Lagging Behind

The UK economy has become a marked underperformer, a record that stretches back to the start of the pandemic in 2020 and Brexit. UK GDP fell by a whopping 11% that year, compared to much smaller declines of 6.3% for the Eurozone and 2.8% in the US. It was hoped that this gap would be closed by a much stronger rebound by the UK economy in 2021-2022.

However, the level of UK GDP at end 2022 was still 0.8% lower than at end 2019. By contrast, at end 2022, GDP exceeded its end 2019 level by 2.4% in the Eurozone and 5.1% in the US. Even looking at the quarterly profile of UK GDP growth last year shows a very disappointing picture, at 0.5%, 0.1%, -0.2% and 0.0% for the four quarters, as the economy stagnated.

The marked underperformance of the UK economy is not expected to abate anytime soon, judging by some very recent forecasts. The IMF is projecting that UK GDP will contract by 0.6% in 2023, the only major economy that it expects to go into recession this year. Its forecast is right in line with the Bank of England, which is also projecting a fall in UK GDP this year, of 0.5%.

In contrast, the European Commission is projecting growth of 0.9% for the Eurozone economy. Meanwhile, the IMF sees the Eurozone economy expanding by 0.7% in 2023, with US GDP rising by 1.4%. For 2024, the IMF sees the UK economy expanding by 0.9%, while the BoE is much more pessimistic, in predicting a further fall in GDP, of 0.25%. By comparison, both the IMF and EC are forecasting that the Eurozone economy will grow by circa 1.5% next year.

There are numerous reasons for the UK's underperformance. Brexit is having an ongoing negative impact on trade and foreign direct investment. Labour force growth has been very anaemic, with many workers leaving the workforce due to long-term illness or early retirement, while inward migration from the EU has declined sharply post Brexit. Meantime, unlike in most other countries, the UK has had to pursue fiscal tightening to stabilise the public finances.

The rate of inflation in the UK has also risen to a higher level than in most other economies, partly reflecting its heavier dependence on gas which surged in price last year. This is putting marked downward pressure on real household incomes, which are also being hit by rising mortgage rates.

The weak performance of the UK economy has taken its toll on sterling. While the currency has recovered from its autumn lows, it is still well below the levels of a year ago. It is trading at $1.20 against the dollar, down from $1.36 last spring, while the euro has risen from 83p to 89p over the past twelve months.

It is difficult to see sterling recovering this lost ground given the bleak outlook for the UK economy. The challenge facing sterling will be even greater if the economy's weak performance sees the BoE start to cut rates well ahead of other central banks. This could well be on the cards if the BoE's forecast that UK inflation will fall comfortably below 2% next year, proves correct.

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