HSBC Global Research

5 January 2022

UK Forecasts

Tweaking GDP projections after revisions

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Economics - United Kingdom

- Q3 2021 GDP growth was revised down from 1.3% q-o-q to 1.1% in December...
- … but 2020 data were revised up, such that GDP in Q3 2021 was 1.5% below its pre-pandemic level (previously: 2.1%)
- We see GDP growth of 7.1% in 2021 (previously: 6.8%) and 4.5% in 2022 (previously: 4.7%)

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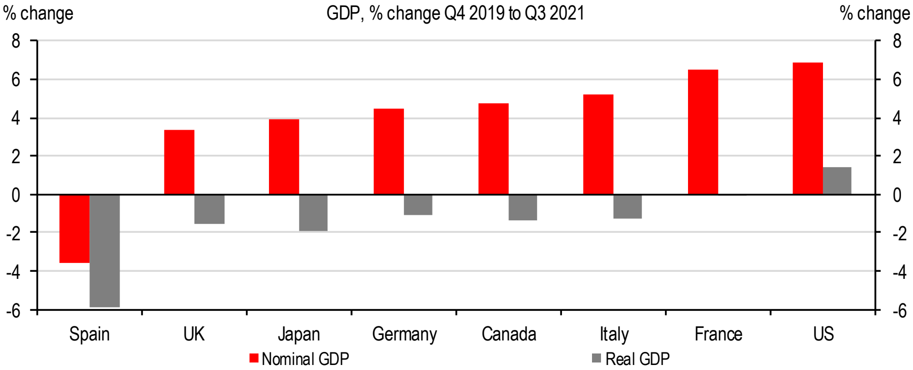
Tweaks, not rethinks

On 21 December 2021, the ONS made some revisions to UK GDP:

- For Q3 2021, growth was revised down from 1.3% q-o-q to 1.1%
- However, for 2020, there were upward revisions, such that full-year GDP growth was revised from -9.7% to -9.4%
- This means that the level of GDP in Q3 2021 was 1.5% below its pre-pandemic peak, compared with 2.1% below on the previous data
- On the latest data, the UK economy is broadly in line with other developed economies in terms of the stage of its recovery, at least in real terms (charts 1 and 2)

As such, we are revising our own forecasts, slightly. We now see GDP growth of 7.1% in 2021 (previously: 6.8%), and 4.5% in 2022 (previously: 4.7%). We continue to see growth of 1.8% in 2023, and we still expect three more rate rises from the BoE (in February, May and August of this year), taking Bank Rate from 0.25% to 1.00%.

1.The UK's recovery in real terms is similar to DM peers'



Source: ONS

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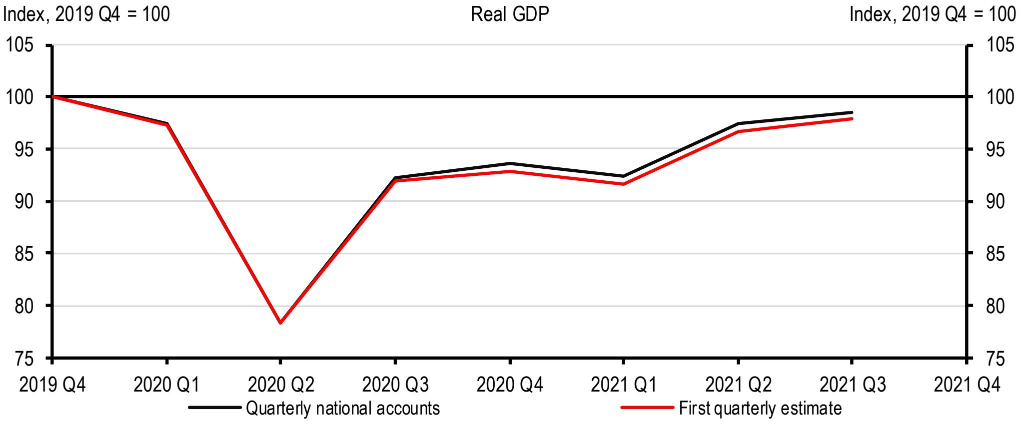
2. The level of UK GDP has been revised up by 0.6ppts in the latest release



Source: ONS

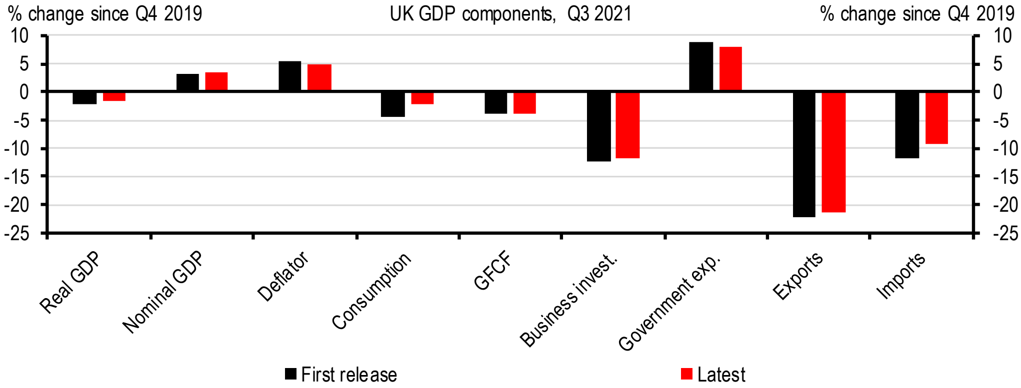
What drove the revisions?

