

Economic forecast

Expert analysis on the outlook for the UK economy, so your business can plan for the future.

December 2023



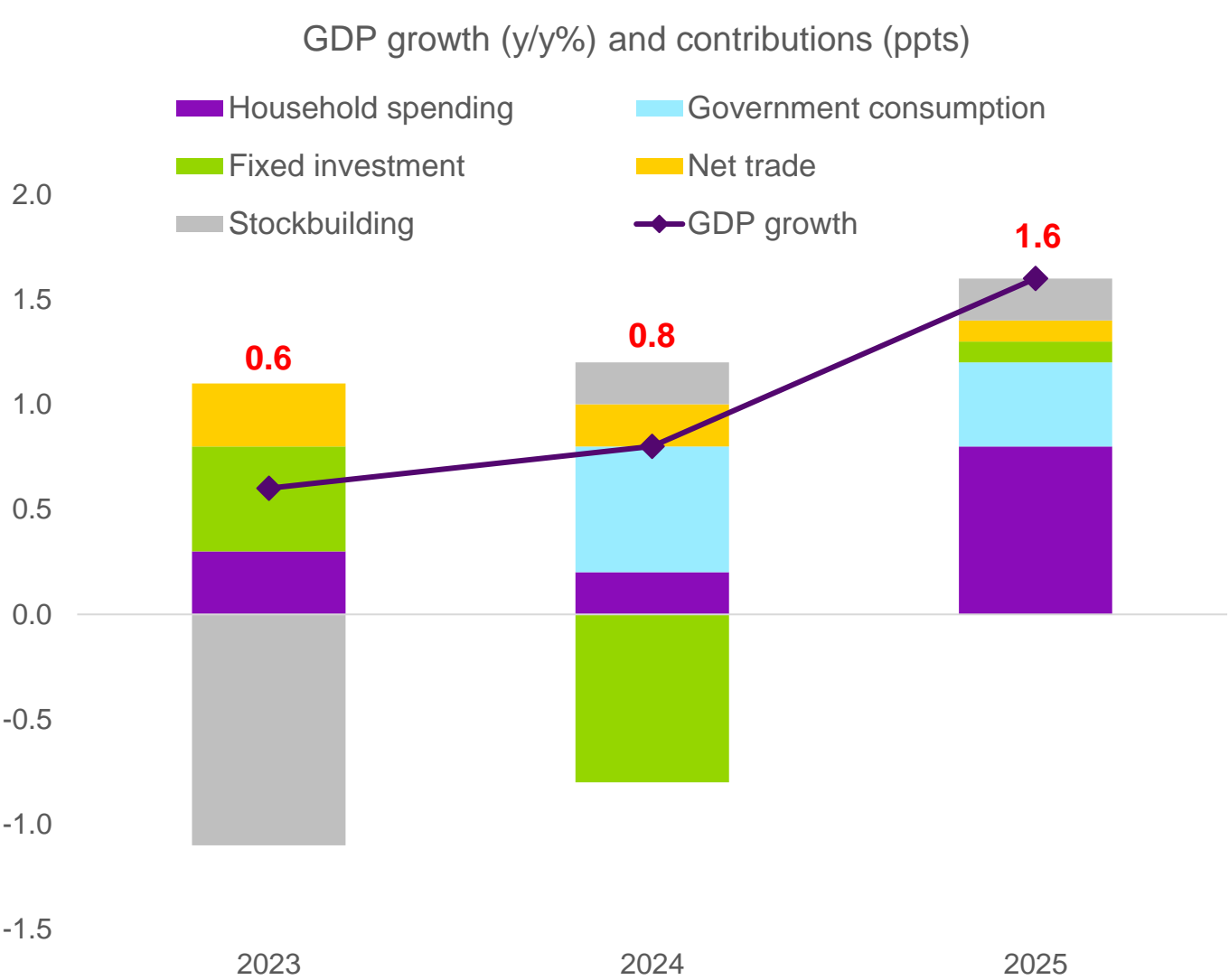
UK economic outlook: shifting headwinds

- In underlying terms, the economy has grown only minimally over the last one-and-a-half years. Business surveys of activity – including the CBI's own surveys – have turned down recently, implying that sluggish momentum will persist in the near-term.
- However, the economy has also displayed a significant degree of resilience: the underlying stagnation seen this year compares to widespread forecasts of a recession at the beginning of 2023. This is particularly remarkable given the scale of headwinds that activity has faced over this period.
- Our latest economic forecast expects weak growth momentum to persist over the year ahead. **Following growth of 0.6% in 2023, we expect a similar rise in GDP over 2024 (0.8%), strengthening to 1.6% in 2025.** While we do not expect an outright contraction in activity, it is notable that our forecast for 2024 represents a large downgrade from our previous expectations (1.8%).
- **Household spending is set to remain sluggish next year**, reflecting a shift in headwinds facing the consumer. Falling inflation will continue to boost real earnings, but this is set against higher interest rates feeding through to mortgage payments and household incomes, and a modest loosening in the labour market. Household spending gains a firmer footing in 2025, as these pressures recede somewhat.
- **Fixed investment is also notably weak over 2024**, as sluggish activity weighs on business investment and tepid real incomes growth pushes down residential investment. Business investment recovers in 2025 as economic growth firms, and the introduction of a permanent investment allowance from mid-2026 should boost capital spending beyond our forecast horizon.
- The UK's standing by international comparison is also mixed. Recent revisions to official GDP data show a stronger post-COVID recovery than was previously the case, leaving the UK looking less like a global outlier. The labour market also appears to have been tighter than in most other advanced economies. However, the latter is partly related to a big fall in labour participation, which appears to be unique to the UK. And inflation has persistently remained higher than in other major global economies.
- It should also be noted that while we expect GDP growth to pick up in 2025, its pace (1.6%) remains a little below the average seen after the 2008/9 financial crisis (2%), and still well below pre-2008 norms (3%).
- While the resilience in growth means that productivity strengthens a little over our forecast, it only returns to the weak underlying trend seen before the onset of the pandemic. It's clear that more needs to be done to ensure a sustainable boost to growth and productivity over the longer-term – including a focus on trade and investment; ambition on R&D intensity and innovation; preparing the economy for the future of work; and honouring climate commitments and securing green growth. For more, please see [the CBI's Business Manifesto](#)



UK economic outlook: shifting headwinds

	CBI Dec 2023 forecast (y/y%, unless otherwise stated)			Change from previous forecast (%pts)	
	2023	2024	2025	2023	2024
GDP growth	0.6	0.8	1.6	+0.2	-1.0
Household spending	0.4	0.4	1.3	+0.5	-1.2
Government consumption	-0.2	2.8	2.1	+0.5	+1.2
Business investment	5.4	-5.0	2.7	+5.4	-6.9
Stockbuilding (ppt. contribution)	-1.1	+0.2	+0.2	+0.9	+0.4
Exports	-0.6	2.6	3.3	+2.2	-0.7
Imports	-1.4	1.7	3.0	+6.6	-1.0
Net trade (ppt. contribution)	+0.3	+0.2	+0.1	-1.5	0.0



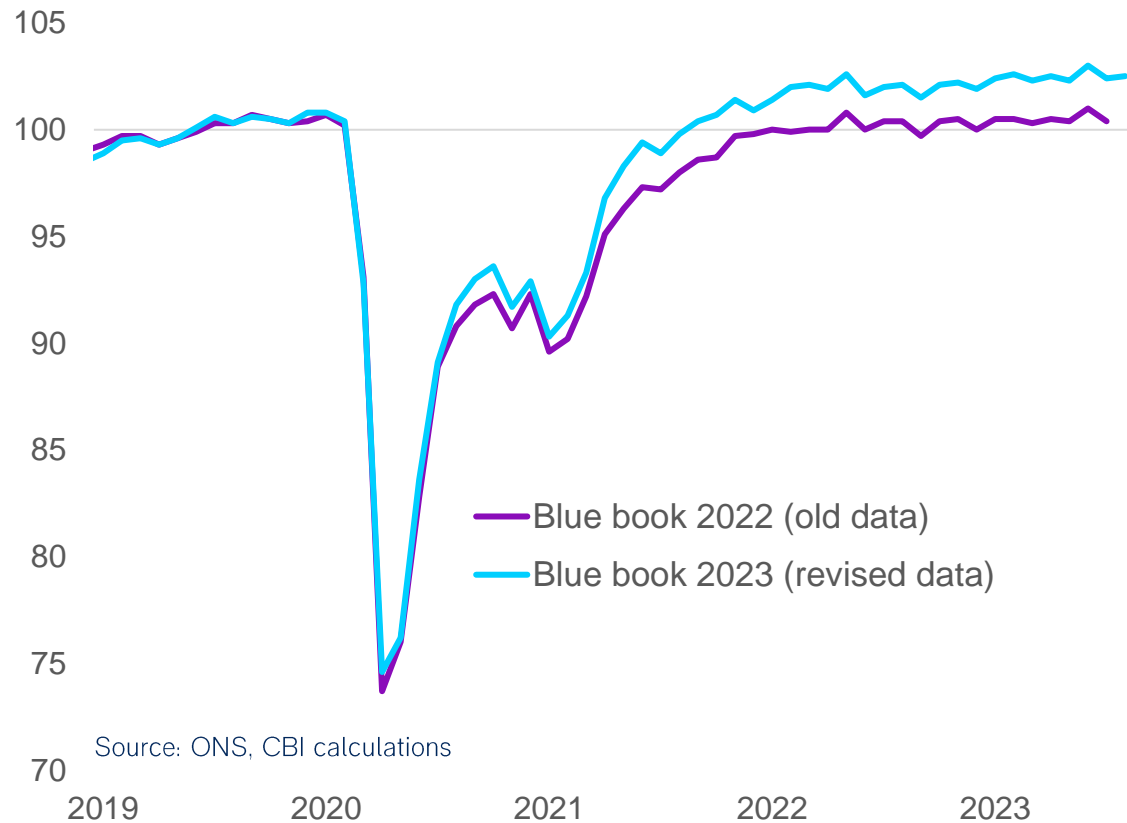
What does our forecast mean for your business?

- Overall, we expect economic growth to remain weak over the coming year, before firming somewhat in 2025. Demand conditions are therefore likely to remain tepid, which is already a key theme being fed back by our members.
- We expect consumer price inflation to moderate, though to remain above the Bank of England's target, over the coming year. But this only means that prices will *grow* at a slower pace, so the *level* of prices will be higher.
- There is also likely to be significant variation by component, with more domestically-focused areas of the CPI basket seeing more persistence in price pressures.
- We expect the Bank of England to have reached the summit on tightening monetary policy. Our forecast is for interest rates to stay at their current level (5.25%), rather than to be reduced over our forecast horizon. Businesses should factor this into their financial planning for the year ahead.
- Due to the lags in the monetary policy transmission mechanism, households (particularly mortgage holders) will feel the impact of higher rates more forcefully in the year ahead. This will be a growing headwind for household spending, counterbalancing the decline in inflation. Businesses, particularly consumer-facing companies and sectors, should be aware of continued constraints on households.
- Our forecast also expects a modest loosening in the labour market, which may take some of the heat out of labour shortages. But with the unemployment rate only peaking at a relatively low 5%, some companies may still struggle to find the people and skills that they need.
- Looser labour market conditions will also bear down on pay growth, which is also expected to ease over our forecast, which may translate to lower pay awards for some companies next year. But the outlook here is particularly uncertain, with forward-looking survey indicators of pay still periodically ticking upwards.
- At the November Autumn Statement, the Chancellor announced full expensing for capital expenditure, making permanent the previously temporary investment allowance that was due to expire in 2026. Businesses should be aware of this tax break as they plan future investment projects.
- While weak demand weighs on capital spending over our forecast, our members have been clear that longer-term objectives are still a priority for spending plans where possible – such as digitisation, automation, sustainability and decarbonisation.
- We expect global economic growth to hold up over our forecast, but companies should be aware of divergent prospects between the UK's main export markets – with the US growing more strongly than the Eurozone.
- Similarly, China's contribution to global growth will reduce (though remain significant). This could have spillovers to smaller Asian economies in its vicinity.

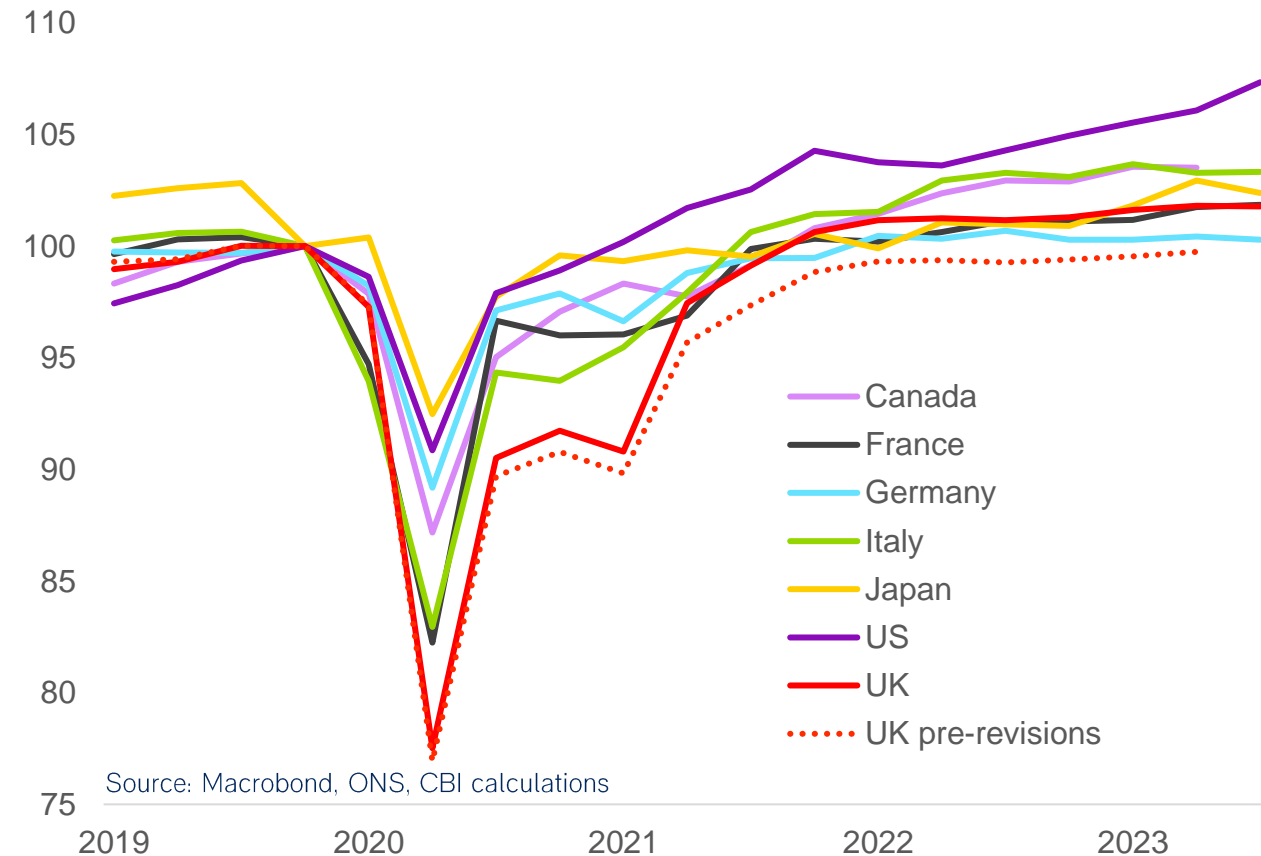


UK growth: a re-write of recent economic history

UK GDP (2019=100)



G7 GDP (Q4 2019=100)

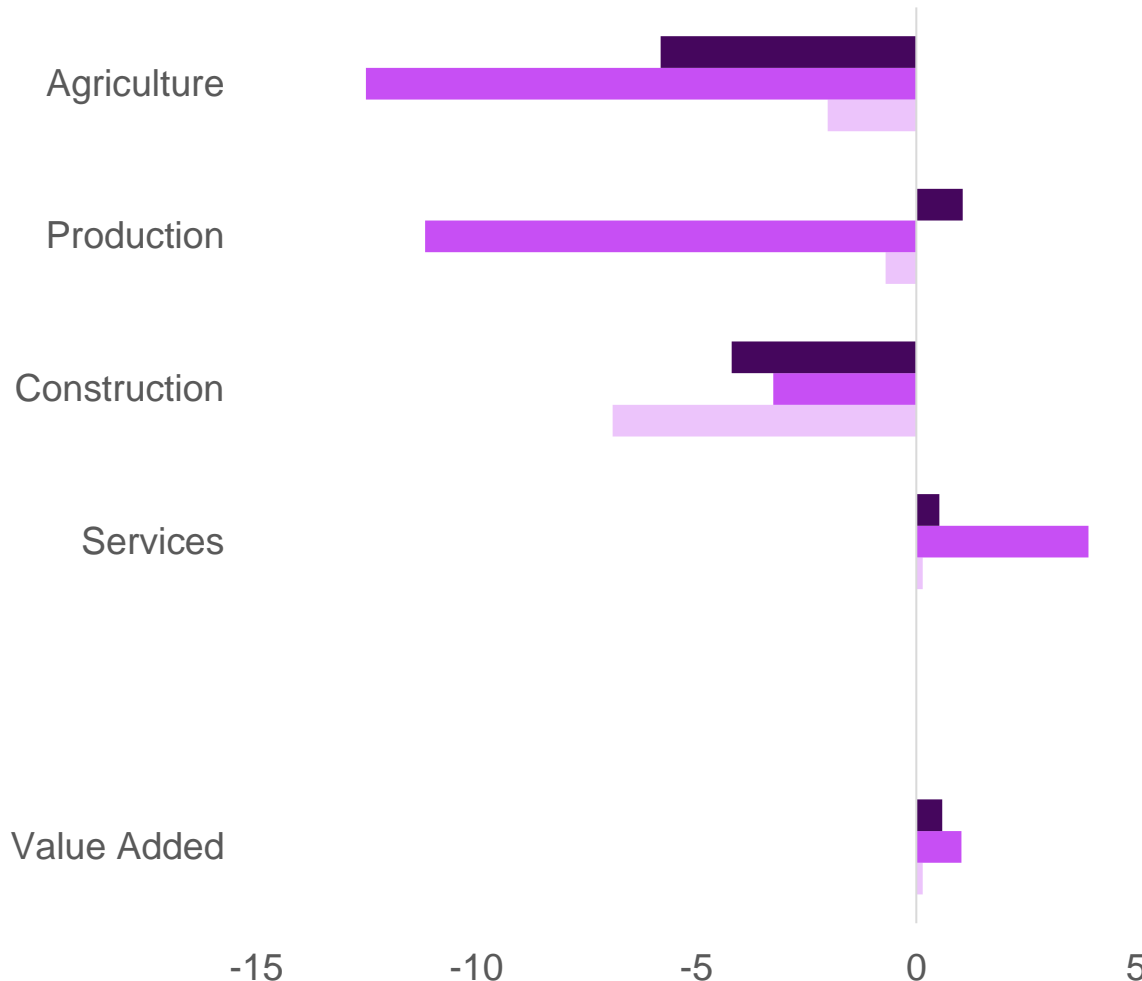


- The ONS have revised post-COVID UK GDP data significantly, as part of their [annual benchmarking of national accounts data](#) (the “Blue Book”)
- The revisions show that the UK had a much stronger recovery in the wake of the COVID-19 pandemic than previously thought. On a monthly basis, the data now shows that GDP regained its pre-COVID level in November 2021, earlier than the initial estimate of May 2022.
- As a result, the UK’s economic performance no longer looks like an outlier when compared to other advanced economies. The UK’s recovery has gone from being the weakest in the G7 to roughly the middle of the pack – on a par with France and (until recently) Japan, and significantly outpacing Germany.

Post-Covid sector story now looks very different

Output growth by sector - revisions to annual growth (ppts)

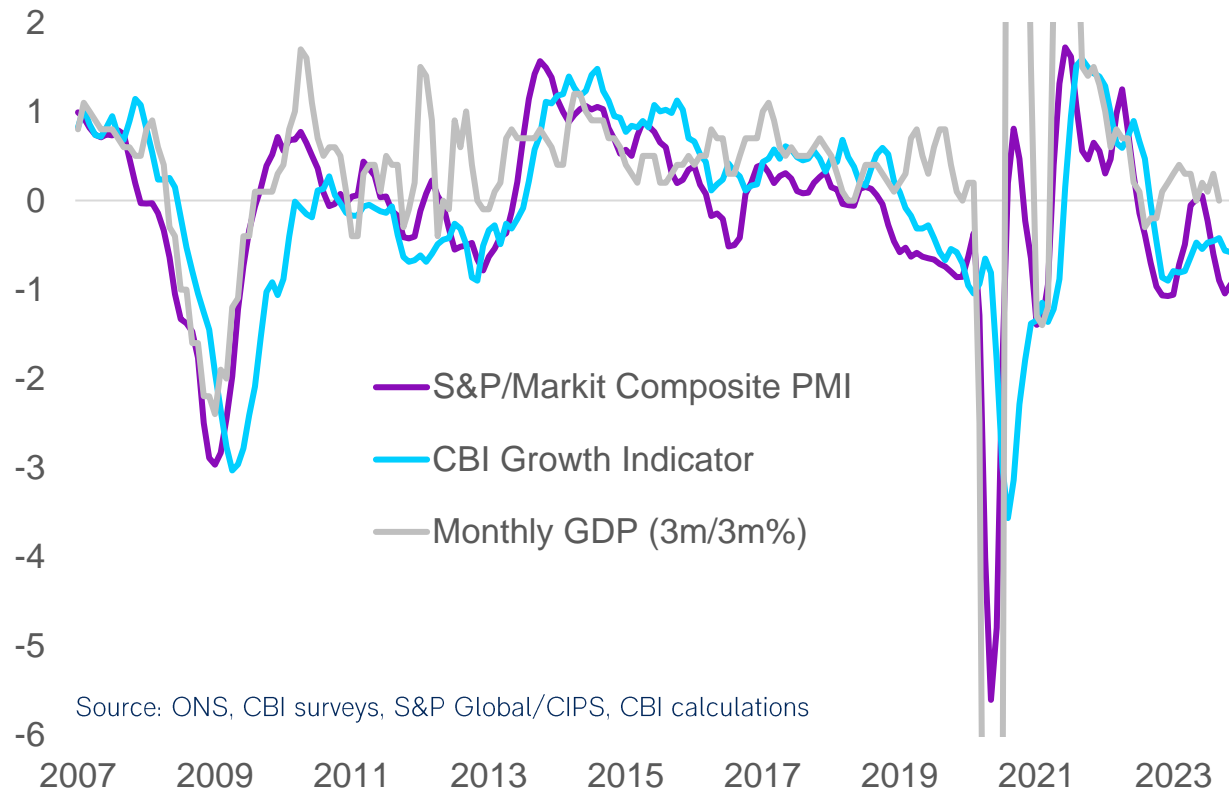
■ 2020 ■ 2021 ■ 2022



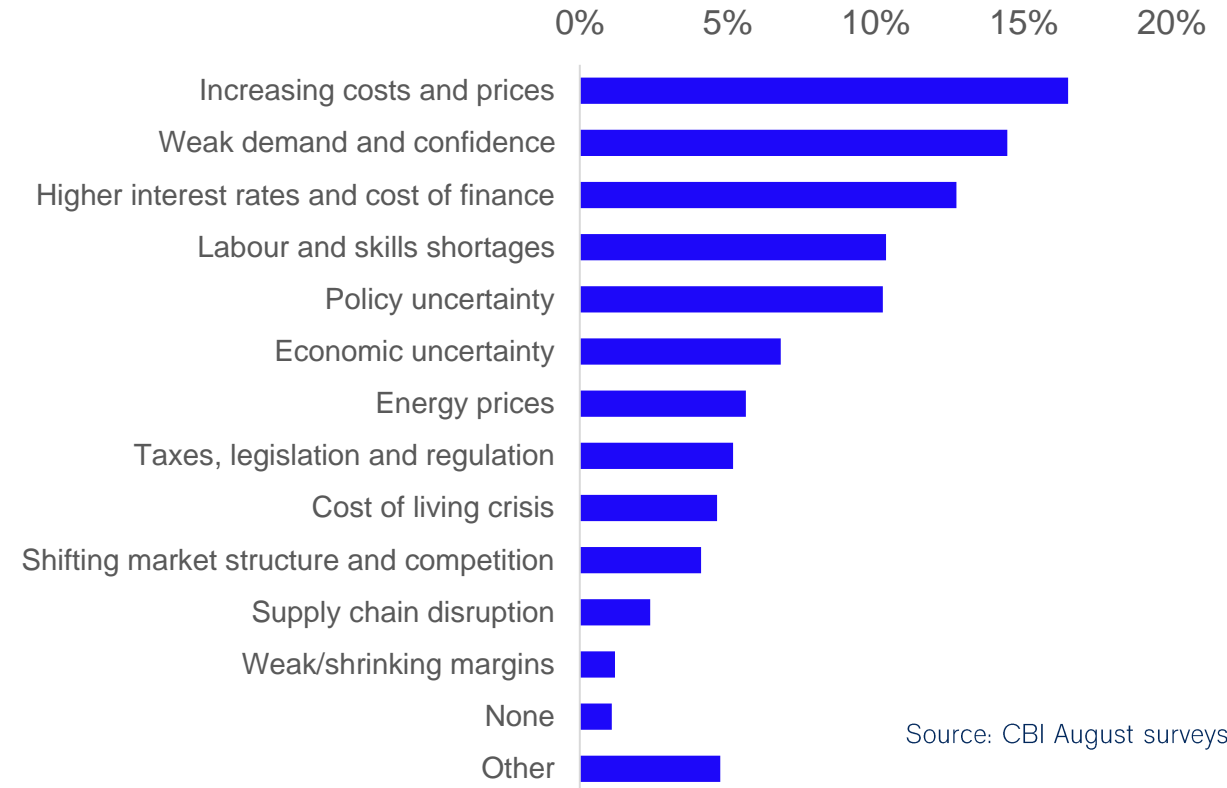
- While the ONS' revisions to total output/GDP growth have been relatively small (but significant), there have been more substantial changes to the growth picture in some sectors
- Broadly, it now looks like the services sector saw a stronger recovery after the COVID-19 pandemic, while other areas of the economy are estimated to have seen weaker growth
- Stronger services growth has been largely driven by revisions to distribution (wholesale, retail and motor trades) and healthcare – due to updated estimates of costs incurred and margins growth. "Other services" – which was a particularly weak sector post-pandemic – is also now shown to have grown strongly in 2021
- In contrast, manufacturing growth is now much weaker in 2021, with the ONS estimating higher costs over the year, alongside increased imports of manufactured metal products and electrical equipment. Energy production is also estimated to have fallen very sharply
- A weaker picture in agriculture is also notable, in light of new trading arrangements with the European Union coming into effect in January 2021 – suggesting a greater impact on output than initially thought

Multiple headwinds are weighing on economic activity

Monthly GDP (3m/3m%) vs business surveys of activity
(standardised, three-month moving average)

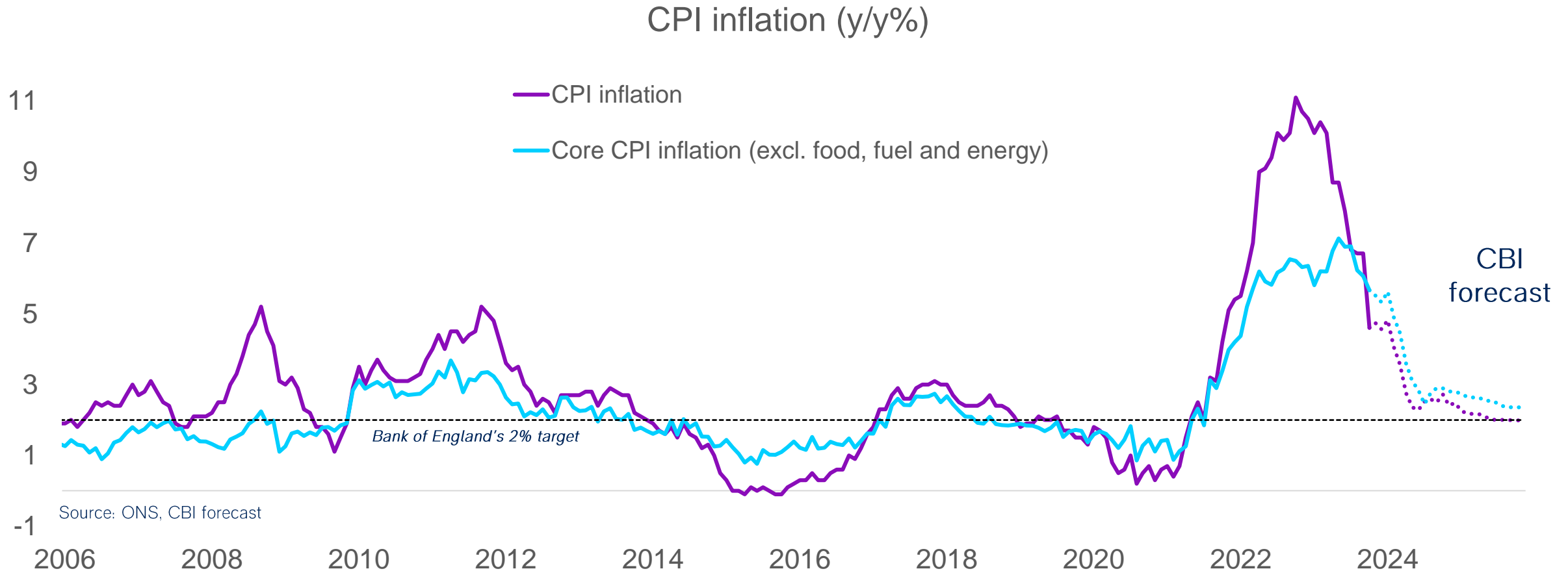


Economic challenges facing UK businesses over the next 6-12 months (% of responses)



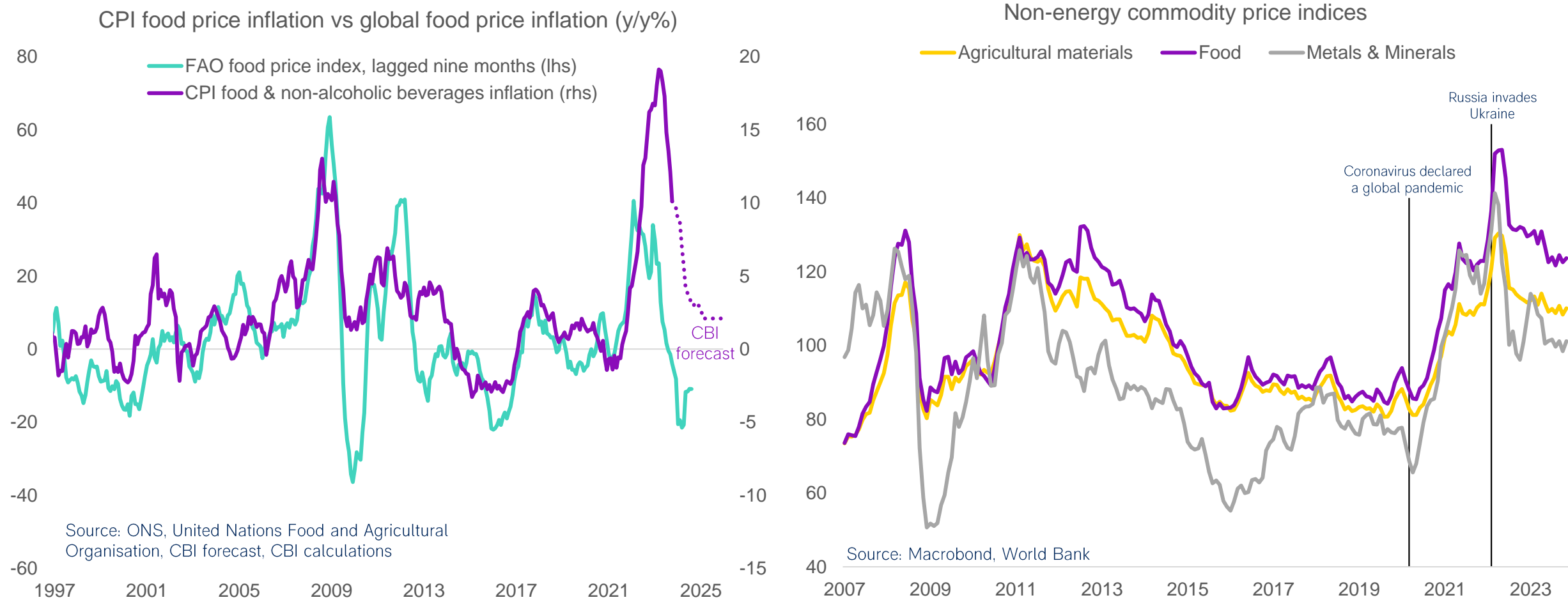
- More recently, business surveys of activity have turned downwards, suggesting weaker economic momentum in the second half of 2023
- The CBI's survey data, alongside anecdote from our members, point to a number of headwinds constraining growth: the most prominent being continually high cost pressures, weakening demand, the growing impact of higher interest rates, and labour shortages
- Our conversations with members also reveal concerns over a number of policy issues, including: the overall regulatory burden; a risk of divergent political agendas; the complexity of the planning system and land use regulations; and relatively high political instability
- Weaker survey data seem to have diverged from somewhat firmer official GDP growth, adding to the uncertainty around near-term economic conditions

Inflation will gradually return to 2% target in mid-2025



- High inflation has been the most prominent of these headwinds. However, the CPI rate has definitively turned a corner, falling to 4.6% in October, compared to a peak of over 11% a year earlier
- The decline has largely been driven by big price rises in energy, food, fuel and goods last year falling out of the annual comparison. Illustrating this, “core” CPI inflation (which excludes food, fuel and energy) has fallen at a much slower pace
- We expect both measures of inflation to continue falling in the year ahead, though at a more gradual pace, due to more limited scope for base-effect driven declines
- Nonetheless, CPI inflation is set to stay above the Bank of England’s 2% target in 2024, only hitting this level in mid-2025

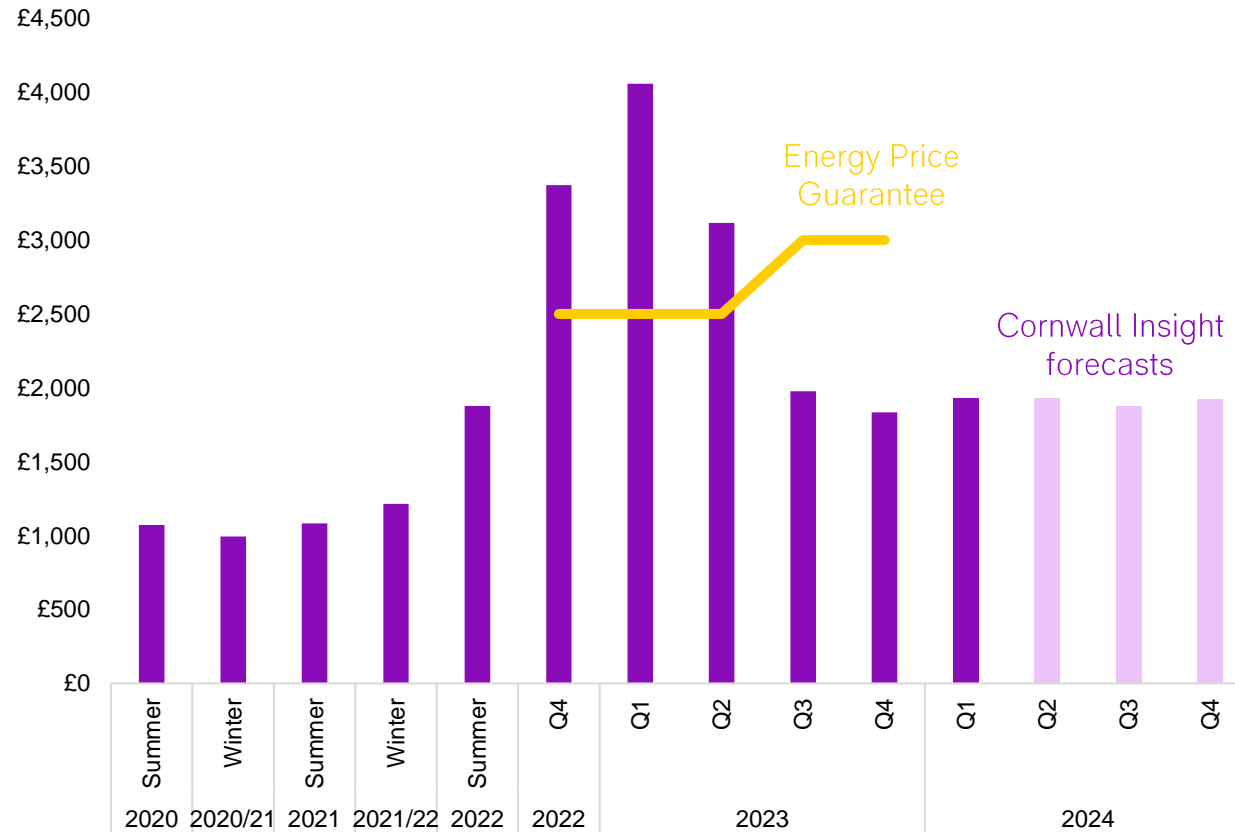
Upward pressure from food price inflation is receding...



