Flash Economics

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Why has the United Kingdom experienced low growth since 2018?

GDP growth forecasts for the UK in 2025 remain low: 1.3% according to the OECD and 1.1% according to the IMF. Growth was 1.1% in 2024 and just 0.4% in 2023. Prior to the Covid-19 pandemic (2011–2019), the UK's average growth rate stood at 1.9%; before the subprime crisis (2000–2007), it averaged 2.8%. This points to a clear slowdown. In Q1 2025, growth reached 0.7% quarter-on-quarter, which is relatively strong, but likely unsustainable (0.3% is observed for Q2).

Growth has been particularly weak since the UK's departure from the European Union in January 2020, following the late-2016 referendum. Several factors may explain this deceleration:

- Underinvestment, particularly since the Brexit announcement, has led to weak productivity gains and a decline in manufacturing output;
- A drop in foreign direct investment following Brexit;
- The replacement of EU-origin immigration with immigration from other regions (mainly India, Pakistan, Nigeria, and China);
- High short- and long-term interest rates since mid-2022. The UK has consistently been affected by high interest rates relative to growth ever since Liz Truss attempted to implement large-scale tax cuts in autumn 2022. More recently, persistently high core inflation has kept interest rates elevated;
- A sharp rise in the household savings rate since 2021;
- A significant deterioration in the trade balance since 2021.

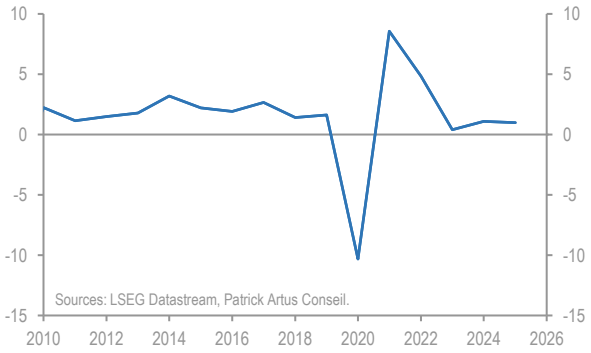
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Decline in UK growth, particularly since Brexit

Projected growth for the UK in 2025 is around 1%, following 1.1% in 2024 and 0.4% in 2023. In reality, **the UK's growth has significantly weakened since the subprime crisis (2008) and again following the implementation of Brexit (2020) (Chart 1)**.

Chart 1
United Kingdom: Real GDP growth (% per year)



We aim to **examine various possible explanations for the weakness of UK growth**, particularly since 2020.

Six possible explanations for the weakness of UK growth since 2020

1. Underinvestment, weak productivity gains, and decline in manufacturing output

Chart 2 shows **the corporate investment rate** in the UK; **Chart 3 displays the level of output per head**; and **Chart 4 illustrates the level of manufacturing production**.

Chart 2
United Kingdom: Business Investment
(value, % of nominal GDP)

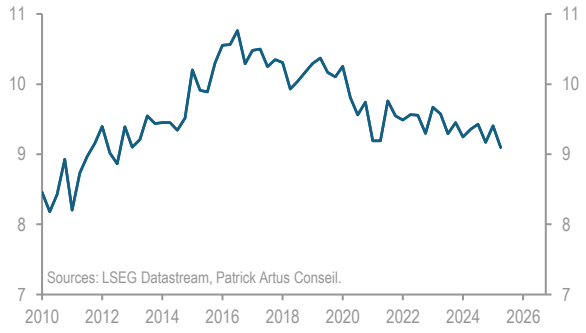


Chart 3
United Kingdom: Productivity per head
(100: 2010.Q1)

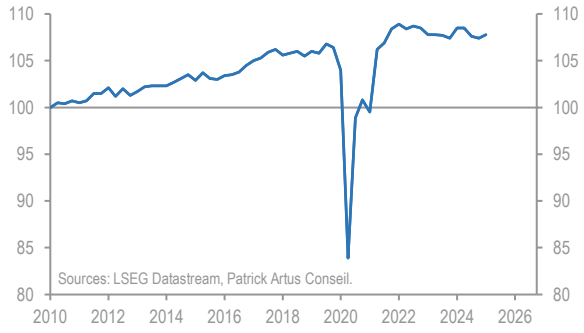
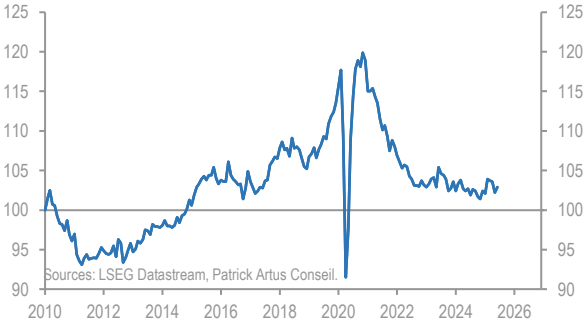


