

# UK Economic Outlook

Can Labour get the economy growing again?  
17th July 2024



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# 1

## Summary





# Key points

1

**Labour are entering office just as growth momentum is picking up**

The worst of the 'cost of living crisis' is behind us and momentum in economic activity is picking up. With global tailwinds - stable energy prices and looser monetary policy globally - the new Government appears to be benefitting from the natural swings of the economic cycle.

Our main scenario projections indicate that the economy is likely to expand by around 1% this year, followed by faster growth in the two years after that. But a more interesting question is whether the Government will be able to meet its more ambitious target, i.e. to secure the highest sustained growth in the G7.

On inflation, in our main scenario, we expect the headline rate to fluctuate around the 2% target for the rest of 2024, as services inflation takes longer to normalise. That means it is not quite 'job done' yet, but we expect the Bank of England will have seen enough progress to start the rate-cutting cycle later this year.

2

**On its current trajectory the UK will miss the objective of securing the highest sustained growth in the G7**

The new Government's number one priority is to kickstart economic growth, and it has set the ambitious target of securing the highest sustained growth in the G7. The UK has not achieved this on a sustained basis over the past few decades.

On its current path, the UK economy is more likely to be the third fastest-growing G7 economy over the next decade, behind the US and Canada but ahead of the rest of the pack. This is broadly in line with its performance in the decade prior to the pandemic.

One key driver is demographics. The UK is expected to see limited growth in its working-age population over the next ten years relative to previous decades. This means that much of the economic growth will need to come from productivity enhancements, and the UK hasn't seen much in the way of that since the pandemic.

3

**The Government can unlock faster growth rates over the next decade by focusing on the "3Is"**

There are three key areas, which we call the "3Is" where the Government and businesses can make a crucial difference to help reach the ambitious growth target.

- **Inactivity:** Drive down economic inactivity back to pre-pandemic levels, focusing on the underlying issues such as physical and mental health (see Box C).
- **Industrial strategy:** Devise and methodically implement a multi-faceted industrial (and services) strategy centred around skills, infrastructure and planning and the green transition (see our [Framework for Growth](#) report).
- **artificial Intelligence:** Focus applying artificial intelligence technology to business and government practices. This will allow workers to focus on higher value-adding activities, which typically require more human capabilities like empathy, team-work, creativity and human judgement.



# 2

## Growth



# Labour has set an ambitious target to secure the highest sustained growth in the G7 - something the UK has not achieved for several decades

## Labour have set an ambitious target on the economy

Throughout the election campaign, the Labour Party have made clear that their number one priority is to get the economy growing again. They have set the ambitious target of “securing the highest sustained growth in the G7”. As we show in the figure to the right, the UK has not achieved this over a sustained period at any point over the past few decades.

At best, the UK has been the second fastest growing economy in the G7 over the past couple decades. At times, it has grown faster than most of the G7 group, particularly in the years preceding the Global Financial Crisis (powered by strong growth in the financial services sector), but it has still generally ranked behind the US and/or Canada.

However, the UK’s relative performance over the pandemic period has been weaker. This is in part due to the post-pandemic rise in inactivity and greater policy uncertainty, as well as more long-term challenges such as heightened trade barriers between the UK and the European Union, and continued low productivity growth due to relatively low levels of public and private investment.

## A turning point for the UK economy?

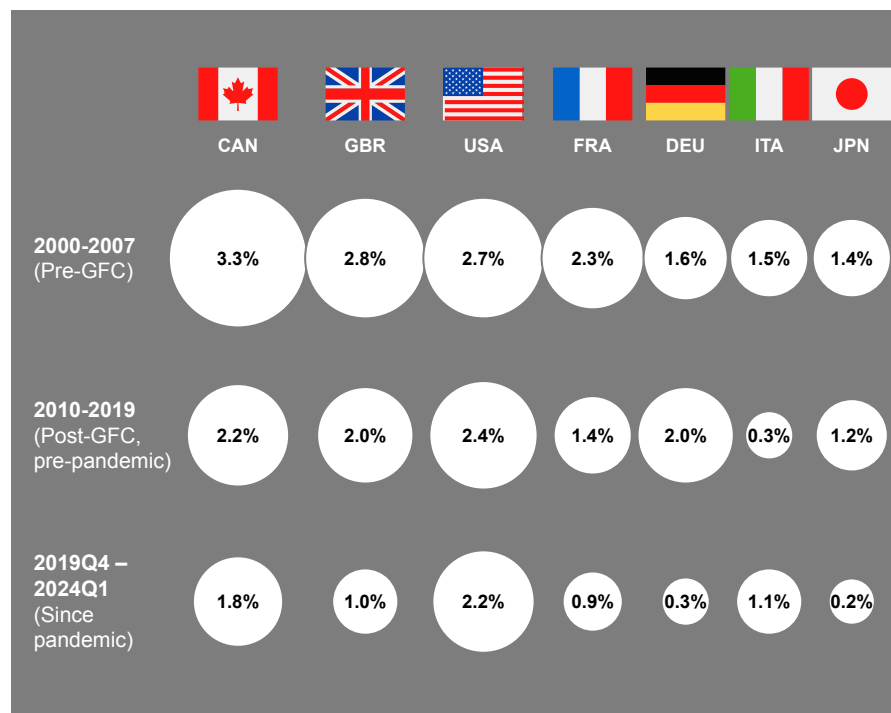
The past few years have been challenging for the UK economy and most of its international peers, as high inflation combined with monetary policy tightening have weighed on economic activity. However, inflation is past its peak, and our modelling indicates that the economy has already felt around two-thirds of the impact of the interest rate rises so far.

So there is good reason to expect that the worst of the cost of living crisis is behind us. That view is supported by a wider body of evidence that suggests economic activity is gaining momentum:

- Real GDP increased by 0.7% in Q1, faster than most expected
- UK business activity expanded at a faster rate than its G7 peers in Q1 2024, driven by strong services sector growth
- Real earnings grew for 11 consecutive months on a year-on-year basis as inflation has fallen
- [Consumer sentiment](#) has returned to levels from two years ago

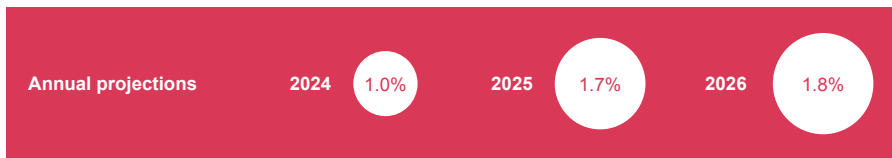
In the following slides, we set out our views on the outlook for the UK economy over the near to medium term.

Figure 2.1: Average annual quarterly real GDP growth rates over select time periods, G7 economies



# Economic activity is gathering momentum just as Labour takes power but it will take time to unlock significantly higher levels of economic growth

Figure 2.2: Real UK GDP, quarter-on-quarter growth, actuals and main scenario projections from Q2 2024



## Economic momentum is picking up from late last year

On the previous slide, we drew attention to the surprisingly strong economic growth rate in Q1 2024, which adds to the wider body of evidence that suggests economic momentum is picking up. However, we think this was somewhat of a one-off, and reflects the reversal of the -0.4% drop in GDP in the second half of 2023, rather than the new norm.

Our main scenario projections have quarter-on-quarter GDP growth falling back to 0.5% in Q2 2024. On a quarterly basis, growth then gradually returns to its long-term trend rate towards the back end of 2025, once the effects of monetary policy tightening on activity have largely subsided. In practice, the road to normality is unlikely to be this smooth. The past year has shown there will be bumps along the road (economic activity has been quite volatile on a quarterly basis), but this represents our best estimate for the economy's overall trajectory. Our main scenario also does not account for potential changes to the international trading environment.

So where do these projections leave the UK economy? On an annual basis, it equates to 1.0% growth in 2024, up from 0.1% in 2023, before picking up to 1.7% in 2025 and 1.8% in 2026. Outside of the pandemic period, the UK hasn't seen growth as high as 1.8% since 2017. However, this is in part due to elevated levels of political and economic instability over this period.

## ... so what could go wrong?

There are good reasons to think that the UK's economic recovery could be derailed. The primary concern would be anything that delays the rate cutting cycle or means it is slower than expected. This could for instance include more persistent inflation pressures than forecasted by the Bank of England due to, for instance, another geopolitical shock or overheated labour markets taking longer-than-expected to cool. We return to these risks later in the report.

Before then, we evaluate the likelihood of the UK becoming the fastest growing G7 economy over the next decade in Box A.

## Box A: Can the UK become the G7's fastest growing economy?

### On its current path the UK is unlikely to be the G7's fastest growing economy

The purpose of this box is to evaluate how likely it is that Labour will achieve their target to secure the highest sustained growth rate in the G7. As we show earlier in the chapter, the UK hasn't achieved this feat over a sustained period at any point over the past few decades. Indeed, the UK has only had the highest annual growth rate amongst this group in seven of the past 44 years.

To provide a baseline, we start by plotting the International Monetary Fund's latest projections for real GDP growth for each of the G7 over the 2025-35 period against the latest United Nation projections for working-age population growth. We use a ten-year period to account for the fact that it will take time for any administration to unlock higher levels of economic growth, as acknowledged by the Prime Minister who has promised a "decade of national renewal".<sup>1</sup>

The chart opposite shows that on its current trajectory, Labour are unlikely to meet their target to secure the highest sustained growth in the G7. Specifically, the IMF's medium-term projections show that the UK is

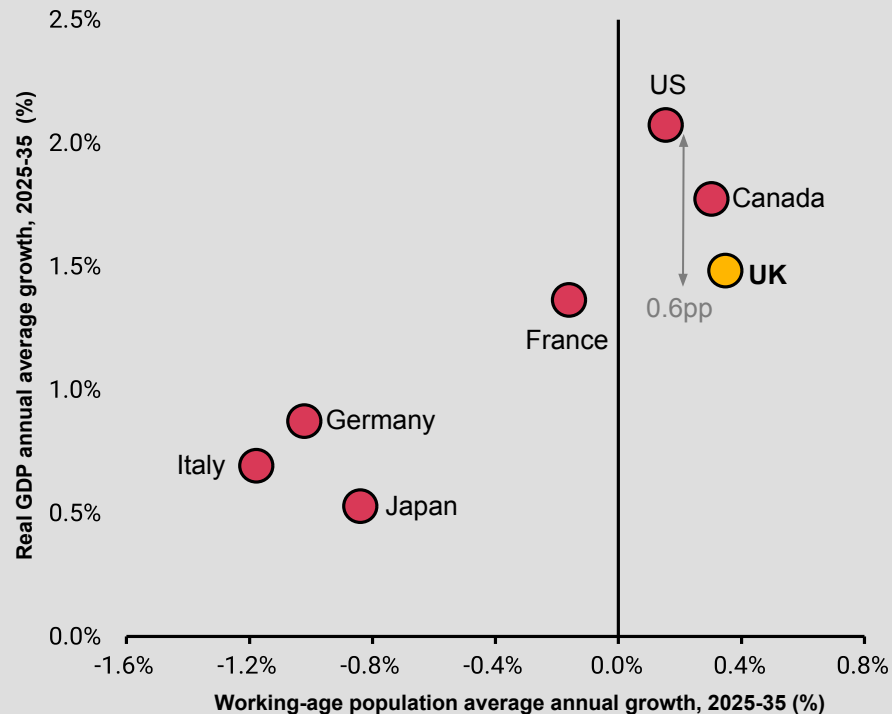
expected to be the third-fastest growing economy over the next decade, behind the US and Canada but ahead of the other advanced economies.