- Falling food price inflation is a key driver of inflation falling back over the coming year. This is already in train, with big rises in food prices this time last year starting to fall out of the annual CPI rate
- This follows a fall in global food prices, though they remain stubbornly high. This reflects renewed concerns around the supply of some commodities – e.g. Ukrainian wheat and new restrictions on rice exports from India – alongside broader supply concerns in the face of weather events and climate change
- Concerns over the supply of rice are particularly concerning for food inflation and supply in many emerging economies, where the commodity forms a key part of staple diets

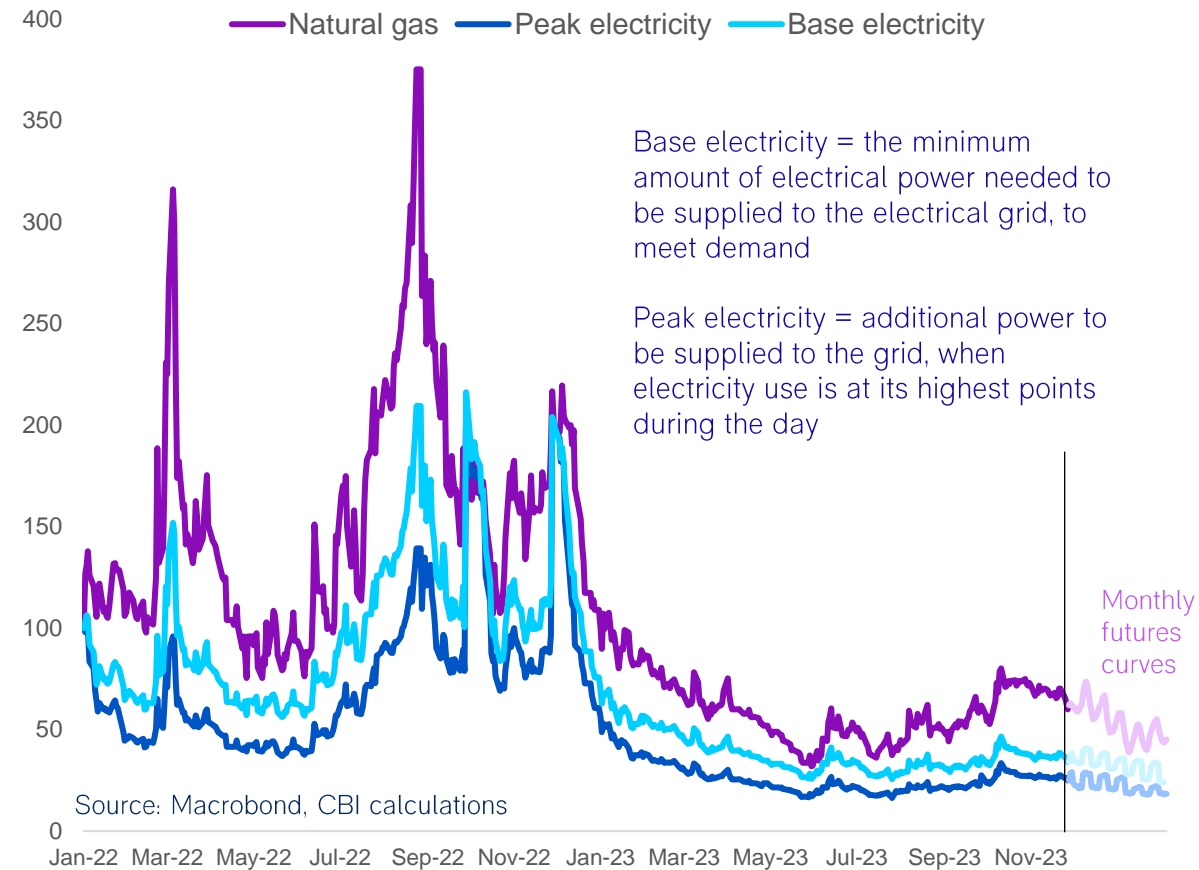
...alongside a more benign energy price environment

Ofgem price cap level (direct debit customers)



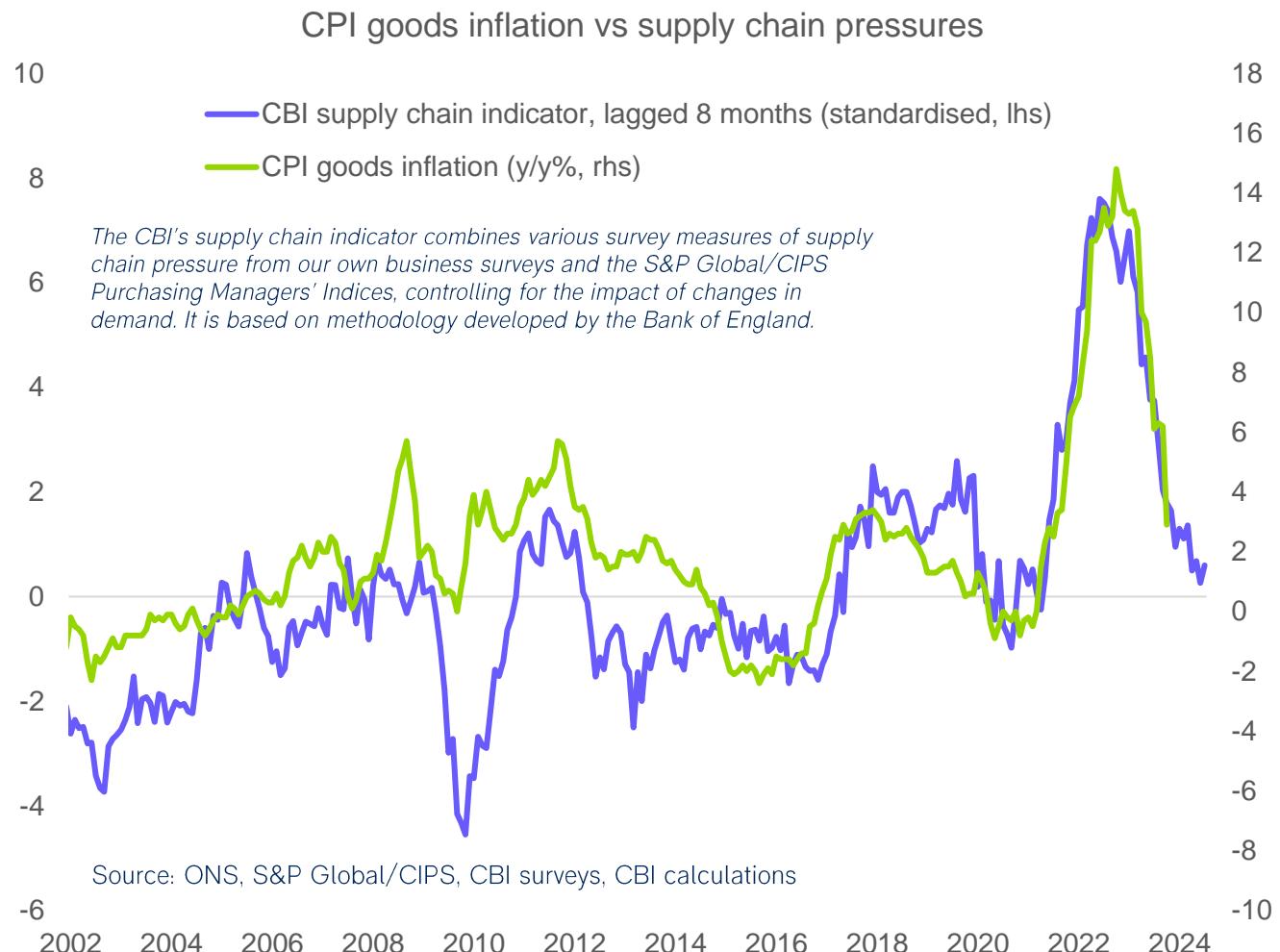
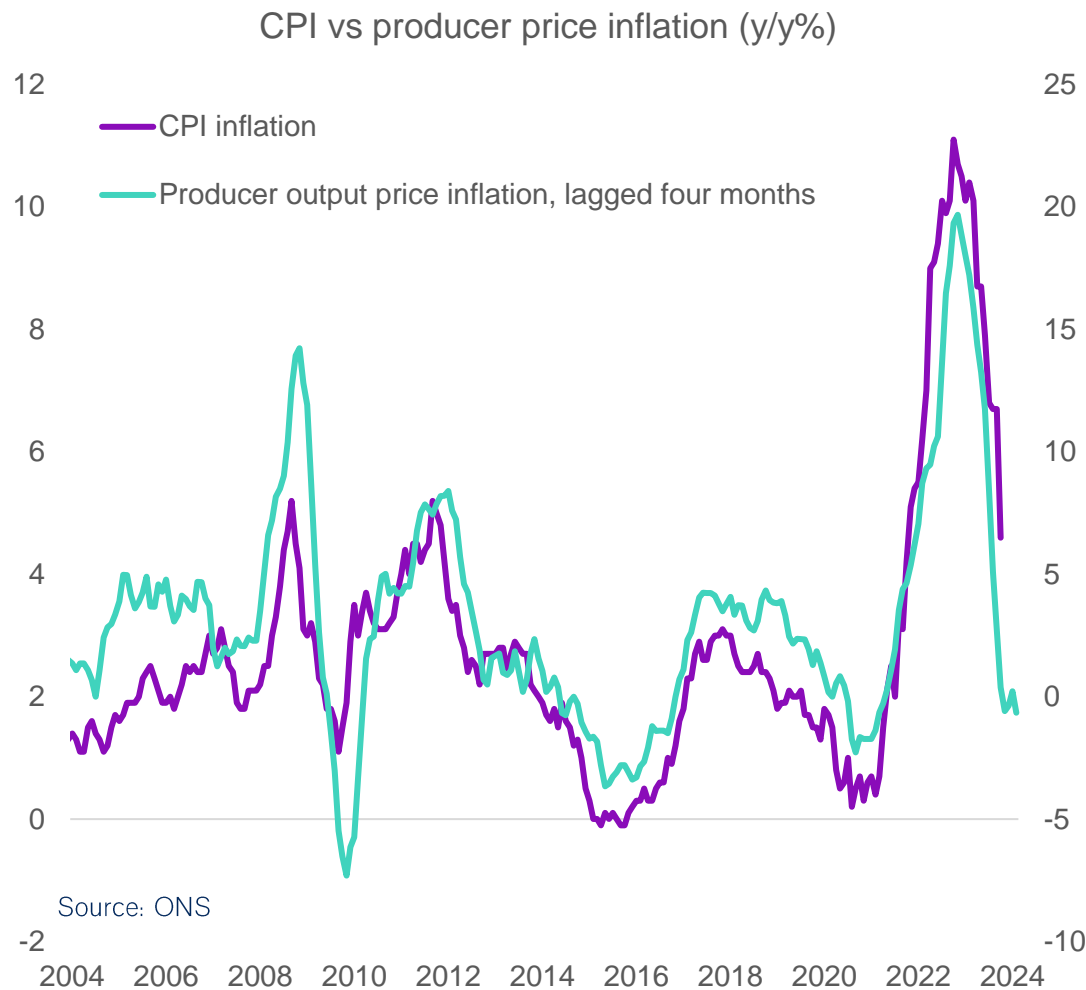
Source: Ofgem, Cornwall Insights

ICE UK wholesale energy prices (Jan 3 2022=100)



- Lower energy prices compared to this time last year have been another key driver of falling inflation so far. Some of these base effects have yet to unwind, so play some role in driving inflation down further over our forecast
- However, there are some minor upside risks in the near-term, with natural gas prices having picked up recently. As a result, Ofgem raised the energy price cap by 5% for Q1 2024, which leads to a very small pick up in our CPI inflation forecast at the turn of the year

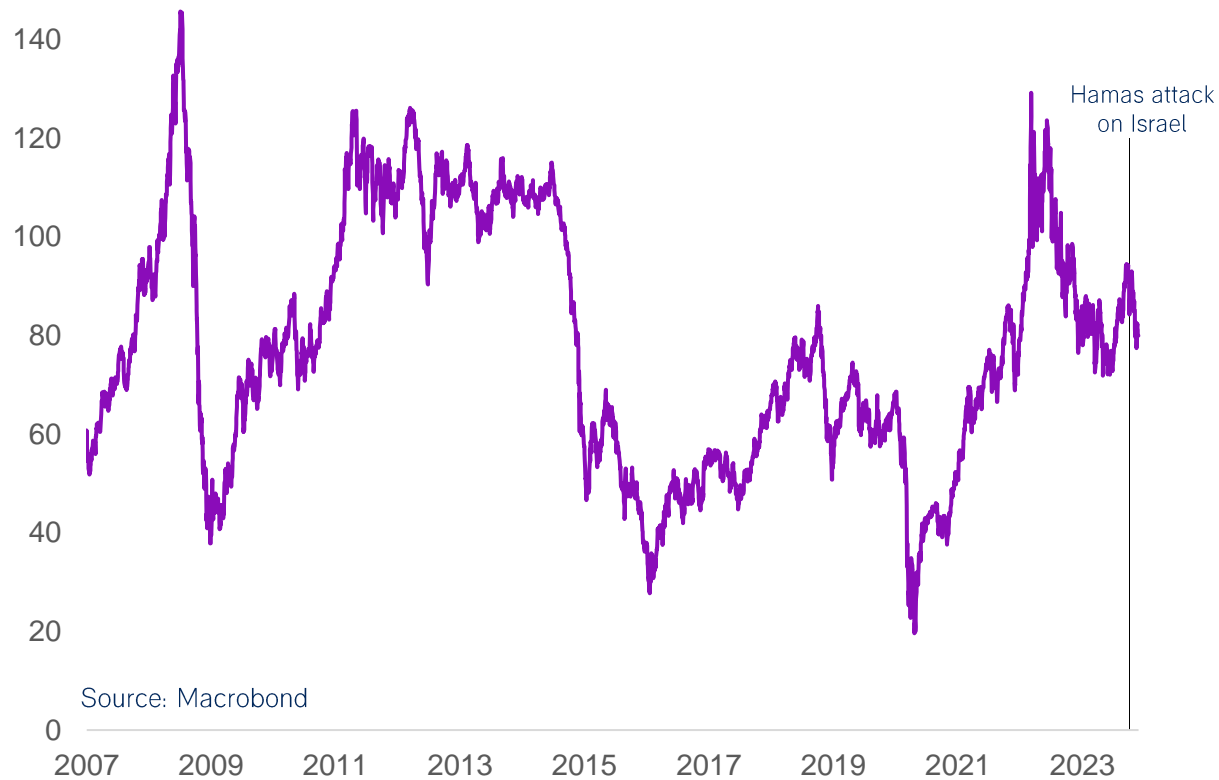
Supply side price pressures are easing too



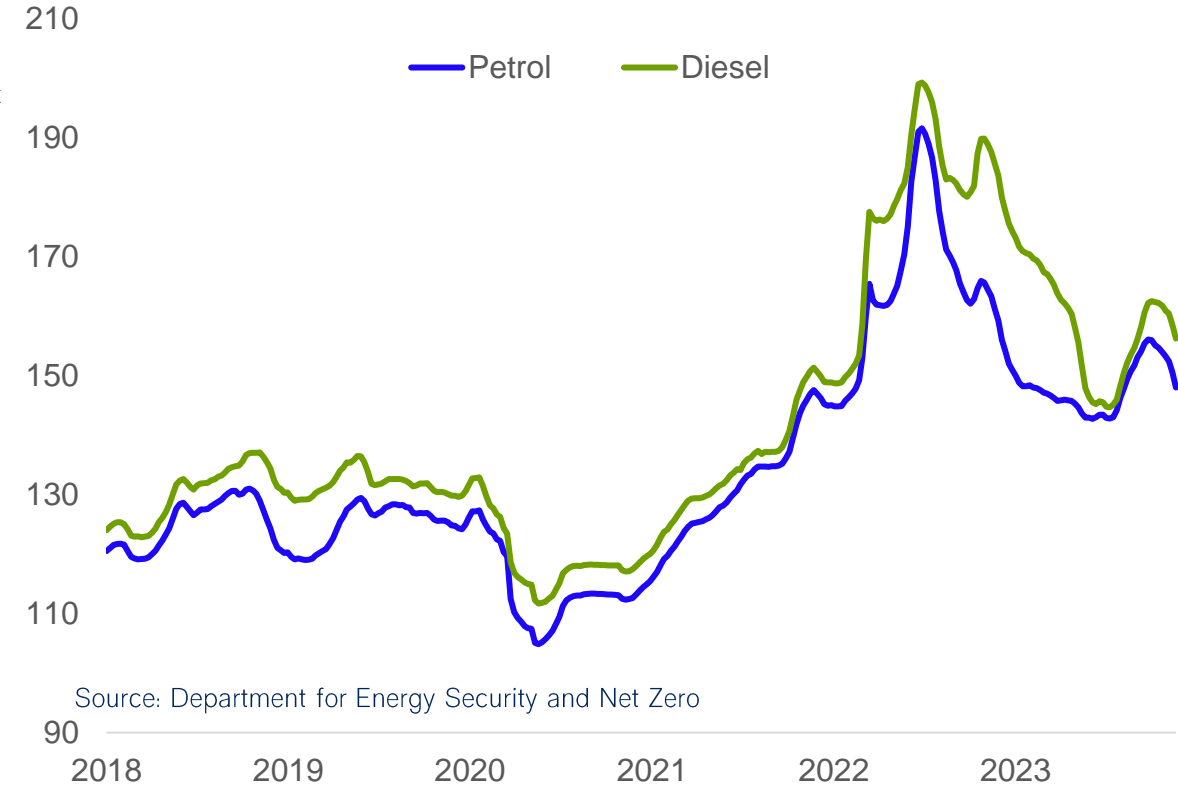
- Much of the global supply side price pressures that drove inflation higher over 2022 have also eased significantly, lending support to our forecast of a further easing in inflation ahead
- Supply pressures have eased largely due to the full re-opening of China's economy, and demand from global industry easing after its post-COVID surge

But higher oil prices pose upside risks to inflation...

Brent crude oil prices (US\$ per barrel)

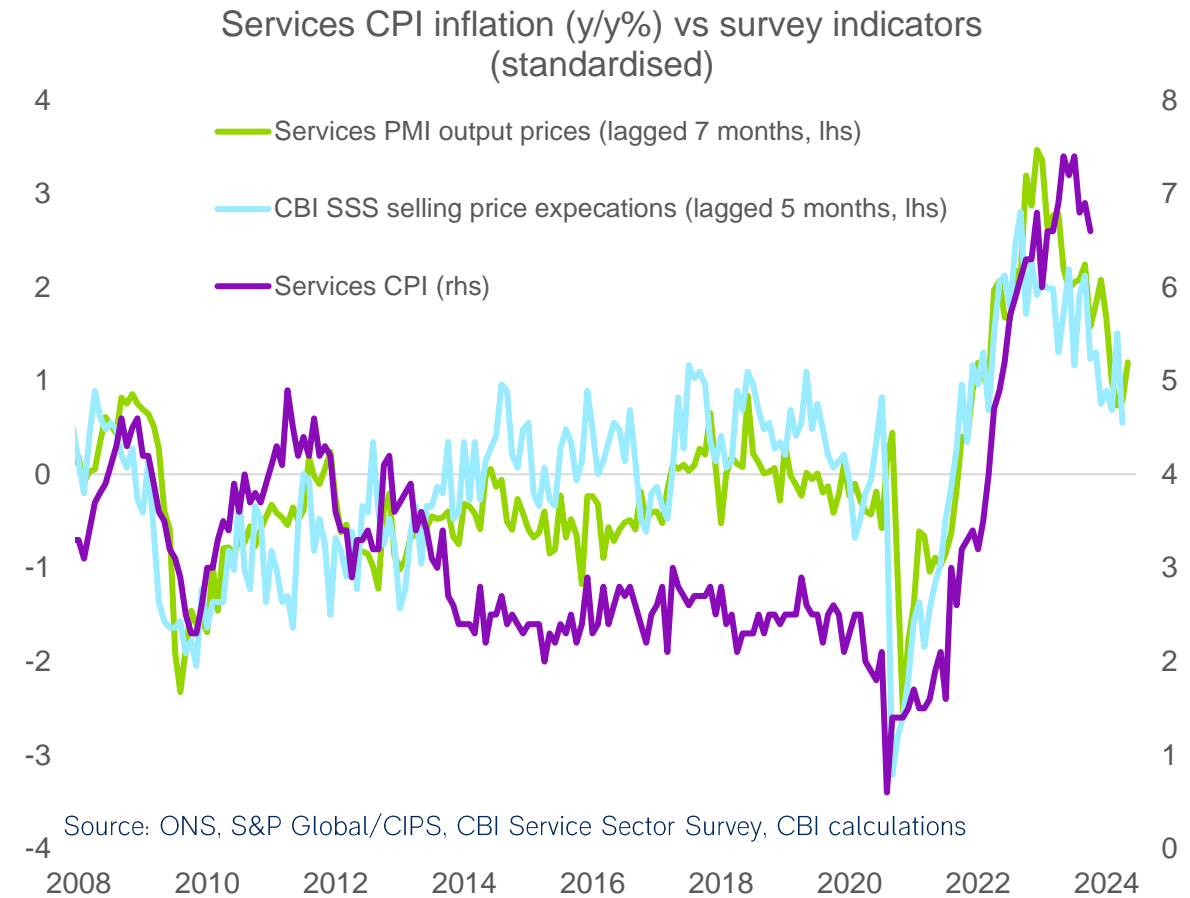
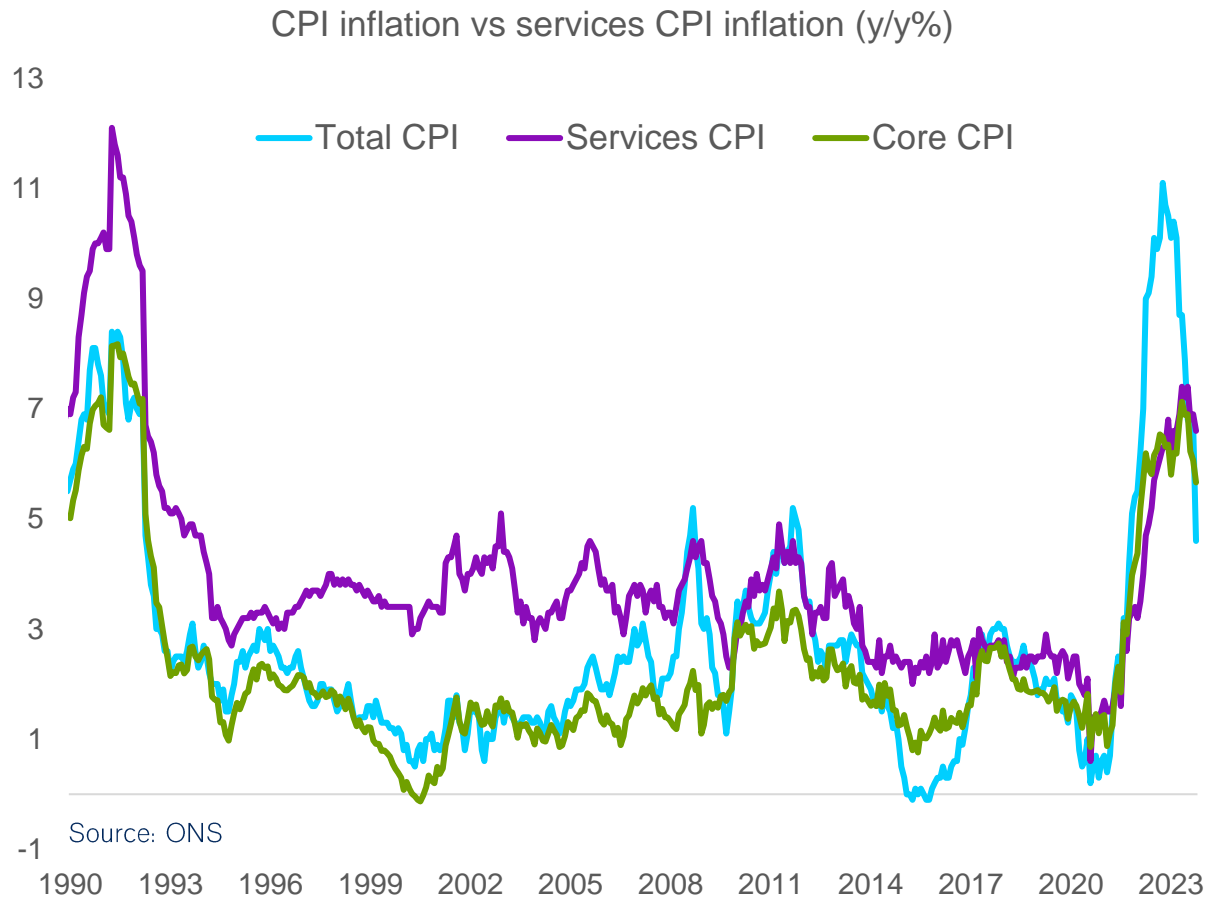


Weekly fuel prices (pence per litre)



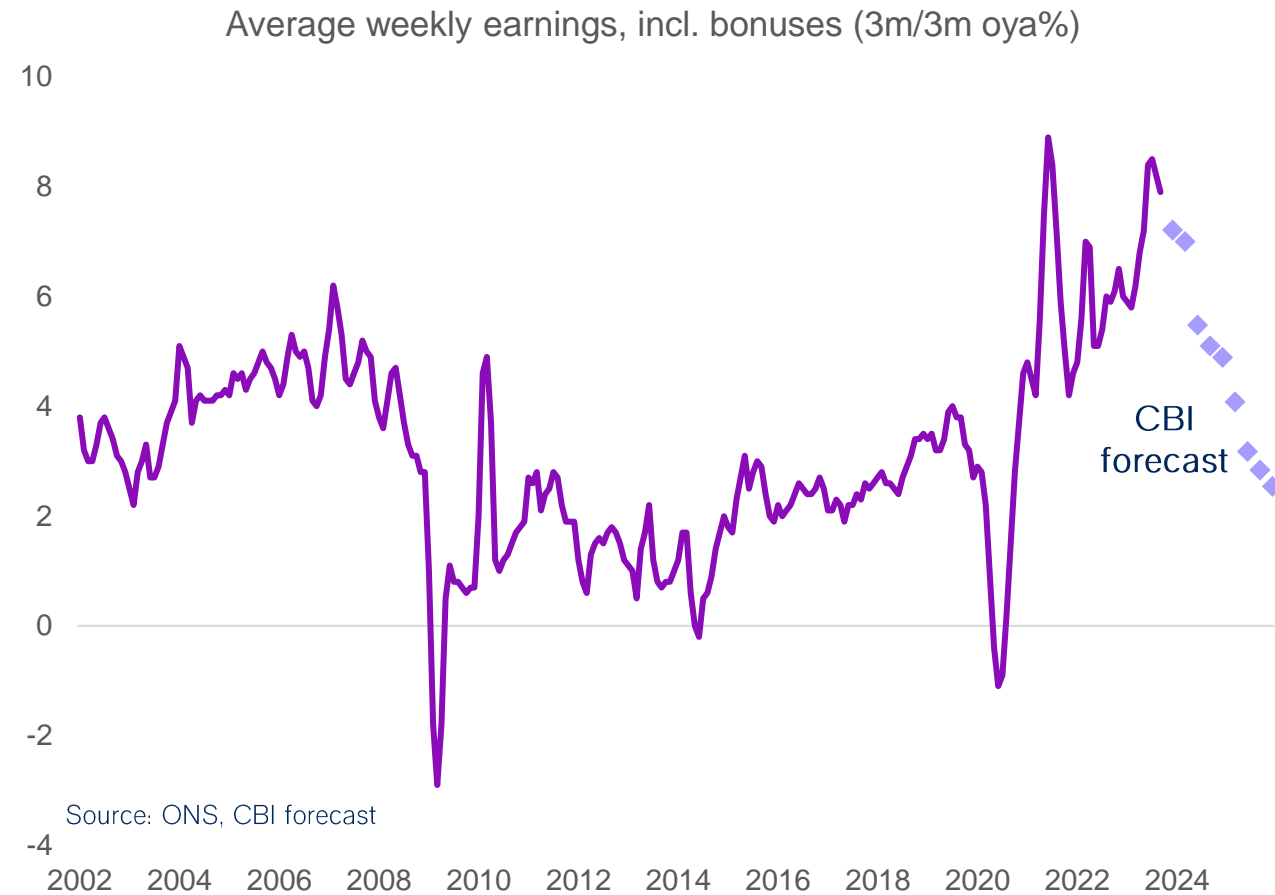
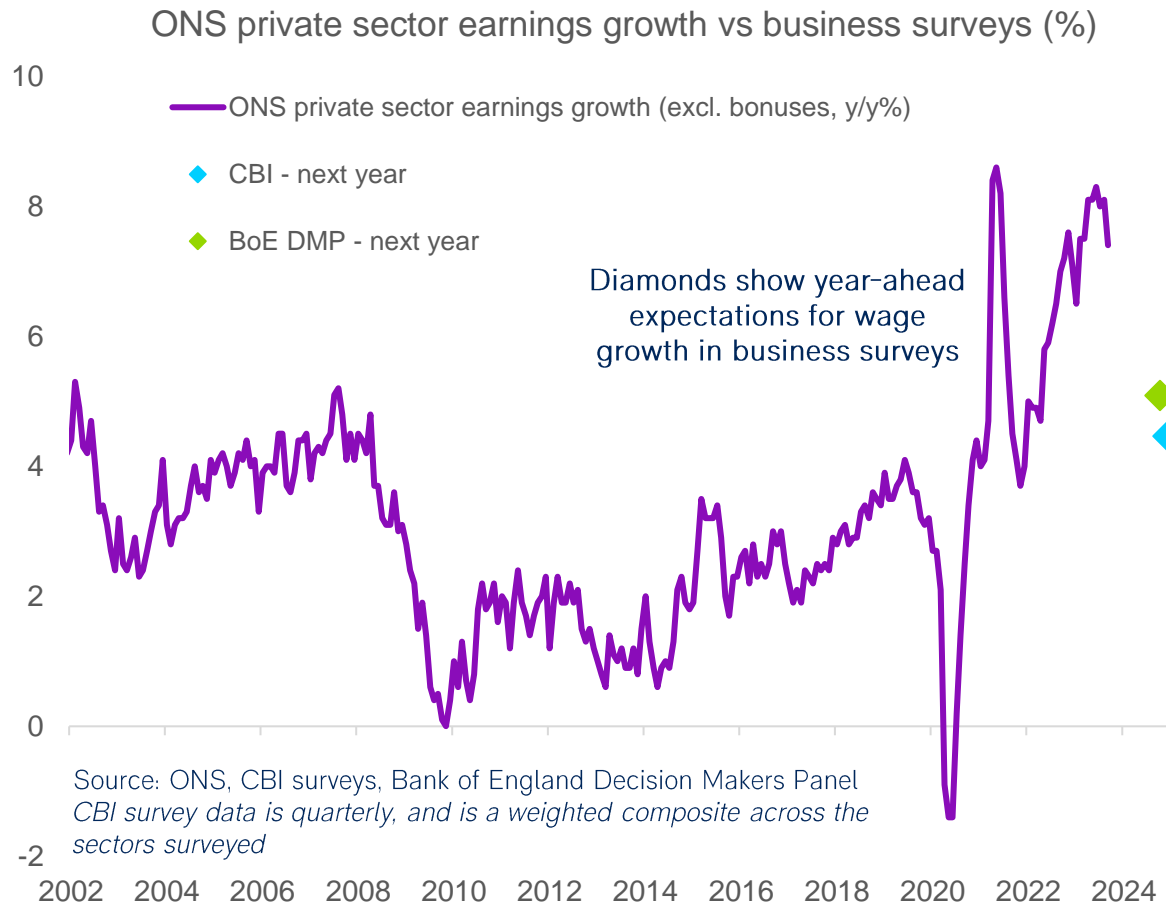
- However, there are some near-term upside risks to inflation from rising oil prices. The pick-up since June had been driven by tightness in global supply, particularly off the back of cuts to production by OPEC and resilient demand for energy, especially from China
- There is growing concern over a spike in prices arising from the conflict between Israel and Hamas. However, oil prices have only reacted mutedly to the conflict so far
- Nonetheless, the oil market outlook now looks more febrile: a potential trigger point for a price spike could be if Middle Eastern oil producers (especially Iran) are drawn into the conflict, or if access to the Strait of Hormuz (through which a significant proportion of oil is transported) is restricted
- More broadly, higher oil prices since the summer have pushed up fuel prices in the UK. We have incorporated this into our forecast, leading to some “bumpiness” in the path of inflation back down

...and domestic price pressures are stubbornly strong...



