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UK sees strong GDP growth at the start of the year

By **Gordon Douglass**, Supervisory Economist, **Jubair Ahmed**, Economist, and **Sixia Zhang**, Economist

Data published this month by the Office for National Statistics (ONS) showed that the UK economy grew strongly in the first quarter of 2025. Output increased by 0.7% in Q1 2025 after growing by 0.1% in Q4 2024 (Figure 1). This rate of growth was slightly higher than the average expected from surveyed analysts.

The ONS observes that the services sector, an important sector for London, grew by 0.7% in the quarter, while the production sector grew by 1.1%. However, the construction sector saw no growth. Real GDP per head also saw growth on the quarter of 0.5%. This follows on from two quarterly falls.

Bank of England cuts interest rates again

The Monetary Policy Committee (MPC) of the Bank of England voted to lower interest rates by a quarter of a point to 4.25% in May. This is the fourth cut in rates since the Bank started lowering rates from their recent high of 5.25%. However, the MPC insisted that it would retain "a gradual and careful approach" which has lowered expectations of the number of future cuts to come this year. The MPC vote was however divided on their decision, with two members wanting a half point cut while two other members favoured keeping rates on hold.

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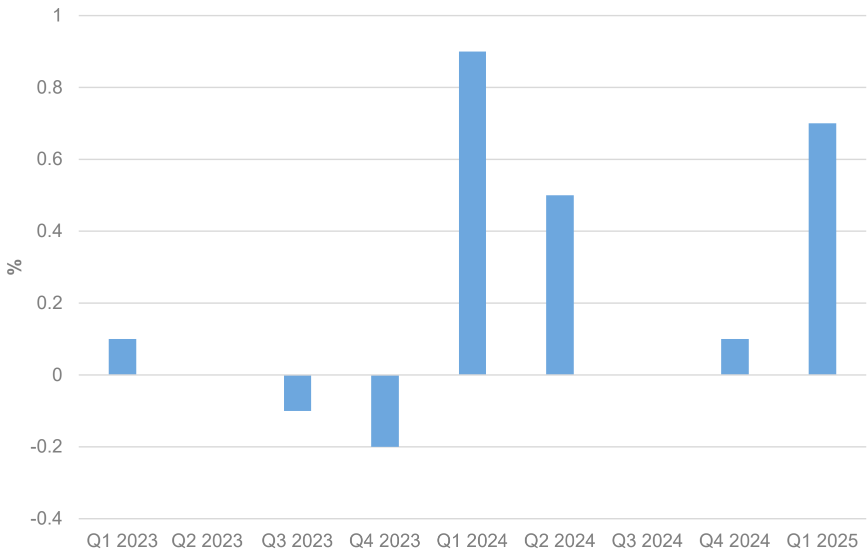


Figure 1: UK real quarterly GDP growth, Q1 2023 to Q1 2025

Source: ONS

The Bank also published their latest economic forecast this month. In it they estimate that inflation would peak at 3.5% in the third quarter of 2025 before dropping back to its 2% target in 2027. Looking at GDP growth the Bank now expects 1% growth this year with this rising slightly to 1.25% in 2026. This was based on the assumption that the "reciprocal" tariffs the Trump administration imposed on other countries would remain paused but that high barriers between the US and China would persist.

UK inflation picked up strongly in April

The ONS has also published data on April's Consumer Price Index (CPI) inflation this month. This showed that CPI inflation rose to 3.5% in the 12 months to April 2025, up from 2.6% in the 12 months to March (Figure 2).

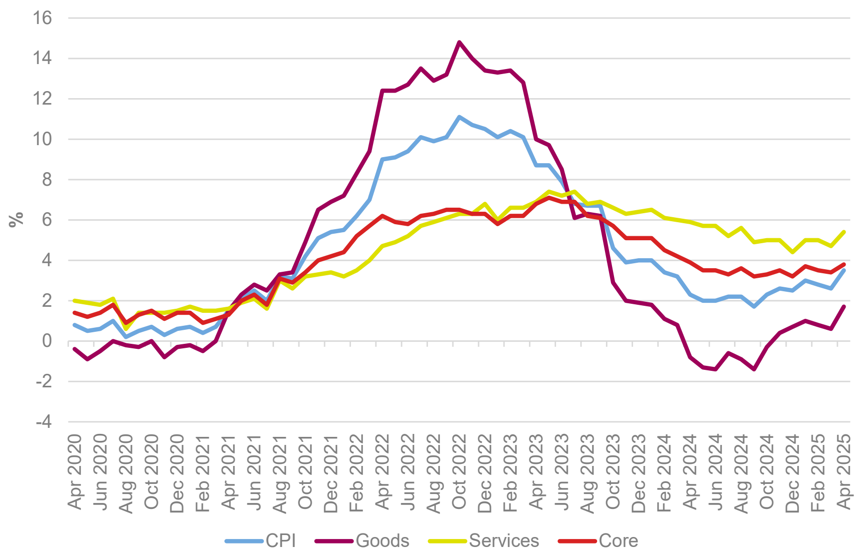


Figure 2: CPI, goods, services and core annual inflation rates, UK, April 2020 to April 2025

Source: ONS

This rise in inflation was higher than expected by most surveyed analysts. Looking at the data in more detail the ONS observed that the largest downward contribution to inflation "came from housing and household services, transport, and recreation and culture; the largest, partially offsetting, downward contribution came from clothing and footwear".

Beyond the headline inflation figure other inflation measures also rose. Core CPI (excluding volatile energy, food, alcohol and tobacco prices) inflation increased to 3.8% over the year to April 2025, up from 3.4% in

March. The CPI goods annual rate rose to 1.7% up from 0.6%. While the CPI services annual rate rose to 5.4% in April up from 4.7% in March. However, looking forward there was more positive news on future cost of living pressures in terms of household energy costs with Ofgem announcing a reduction in the energy price cap from July. The new cap will mean a typical annual household energy bill for a dual-fuel customer paying by direct debit will cost £1,720, down from the current level of £1,849. This is a 7% fall but prices remain significantly higher than before the Russian invasion of Ukraine.

Significant falls in inward migration – with sustained falls signalled by government

The latest ONS data points to UK net migration nearly halving, from roughly 860,000 in 2023 to 431,000 in 2024. This record drop was driven by fewer work visas and study-dependant visas, with Non-EU work-related visa acceptance falling by roughly 190,000, and study-visa related acceptance falling by roughly 150,000.

Changes outlined in the new immigration white paper are likely to further reduce inward migration through the closure of the care visa route, new restrictions on the Skilled Worker visas, and shortened Graduate visa terms. These observed (and proposed) changes have substantial labour market implications for key sectors in London. Roughly 30% of NHS staff in London are non-British nationals (35% of doctors and 27% of nurses) – and a substantial portion (63%) of London's hospitality sector workforce is non-UK born. International workers also make an important contribution to the tech sector, with around 39% of the workforce in the Information and communication sector being foreign-born. With London's vacancy rate usually above the UK average, these changes are likely to increase pressure on sectors where domestic recruitment remains a challenge.

It is important to note that the latest data reflects the previous government's migration restrictions, which have yet to fully materialise in the data - and that generally, the effects of migration are not immediately felt in the labour market. The migration observatory states that "there are still some falls to come due to the previous government's tightening of the rules, while the new white paper will have a smaller impact." Upcoming analysis on (1) employment patterns by nationality and (2) the Employer Skills Survey will explore these developments further.