Much of this is driven by demographics. All of the G7 economies are expected to see relatively subdued growth in their working-age populations over the next decade. The UN expect the UK working-age population to grow at an average rate of 0.3% a year, compared to 0.6% average growth over the 2000-19 period. This suggests that productivity growth will increasingly need to do the heavy lifting to drive economic growth in the UK and the other major economies. However, the UK is still expected to fare better on demographics than all of the other G7 economies, which in part explains why on its current trajectory it is expected to be the third fastest growing economy.

### Where can growth come from?

We identify three key sources of economic growth. The first is supporting people back into work, which the Labour Party have already identified as a key priority.<sup>2</sup> There are still more than three-quarters of a million additional working-age people

Figure 2.3: Projected annual average growth in real GDP (y-axis) and working-age population (x-axis), 2025-35





## Box A: Can the UK become the G7's fastest growing economy? (continued)

(0.82m) that have fallen out of the labour market since the pandemic started, primarily due to long-term sickness. This is an important economic challenge for the UK that we have covered previously (see [November 2023 edition](#)). Later in this publication, we investigate this trend in more detail to identify the drivers of inactivity amongst younger and older workers, who account for 89% of the rise in inactivity since the pandemic.

The economic benefits from reintegrating this group into the workforce are pretty sizeable. If they all were to return to employment, that has the potential to boost UK GDP by up to 2.6% relative to 2023 levels. If this took place over a ten year period, that would equate to roughly a quarter of a percentage point additional economic growth a year. This is a significant uplift but not quite enough to close the projected gap with the US (0.6pp).

The second source of growth that we have identified is the formation of a new industrial strategy, which Labour have pledged to introduce. This is important as the UK increasingly finds itself competing with

countries where governments play a more active role in supporting the private sector.

Our new [Framework for Growth](#) starts to lay out the foundations for what a successful industrial strategy would look like based on our modelling and the views of business leaders. The report estimates that the economic gains could be as large as £923bn by 2035, equivalent to ~40% of UK GDP and more than enough to close the gap with the US.

The other way to get growth is by using our existing resources more efficiently, and AI presents the best opportunity to improve productivity over the next decade. Our [AI Jobs Barometer](#) provides some initial evidence that there are already signs of productivity gains in AI-exposed sectors, such as financial services, information technology and professional services.

### How likely is it that Labour will achieve their target?

On the basis that the past is the best predictor of the present, not very. Even when the UK economy was at its strongest, in the years preceding the global financial crisis,

the UK lagged behind Canada. However, our analysis shows that a period of economic and political stability, combined with progress on economic inactivity, AI and an industrial strategy could help Labour to achieve their ambitious objectives.

# £923bn

PwC's estimate for the potential GDP uplift by 2035 (in 2023 prices) if the UK adopts a successful industrial strategy, equivalent to around 40% of UK GDP.



# London and Northern Ireland to be the joint-fastest growing regions in 2024 as the capital pulls further ahead of the rest of the UK

## London and Northern Ireland are expected to grow the fastest in 2024

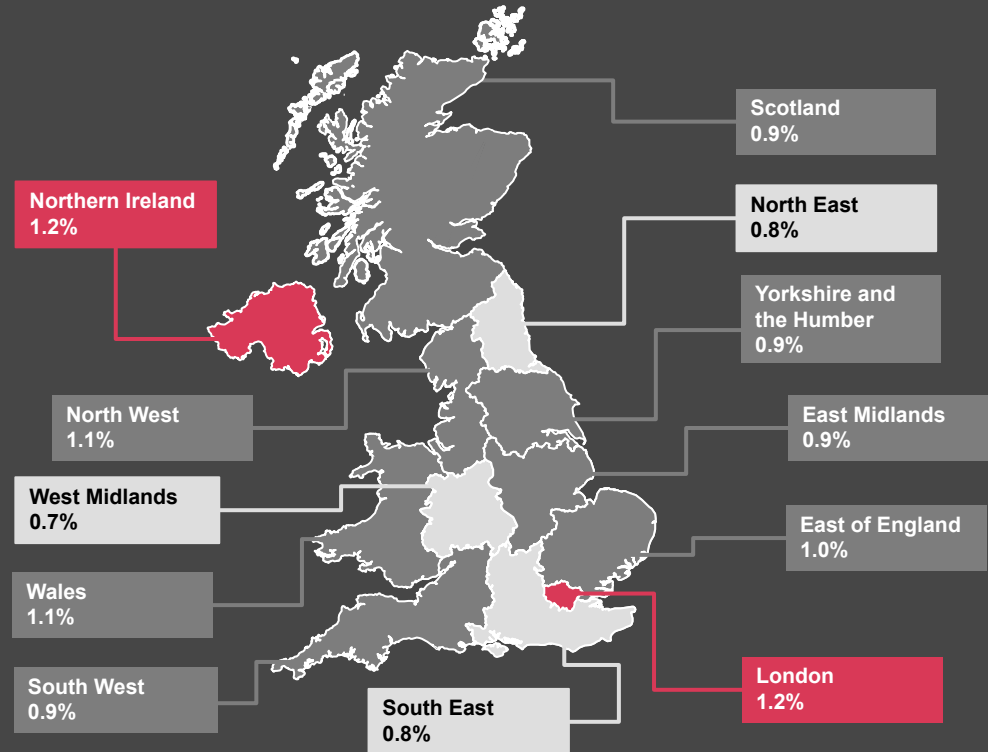
Our modelling indicates that the capital is once again poised to be the fastest growing region, as was the case in 9 of the past 25 years. The London economy has shown its resilience to recent economic turbulence. The latest PMI data indicates that it was the third fastest growing region in May as measured by business activity, despite the fact that many of its key sectors (financial services, business services, IT) are starting to slowdown following their pandemic booms.

On a more positive note for addressing regional inequalities, the Northern Ireland (NI) economy is also projected to grow by 1.2%. The region has trailed behind the UK across several economic metrics for some time, such as productivity levels. However, in recent years it has benefitted from greater access to the EU single market, and strong growth in the public sector, which makes up around a quarter of employment in the region. Now Stormont is fully operational, we expect that greater political stability should help to support business investment and economic growth over the next year.

Elsewhere, the picture is less positive. For the second year running, our projections indicate that the West Midlands could be the slowest growing region in the UK. The region has been particularly exposed to the slowdown in the manufacturing sector and the automotive sector in particular.



Figure 2.4: UK 2024 real GVA projections, by region



# Despite a flatlining economy, the sectoral picture is more nuanced and we expect it will take some time for consumer-facing sectors to see a pick-up in demand

## Despite the economy flatlining, ten sectors have grown over the past year

Though the economy has flatlined, the sectoral data shows a more nuanced picture. This slide draws out three cross-cutting sector trends.

### Strong growth in the public sector drags up economy-wide performance.

The three sectors dominated by the public sector grew strongly, including health and social work (2.7%), public admin. and defence (2.2%), and education (1.2%). In part, we expect this is due to the effects of less industrial action compared to the previous year. Across the whole economy, there were 294,000 days lost to strike action in Q1 2024, almost three-quarters lower than in Q1 2023 (1.1 million). Combined, these sectors accounted for 19% of UK's GDP in 2023, and have made a contribution of around +0.4ppt to economic growth over the past year.

### Business services, financial services and IT are probably past the worst of it.

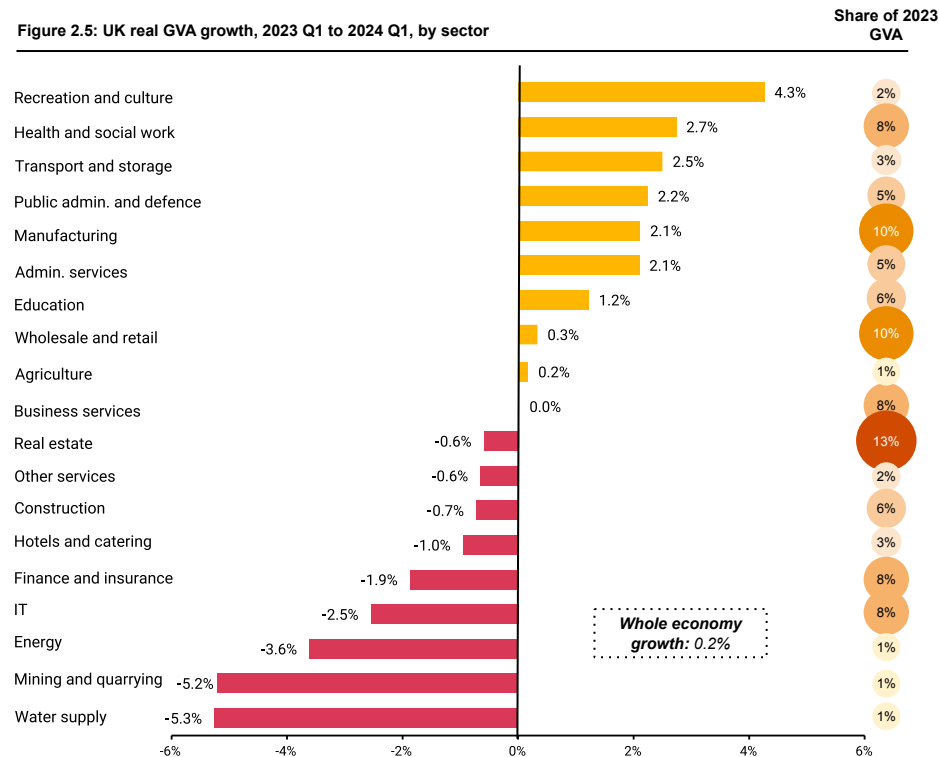
Historically they have been three of the UK's fastest growing sectors, but over the past year they have all flatlined or contracted. To some extent, especially in the case of business services and IT, this just reflects a

normalisation of demand patterns following their pandemic booms. But the monetary policy tightening cycle is also having an impact, with high funding costs making firms less willing to spend on services. There are still some bright-spots, with demand growing for insolvency and restructuring services, as well as cybersecurity and AI services. And with rate cuts on the horizon, we are optimistic that activity has troughed and will start to pick up as funding costs stabilise.<sup>3</sup>

### Consumer demand remains subdued as households remain cautious.

Wholesale and retail and hotels & catering have both seen weak or negative growth over the past year, as the cost-of-living crisis continues to weigh on consumer demand. Though inflation is falling, there clearly remains some hesitancy amongst consumers regarding their financial situation. In PwC's latest [Consumer Sentiment Survey](#), 7 in 10 people said they still expect to make some spending cutbacks over the next three months, despite the fact that most consumers say their finances are in "healthy" or "ok" shape. Even so, it is likely just a matter of time before improving economic conditions starts to have a material impact on household finances and sentiment.

Figure 2.5: UK real GVA growth, 2023 Q1 to 2024 Q1, by sector



# Box B: Corporate insolvencies reached a three-decade high in 2023 and we expect that they haven't peaked yet

## Corporate insolvencies are now higher than during the Global Financial Crisis

The UK recorded nearly 27,000 corporate insolvencies in 2023. This is the highest level for over three decades, surpassing insolvency volumes during the Global Financial Crisis. Though it is important to set this figure in some context. Relative to the total number of active companies, insolvencies remain reasonably low.

Only one in 186 active companies entered insolvent liquidation in 2023, equivalent to a liquidation rate of 54 per 10,000 active companies.<sup>4</sup> This is partially because insolvencies only make up less than 5% of dissolutions.<sup>5</sup> However, the number of insolvencies can still be a useful benchmark for broader firm distress.

