CBI Economics

Economic forecast

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

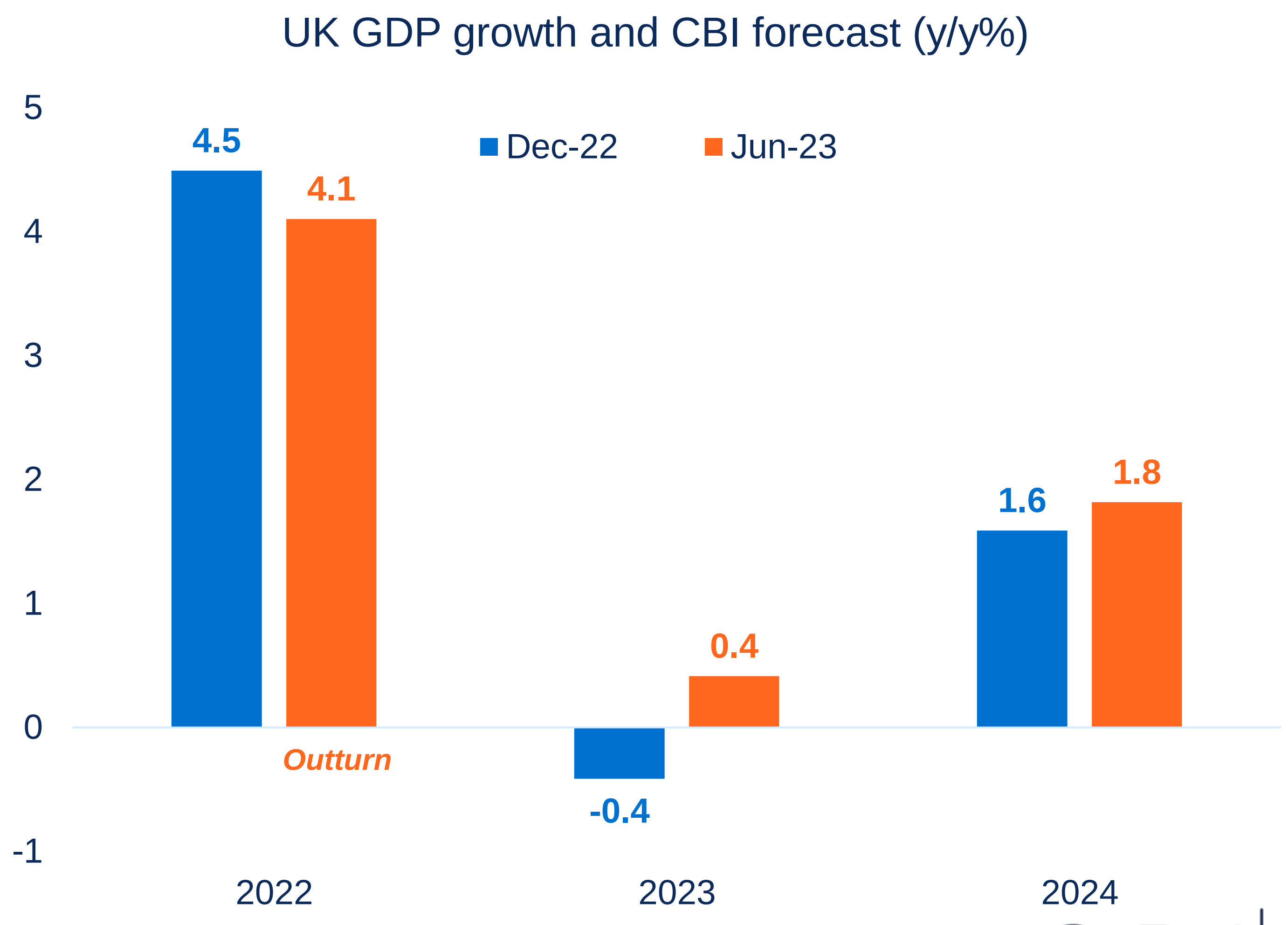
June 2023

UK economic outlook: glass half full?

- UK GDP was broadly flat in Q1 2023, continuing the underlying trajectory of stagnation seen over much of last year.
- Nonetheless, this outturn was better than we had expected in our December forecast, when the economy was predicted to fall into a mild recession this year. Instead, recent indicators of activity and household spending have indicated some resilience in economic growth.
- Tailwinds to growth certainly seem to have firmed since the start of the year: inflation is likely to have peaked, energy prices have fallen, supply chain pressure has eased and the global outlook is now a little brighter.
- As a result, **we have upgraded our forecast for UK growth. Significantly, we expect the economy to grow slightly this year (by 0.4%),** avoiding the recession expected in our previous forecast (-0.4%). **Growth then picks up in 2024 (to 1.8%),** again slightly firmer than we previously expected (1.6%).
- Nonetheless, 2023 will still mark another challenging year for consumers and businesses. Real household incomes are set to fall strongly once again, marred by strong inflation, higher interest rates, and tepid growth in other areas of the economy. This will inevitably weigh on household spending.
- The drag from inflation should ease as the year progresses, but price pressures will nonetheless remain strong by historical comparison. Signs of persistence in domestic inflationary pressure – notably services inflation and wage growth – will also likely prompt further monetary tightening by the Bank of England.
- Sluggish growth in both GDP and real incomes will also weigh on business and residential investment, notwithstanding our surveys suggesting companies' investment plans have turned a corner. But growth in investment is set to pick up next year, driving some of the acceleration in GDP growth.
- But despite this, and a stronger outlook than in our previous forecast, the longer-term challenges facing the economy remain steadfast.
- Trade intensity in the UK remains weak, and has continued to lag behind other developed economies. The same is true of business investment, despite the expected pick-up in 2024, and the longer-run underperformance seen over the last few decades looks set to continue.
- There are also signs of persistent "scarring" in GDP from the COVID-19 pandemic, with the economy around 7% smaller than its pre-COVID trend at the end of next year.
- Taken together, this means that UK productivity remains lacklustre, presenting ongoing challenges to living standards and potential growth.

UK economic outlook: glass half full?

	CBI Dec 2022 forecast (y/y%, unless otherwise stated)			Change from previous forecast (%pts)	
	2022	**2023**	**2024**	***2022***	***2023***
GDP growth	**4.1**	**0.4**	**1.8**	***+0.8***	***+0.2***
Household spending	5.6	-0.1	1.6	*+1.4*	*-0.4*
Government consumption	1.8	-0.7	1.6	*-5.2*	*0.0*
Business investment	10.8	0.0	1.9	*+1.5*	*+1.9*
Stockbuilding (ppt. contribution)	0.3	-2.0	-0.2	*+0.4*	*+0.4*
Exports	9.9	-2.8	3.3	*-10.4*	*+0.6*
Imports	13.3	-8.0	2.7	*-5.9*	*+0.8*
Net trade (ppt. contribution)	-1.2	1.8	0.2	*-1.2*	*-0.1*

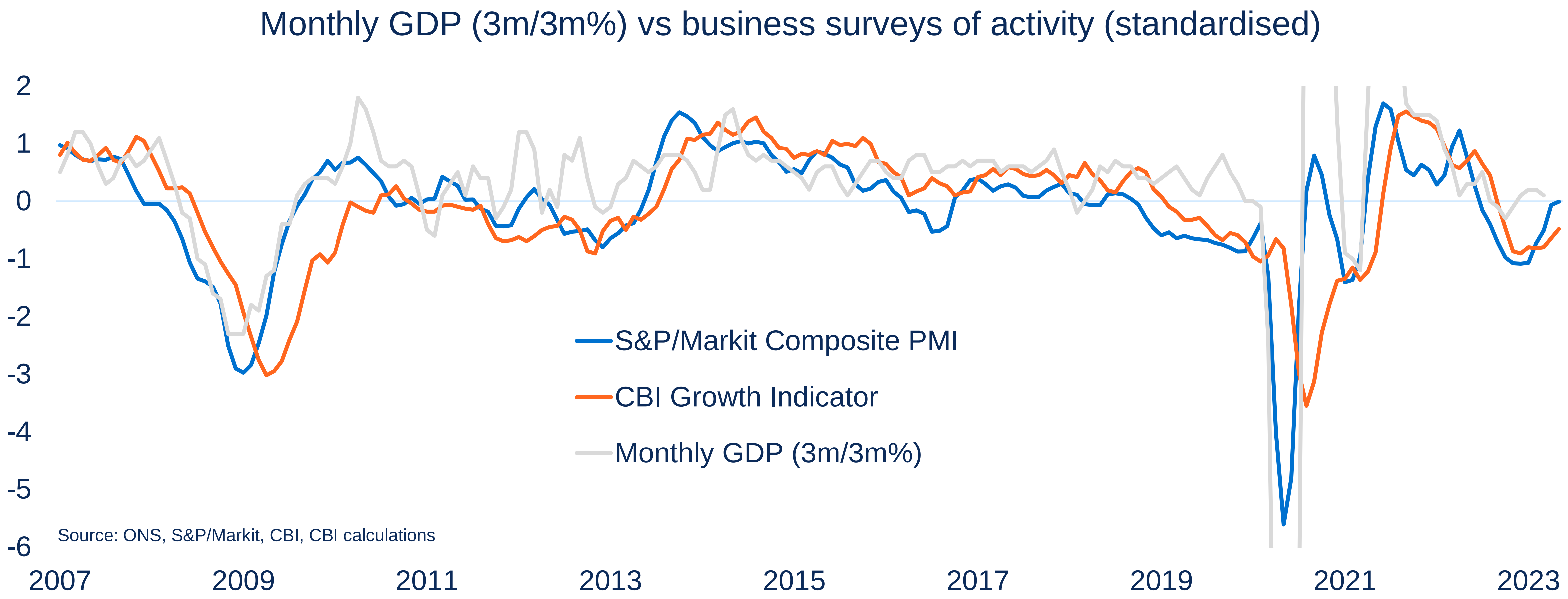


CBI

What does our forecast mean for your business?

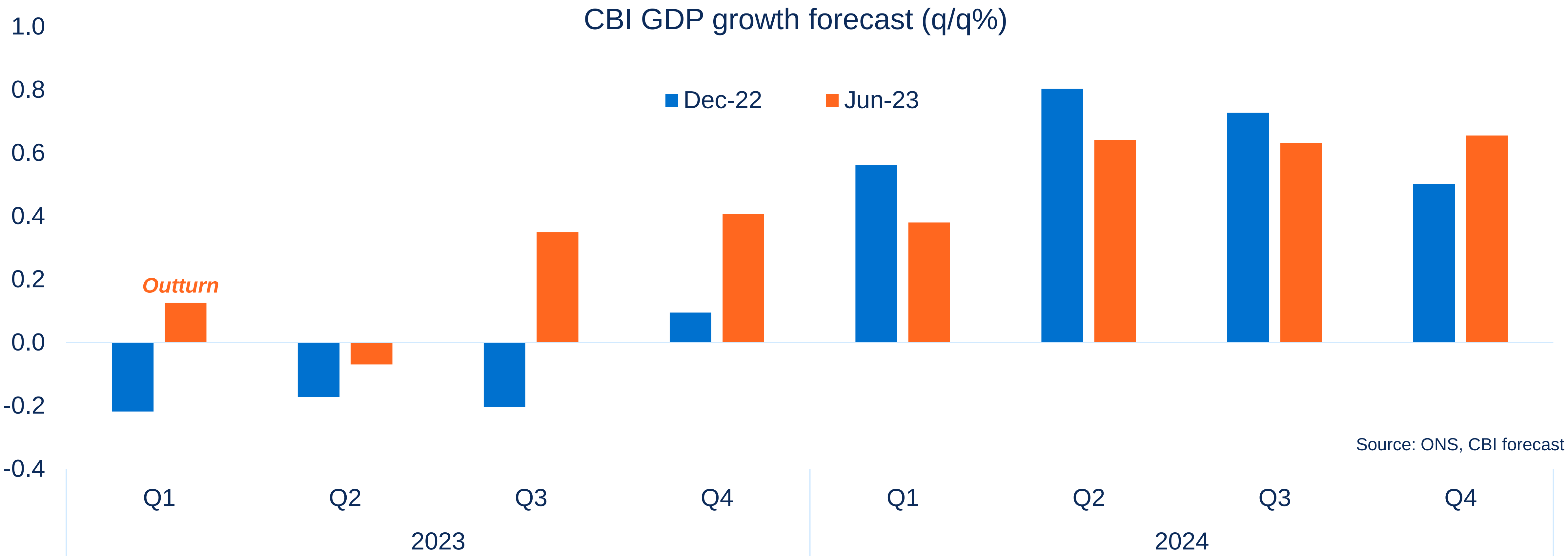
- We expect economic growth to be firmer than in our previous forecast, which all else equal, should translate to more resilient demand conditions.
- However, there may be divergences in sector performance: consumer-facing companies will be exposed to cash-strapped households, and thus may find trading conditions more challenging; the recent strength in air travel sits at odds with the constraints on household incomes and consumer-facing sectors at present; and firms in residential construction can expect the building impact of interest rate rises on mortgage availability to increasingly feed through to housing demand.
- Global cost pressures, particularly commodity prices and supply chain pressures, have eased and should remain lower, and firms should be seeing stabilisation in the prices of some raw materials and fuel costs. But domestically-generated price pressures – like pay and as some firms pass through past cost rises - remain firm.
- Given the stickiness in domestic inflation, we expect two more rate rises from the Bank of England, bringing Bank rate up to 5% in August. While many analysts expect some reduction in rates next year, we predict that interest rates will need to stay at this level to drive down inflation.
- We expect the labour market to remain tight over our forecast, which should be born in mind when formulating recruitment strategies. Focusing on areas such as employee propositions and ED&I remain big priority areas for our members
- While we expect a fairly weak year for business investment, it's clear that there is a strong focus on decarbonisation opportunities and hitting Net Zero goals. Alongside assessing their own progress and taking advantage of market opportunities, companies may wish to be mindful of their peers' activities in this space, and any implications for their supply chains
- On the global front, a big change since our previous forecast has been China lifting COVID restrictions, and opening up its economy. This will be a boon to companies with a presence in China, but also to those exposed to the positive spillovers in other ASEAN economies.
- Recent turmoil in the regional US banking sector has naturally sparked concerns over the potential for another global banking crisis. While we do not expect this to be the case, it is possible that some vulnerabilities may still be lurking among regional US banks or elsewhere in the global banking system, which may become more apparent as central banks raise rates further. The UK banking sector remains well-capitalised, so the main risk would be further volatility in financial markets.

Business surveys pointing to resilient activity…



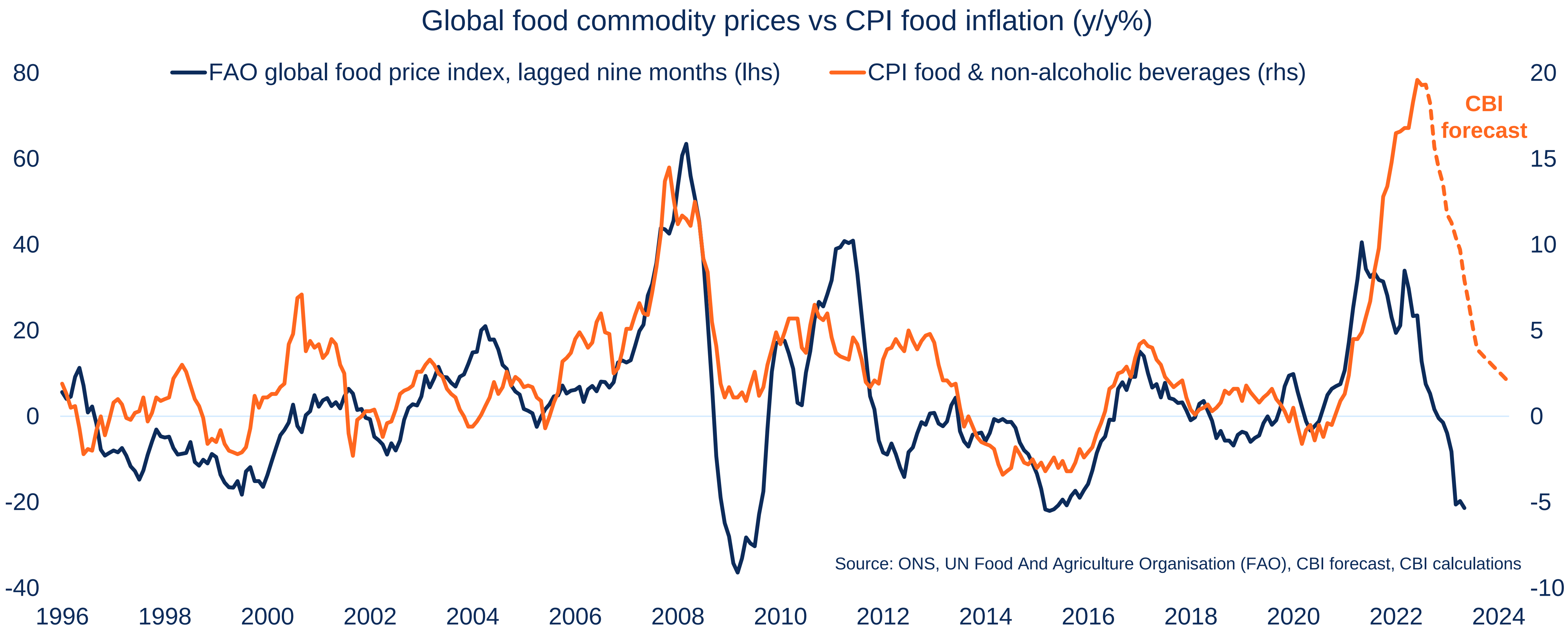
- Business surveys are showing more resilience in activity than previously expected – in particular, expectations for growth in our surveys have turned slightly positive, for the first time in almost a year
- This has led many to expect that the UK may avoid a technical recession this year, as many analysts (including the CBI) were forecasting at the end of 2022

…and near-term economic outlook has improved



- We have upgraded our forecast for UK growth, due to a combination of better-than-expected activity so far, lower global inflationary pressures, and the knock-on impact on other areas of activity (notably business investment)
- The upgrade is particularly significant for this year: we no longer expect the economy to fall into a recession, and expect growth to pick up somewhat from the second half of this year
- Near-term output is still subject to some volatility due to the extra bank holiday in May, and ongoing disruption from industrial action.