Other than the potential labour shortages discussed above, migration falling at such pace also affects the housing picture. We might initially expect falling migration to pass through quickly to falling housing demand (and subsequent easing of rental pressures), but the picture is complex. London has a high reliance on non-UK construction workers, which could affect efforts to meet London's housing targets – hindering efforts to alleviate housing cost pressures.

Trade developments between the UK and the EU, India, and the US present improved trading relations

This month saw a number of trade deals for the UK of various scope and breadth. The 19th May UK–EU summit marked a modest but tangible shift in relations between the trading partners, with direct implications for London's economy.

- SPS Alignment: The agreement to pursue dynamic alignment on sanitary and phytosanitary (SPS) measures will ease food trade frictions that directly impact London's hospitality sector, as restaurants and hotels in the capital source a significant proportion of their stock from EU countries.
- Youth Mobility & Erasmus+: A proposed youth mobility scheme and steps towards rejoining Erasmus+ would boost London's labour supply pipeline. The Centre for European Reform estimates a youth mobility scheme could add 0.45% to UK GDP over a decade – and London's tech and creative sectors (facing acute skills shortages) stand to benefit immediately.

- ETS Linkage & Energy Cooperation: Plans to link emissions trading systems (ETS) between the UK and EU could protect London-based firms from future EU carbon border taxes, potentially saving UK exporters up to £800 million annually. Although these savings primarily impact firms in manufacturing (outside of London), the move supports London's ambitions to lead in green finance, providing a more stable pricing environment for "green" (ESG-aligned) investments.

These developments do not, however, address the broader frictions for London's professional services sector (a substantial portion of total output) - and without progress on reducing regulatory barriers (and the resulting increased compliance costs), the bulk of the post-Brexit cost-pressures are likely to persist, at least in London.

Elsewhere, despite stalled talks on a comprehensive free trade agreement, recent developments from April's UK-US Trade and Investment Council (TIC) meeting offer some targeted wins for the capital's economy. The TIC has so far prioritised regulatory dialogue in strategic areas rather than pursuing a full Free Trade Agreement (FTA), focusing on:

- regulatory cooperation in emerging sectors like AI, fintech, and quantum computing. This directly impacts London's tech sector, which attracted record venture capital in 2024.
- digital trade, including secure data flow frameworks, which are vital for London's financial and creative industries. A proposed "data bridge" could allow certified UK companies to transfer personal data to U.S. partners without extensive legal checks—crucial for London's fintech, legal tech, and creative industries. The city is home to over 3,000 fintech firms, and the sector accounted for £11 billion in revenue in 2023.

However, the absence of comprehensive federal-level market access continues to limit full-scale benefits - but sectoral cooperation is meaningful, especially in the sectors highlighted above.

Regarding goods with less relevance to the capital, the developments have led to the US agreeing a quota of 100,000 vehicles for UK automotive imports at a 10% tariff rate (and an accompanying arrangement for auto parts). The US has also agreed to construct a quota at most favoured nation (MFN) rates for UK steel and aluminium (and certain derivative steel and aluminium products).

Finally although the exact, legally-binding text of the UK-India FTA is yet to be finalised, it is expected to be substantial and is primarily expected to:

- eliminate or reduce tariffs on 90% of UK goods exports to India – and provide UK firms with access to India's public procurement market (estimated at over £38 billion annually).
- liberalise market access for UK financial, legal, and business services, providing a "level playing field" with Indian firms – and include provisions to support digital trade, intellectual property protection, and cross-border data flows.
- facilitate mutual recognition of professional qualifications, supporting labour mobility - and create targeted mobility routes for certain occupations (e.g. tech consultants, chefs, musicians), with streamlined visa processes and exemptions from dual social security contributions.

Department for Business and Trade analysis projects that the agreement will boost UK GDP by £4.8 billion annually in the long term, with bilateral trade expected to increase by £26 billion each year by 2040. Given London's status as the UK's primary hub for services exports (a key component of negotiations), the capital is poised to benefit substantially from this growth – with the City of London Corporation estimating that modest financial services liberalisation alone could boost exports by hundreds of millions annually.

US sovereign credit rating downgraded by Moody's

This month saw the credit ratings agency Moody's downgrade US government debt from triple A status by one notch to Aa1. Commenting on its decision it noted that "while we recognise the US's significant economic and financial strengths, we believe these no longer fully counterbalance the decline in fiscal metrics". With it adding "this one-notch downgrade on our 21-notch rating scale reflects the increase over more than a decade in government debt and interest payment ratios to levels that are significantly higher than similarly rated sovereigns". This means that for the first time in history none of the three main ratings agencies now rate US debt as triple A with S&P having downgraded it in 2011 and Fitch in 2023.

This month also saw the publication of the second estimate of US GDP for Q1 2025. This showed an annualised fall of 0.2% compared to an annualised increase of 2.4% in Q4 2024. However, this decline seems to have been driven by a rush by US companies to buy goods from abroad before the Trump administration's tariffs came into effect with US imports rising by an annualised 41% during the quarter.

The Trump administration's tariff policy was thrown into question on 28 May when a Federal court, the Court of International Trade, ruled that the President had exceed his powers in unilaterally imposing tariffs on nearly every country in the world.

Growing financial pressures on higher education providers

The annual report from the Office for Students (OfS) into the financial stability of higher education institutions has highlighted the increasing number of these institutions in the UK reporting financial deficits. Thus in 2024-25 45.2% were reported to be in deficit, up from 29.6% in the previous year. This is in part being blamed on weaker than expected international student numbers with OfS data showing numbers were 15.5% lower than forecast in 2023-24 with entrant numbers in 2024-25 expected to be 21% below what they had been forecast to be. Commentating on these deficits the OfS said that it showed that "significant reform and efficiencies" were needed in these institutions.

London's housing challenge: Sales stagnation and rental inflation

London's housing and rental market continue to place distinct pressures on Londoners. Anaemic price growth and cautious investment activity remains in the sales market, while tenants in the rental market face increasingly high rental inflation.

The ONS House Price Index reported London's average house price at £558,000 in March 2025, up 1% year-on-year. Halifax and Nationwide data for April shows similar rises (of 1.3% and 1.9% respectively). All three sources point to prices growth in London far below the rest of the UK regions. In the face of increases in supply and a more cautious buyer's environment, modelling from Knight Frank (industry experts) points to flat house price growth across London throughout 2025, with prices in central London actually modelled to fall 1.6% this year. On one hand, this means homeowners are seeing minimal-to-no returns on their purchases (with real-terms losses for some) - but on the other, cooling house prices maintains affordability levels for Londoners aiming to buy.

In the rental market, however, prices continue to soar. According to the ONS, average monthly rents in London reached £2,200 in April, increasing 8.4% on year. Knight Frank's most recent forecasts indicate a cumulative 5-year rental growth of over 17%, reflecting continued structural pressures on London's rental market. This intensifies cost-of-living pressures, pushing Londoners to spend increasing portions of their take-home pay on housing costs, rather than broader consumption.

London's labour market continues to show softness

Labour market conditions were little changed in the latest quarter, according to ONS data. While pay growth continues to be robust, unemployment remains at elevated levels and the number of payrolled employees in

London continued to drift lower from the high-point in mid-2024. That softness includes falling job numbers in some of London's key industries including IT, hospitality and construction, all of which have seen declines of over 3% in the last year.

