



Near term prospects favourable for UK economy

Similar to elsewhere, the dominate factor impacting the UK economy has been the Covid-19 pandemic. Indeed, last year, the fall in UK GDP of nearly 10% was bigger than the other main advanced economies.

Meanwhile, the UK economy started 2021, like many other European economies, in a state of 'lockdown'. This was reflected in GDP declining by 1.5% in quarter one. Not surprisingly given the type of restrictions in place, consumer spending was the main drag on growth, falling by 3.8% and knocking 2.4 percentage points off GDP. However, the rapid rollout of vaccines in the UK has seen restrictions lifted over recent months. This has led to a sharp rebound in activity, helped by additional fiscal stimulus.

In fact, the monthly GDP data showed that by the end of the first quarter, the UK economy was already back in expansion mode. The most recent data, for May, saw the economy grow by 3.6% on a three month-on three month basis. The economy is now just roughly 3% below its pre-Covid February 2019 level.

All forecasters are looking for a strong UK recovery in 2021-22, with growth projections being revised significantly higher in recent months. It should be noted that given the aforementioned particularly large fall in GDP in 2020, the UK has scope for a very strong rebound in 2021-22. The OECD also says the UK is likely to grow 7.2% in 2021, up from its March projection of 5.1% and is forecasting growth of 5.5% for 2022.

Meanwhile, it is expected that the UK jobless rate will rise when the government's furlough scheme is wound up at the end of September. The economy is likely to be well into a robust recovery by this stage. Hence, forecasters have become more optimistic that UK unemployment will not rise to the levels expected previously and now see the UK jobless rate peaking at 6% in Q4 2021 after the expiry of furlough schemes.

In terms of inflation, the headline CPI rate rose to 2.5% in May, representing a nearly 3 year high. Higher commodity and energy prices, supply shortages, and the unwinding of most of the VAT cut have been key drivers of the spike higher in inflation recently. While it is likely to continue to accelerate over the coming months, the general consensus is that the spike will prove transitory

Overall, the near term outlook for the economy looks very positive. The quick pace of the vaccine rollout has allowed the economy to gradually re-open, with most domestic restrictions now removed. The Budget kept supports in place beyond the re-opening, and introduced measures to boost investment. Thus, the economy appears to be in the midst of a strong economic rebound.

However, longer term there are potential economic headwinds on the horizon that will need to be navigated carefully. The Delta variant delayed the full re-opening of the economy by a number of weeks, and failure to stop it spreading risks further challenges. Brexit could also dampen investment and trade over the medium term. Furthermore, to counterbalance increased spending, a host of tax hikes, including to corporation tax in 2023, are planned. These may hinder growth in the



UK in the years ahead. By that stage global growth may have cooled somewhat as well. Indeed, most forecasts are for UK growth to drop back to 2% or below in 2023 and beyond.

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