The UK economy

• The UK economy is expected to grow by 2.0 per cent in 2016, down from the 2.3 per cent predicted in the February Review. Growth will pick up to 2.7 per cent in 2017.
• We expect the Bank of England to start raising interest rates in November. Rates will then continue rising throughout 2017, ending the year at 1.5 per cent.
• Although broadly unaffected in 2016, GDP is projected to be 1 per cent lower than our baseline forecast in 2017 if the UK votes to leave the European Union in next month’s referendum. In the longer run, GDP is expected to be between 1.5 and 3.7 per cent lower than our baseline forecast.

Uncertainty surrounding the outcome of the UK’s referendum on leaving the European Union has probably weighed on economic growth in recent months. But assuming a vote to remain in the EU, we expect an uptick in growth in the second half of this year as delayed investment decisions are implemented.

The EU referendum has also led us to push back the point at which we expect the tightening phase of the monetary cycle to begin, to November of this year. Consumer price inflation is forecast to be below the 2 per cent target in the second half of this year and throughout 2017. From then on inflationary pressures should build to a level broadly consistent with the Bank’s target rate in 2018.

The recent depreciation in sterling can be largely attributed to the risk that the UK will vote to leave the EU. Given this, and our forecast assumption that the referendum will result in a vote to remain in the EU, we expect sterling to appreciate sharply in the third quarter, ending this year broadly where it started in 2015.

We expect house price inflation to peak in 2016. While income growth should prove a support, affordability remains an acute constraint on the inflow of first-time buyers. The recent tightening of lending standards by the Financial Policy Committee, together with the rate of gradual increases in interest rates and hence mortgages, should also weigh on future demand for housing.

Given the fiscal plans announced in the March Budget and the outlook for the economy, we expect an absolute fiscal surplus to be achieved in 2019–20, in line with the government’s target.

Our analysis suggests that GDP will be 1 per cent lower in 2017 than our baseline forecast if the UK votes to leave the EU. Inflation would jump dramatically as sterling depreciates, investment would plummet, and consumer spending would be hit by lower real incomes.

The longer-term impact of leaving the EU could reduce GDP by anything between 1.5 and 3.7 per cent by 2030 depending on the subsequent relationship between the UK and the EU, as well as the rest of the world. But in all possible scenarios, our simulation exercises show a substantial loss of export trade.

Summary of the forecast – UK economy

<table>
<thead>
<tr>
<th>Year</th>
<th>Real gross national income(a)</th>
<th>Real GDP(b)</th>
<th>Unemployment(b)</th>
<th>CPI(c)</th>
<th>RPIX(d)</th>
<th>External current balance(e)</th>
<th>PSNB(f)</th>
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<tbody>
<tr>
<td>2015</td>
<td>2.6</td>
<td>2.3</td>
<td>5.1</td>
<td>0.1</td>
<td>1.1</td>
<td>-96.2</td>
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<tr>
<td>2016</td>
<td>1.3</td>
<td>2.0</td>
<td>5.2</td>
<td>0.3</td>
<td>1.3</td>
<td>-122.3</td>
<td>63.7</td>
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<tr>
<td>2017</td>
<td>1.5</td>
<td>2.7</td>
<td>5.2</td>
<td>1.3</td>
<td>2.0</td>
<td>-127.6</td>
<td>52.9</td>
</tr>
</tbody>
</table>

(a) Percentage change, year-on-year. (b) ILO definition, fourth quarter, rate. (c) Consumer prices index, percentage change, fourth quarter on fourth quarter. (d) Retail price index, excluding mortgages, percentage change, fourth quarter on fourth quarter. (e) Year, £ billion. (f) Public sector net borrowing, fiscal year, £ billion. Includes the flows from the Bank of England’s Asset Purchase Facility.