Looking at the data in more detail the most timely estimate of payrolled employees (subject to revision) shows a fall of 15,900 (-0.4 percentage points (pp)) in the number of payrolled employees in London between March and April 2025, and a decrease of 0.9% on the year. London's unemployment rate was estimated at 6.2%, up on the three months to March 2025 and an increase of 1.6pp from a year earlier. The UK average was 4.5%. However, London's inactivity rate (the measure of those not looking and/or not available to work) was estimated at 20.7%. This was a fall of 1.1pp on the previous year, and a fall on the quarter. It is lower than the UK-wide estimate of 21.4%.

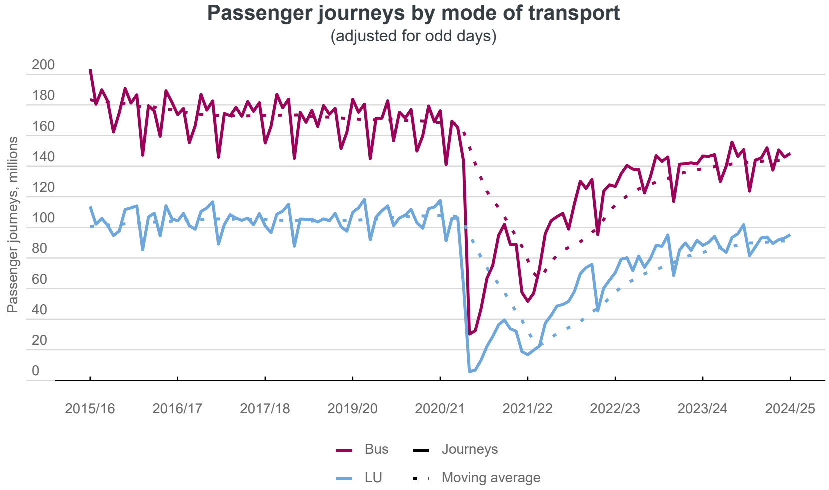
GLA Economics will continue to monitor all these and other aspects of London's economy over the coming months in our analysis and publications, which can be found on our publications page and on the London Datastore.

Economic indicators

The underlying trend in passenger journeys on London public transport marginally increased in July 2024

- In 2024, 243.5 million passenger journeys were registered between 23 June and 20 July, 4.7 million more than in the previous period. 238.9 million passenger journeys were registered between 26 May and 22 June.
- In the latest period, 95.2 million of all journeys were underground journeys and 148.3 million were bus journeys.
- The 13-period-moving average in the total number of passenger journeys rose marginally from 234.9 million in the previous period to 235.1 million in the latest period.
- Due to the cyber incident at TfL, the release of passenger journey data has been postponed. The next release date is yet to be confirmed

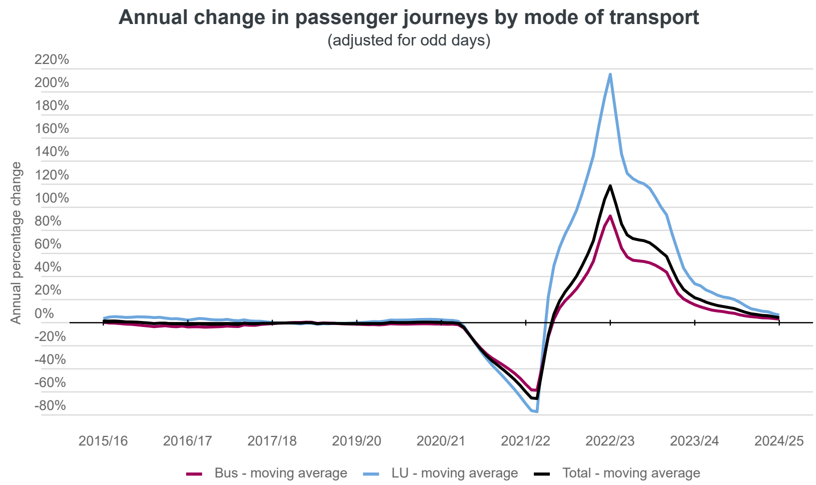
Source: Transport for London
Latest release: August 2024, Next release: TBC



Annual growth in passenger journeys remained positive, if slowing

- In 2024, the 13-period moving average annual growth rate in the total number of passenger journeys was 4.4% between 23 June and 20 July, down from 5.1% between 26 May and 22 June.
- The moving average annual growth rate of bus journeys decreased from 3.6% to 3.1% between the above-mentioned periods.
- Likewise, the moving annual average of underground passenger journeys decreased from 7.7% to 6.6% between those periods.
- Due to the cyber incident at TfL, the release of passenger journey data has been postponed. The next release date is yet to be confirmed.

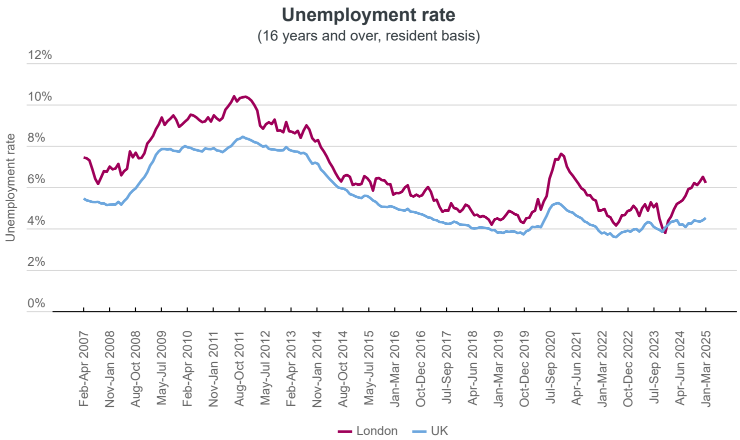
Source: Transport for London
Latest release: August 2024, Next release: TBC



London's unemployment rate fell over the last quarter

- Around 321,000 residents aged 16 and over were unemployed in London in the period from January 2025 to March 2025.
- The unemployment rate in London for that period was 6.2%, marginally up from 6.1% in the previous quarter (October 2024– December 2024).
- The UK's unemployment rate was 4.5% in this latest measured period, a slight uptick from the previous quarter.
- The Office for National Statistics cautions that significant volatility has been observed in recent periods, and short-term changes should be treated with vigilance and used in conjunction with other indicators.

