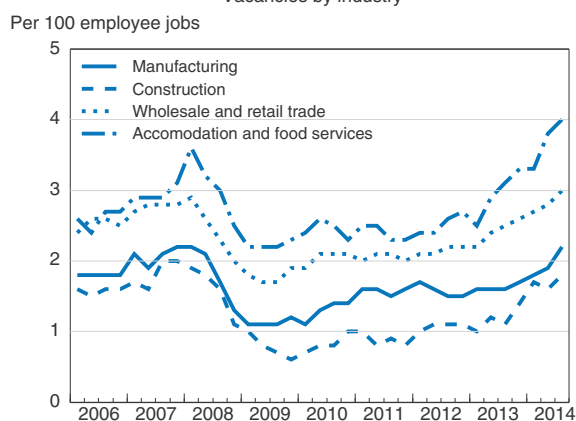
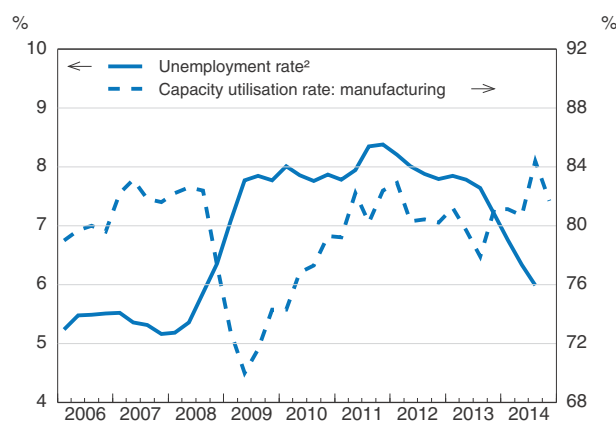
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is projected to change. Stimulating retraining and encouraging migration in occupations where shortages arise would reduce labour mismatches and support balanced growth through higher productivity.

**Fiscal consolidation will continue**

The government has continued to implement its medium-term fiscal plan, which should lead to a cumulative tightening in the structural budget deficit of about 2.5% of GDP in 2015 and 2016. The collection of some receipts has been delayed owing to recent income tax changes. However, weaker wage growth, lower residential property transactions and lower oil and gas revenues have led to weaker tax receipts than expected by the Office for Budget Responsibility. Further measures are

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**Vacancies are rising**  
Vacancies by industry<sup>1</sup>**Spare capacity is narrowing**

1. Data are seasonally adjusted.

2. Population aged 16 and over.

Source: Office for National Statistics (ONS); OECD Economic Outlook 96 database; and OECD Main Economic Indicators database.

StatLink  <http://dx.doi.org/10.1787/888933169494>

United Kingdom: **Financial indicators**

	2012	2013	2014	2015	2016
Household saving ratio, gross <sup>1</sup>	7.3	5.2	5.8	5.7	5.8
General government financial balance <sup>2</sup>	-5.9	-5.6	-5.5	-4.4	-3.1
General government gross debt <sup>3</sup>	95.7	93.3	95.9	97.6	98.0
General government debt, Maastricht definition <sup>2</sup>	83.8	85.3	87.9	89.5	90.0
Current account balance <sup>2</sup>	-3.7	-4.2	-4.8	-4.6	-4.4
Short-term interest rate <sup>4</sup>	0.8	0.5	0.5	1.0	2.4
Long-term interest rate <sup>5</sup>	1.9	2.5	2.7	2.9	3.7

1. As a percentage of disposable income (gross saving).


2. As a percentage of GDP.

3. As a percentage of GDP at market value.

4. 3-month interbank rate.

5. 10-year government bonds.

Source: OECD Economic Outlook 96 database.

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needed to help to offset revenue shortfalls while easing pressure on public services that have already contributed to fiscal consolidation.