- In contrast to globally-focused sources of inflation easing, domestic price pressures remain stubbornly strong
- This is best illustrated in services inflation, a more domestically-oriented area of the CPI basket, which has eased only slightly from its 30-year high. This reflects the “second round” impact of a period of high inflation, becoming further embedded in domestic price and wage setting
- However, survey measures of pipeline services inflation point to a significant easing in the months ahead, albeit to levels that are still historically high
- Developments in domestic price pressures are a key consideration for the Bank of England in setting monetary policy. The risk of further stickiness in this area of the CPI basket presents some upside risk to our forecast of inflation falling back persistently

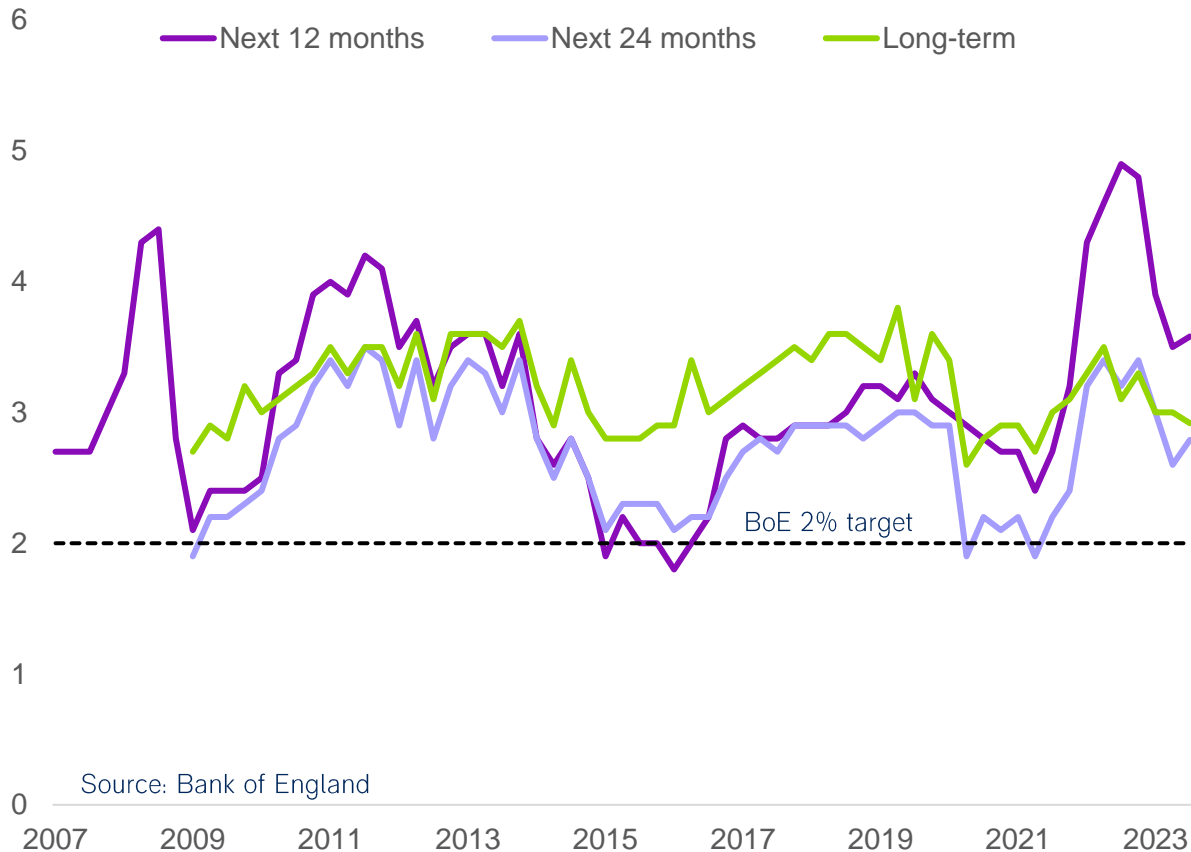
...although some easing off is in the pipeline



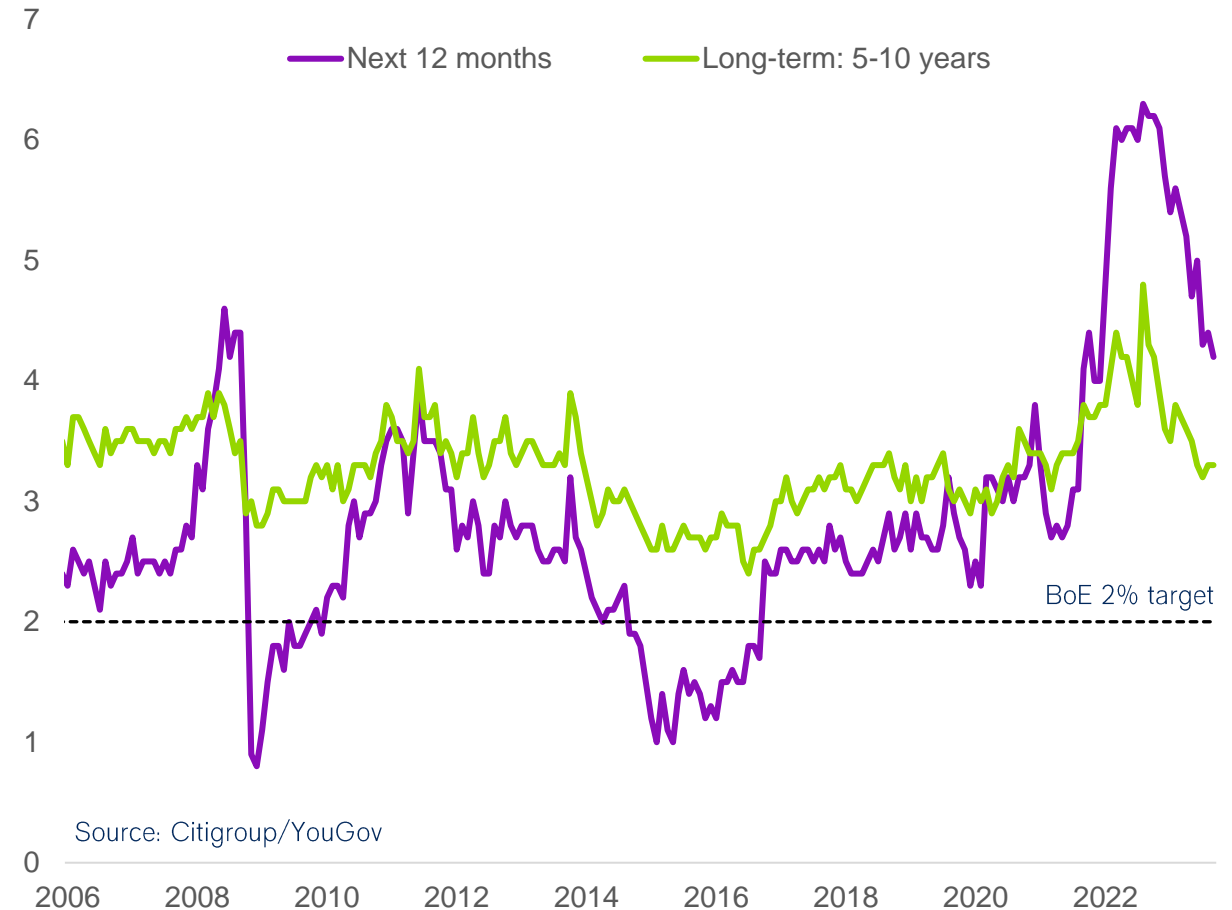
- Private sector wage growth is another indicator of domestic inflationary pressure that has remained elevated
- Survey indicators are pointing to some easing in earnings growth over the year ahead, though once again to a level that is still historically high. Pay settlements data also remain stubbornly firm
- Furthermore, the predictive power of wage surveys against official data has weakened somewhat since the COVID-19 pandemic, consistently pointing to softer wage growth than official data outturns

Inflation expectations remain above 2% CPI target

Bank of England Inflation Attitudes Survey:
median household inflation expectations (%)



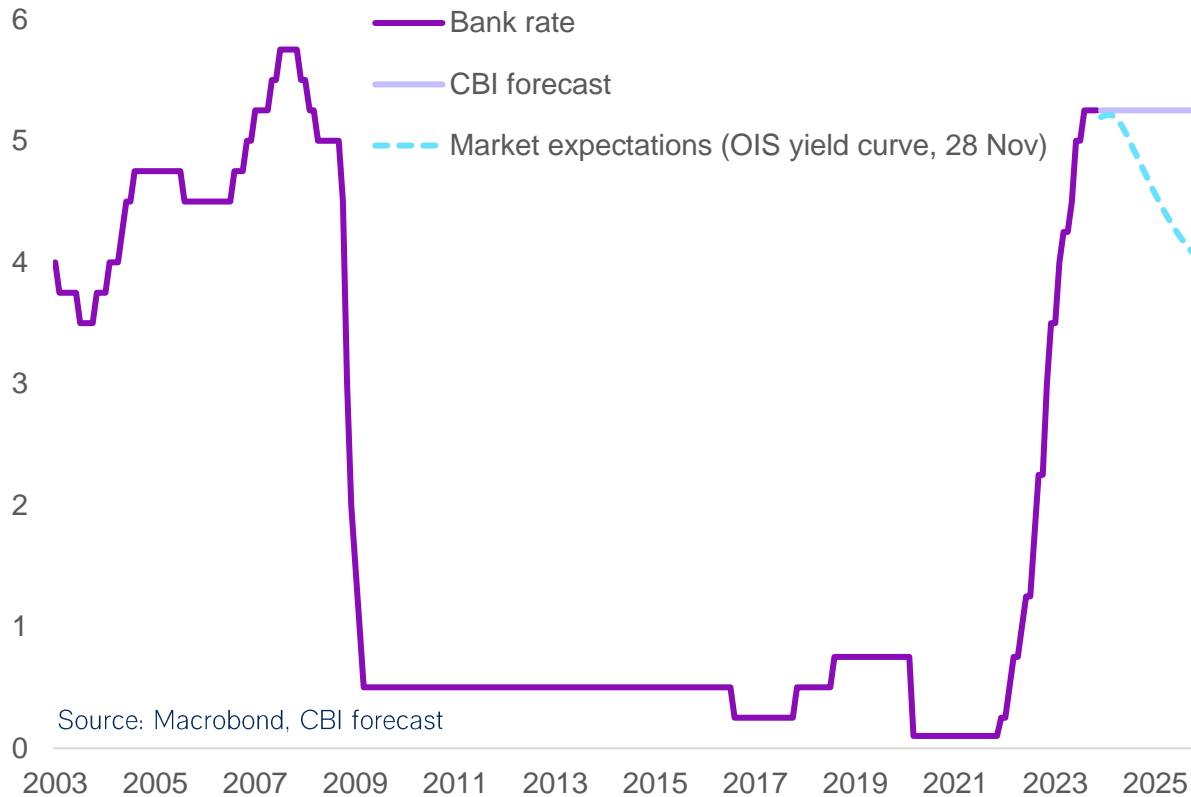
Citi/YouGov consumer price inflation expectations (%)



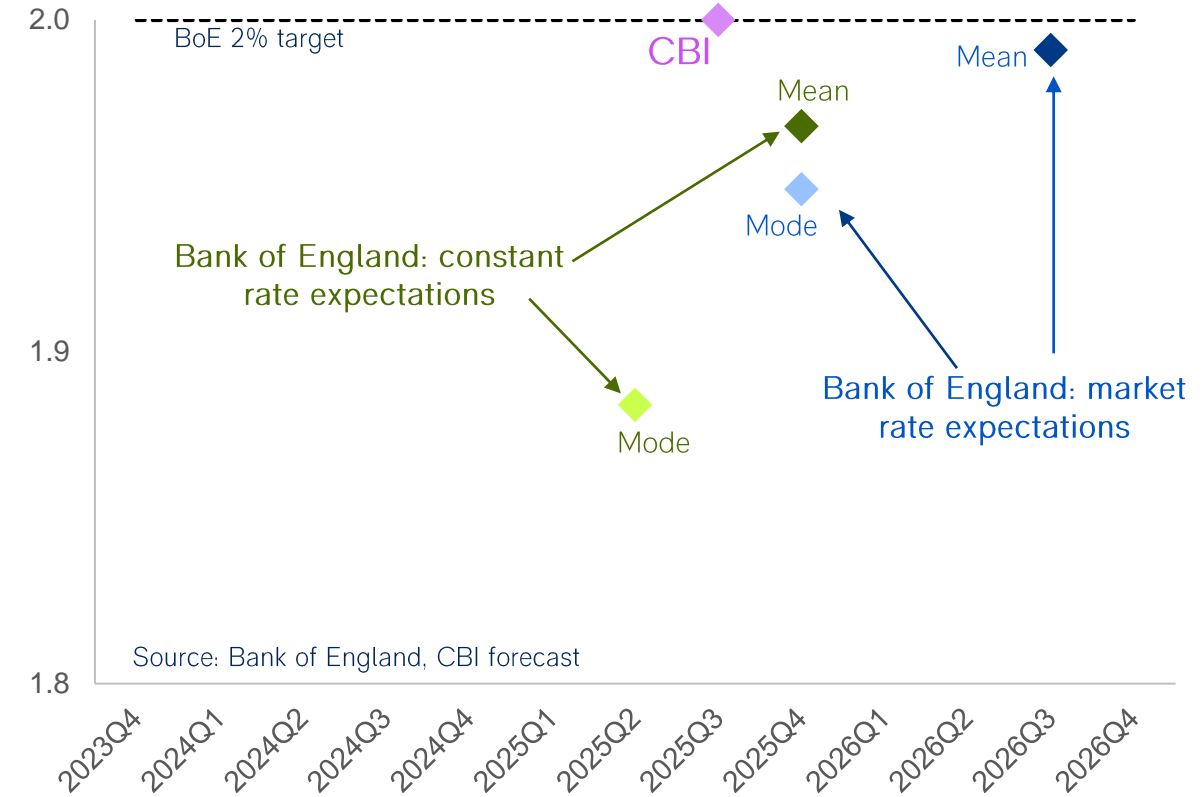
- Measures of household inflation expectations have receded from their highs, but remain well below the Bank of England's 2% inflation target
- Expectations of inflation are a key influence around purchasing and pricing behaviour, and so are an important consideration for the Bank of England
- While it is encouraging that they have fallen, their elevated level reinforces the Bank's "higher for longer" rhetoric around monetary policy

Bank rate to remain at a “restrictive” level

UK Bank rate (%)

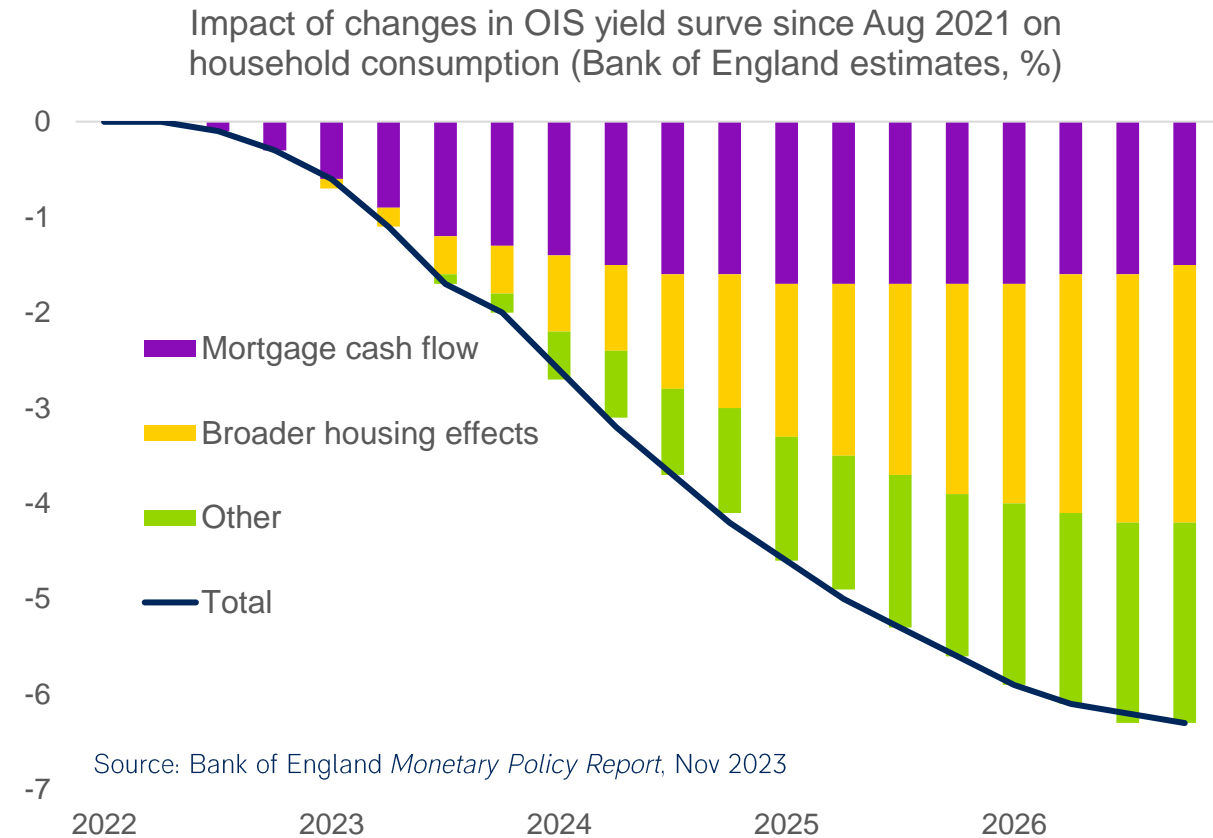
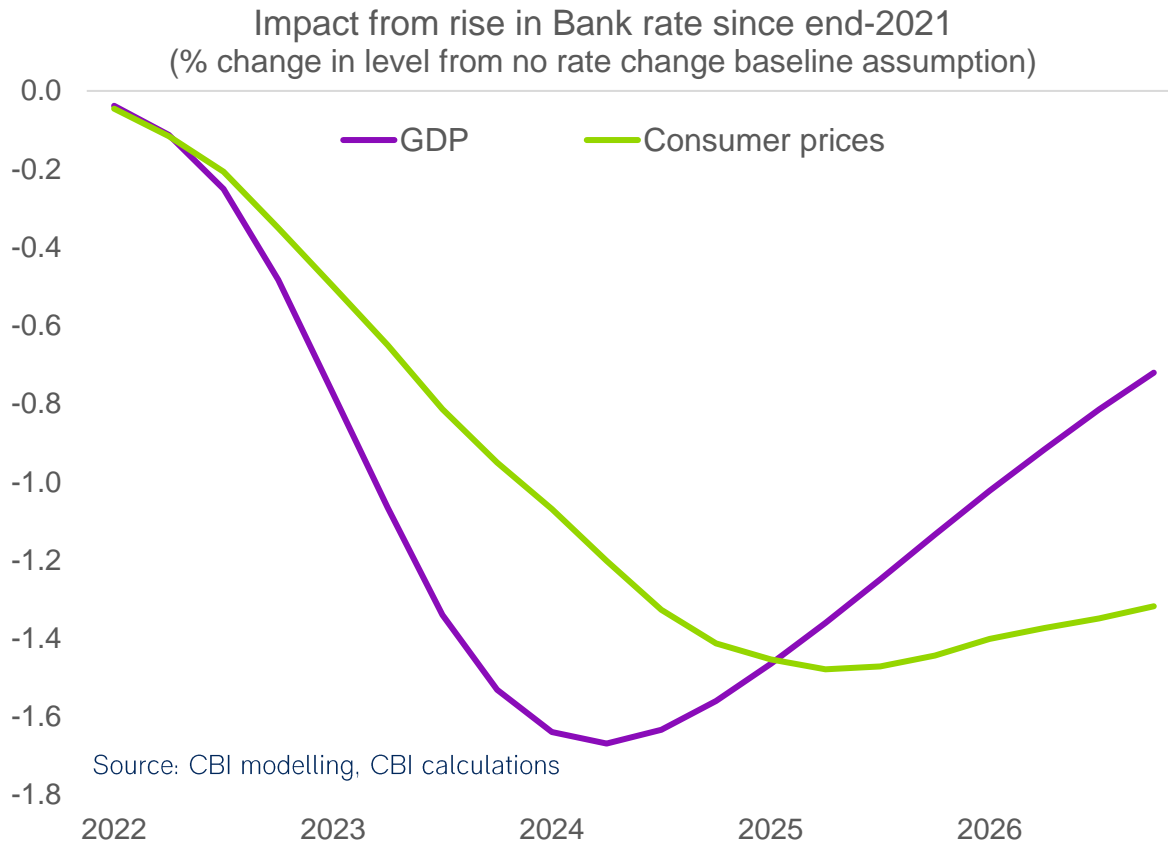


CPI inflation forecasts - timing of return to BoE 2% target



- We expect Bank rate to have peaked at 5.25%, with the MPC having kept rates unchanged for two consecutive meetings. The Committee have signalled their view that the current level of Bank rate is sufficiently restrictive to bring inflation back to target, and they are mindful of weakening economic growth and a loosening in the labour market (concerns over official data notwithstanding)
- The Bank have also more explicitly signalled the need for monetary policy to be “restrictive for an extended period of time” to bring inflation down. As a result, we do not expect rates to be cut over our forecast, in contrast to financial market expectations (which are pencilling falls in rates from mid-2024)
- The Bank’s latest forecast seem to lend some support to this. Under an assumption where interest rates do not change (“constant rate”) their mean CPI inflation forecast (which takes into account the full skew of forecast risks) returns to target in around two years’ time – chiming with estimates of the horizon at which the cumulative rise in interest rates should have its full impact on inflation

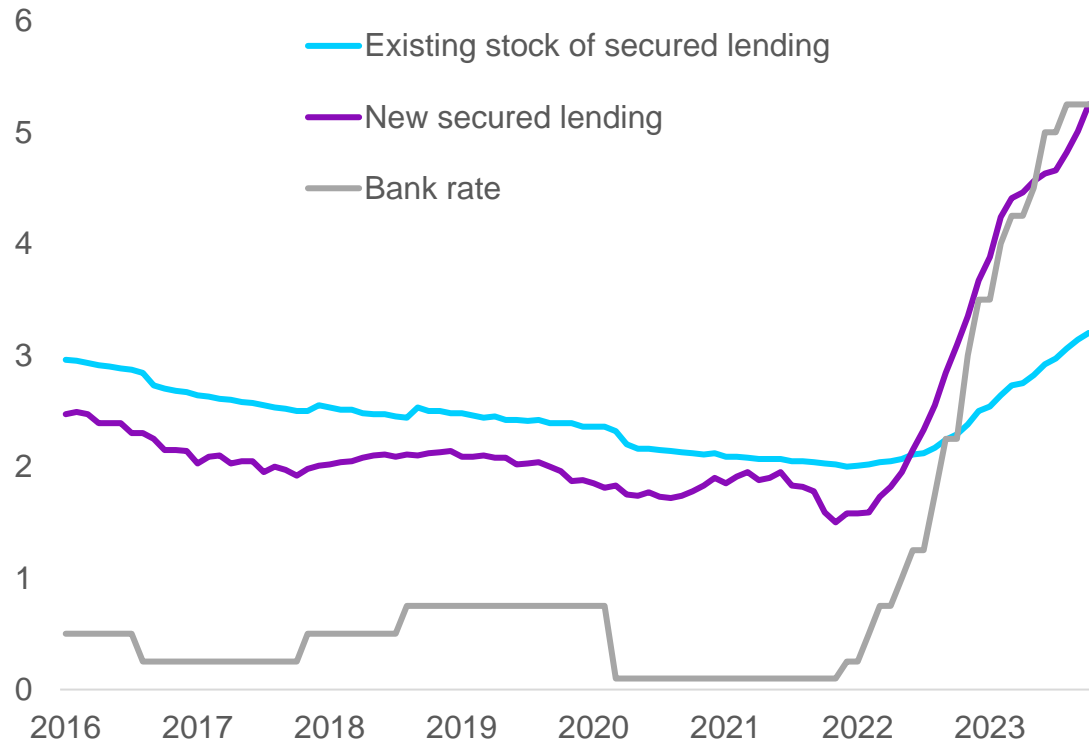
Peak impact of higher rates is yet to be felt...



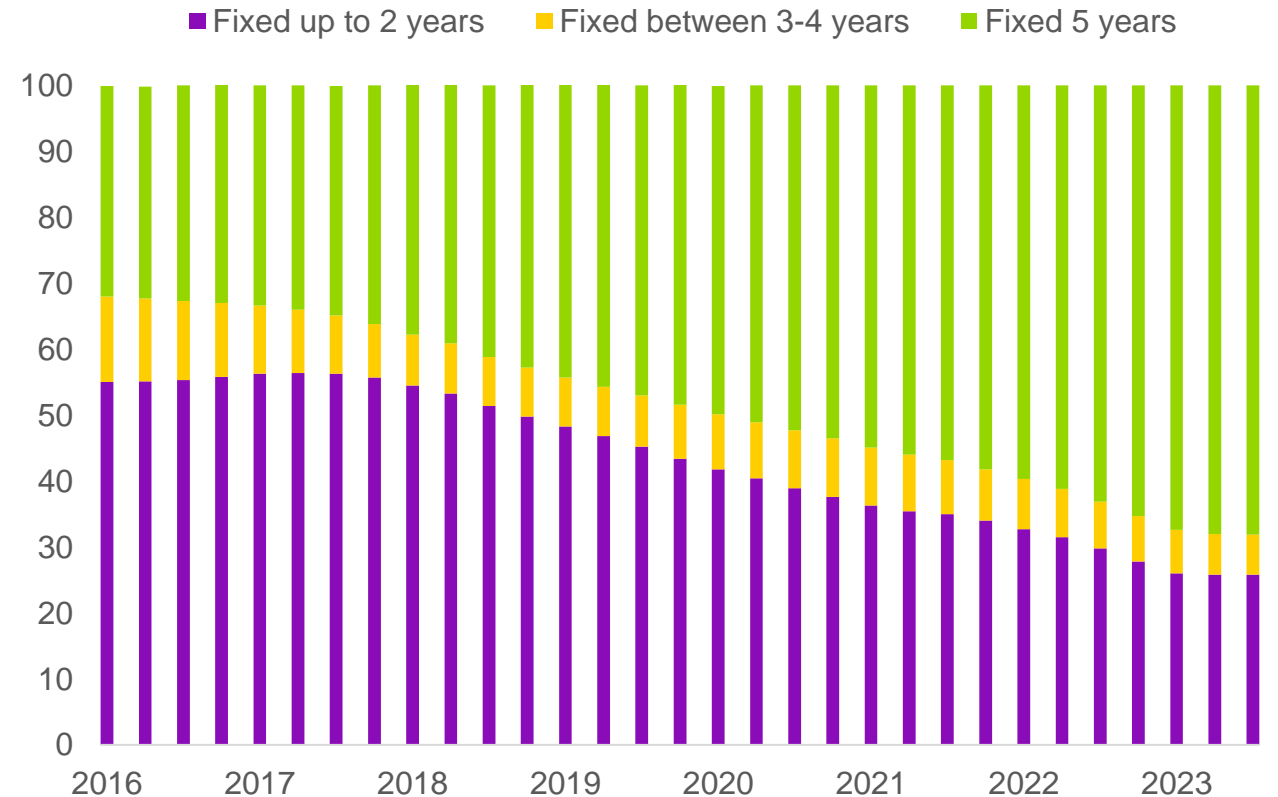
- As a rule of thumb, changes in Bank rate are estimated to feed through to the economy with a lag of between 18 to 24 months, with the impact on GDP occurring sooner than on prices
- On this basis, the peak impact of the cumulative rise in rates is only just starting to be felt. Our modelling suggests that the peak impact on GDP will hit in the middle of 2024, with the peak impact on prices occurring only a year later (compared to a scenario were rates were unchanged at their historic low of 0.1%).
- Similarly, the Bank of England estimate that the cumulative impact on household spending has only just started to build
- Estimates of the feed-through of interest rates to activity/prices need to be treated with caution, given varying assumptions around numerous factors – including households' changing propensities to spend and save, the behaviour of financial markets, and developments in the global economy and monetary policy abroad.