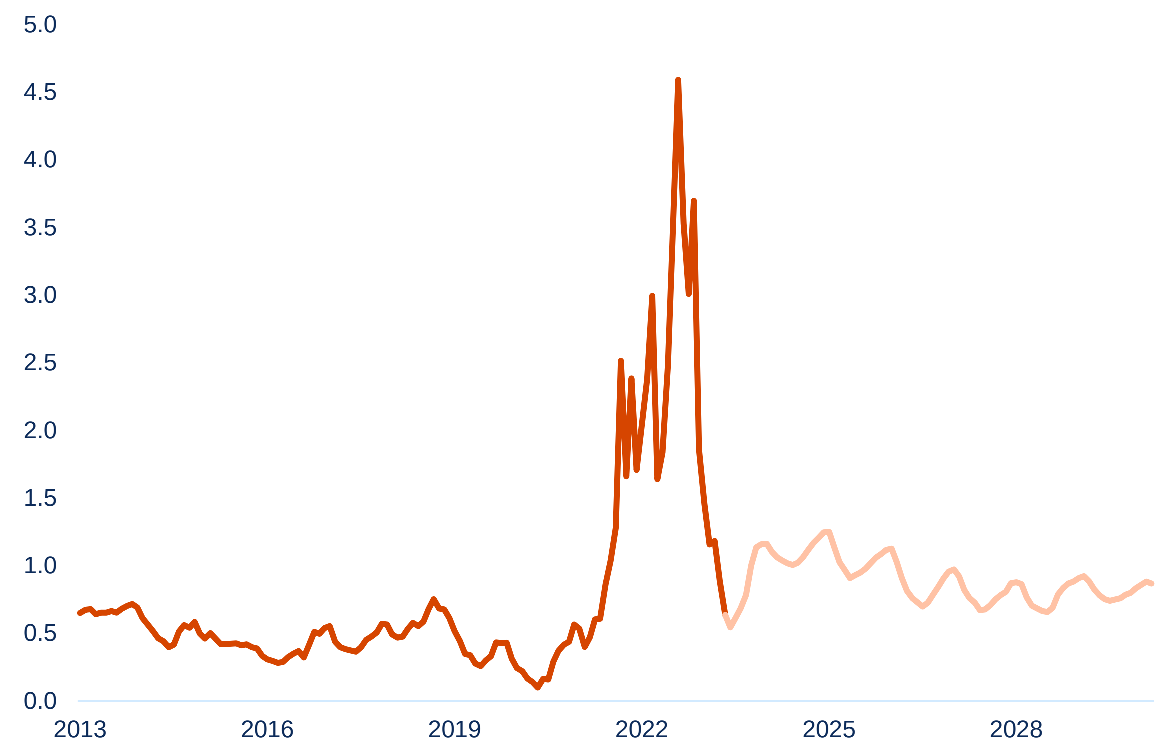
Inflation to fall - #1 food price inflation will ease



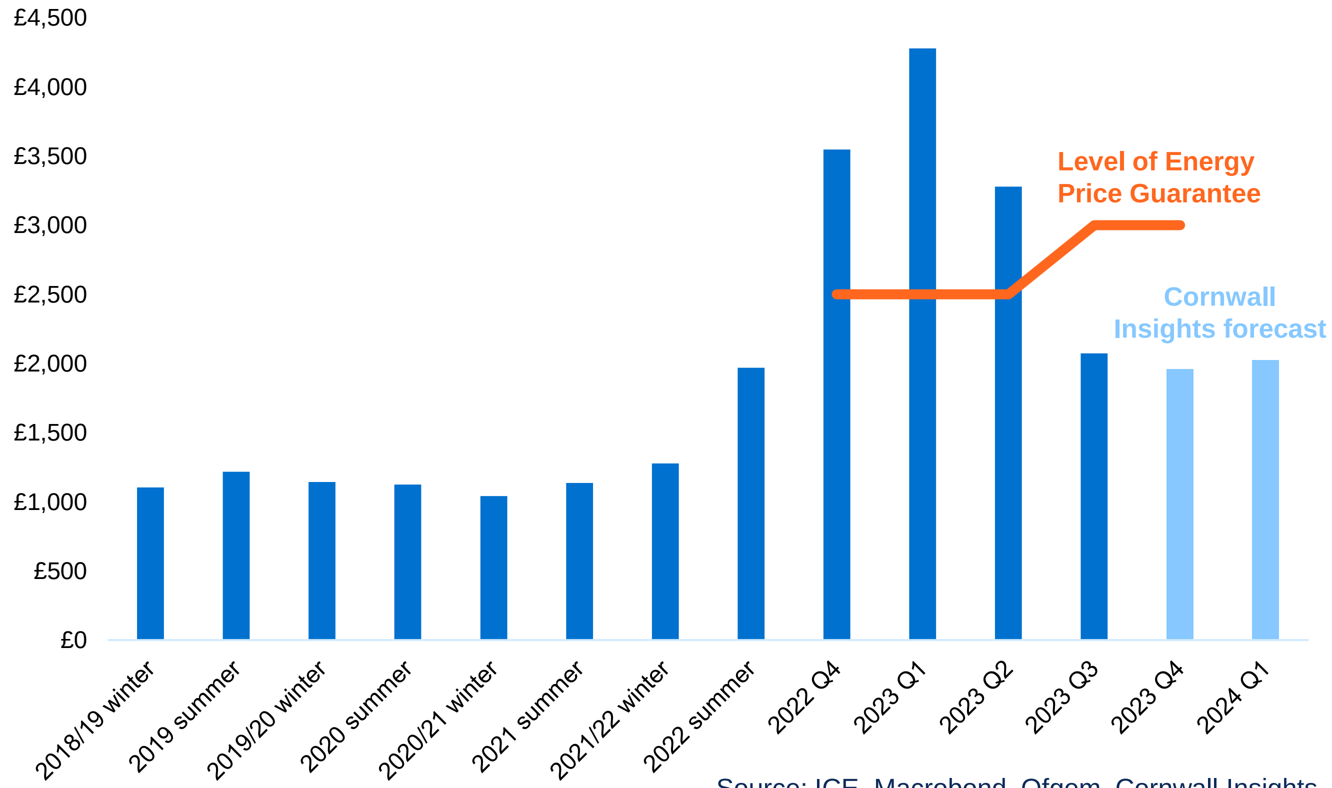
- Despite the resilience in indicators of activity, headwinds to growth remain strong – especially from inflationary pressures
- In particular, food price inflation has soared – reaching 19% in April, close to the highest since 1977
- However, global commodity food inflation has already turned downwards, pointing to a substantial decline in food price inflation ahead

Inflation to fall - #2 gas price outlook more benign…

ICE global spot and futures prices (GBP/therm)



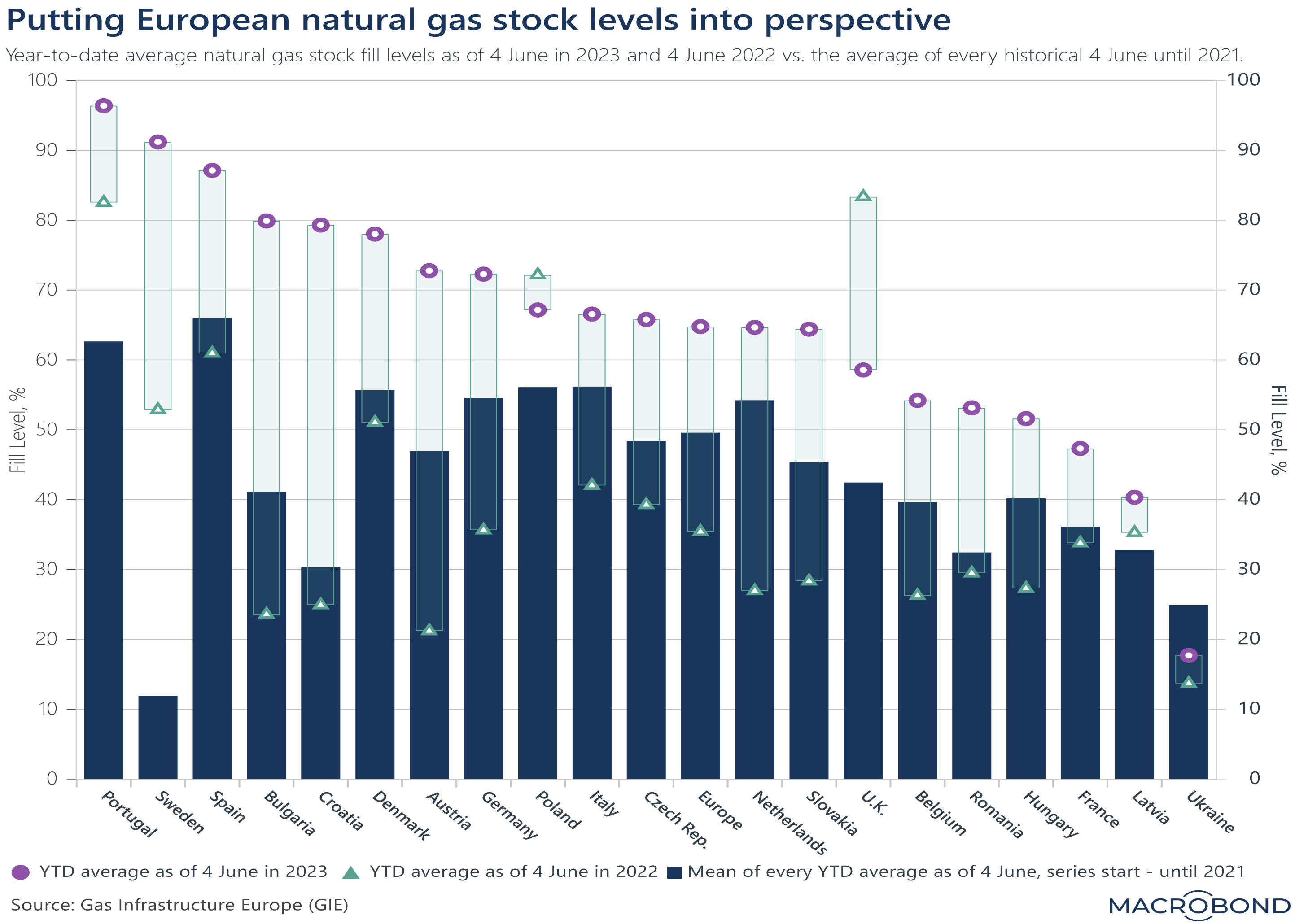
Ofgem price cap level (direct debit customers)



Source: ICE, Macrobond, Ofgem, Cornwall Insights

- Global gas prices have fallen back significantly since the end of 2022, off the back of a relatively mild winter, the replenishment of gas stocks in Europe, and expectations of weaker global demand
- This means that Ofgem's energy price cap for Q3 was cut further. Coupled with the government's Energy Price Guarantee effectively capping energy bills until the end of 2023, this is a key driver of the decline in CPI inflation in our forecast

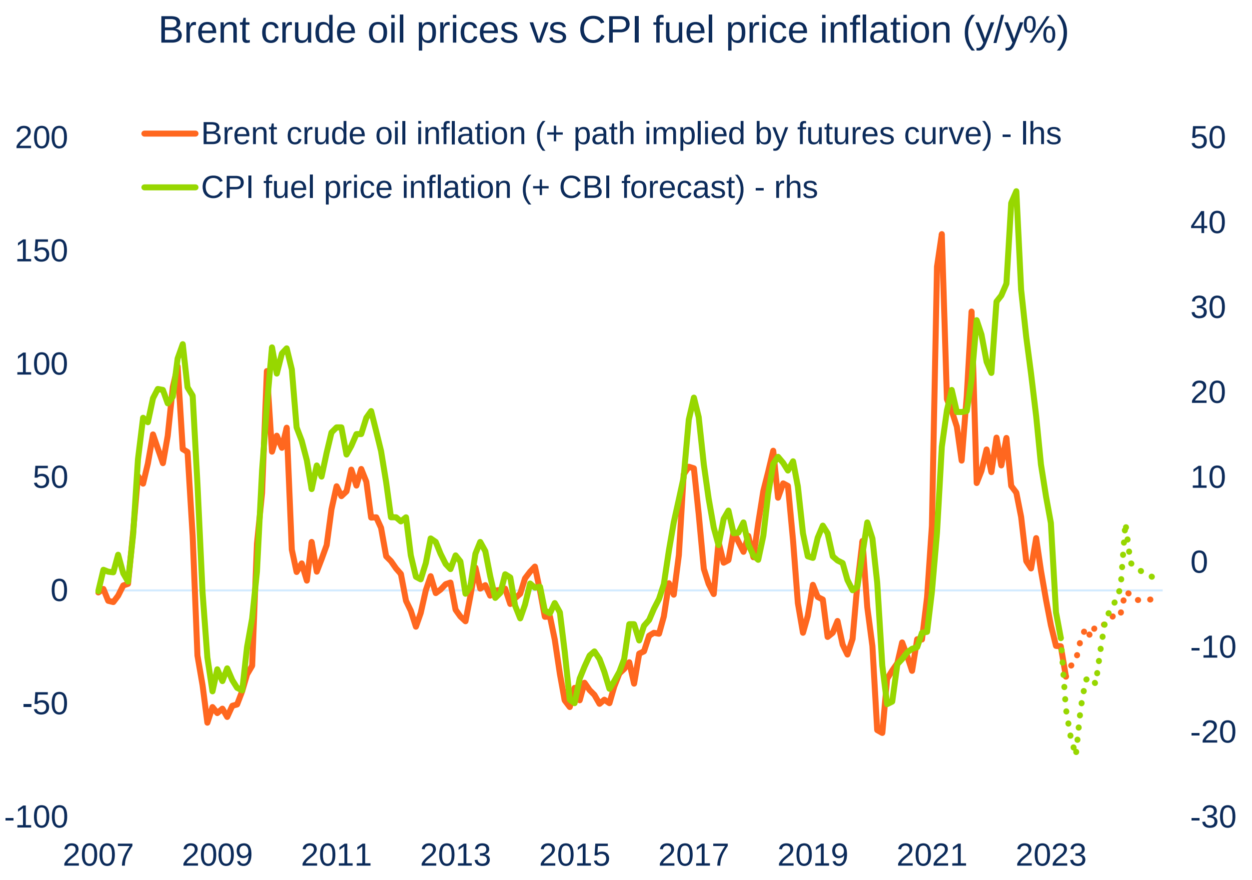
…as concerns over energy supplies recede

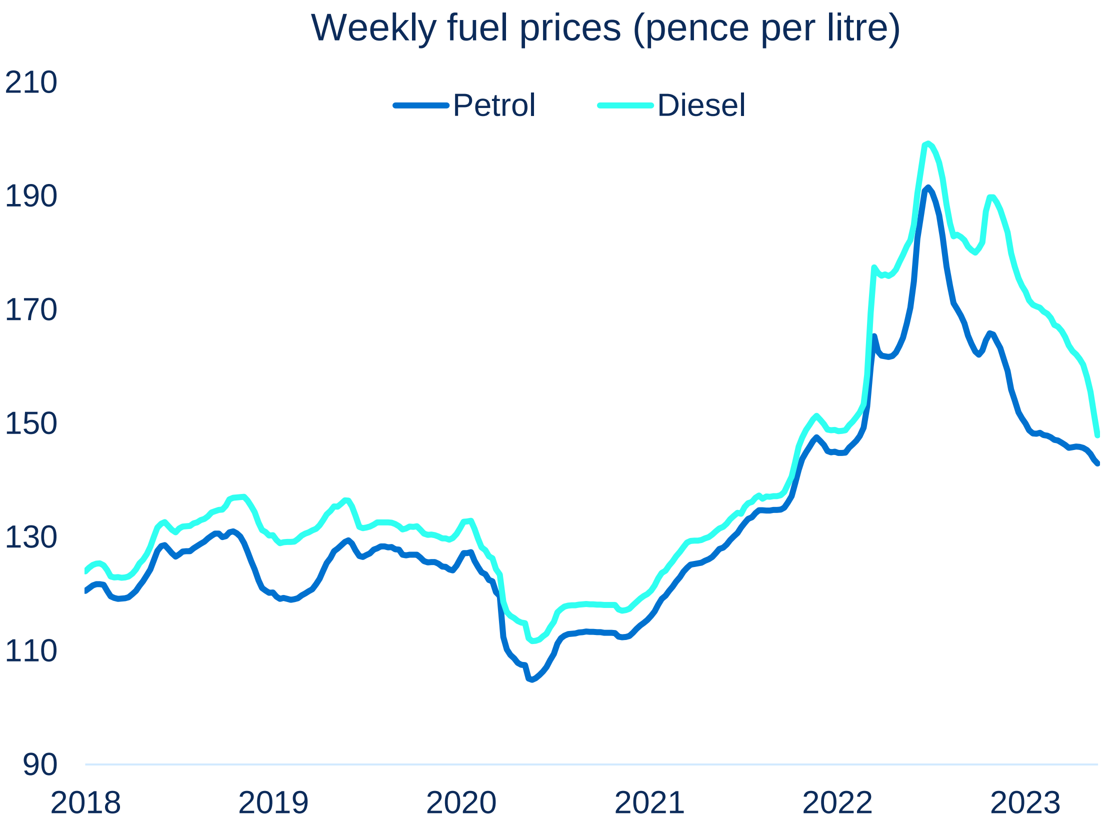


- The replenishment of gas stocks in Europe has been a significant factor in driving gas prices lower, and contributing to a more benign outlook for inflation
- Ample stock levels also mean that the prospect of gas shortages in winter 2023 – in the face of lower supplies from Russia – is also less of a risk for this winter
- However, risks to gas supplies remain strong: particularly if temperatures drop by more than expected over the coming winter, or China's re-opening leads to competing demand for energy.

Source: Macrobond

Inflation to fall - #3 fuel price pressures unwind

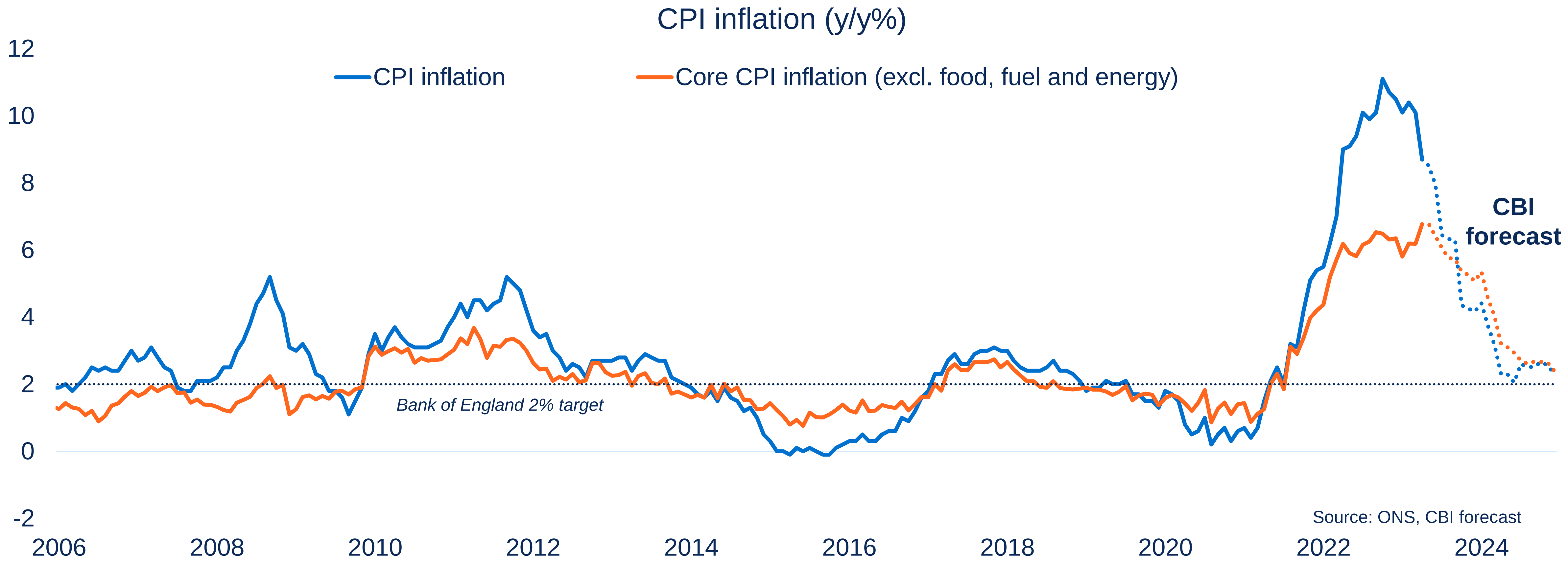




Source: Macrobond, ONS, Department for Energy Security and Net Zero, CBI forecast

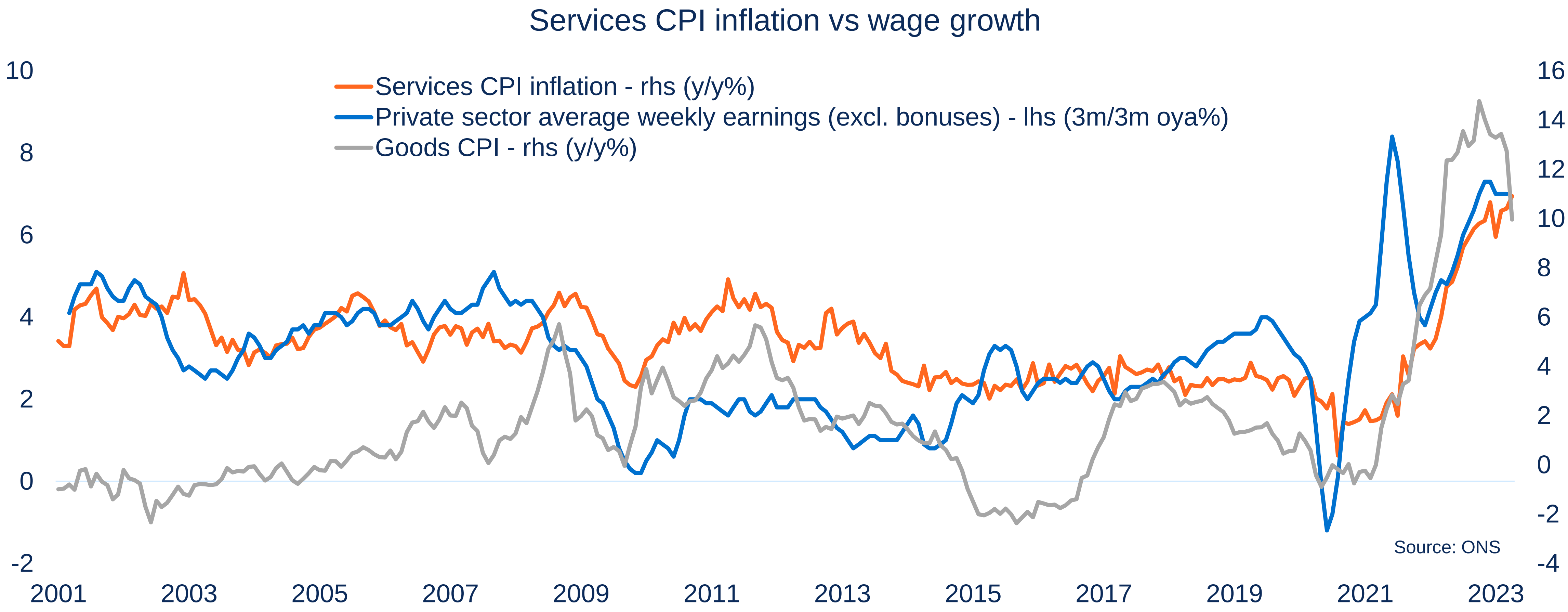
- Global oil prices have also come off their previous peaks, as the post-COVID surge in global demand and supply chain pressure fade. As a result, domestic fuel price inflation has also eased considerably
- A further waning in fuel price inflation is another key driver of inflation falling back over our forecast