## The rise in insolvencies was initially concentrated amongst smaller firms

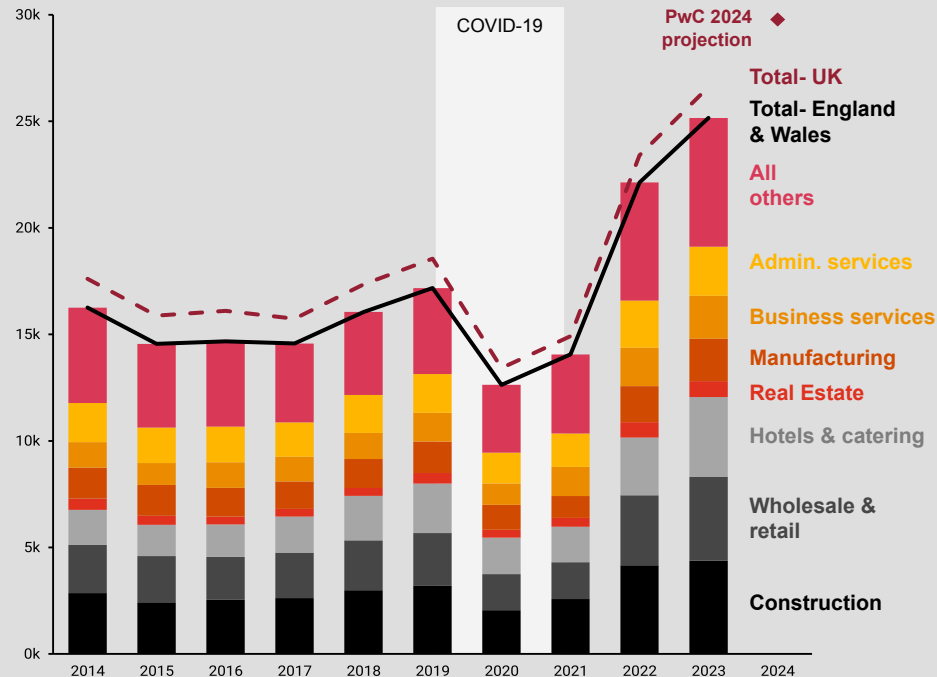
Much of the initial rise in insolvencies after the pandemic was concentrated amongst smaller 'micro' firms.<sup>6</sup> During the pandemic, there was a surge in business creation, driven by individual entrepreneurs creating companies for the first time. Naturally, a surge in business creation is likely to be followed by a surge in business exits.

There is also some research that suggests that the firms created during the pandemic were more likely to dissolve than firms started pre-pandemic. Many of these firms hired few (if any) employees and held little debt; with a large proportion of the debt they did hold being in government-backed loans from during the pandemic period.<sup>7</sup> As a result, the impact of these firm exits from a macroeconomic and financial stability perspective is likely to have been relatively limited.<sup>8</sup>

## We expect corporate insolvency volumes to continue rising for a short period

The key unknown is when insolvencies will reach their peak. One useful leading indicator is the Companies House data on the number of firms in the process of dissolving. Research by Bank of England staff suggests there are still a much larger number of firms in the process of dissolving than normal. As of December 2023, 12% of the firms on the register had started a dissolution procedure (~600k firms), with a further 4% (~170k) at the risk of being dissolved.<sup>9</sup> This indicates that insolvencies could continue rising for some time.

Figure 2.6: UK corporate insolvency volumes, 2014 to 2024





# Box B: Corporate insolvencies reached a three-decade high in 2023 and we expect that they haven't peaked yet *(continued)*

## Our modelling indicates that insolvencies could reach c. 7,500 a quarter

To project forward corporate bankruptcies, we have developed an econometric model that links insolvency volumes to broader macroeconomic conditions (see appendix for more details). Our modelling indicates that corporate insolvencies will reach 30,000 in 2024, equivalent to around 7,500 a quarter. This would mean that on annual basis insolvencies reach another record high.

It may seem surprising that our modelling projects that insolvencies will rise at a time when macroeconomic conditions are improving. However, that is because the relationship between macroeconomic conditions and corporate insolvencies is lagged by around 18-24 months, due in part to the time it takes to go through the insolvency process.

## The profile of businesses declaring insolvency is changing over time

Most of the rise in insolvencies has been concentrated in smaller micro firms, particularly in the wholesale & retail, construction and hotels & catering services sectors. Combined, these three sectors account for around half of the rise in

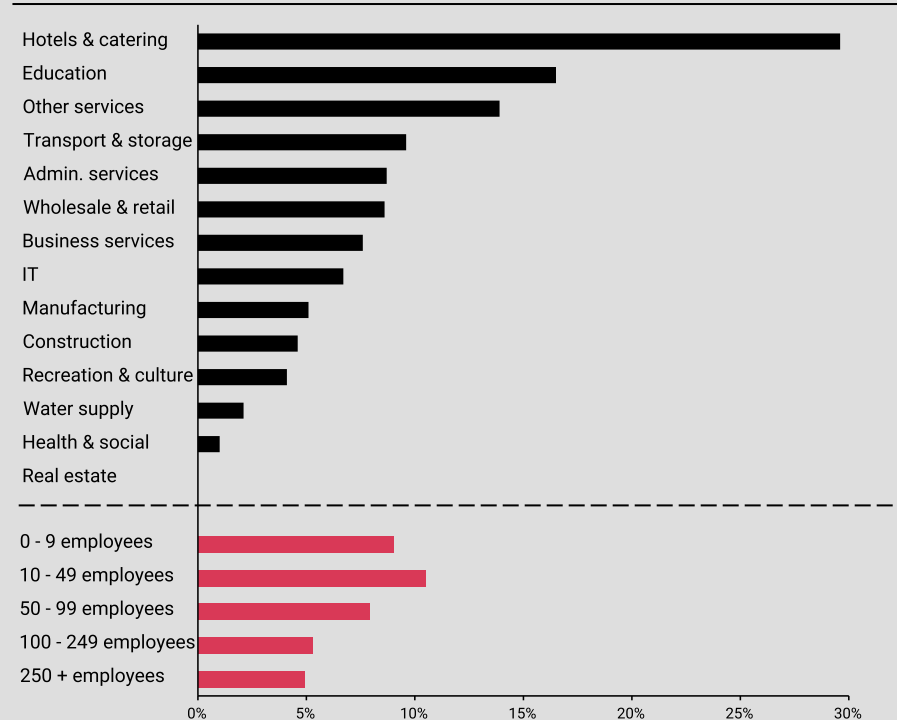
corporate bankruptcies over the past four years. However, there is some evidence that the profile of firms declaring insolvency is changing. For one, the size of firms in the process of declaring insolvency is becoming larger.<sup>10</sup> This is intuitive, as it takes longer for larger firms to go through the insolvency process.

In addition to this, the sectoral concentration of insolvencies may change over time as the cumulative effect of subdued demand, higher borrowing costs and higher input costs weighs on corporate balance sheets. The chart to the right shows the proportion of firms in each sector that report a moderate to severe risk of insolvency. This should provide a useful indication of where there are the greatest pressures and an insight into forthcoming insolvency trends.

“One thing we have seen in the past is that as we emerge from a recession and companies enter a restocking phase, there is more pressure on their working capital and an increase in liquidity issues and insolvencies”

**David Kelly**  
PwC Partner, UK Head of Insolvency

Figure 2.7: % of firms reporting moderate or severe risk of insolvency, May 2024



3

Inflation



# Headline consumer price inflation returned to the 2.0% target in May, but it is not ‘job done’ yet

May 2024 marked an important milestone in the fight against inflation as headline inflation fell to 2.0%. To kick off this chapter, we share four facts from this inflation episode:

**1. Headline inflation returns to target for the first time in nearly three years**

This is the longest period that inflation has exceeded the 2% target since the early 2010s, when it took four years to return to target. However, during that period headline inflation only peaked at 5.2%, compared to a peak of 11.1% in October 2022.

**2. Consumer prices have risen by 20% since inflation was last at target**

For context, if consumer prices had risen at a rate consistent with the 2% target, they would have only risen by 6% over this period. That means that the cumulative rise in prices has been more than three-times greater than the Bank of England target.

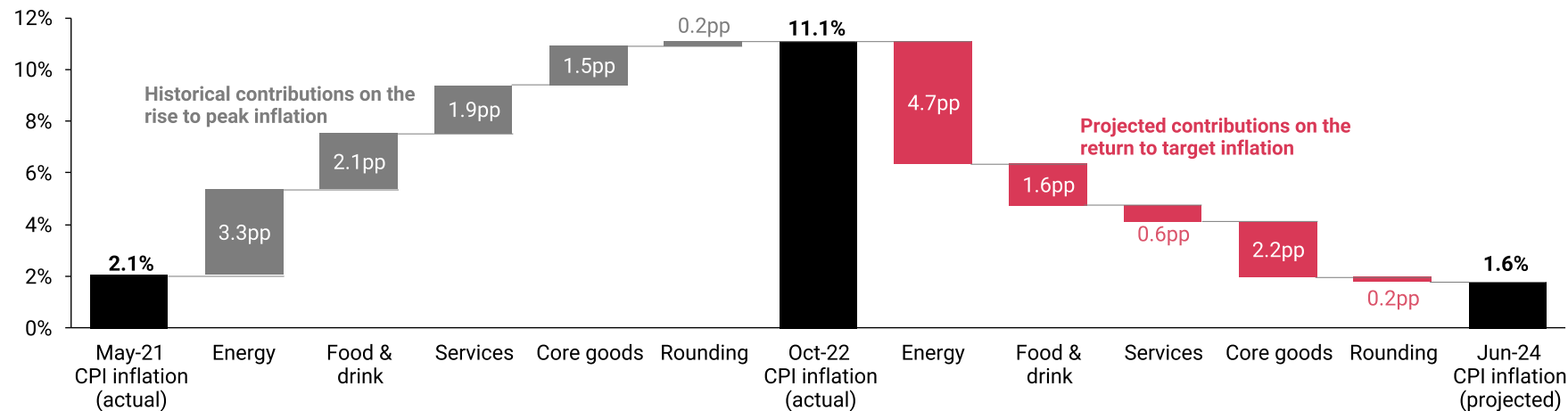
**3. Real earnings have declined by 1.3% over this inflation episode**

The one saving grace for household is that nominal earnings growth has also been elevated over this period at 18%. That has helped to prevent a sharper decline in living standards during this high inflation episode.

**4. 2.0% inflation does not mean the disinflation process is complete**

Energy inflation has done much of the heavy lifting, accounting for around a third of the rise in inflation and half of the decline. If prices continue to rise at the same month-on-month rate in June as they did in May (0.3%), then headline inflation will again exceed 2.0%.

Figure 3.1: UK CPI inflation contributions, May 2021 to June 2024



# The UK now looks more of a “laggard” on inflation than an “outlier”, when compared to its international peers

## The disinflation process is well underway in most of the major economies

Throughout most of last year, there was a concern amongst economists and policymakers that the UK was an outlier amongst the advanced economies, with more persistent domestic inflation pressures than its peers. This was most evident in June 2023, when headline inflation was at 3.0% in the US and 5.5% in the Eurozone, compared to 7.9% in the UK.