...and could take longer to materialise in this tightening cycle

Effective interest rates on secured lending and Bank rate (%)



Stock of fixed secured lending by term (% of total)



Source: Bank of England

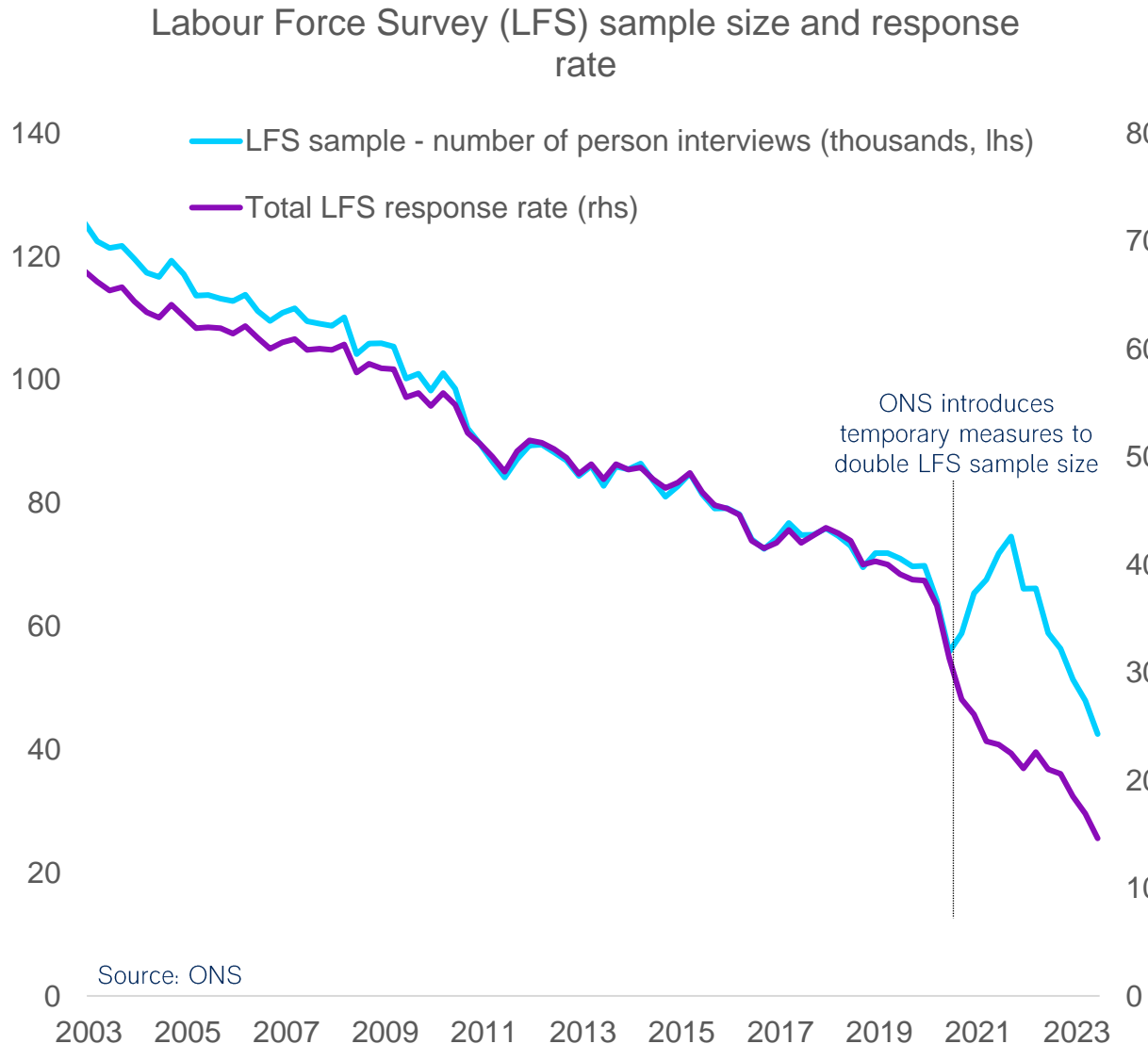
- However, it is likely that rising rates are taking longer than usual to feed through to GDP and inflation
- One reason is because there are now more mortgagors on fixed rate mortgages than in previous tightening cycles (fixed-rate mortgages now make up 90% of the total)
- The average length of mortgage fixes has also risen over time, with fixes of 5 years and above now making up the majority of fixed-rate mortgages
- As a result, rates on the stock of secured lending have risen by less than on new loans. This suggests that the full hit from rising rates to the consumer has yet to be felt.

Is R^* an appropriate benchmark for monetary policy?

- Our forecast for no further change in Bank rate makes us somewhat of an outlier among private sector forecasters, most of whom are anticipating some reduction in rates next year. Our expectation of interest rates staying at their current level is underpinned by the judgements inherent in our broader projections:
 - The stickiness in the path of inflation ahead, particularly given that it remains above the Bank of England's 2% target until mid-2025, and core inflation remains above 2% throughout our forecast period
 - The ongoing persistence of domestic price pressures, with wage growth remaining above levels consistent with 2% inflation for much of our forecast
 - The general rhetoric from MPC members, pointing to no cut in rates for the foreseeable future
 - Demand-side inflationary pressures picking up in 2025, with activity firming and the labour market beginning to recover
- Given growing scrutiny over where policy rates across the world will settle, there is increased interest in the concept of R^* - the real interest rate that prevails when an economy is at its potential (i.e. at full employment/maximum output, while inflation is constant). The general view is that central bankers will consider this as a benchmark for the "appropriate" level of interest rates over the long-run.
- In theory, R^* is influenced by the balance between saving and investment preferences in an economy. For example, an increase in desired saving for a given desire to invest will lower the real interest rate required to bring actual saving and investment into line
- There is general consensus that R^* has fallen over the last few decades due to a number of factors (outlined below). This has led many to believe that peak central bank rates across the world will be lower than in previous tightening cycles, and may even be cut sooner:
 - *Ageing populations mean that people have accumulated more savings, or may choose to save more over their lives to fund spending in retirement, which pushes down on R^**
 - *Similarly, rising income inequality has meant that more money has flowed to those in higher income groups, who tend to save more*
 - *Desired investment is lower, as the cost of finance has fallen by less than risk-free rates, which will reduce R^**
 - *This could reflect investors needing more compensation to hold risky assets, perhaps reflecting increased risk aversion or heightened perceptions of risk*
 - *Relatedly, slower trend productivity growth has also reduced R^* , since lower expected returns on investment have reduced demand for capital*
- R^* is unobservable, making it a tricky benchmark. It is also very path-dependent, influenced by a myriad of moving parts in the global economy over time. While there is speculation that it has risen in recent times (contrary to its longer-term downward trend), this is very difficult to prove, and very dependent on assumptions employed in its modelling
- Thus, estimates of what the value of R^* is vary wildly, and most studies focus on the global rate or, at best, the rate in the US
 - *A recent study by the Bank of England estimates global real R^* to be between zero and -0.75% in real terms. Adding on the Bank's 2% inflation target, this implies a nominal global short-term interest rate of between 1.25% to 2%*
 - *A study by the US Richmond Federal Reserve puts R^* at a median of 2.28% in the US, as of Q2 2023. But another study by the New York Fed puts US R^* at around 1.2%*
- Despite the inherent uncertainty, estimates of R^* suggest that global monetary policy is restrictive – i.e. policy interest rates are above the level of R^* , thus tightening economic conditions
- But while R^* is a useful framework for think about the "appropriate" level of interest rates over the long-term, there is little evidence to suggest that plays a guiding role for central bankers in making decisions about short-term changes in monetary policy

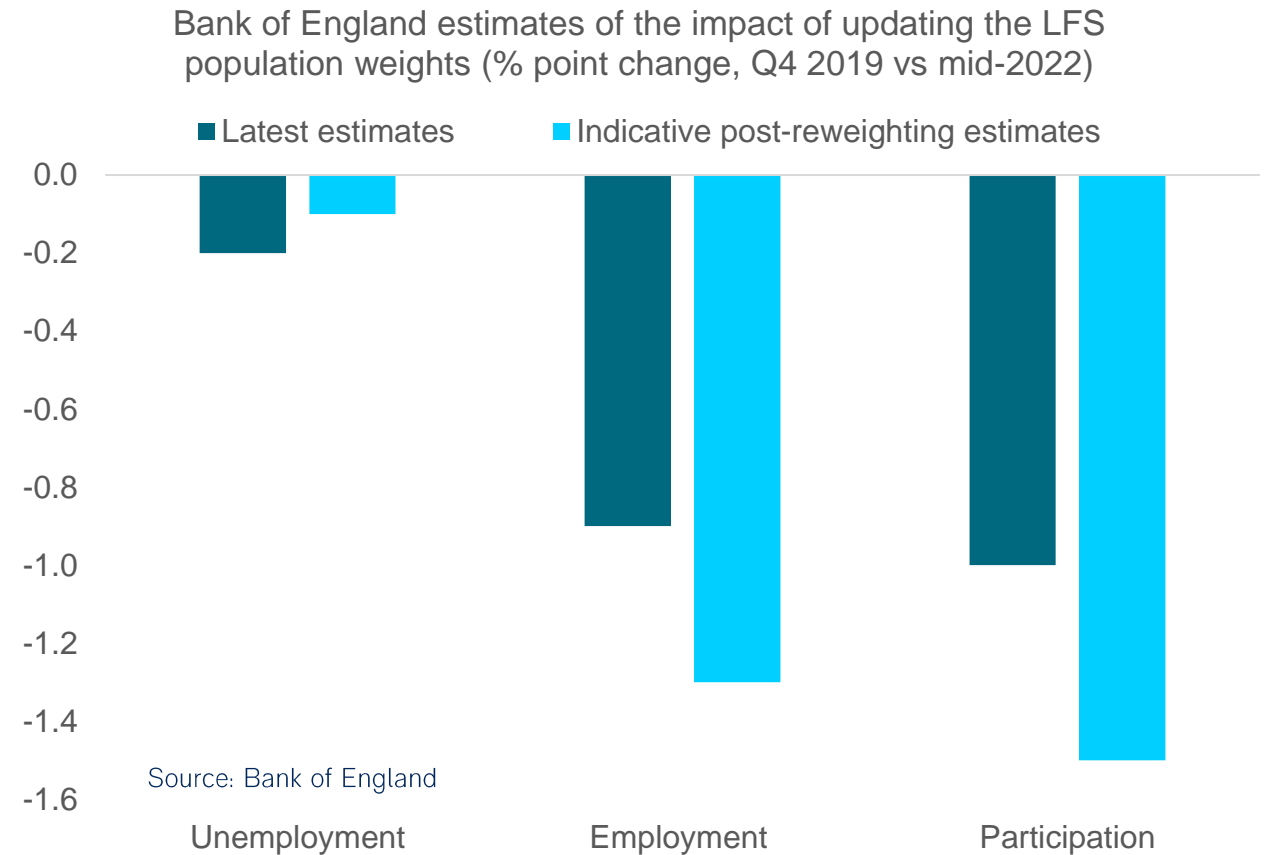
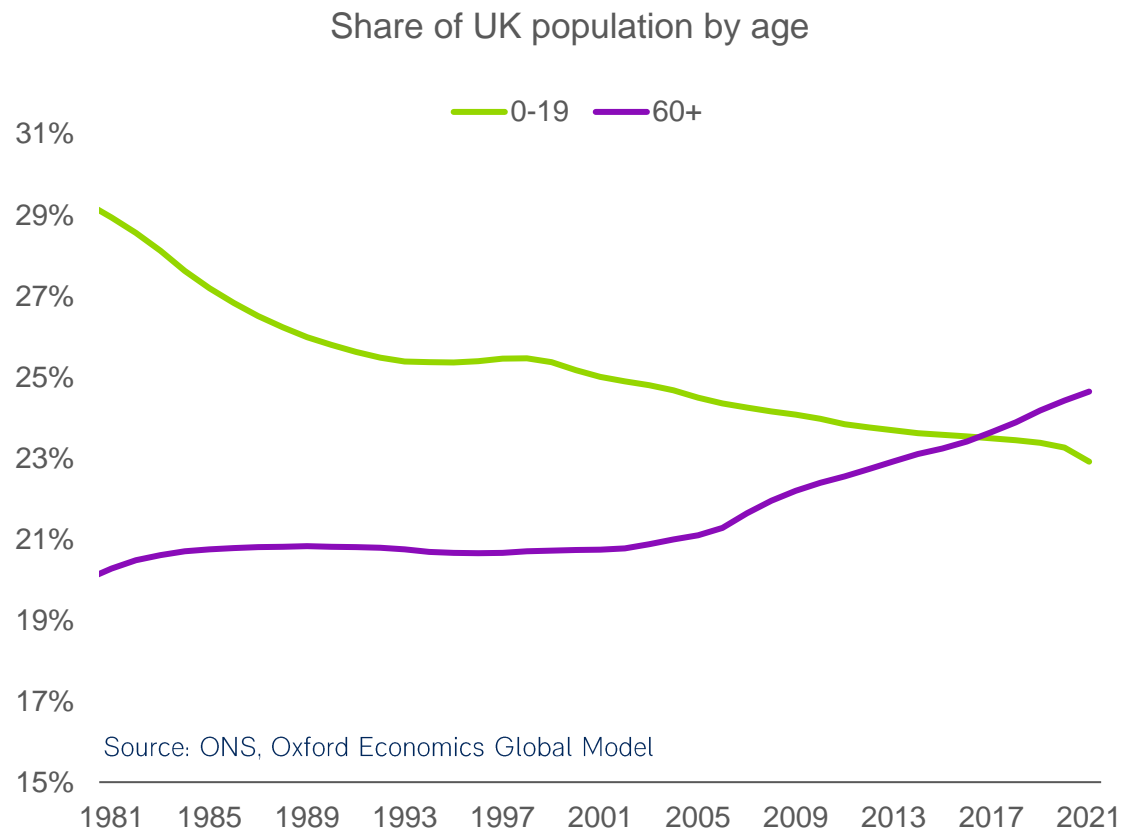
Sources: Bank of England, Financial Times

Sampling issues muddy the UK's labour market picture



- The Office for National Statistics is grappling with sampling issues in its Labour Force Survey (LFS), which is raising questions over the accuracy of some labour market data
- The response rates for the survey have been in long-term decline, exacerbated by social distancing measures during the COVID-19 pandemic (which meant that face-to-face interviews could not be conducted)
- The ONS have made some attempt to address this – doubling its sample size in mid-2020, and introducing a “knock-to-nudge” approach (i.e. re-instating face-to-face engagement on the doorstep) in November 2022 to boost response rates in under-represented areas
- However, the response rate is now so low that the ONS themselves have flagged caution over the quality of the LFS parts of the labour market data – which includes employment, unemployment and inactivity
- The ONS have instead been producing ["adjusted" LFS data](#), which adjusts headline employment and unemployment estimates using PAYE data from HMRC, and claimant count figures on the numbers claiming jobless benefits. Both sets of data have their own methodological issues
- A new transformed LFS is due to be launched in Spring 2024, which will be an online-first survey. But this leaves a vacuum of robust labour market data until then, complicating assessments of labour market developments and prospects
- In particular, assessment of labour market tightness/slack is a key consideration for the Bank of England's Monetary Policy Committee, so a lack of reliable data could have implications for setting monetary policy.

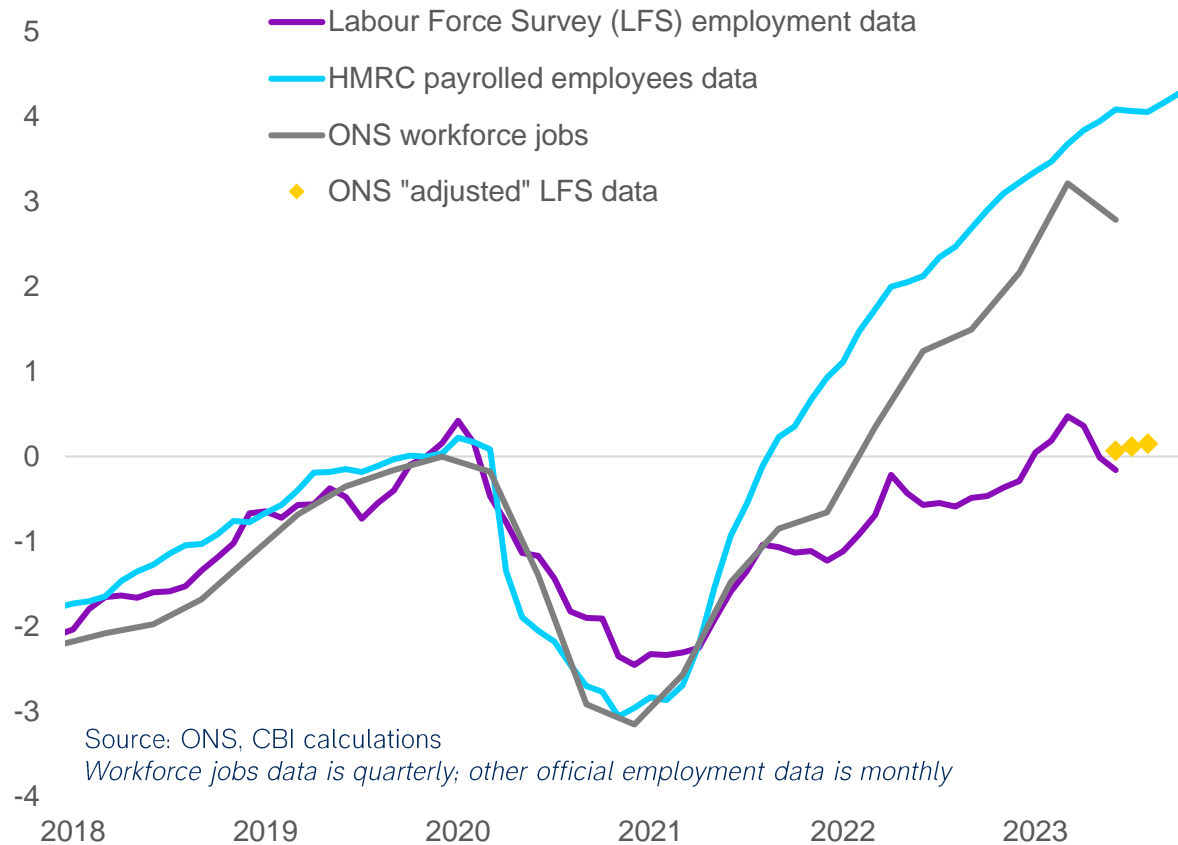
What is the UK's true labour market story?



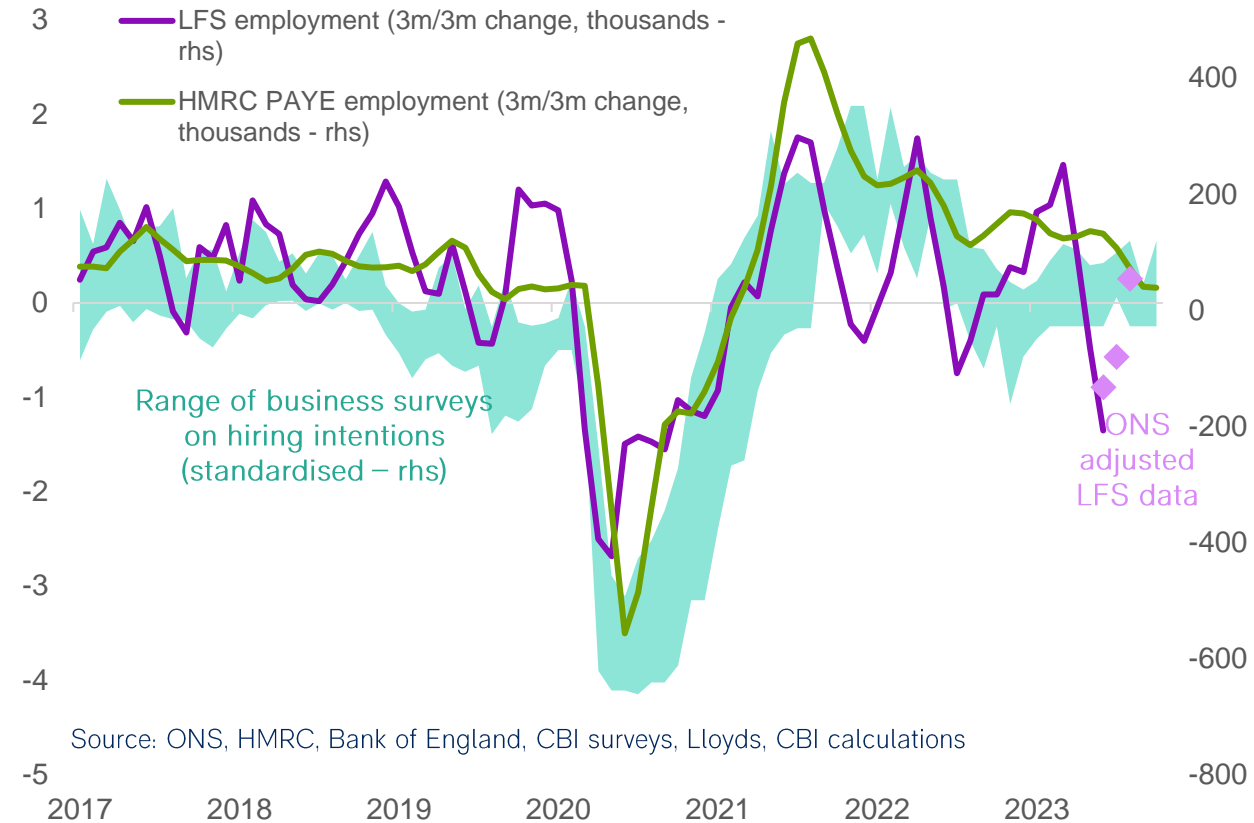
- The LFS data is also weighted using population assumptions in mid-2021 – and therefore assumes that the dynamics of the population have not changed since then
- The data doesn't capture more recent information about the population, such as greater-than-assumed inward migration and the ageing demographics
- In particular, the latter means that the LFS data underweights older people, as they are more likely to be out of the workforce. This means that current estimates of the participation and employment rates are likely too high
- Estimates by the Bank of England suggest that the population re-weighting would reduce the employment and participation rates in mid-2022 by around 0.4 percentage points, with little impact on unemployment

What is the UK's true labour market story?

UK employment (% change since Q4 2019)

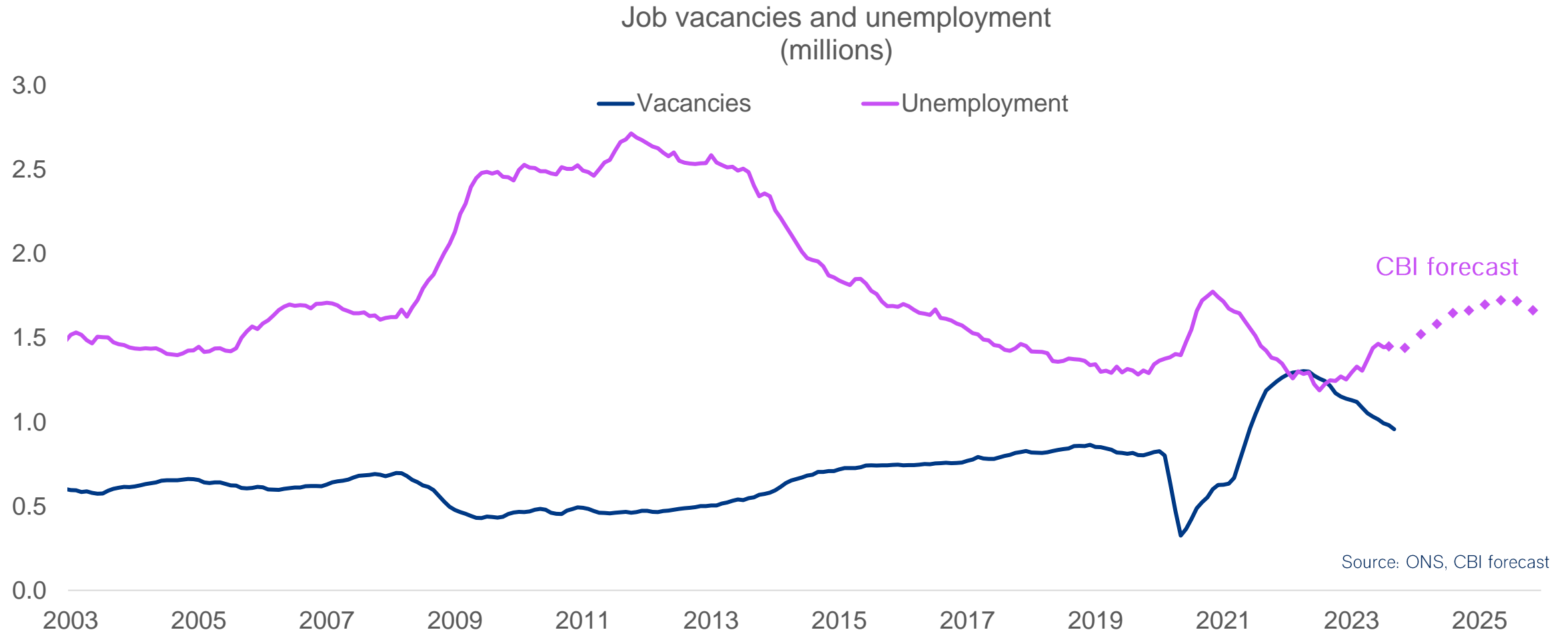


Employment growth vs hiring intentions



- The sampling issues in the Labour Force Survey have cast doubt over the accuracy of the employment data. The "adjusted" series produced by the ONS implies that while the labour market is still loosening, it is doing so to a lesser degree than the LFS data suggests
- Other measures – such as payrolled employees and workforce jobs – suggest a much stronger labour market picture. Though the payroll data particularly is subject to frequent revisions, and is not classified by the ONS as a national statistic
- Survey data (including the CBI's) act as another indicator of labour market prospects. A range of surveys suggest that hiring intentions have softened over the last year, but the picture here still seems to be one of relative resilience.

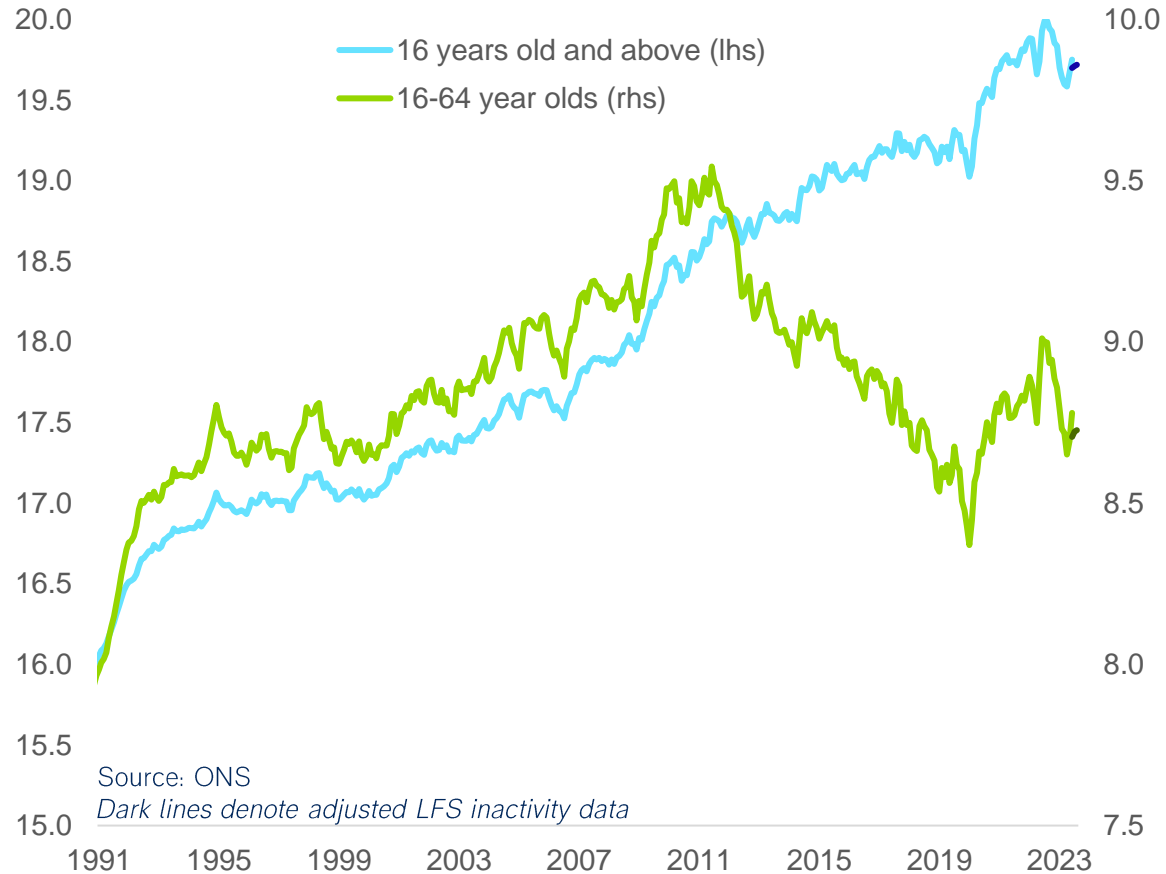
Labour market to loosen, but stay relatively tight



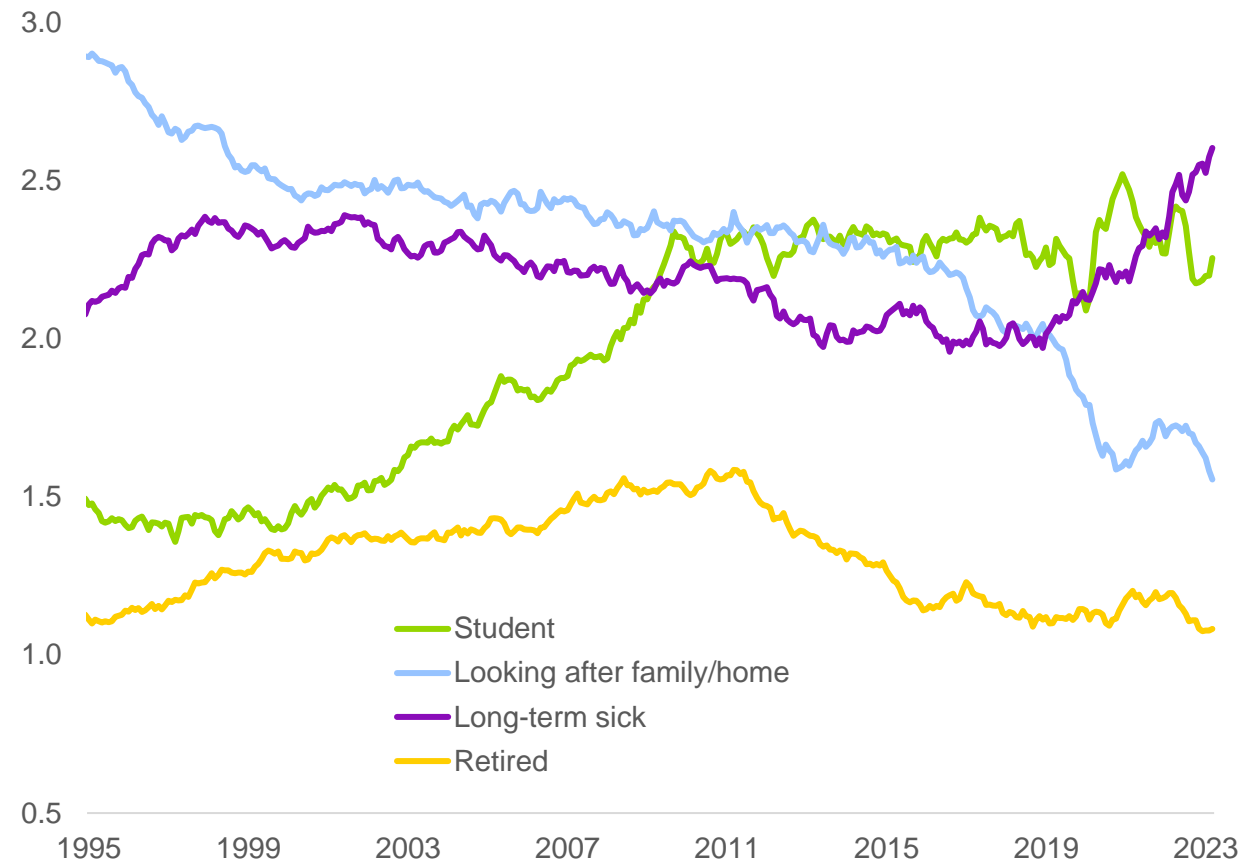
- We expect a modest loosening in the labour market up until mid-2025, as continually weak growth weighs on hiring. Unemployment is then set to fall back towards the end of our forecast horizon, as economic activity gains a firmer footing
- Despite the rise in unemployment over the year ahead, it remains low by historical comparison. The big picture remains one of a mild loosening in the labour market from a historically tight position, rather than a larger and more sustained rise in unemployment
- Uncertainty over the LFS data over the recent past poses some risk to our forecast

High inactivity could perpetuate labour market tightness

Labour market inactivity (millions)