UK inflation has a sticky core



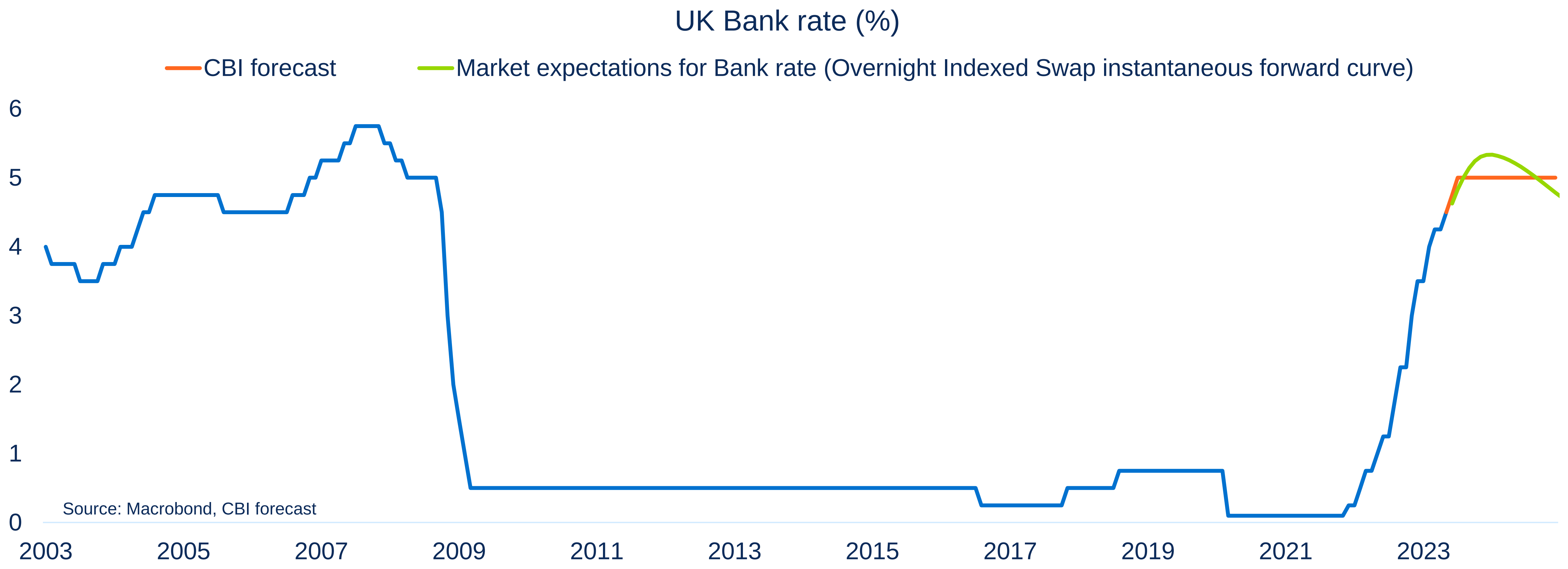
- We expect inflation to continue falling over our forecast, driven particularly by an easing in global price pressures – food, energy and fuel – alongside a range of other base effects unwinding
- However, amid signs of greater persistence in more domestic inflationary pressures, we expect "core" inflation (which excludes food, energy and fuel) to fall at a slower pace
- Furthermore, while CPI inflation falls over the course of this year, 2023 will still be characterised by strong overall inflation: it ends this year at around 4%, double the Bank of England's 2% target

Domestic price pressures remain stubbornly strong…



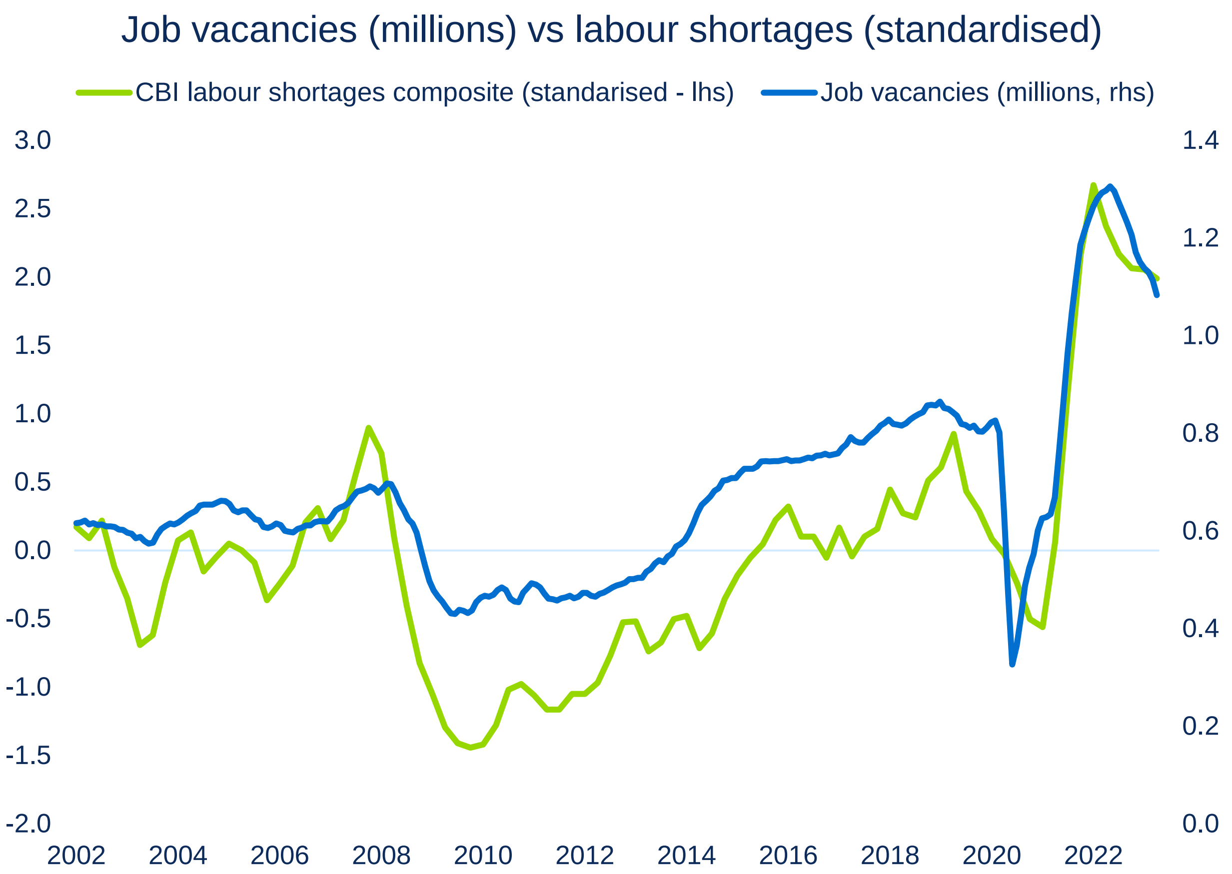
- In contrast to waning global prices pressures, domestically-generated inflation has been much more persistent – most evidently illustrated in private sector wage growth and services inflation
- Continued persistence in domestic price pressures is a key upside risk to our inflation forecast
- It's also something that the Bank of England will keep a close eye on, given the implications of high inflation becoming embedded in price and wage setting.

…which will hold the Bank of England's feet to the fire



- We expect the Bank of England to raise interest rates twice further, bringing the peak to 5% in August
- Financial markets expect rates to be cut in 2024, as inflation falls back more decisively. However, we believe that the Bank will instead choose to keep rates unchanged, in the face of firmer economic growth with persistently strong wage growth and other inflationary pressures. Should domestic price pressures prove more persistent, it's likely that the Monetary Policy Committee will raise rates by more than we expect

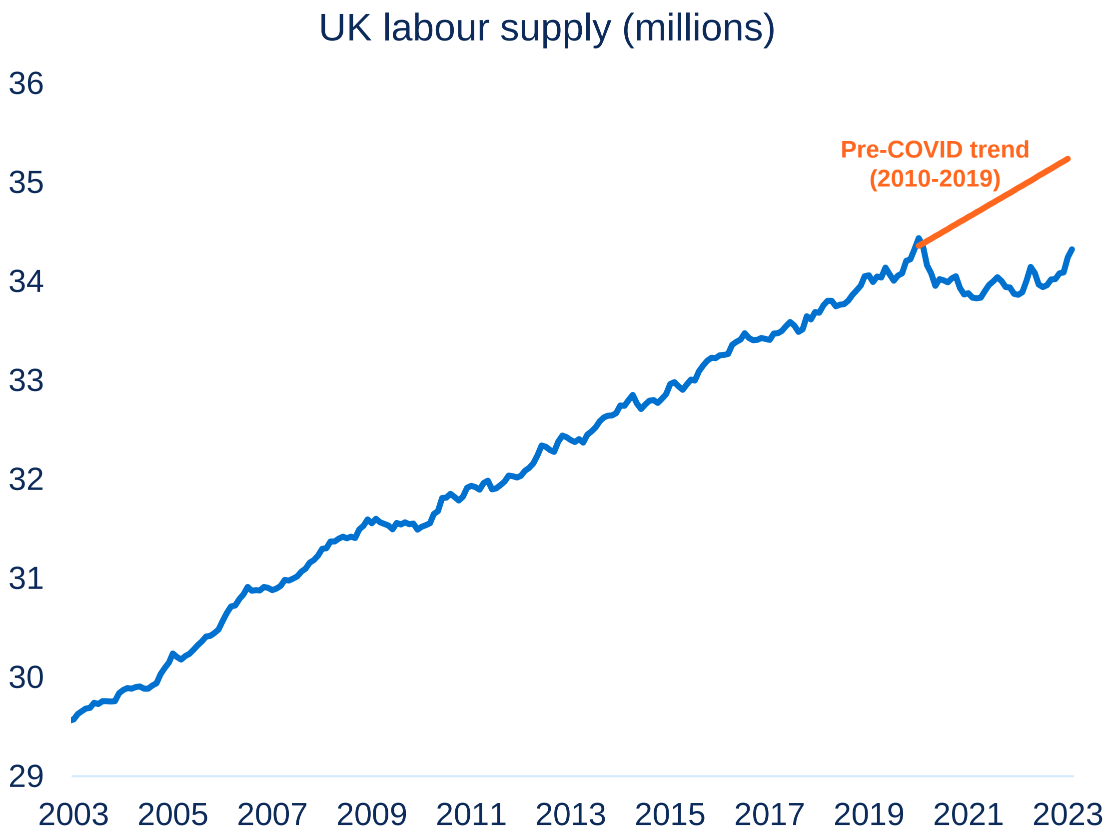
Some easing in a tight labour market…

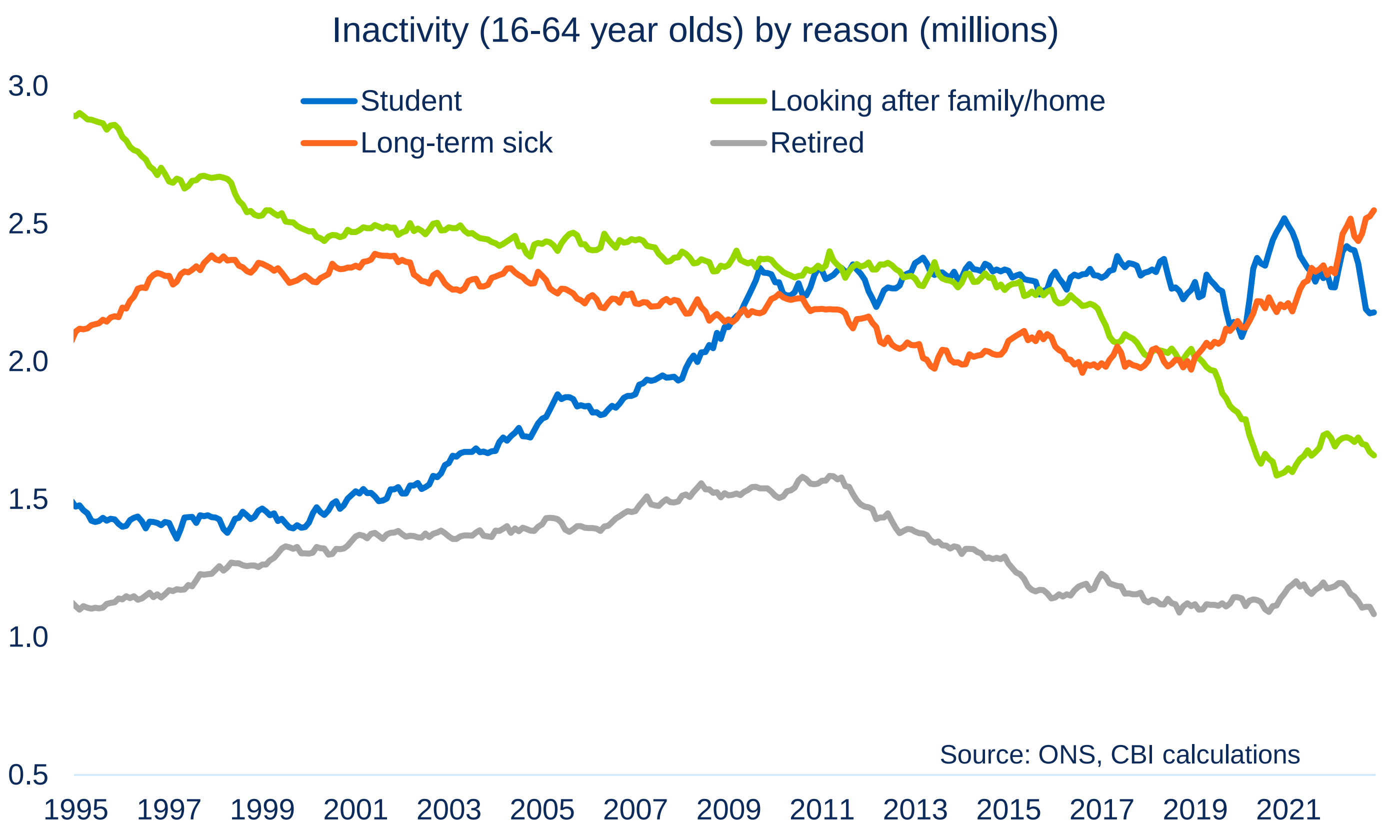


Source: ONS, CBI surveys, CBI calculations

- There are some signs of the labour market loosening, but overall it remains tight: although vacancies have fallen and labour shortages have eased, both are still historically high
- Against this backdrop, hiring intentions in our surveys have moderated considerably over the first half of this year. This could reflect a lagged response to sluggish growth last year, but also companies responding to labour shortages through delivering production via other means

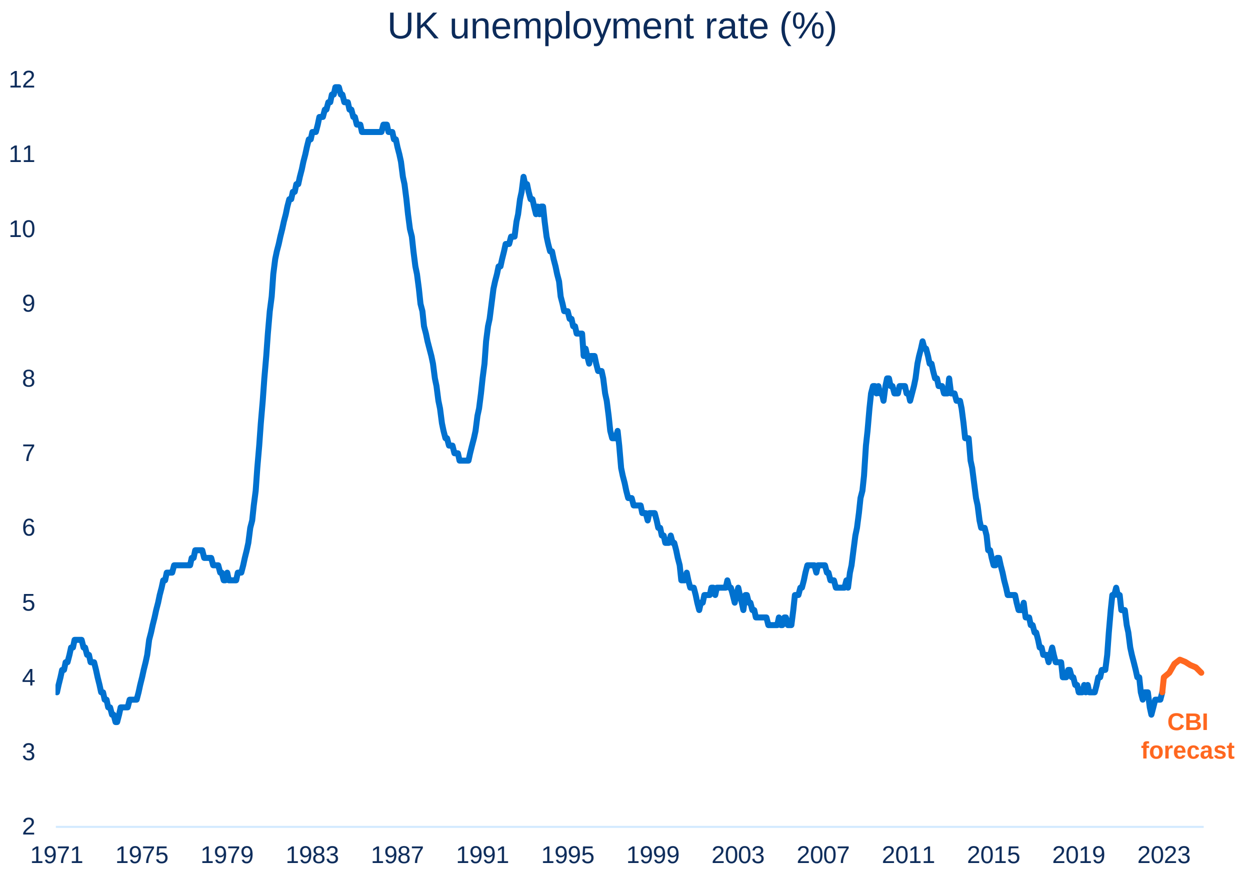
…but labour participation has a long way to recover





- Labour market participation has fallen significantly since the onset of COVID, and remains approximately one million below its pre-COVID trend (the "missing million")
- Inactivity has been falling back recently, driven by a fall in the number of students (possibly reflecting an unwinding of the large surge in numbers entering education during COVID)
- However, those out of the labour market due to long-term sickness has continued to rise, to a new record high. This is now the dominant reason cited for being out of the workforce (among 16-64 year olds)

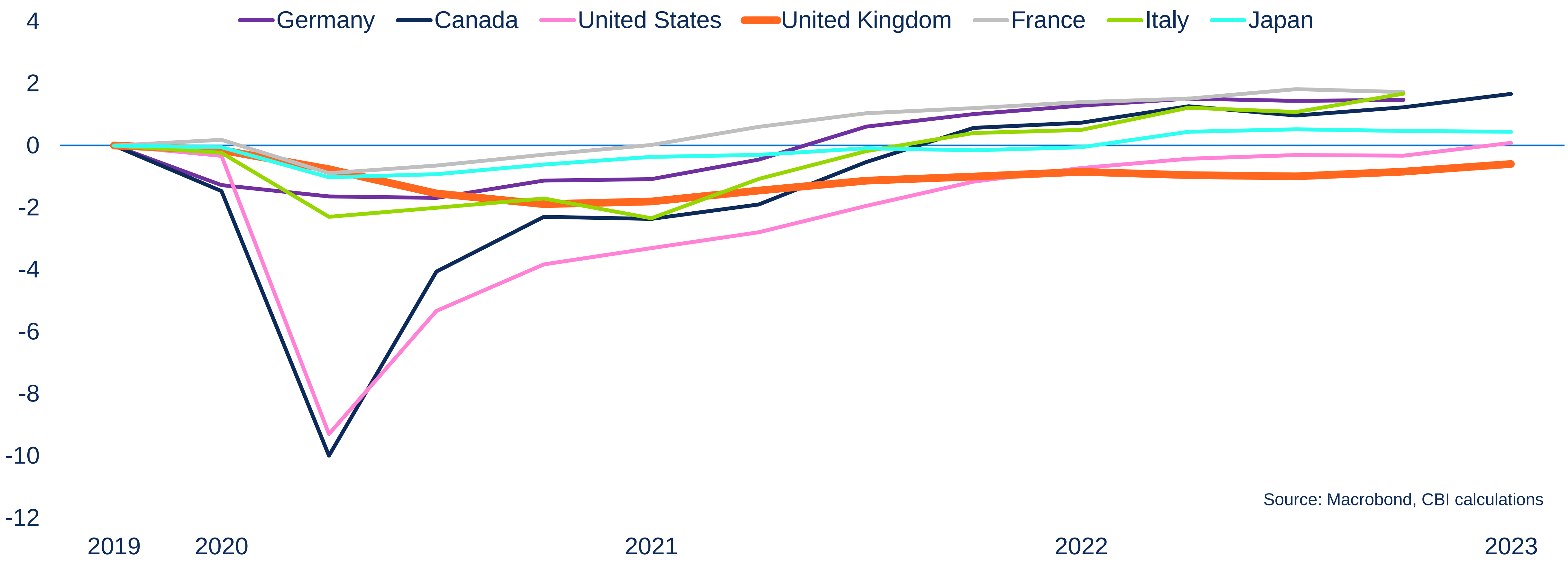
Labour availability should grow modestly…