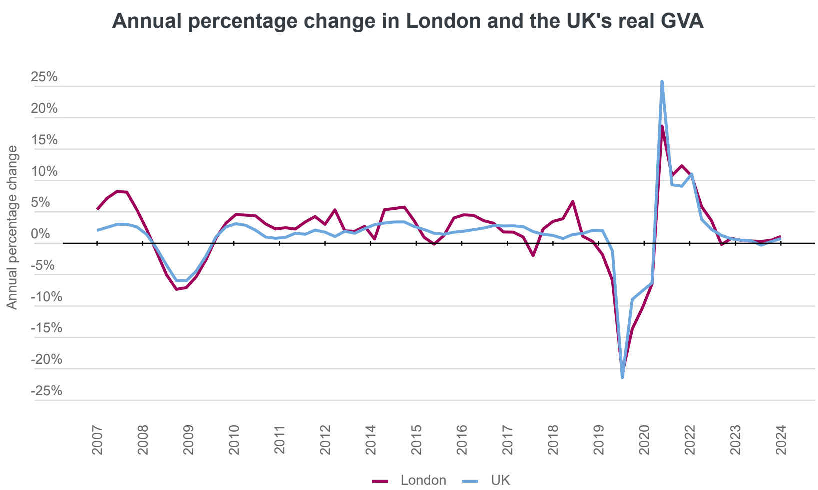
Source: ONS Labour Force Survey
Latest release: May 2025, Next release: June 2025



London saw growth in the first half of 2024

- London experienced two consecutive quarters of economic growth in the first half of 2024, with real Gross Value Added (GVA) increasing by 0.6% in both Q1 and Q2 2024.
- In 2023, London's real GVA grew by 0.5%, outperforming the UK's growth rate of 0.3%.
- London's economy returned to pre-pandemic levels in Q4 2022, aligning with the UK's overall recovery timeline. By Q2 2024, London's real GVA was 2.0% above its pre-pandemic level (Q4 2019), though this remains below the UK's overall increase of 2.9%.
- London's real GVA quarterly estimates for the period Q1 1998 to Q4 2012, and from Q4 2022 onwards have been produced by GLA Economics. Estimates for the intervening period are based on outturn data from the ONS, which has not published up-to-date quarterly estimates for London's real GVA for the other periods.

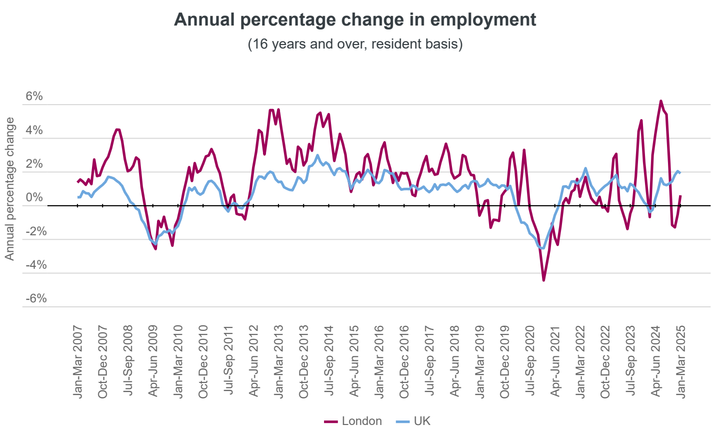
Source: ONS and GLA Economics calculations
Latest release: December 2024, Next release: June 2025



London's year-on-year employment growth rate was positive in the quarter to March 2025

- Around 4.8 million London residents aged 16 and over were in employment during the three-month period from January 2025 to March 2025.
- London's annual change in employment saw an increase of 0.6% in the year to this quarter, compared to the fall of -1.1% in the year to the previous quarter.
- The UK as a whole continues to experience employment growth, with a 1.9 % annual increase in employment in this quarter, a slight downtick from 1.5% in the previous quarter.
- The Office for National Statistics continues to caution the significant volatility observed in recent periods, and short-term changes should be treated with vigilance and used in conjunction with other indicators.

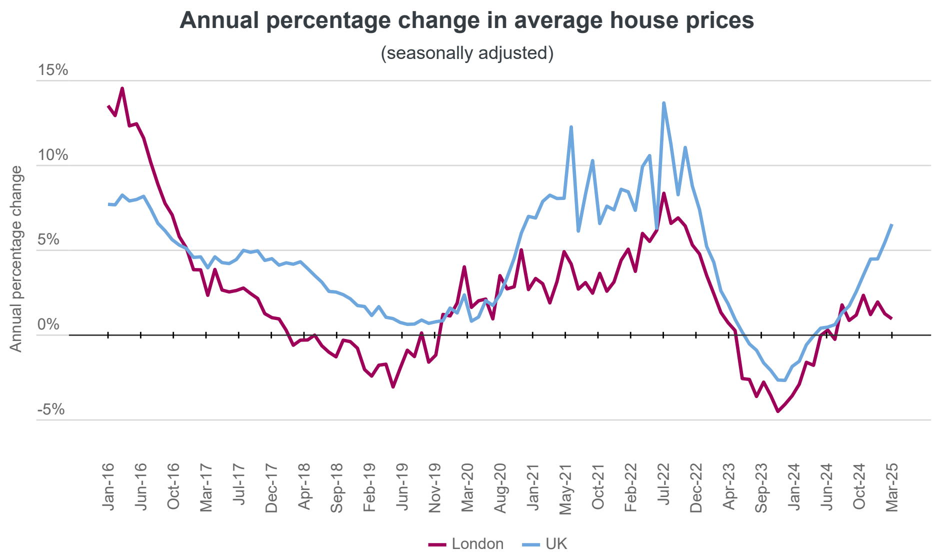
Source: ONS Labour Force Survey
Latest release: May 2025, Next release: June 2025



On an annual basis house prices increased in London in March 2025

- In March 2025, the average house price in London was £558,000 while in the UK it was £273,000.
- Average house prices in London rose by 1% year-on-year in March, lower than the increase of 1.3% in February.
- Average house prices in the UK rose by 6.5% on an annual basis in March, higher than the increase of 5.5% in the year to February.

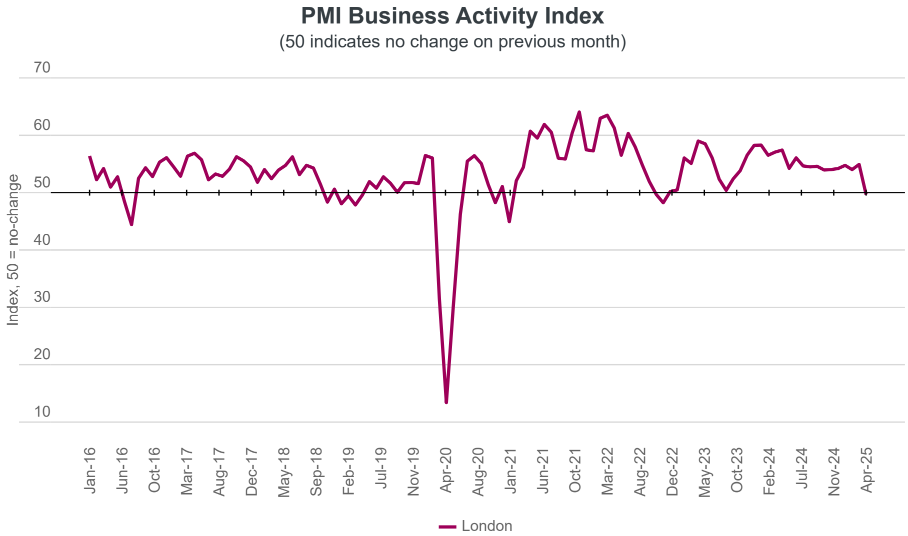
Source: Land Registry and ONS
Latest release: May 2025, Next release: June 2025



In April, the sentiment of London's PMI business activity index decreased

- The business activity PMI index for London private firms decreased from 54.9 in March to 49.7 in April, thus showing a marginal contraction in business activity in the month.
- The Purchasing Managers' Index (PMI) survey shows the monthly business trends at private sector firms. Index readings above 50 suggest a month-on-month increase in activity on average across firms, while readings below 50 indicate a decrease.