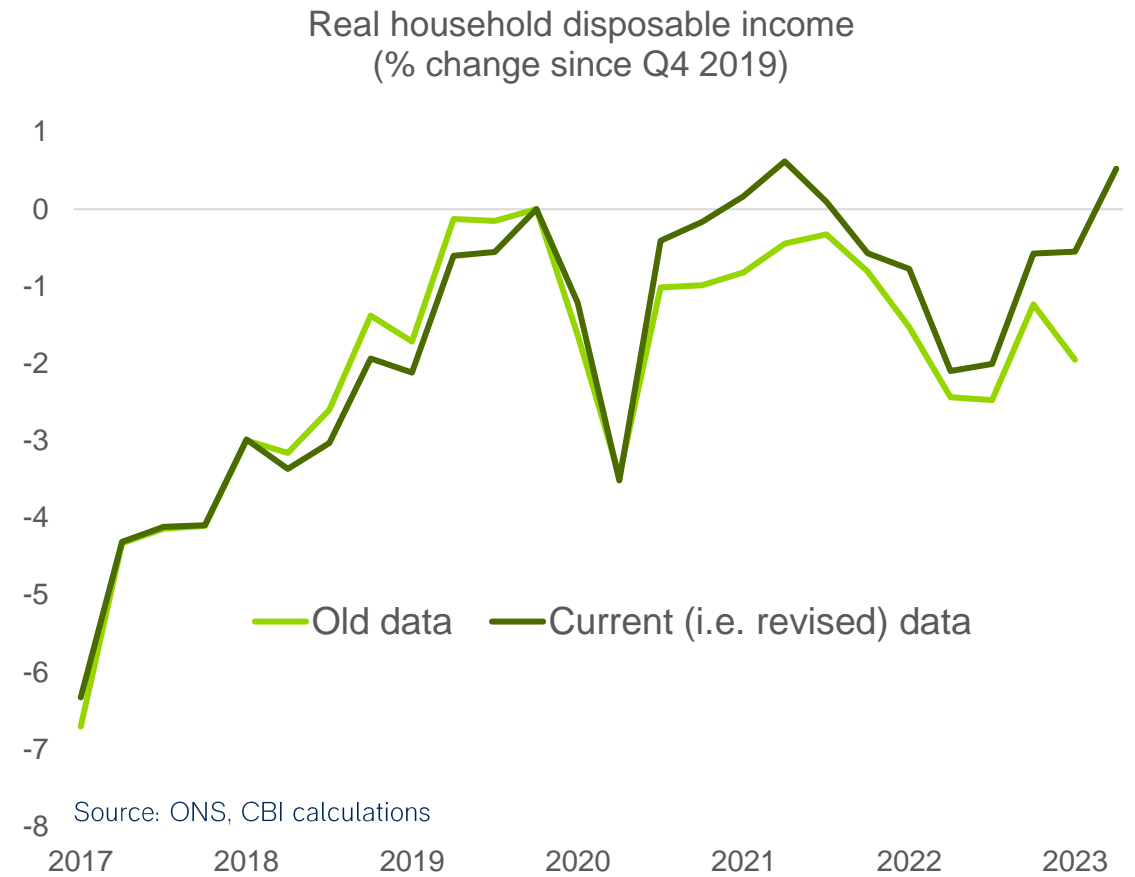
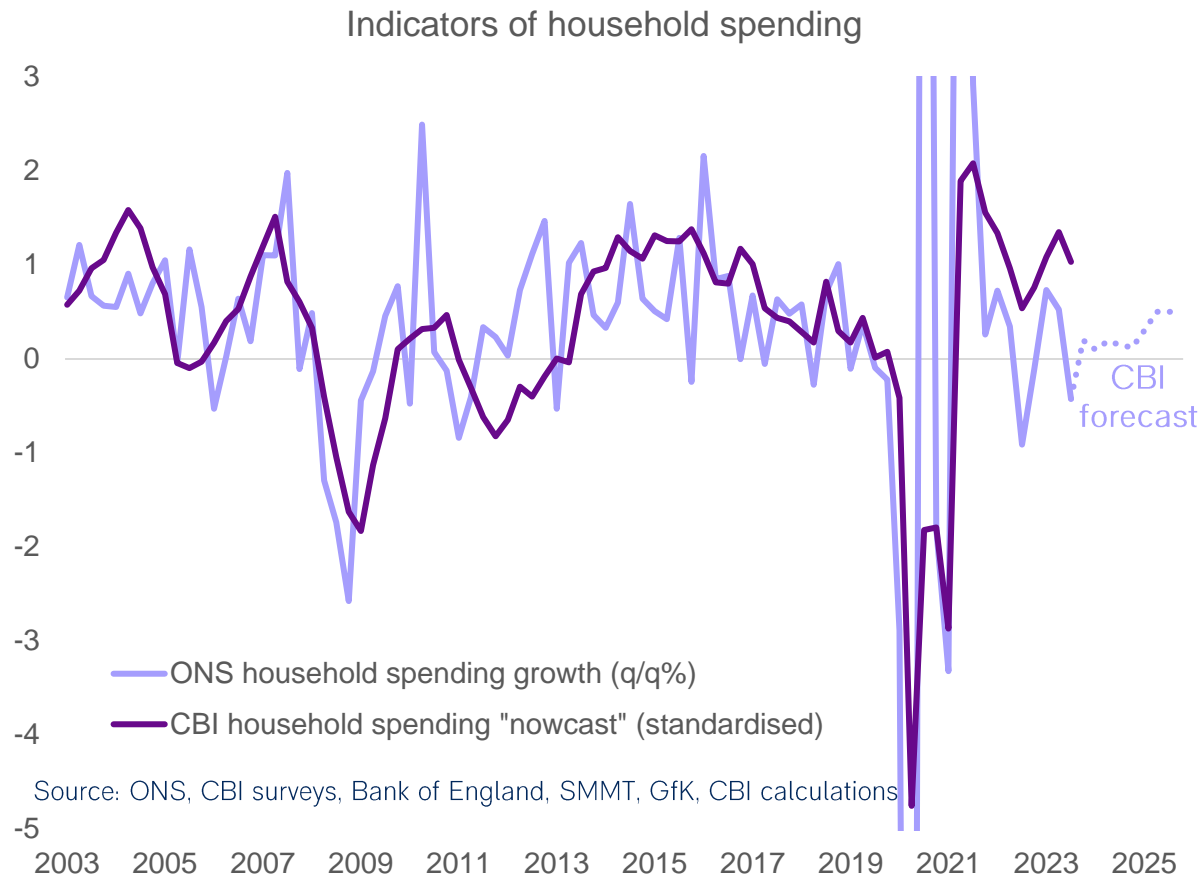


Inactivity (16-64 year olds) by reason



- The tightness in the UK labour market specifically has been exacerbated by rising inactivity – i.e. people dropping out of the labour force – since COVID
- While inactivity among the working age population has fallen back, it is still above pre-COVID levels, and participation continues to fall among those aged 65 and above
- Moreover, the numbers becoming inactive due to long-term sickness continue to rise to new record highs, standing at 2.6 million in the 3m to July 2023
- This is a key area of consideration for policymakers, and trends in inactivity going forward are also a significant risk for our labour market forecast. Once again, uncertainty over the LFS data, and the prospect of revisions to historical data further ahead, are also muddying the waters.

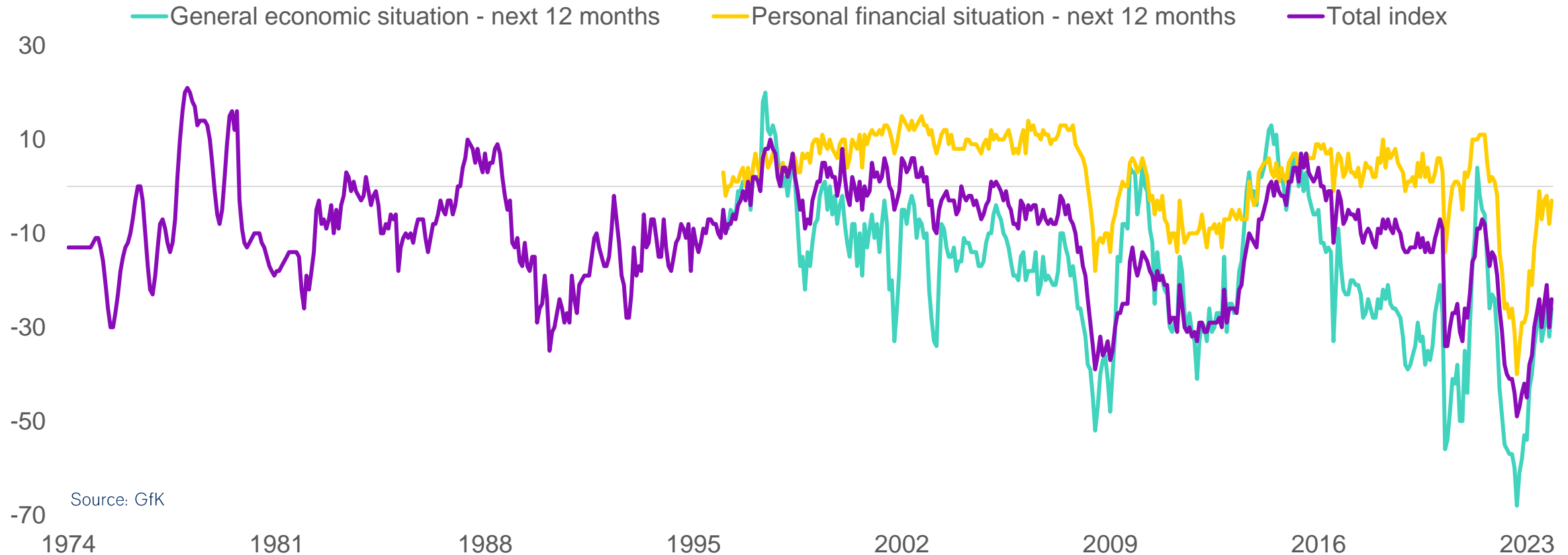
Household spending has been weak, but resilient



- Household spending has been weak over the last couple of years, but remarkably resilient in the face of high inflation and the erosion of real incomes
- Our consumer spending "nowcast" – a composite of various indicators of household activity – corroborates this, and has pointed to even more resilience in household activity than implied by ONS data
- Part of this has been underpinned by substantial revisions to real incomes data by the ONS. While incomes still look to have fallen significantly in 2022, the new vintage of data suggests that they have recovered significantly since, rising back above pre-COVID levels in Q2 2023.

Consumer confidence is starting to pick up

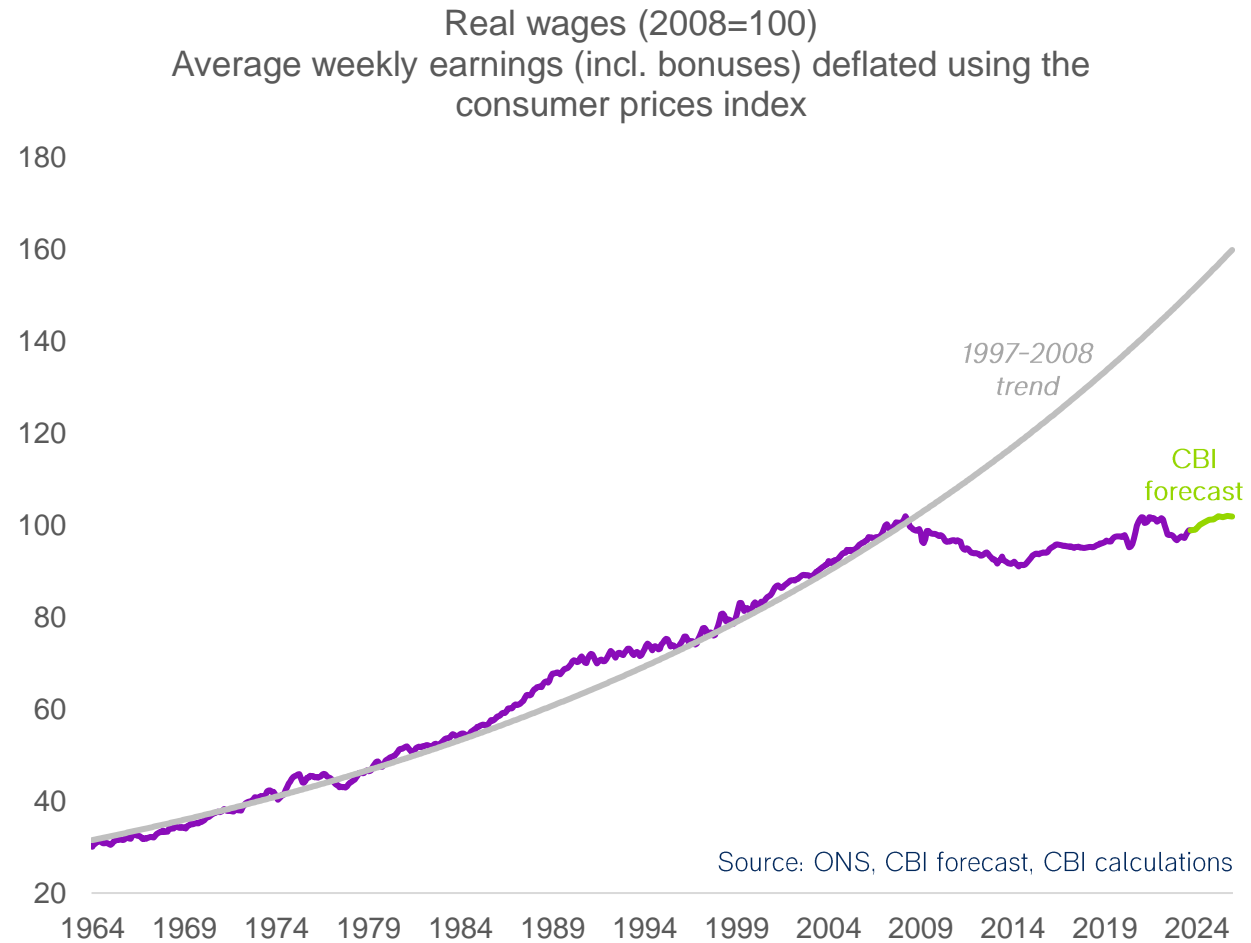
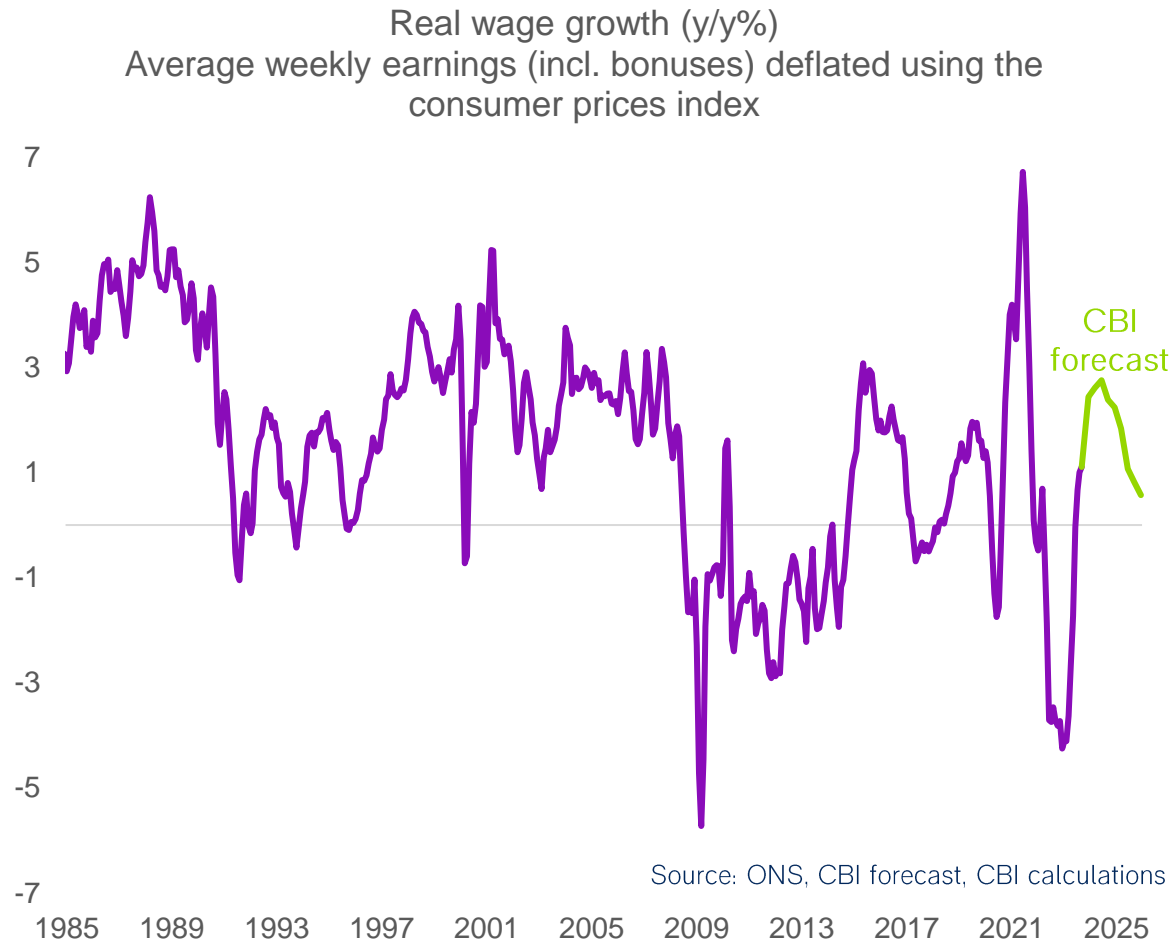
GfK consumer confidence index



Source: GfK

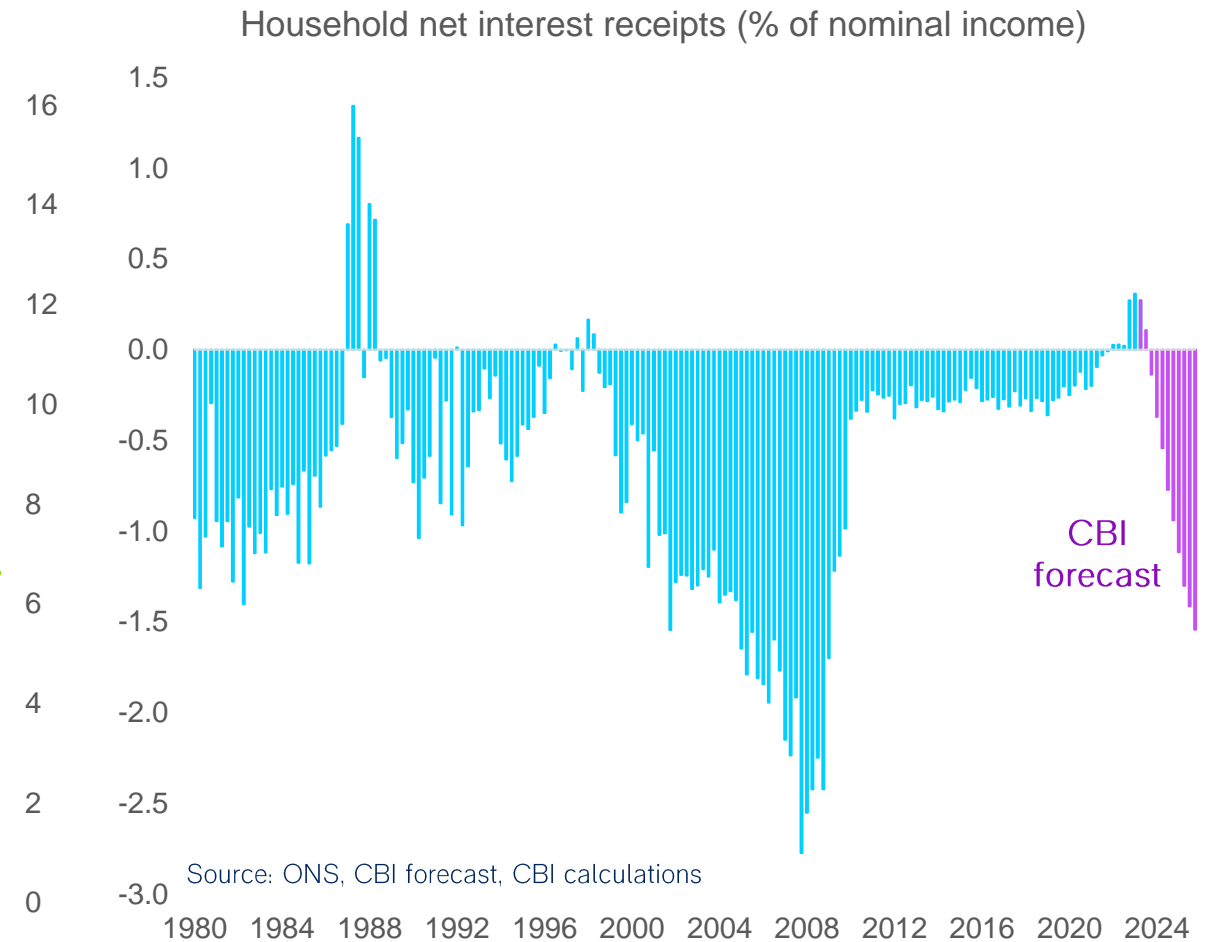
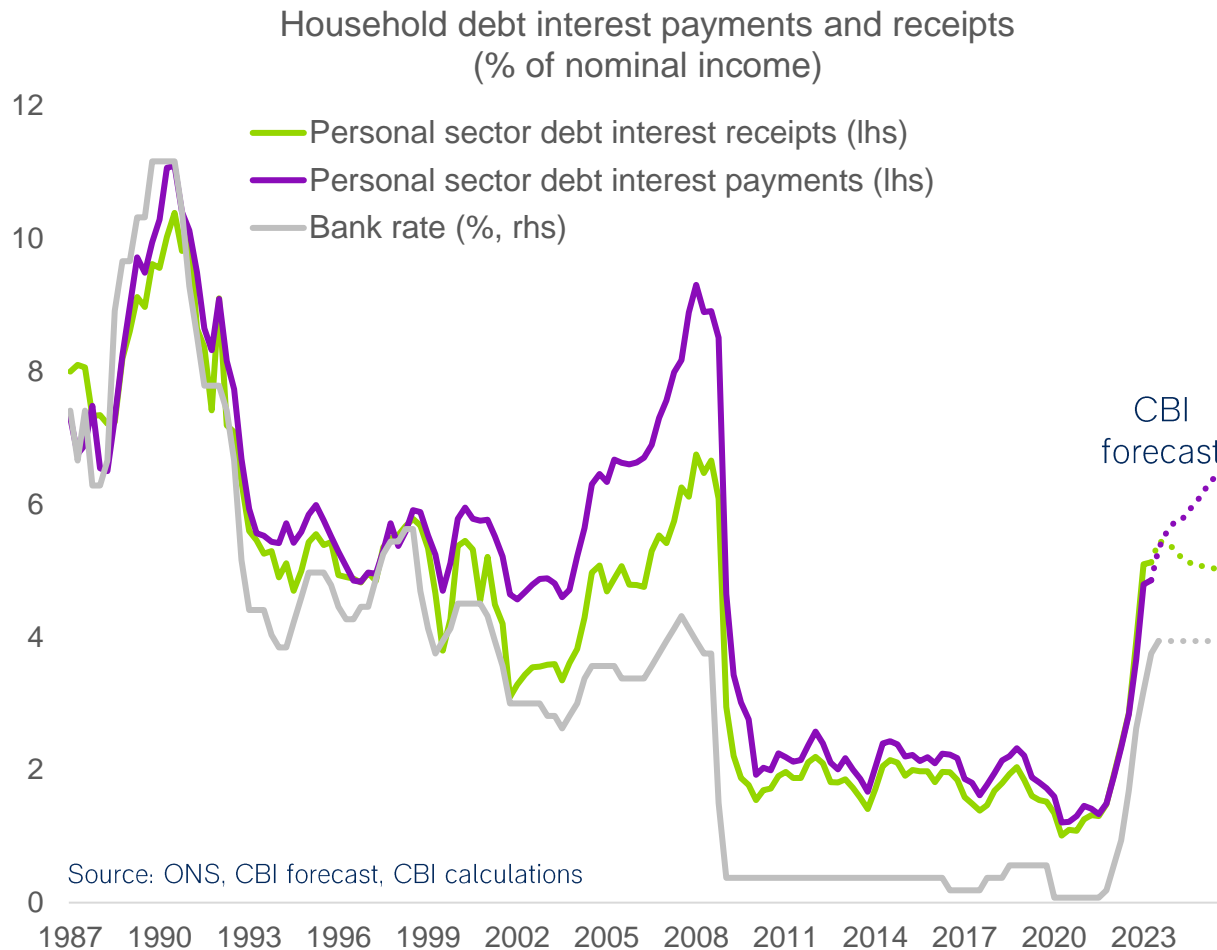
- Consumer confidence has also started to pick up from its record low in September 2022. The rise has been broad-based, but particularly notable in households' expectations about their personal finances and the general economic situation
- This has been underpinned by inflation falling back, real wages returning to growth, and a still-tight labour market
- However, consumer confidence is rising from a very low base, and household sentiment remains febrile – as illustrated by a dip in the GfK index in October

Rising living standards mask longer-term stagnation...



- Real pay growth has already returned to positive territory, with inflation falling back and nominal earnings growth picking up
- We expect real pay growth to continue building momentum until mid-2024, giving a firmer underpin to household spending. However, it slows thereafter, as nominal earnings growth eases, off the back of a cooling labour market and a lower inflationary impulse.
- The recovery in real earnings also does little to shift the underlying trend of stagnation that has been apparent since the 2008/09 financial crisis. By the end of our forecast, real wages are still 36% below a continuation of their pre-crisis trend

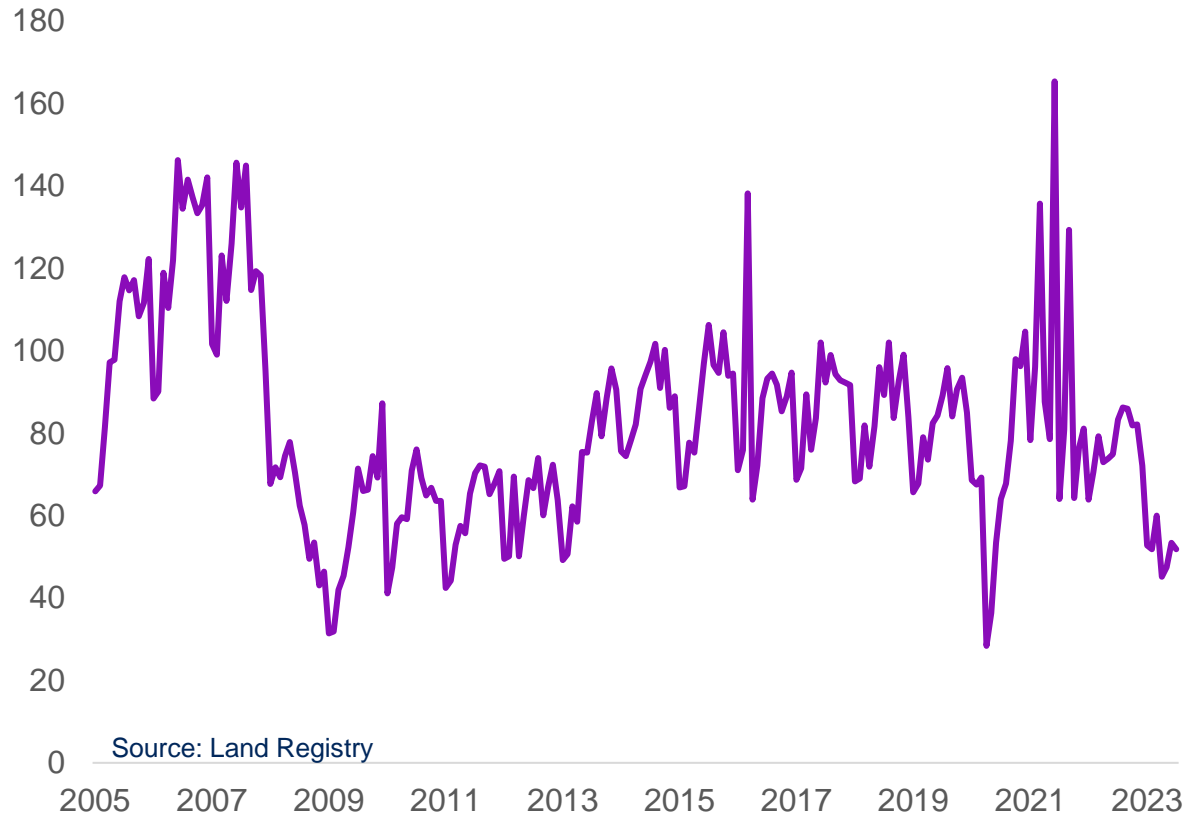
...and higher interest rates will increasingly bite on households



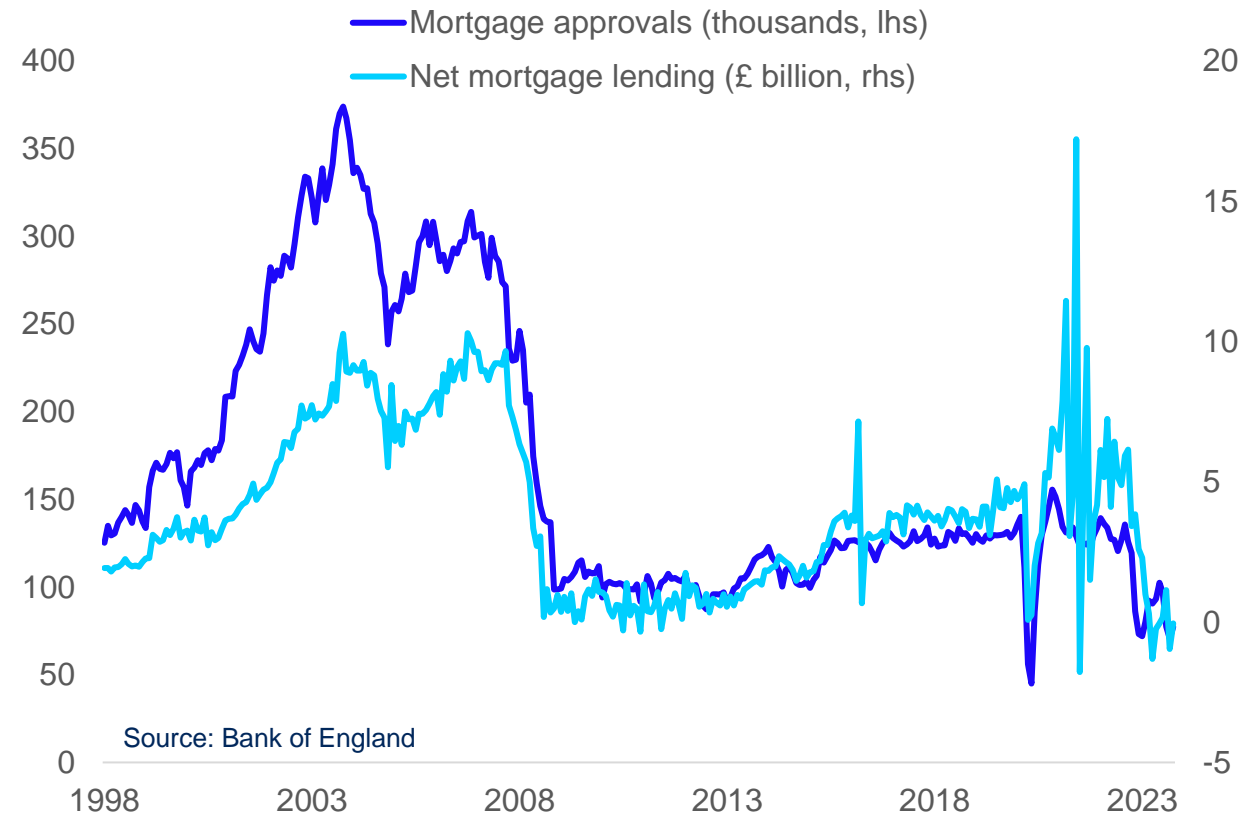
- However, the initial boost from real wage growth is partially offset by a sharp fall in households' net interest receipts
- This reflects the impact of higher interest rates feeding through to debt interest repayments, particularly on mortgages. As such, the gap between debt interest payments and receipts widens over our forecast
- On a net basis, interest receipts turn negative, to the greatest extent since early 2009 (i.e. just before Bank rate was cut to a then-historic low of 0.5%)

Higher interest rates are also weighing on the housing market...