Chart 4
United Kingdom: Manufacturing production
(2010.M1 = 100)



We observe that:

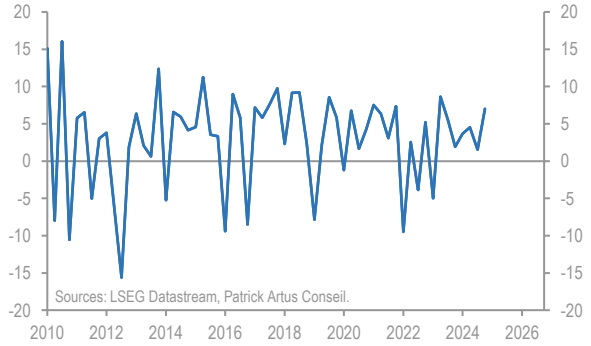
- The investment rate has been declining since 2017;

- Output per head has stagnated since 2021;
- Manufacturing output has fallen by 17% since 2021.

2. Decline in foreign direct investment?

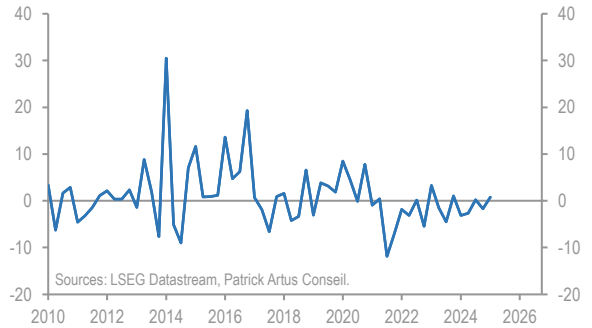
Charts 5A and 5B show the levels of **inbound and net foreign direct investment** for the United Kingdom.

Chart 5A
United Kingdom: Direct investment inflows*
(as % of nominal GDP)



(*) Direct investment inflows are capital inflows leading to an increase in liabilities (in this case for United Kingdom) and therefore have a positive sign.

Chart 5B
United Kingdom: Net direct investment*
(as % of nominal GDP)



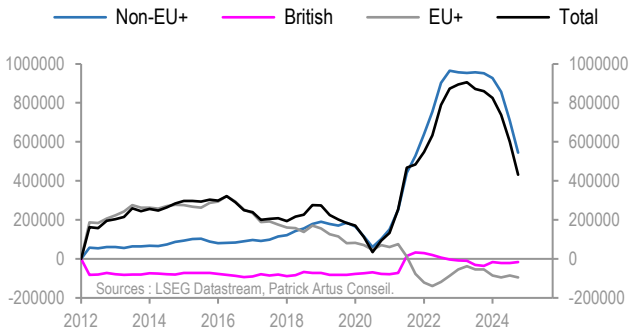
(*) A negative balance of direct investment corresponds to net capital inflows (an increase in liabilities), while a positive balance reflects net capital outflows (an increase in assets).

We can see that since 2017, there has been no decline in the UK's attractiveness to foreign direct investment.

3. Replacement of EU immigration with non-european immigration

Chart 6 shows the level of **net migration to the UK**, from the European Union, from the rest of the world, and total net migration.

Chart 6
United Kingdom: Net migration of non-EU+, EU+ and British nationals (annualized data*)



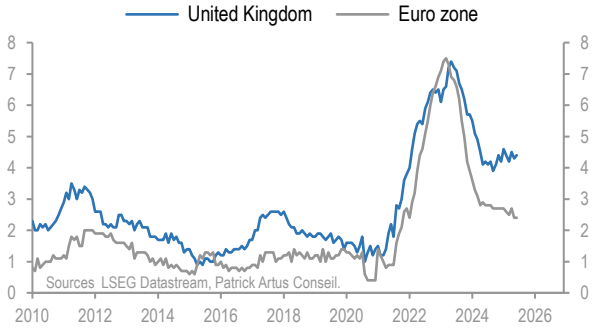
*EU+ is all current EU countries plus Norway, Iceland, Liechtenstein and Switzerland.

We observe that **since 2021, immigrants from the European Union have been replaced by immigrants from other regions** (notably from India, Pakistan, and Nigeria), which may have disrupted business operations and lowered the average skill level of incoming migrants.