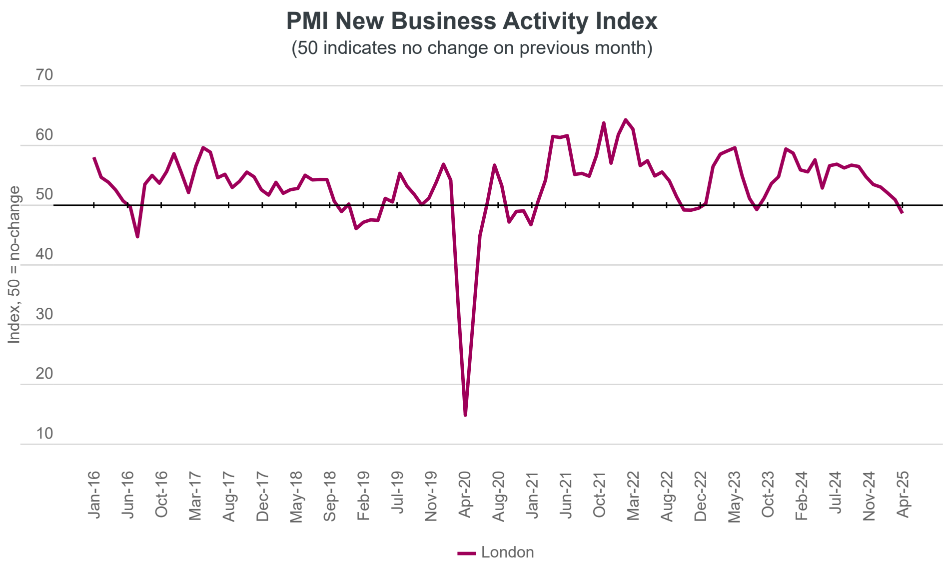
Source: IHS Markit for NatWest
Latest release: May 2025, Next release: June 2025



In April, the sentiment of London's PMI new business activity decreased and turned negative

- The PMI new business index in London decreased from 50.9 in February to 48.6 in March.
- An index reading above 50.0 indicates an increase in new orders on average across firms from the previous month.

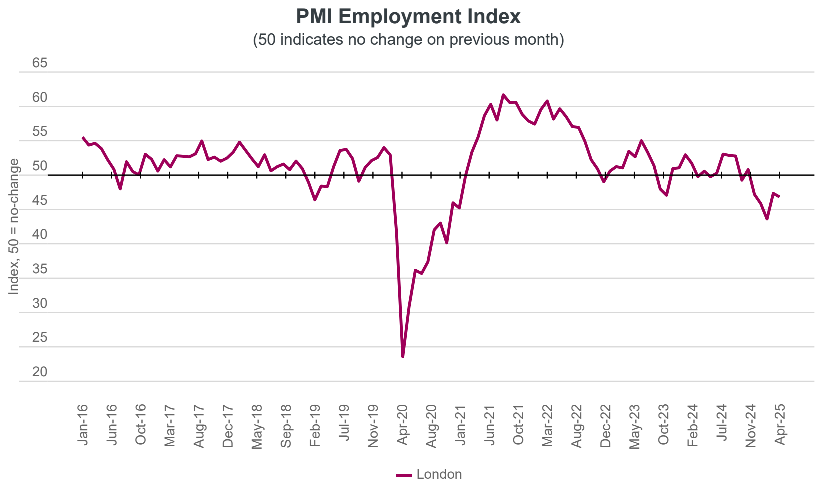
Source: IHS Markit for NatWest
Latest release: May 2025, Next release: June 2025



In April, the sentiment of the PMI employment index in London fell

- The Employment Index for London fell from 47.3 in March to 46.8 in April.
- The PMI Employment Index shows the net balance of private sector firms for the monthly change in employment prospects. Readings above 50.0 suggest an increase, whereas a reading below 50.0 indicates a decrease in employment prospects from the previous month.

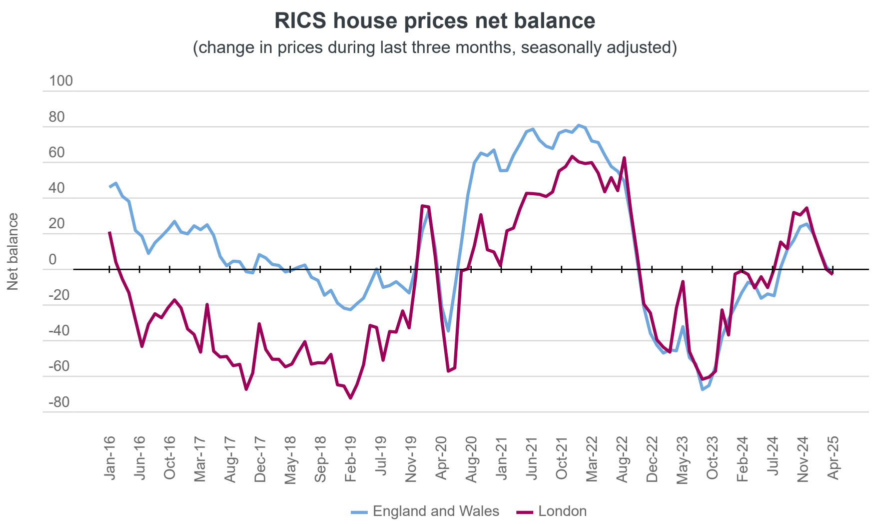
Source: IHS Markit for NatWest
Latest release: May 2025, Next release: June 2025



Marginally less than half of all property surveyors in London reported house price increases in April

- In April, more property surveyors in London reported falling prices than rising prices. The net balance index was -3, down from 0 in March.
- The net balance index measures the proportion of property surveyors reporting a rise in prices minus those reporting a decline.
- For England and Wales, the RICS house prices net balance index dropped from 2 in March to -3 in April.

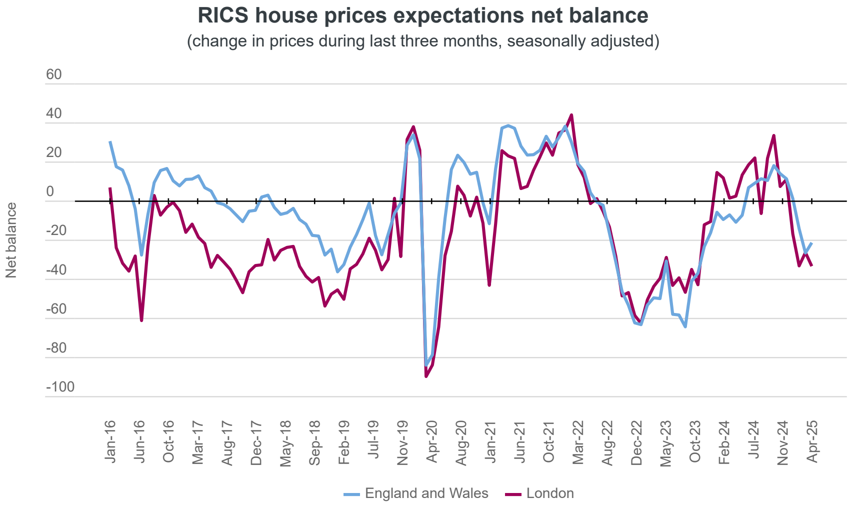
Source: Royal Institution of Chartered Surveyors
Latest release: May 2025, Next release: June 2025



In April, over half of all property surveyors expressed negative expectations for house prices in London over the next three months

- The net balance of house prices expectations in London was -33 in April, down slightly from -26 in March.
- The net balance index measures the proportion of property surveyors reporting a rise in prices minus those reporting a decline.
- The index for England and Wales was -21 in April, up slightly from -26 in March.