Real estate transactions (thousands)

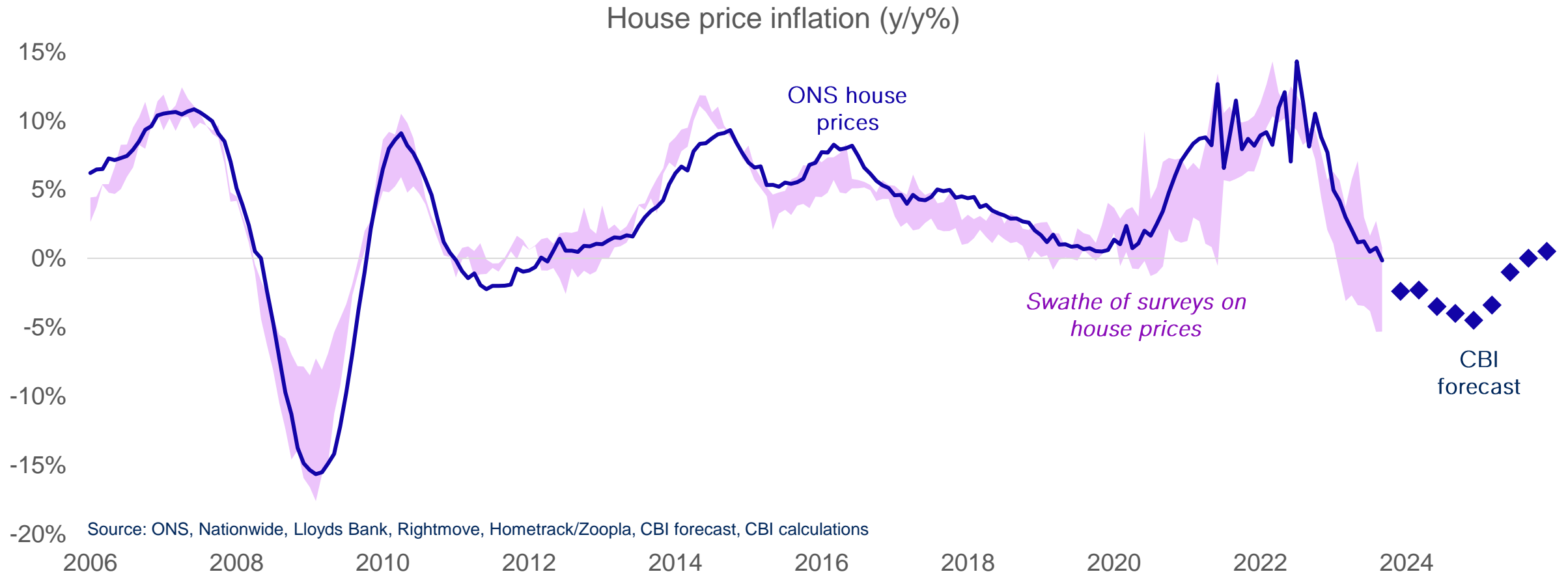


Mortgage approvals and net mortgage lending



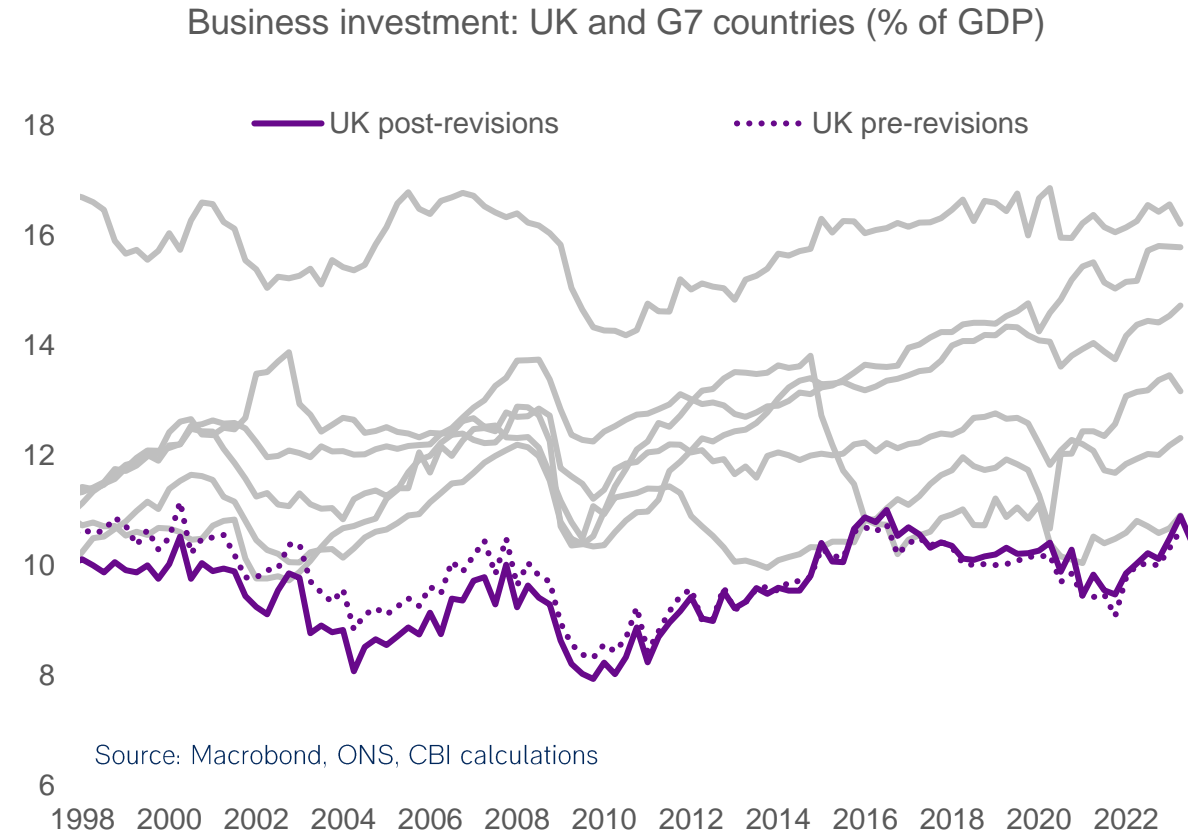
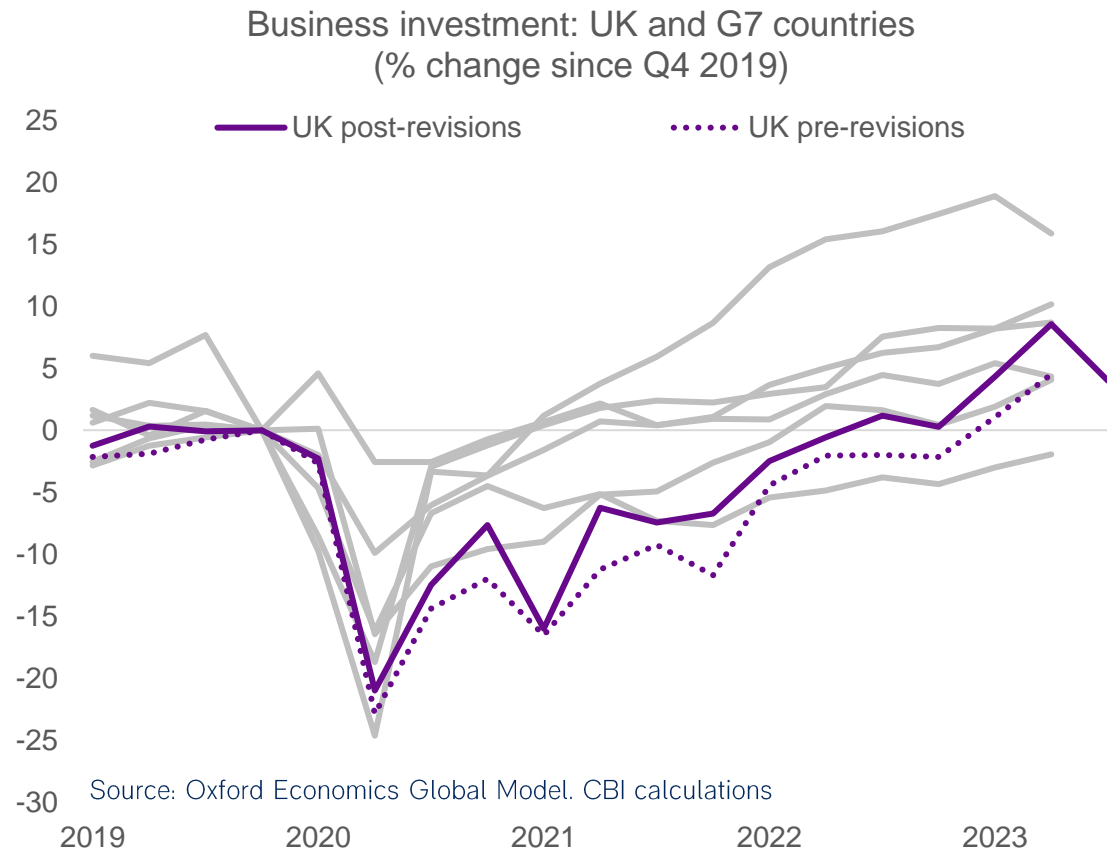
- The combination of higher interest rates and soft consumer fundamentals has led to a weakening in housing market activity. Mortgage activity is close to historic lows, and housing transactions have fallen persistently over the past year
- Nonetheless, there have been some upside influences on housing activity too: the supply of new homes remains constrained and demand from first-time and cash buyers has been unexpectedly strong (the former likely driven by strong rises in rents). General economic resilience and a tight labour market have also shored up activity at the margin.
- However, lags in the monetary policy transmission mechanism mean that the full impact on housing activity is likely to be felt in the year ahead

...leading to falling house prices over our forecast



- Despite the downturn in housing activity, house prices have only fallen slightly to date on most measures
- However, we expect the decline to gather pace over the year ahead: in the face of continual headwinds to household incomes, a loosening labour market, and general weakness in economic activity. The decline in prices moderates over 2025, as these headwinds recede
- Falling house prices exacerbate some of the weakness in household spending over our forecast, through reducing the value of household wealth
- Weaker housing activity and real incomes growth also play a large role in keeping residential investment weak over our forecast horizon

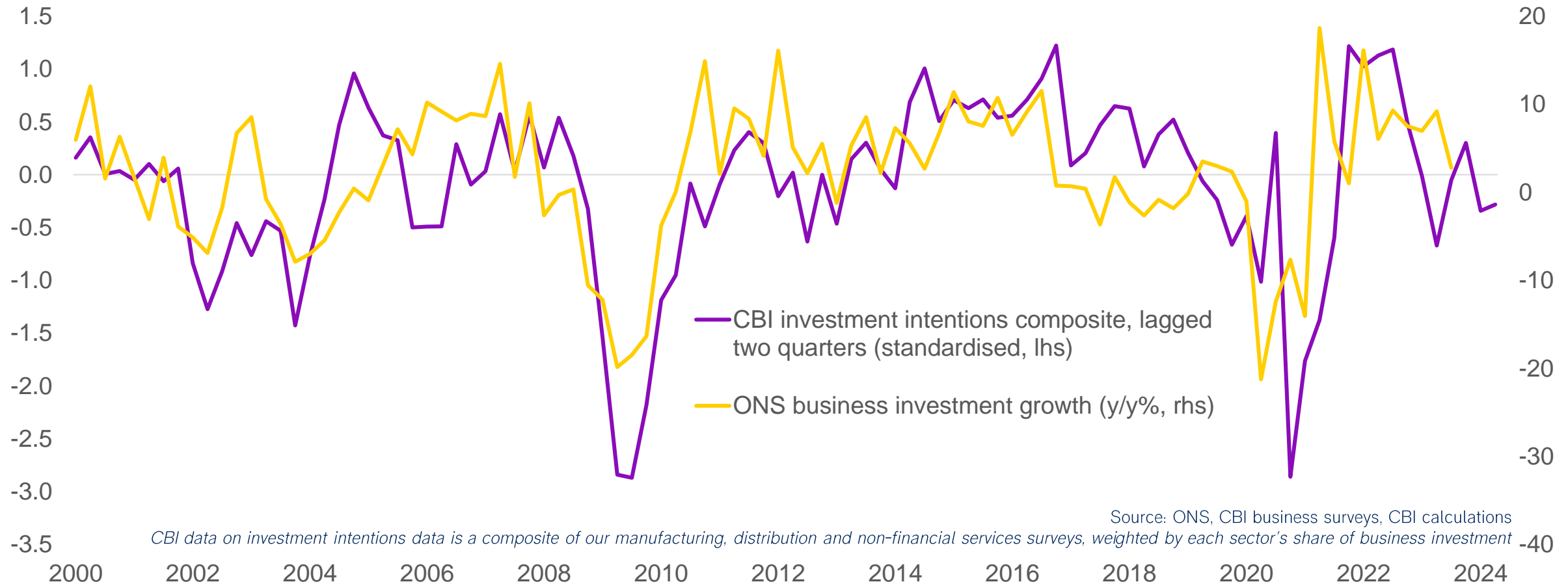
Business investment now looks better over the recent past



- The ONS' revisions to business investment data haven't been quite as stark as those to GDP. Nonetheless, they have resulted in a modest improvement in the UK's business investment performance, pushing it further above its pre-COVID level (9% in Q2 2023, vs 5% above previously). This has also left the UK looking a little better by international comparison
- Nonetheless, the story of historic underperformance in business investment remains unchanged – as a proportion of GDP, it remains at the bottom of the G7 league table (although has recently closed some of the gap with Italy).

Companies' investment plans remain weak...

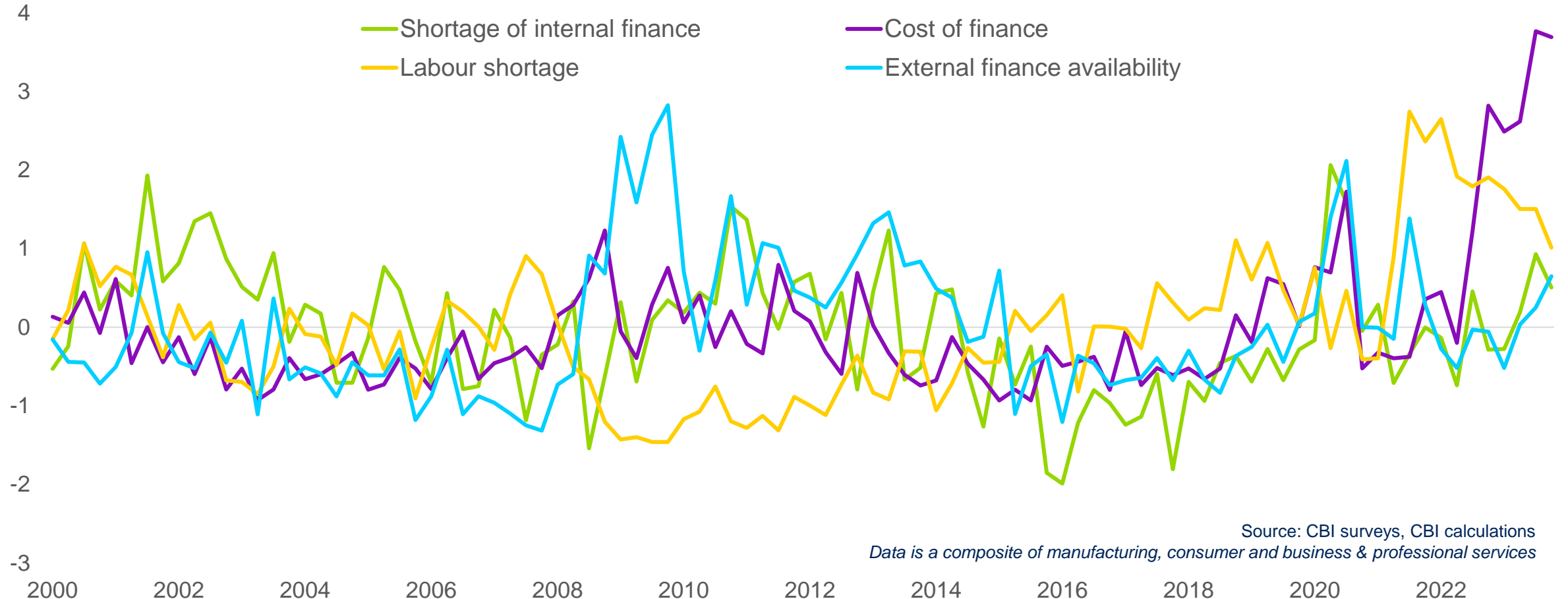
Business investment vs capital spending plans



- Business investment growth has remained relatively resilient over the past year. However, much of this likely explains one-off factors: strong growth in Q1 2023 reflected investment being brought forward in response to the government's superdeduction. Growth in Q2 was driven largely by a rise in transport equipment capex, due to acquisition of new aircraft
- Our surveys show that capital spending plans for the year ahead remain weak

...as the cost finance becomes a more biting concern...

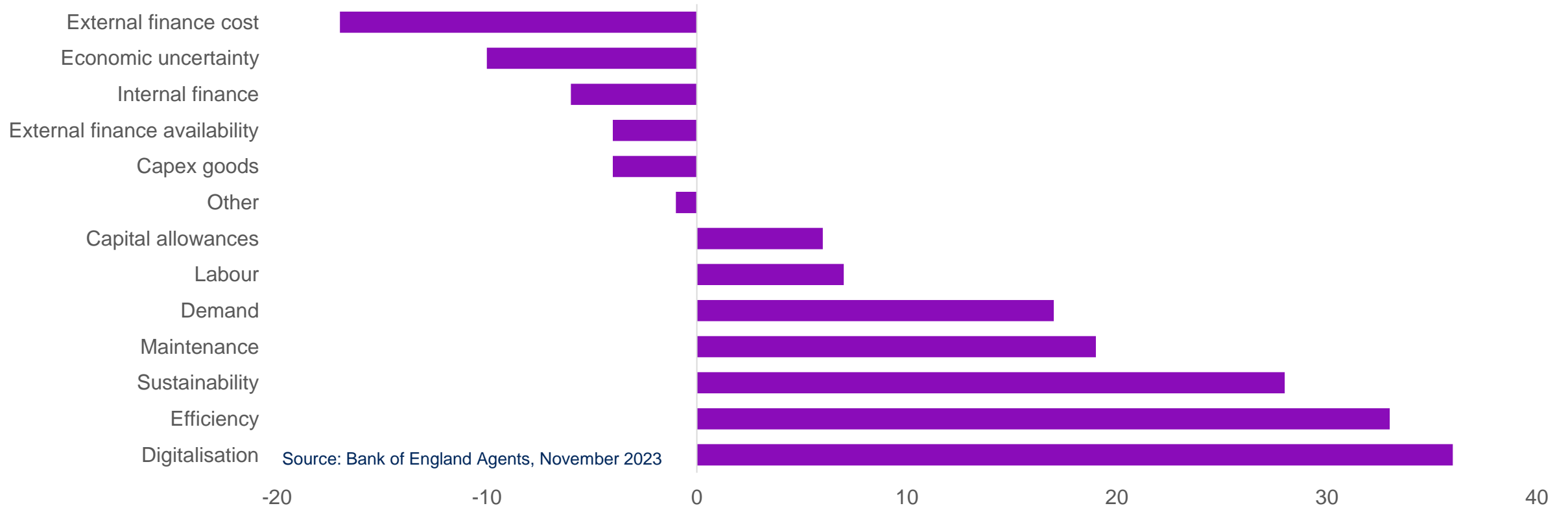
CBI surveys: constraints to investment in the year ahead (standardised %)



- Our surveys continue to indicate that the cost of finance is a biting constraint on capex plans, and one that has intensified over the past year
- This is likely linked to higher interest rates, and chimes with separate data from the Bank of England's Decision Makers Panel in which respondents expected higher rates to reduce investment by 8% over the coming year
- While wider concerns over finance availability are more contained, it is notable that they have also been creeping up since the start of 2023

...though longer-term objectives are a tailwind for capex

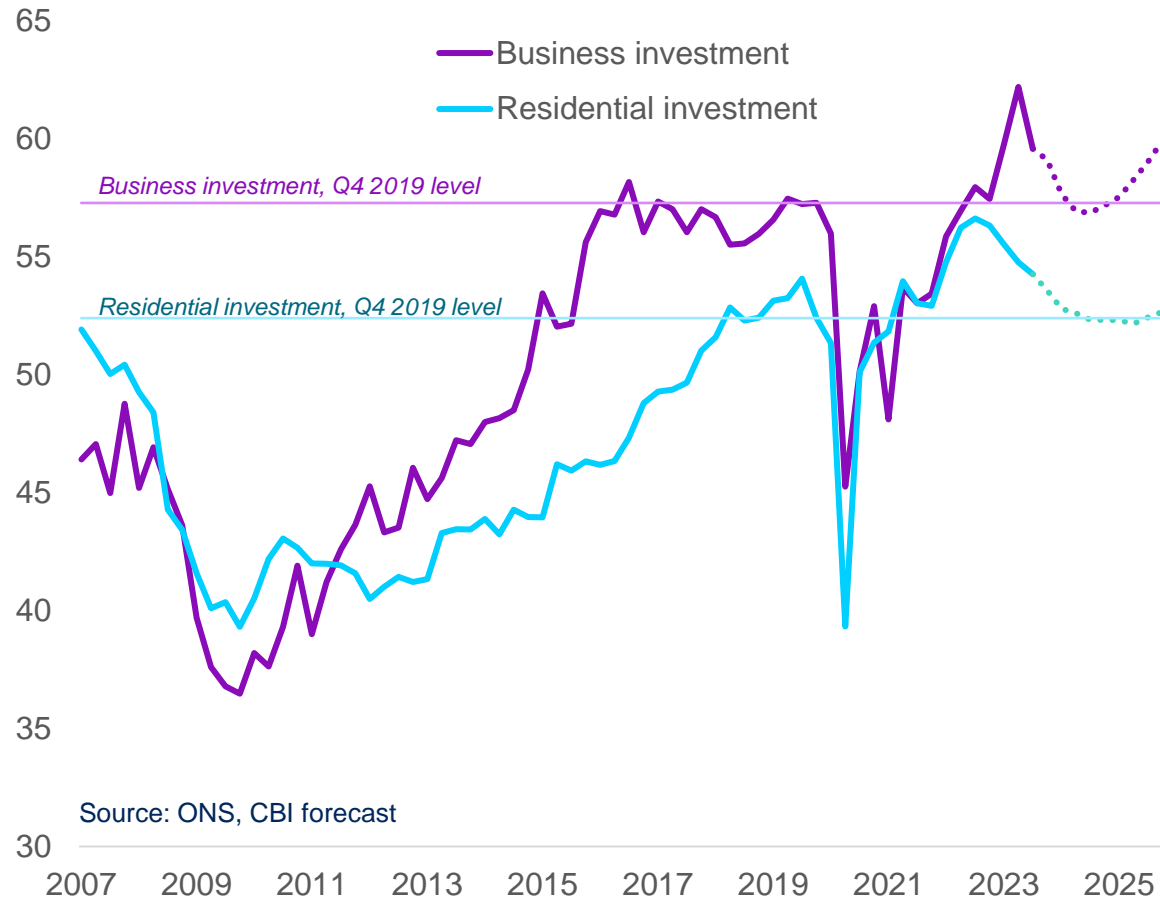
Bank of England Agents survey: factors affecting investment over the next 12 months
(net % balance of respondents)



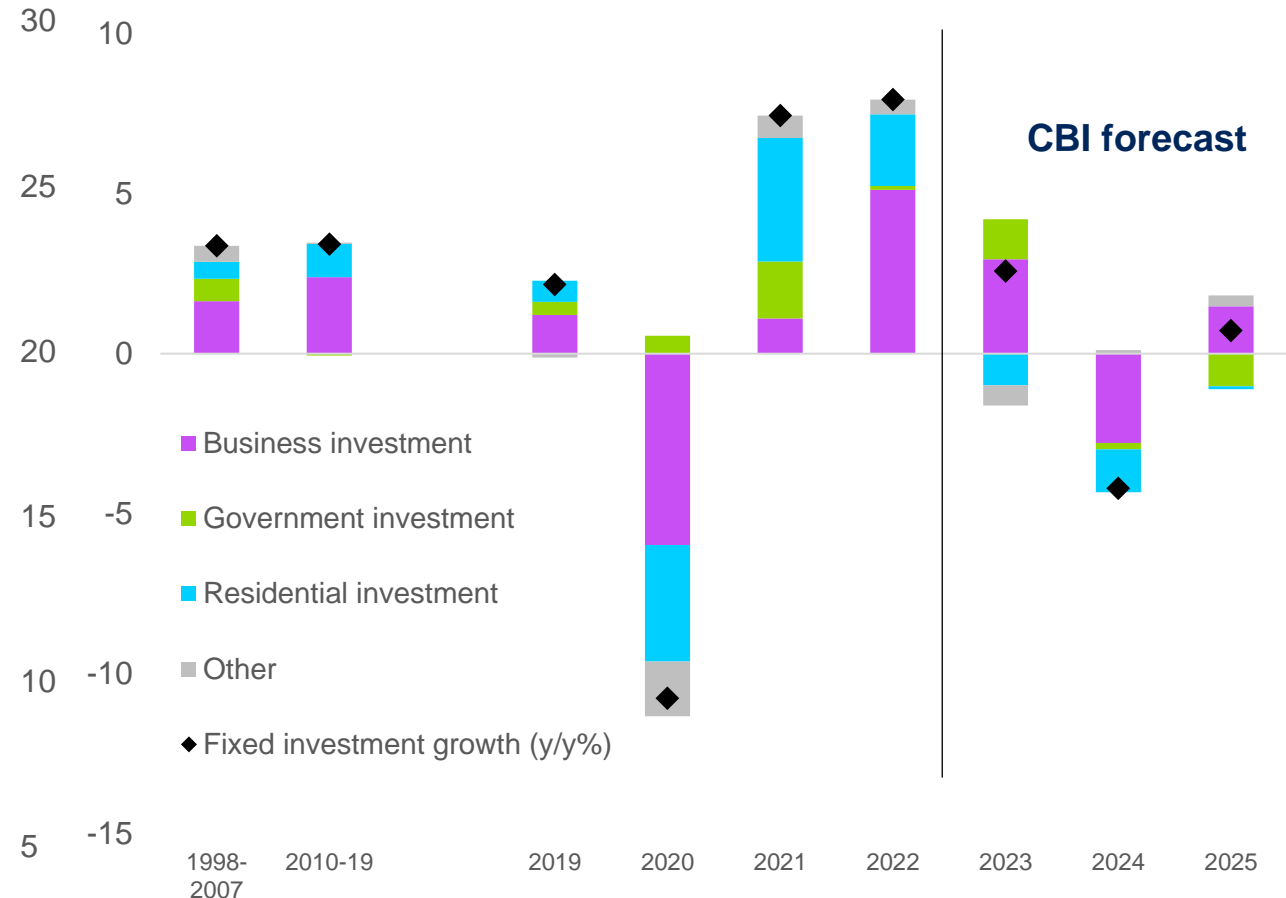
- The constraints to capital spending plans highlighted in our business surveys chime with a special survey run by the Bank of England's regional agents in which the cost and availability of finance featured highly as negative influences on investment plans
- However, in line with anecdote from our members, longer-term business objectives are having a more positive influence on investment: notably digitalisation, sustainability/net-zero goals and automation/AI
- Therefore, there are a number of offsetting influences on business investment at present. Quantifying the more positive drivers of investment is subject to a large degree of uncertainty, and it's unclear at this stage how much of an offset they will prove to the more cyclical headwinds to capital spending at present
- Much depends on the timing of the investment in question and the financial position of the individual firm, particularly their exposure to external financing needs

Economic weakness to hold back investment over 2024...

Business and residential investment (£bn)

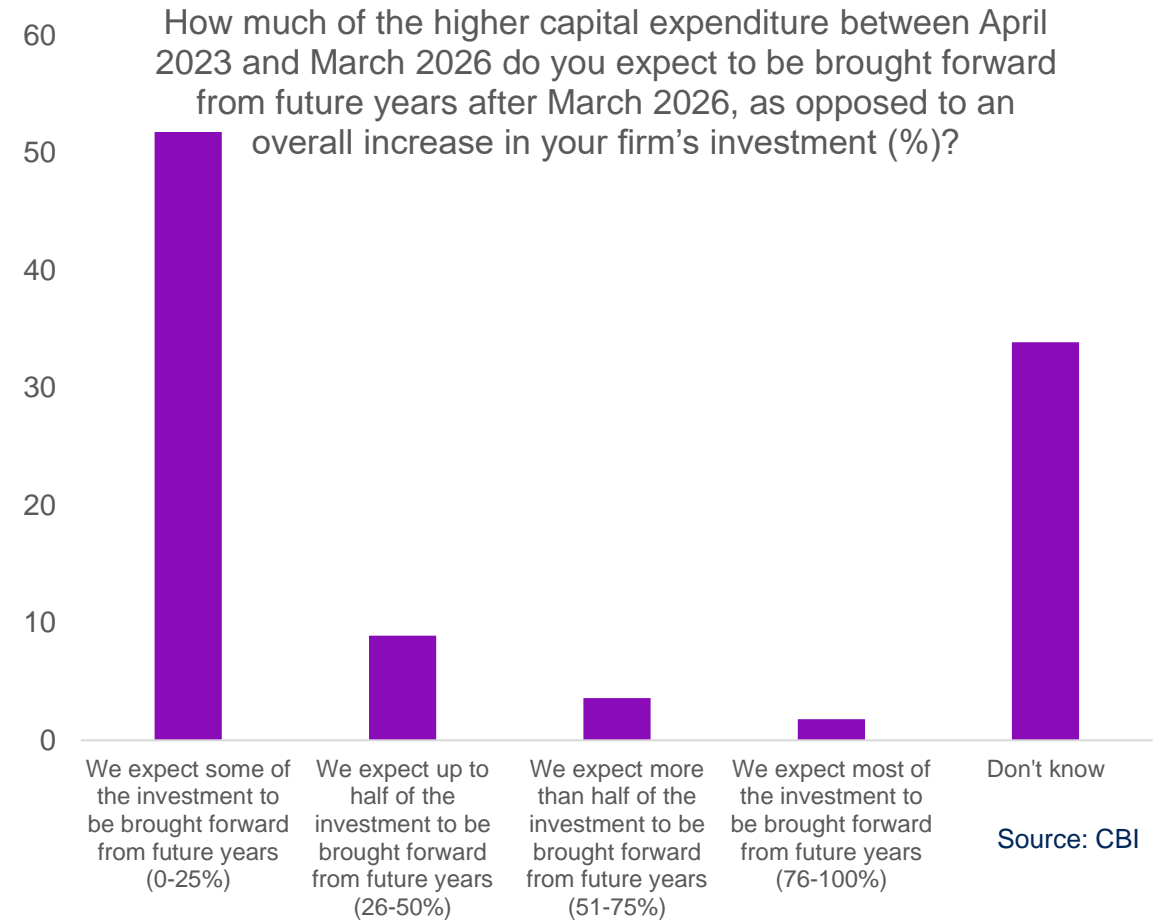
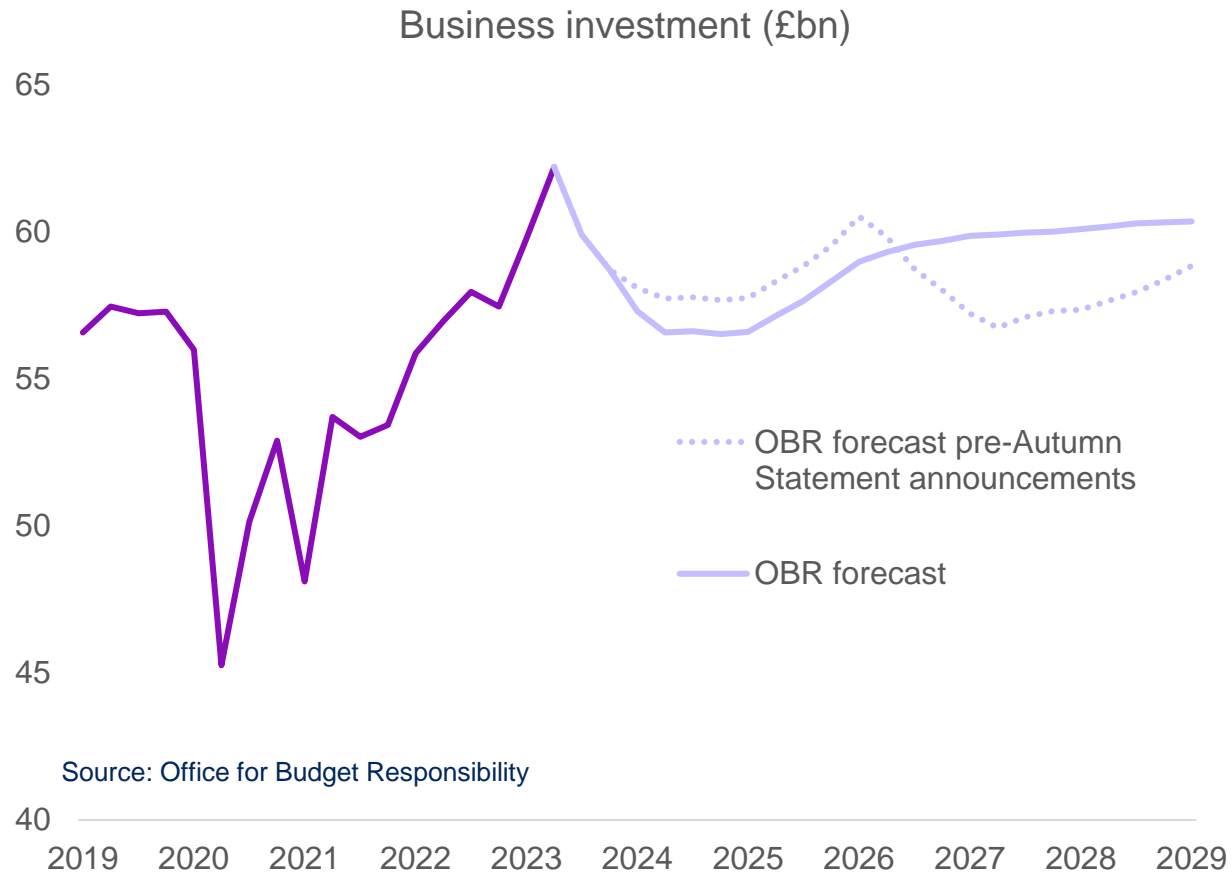


Fixed investment growth (y/y%) and contributions (ppts)