This divergence was in part due to interventions from governments and regulators (e.g. the energy price cap led to higher-for-longer energy inflation in the UK relative to its Eurozone peers that implemented alternative measures). Despite this, the view that domestic inflation pressures were greater in the UK was arguably part of the motivation for the acceleration in the Bank of England's rate hiking cycle in mid 2023.<sup>11</sup>

However, the latest inflation data indicates that the UK has fallen much more in line with its international peers. In May 2024, headline CPI inflation was at 3.3% in the US and 2.6% in the Eurozone, compared to 2.0% in the UK. Arguably even more importantly,

underlying inflation momentum has also converged across the three markets (see Figure 3.3).

The 3-month annualised CPI inflation rate, which shows how much prices would change if the most recent 3-month change in prices persisted for 12 months, is now at around 4.8% in the UK, 2.8% the US and 6.2% the Eurozone. This indicates that consumer price growth momentum is broadly similar in the three markets, albeit still above levels that are consistent with 2% inflation targets.

On the following page, we look at the trajectory of four inflation components (core goods, energy, services, food and drink) to identify the key drivers of persistent inflation pressures in the three markets.

“The dynamics for inflation are rather different now, between Europe ... and the U.S. I think there's more demand-led inflation in the U.S. than we're seeing”

**Andrew Bailey**  
Governor of the Bank of England,  
April 2024

Figure 3.2: CPI inflation in Eurozone and G7 countries, annual rate, by country, 2019-2024

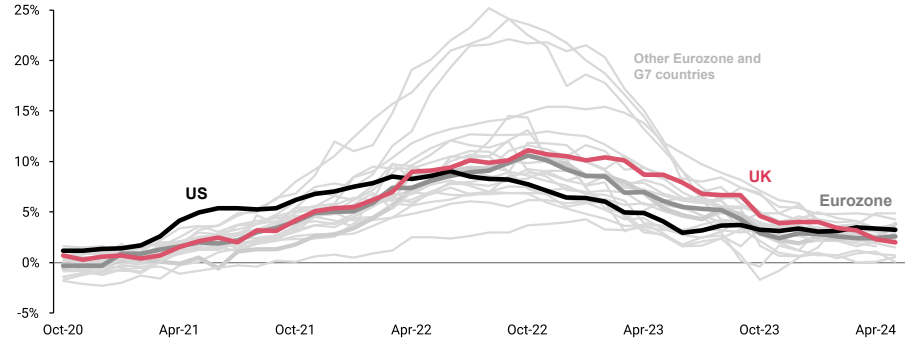
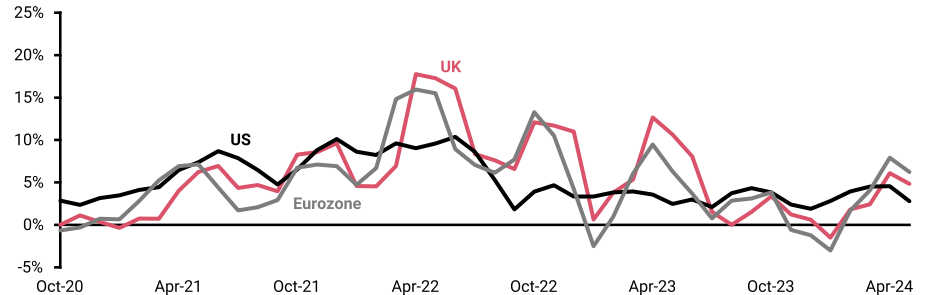


Figure 3.3: 3-month annualised CPI inflation in UK, US and Eurozone, by country, 2020-2024





# There is a growing divergence between services and goods inflation in most of the advanced economies, as the former proves to be more stubborn than the latter

## Lower goods inflation has driven the disinflation process so far

Lower goods inflation has accounted for virtually all of the decline in headline inflation in the UK from its peak of 11.1% in Oct 2022 to 2.0% in May 2024. Figure 3.4 shows the picture is similar in the US and the Eurozone.

In the UK, the largest downward contribution has come from energy inflation. Over most of 2022, UK energy inflation tracked higher than in its peers as the household energy price cap bundled up price rises into several large bursts. Though the flip-side is that - as these large price rises have unwound - energy inflation has fallen further into negative territory in the UK than in its peers.

The trajectory of core goods and food and drink inflation in the UK has largely mirrored that of the Eurozone, while lagging behind the US. Inflation pressures have moderated in all three markets as supply chains have recovered, energy costs have moderated and the effects of the Russia Ukraine war have subsided.

Going forward, there isn't much scope for goods inflation to fall significantly further. Our projections indicate that energy inflation

has already made its largest negative contribution to headline inflation and its impact will gradually diminish over 2024, despite the fact that the energy price cap is set to be cut by 7% in July.<sup>12</sup> Likewise, the Producer Price Inflation data indicates that both core goods and food and drink inflation are close to bottoming out.

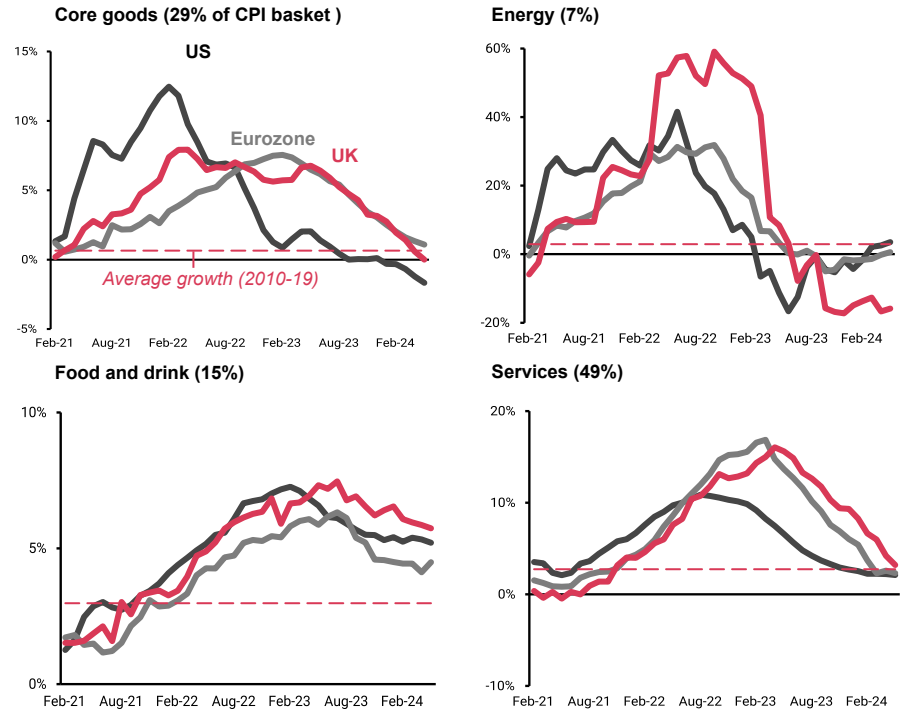
## Stubborn services inflation

One area where the UK has looked more like the US than the Eurozone is services inflation. Both the US and the UK saw the sharpest rise in services inflation during the pandemic and it has not come down to the same extent as goods inflation has. Indeed, with services inflation now at 5.7% in the UK, it is now 0.4pp above the Bank of England's May Monetary Policy Report forecast.

To some extent, this is not surprising. Labour-intensive services businesses are affected to a greater extent by high wage growth, and labour markets tend to lag behind the rest of the economy.

Previous research by this publication has shown that historically, services inflation has been more persistent than goods inflation. In the next chapter, we look at the labour market in more detail.

Figure 3.4: Annual inflation rates, UK (CPI), Eurozone (HICP) & the US (CPI), by sub-component, from Feb-21 to May-24



# We expect CPI inflation to bounce around the Bank of England's 2% target throughout the rest of this year

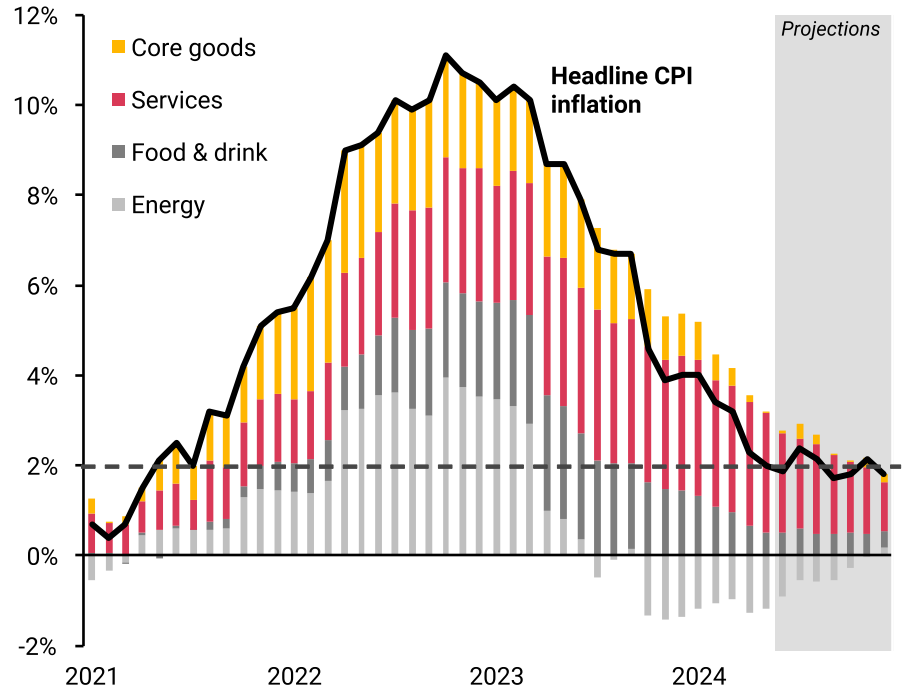
## Inflation is at target. What happens next?

Our main scenario projections are that headline inflation will bounce around the 2% target throughout the rest of this year (see chart to the right), and will end the year broadly on target. We expect that this volatility will be driven by divergent inflation pressures across the four components:

- **Core goods:** → The annual core goods inflation rate is at its lowest level (0%) since it peaked at 8% in April 2022. Our modelling indicates that it will stay broadly flat at this level throughout 2024. This is supported by the Producer Price Inflation data (PPI), which has been in zero or negative territory since mid 2023, indicating that cost pressures for goods producers have moderated.
- **Services:** ↓ Annual services inflation sits at around 5.7%, down from its peak of 7.5%. However, this is higher than what the Bank of England expected in May 2024 (5.3%) and way in excess of its level the last time inflation was at target in July 2021 (1.6%). By the end of the year, we expect services inflation will fall to around 2%, as the labour market cools and labour cost inflation moderates.