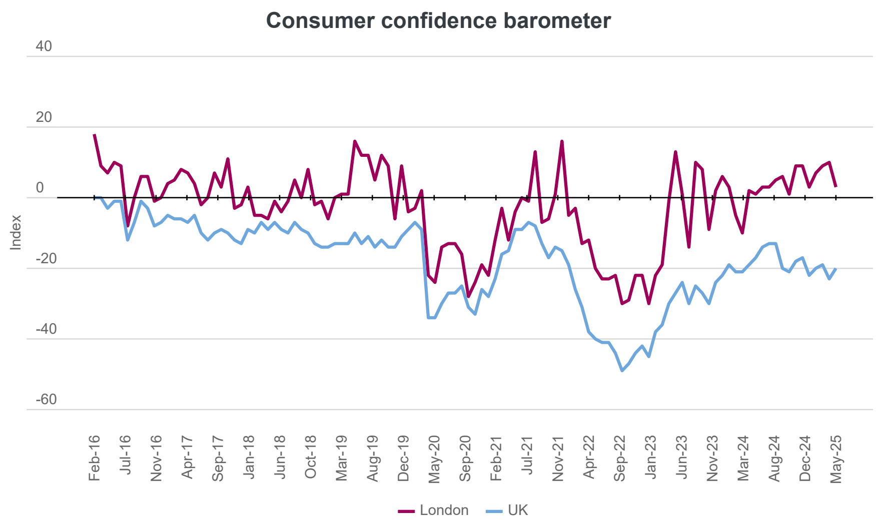
Source: Royal Institution of Chartered Surveyors
Latest release: May 2025, Next release: June 2025



Consumer confidence in London slows in May

- The consumer confidence index in London slowed from 10 in April to 3 in May.
- The GfK index of consumer confidence reflects people's views on their financial position and the general economy over the past year and in the next 12 months. A score above zero suggests positive opinions; a score below zero indicates negative sentiment.
- The sentiment for the UK rose slightly from -23 in April to -20 in May. The UK has not seen a positive index score since January 2016.

Source: GfK
Latest release: May 2025, Next release: June 2025



The Sectoral Composition of UK Investment: Divergences Abound!

By **Adam Yousef**, Senior Manager

It is commonly acknowledged that the UK in general, including London, has experienced low rates of investment especially since the 2008 Financial Crisis. This idea, however, masks divergences in the sectoral composition of UK investment over the past 25 years, which in some cases contributed to that relative slowdown.

In a previous supplement to this publication (also published as a blog on the London Datastore) we have examined investment in London and how it compared to that of other UK regions as well as the capital's international peers. This supplement provides a detailed breakdown of investment by sector and asset, instead of focussing solely on source. It will do so, looking at the UK using a combination of recent experimental data from the Office for National Statistics (ONS) as well as the OECD.

Before delving into the details, it is worth reminding ourselves of the definitions used by the ONS[1] to define certain important terms:

- **GFCF**: an estimate of net capital expenditure by both the public and private sectors.
- **Business investment**: Net capital expenditure by businesses within the UK; they exclude expenditure on dwellings and the costs associated with the transfer of ownership of non-produced assets, and capital expenditure by local and central government.
- **Chained volume, seasonally-adjusted data**: This supplement will only look at chained volume, seasonally-adjusted GFCF data as it would adjust for the impact of inflation over time as well as reveal underlying movements rather than incorporate seasonal variation in investment. For example, retailers typically hold more inventories in the run-up to Christmas and government organisations tend to spend more in Quarter 1 of each year at the end of the financial year. The seasonally-adjusted data removes such effects.

Figure A1 presents detailed definitions of asset types defined by the ONS.

1 Taken from: ONS (2017). 'A short guide to gross fixed capital formation and business investment'.

Figure A1. Definition of Asset Types

Published Asset	Includes	Definition	Examples (N.B. not exhaustive)
Dwellings	Dwellings	Dwellings are buildings, or designated parts of buildings, that are used entirely or primarily as residences, including any associated structures, such as garages, and all permanent fixtures customarily installed in residences	Houses, mobile homes and caravans. However, it should be noted that dwellings does not include prisons, boarding schools or hospitals
Transport	Transport equipment	Transport equipment consists of any equipment used to move people and objects.	Motor vehicles, trailers, ships, trains, trams, aircraft, motorcycles, and bicycles
Intellectual property products (IPP)	Research and development	This is the value of expenditure on creative work to increase the stock of knowledge, which developers can market or use for their own benefit when producing goods and services.	Development of software programs or design for a new aircraft
	Mineral exploration	This is the value of expenditure on exploration for petroleum and natural gas and for non-petroleum deposit and the subsequent evaluation of the discoveries made.	License and acquisition costs, appraisal costs, costs of test drilling and boring
	Software and Databases	Software consists of computer programs and supporting systems for both systems and application software.	Packages such as Microsoft Office and VLC Media Player
	Entertainment	This consists of the original films, recordings, manuscripts, tapes, etc which drama performances, radio, television programmes, sporting events and etc are recorded and embodied.	Films, tapes, recordings, radio and television programmes and books
Other buildings and structures and transfer costs	Other buildings	Other buildings are buildings that are not dwellings. This includes industrial buildings, commercial buildings, educational buildings and health buildings.	Schools, hospitals, prisons, religious, sport, amusement and community buildings
	Transfer costs	Transfer costs, sometimes known as cost of ownership transfer, are the costs associated with buying or selling an asset	Transportation costs, legal fees and stamp duty.

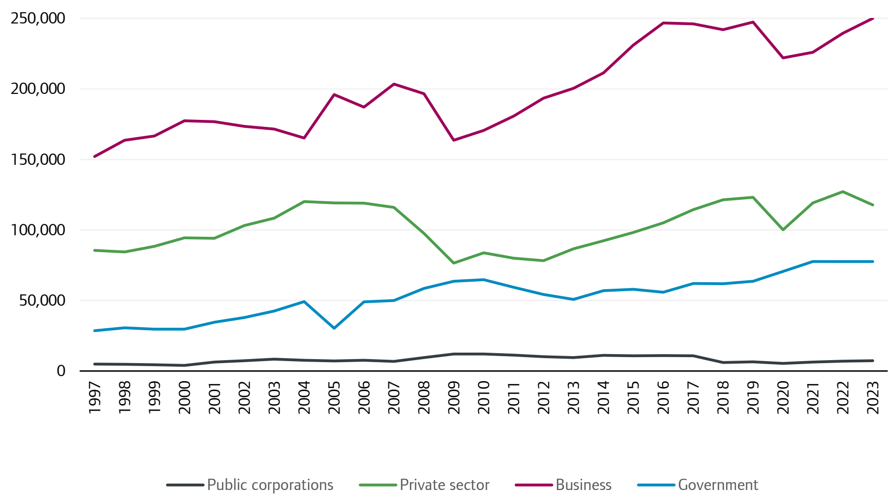
Published Asset	Includes	Definition	Examples (N.B. not exhaustive)
Information and communication technology equipment (ICT) and other machinery and equipment	ICT	This mainly consists of computer hardware and telecommunications equipment such as computers and mobile phones	Computers, laptops, mobile phones and gaming consoles
	Other machinery and equipment including weapons	Other machinery and equipment consists of all equipment and machinery that is for general or special use. General use machinery includes engines, turbines, ovens, etc. Special use machinery includes machinery for mining, domestic appliances, agricultural equipment, etc	Typically large electronic equipment (e.g. equipment used in the production of goods and services)
	Cultivated	Cultivated assets are livestock for breeding (including fish and poultry)	Livestock not for slaughter, orchards, vineyards, dairy draught

Source: ONS

UK Investment by Sector

The ONS presents seasonally-adjusted data on annual gross fixed capital formation by sector. Sectors include business, government, public corporations, and private sector (excluding private business). Figure A2 looks at investment (in real terms) by sector over a 26-year period from 1997 to 2023.