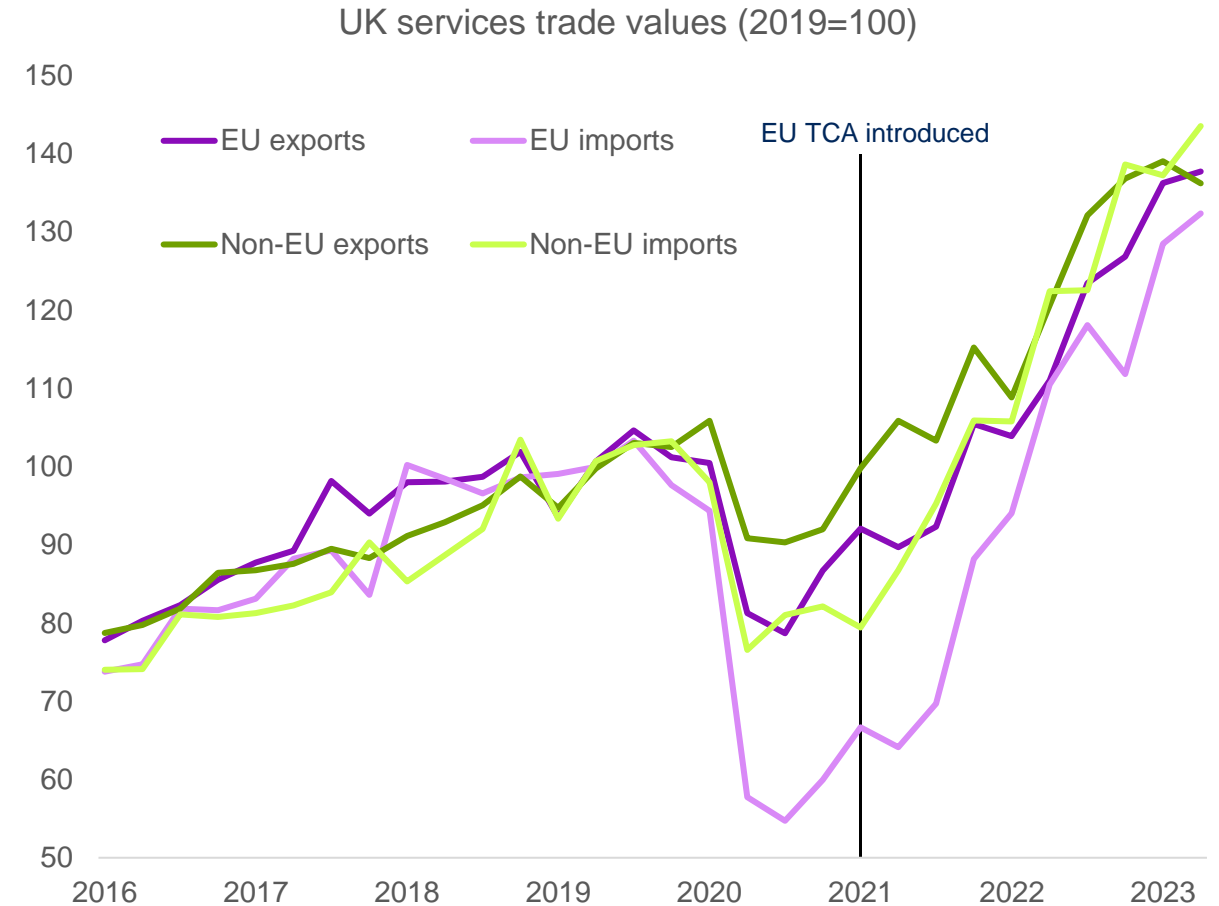
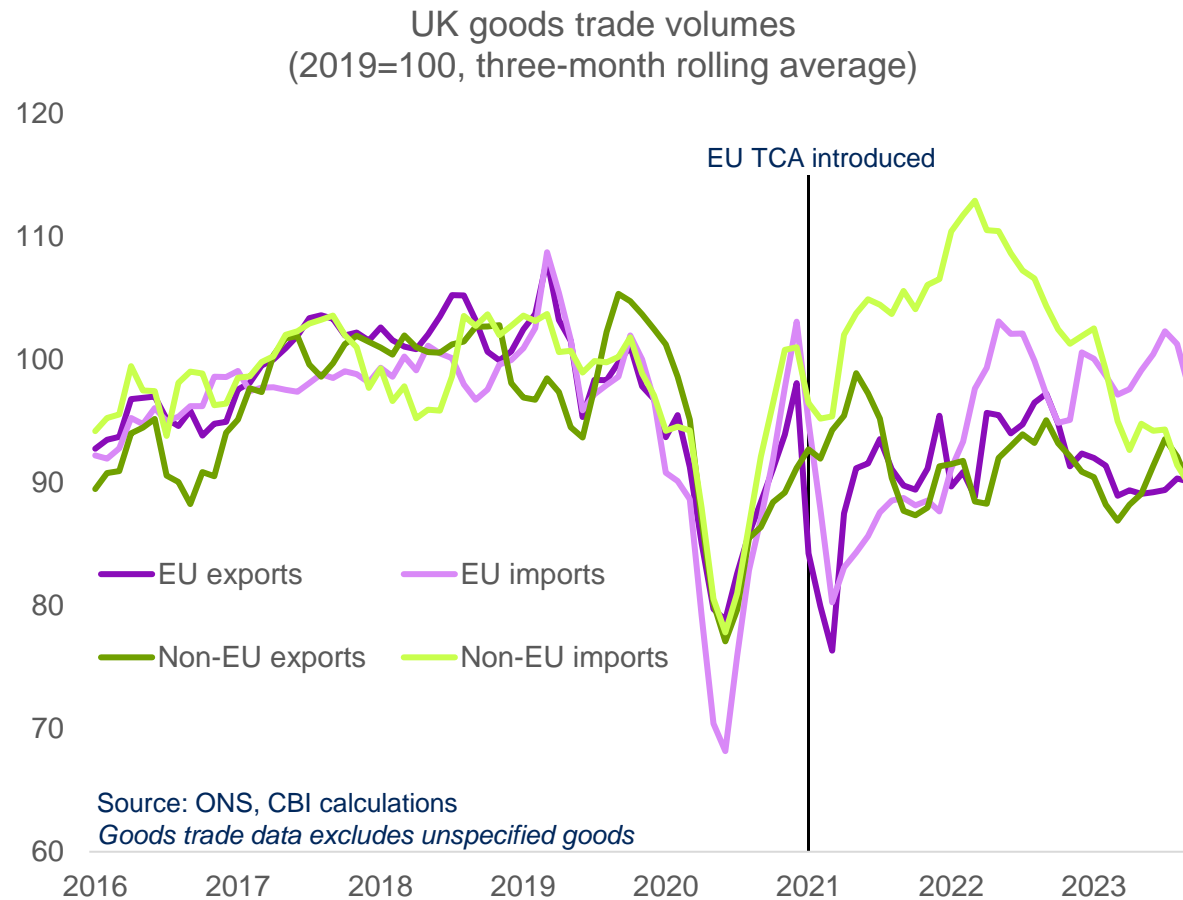
- We expect fixed investment to weaken over the year ahead, as tepid growth weighs on capital spending plans, and weakness in the household sector drags on housing investment. This is a key factor holding back GDP growth over 2024
- This is followed by some recovery in 2025, as economic growth picks up, allowing the longer-term objectives around companies' spending plans to be realised more fully
- However, residential investment fails to recover to the same degree, reflecting the lingering impact of lacklustre growth in real incomes, and continued weakness in the housing market

...but full expensing is a helpful longer-term boost to capex



- At the Autumn Statement, the Chancellor announced permanent full expensing for capital spending, replacing the temporary investment allowance that was due to expire in Spring 2026
- The Office for Budget Responsibility (OBR) expect that this will lift business investment from Q2 2026, given that companies have planned capex taking into account the previous temporary allowance. The OBR predict that permanent expensing will actually reduce business investment in the near-term, as there is a lower imperative for companies to bring forward spending plans
- This chimes with similar findings from a special CBI survey after the Budget, which flagged only a minimal advancement in existing capital spending plans
- Therefore, full expensing does not support business investment over our forecast (which ends in 2025), but sets the stage for a capital spending boost beyond this horizon. The OBR expect the measure to boost business investment by £14bn over their forecast (a 1.2% lift), and to raise potential output by 0.1%

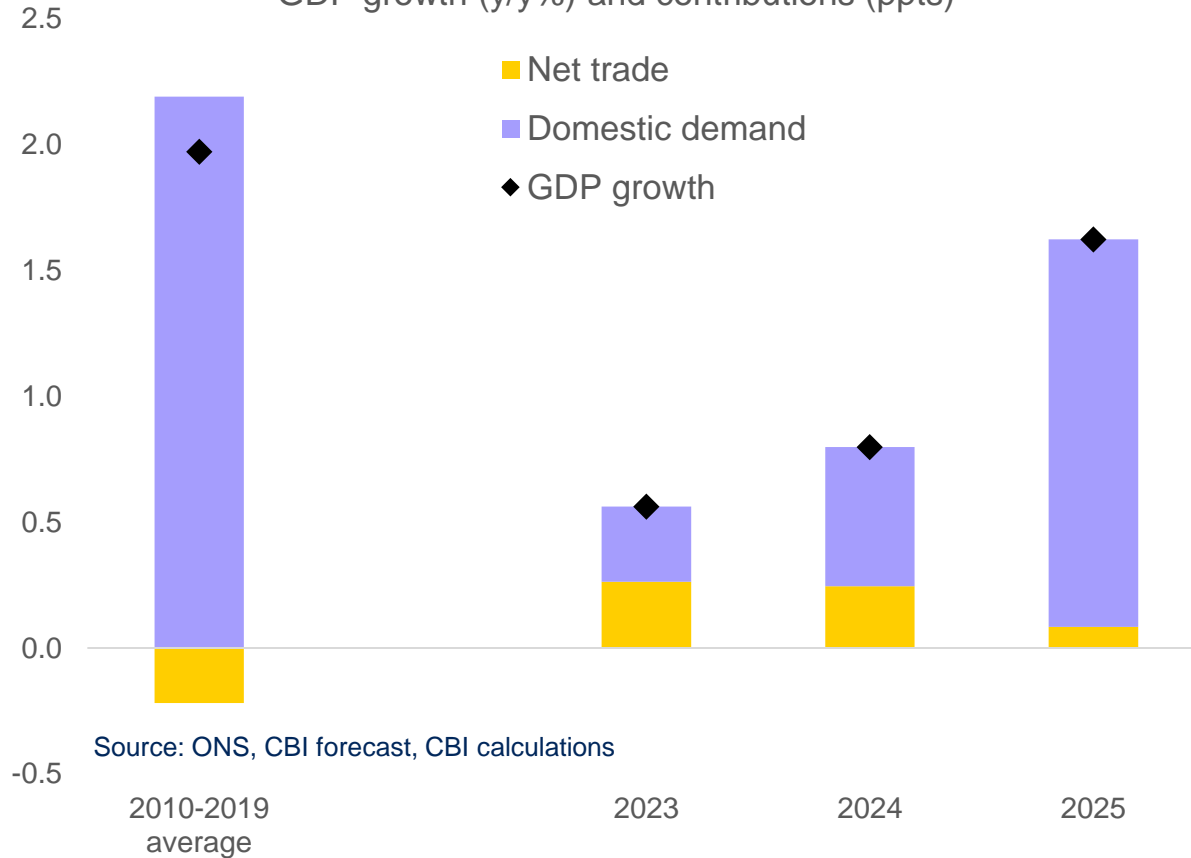
UK trade flows have been volatile



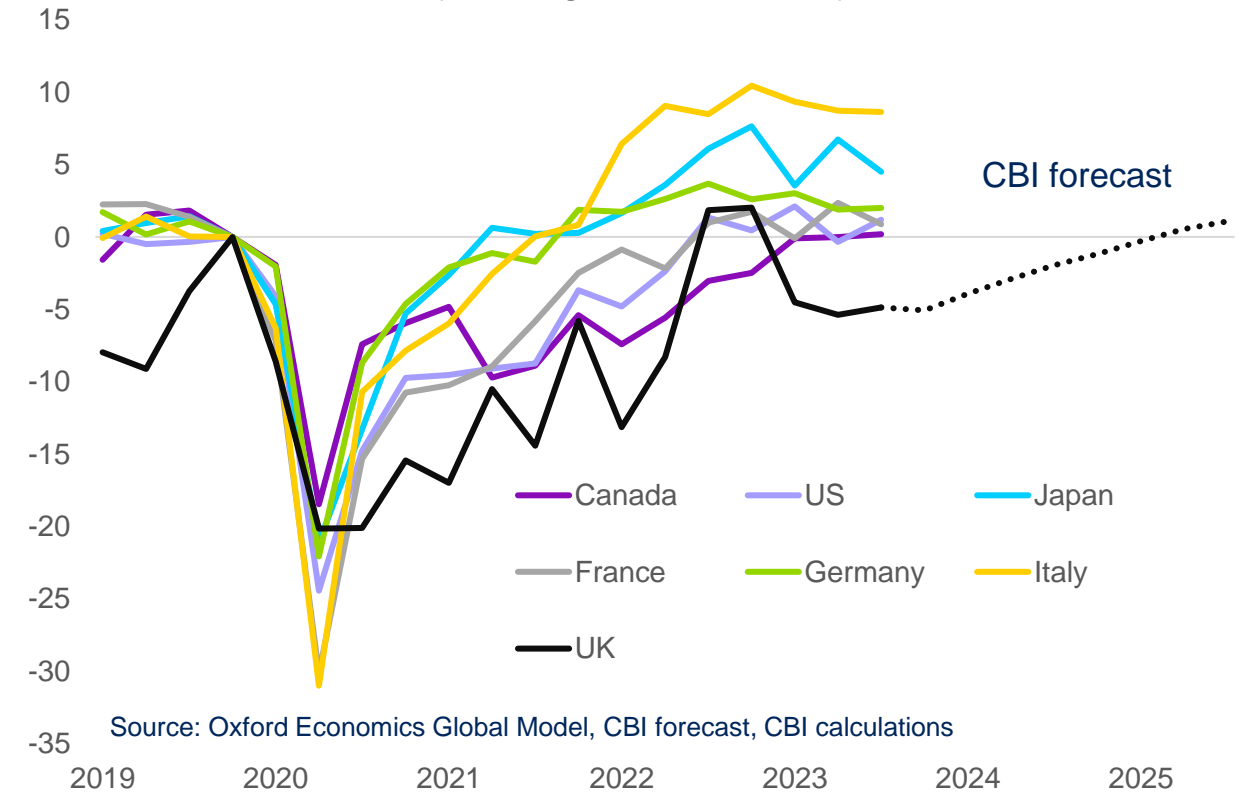
- UK trade data has been volatile lately, in part due to flows of erratic components such as non-monetary gold, and in part reflecting [ongoing methodological issues with trade data](#). Therefore, the informational value of the data should be treated with some caution
- Taken at face value, some components of the UK's trade flows have recovered from the significant disruption seen after the introduction of the Trade and Co-operation Agreement (TCA) with the EU in January 2021
- However, both EU goods exports and imports remain 13-14% below their pre-TCA levels; although a similar degree of weakness is also seen in non-EU imports
- While services trade appears to have performed more strongly, ongoing concerns with some elements of the TCA – such as youth mobility and recognition of professional qualifications – remain a risk to the outlook

Net trade to support growth modestly over our forecast...

GDP growth (y/y%) and contributions (ppts)



Export volumes across G7 countries
(% change since Q4 2019)

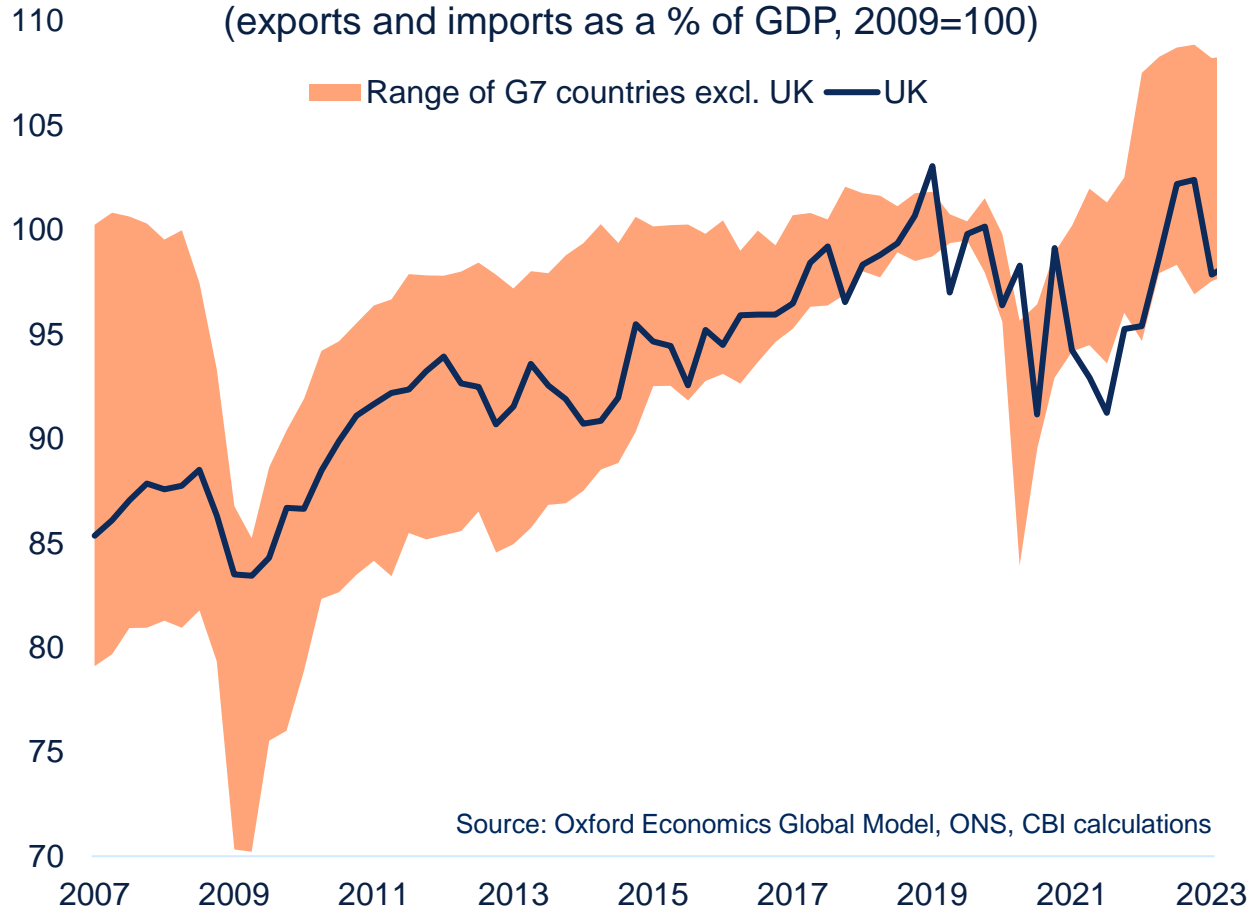


- We expect some modest support from net trade to GDP growth over our forecast, especially in 2024. This reflects exports growth holding up, albeit at a fairly weak level, supported by continued global GDP and trade growth. Lacklustre domestic demand also limits imports growth in the first half of 2024.
- However, the underlying picture of the UK's trade performance remains one of weakness. UK exports have persistently grown at a slower pace than their G7 counterparts since the COVID-19 pandemic, and only reach their pre-COVID levels towards the end of our forecast – with several advanced economies having already surpassed this milestone.

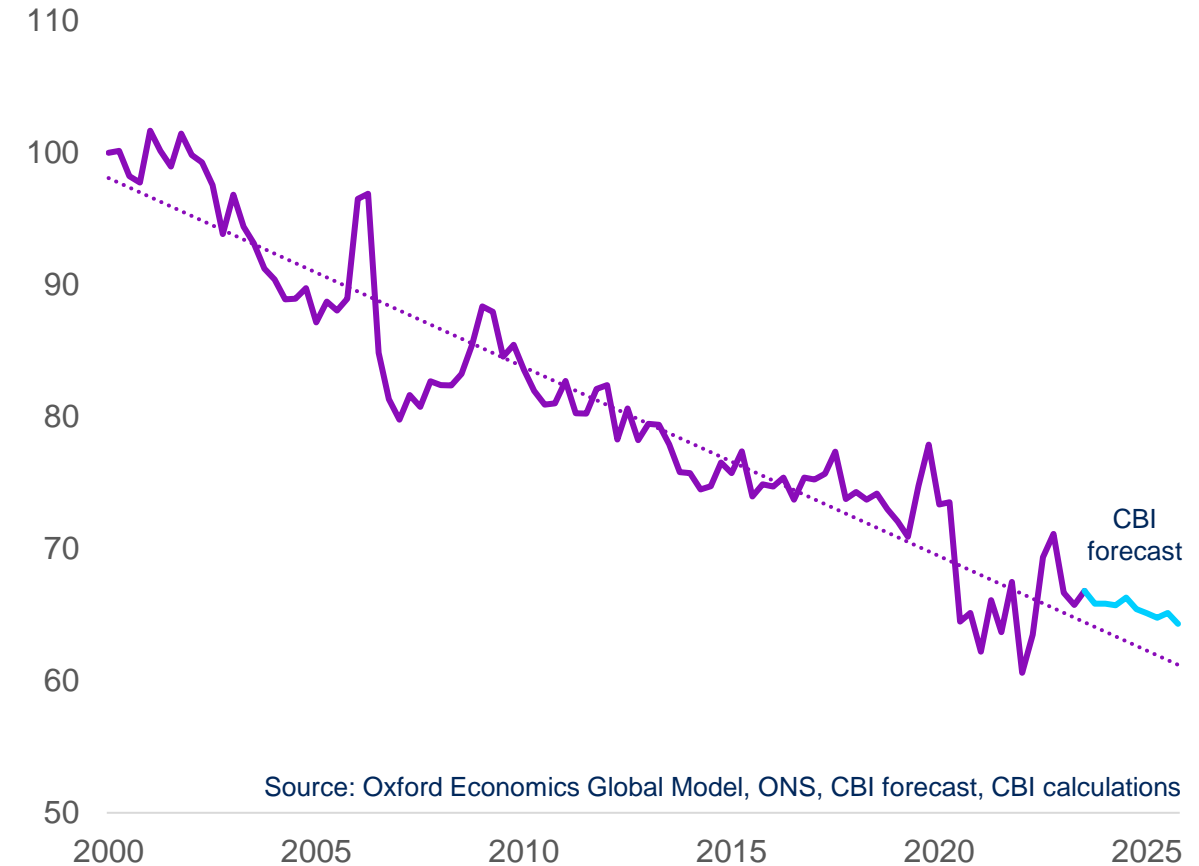
...but underlying trade performance remains weak

Trade intensity of GDP
(exports and imports as a % of GDP, 2009=100)

Range of G7 countries excl. UK — UK



UK exports market share (Q1 2000=100)
Share of UK exports in UK-weighted world trade



- There are also signs of deeper, more structural underperformance in UK trade
- Trade intensity has recovered somewhat since its fall during the pandemic, but remains towards the bottom of the G7, boding ill for productivity growth going forward
- We also do not expect much change in the long-run decline in the UK's global exports share over our forecast

Global growth set to hold up, but diverge across economies

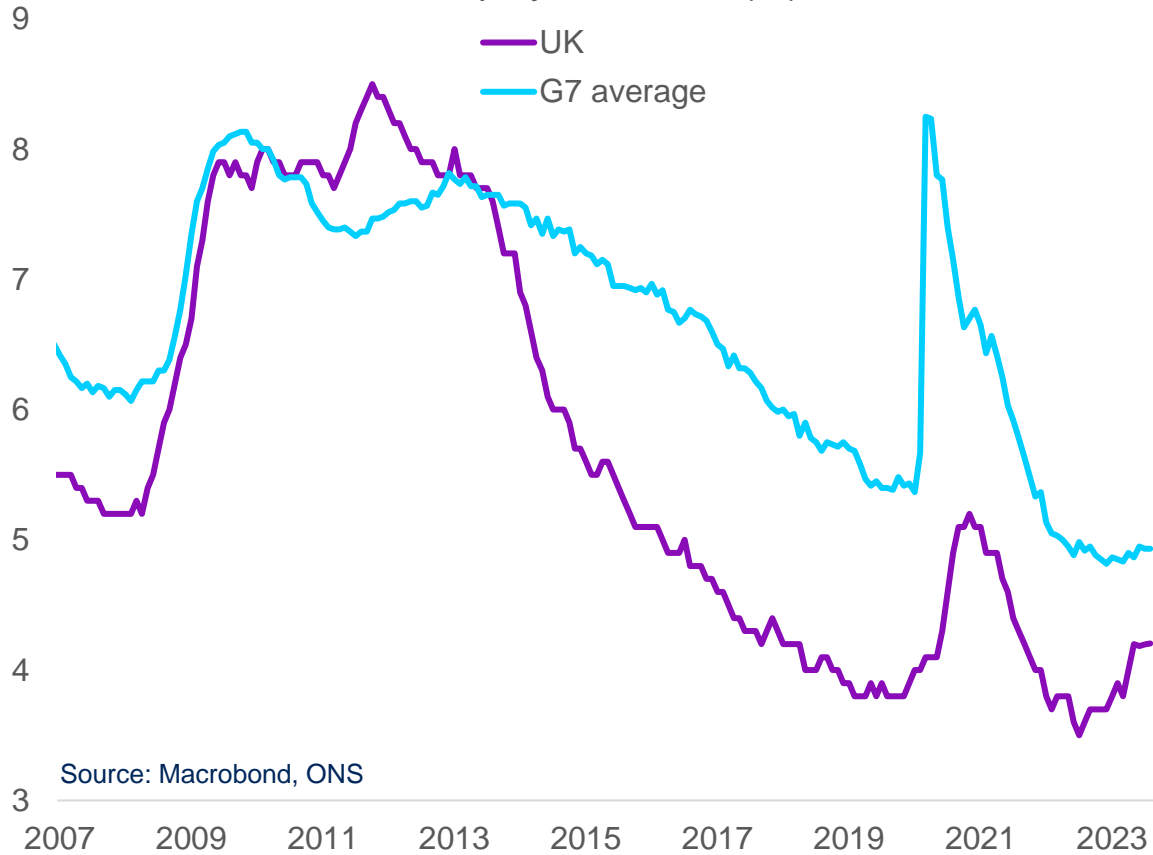
GDP growth, y/y% (Dec 2023 forecast)					Change from previous forecast (%pt difference)	
	2023	2024	2025		2023	2024
US	2.4	1.4	1.3		+1.6	+0.8
Eurozone	0.5	0.7	1.6		-0.3	-0.4
Germany	-0.2	0.2	1.6		+0.1	-0.7
France	0.8	0.5	1.5		+0.3	-0.3
Spain	2.4	1.3	1.9		+0.3	-0.9
Italy	0.7	0.6	1.2		-0.5	-0.3
UK	0.6	0.8	1.6		+0.2	-1.0
Japan	1.6	1.4	1.4		+0.4	+0.5
China	5.2	4.4	4.2		-0.4	-0.1
India	6.6	6.3	6.1		+0.8	-0.2
World (purchasing power parity)	3.0	2.9	3.1		+0.5	-0.1

Source: Bank of England Agents, November 2023

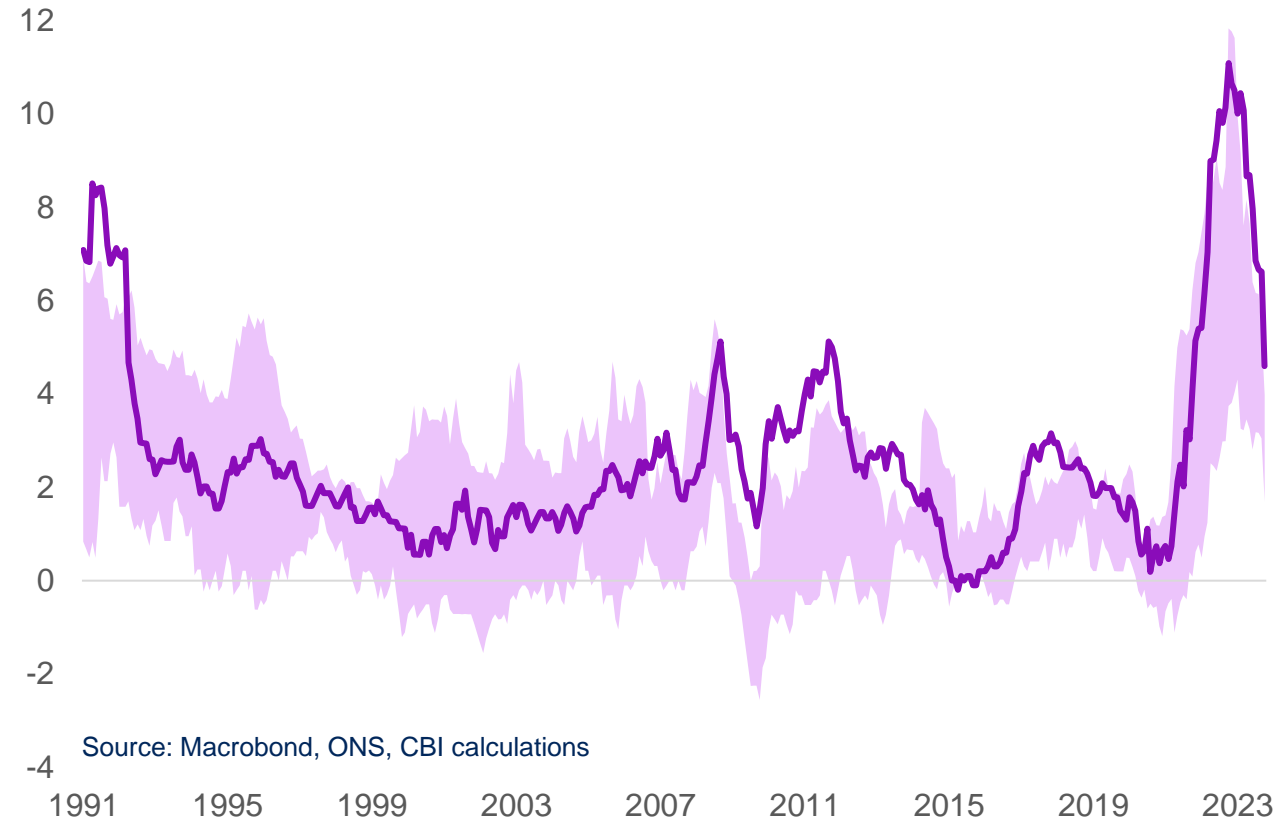
- Global growth remains constant over our forecast, though there is a notable divergence between stronger growth in the US, and weaker prospects in the Eurozone and the UK
- In particular, we have downgraded our forecast for Eurozone growth across the board in 2024, reflecting higher interest rates feeding through to credit conditions, the bloc's greater exposure to weaker global industrial activity and continued drags from the 2022 energy crisis
- Among emerging markets, slower growth in China is also likely to spillover into emerging Asia

Household spending underpins global resilience

Unemployment rates (%)



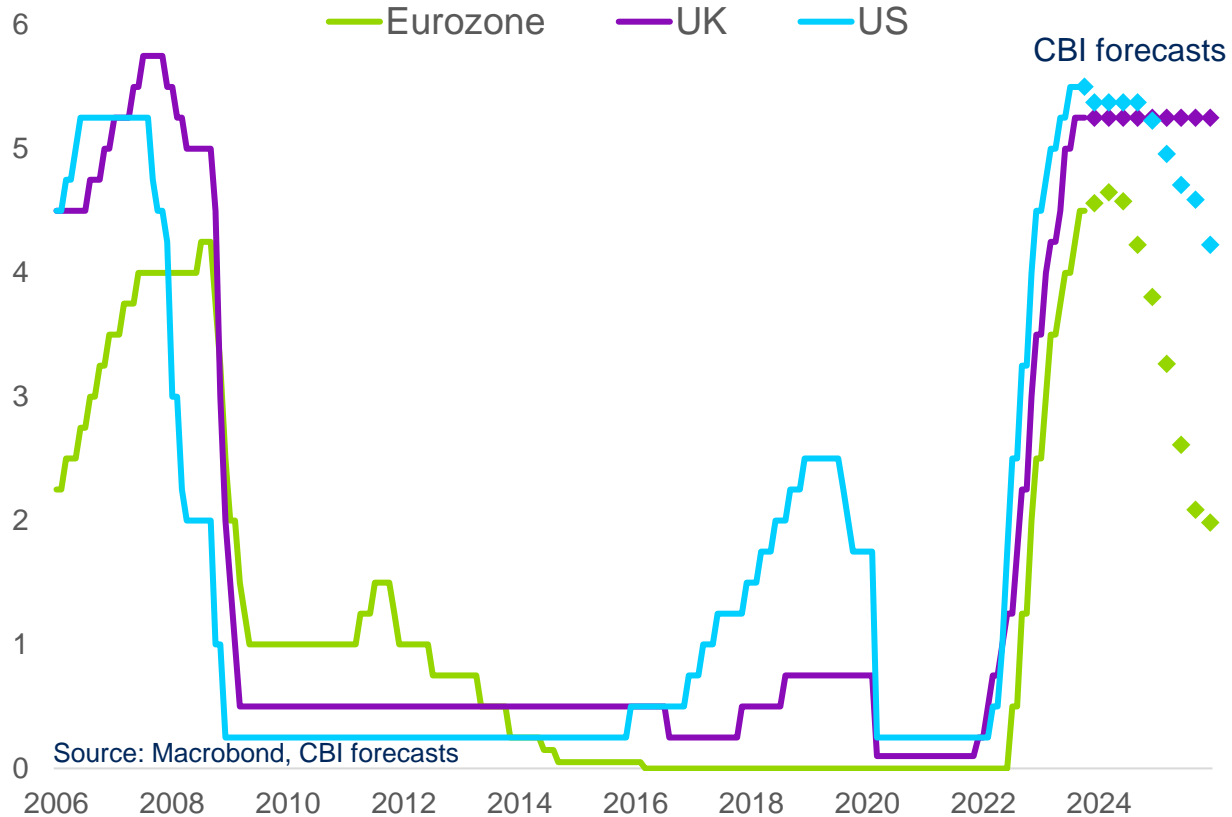
CPI inflation or equivalent (y/y%)