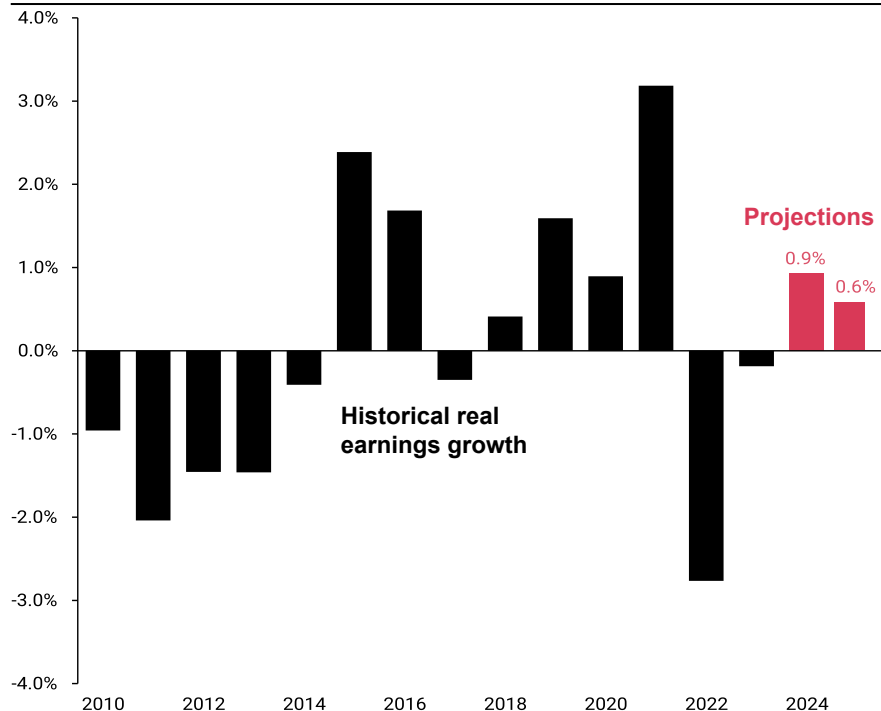
- **Food & drink:** → The food & drink annual inflation rate has come down massively from its peak of 16.1% in April 2023 to 3.2% in May 2024, as global cost pressures from the Russia-Ukraine war have receded. We expect that it will stay broadly at current levels, given that food input PPI has been hovering around the zero mark for roughly six months, indicating cost pressures have flatlined. Though government estimates suggest new post-brexid border checks on some food items from 30 April will add 0.2pp to inflation over the next three years.<sup>13</sup>
- **Energy:** ↑ Household energy prices are set to fall further, as the price cap is cut by 7% in July, though futures curves indicate it may pick up again slightly in October (+7.1% projected rise as at July 2024). Regardless of a potential Autumn rise, energy inflation has likely bottomed out and is expected to make roughly no contribution (up from a -1.2pp negative contribution in May) by the end of the year. That is primarily because the cuts to the price cap last year were larger in magnitude than the forthcoming changes (i.e. base effects are dominant).

Figure 3.5: UK Consumer Price Inflation, main scenario projections from June 2024, by sub-component



# The rapid decline in inflation should usher in a return to positive real earnings growth, but there are signs of continued spending hesitancy amongst consumers

Figure 3.6: Annual real average weekly earnings growth, main scenario projections from 2024



### An end to the cost of living crisis

Real earnings have been on a broadly upwards trajectory since early 2023, as headline inflation has fallen while nominal earnings growth has remained strong. As a result, real earnings are now around 3.1% higher than their pre-pandemic level.

Our main scenario projection is that workers will see positive real earnings growth across 2024 (0.9%) and 2025 (0.6%). Though this may provide some respite to households, the only way to generate sustainable real earnings growth over the long-term is through productivity growth, which has been weak since the Global Financial Crisis.

### Continued 'spending hesitancy' despite economic improvements

The financial position of most households is improving or stabilising due to a result of:

- Real earnings growth
- Combined 4p cut to National Insurance Contributions
- Increases to National Minimum Wage (NMW) and National Living Wage (NLW), affecting low earners primarily

Though this has been partially offset by a) rising housing costs and b) the freezing of

the personal allowance and income tax thresholds since 2021.

The main challenge is that we have yet to see these broadly positive economic indicators pull through to a sustained recovery in consumer sentiment or spending. PwC's [Consumer Sentiment Index](#) deteriorated in March 2024 following prior improvements, while real total household consumption remains around 2% lower than than pre-pandemic levels.

In recent years, the household savings ratio has also ticked up from 6.6% in Q2 2022 to 11.1% in Q1 2024, suggesting that households are pouring additional earnings into savings rather than spending them. This suggests that previous financial and economic uncertainty has created a 'spending hesitancy' amongst consumers. Until consumers feel more confident about the outlook for the economy and their finances, the economic recovery is likely to remain relatively subdued, as household consumption makes up around 60% of UK GDP. Though our expectation is that the coming months will see a positive change in sentiment as economic improvements filter through into people's wallets - and psyche.

# We expect the Bank of England will start its rate cutting cycle in August or September, now that headline inflation has hit its target rate

## Rates kept on hold, but still a slight dovish shift in Bank commentary

Unsurprisingly, the Bank of England's Monetary Policy Committee voted 7-2 in favour of holding rates at 5.25% in June. There was no decisive shift in their forward guidance, with the minutes still stating that "monetary policy will need to remain restrictive for sufficiently long to return inflation to the 2% target sustainably".<sup>14</sup>

However, there were still initial signs of a dovish shift in sentiment. Some of the committee members attributed recent upside surprises in services inflation to annual index-linked price hikes and volatile services components. The view of these members was that these upside surprises will not affect the medium-term inflation outlook, and neither would recent NMW and NLW rises.

## Summer rate cut still seems likely

The Monetary Policy Committee have been coy about when the first rate cut will come. However, it is clear they are preparing the ground for rate cuts. Governor Andrew Bailey has previously left the door open to a June rate cut, albeit saying it is "not a fait accompli" and has also not ruled out a period of consecutive rate cuts.

Our main scenario expectation is that the first rate cut will come in August (the next meeting) or September. This is broadly in line with the view of financial markets, who have priced in around 100 basis points of cuts to the base rate over the next 12 months. By the end of 2027, markets expect the base rate will settle at around 3.4%.

The pace and scale of rate cuts matters because it will determine the strength of the economic recovery. Our modelling indicates that the economy has felt around three-quarters of the cumulative impact of the base rate rises. It will take around 12-18 months before the effects of monetary policy loosening on economic activity is seen in the headline GDP statistics.

"The essence of monetary policy is to look ahead, not to where inflation is, but to where inflation will be... The risk as inflation comes down at a fair old clip is that the Bank might be a bit slow in cutting in the same way as it was a bit slow in raising."

**Andy Haldane**  
former BoE Chief Economist

Figure 3.7: Monetary Policy Committee recent voting history, from 22 June 2023 to 20 June 2024

Meeting date	22 June 2023	3 Aug 2023	21 Sept 2023	2 Nov 2023	14 Dec 2023	1 Feb 2024	21 Mar 2024	9 May 2024	20 June 2024
Rate decision	Raise (5.00%)	Raise (5.25%)	Hold (5.25%)	Hold (5.25%)	Hold (5.25%)	Hold (5.25%)	Hold (5.25%)	Hold (5.25%)	Hold (5.25%)
Bailey	↗	↗	→	→	→	→	→	→	→
Breedon	not member	not member	not member	→	→	→	→	→	→
Mann	↗	↗	↗	↗	↗	↗	→	→	→
Greene	not member	↗	↗	↗	↗	→	→	→	→
Dhingra	→	→	→	→	→	↘	↘	↘	↘
Ramsden	↗	↗	→	→	→	→	→	↘	↘
Pill	↗	↗	→	→	→	→	→	→	→
Broadbent	↗	↗	→	→	→	→	→	→	→
Haskel	↗	↗	↗	↗	↗	↗	→	→	→

MPC member vote: ↗ Increase → Hold ↘ Decrease



# 4

## Labour market



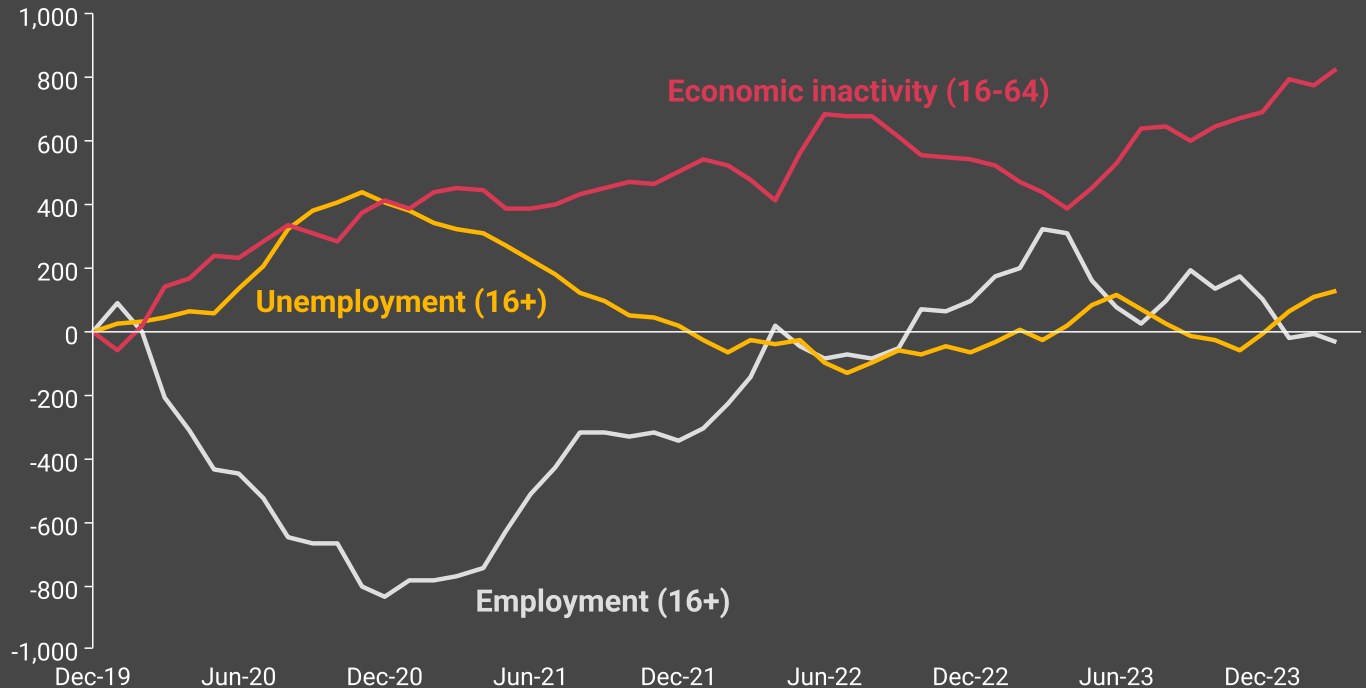
# The labour market continues to normalise in most areas but continues to be held back by persistently higher levels of economic inactivity

## The labour market is cooling but inactivity continues to rise

The ONS continue to advise caution when interpreting labour market statistics due to low response rates to their Labour Force Survey. However, a broad suite of indicators provides strong evidence that the labour market is normalising. Unemployment and employment have broadly returned to their pre-pandemic levels (see Figure 4.1) and vacancies are now just 13% higher than pre-pandemic. At its peak, they were 64% higher. Likewise, annual total earnings growth has cooled from a peak of 8.9% to 5.9% as at the three months to April 2024. All of which suggests that higher interest rates is having the desired effect of cooling the overheated labour market.

However, one challenge that has not gone away is the post-pandemic rise in economic inactivity. There are now around 820,000 additional people of working-age not in employment, who are not seeking work and/or are unable to start work compared to before the pandemic. This remains a significant barrier to growing the UK economy. We investigate this trend further over the following slides.

Figure 4.1: Change in UK unemployment, employment and economic inactivity, from pre-pandemic levels, in 000s, from three months to Jan-20 to three months to Apr-24



# Economic inactivity remains elevated amongst both older and younger workers, due primarily to higher prevalence of long-term sickness

## Economic inactivity has risen by around 820,000 compared to pre-pandemic

As we show in the chart below, nearly all of this increase has been driven by both younger (16-24) and older workers (50-64). Increased prevalence of long-term sickness explains around two-thirds of the rise in economic inactivity. The other major factor has been a rise in non-working students, which has increased by nearly 360,000 since the pandemic started.