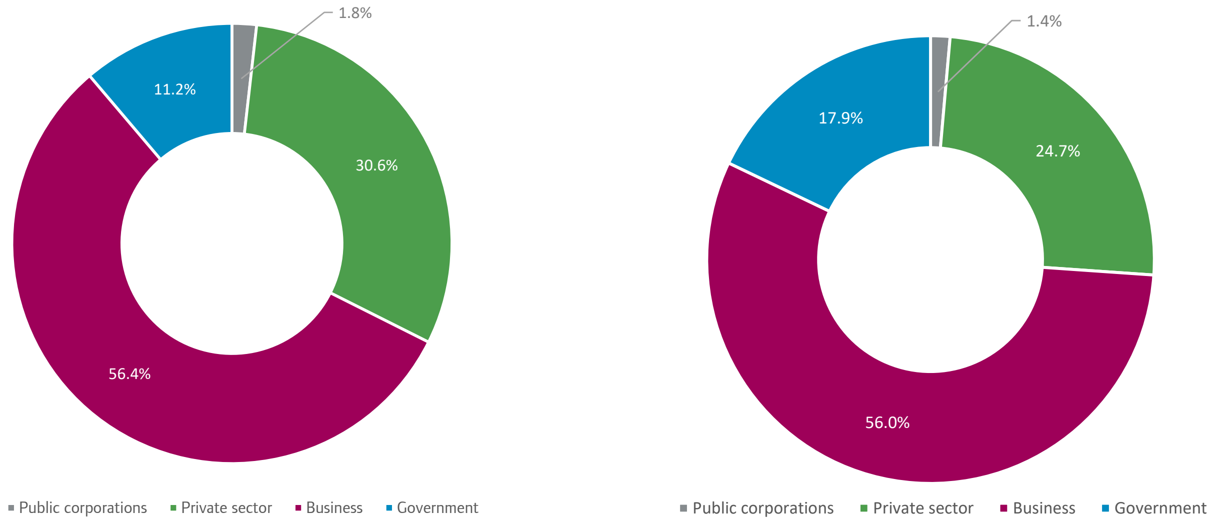
Figure A2: GFCF by sector in real terms



Source: ONS Note: Inflation-adjusted in £2022 millions

Over the past 25-30 years, businesses have been the major sector in terms of investment volume, comprising more than 50% of total gross fixed capital formation in the UK in each and every year. In fact, in 1997, businesses were responsible for 56% of UK GFCF, and that is the percentage for 2023. That said, the sectoral composition of said investment is quite different when examining the trends for other sectors, as the pie charts in Figure A3 reveal.

Figure A3: Sector composition of UK investment (1997 (left) and 2023 (right))



Source: ONS

These figures show that between the late 1990s and 2023, two shifts occurred in UK GFCF:

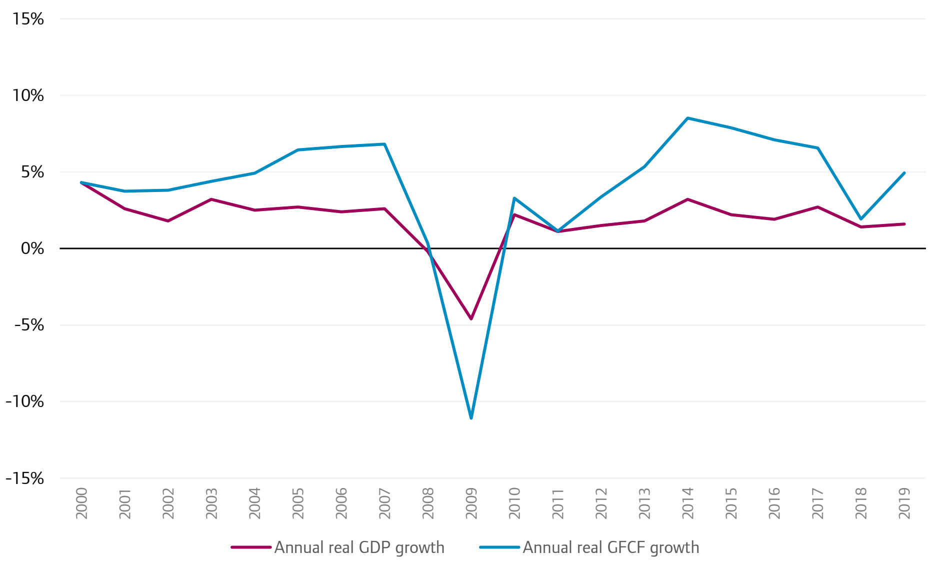
The share of government investment has risen by nearly 7 percentage points, and

The share of other private investment (excluding private businesses) decreased by nearly the same number of percentage points.

Therefore, the past 25 years or so have seen a growing role of government investment in the UK economy, while private sector investment (particularly in dwellings) diminished. It is important to note, meanwhile, that the UK's public-sector productivity has been generally flat since 2008 (and this has contributed to the country's poor overall productivity record). This would suggest that the increased share of government investment has not facilitated productivity growth, and thus it did not help the country reverse its poor GDP growth especially since the Financial Crisis.

Figure A4 reveals the growth rates of both GFCF and national GDP (in real terms) from 2000 to 2019. Broadly speaking, there's a correlation between growth in investment and GDP. However, that correlation is stronger and clearer prior to the Financial Crisis. Since then, the relationship has weakened; this would suggest that the Financial Crisis introduced additional variables or factors that have 'diluted' the role of public and private investment in boosting growth.

Figure A4: Growth of real GDP and real GFCF (2000-2019)



Source: ONS

Earlier, it was noted that the share of government investment out of total investment grew by nearly 7 percentage points between the late 1990s and 2023. Looking at government investment exclusively, it grew by nearly 180% in real terms between 1997 and 2023. This compares to a 73% growth rate in total investment over the same period, 72% in business investment, and 39% for private investment.

That said, despite the increase in share of government investment in recent years, the UK still underperforms the OECD average. Figure A5 presents government investment as a share of total GFCF by OECD country for 2019, and the UK lagged most G7 countries (except Italy and Germany).

Figure A5: Government investment as a % of total GFCF by G7 country

Source: OECD

This also seems to corroborate data from the Office for Budget Responsibility's (OBR) 2020 Economic and Fiscal Outlook[2], which showed that when it comes to government investment,

"the UK was consistently positioned within the bottom quarter in terms of government investment as a share of GDP – more specifically, it was ranked between 23rd and 27th out of 30 countries in every year. UK government investment was a little higher as a share of GDP in 2017 than in 2007, having first risen during the crisis then fallen back. The large increase over the next five years will take it to around the present OECD median. But it will still fall well short of levels in countries whose governments invested most over the past decade – in South Korea, Estonia and Latvia investment averaged around 5 per cent of GDP a year".
- OBR EFO March 2020 page 100.