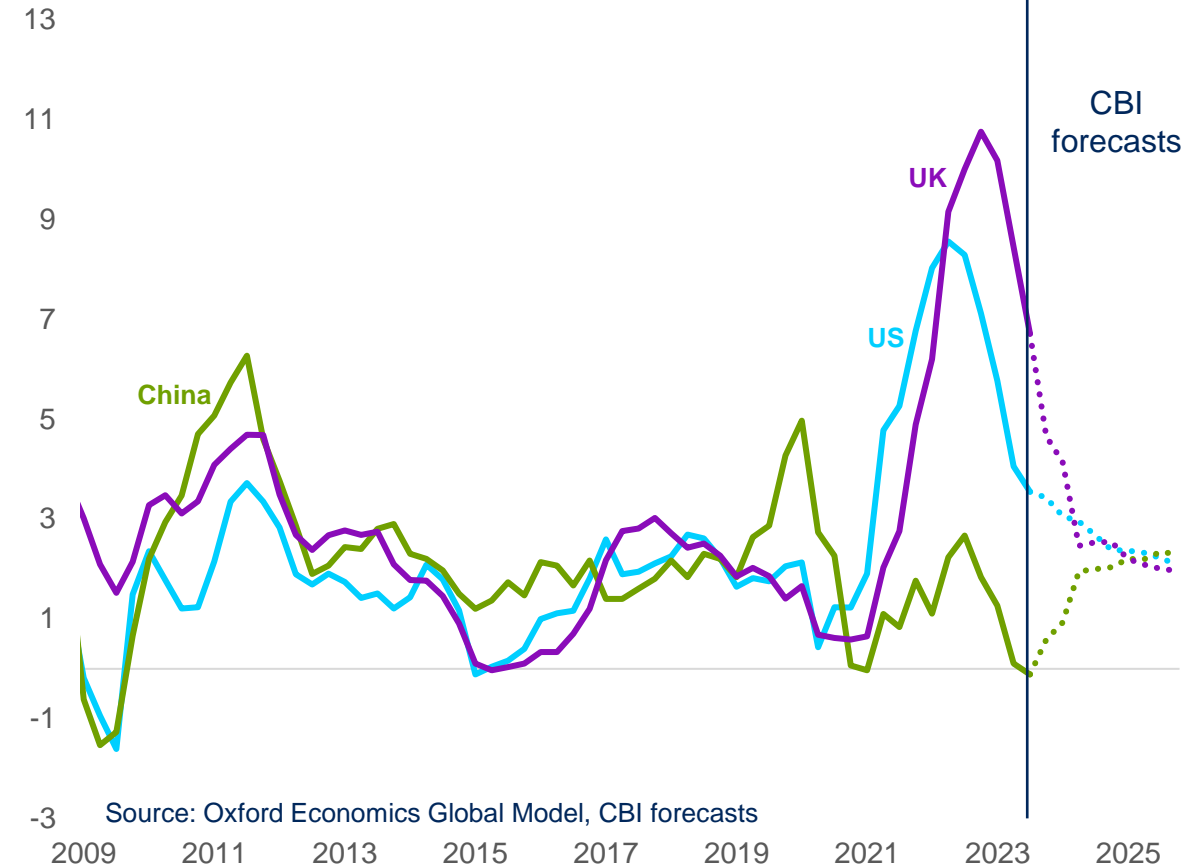
- Across advanced economies, the consumer remains a key driver of growth – supported by labour markets remaining tight, and the boost to real earnings from inflation falling back
- CPI inflation in the UK has been consistently higher than the rest of the G7. This remains the case, although the gap is closing and the UK is looking increasingly less like an outlier

Lower inflation allows central banks to hit pause

Central bank interest rates (%)

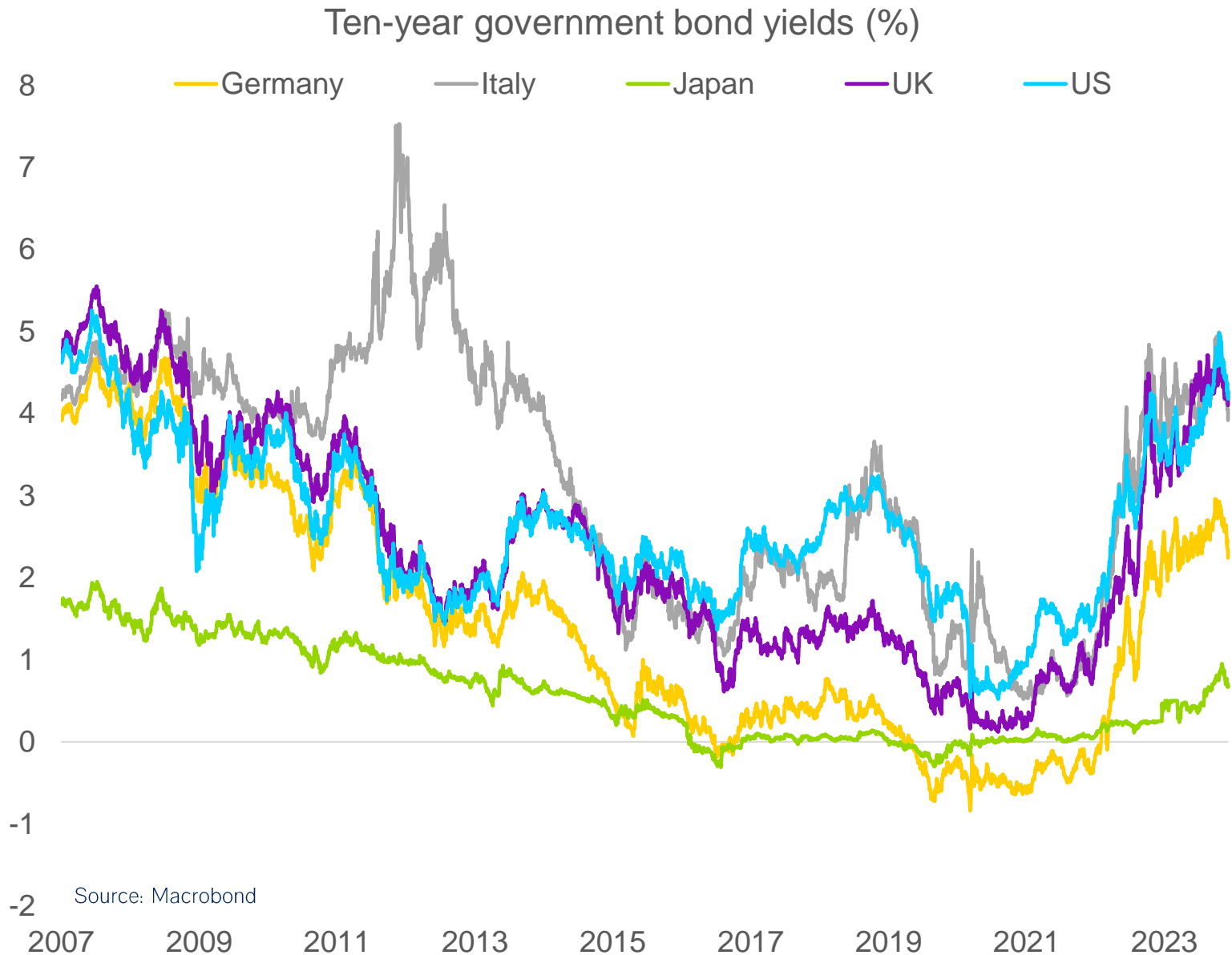


CPI inflation (y/y%)



- Lower inflation across major economies also allows central banks to pause on their monetary policy tightening cycles. We expect the US Federal Reserve and the European Central Bank to cut interest rates next year. The Bank of England is expected to keep rates at their current level over our forecast, but not raise them further.
- However, the impact of past rises in interest rates will likely continue to weigh on activity, as the lags in monetary policy transmission mechanisms come into effect. The timing and pace of these is uncertain, given the differing nature of interest rate pass-through across the world.
- In the global inflation story, China is a notable outlier, sitting on the cusp of deflation (i.e. prices falling) in the face of weaker activity.

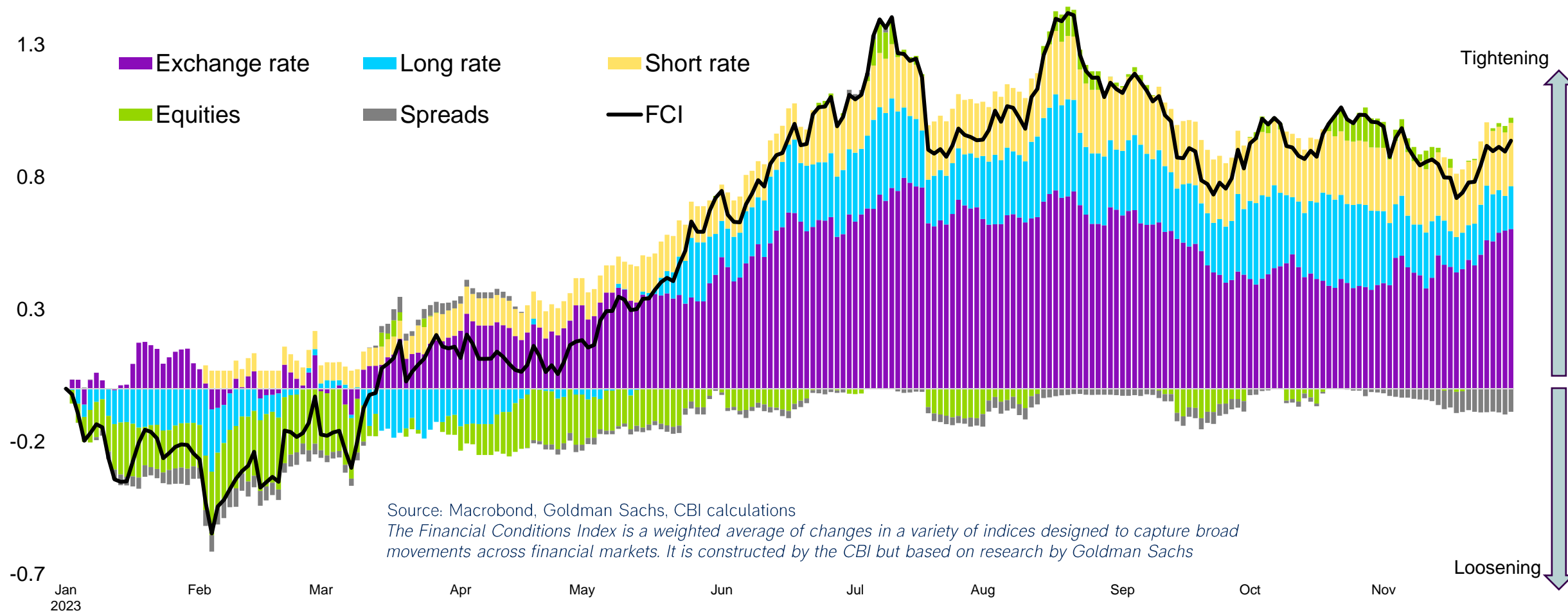
Rising rates sparked volatility in global bond markets...



- The end of September/beginning of October saw significant turmoil in sovereign debt markets. The root cause appeared to be financial markets adjusting to the US Federal Reserve's "higher for longer" message around interest rates. Analysts' forecasts for terminal rates were also revised higher, off the back of central bank messaging and the persistence of inflationary dynamics
- Markets were further spooked by perceptions of weakening public finance fundamentals in the US, following a potential stand-off over raising the government debt ceiling, in the face of an already-large fiscal deficit
- The rise in global bond yields in the US spilled over into other countries, particularly the Eurozone. Rising yields led to renewed concerns over the solvency of large, indebted economies such as Italy
- Bond yields have largely calmed since. However, the episode underlines the potential for further market volatility off the back of continued rises in interest rates, especially if markets are caught off guard

...but had little impact on financial conditions in the UK

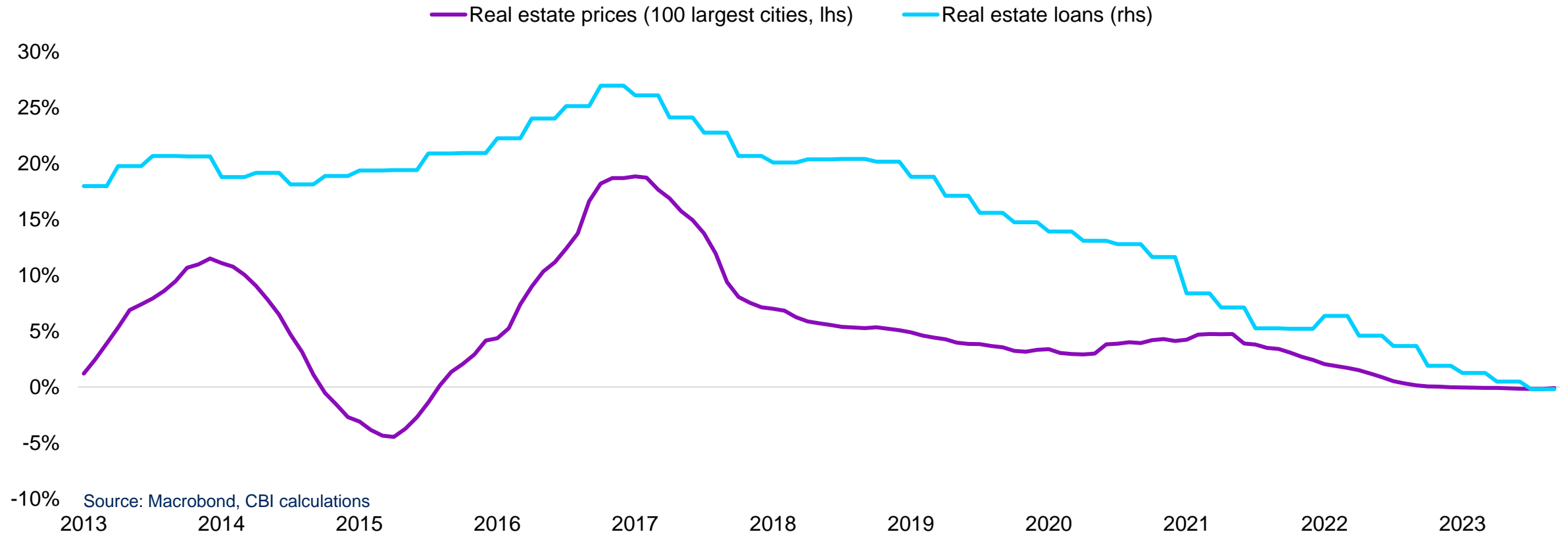
UK Financial Conditions Index, 2023
(Jan 2nd=0)



- In the UK, the rise in government bond yields led to only a modest tightening in financial conditions, which remained roughly within the range seen in the month prior.
- Overall, financial conditions remained less tight than their levels over the summer.

China's property sector poses risks both at home and abroad

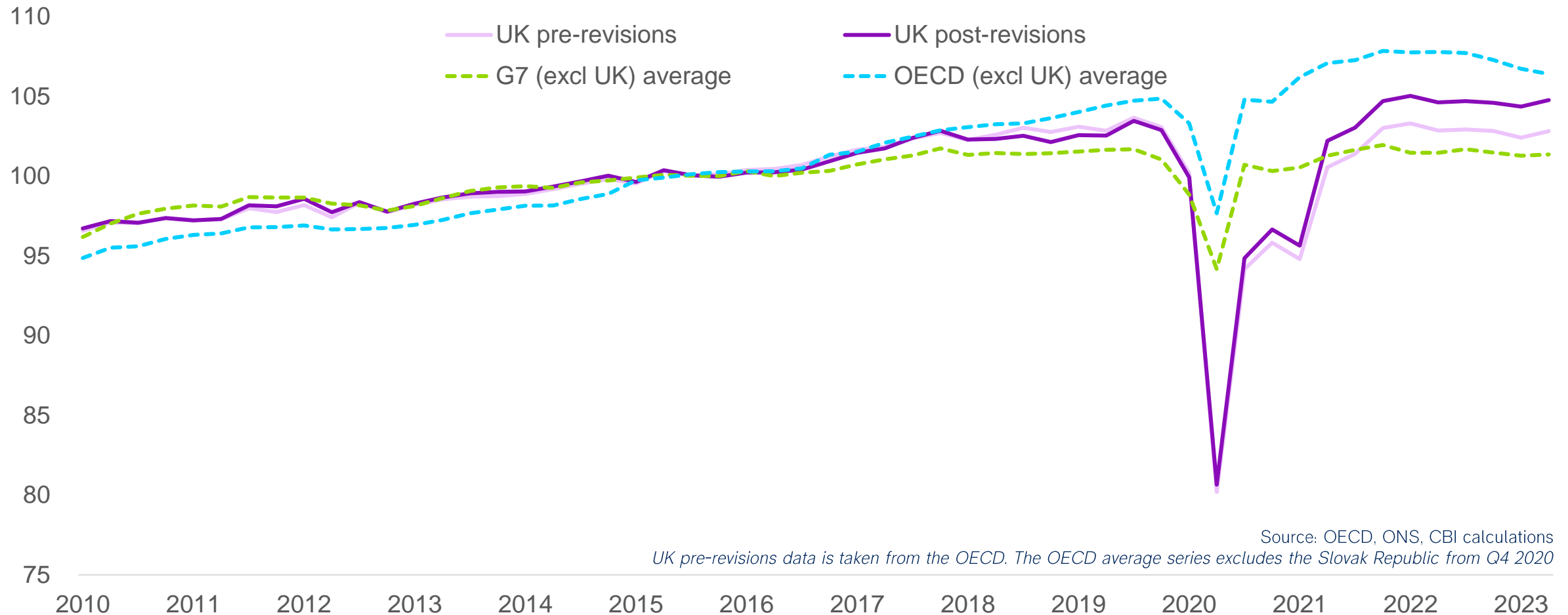
China real estate prices and debt (y/y%)



- China's property sector has seen a marked downturn recently, as weaker growth bites on housing activity. This is raising concerns over financial stability, following a liquidity crisis in Country Garden, the world's largest property developer
- Volatility in the property sector would likely spillover significantly into other areas of the economy: to mining and manufacturing, through downstream impacts on services, and via consumption on housing-related goods such as furniture and electronics
- Issues in China's property sector therefore pose a key risk to activity and financial stability within its borders, but also for the rest of the world given the economy's large global footprint
- Continued weakness in this area is a key factor behind most forecasters' expectations of slower Chinese growth in the years ahead

Data revisions leave UK productivity looking a little better...

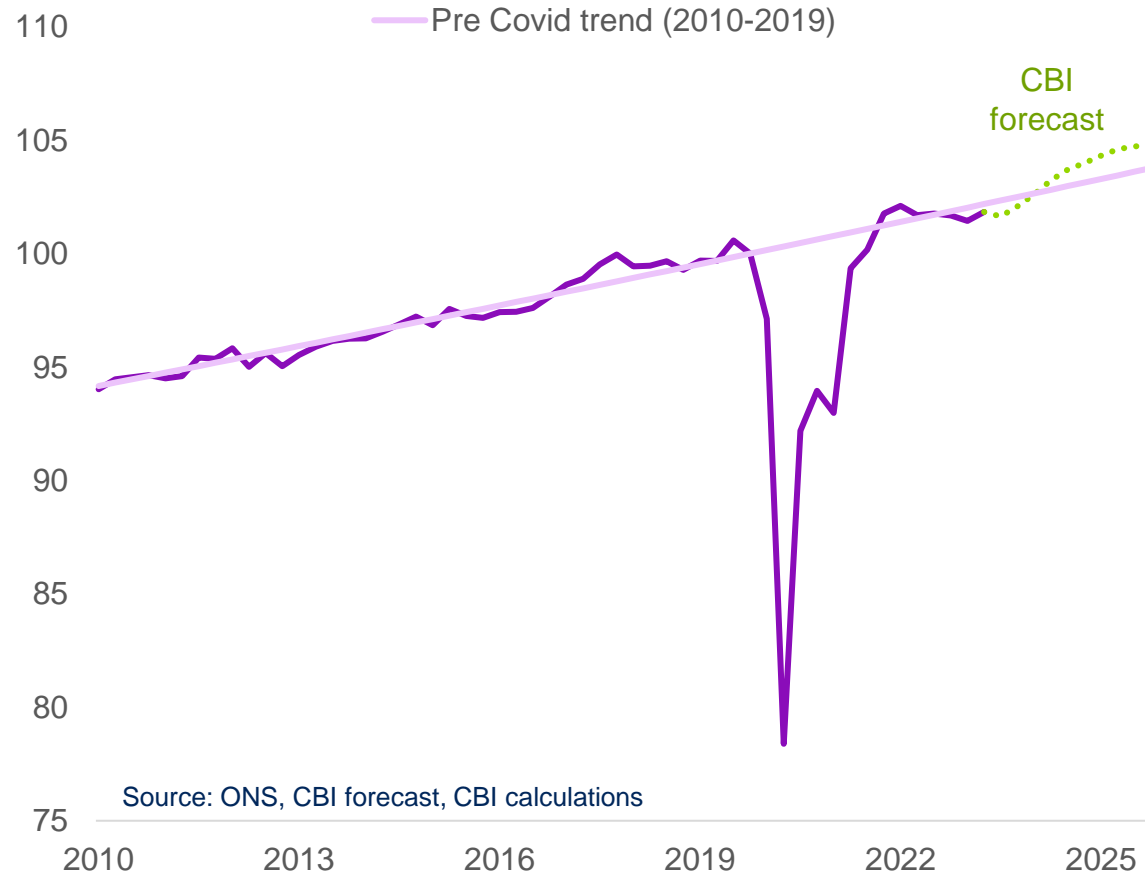
Productivity: GDP per person employed (2015=100)



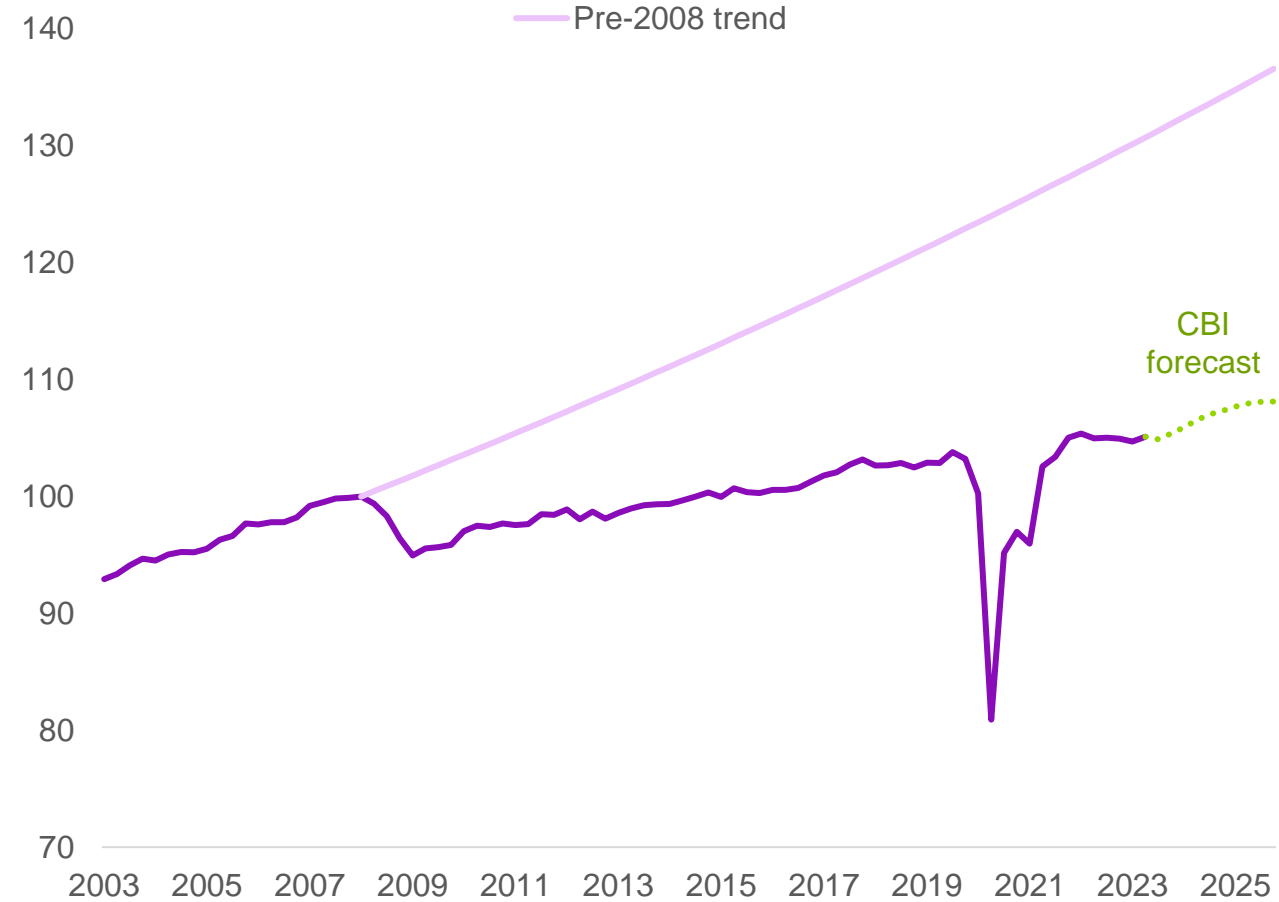
- Revisions to GDP data have left the UK's productivity performance looking better by international comparison: while still below the average of the rest of the OECD, UK productivity growth has moved further above the average of the rest of the G7
- However, while encouraging, much of the nuances around the UK's productivity problem remain unchanged. It has remained largely stagnant since the 2008/9 financial crisis, and regional disparities in productivity remain large

...but the bigger picture remains one of weakness

Productivity: output per worker (Q4 2019=100)



Productivity: longer-term trend (Q1 2008=100)



- A combination of revised outturn data, and GDP growth holding up against a deteriorating labour market, means that productivity sees some growth over our forecast, particularly in 2024. Output per worker regains and rises above its pre-pandemic trend
- However, there is still a yawning gap against the pre-2008/09 financial crisis trend, and the growth over our forecast does little to dent the underlying stagnation in productivity apparent since 2008
- Near-term weakness in public and private sector investment and trade intensity mean that the underpins to productivity growth remain weak

CBI Economics

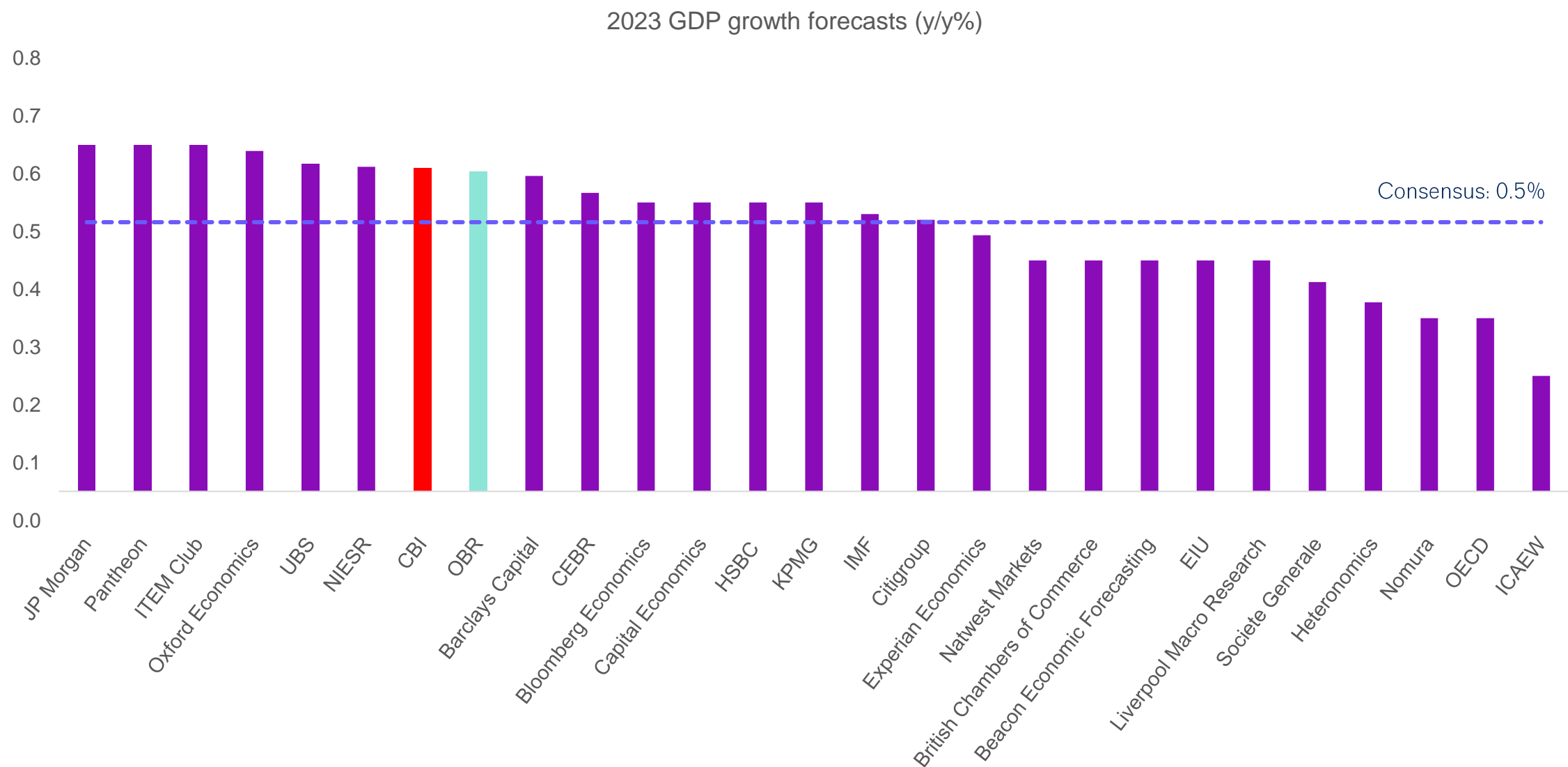
Alpesh Paleja

Lead Economist, CBI

Email: Alpesh.paleja@cbi.org.uk

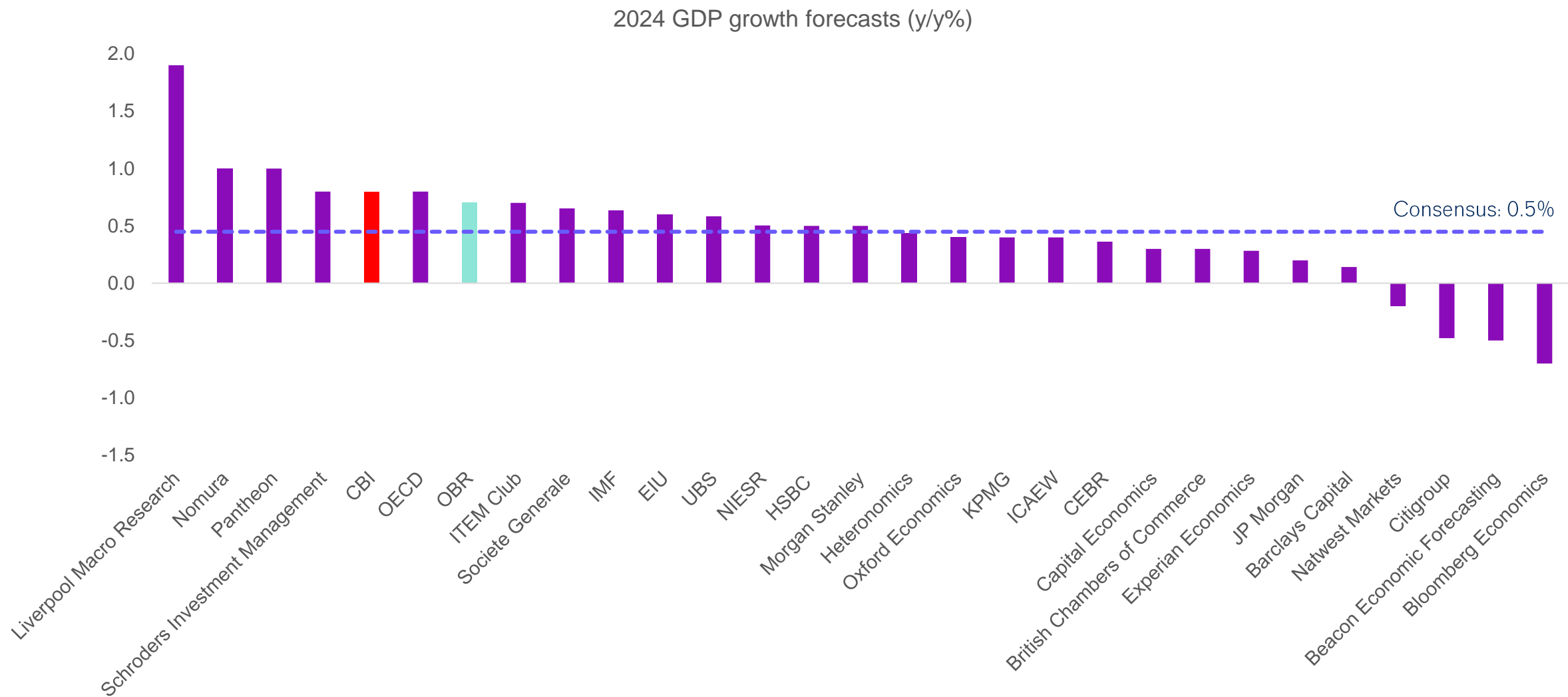
X @CBI_Economics

CBI forecast v HMT consensus: 2023



Source: HM Treasury, CBI forecast

CBI forecast v HMT consensus: 2024



Source: HM Treasury, CBI forecast