In prior publications, we have focused on the rise in economic inactivity amongst older workers. Our research has shown that:

- Several advanced economies experienced a rise in inactivity amongst older workers during the pandemic but it has been more persistent in the UK.
- Access to healthcare, house prices and return on investments are some of the key drivers of 55-64 employment rates.

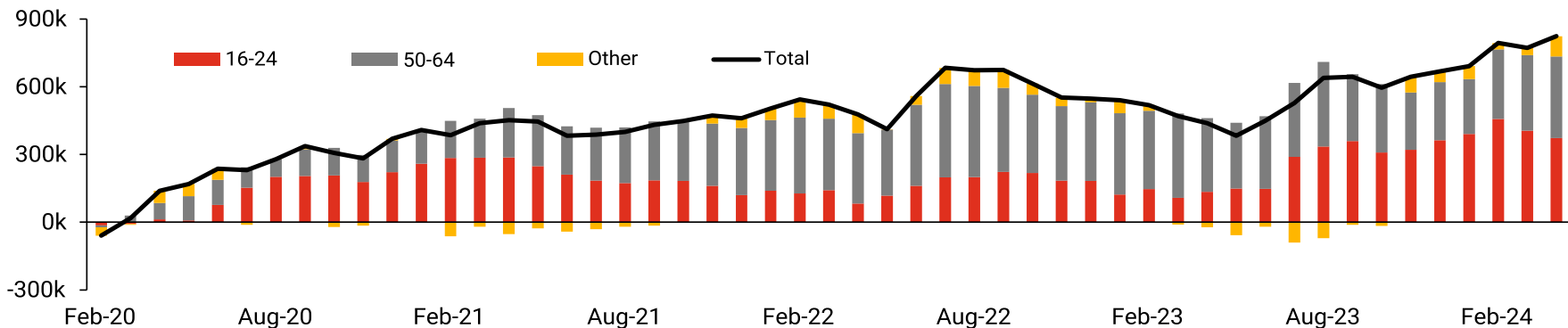
- Population ageing will drive further increases in economic inactivity amongst older workers in the coming decades.<sup>15</sup>

Over the past year, economic inactivity amongst younger workers has become a growing problem, now accounting for around a third of the total rise in inactivity. We unpack what is driving this rise in youth inactivity in more detail over the following pages.

**89%**

The proportion of the total rise in economic inactivity since the pandemic accounted for by younger (16-24) and older workers (50-64).

Figure 4.2: Cumulative change in inactivity levels in the UK since the three months to Jan 2020 to the three months to Apr 2024, 16-64 year olds, 000s



# Box C: What can the new government do to help young people return to employment?

## Inactivity amongst young people accounts for a third of the total rise

There are now around 250,000 more economically inactive young people (18-24) than before the pandemic. This accounts for 30% of the overall rise in inactivity over this period, which is the largest proportionate rise amongst any age group. In part, this is due to an increase in the number of non-working students. However, there has also been a rise in the number of young people not in education, employment or training (NEET), with the total currently estimated to be 900,000 in Q1 2024, up from 812,000 a year prior. Supporting these young people to return to employment is expected to be a key focus for the new government.

To better understand the drivers of economic inactivity, we conducted a survey of circa 1000 people at the end of March 2024, using a nationally representative sample. We outline our key findings over the next couple pages, focusing particularly on the key factors that could be contributing to the rise in economic inactivity among young people.

### Key findings

#### 1. Young people suffer from long-term

## mental health conditions at a higher rate than the general population. 22% of respondents to our survey aged 18-24 told us that they suffer from a long-term mental health condition, compared to 8% of all respondents. The most common mental health conditions cited amongst young people include anxiety, eating disorders and depression. This is broadly in line with the findings from external research, which has shown that young people's mental health has deteriorated since the mid-2010s. Young people now have the highest prevalence of common mental disorders (CMD) of any group, despite the fact that two decades ago they had the lowest incidence.<sup>16</sup>

### 2. Mental health challenges amongst young people impacts their career choices and wellbeing at work.

Our analysis supports the theory that rising prevalence of mental health conditions amongst young people has contributed to the rise in economic inactivity. Nearly one in five respondents aged 18 to 24 told us mental health conditions prevented them from pursuing their preferred career.

*Continued on the following page.*

Figure 4.3: Proportion of respondents who suffer from a long-term mental health condition, 18-24 years vs. all adults

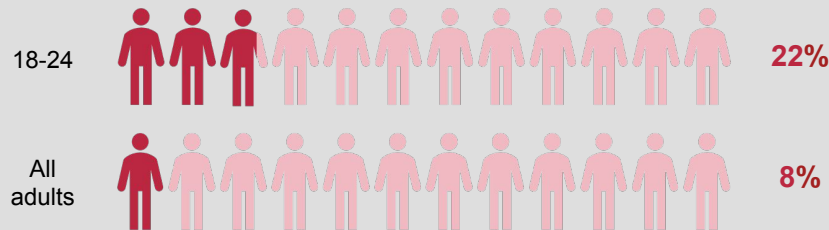
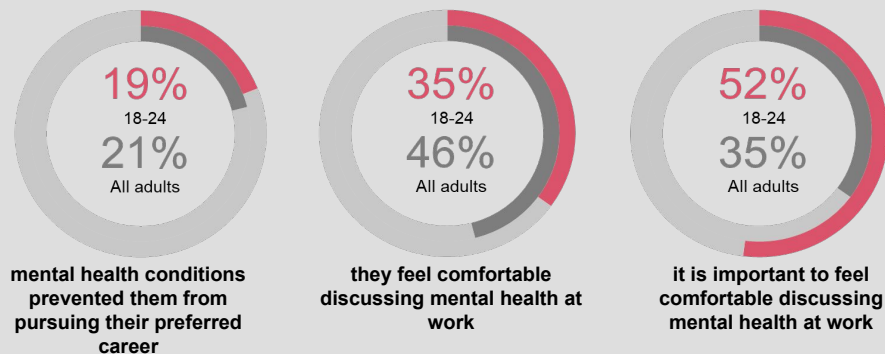


Figure 4.4: Proportion of survey respondents that told us:





# Box C: What can the new government do to help young people return to employment? (continued)

More than half of respondents in this age group also said that it is important to feel comfortable discussing mental health at work. However, only 35% of 18 to 24 year olds feel comfortable doing so. Social taboos around discussing mental health issues may prevent steps being taken to support those who need the most help.

**3. Most young people think their employers could do more to support their mental health.** Only a third of 18 to 24 year olds feel that employers provide the right support for their mental wellbeing at work, compared to 46% of all adults. This suggests there is a gap between the wellbeing resources provided by employers and the needs of workers who would likely make the most use of these resources.

**4. Improving mental health support at work will be a key lever to bring these young people back into the workplace.** Nearly 40% of 18 to 24 year old respondents currently not in work would be more likely to return to work if their future employer provided mental wellbeing support. This compares to 21% of respondents across all age groups. The mental health charity Mind

recommends that organisations should promote wellbeing, tackle causes of work related problems and support those who are experiencing difficulties. For example, this may be through creating a culture of openness or decreasing long working hours.

**5. However, the overall job package also has an important role to play in determining mental health at work.**

Unsurprisingly, pay came up as the number one issue, with one in four respondents aged 18 to 24 saying that pay is the most likely to impact their mental health at work. The second-most cited issue amongst all respondents was work-life balance. However, interestingly, young people told us that feeling valued at work and flexible hours has a greater impact on their mental health at work than work-life balance.

Our research highlights some of the key factors that are likely contributing to the rise in economic inactivity amongst young people. Young people are clear on the solutions. They want better mental health support in the workplace and an overall employment package that shows they are valued.

Figure 4.5: Proportion of respondents stating the factors most likely to impact their mental health at work

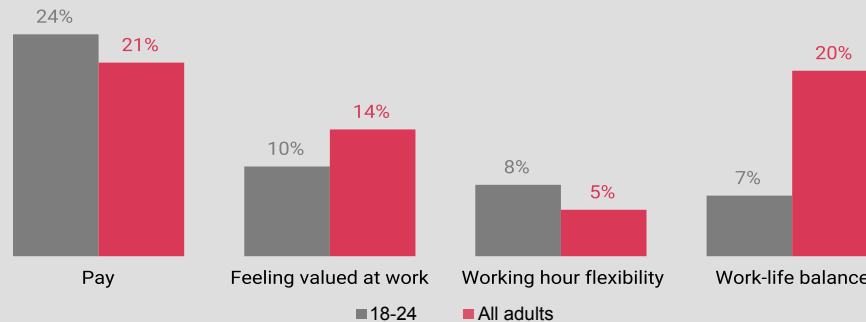


Figure 4.6: Respondents describe the greatest barriers they face when looking for a job

<p>"A work-life balance; hours that'll allow me time to relax and take care of my mental health at home." Female, 18-24</p>	<p>"How safe I feel and how much physical endurance it requires as I get really nervous" Male, 18-24</p>
<p>"Anxiety of failure or it not working out and having to leave and look again" Male, 25-34</p>	<p>"Working hours which fit around my child" Female, 25-34</p>

# Vacancies appear to be settling at a new equilibrium following the disruption from the pandemic

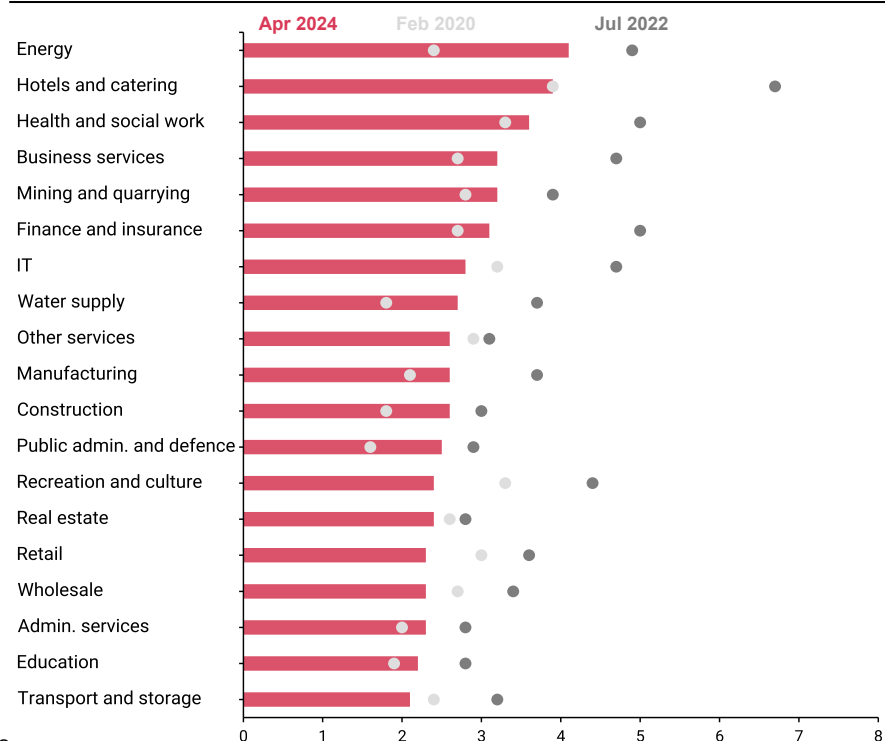
## Labour demand has softened but remains fairly strong compared to pre-pandemic

The vacancies data, which does not suffer from the same issues with response rates as most of the labour market data, provides further evidence that labour demand has softened but remains fairly strong. The number of vacancies posted appears to be levelling off at around 900,000, down by close to a third from the pandemic peak (1.3m) but still in excess of the pre-pandemic norm of around 800,000.

