THE UK ECONOMY
Forecast summary

GDP is forecast to grow by nearly 2 per cent this year and in 2019. Our forecasts have been revised higher since November.

Annual consumer price inflation peaked at 3 per cent in the final quarter of 2017 and is forecast to ease back to the target rate of 2 per cent over the next eight quarters.

We expect the Bank of England to continue normalisation by raising Bank Rate in May by 25 basis point steps and every six months after that until the policy rate reaches 2 per cent.

The economy has strengthened in the second half of 2017. Preliminary data shows quarterly growth of 0.5 per cent for the final quarter of 2017 and 1.8 per cent for the calendar year. Activity has been supported by the weaker exchange rate and by a buoyant global economy. These two factors have helped rebalance the UK economy away from domestic growth and towards net trade.

The upward revision to our growth forecast primarily reflects a more positive outlook for global growth and to a lesser degree is also a response to the progress in Brexit negotiations. The agreement in December has helped lift some of the uncertainty that has weighed down on business investment in our view. All in all, net trade will continue to make a sizeable contribution to economic growth, helping the economy rebalance away from domestic demand over the next two years.

The contribution of the global recovery to the UK has been critical. The forecast for global growth has been raised substantially since the August 2016 forecast, which immediately followed the EU referendum. EU growth, in particular, has surprised to the upside over this period. Had global growth remained in line with that forecast, UK economic growth would have been around 1.2 per cent in 2017 instead of 1.8 per cent. Put differently, the squeeze in domestic demand that was caused by uncertainty and an erosion to disposable income was offset by a buoyant trade sector.

The central forecast has been conditioned on a ‘soft’ Brexit assumption where the UK achieves close to full access to the EU market. That high level of market access will, in our view, come at a cost. We assume that the UK continues to make a budgetary contribution to the EU as before and net migration remains unaffected.

There is a risk that talks between the UK and the EU fail and the UK ends up trading under WTO rules. We estimate that a scenario where the UK is unable to replace the existing trade deals will lead to a long-term annual loss in GDP per head of up to £2,000, or close to 6 per cent, relative to the baseline. A large part of this loss is driven by the reduction in trade but there is also collateral damage to productivity growth.

Inflation on the CPI measure peaked at 3 per cent in the final quarter of 2017. Our forecast is broadly unchanged from November. We expect the MPC to continue with policy normalisation by raising Bank Rate every six months until the policy rate reaches 2 per cent in the middle of 2021.

Summary of the forecast – UK economy

	Real GDP(a)	Unemployment(b)	CPI(c)	RPIX(d)	External current balance(e)	PSNB(f)
2017	1.8	4.3	3.0	4.0	–93.7	50.8
2018	1.9	4.3	2.4	3.1	–88.5	38.1
2019	1.9	4.3	2.0	2.7	–77.2	26.8

(a) Percentage change, year–on–year. (b) ILO definition, fourth quarter, rate. (c) Consumer prices index, percentage change, fourth quarter on fourth quarter. (d) Retail price index, excluding mortgages, percentage change, fourth quarter on fourth quarter. (e) Year, £ billion. (f) Public sector net borrowing, fiscal year, £ billion. Includes the flows from the Bank of England’s Asset Purchase Facility.