4. Inflation, public deficits, and interest rates

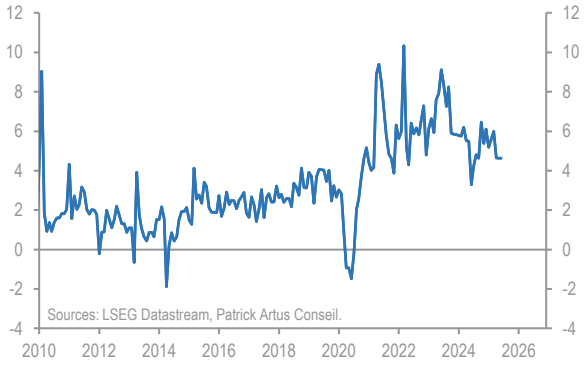
Since mid-2023, core inflation in the UK has remained elevated (**Chart 7**, which compares the UK with the euro area).

Chart 7
Core inflation
(HICP excl. energy and unprocessed food, Y/Y as %)



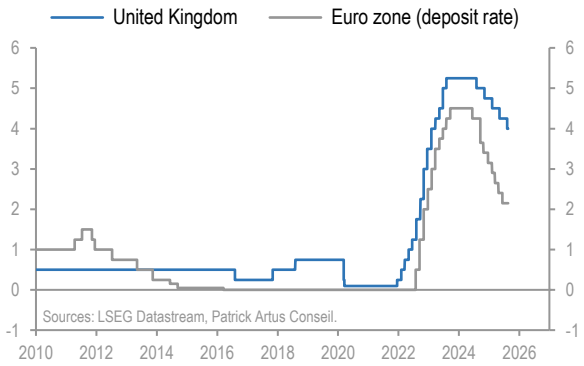
The elevated level of inflation is the result of **rapid wage growth** (**Chart 8**), driven by strong tensions in the labour market and the lack of productivity gains (as shown earlier in **Chart 3**).

Chart 8
United Kingdom: Nominal wage growth (Y/Y, as %)



This explains **the persistently high short-term interest rates (Chart 9)**.

Chart 9
Central banks' key interest rate (as %)



Long-term interest rates have also been significantly higher in the UK than in the euro area since autumn 2022 (**Chart 10**), due to excess inflation and in response to expansionary fiscal policy (**Chart 11**), even though the tax cuts proposed by Liz Truss in September 2022 were ultimately reversed. The fact that **long-term interest rates have exceeded growth since 2023** is constraining economic activity.

Chart 10
Interest rate on 10-year government bonds (as %)

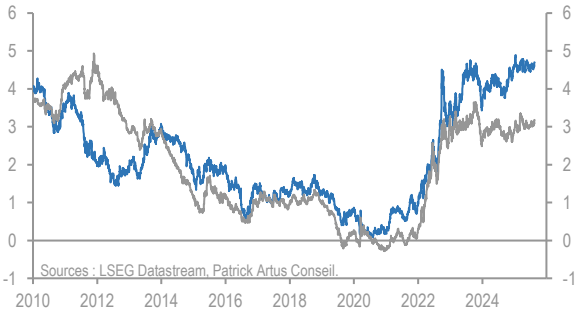
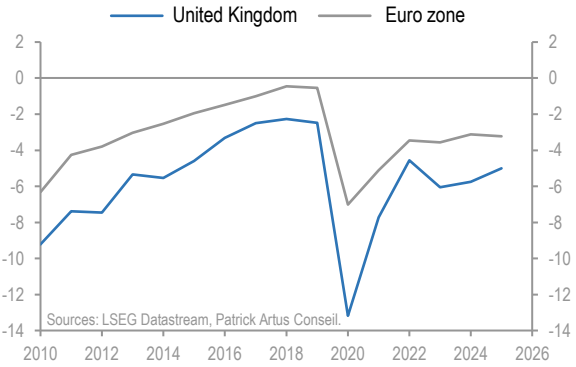


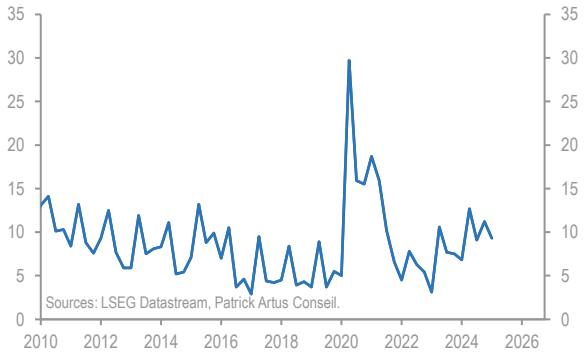
Chart 11
Fiscal deficit (as % of nominal GDP)



5. Sharp increase in the household savings rate since 2021

The rise in the UK household savings rate since 2021 (Chart 12) has weakened household consumption, thereby dampening growth.