On the chart to the right we show the vacancy rate by sector. The vacancy rate is below the pandemic peak in all of the sectors. The largest proportionate falls have been in the Hotels & catering and Recreation & culture sectors. However, in the majority of sectors the vacancy ratio is still higher than their pre-pandemic levels, showing that demand remains robust in most sectors.

As labour demand has cooled, so has nominal earnings growth. Annual growth in regular earnings has fallen from a peak of 7.9% last year to 6.0% in the three months to April 2024. However, this is still in excess of the circa 3% level that is consistent with the Bank of England's 2.0% inflation target.

Figure 4.7: Vacancy rate (job vacancies per 100 employee jobs), by sector, seasonally adjusted



# 5

Fiscal  
spotlight: The  
future of fuel  
duty



# The UK's public finances face significant long-run challenges, which fiscal policy will need to be responsive to

## Public sector net debt is expected to rise to over 300% of GDP in the next 50 years

According to the OBR, the tax cuts announced in the Spring Budget earlier this year cut down the government's fiscal headroom to £8.9bn. This means there is limited scope for the new government to announce unfunded spending commitments or tax cuts, without changing the current fiscal rule (to get debt as a share of GDP falling). In May 2024, public sector net debt was at 99.8% of GDP, the highest May figure since the early 1960s.

Stabilising public finances and “rebuilding fiscal buffers” as the IMF have recently recommended will be challenging enough in the short and medium-term.<sup>17</sup>

The longer-term challenges are even greater. Under the OBR's baseline scenario, public debt is forecasted to exceed 300% of GDP in the next 50 years (see Figure 5.1), primarily due to spending pressures related to demographic ageing, in addition to the relatively high starting position. Getting public finances on a more sustainable footing is likely to require a combination of boosting economic growth and changes to tax and spending policies.

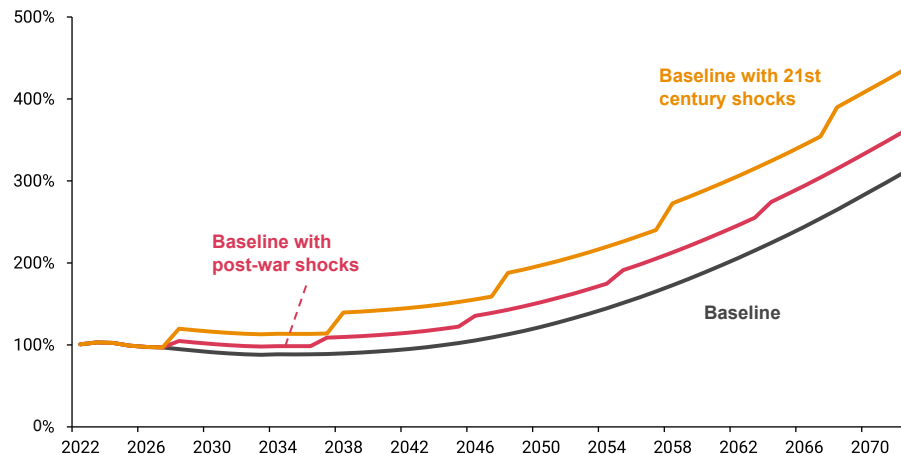
## A shrinking fuel duty tax base will further exacerbate the current fiscal position

It is now more important than ever for policymakers to think about the long-term sustainability of tax revenues. Central to this is the replacement of large revenue sources with a diminishing tax base, such as fuel duties.

According to the Treasury's 2021 Net Zero Review, tax revenues from fossil fuel related activity per year in the 2040s could be up to 1.5% of GDP lower than at present. This may not be offset by carbon pricing alone, meaning that “motoring taxes will need to keep pace with these changes during the transition to ensure the UK can continue to fund first-class public services and infrastructure.”<sup>18</sup> It is difficult to imagine a future government giving up its substantial current fuel duty revenue without a replacement in mind.

In the rest of this section, we discuss the fiscal implications of the shrinking fuel duty tax base as well as potential solutions.

Figure 5.1: OBR long term projections of public sector debt as a percentage of GDP with shocks



“Some revenue raising measures were made to balance the cut against National Insurance, but when we match what was given with one hand and taken away with the other, the UK's fiscal headroom is severely limited.”

**Barret Kupelian**  
Chief Economist, PwC UK

# Uptake of electric vehicles (EVs) is predicted to significantly reduce tax revenue from driving - given its size, this represents a key fiscal risk

**One in two cars could be electric by 2035, meaning a £20bn drop in tax revenues**

Fuel duty, Vehicle Excise Duty (VED) and VAT are the largest components of UK government revenue from road usage.

Figure 5.2: Summary of fuel duty and VED

	Fuel Duty	VED
<b>Cost</b>	52.95p/litre	£190-2745/yr2 onwards
<b>Exemptions</b>	EV (defacto)	EV (until 2025)
<b>Expected receipts this year</b>	£24.7bn (equivalent to 2.2% of all receipts or £850 per household)	£8.3bn (equivalent to 0.7% of all receipts or £290 per household)

A VAT rate of 20% is applied on fuel purchases and associated fuel duty, along with public EV charging. Electricity used for home charging incurs 5% VAT.

A study by the Resolution Foundation estimated the adoption rate of electric vehicles (EV) over the next 10 years and the associated loss in tax revenue (see Figure 5.2). By 2035, the study estimated that 50% of cars will be electric vehicles. This could mean a £20bn reduction in revenues relative to the current year.

Figure 5.2: Estimated increase in EV uptake and fuel duty revenue loss incl. VAT impact. 2023 prices.

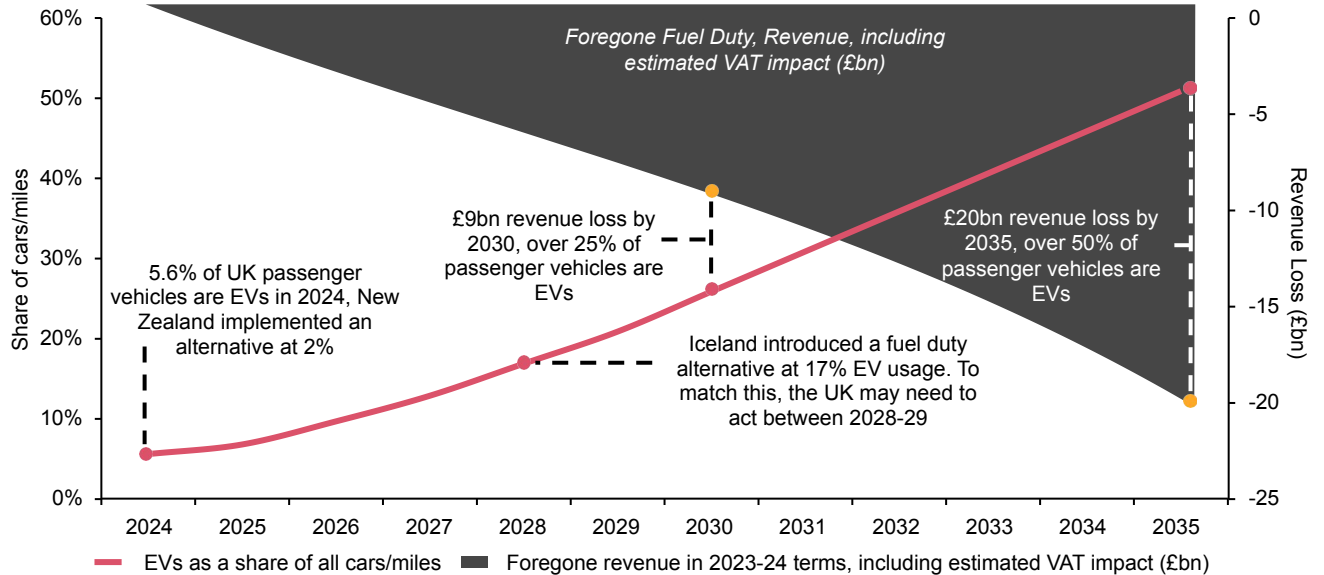





Figure 5.3: Illustrative fiscal measures that are equivalent in size to the expected loss in fuel duty revenue incl. VAT impact at 2023 prices.

 **2030 - £9bn loss:** Equivalent to increasing VED by **2.2x**

 **2040 - £27bn loss:** Equivalent to reducing the defence budget by **50%**

 **2050 - £36bn loss:** Equivalent to increasing income tax basic rate from **20% to 25%**



# Other countries have started to replace fuel duty with alternative charges. Organisations in the UK have also proposed alternatives

Figure 5.3: Similarities and differences between fuel duty replacement taxes

	The UK's current fuel duty	Suggested replacements <sup>1</sup>	Iceland's distance charge	New Zealand's distance charge
<b>Type of charge/ tax</b>	Duty on fuel	Charge per mile	Charge per km	Charge per 1000km
<b>Who it covers</b>	All ICE vehicles	All vehicles (ICE, EV & PHEV)	From 2024: EV & PHEV From 2025: +ICE	From 2024: Diesel ICE, EV & PHEV TBC: +Petrol ICE
<b>Cost/ charge (GBP)</b>	ICE: 52.95p/litre	~6p/mile	EV: 5.4p/mile PHEV: 1.8p/mile	EV & Diesel ICE: 5.9p/mile PHEV: 2.9p/mile
<b>Payment mechanism</b>	Included in retail price of fuel.	Varies: GPS and/or odometer tracking and payment.	Self-report mileage with mandatory checks. Monthly average payment.	Self-report mileage with mandatory checks. Prepayment.

**Alongside the main fiscal reasons, as outlined by the [RAC Foundation](#), there are other arguments to replace fuel duty:**

- Albeit less than ICE vehicles, EVs are still damaging to the environment, including 'embodied carbon' in the vehicle itself and particulate pollutants
- The 'user-pays' principle around road usage can still apply, as EVs still contribute to road degradation through use
- Issues around congestion, accidents and encouraging other transport modes

**UK organisations have proposed replacements to fuel duties that charge on distance travelled instead**

These have included the Wolfson Prize nominated report from the [Policy Exchange](#) and reports from the [Centre for Policy Studies](#) & [Resolution Foundation](#). Each of these proposed a form of distance charging regime for electrical vehicles (EVs). The details of each proposal differ, including the payment/compliance mechanism used for calculating charges. These range from geolocation trackers to self-reporting through app/websites. Another potential approach is including the distance charge within car insurance premiums.

**Other economies including Iceland and New Zealand have already introduced distance charging regimes**

In August 2022, the Iceland Automobile Owners Association (FiB) proposed a distance charge to replace the country's fuel duty. This change was welcomed by the Finance Ministry, who began joint collaboration on policy design with the FiB and implemented a distance charge in 2024. Iceland's distance charge currently applies

only to EVs and PHEVs (Plug-in Hybrid Electric Vehicles). The rates (shown in Figure 5.3) equate to fuel duty payments on petrol/diesel cars on average per year. Road users pay through a secure app by self-reporting odometer readings, and are invoiced monthly based on their estimated average yearly driving distance. Iceland has plans to expand its initiative in 2025 by introducing distance charging for petrol and diesel cars and eliminating its fuel duty.