- We expect employment to be largely flat this year, as weak GDP growth weighs on the labour market
- This translates into a very modest rise in unemployment. Even taking this into account, labour market conditions remain relatively tight over our forecast
- The key uncertainty around the labour market outlook is the extent to which inactive workers re-enter the workforce. We expect some recovery in participation, but it remains below pre-COVID levels at the end of 2024

…but is underperforming by global comparison

Change in employment rates (15-64) since the COVID-19 pandemic (ppt change since Q4 2019)

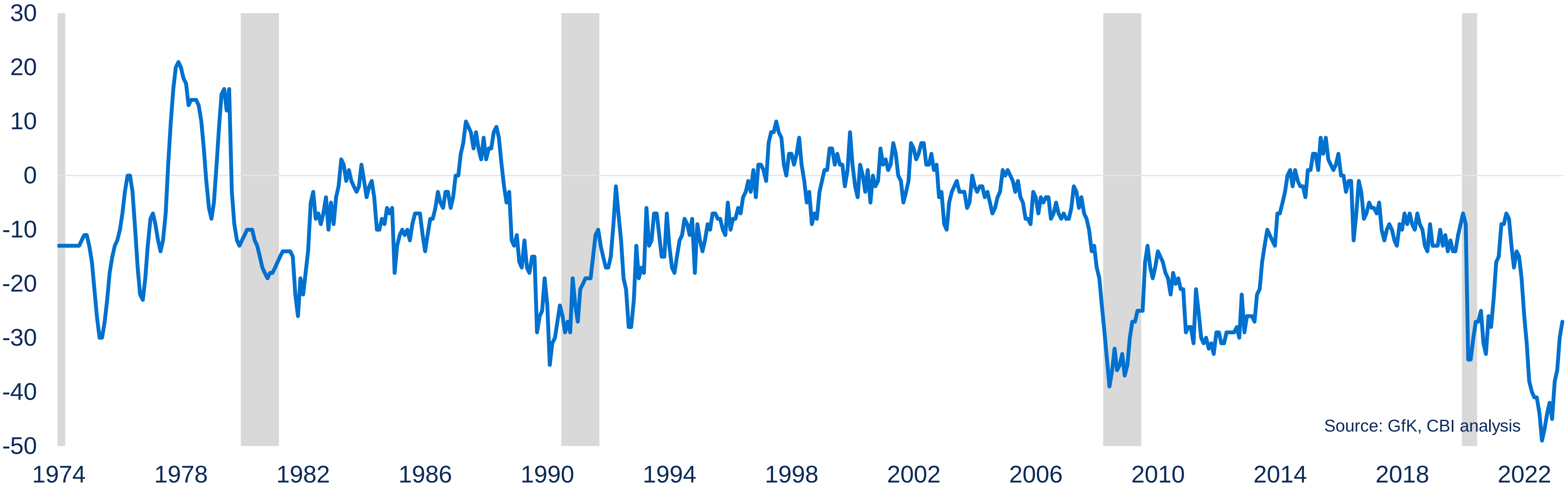


Source: Macrobond, CBI calculations

- Despite the resilience in the UK labour market over the last few years, growth is lagging behind other advanced economies
- This is notable given that many countries – such as Canada and the US – saw much sharper falls in employment during the pandemic

Consumer confidence turns a corner…

GfK consumer confidence index
(shaded areas mark periods of recession in the UK)



- Consumer confidence has also started to recover, after hitting a historic low in September 2022.
- The pick-up has been underpinned by households' improved perceptions of the general economic situation and their own personal finances in the year ahead – chiming with lower energy prices and broader inflation having peaked.
- This uptick is likely underpinning resilience in consumer spending. Nonetheless, the level of consumer confidence remains low by historical comparison, and still comparable to that seen during periods of recession.

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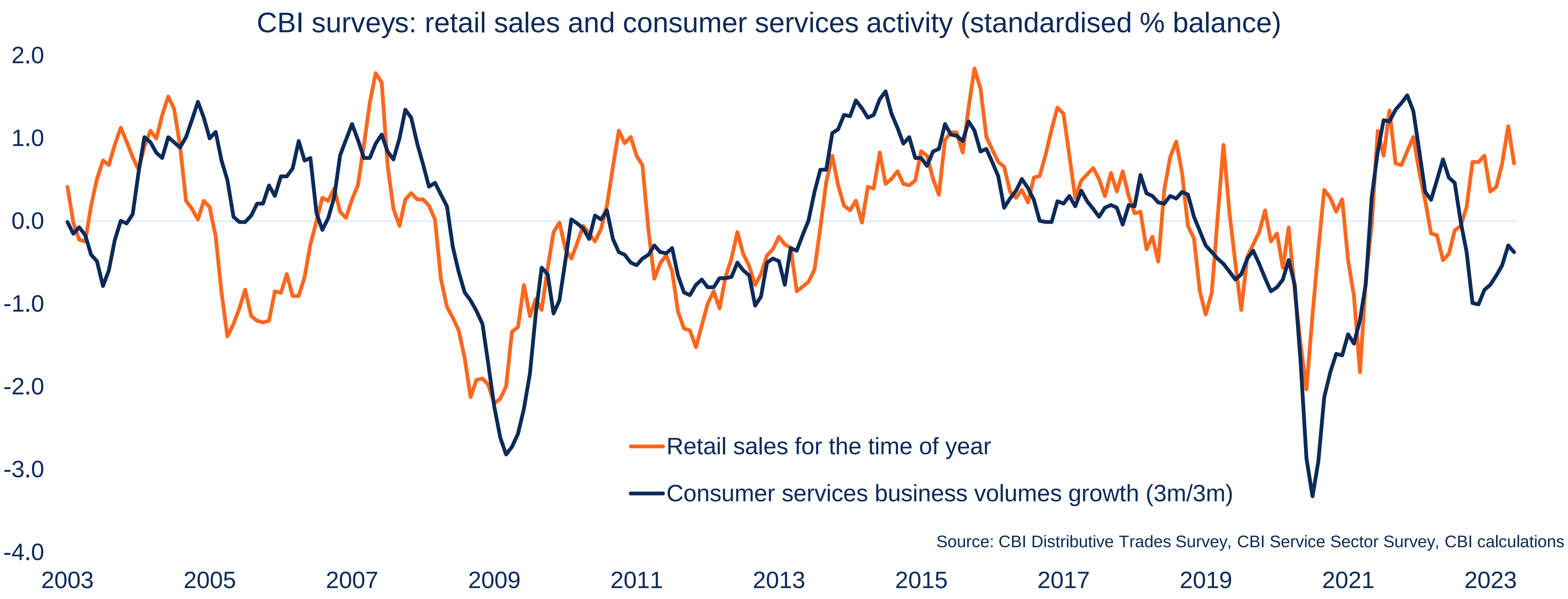
…amidst resilience in household spending…

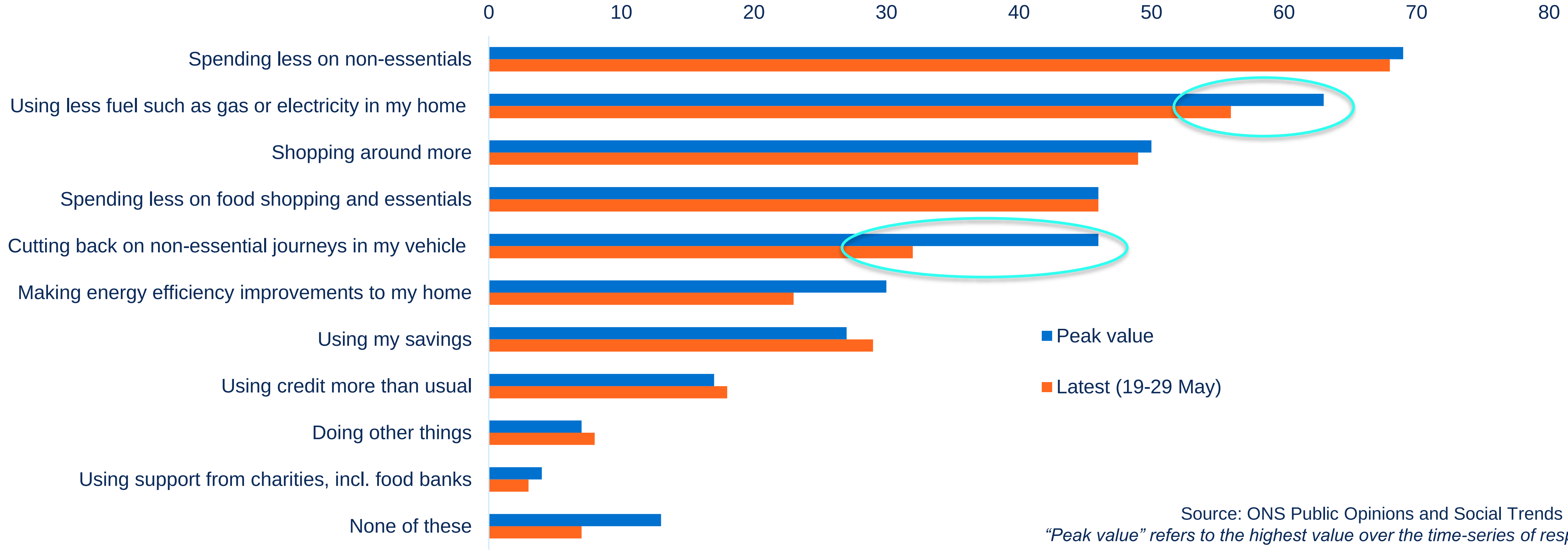


Source: CBI Distributive Trades Survey, CBI Service Sector Survey, CBI calculations

- Indicators of household activity shown some degree of resilience since the start of the year – despite the erosion of real earnings via high inflation
- However some indicators have been stronger than the trend implied by official data on household spending

…as lower energy prices give some breathing space

Households' responses to a higher cost of living (% of respondents)

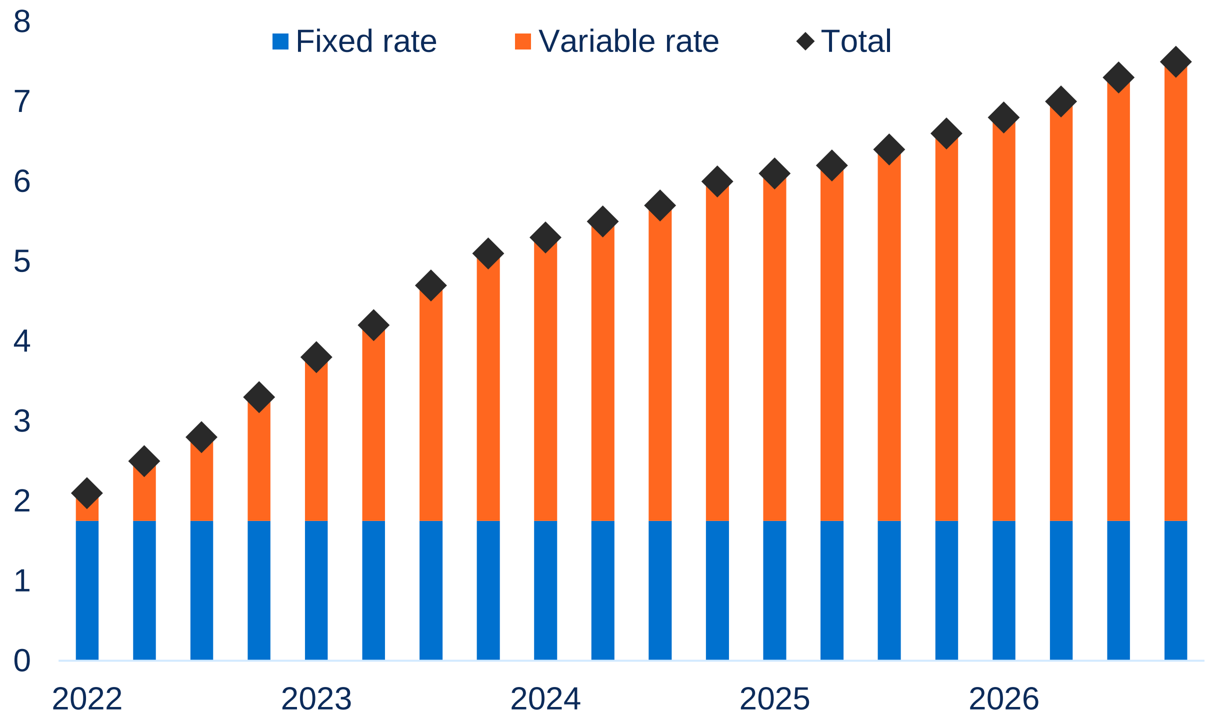


Source: ONS Public Opinions and Social Trends Survey
"Peak value" refers to the highest value over the time-series of responses

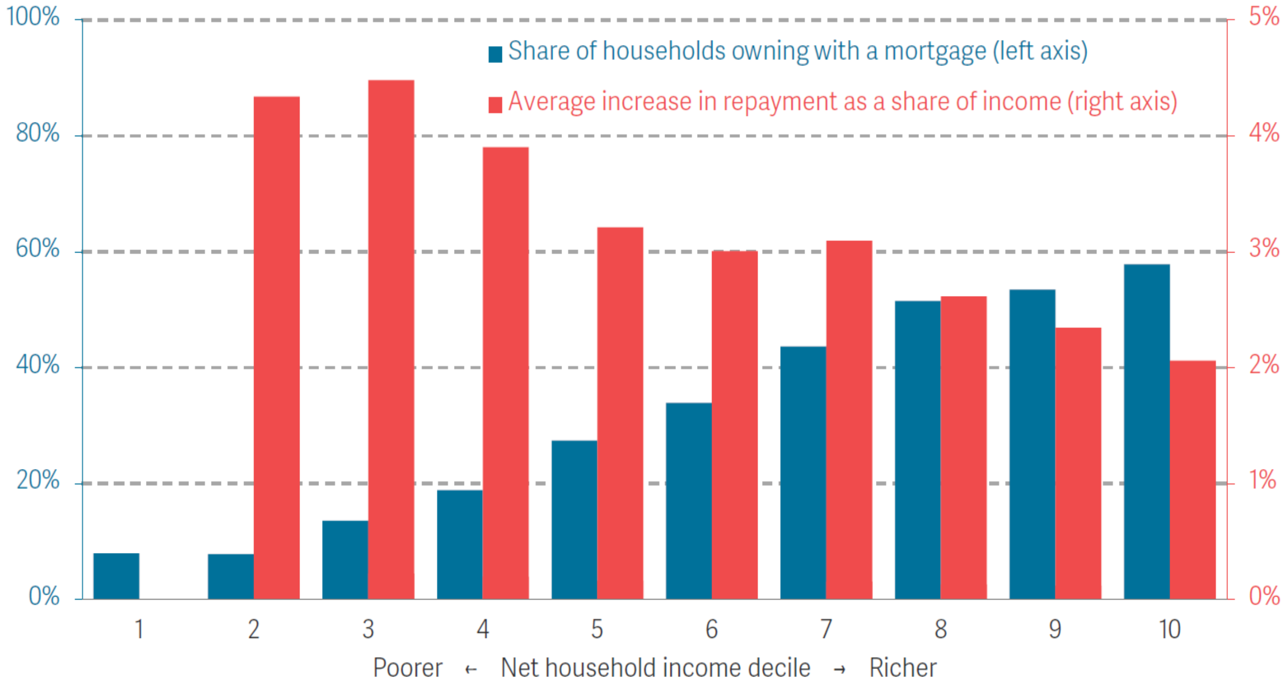
- Households are continuing to adjust to a higher cost-of-living in number of ways. The majority are continuing to spend less on non-essential items, and curbing energy use in their homes
- However, the proportion curbing energy use and non-essential vehicle journeys has fallen noticeably, which is likely linked to the recent fall in wholesale energy prices. This may be providing a fillip to household spending, explaining some of the recent resilience in indicators of consumer spending
- The proportion spending less on food & essentials is relatively unchanged, suggesting that the high cost of living continues to bite hard

But more households to feel impact of higher rates…

Estimated cumulative number of households facing a change in mortgage rate since Q4 2021 (million)



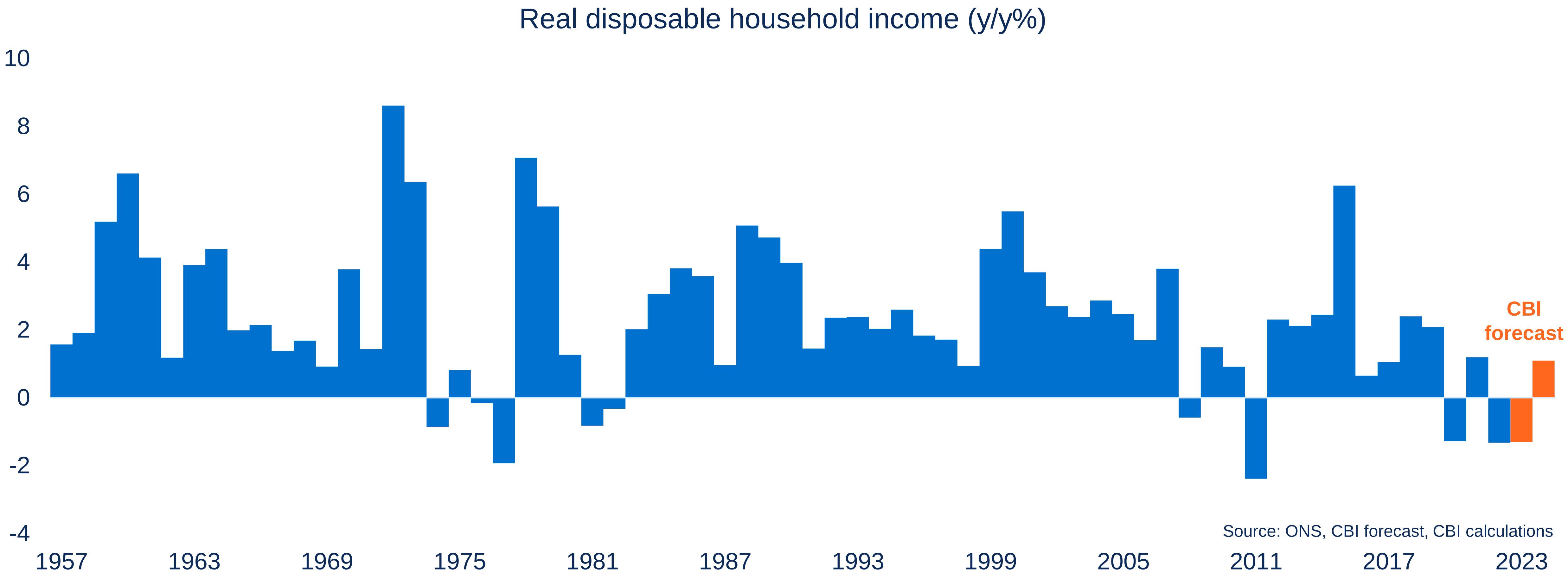
Proportion of households that own their home with a mortgage and estimated average increase in annual mortgage repayments from Q4 2021 to Q4 2026, by income decile: UK



Source: Resolution Foundation Macro Policy Outlook, Q2 2023

- Set against the tailwinds to household spending, a year of rising interest rates is starting to have an impact on consumer activity in our forecast
- This will likely amplify over 2023 and beyond, as more households roll off fixed mortgage contracts
- While fewer low- to middle-income households are mortgage holders, those that are tend to spend a greater proportion of their income on mortgage repayments. As a result, these cohorts will face the sharpest increase in repayments – amplifying the distributional hit to real incomes that has been apparent since COVID.