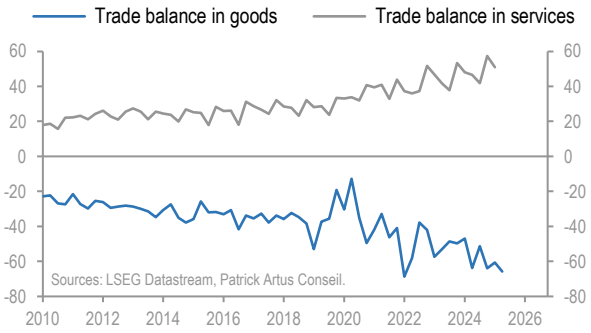
Chart 12
United Kingdom: Gross household savings rate (as %)



6. Significant deterioration of the UK trade balance

Chart 13 shows the **UK's trade balance for goods and services**.

Chart 13
United Kingdom: Trade balance in goods and services
(quarterly data, GBP bn)



We observe a significant deterioration in the trade balance for goods, which can be linked to the weakening of manufacturing output. This deterioration results from rising imports (**Chart 14**) while exports remain stagnant (**Charts 15A and 15B**), both to the European Union and to other countries.

Chart 14
United Kingdom: Exports and Imports of Goods
(Monthly Data, USD bn)

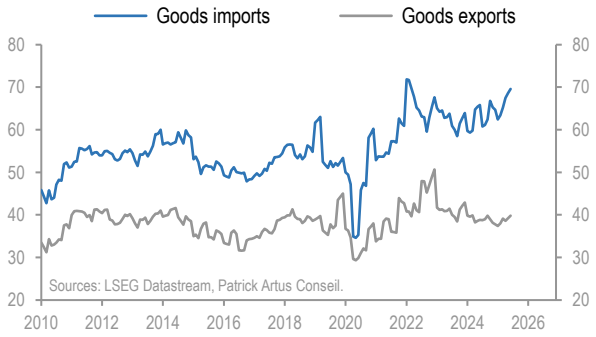


Chart 15A
United Kingdom: Total goods exports and goods exports
to the European Union (Monthly data, USD bn)

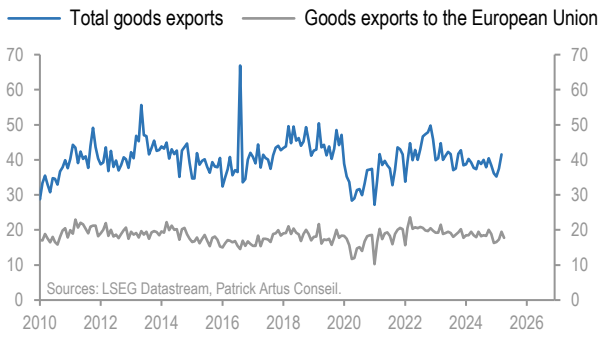
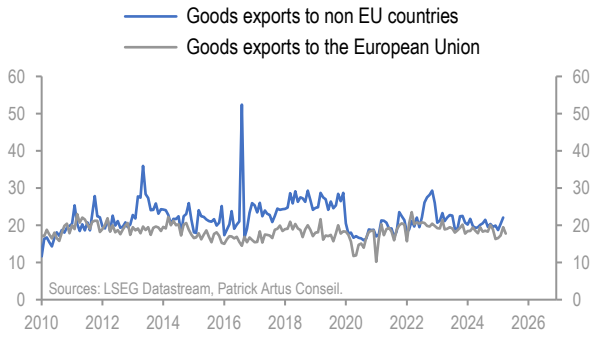


Chart 15B
United Kingdom: Goods exports to the European Union
and to non-EU countries (Monthly data, USD bn)



Summary: multiple factors behind the weakening of UK growth

The UK's weak growth, particularly since 2020, results from:

- Brexit, which has led to underinvestment and thus slowed productivity growth, as well as the departure of migrants from the European Union;
- The deterioration of the trade balance;
- Concerns among UK households, leading to a rise in their savings rate;
- Strong labour market pressures, causing rapid wage increases due to the departure of EU migrants and the absence of productivity gains;
- Highly expansionary fiscal policy and the resulting increase in long-term interest rates above the level of long-term growth.

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