New Zealand has a longer history with distance charging regimes. The country's Road User Charge (RUC) was introduced in 1978 for heavy and passenger diesel vehicles, whereas petrol vehicles pay a fuel duty instead. When EVs and PHEVs entered the market in the late 2000s, the government introduced an RUC exemption for the vehicles on the basis that they would be included in RUC once they comprised 2% of the passenger fleet. The threshold was surpassed in late 2023 and the Transport Minister signaled the transition to an RUC for EVs and PHEVs in January 2024, to take effect at the start of April. There is currently no timetable for RUC expansion, but like Iceland, it plans to eventually eliminate its fuel duty regime.

# If a fuel duty alternative is to be introduced to the UK, there are many factors that need to be considered before implementation

If the UK government sought to introduce an alternative to fuel duty, similar to Iceland & New Zealand, this would be a major undertaking. Success would depend on effective planning & engagement with citizens. Below we have listed some of the implementation considerations that will need to be taken into account

## Policy Design

The policy design of a distance charge will need to consider a range of parameters, such as the tax base, rates, thresholds and any exemptions. Above-all, it needs to be analysis and evidence-based, with a clear business case, value for money and impact assessment. Policy design needs to clearly consider how the policy can be delivered, both operationally and technologically.

## Timing & Consultation

Prior communication of the new policy is crucial to ensure public acceptance and then compliance. Both New Zealand and Iceland provided an implementation timeline in advance, enabling EV drivers to plan ahead. Further, collaboration with citizen-led motoroting agencies in policy creation (e.g. Iceland Automobile Association) will facilitate public confidence and trust.

## Stakeholder Engagement & Behavioural Change

To familiarise the public with a novel taxation payment process, a comprehensive information campaign will be needed. This could clarify the simplicity of the system and address concerns, such as about data privacy and perceived 'fairness'. The necessity and reasoning behind the change will need to be clearly articulated given the highly sensitive nature of road taxes.

## Cross-Government Collaboration

In our 'Future of Government' publication in March 2024, we described the importance of cross-governmental collaboration to respond to cross-cutting challenges and achieve greater economies of scale. This will be needed for any fuel duty replacement, as HMT, DfT and devolved administrations, among others, will need to collaborate to develop and implement the solution.

## Implementation considerations for a fuel duty alternative

## Back Office Administration

Fuel duty is paid in bulk at point of import or production. For a distance charge, the UK must determine the agency responsible for processing payments, as well as handling payments and data. In Iceland this is handled by the Treasury, in New Zealand the Transport Ministry, Policy Exchange outlined an alternative where insurance providers could pay the charge on behalf of their drivers.

## Technology & Payment Solution

Any replacement must ensure that payment is easy to complete and understandable by the public. The UK must decide on the calculation of the new charge and the method of payment. Iceland and New Zealand differ on both, with the former opting for user self-reporting on an app and a per-km charge and the latter using a licence-based system and a charge per 1000km.

## Compliance, Fraud & International Compatibility

Any time a new tax regime is introduced, fraud and compliance are major risks. To mitigate these, Iceland and New Zealand have imposed mandatory checks. Any alternative will have to be internationally compatible for foreign vehicles, as the UK receives a much greater volume of international traffic than Iceland and New Zealand.

## Other

There are several other considerations the UK must make in implementing a distance charge. Data collection must be conducted in a responsible way to protect public privacy. Also, taxes must be set such that revenue loss is mitigated, but EVs and PHEVs remain incentivised relative to ICE vehicles. The approach taken for business and/or heavy goods/unique vehicles could be different.

# 6

## Appendix





# Appendix A – Approach to projecting UK national real GDP

## Model structure

There are several classes of models that are commonly used to project forward macroeconomic aggregates, such as real GDP growth. We implement a Vector Autoregression (VAR) model, given they provide excellent short-term forecasting performance in a relatively simple framework. These models rely on empirical relationships between variables, often not imposing an assumption-based structure on these variables. Other models (e.g. structural simultaneous equations, DSGEs) are more resource intensive to maintain, require many assumptions, or tend not to forecast as well.

## Mixed frequency data

Given the fast-moving nature of the economy, it is important that any forecasting model can use the latest-breaking data releases. Monthly data released through a quarter can pin-down real GDP forecasts far before official quarterly estimates are published by the ONS.

As a result, we utilise mixed-frequency data in our model. While our real GDP growth variable is quarterly, we can incorporate

monthly series into our model. There are several approaches to this in the literature; we follow Ghysels (2016) and McCracken et al. (2021) in splitting monthly series into three quarterly series and ‘stacking’ these series together to estimate a VAR at quarterly frequency.

For example, stacking in terms of ‘economic time’ puts together the quarterly real GDP variable ( $y$ ), with three quarterly series made from a monthly variable ( $x$ ), relating to the first, second, and third month of each quarter respectively.

$$Y_t = [x_{t,1}, x_{t,2}, x_{t,3}, y_t]$$

A model is then estimated where the components of this vector depend on  $p$  lagged values of these series.

$$Y_t = \alpha + \beta_1 Y_{t-1} + \dots + \beta_p Y_{t-p} + \epsilon_t$$

By stacking the series this way, we can impose actual data points released part way through the quarter to construct a ‘conditional’ forecast, using the framework of Waggoner and Zha (1999). This allows us to incorporate information through the quarter, constantly refining the forecast.

## Bayesian estimation

Including multiple monthly series means the number of parameters to be estimated grows large very quickly. We therefore use the Bayesian methods, including the hierarchical prior selection methods of Giannone et al. (2015).

## Variable selection

We collected data on over 100 macroeconomic series. To select the most suitable variables for our model, we conducted several ‘live data’ backtesting exercises, testing performance of various models in out of sample forecasts. Chosen variables include the BoE base rate, unemployment rate and consumer spending.

## Scenario construction

Bayesian estimation recovers the entire posterior distribution of our model parameters, therefore giving a distribution of GDP forecasts. This gives an indication by percentile, of the range of possible outcomes for real GDP. We construct our downside scenario by combining points on this

distribution of forecasts, with expert judgement and our scenario narrative. Given certain values for our initial negative shocks, we then use the conditional forecasting feature of our model to construct a path where growth returns to trend.

*Ghysels, E. (2016), ‘Macroeconomics and the reality of mixed frequency data’, Journal of Econometrics*

*Giannone, D., et al. (2015), ‘Prior Selection for Vector Autoregressions’, Review of Economics and Statistics*

*McCracken, M., et al. (2021), ‘Real-time Forecasting and Scenario Analysis Using a Large Mixed-Frequency Bayesian VAR’, International Journal of Central Banking*

*Waggoner, D. and Zha, T. (1999), ‘Conditional Forecasts in Dynamic Multivariate Models’, The Review of Economics and Statistics*

# Appendix B – Approach to projecting corporate insolvencies

## Approach

We project forward corporate bankruptcies based on the historical link between macroeconomic conditions and the volume of corporate bankruptcies. We use a panel dataset covering the period 2010-2023, which provides us with sufficient variability in the data to disentangle the significance of several key drivers of corporate bankruptcies: macroeconomic conditions (interest rates, real GDP growth, Brent crude oil prices), one-off events (GFC, Covid-19), country-specific drivers (e.g. institutional framework) & country-specific time trends.

## Inputs

- **Interest rates**
  - OECD’s Economic Outlook (May 2024)
- **Real GDP growth**
  - PwC’s GDP growth forecasts as at July 2024
- **Brent crude oil prices**
  - Futures curves as at June 2024
- **Corporate bankruptcy rates**
  - ONS (historic up until 2023)

## Econometric specification

$$Bankruptcy_{ct} = \beta_1 x_{ct} + \gamma_c + \lambda_{ct} + \epsilon_{ct}$$

I.e the bankruptcy rate at time  $t$  is a function of several time-varying macroeconomic variables ( $x_{ct}$ ), incl. Interest rates, real GDP growth & oil prices, country fixed effects ( $\gamma_c$ ), and country-year fixed effects ( $\lambda_{ct}$ ). For more details see the table on the right:

Type	Variable	Impact on bankruptcies	Intuition
Macro	Interest rate	Positive	Higher interest rates raise the cost of credit for firms
	Real GDP growth rate	Negative	Higher GDP growth is linked to higher firm revenues
	Oil prices	Positive	Higher oil prices raise the input costs for firms, particularly if energy-intensive
Country-specific	Time trends	[country-specific]	Impact of bankruptcies changing over time in each country
	Fixed effects	[country-specific]	All other country-specific aspects that are not modelled directly but form part of the factors that drive bankruptcies (e.g. institutional and legal framework, cultural differences including attitudes to risk and credit uptake, sophistication of the business community etc.)
One-off events	Global Financial Crisis dummy	Positive	When financial conditions tighten, it is harder for firms to access finance
	COVID-19 dummy	Negative	Higher government fiscal support for firms helps to keep them afloat



# Appendix C – Sector list

The full list of sectors covered by our analysis from the ONS is listed below, alongside the short names we use throughout the article.

Full sector name	Short name
Accommodation and food service activities	Hotels and catering
Administrative and support service activities	Admin. services
Arts, entertainment and recreation	Recreation and culture
Construction	Construction
Education	Education
Electricity, gas, steam and air conditioning supply	Energy
Financial and insurance activities	Finance and insurance
Human health and social work activities	Health and social work
Information and communication	IT
Manufacturing	Manufacturing
Mining and quarrying	Mining and quarrying
Other service activities	Other services
Professional scientific and technical activities	Business services
Public admin and defence; compulsory social security	Public admin. and defence
Real estate activities	Real estate
Retail	Retail
Transport & storage	Transport and storage
Water supply, sewerage, waste and remediation activities	Water supply
Wholesale	Wholesale
Wholesale and retail trade and repair of motor vehicles and motorcycles	Wholesale and retail



# Endnotes

<sup>1</sup> Labour party press release, 9 October 2023. **Keir Starmer promises to kick off “decade of national renewal” as he sets out plan to “get Britain’s future back”** [Link](#)

<sup>2</sup> Labour party, 2024. **Labour Party Manifesto 2024** [Link](#)

<sup>3</sup> Bank of England, Q1 2024. **Agents' summary of business conditions - 2024 Q1.** [Link](#)

<sup>4</sup> UK Government, 30 January 2024. **Commentary - Company Insolvency Statistics October to December 2023.** [Link](#)

<sup>5, 6, 9, 10</sup> Bank Underground, 18 April 2024. **Three facts about the rising number of UK business exits.** [Link](#)

<sup>7, 8</sup> Bank Underground, 9 March 2023. **Corporate insolvencies reaching record highs: a look under the hood.** [Link](#)

<sup>11</sup> Bank of England, 19 April 2024. **Outlier or laggard: divergence and convergence in the UK’s recent inflation performance– speech by Dave Ramsden** [Link](#)

<sup>12</sup> Ofgem, 24 May 2024. **Energy price cap for July to September confirmed** [Link](#)

<sup>13</sup> BBC, 30 April 2024. **'Brexit trade checks will cost me £200,000 a year'** [Link](#)

<sup>14</sup> Bank of England, June 2024. **Bank Rate maintained at 5.25% - June 2024** [Link](#)

<sup>15</sup> PwC, April 2023. **UK Economic Outlook** [Link](#) & PwC, July 2023. **Golden Age Index 2023** [Link](#)

<sup>16</sup> Resolution Foundation, February 2024. **We’ve only just begun** [Link](#)

<sup>17</sup> IMF, 3 May 2024. **IMF advice on fiscal policy- Draft issues paper** [Link](#)

<sup>18</sup> HM Government, 18 November 2020. **The Ten Point Plan for a Green Industrial Revolution** [Link](#)

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