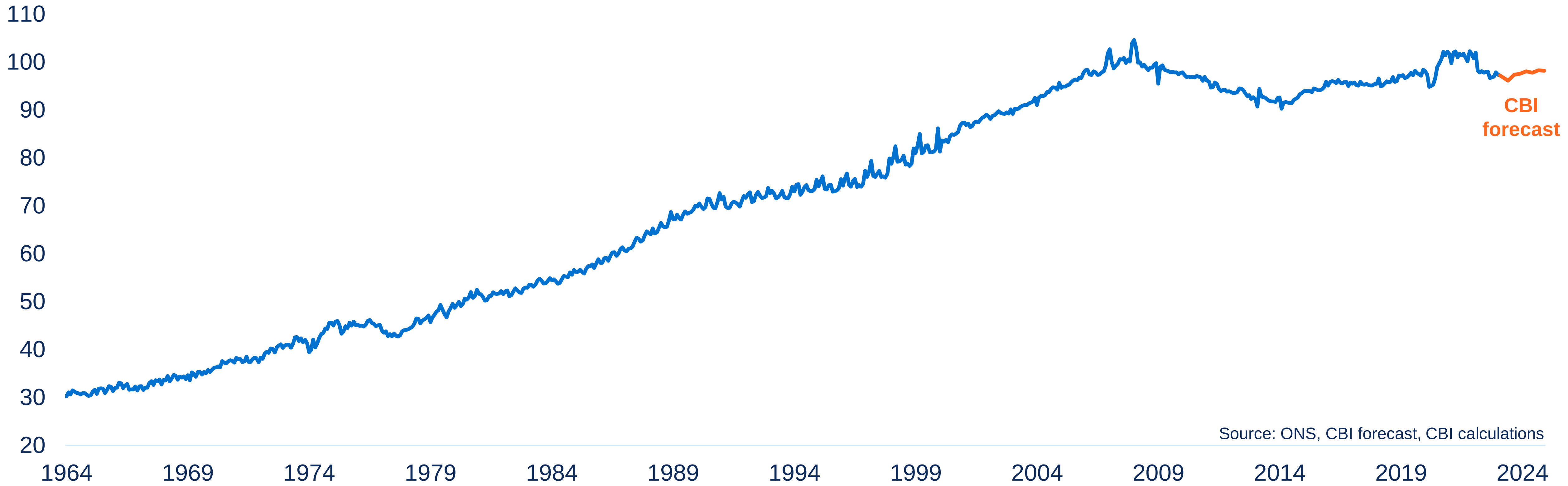
…and falling real incomes will drag on spending…



- Despite recent resilience in the data, 2023 is set to be another difficult year for the UK consumer. We expect real incomes to fall again, with inflation remaining high (albeit falling through the year), and employment & earnings growth slowing.
- Combined with higher interest rates, this leads to a small decline in household spending (-0.2%) for the year as a whole.
- Both real incomes and household spending are set to return to growth in 2024, as inflation falls back further and economic & labour market momentum improve.

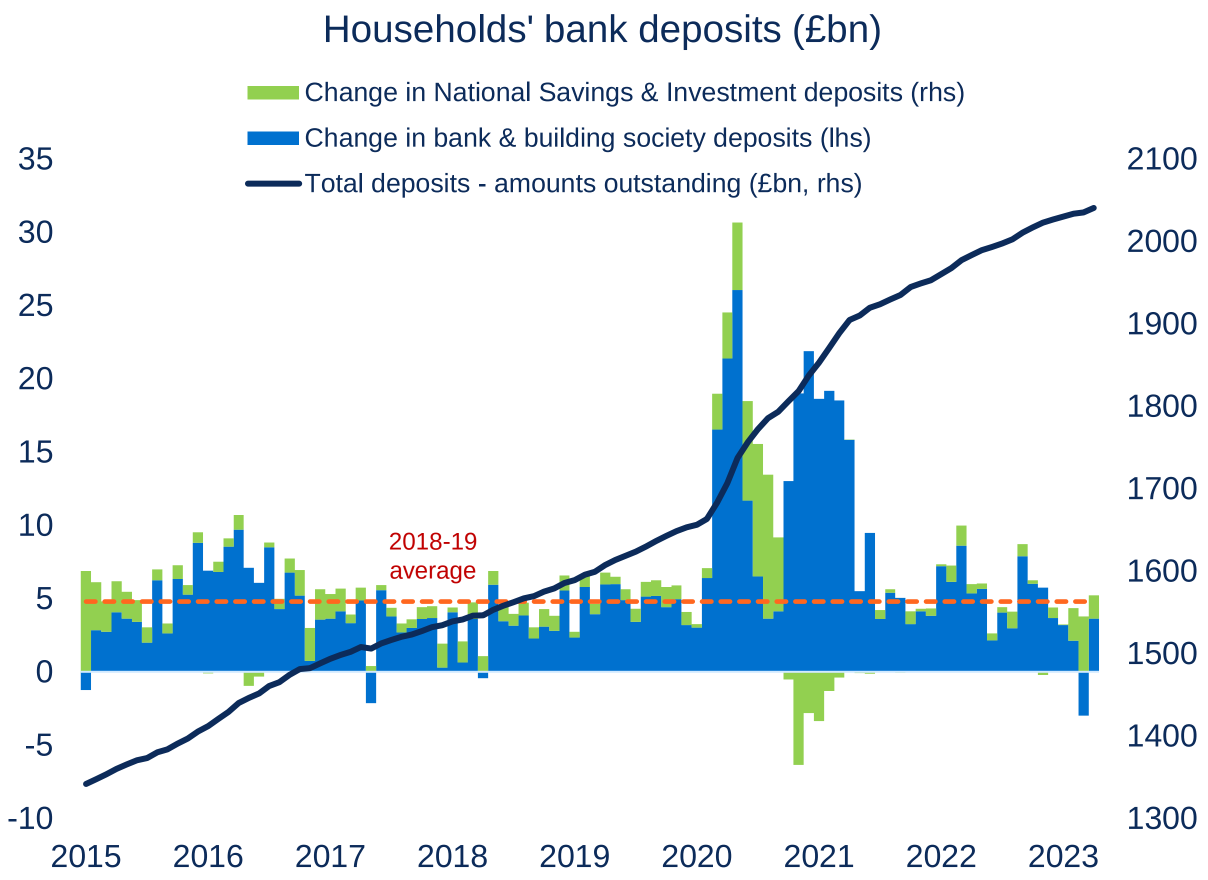
…as living standards continue to stagnate

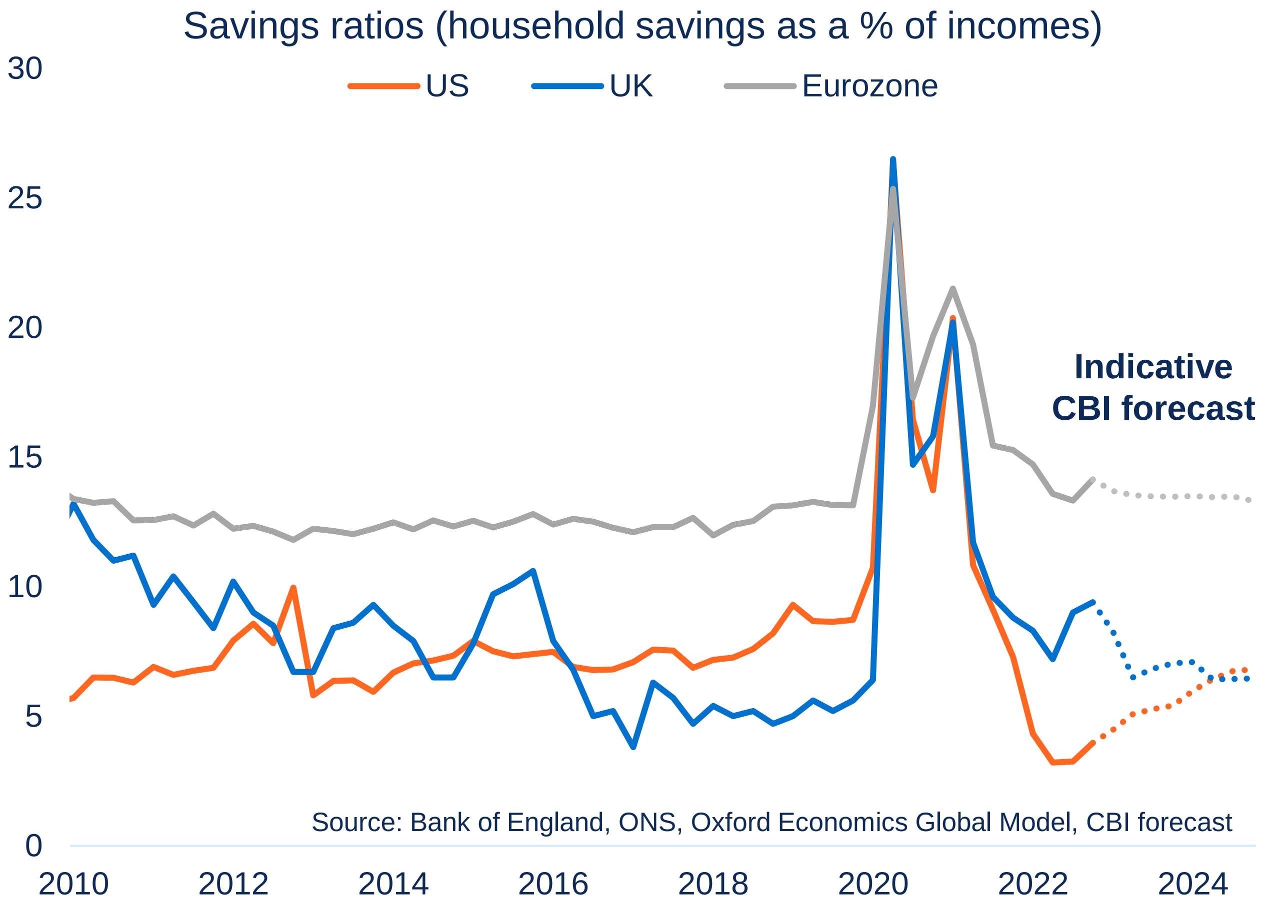
Real wages (2008=100)
Average weekly earnings (incl. bonuses) deflated using the consumer prices index



- The pick-up in real incomes next year is underpinned by a recovery in real wage growth, as inflation falls back
- However, even accounting for this growth, the level of real wages remains below its level prior to the global financial crisis, in 2008
- This will mark a 16-year period in which real wages have been largely stagnant – linked strongly to the sluggishness in productivity over the same period.

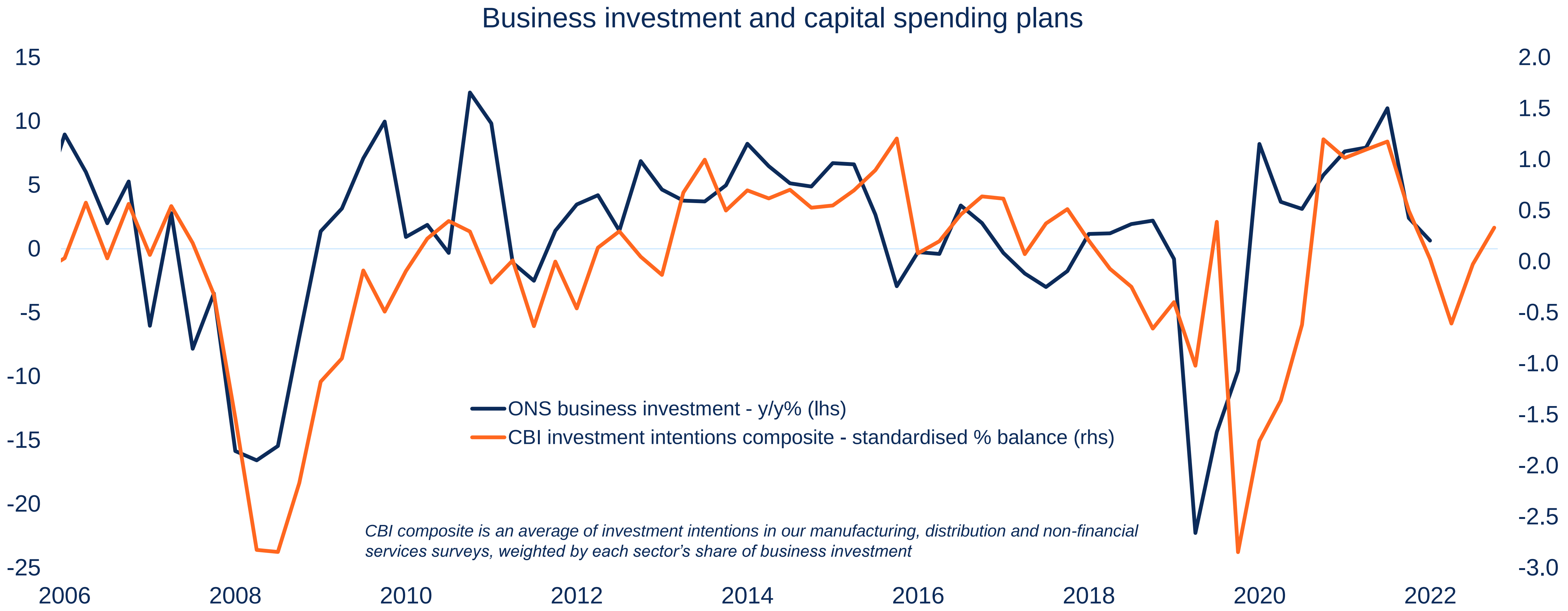
Little support to spending from household savings





- A risk to our forecast is the extent to which households will draw down on savings built up during the COVID-19 pandemic
- There is little sign of this so far, with households continuing to add to their deposits in banks, building societies and NS&I products
- National accounts indicators of savings also suggest that most of the rundown has already occurred. As such, we do not expect much support to consumption from savings over our forecast.

Investment intentions recover…



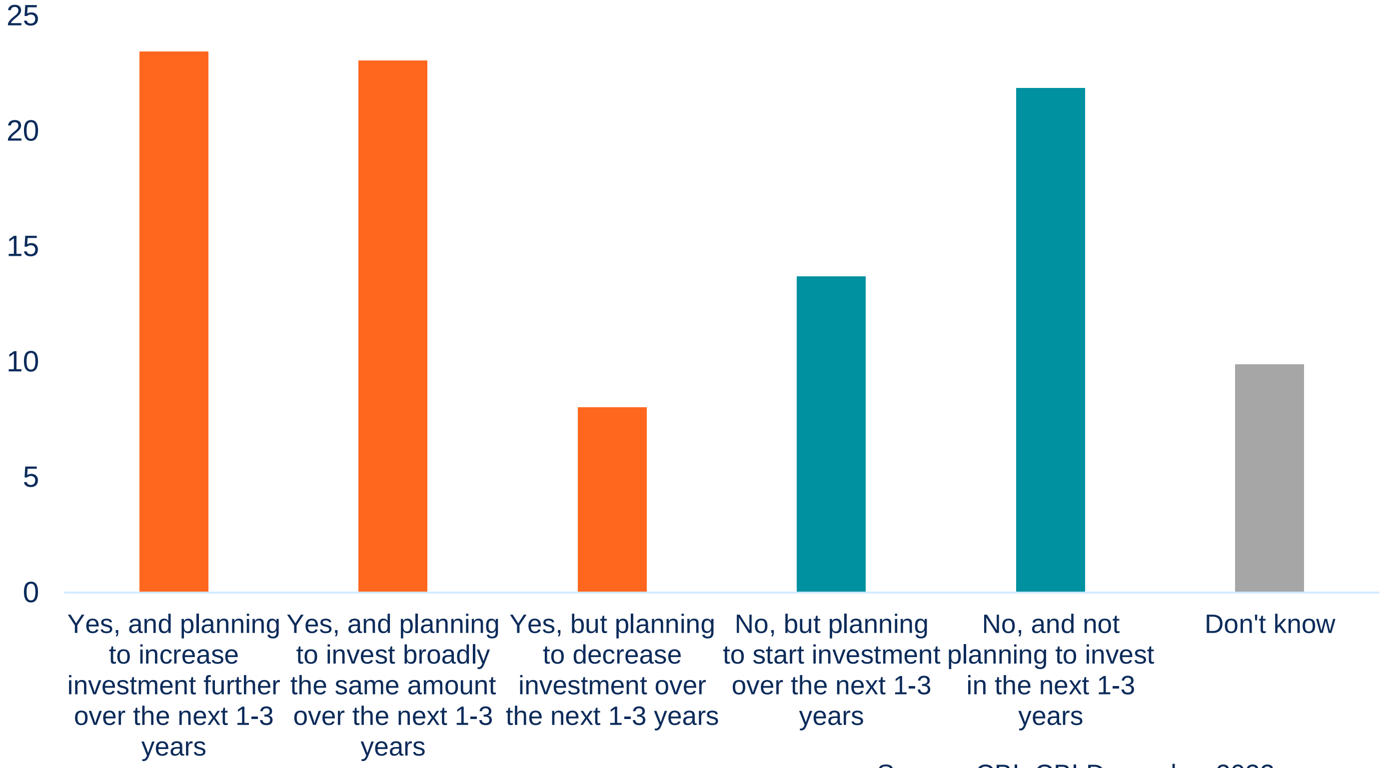
Source: ONS, CBI surveys, CBI calculations

- Investment intentions in our business surveys have improved over the first half of 2023, in line with an upturn in business confidence

…as decarbonisation objectives move to the fore

Anecdote from CBI members around investment plans – word cloud

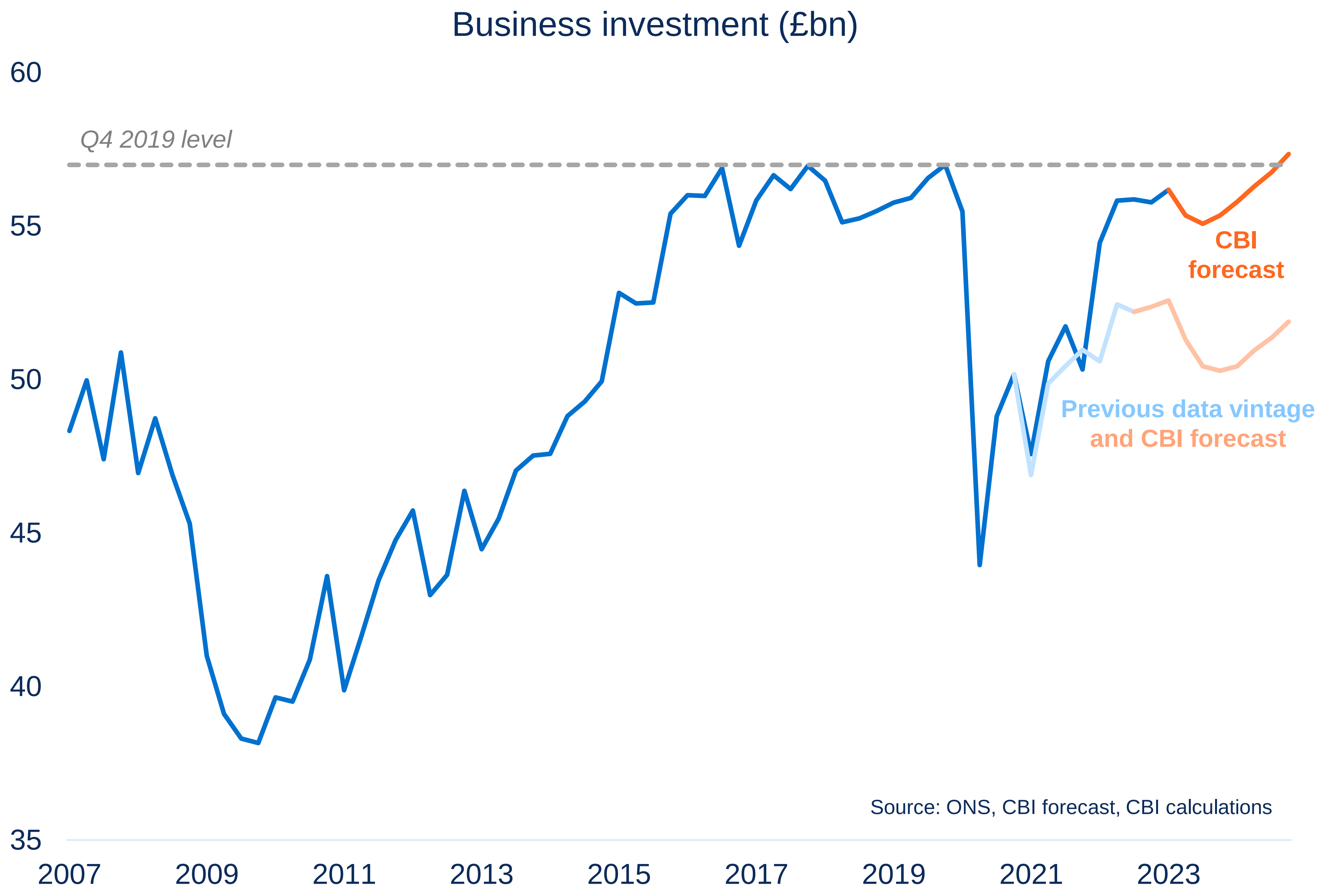
From your organisation's perspective, have you invested in the net zero transition to date and do you plan to do so over the next 1-3 years? (%)



