The UK economy

- Economy to grow 2.3 per cent in 2016 and 2.7 per cent in 2017.
- Inflation rate of just 0.3 per cent this year and 1.3 per cent in 2017, reaching 2.1 per cent in 2018.
- Bank Rate now expected to remain ½ per cent until the second half of 2016.
- Chancellor forecast to miss the primary target of the Fiscal Mandate by a slim margin.
- Productivity performance the largest domestic risk, but emerging market slowdowns, financial market volatility and policy missteps also represent risks.

The central outlook for the UK economy is little changed. Despite financial market turbulence since the start of the year, our modal GDP forecasts for this year and next are broadly the same as those we published just three months ago. A near-term slowdown in export growth, predominantly a result of weaker demand from emerging markets, is offset by an acceleration of domestic demand as falling oil prices and a loosening of both fiscal and monetary policy act to bolster consumer spending. Growth accelerates again in 2017 as the improving external environment strengthens export demand.

Continued commodity price falls, the depreciation of sterling and weaker than expected data outturns have led us to soften the profile for consumer prices, which will grow by an average of just 0.3 per cent in 2016. However, there are signs that underlying inflationary pressure is holding up more robustly and as the influence of temporary factors wanes we expect inflation to recover to 1.3 per cent in 2017. After this there is a marginal overshoot of the Bank of England's inflation target, before price growth returns to 2 per cent in 2020.

A key judgement for our forecast is the timing and pace of monetary tightening. We have pushed back the point at which we think the Monetary Policy Committee is most likely to begin raising Bank Rate to the second half of 2016, based on recent communications by committee members and the timing of the UK's impending referendum on membership of the European Union. However, there remain a number of factors which indicate that commencing with interest rate rises soon would not be inconsistent with meeting the MPC's remit over the medium term.

November's *Autumn Statement/Comprehensive Spending Review* built on the *Summer Budget* and presented a further loosening of fiscal policy. Significant increases in government consumption are planned, made possible largely by changes to assumptions underpinning the OBR's macroeconomic forecasts. Official forecasts suggest the government will hit its primary fiscal target of an absolute surplus in 2019–20 with a marginal degree of room to spare. Under our updated projections, with given current spending plans the Chancellor fails to meet his Fiscal Mandate, albeit borrowing a modest £600 million in 2019–20. Were the official forecasts to move in the same direction as our own, the inflexibility of the current Fiscal Mandate would require a tightening of fiscal policy by the Chancellor.

Summary of the forecast – UK economy

	Real gross national income(a)	Real GDP(a)	Unemployment(b)	CPI(c)	RPIX(d)	External current balance(e)	PSNB(f)
2015	2.6	2.2	5.0	0.1	1.1	–76.1	79.6
2016	1.9	2.3	5.1	0.4	1.2	–78.3	61.4
2017	1.9	2.7	5.1	1.8	2.4	–93.4	40.9

(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.

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