### Interest rate increases should begin in 2015

These projections imply that the slack in the labour and product markets will continue to narrow rapidly. To keep inflation close to the target of 2%, interest rate normalisation should begin in mid-2015. Clear communication regarding the unwinding of quantitative easing and the path of interest rates increases will be important for an orderly withdrawal

United Kingdom: **Demand and output**


	2013	2014	2015	2016	Fourth quarter		
					2014	2015	2016
	Current prices £ billion	Percentage changes from previous year, volume (2011 prices)					
<b>GDP at market prices</b>	1 713.3	3.0	2.7	2.5	3.1	2.5	2.5
Private consumption	1 110.8	2.1	2.4	2.1	2.5	2.3	2.1
Government consumption	346.8	1.0	-0.5	-1.2	0.7	-1.3	-1.1
Gross fixed investment	281.5	8.1	7.1	7.6	7.1	7.4	7.8
Public <sup>1</sup>	32.1	-3.9	2.1	2.2	-5.2	1.9	2.3
Residential	123.0	8.8	6.7	7.1	6.9	6.9	7.2
Non-residential	126.4	11.3	8.9	9.2	11.7	9.0	9.3
Final domestic demand	1 739.1	2.9	2.6	2.5	2.9	2.5	2.5
Stockbuilding <sup>2</sup>	6.3	0.4	0.0	0.0			
Total domestic demand	1 745.4	3.2	2.6	2.5	2.7	2.5	2.5
Exports of goods and services	511.3	-1.3	1.2	2.4	-0.3	1.8	2.6
Imports of goods and services	543.4	-1.6	1.2	2.2	-1.9	1.6	2.6
Net exports <sup>2</sup>	- 32.1	0.1	0.0	0.0			

Note: Detailed quarterly projections are reported for the major seven countries, the euro area and the total OECD in the Statistical Annex.

1. Including nationalised industries and public corporations.

2. Contributions to changes in real GDP, actual amount in the first column.

Source: OECD Economic Outlook 96 database.

StatLink  <http://dx.doi.org/10.1787/888933170214>

United Kingdom: **External indicators**

	2012	2013	2014	2015	2016
	\$ billion				
Goods and services exports	793.5	799.3	807.9	793	825
Goods and services imports	848.1	849.6	849.7	827	857
Foreign balance	- 54.6	- 50.3	- 41.8	- 34	- 32
Invisibles, net	- 43.6	- 63.4	- 101.6	- 103	- 104
Current account balance	- 98.2	- 113.7	- 143.3	- 137	- 136
	Percentage changes				
Goods and services export volumes	0.7	0.5	- 1.3	1.2	2.4
Goods and services import volumes	3.1	0.5	- 1.6	1.2	2.2
Export performance <sup>1</sup>	- 1.6	- 2.0	- 4.6	- 2.9	- 2.7
Terms of trade	0.4	0.6	0.8	0.8	0.3

1. Ratio between export volume and export market of total goods and services.

Source: OECD Economic Outlook 96 database.

StatLink  <http://dx.doi.org/10.1787/888933170221>

of stimulus. The end of very low interest rates should increase incentives to properly allocate resources and ensure more sustainable growth.

### Balancing the housing market requires reforms

House prices have continued to increase rapidly across the United Kingdom in 2014, with an annual increase of about 20% in London and nearly 10% in the rest of the country. This increase has not been driven by excessive lending, although macro-prudential authorities have taken welcome precautionary measures to limit high loan-to-income ratios and requested from the government additional powers to cap loan-to-value and debt-to-income ratios. To balance the housing market, it is essential to further ease planning restrictions to enhance supply. Also, housing demand needs to be made more sensitive to price developments by updating property values used in the council tax.

### Growth is expected to remain strong

GDP growth is set to continue at a strong, if slightly easing, pace, despite fiscal consolidation. The unemployment rate is projected to fall further and labour productivity to recover, supporting nominal wage growth, and allowing households to increase consumption while stabilising their saving.

### Low productivity growth is a key risk

Robust productivity is an essential condition for strong and sustainable growth, and uncertainty over its recovery is a major risk to the projection. Labour market pressures could disconnect real wage growth from productivity and lead to cost-push inflation. Alternatively, if the strong correlation between real wages and productivity were to persist, then weaker-than-expected productivity could translate into weaker growth. Exports might turn out to be weaker if growth in the euro area disappoints, which would be a drag on investment and productivity. On the positive side, the continuation of structural reforms could boost productivity.



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