Source: CBI, CBI December 2022 surveys

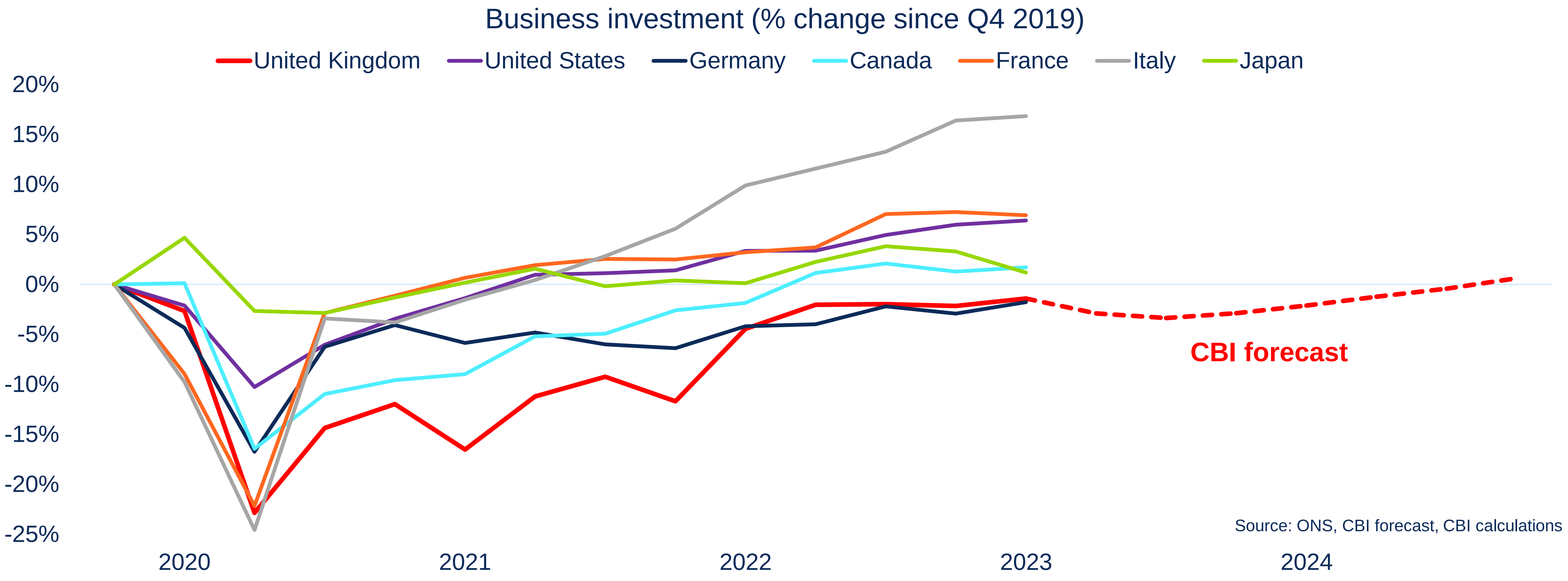
- The recovery in investment plans is underpinned by a growing focus around investing in green initiatives and sustainability, due to business' efforts to meet Net Zero targets and objectives
- Investment in automation, digital and IT were also key themes, taking place in response to labour shortages and the need to bolster operational efficiency
- But while business optimism has picked up, there were still citations of economic uncertainty weighing on investment plans

Tepid economic growth to weigh on capex this year



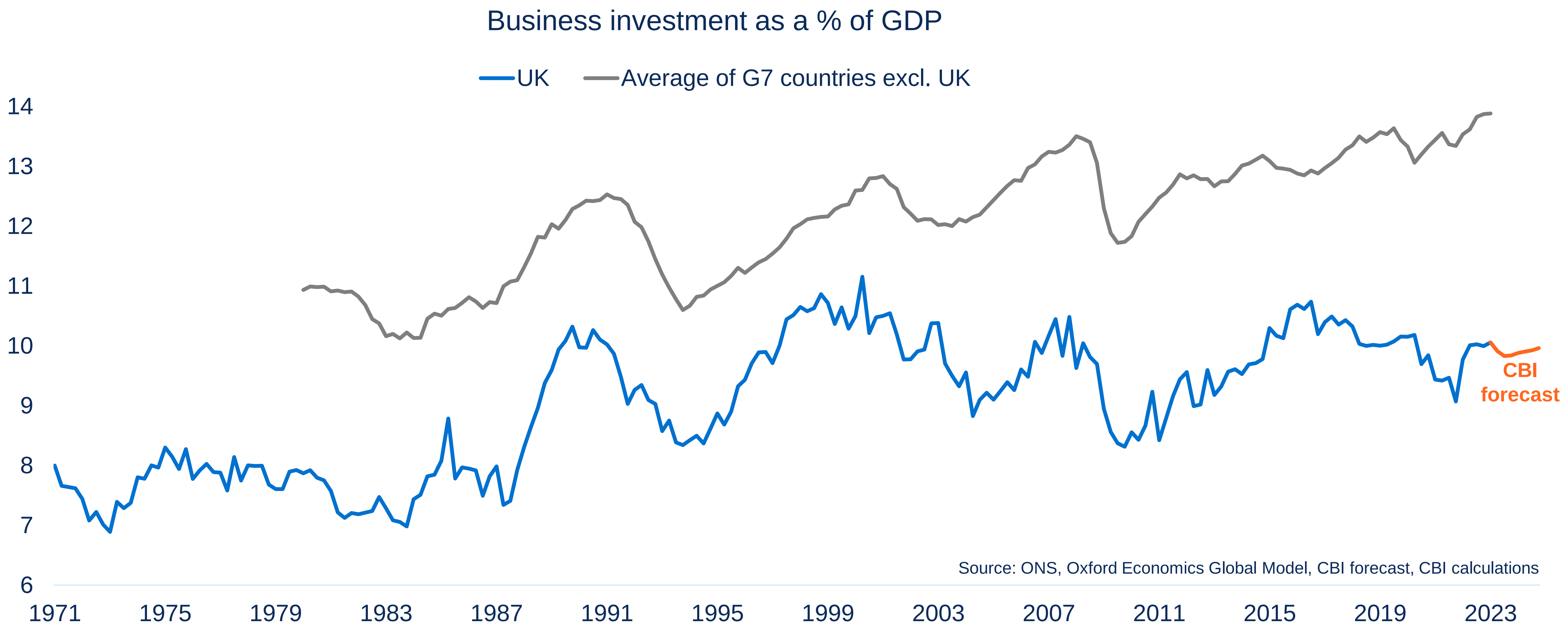
- Despite the improvement in capital spending plans, we expect business investment to be stagnant this year, due to tepid economic growth, a weak overhang from 2022 and tighter financing conditions. Falling real incomes also weigh on residential investment.
- We expect a more definitive recovery in 2024, as GDP growth gains a firmer footing. Revisions to outturn data since our last forecast lift the starting point for our projections and, as a result, we expect business investment to regain its pre-crisis level at the end of next year.
- However, the longer-term picture broadly remains one of stagnation. At the end of our forecast, the level of business investment only rises back to where it was at the end of 2015.

Business investment still lags rest of the G7 #1



- Despite the recent pick-up in UK business investment, its recovery has lagged other advanced economies
- While business investment rises above its pre-COVID level at the end of our forecast, most other advanced economies have already surpassed this milestone.

Business investment still lags rest of the G7 #2



- The longer-term underperformance of business investment, relative to the G7, is also expected to continue over our forecast

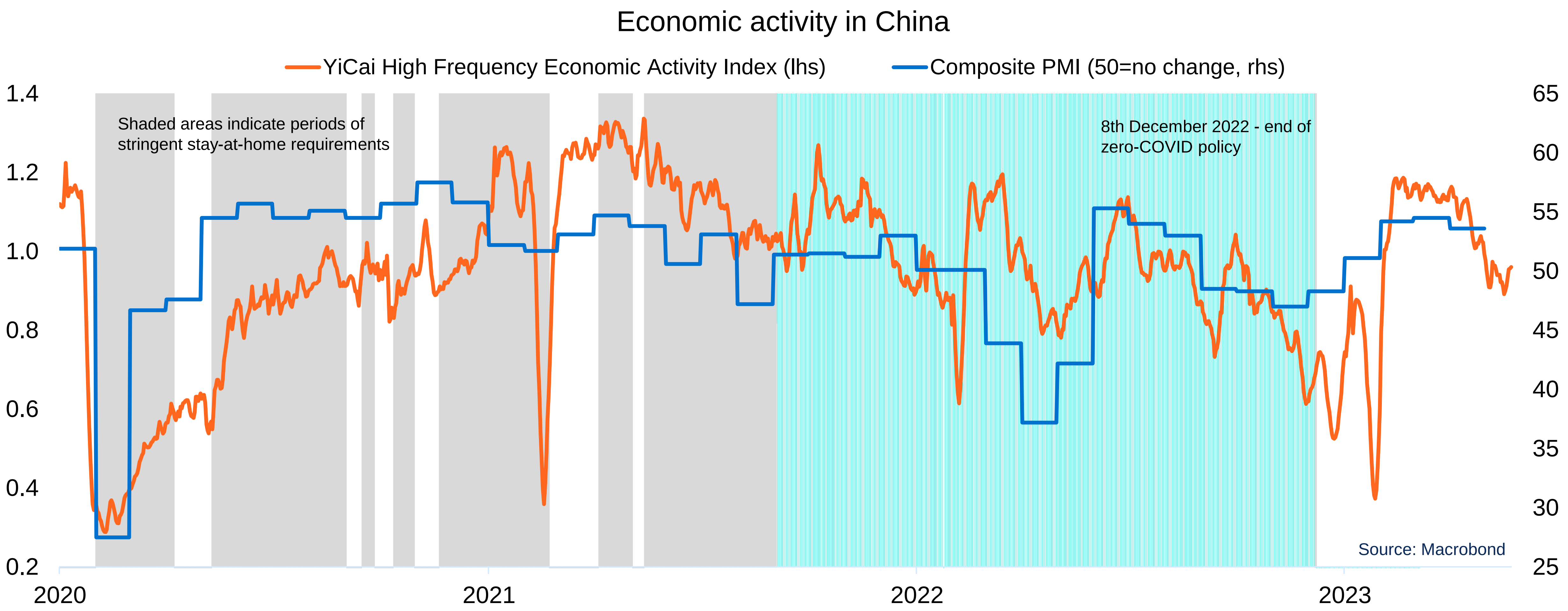
Near-term global outlook has improved…

	GDP growth, y/y% (Jun 2023 forecast)			Change from previous forecast (%pt difference)	
	2022	2023	2024	2023	2024
US	2.1	0.8	0.7	+0.8	0.0
Eurozone	3.5	0.8	1.0	+1.0	-0.9
Germany	1.8	-0.3	0.9	+0.3	-0.7
France	2.6	0.5	0.8	+0.4	-0.5
Spain	5.4	2.1	2.2	+1.3	-0.1
Italy	3.8	1.2	0.9	+1.5	0.0
UK	4.1	0.4	1.8	+0.8	+0.2
Japan	1.0	1.2	0.9	-1.4	-1.1
China	3.0	5.6	4.6	+1.6	-0.6
India	6.7	5.8	6.4	+1.6	-0.7
World (purchasing power parity)	**3.3**	**2.6**	**3.0**	**+0.6**	**-0.4**

Source: Oxford Economics Global Economic Model, CBI forecast

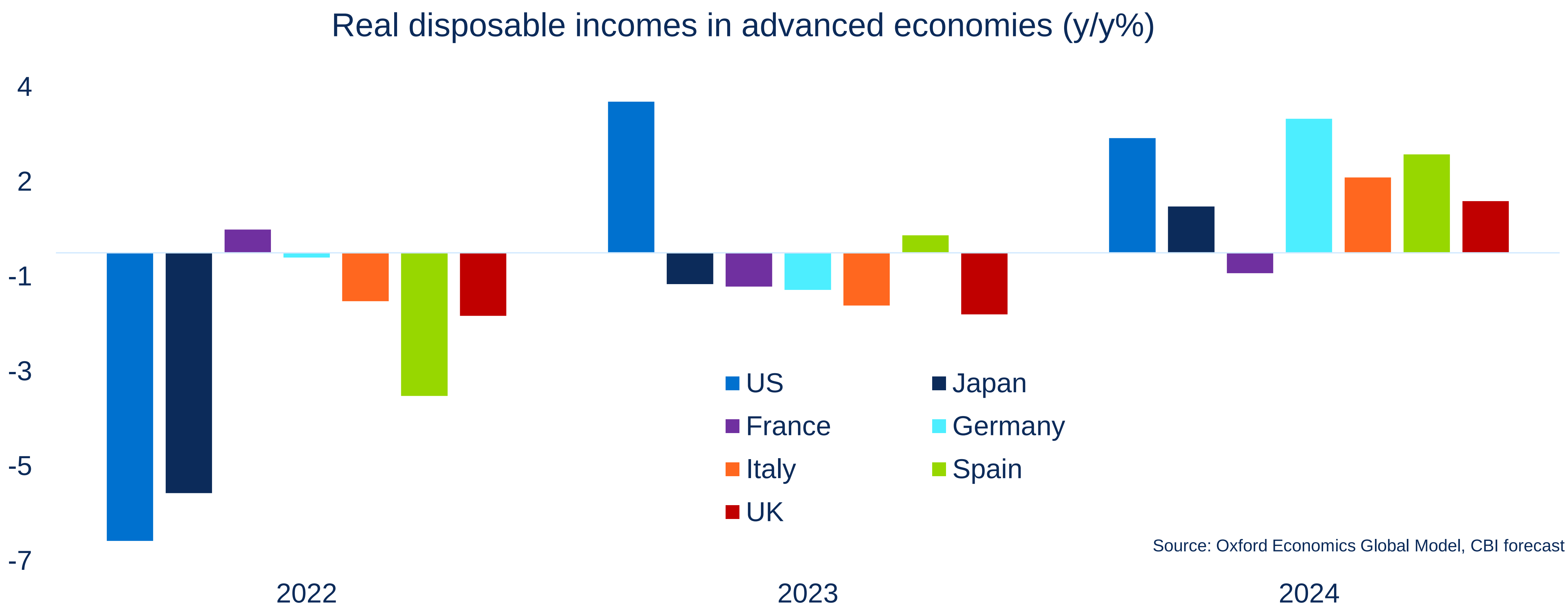
- We expect somewhat stronger global GDP growth this year, relative to our previous forecast
- The upgrade is broad-based across countries, underpinned by China's economy re-opening; lower energy prices; and better consumer and business confidence

…underpinned by China lifting COVID restrictions



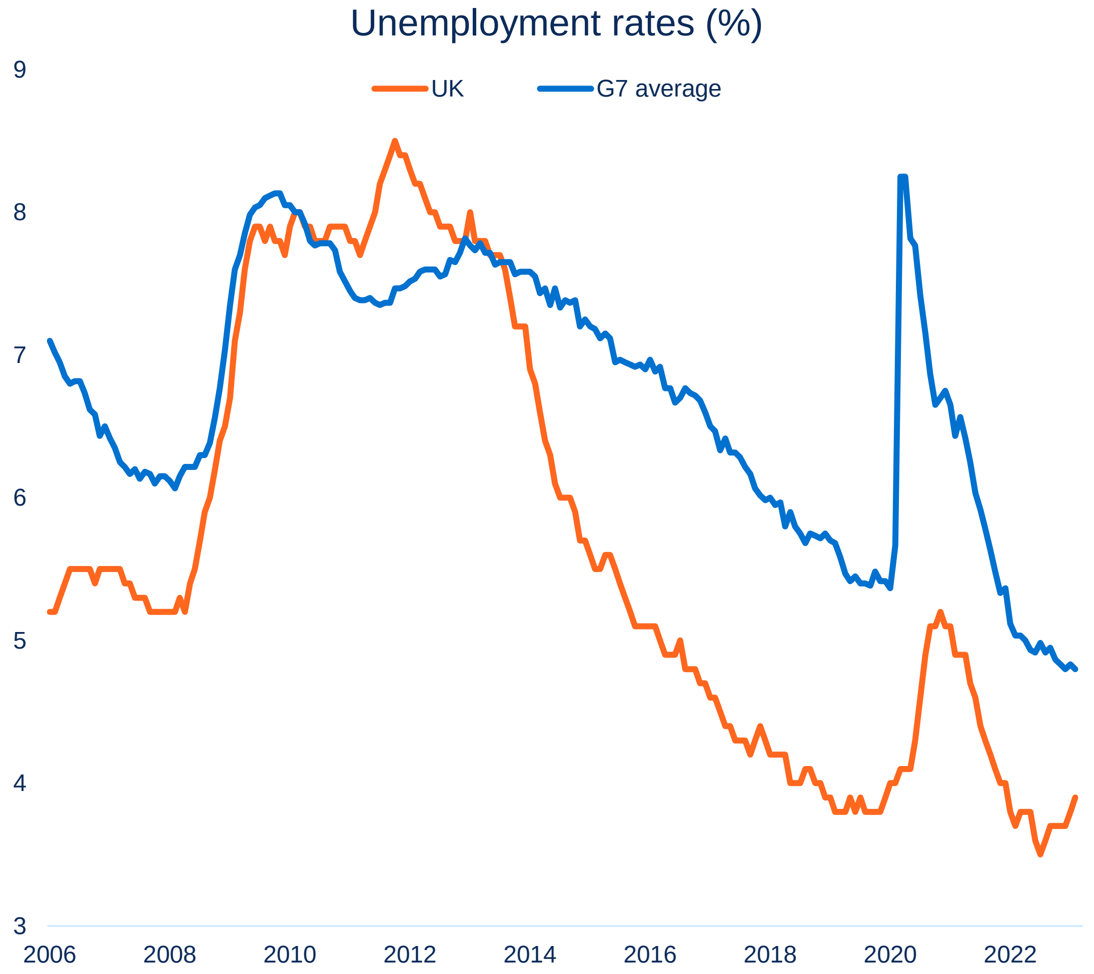
- Activity in China has picked up considerably, following the lifting of stringent COVID restrictions in December 2022.
- This has led us to significantly upgrade our forecast for China GDP growth this year, which is a key driver of a better global outlook.
- However, China coming back online also risks exacerbating global inflationary risk, through pushing up demand for energy and other global commodities.

