National Institute of Economic and Social Research

Press Release

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Prospects for the UK economy

- After growing by 3 per cent in 2014, the economy will grow by 2.5 per cent in 2015
- Unemployment will stabilize at 5.5 per cent
- CPI inflation will be close to target this year and next. We expect interest rates to begin to rise gradually from the middle of 2015

We expect GDP growth of 3 per cent this year, moderating to 2.5 per cent in 2015. UK economic statistics have recently undergone significant revisions, but they do not change the broader picture: the turnaround of the UK economy remains the weakest in the past century while the UK's large productivity puzzle persists and, notwithstanding the gradual accumulation of an evidence base, remains largely unsolved.

Domestic demand growth appears to be somewhat more balanced, with business investment providing a greater positive contribution since the end of the Great Recession. At the same time, this implies business investment will contribute less to economic growth over the forecast horizon than previously expected. We expect business investment to grow by 9.3 per cent this year and by 8.2 per cent in 2015, before easing to 2-3 per cent in 2016 and 2017.

Recent weak inflation numbers appear to have alleviated the pressure to tighten monetary policy. The appreciation of sterling between March 2013 and July 2014 will still have a downward effect on the rate of inflation in the short term. Looking through this temporary effect suggests an underlying rate of inflation closer to 2 per cent. On balance, we think the risk of waiting a few more months to start raising interest rates outweighs the risk from a premature tightening. We have revised our view of the initial increase in interest rates from February to June 2015.

Unemployment has now fallen 1.5 per cent in the past year, dropping below 6 per cent in the second half of this year. We expect the wedge between the growth rates of employment and the labour force to narrow over the forecast horizon, as the unemployment rate stabilises at around 5.5 percent from 2018.

We expect public sector net borrowing to be little changed between the last fiscal year and 2014-15, at around £97 billion. Tax revenues for this fiscal year have proved to be weaker than expected, as a consequence of the subdued average wage growth. Realisation of the announced path for future government consumption should move the public sector into surplus by 2019-20.

The key domestic risk to the progress of the recovery is productivity growth: should this fail to recover as we expect, the impact on both living standards and public finances will be significant. Externally, the generalised weakness of the global recovery and, in particular, continued stagnation (or worse) in the Euro Area, are obviously significant risks for the UK economy.

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Notes:

The forecast for the UK economy is published in the National Institute Economic Review, no. 230, November 2014.

For a full copy of the UK economic forecast or to arrange interviews, please contact the NIESR Press Office: Brooke Hollingshead on +44 (0) 20 7654 1923/ B.Hollingshead@niesr.ac.uk

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Details of our previous forecast for the UK economy can be found here.

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