Private consumption looks considerably stronger following the revisions

Looking at GDP by expenditure, private consumption saw one of the biggest upward revisions. On previous estimates, it stood 4.4% below its pre-pandemic level in Q3. On the new estimate, the shortfall had more than halved to 2.0% (chart 2). Within consumption, one of the biggest revisions was to spending at restaurants. In the first GDP release, this was shown as 15.6% down on pre-pandemic levels. In the latest release, the gap has narrowed to 0.1%.

This stronger household spending picture is consistent with a continuing decline in the household saving ratio, which decreased to 8.6% in Q3, from 10.7% in Q2 and 23.7% at the height of the first lockdown – but still remained some way above the 6% level seen in Q4 2019.

3. Consumption looks a lot stronger in the revised data… but it's still government spending that has led the recovery



Source: ONS

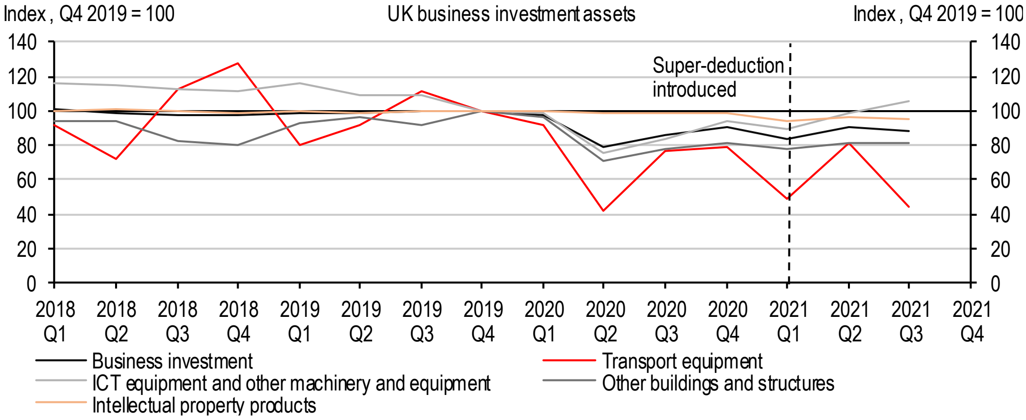
Business investment was revised up a little, but still looks very weak

Business investment was also revised up a little, as had been previously flagged. Still, it remained 11.7% below its pre-pandemic level. As a reminder, this is in the context of a 1.5% gap for overall GDP. As we have noted in the past, this is particularly disappointing given that the super deduction investment allowance has been in place for two quarters now. However, as the ONS points out, the nature of the super deduction policy should mean it mostly affects information and communication technology (ICT) equipment, and other machinery and equipment – and indeed, that is the only component of business investment that is back above its pre-pandemic level (chart 3). The biggest drag on business investment comes from transport equipment (still 56% below its pre-pandemic level in Q3 2021), which is consistent with the severe supply chain issues in the auto industry. That might point to good scope for recovery once those issues abate (though of course it is hard to say when that might be).

But government spending is still the only component back above pre-pandemic levels

The upward revisions in aggregate household spending and business investment were partially offset by downward revisions to government spending and an upward revision to imports. Still, it remains the case that government spending has been a key driver of the UK's (now almost complete) V-shaped recovery, while private sector-driven components (household spending, business investment, net trade) have further ground still to make up. Nowhere is this more the case than for exports, which were still 21% below their pre-pandemic level in Q3 2021.

4. The super deduction policy appears to have supported ICT investment… but not enough to offset the fall in transport equipment



Source: ONS

What's next?

In our Global Economics Quarterly (read the summary *here*), published before the revisions, we revised down our forecast for 2021 from 7.1% to 6.8%, assuming a 0.7% q-o-q rise in GDP in Q4 2021. In this note, we are revising it back up to 7.1%. This is because of the uplift to the base level from the revisions, partly offset by a slight downward revision to our Q4 forecast (from 0.7% to 0.6%). This latter adjustment reflects our expectations of a weaker December than originally assumed, due to the spread of Omicron and its impact on staffing and hospitality. We now think GDP might have fallen by around 0.5% in that month.

We see GDP growth of 7.1% in 2021 and 4.5% in 2022

For 2022, we have left our forecast profile unchanged: we see GDP growth of 0.7% in Q1, as the Omicron effect continues to play out, but activity levels pick up, and then a considerably stronger Q2 as that recedes. This means we are revising down our forecast for 2022 GDP growth from 4.7% to 4.5%.

However, there are still risks: we still see real incomes being squeezed by inflation and tax rises, absent any changes in government policy to try to cushion the blow. The UK economy is relying on resilient consumers, a continuing fall in the savings rate and a rebound in business investment. (We are not assuming much in the way of a net trade rebound, given the ongoing Brexit challenges.) If this central case materialises, then it should be able to withstand the withdrawal of both monetary and fiscal stimulus.

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