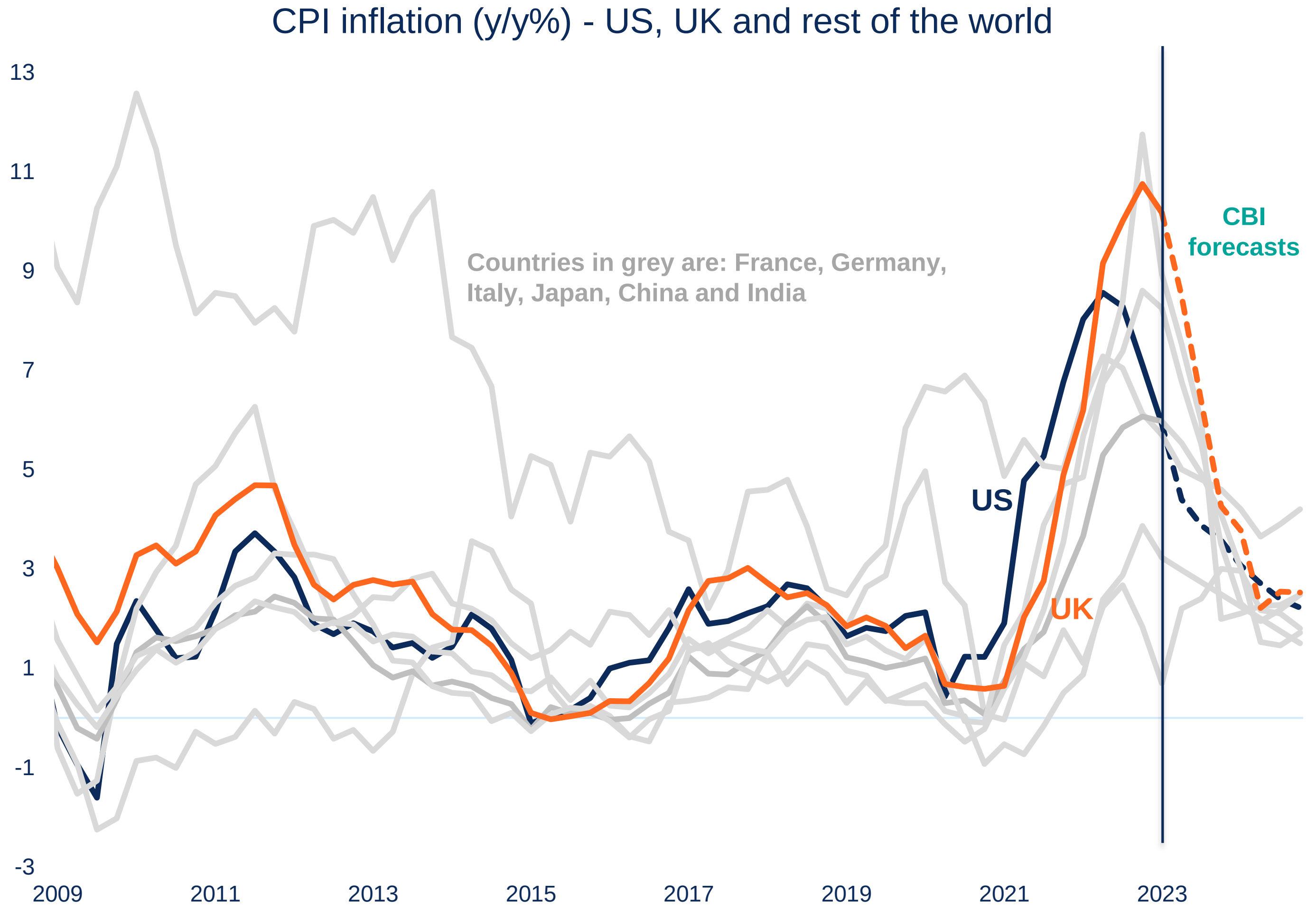
Consumer fundamentals set to strengthen…



- The improvement in global growth next year is largely driven by real household incomes recovering, as inflation falls back
- For some countries, a more benign inflation outlook (relative to our previous forecast) has led to a little less pressure on consumer fundamentals

…amid tight labour markets and falling inflation

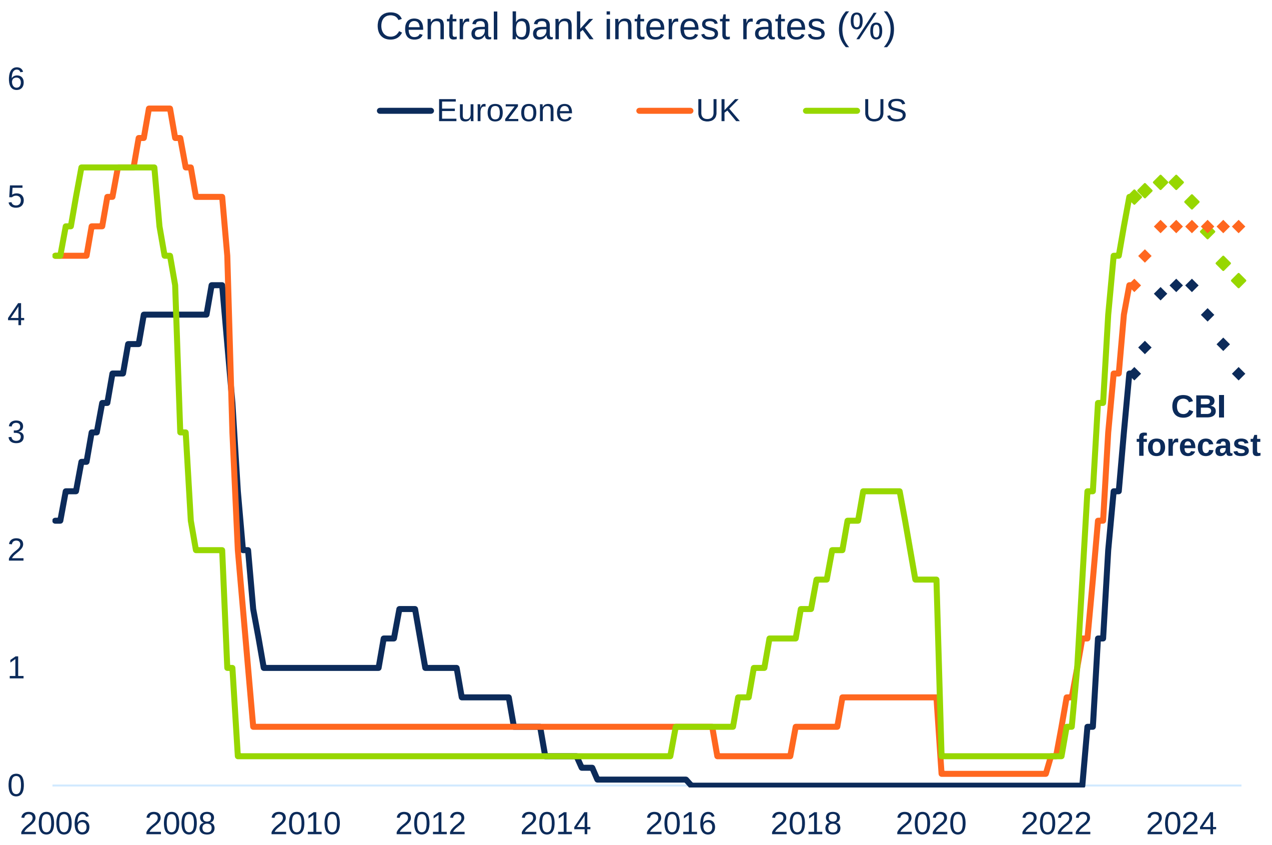


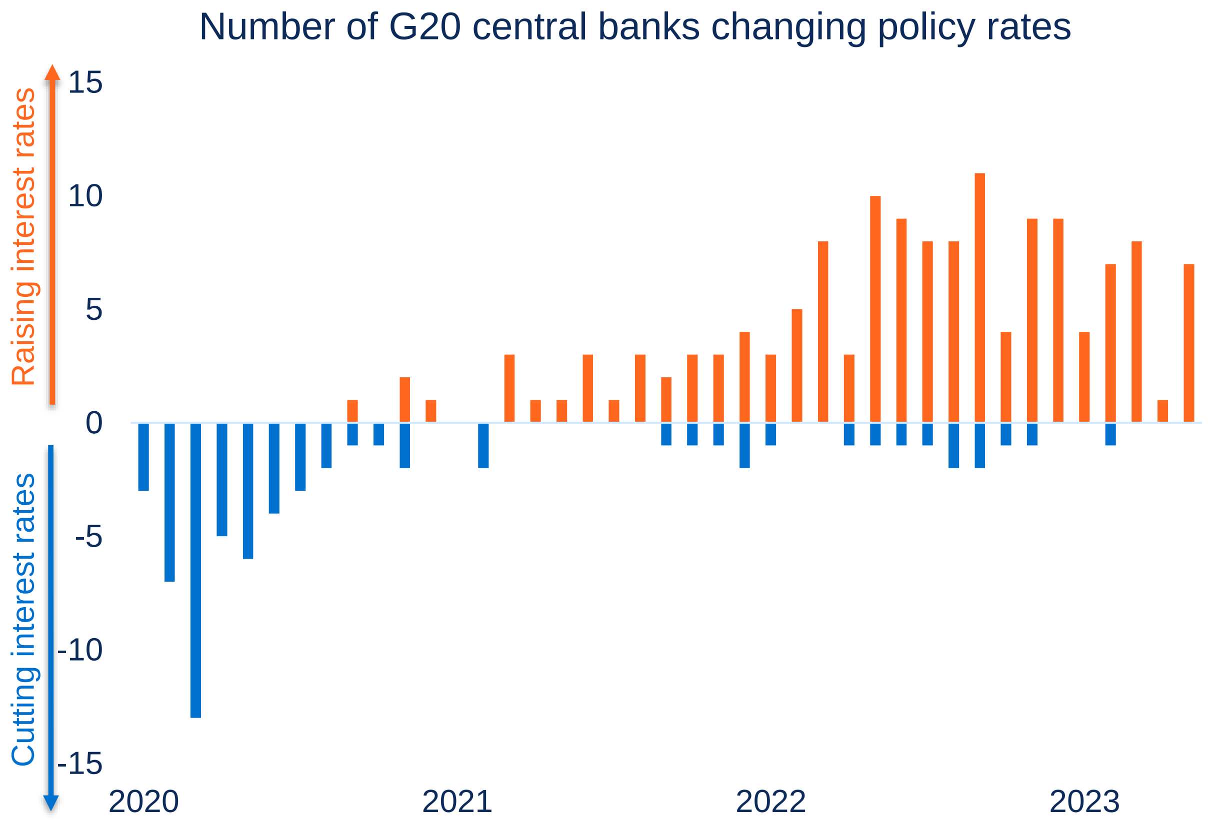


Source: Macrobond, Oxford Economics Global Model, CBI forecast, CBI calculations

- Real incomes and household spending are underpinned by tight labour markets and falling inflation over our forecast

Monetary policy cycles are close to peaking

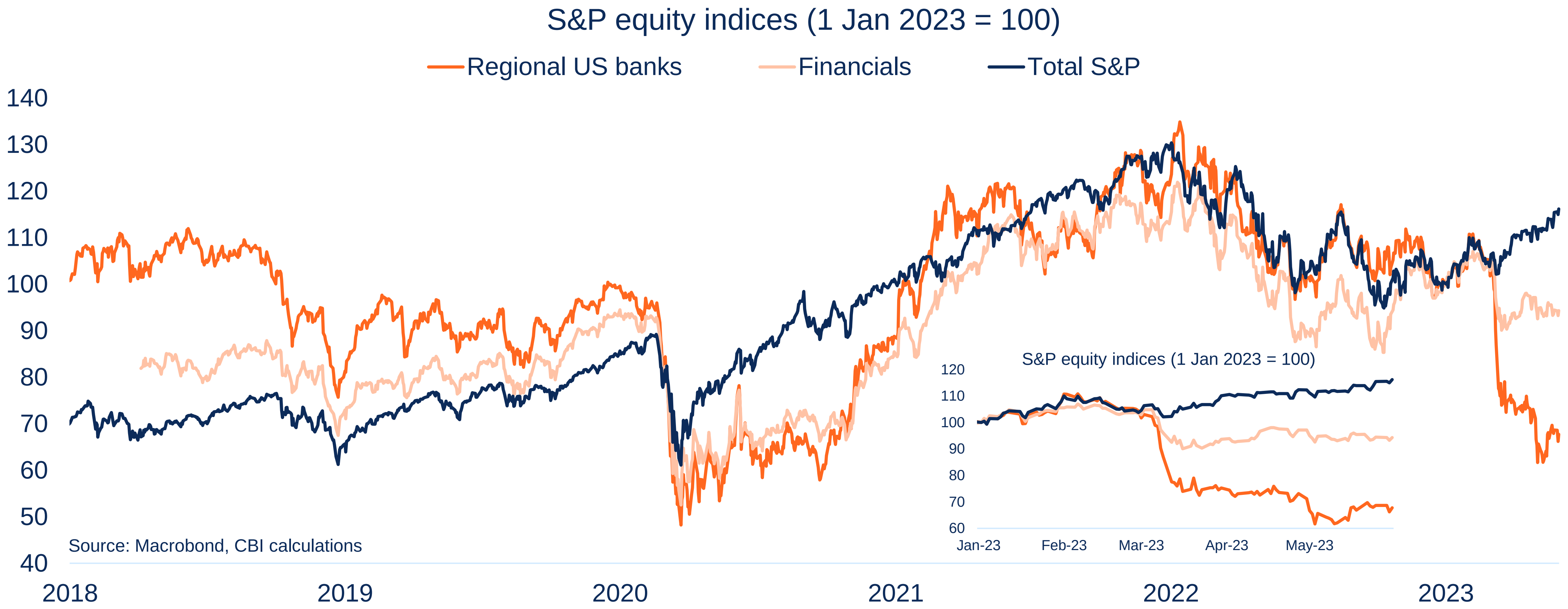




Source: Macrobond, CBI forecast, CBI calculations

- With global inflation likely to have turned a corner, we expect monetary policy tightening cycles by most central banks to be close to peaking.
- Given the length of transmission mechanisms to the real economy, the cumulative rise in interest rates so far will weigh on growth and financial conditions over our forecast

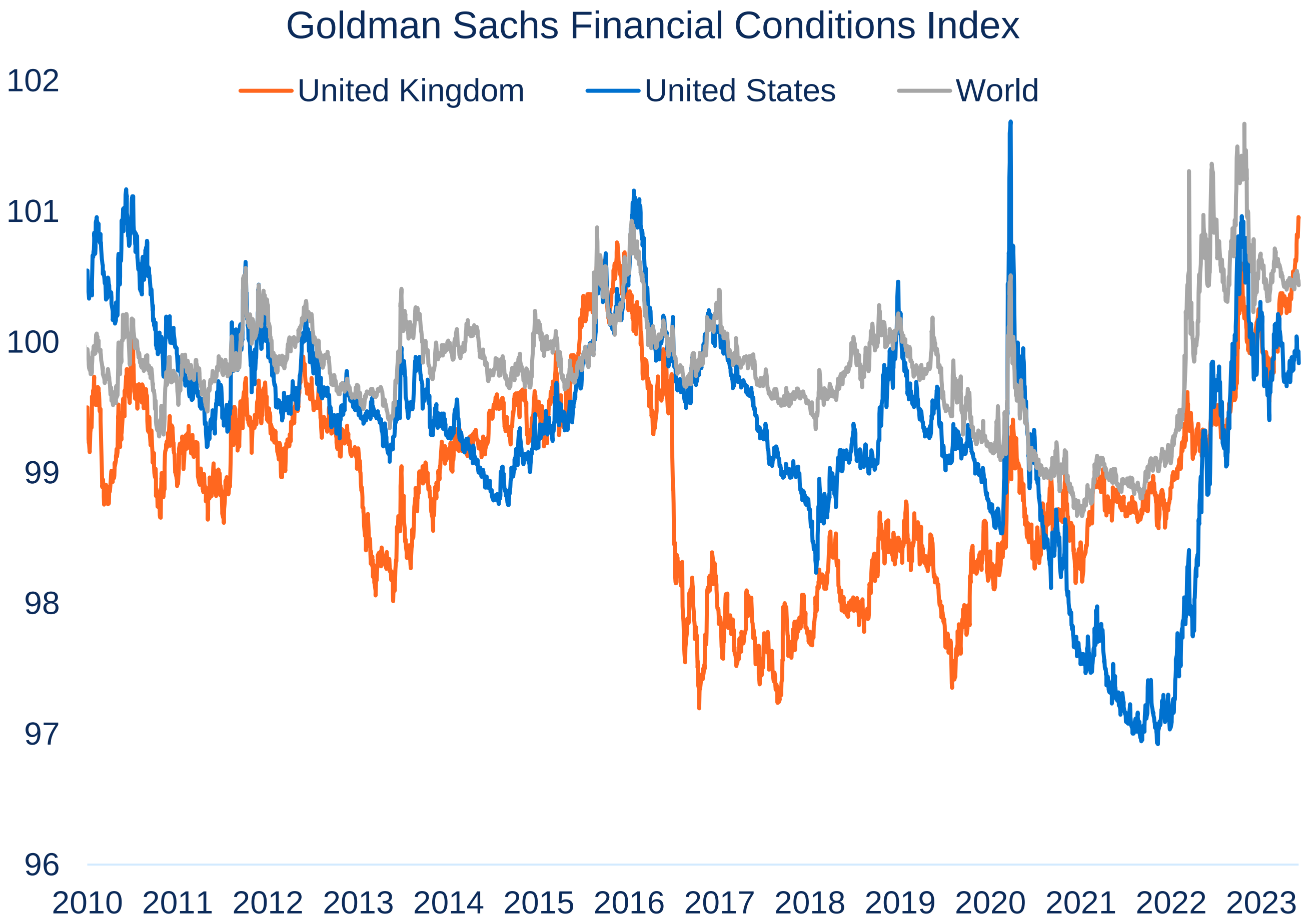
Regional US bank stocks remain under pressure…

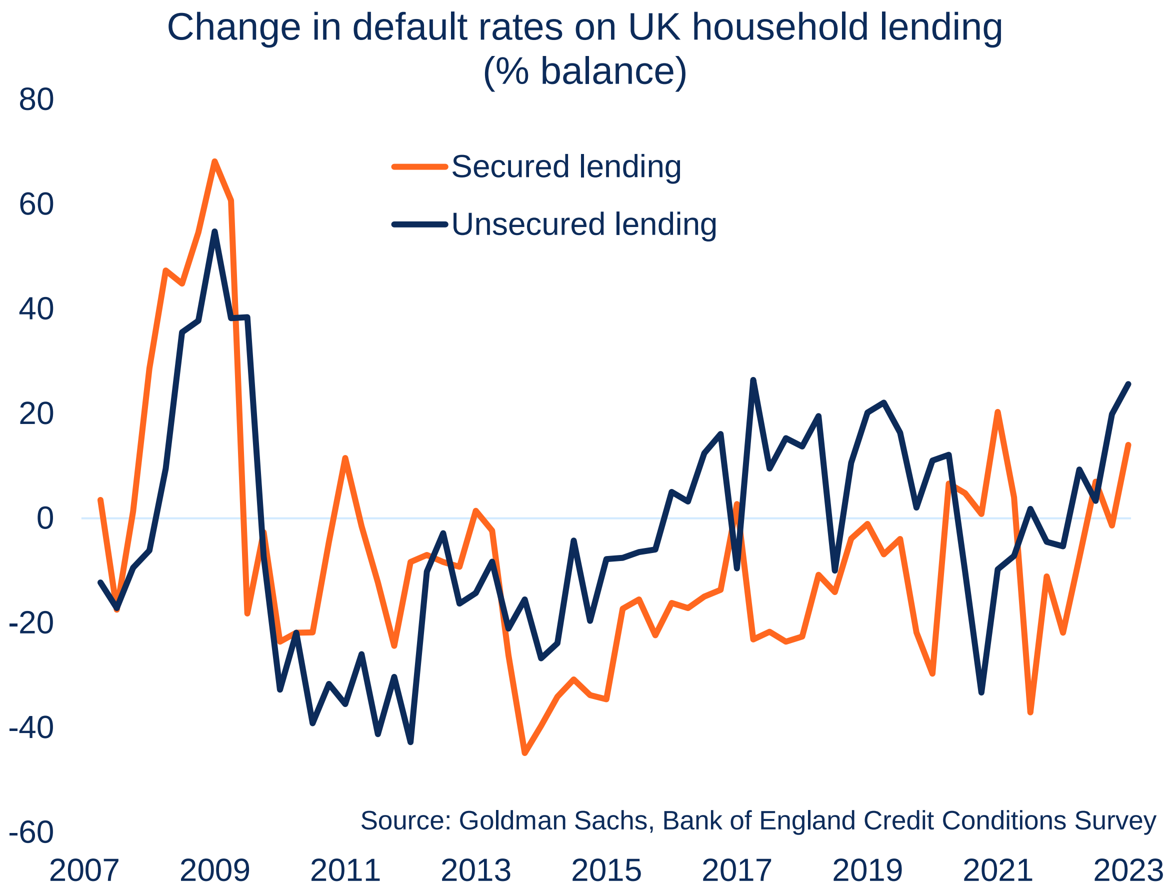


- The failure of several regional banks in the US (followed by Credit Suisse in March) has led to considerable pressure on equity prices in this sector. In contrast, wider stock market volatility has been much more limited (though still stoked by concerns over softer global growth)
- While US authorities have managed to contain the banking crisis for now, concerns remain over lingering vulnerabilities in smaller, more regionally focused US banks as central banks continue to raise interest rates. To read more, see our recent note covering what you need to know about the global banking crisis

CBI

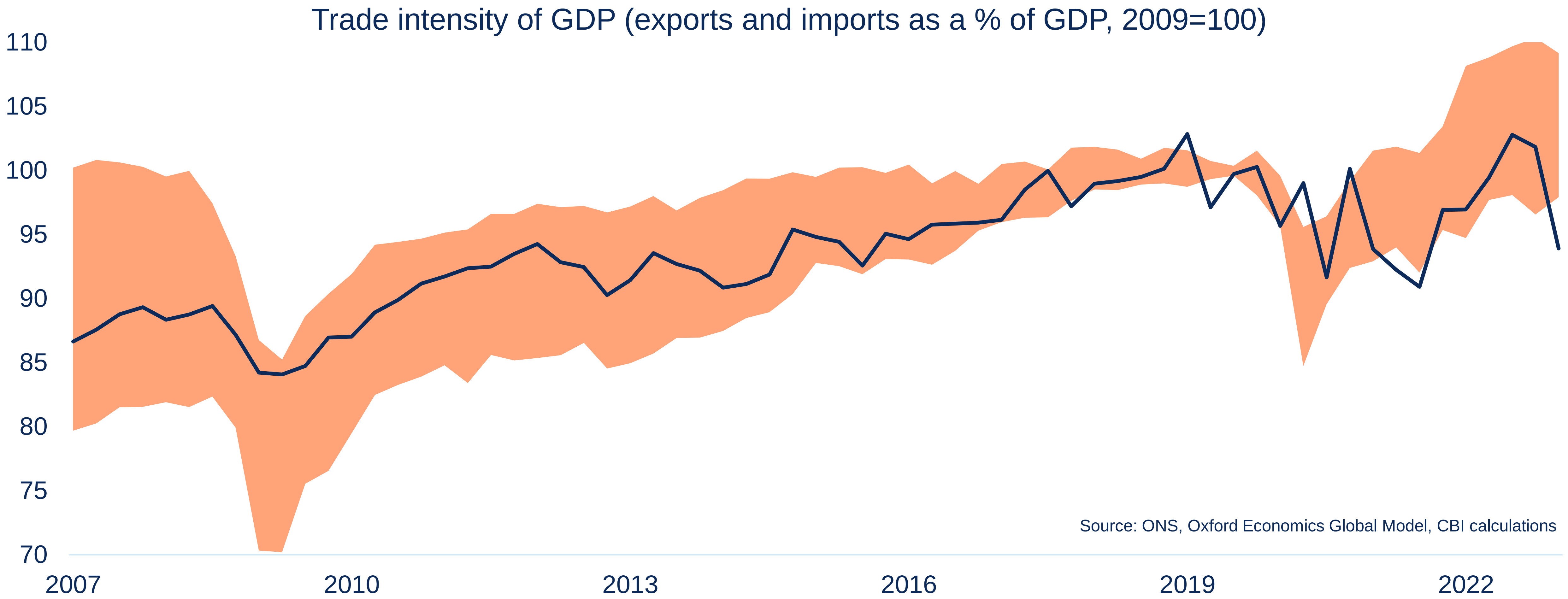
…as financial conditions have been tightening





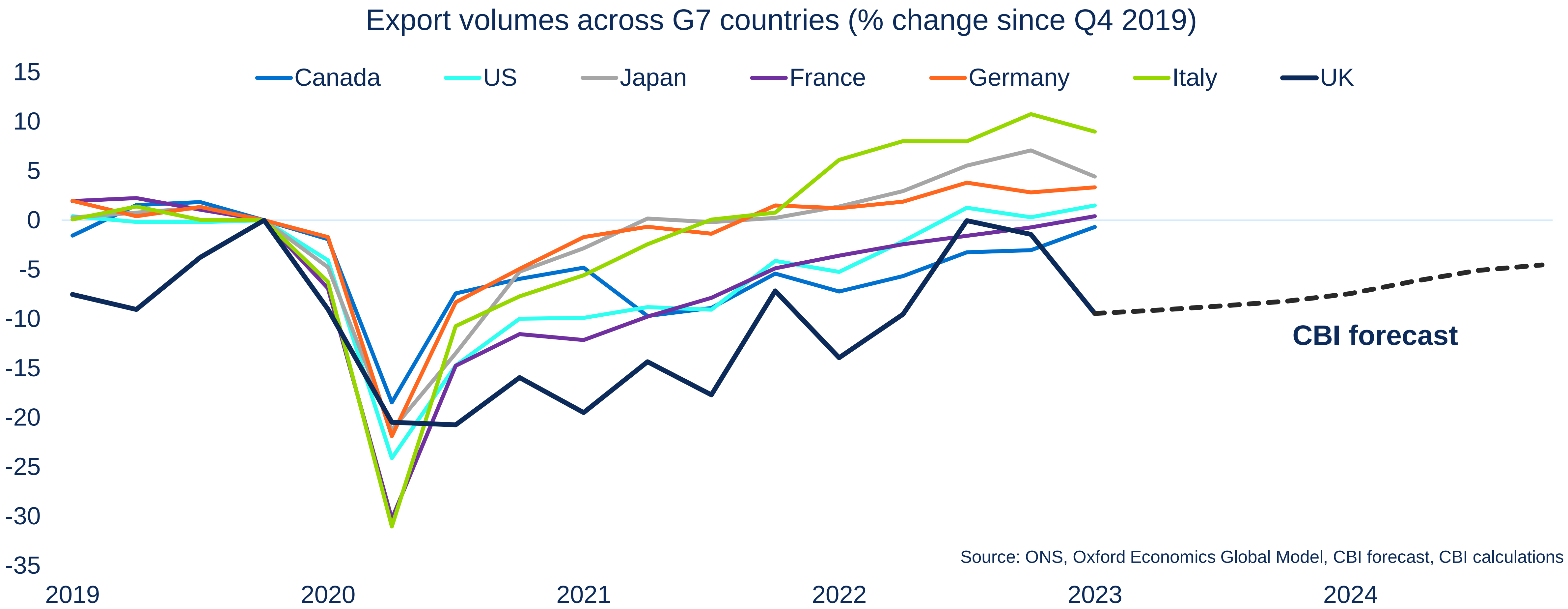
- Developments in global banking occurred at a time when financial conditions were already tightening throughout the world, due to rising interest rates
- While there are some signs of this having an adverse impact – for example, defaults on consumer debt seem to have picked up – there do not appear to be widespread signs of disorderly spillovers so far.

UK trade intensity lags the G7…



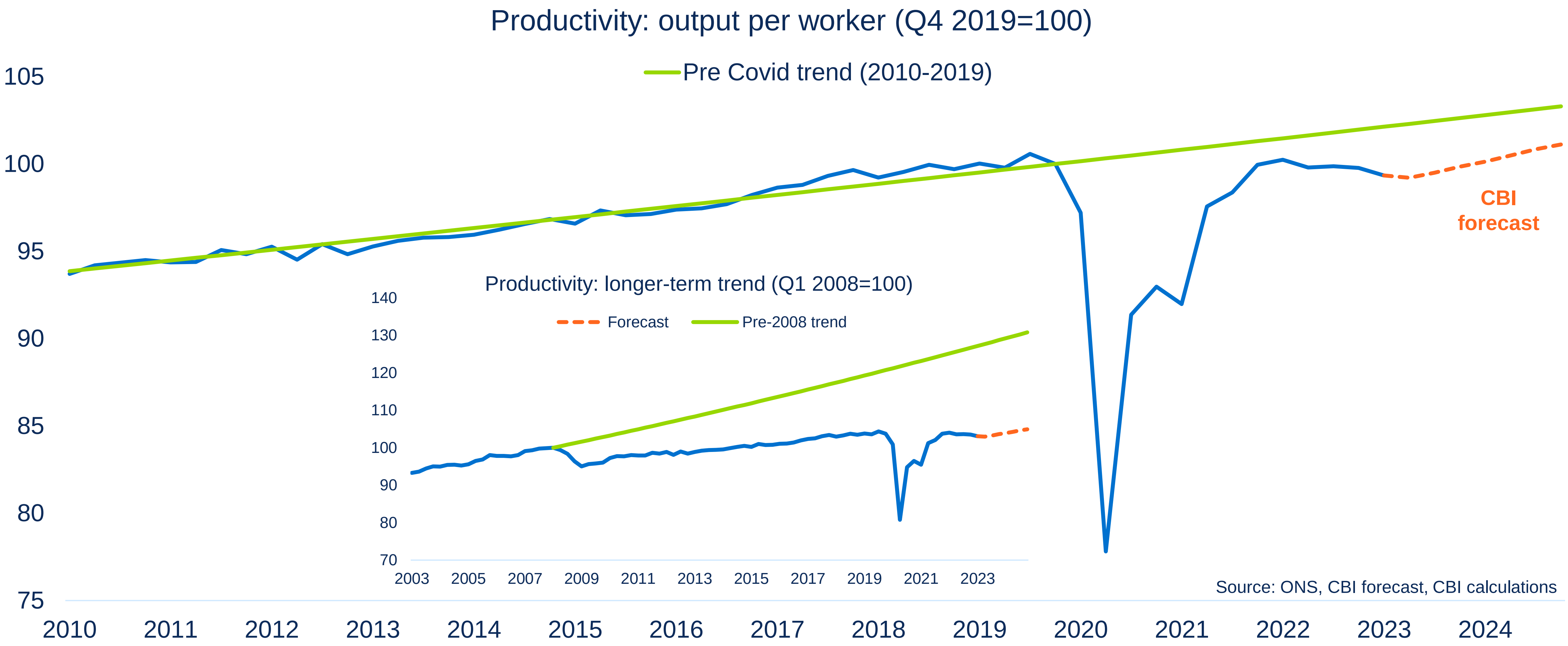
- The UK's trade intensity remains among the lowest in the G7 – while it is recovering from the decline seen during the COVID-19 pandemic (one that was mirrored across advanced economies), this pick-up has lagged global counterparts
- Frictions from adjusting to a new trading regime with the EU have likely played a role. Should the weakness in trade intensity continue, it would have further adverse implications for future productivity growth

…as export performance remains lacklustre



- Underpinning the weakness in trade intensity, the recovery in the UK's exports since the pandemic has lagged the rest of the G7, despite UK exports having fallen to a lesser (albeit still sharp) degree in 2020.
- The low starting point from another decline in Q1 means that even though exports growth picks up over our forecast, they remain below their pre-COVID level at the end of 2024 – a milestone that many other G7 countries have already passed.
- However, the weakness in trade intensity is not one-sided: imports growth has also lagged other advanced economies.

Productivity will continue to underwhelm…



- Productivity rises gently over our forecast, as growth in GDP outpaces employment growth
- But it remains sluggish by historical comparison, staying 2% below its (already weak) pre-COVID trend, and 20% below its pre-financial crisis trend
- Continued weakness in trade intensity and investment also risk exacerbating the stagnation in productivity

…but generative AI (such as ChatGPT) is a wildcard

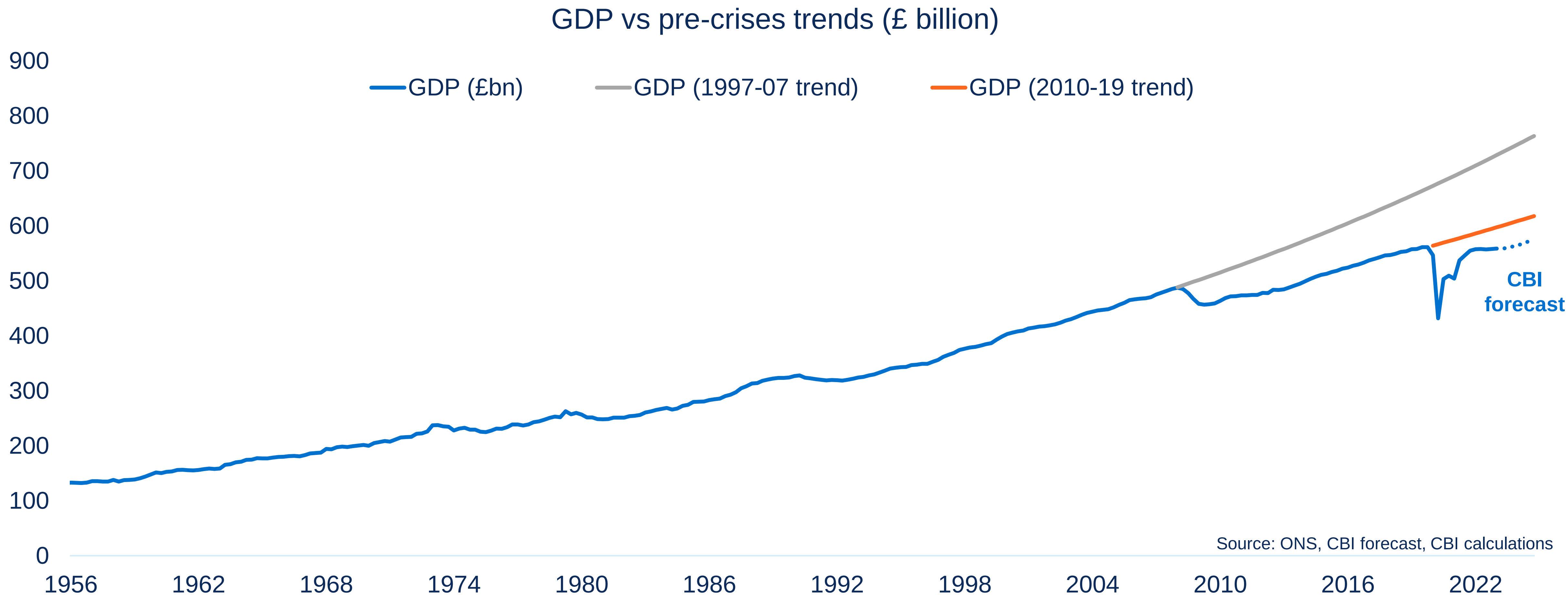
The rollout and adoption of generative Artificial Intelligence (AI) and large language models (like ChatGPT) has the potential to transform jobs and workplaces. As a result, there is speculation that it could deliver a much-needed boost to productivity in some sectors.

Despite having only been launched to the public in November 2022, with 100 million users by January, ChatGPT had been widely adopted and has rocked the AI tech space. At the same time, several studies have looked at the possible productivity impacts of large language models, which may revolutionise the way we work.

- **Large language models can speed up the production of tasks:** one study from MIT of 444 business professionals using ChatGPT to write business documents found that the average time to produce documents fell from 27 to 17 minutes with the help of an AI, an 37% improvement in time. The AI-supported documents were also found to be of higher quality (with a score of 4.5 out of 7, compared to 3.8 without).
    - This was primarily because ChatGPT **reduced skill inequalities, and changed the way users spent their time** preparing documents; as those using the AI spent more time polishing the draft as opposed to brainstorming and writing.
- Open AI's (the developer of ChatGPT) own staff found that **large language models could affect 80% of the workforce:** with AI models heavily affecting 19% of their jobs with at least 50% of their tasks exposed. Around 15% of all worker tasks in the US could be completed significantly faster at the same level of quality.
- A study of employees and employers in six countries found that **ChatGPT may result in a 74% increase in productivity**. Employers predicted an average productivity boost of 74%, compared to employees expecting 66%. Among those who believe it could at least double productivity, 45% would use it for coding tasks, while another 38% believe it would be most beneficial for IT and engineering departments.
- The introduction of a generative AI-based conversational assistant increased issues resolved per hour by 14%, on average. **Adoption of AI had the greatest impact on novice and low-skilled workers, with a minimal impact on highly skilled workers**, as the assistant copied the behaviours and characteristics of the most productive workers and helped newer workers move up the experience ladder.
- Most importantly, the **adoption of generative AI could raise global GDP by 7%** through productivity effects, as AI could lift **productivity growth by 1.5 percentage points (annually)** over a 10-year period.

Sources: MIT, Open AI, National Bureau of Economic Research (NBER), Goldman Sachs

Signs of persistent COVID-“scarring”



- There are signs that the UK hasn’t recovered fully from the economic hit to the pandemic. While the level of GDP has now surpassed its pre-COVID level, it remains around 7% below its pre-COVID trend at the end of our forecast
- The exact causes of scarring are as yet unclear, but could be related to a comparatively later lockdown in 2020 than other economies, exacerbating the pandemic’s hit to GDP; repeated restrictions on activity thereafter; higher inflation relative to the rest of the G7; and an usually large rise in labour market inactivity, stemming from long-term sickness

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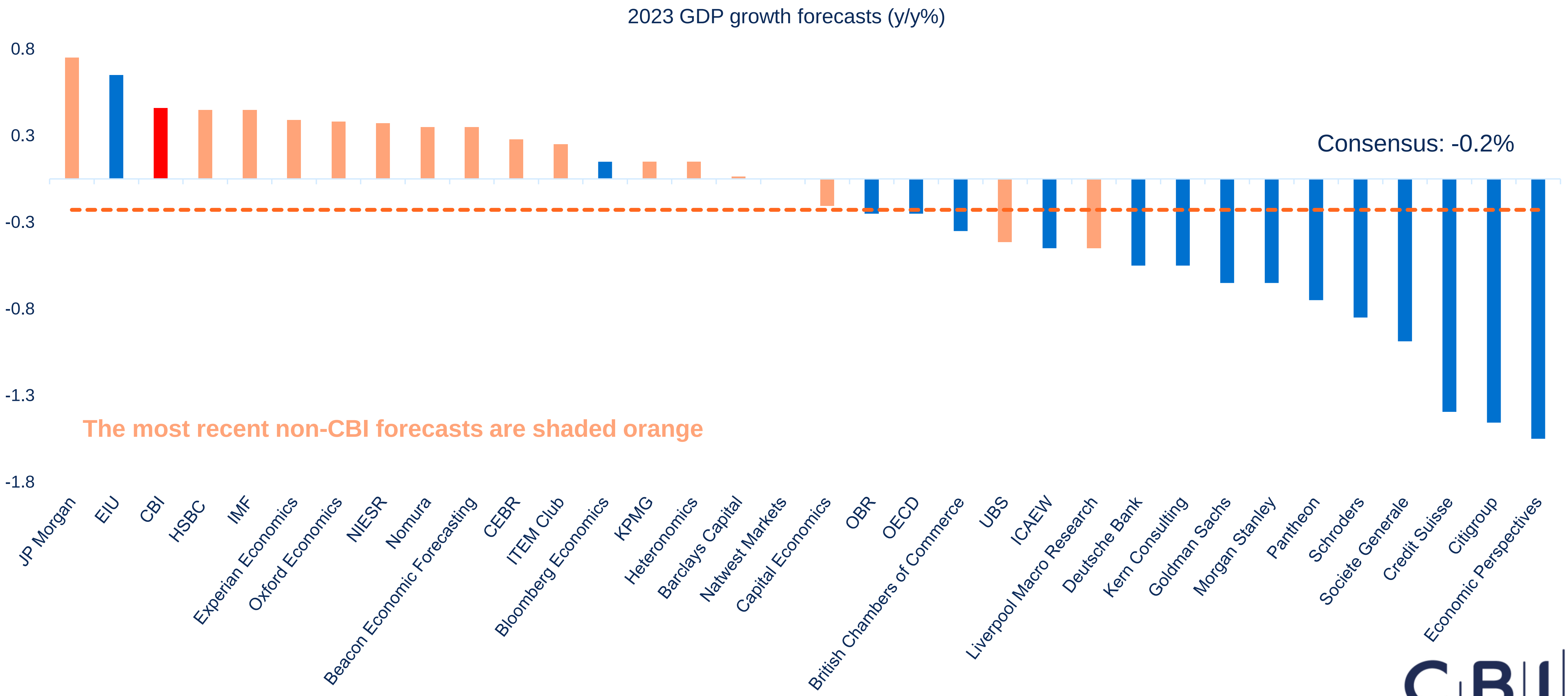
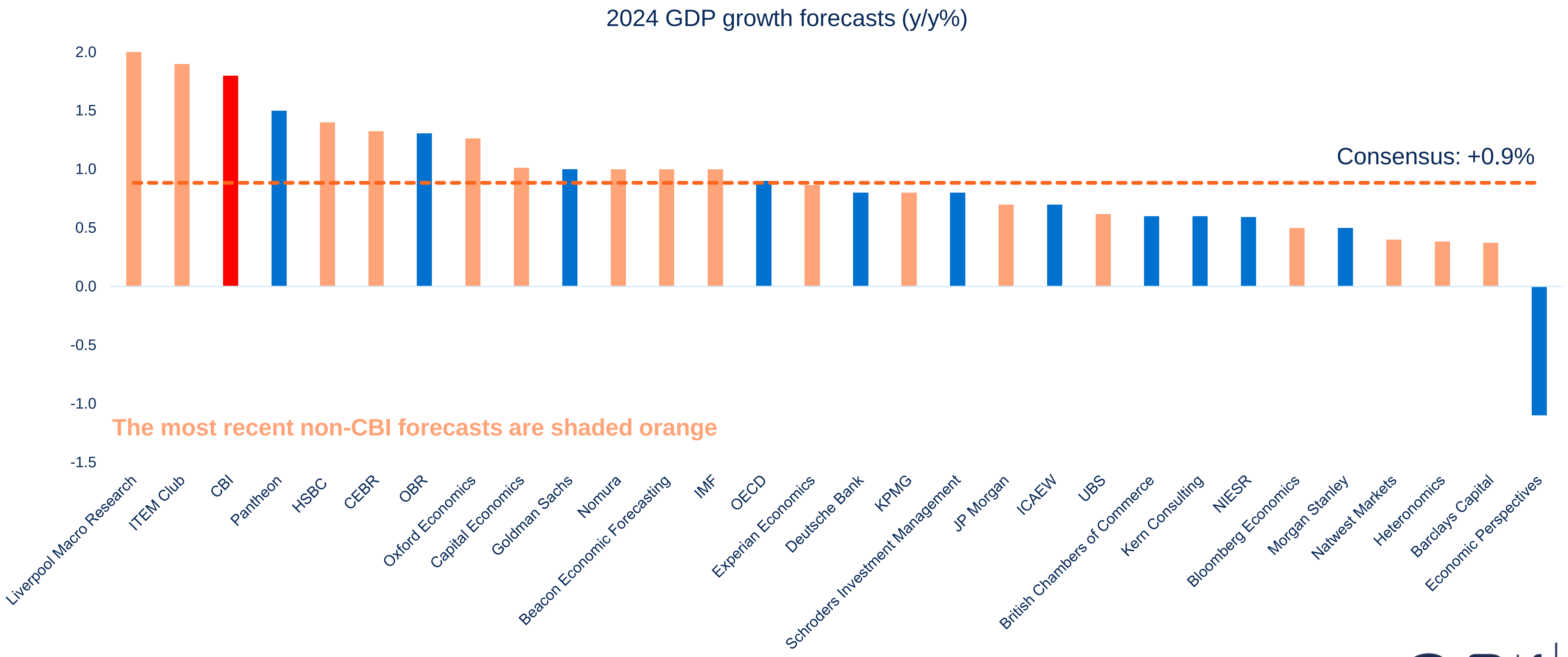
CBI forecast v HMT consensus: 2023



Source: HM Treasury, CBI forecast

CBI forecast v HMT consensus: 2024



Source: HM Treasury, CBI forecast