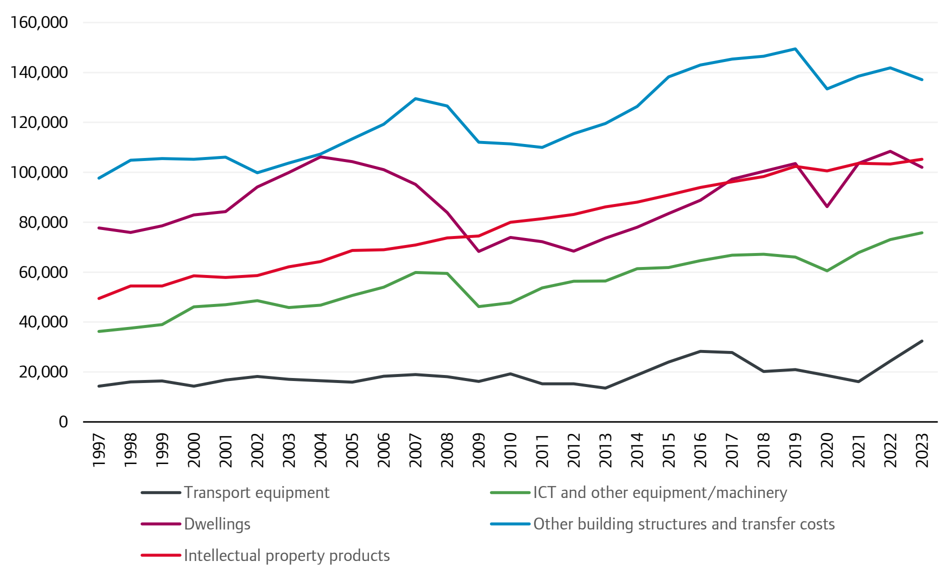
There are two takeaways from this:

- Despite the UK increasing its share of government investment, this has not translated effectively into growth over the past 15 years.
- Despite that increase in share, the UK still lags the OECD average and most other G7 countries.

UK Investment by Asset

In addition to examining the data by sector, it is worth looking at the asset composition of UK investment. ONS data breaks down GFCF investment by the following five asset types: transport equipment, ICT equipment and other machinery/equipment, dwellings, other building structures and transfer costs, and intellectual property products. Figure A6 looks at real investment by asset from 1997 to 2023.

Figure A6: GFCF by asset

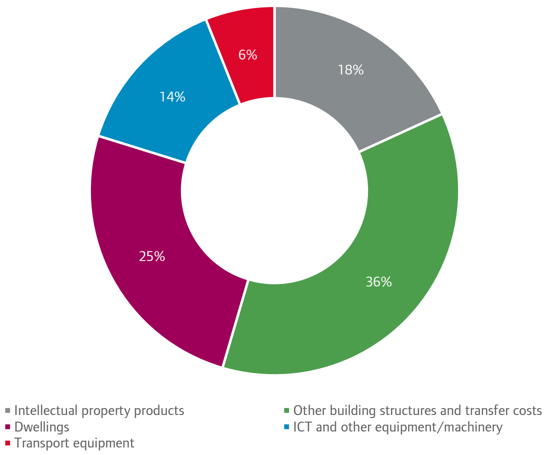


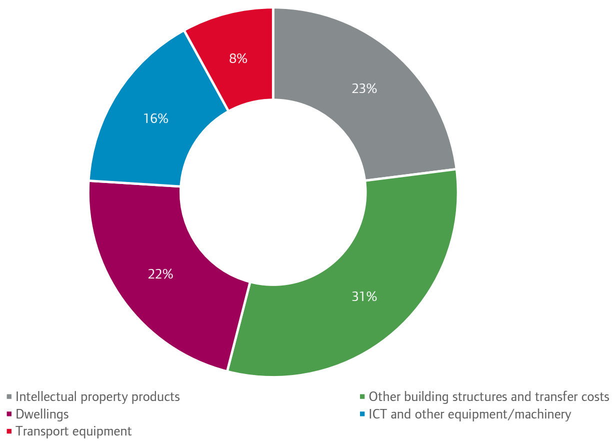
Source: ONS, Notes: Inflation-adjusted in £2022 millions

Over that period, dwellings and other building structures represented at least 50% of investment assets in each year. That said, their share of total investment dropped from 63% in 1997 to 53% in 2023. With that in mind, the asset composition of said investment is quite different when examining the trends for other assets, as the pie charts in Figure A7 reveal.

2 OBR (2020). 'Economic and fiscal outlook – March 2020'.

Figure A7: Asset composition of UK investment (1997 (left) and 2023 (right))



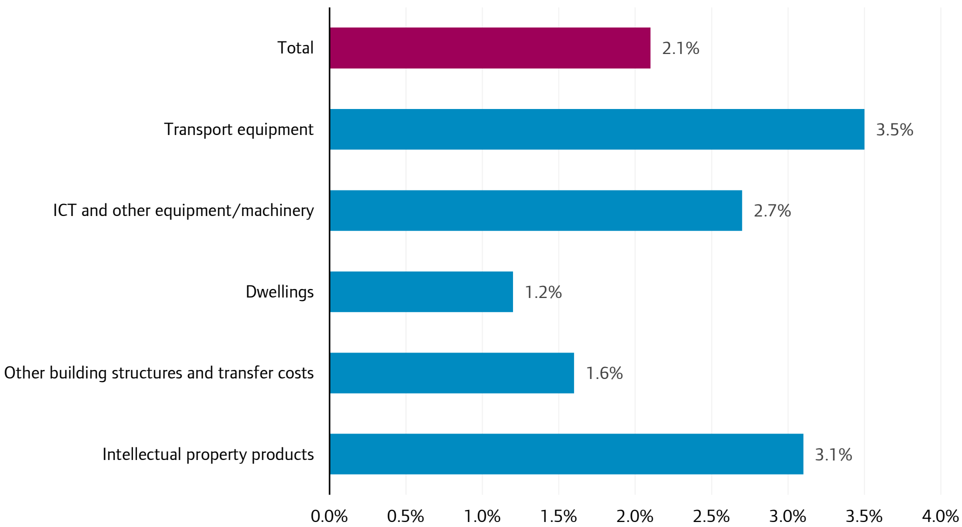


Source: ONS

The pie charts show that between 1997 and 2023, the share of dwellings and other buildings has decreased, whilst being offset by investment in machinery, transportation, and intellectual property. This could reflect, in part, the UK economy's changed industrial structure away from manufacturing towards professional services over the past several decades. An economy that relies more heavily on service provision would likely benefit from greater investment in assets that support this type of activity.

Figure A8 looks at the annual growth rate of investment by asset type between 1997 and 2023. Total GFCF (in real terms) grew annually by 2.1% over that period; to put this in context, this compares to an annual real GDP growth rate of 3.6% between 2000 and 2019. Meanwhile, the annual growth rates in real GFCF differ by asset type: investment in transport equipment, for example, grew annually by 3.5% in real terms. Intellectual property investment, meanwhile, grew by 3.1%. At the other end of the spectrum, investment in dwellings grew by 1.2%, while that for other buildings grew by 1.6% annually- which explains their declining share of total GFCF over the course of the 26-year period.

Figure A8: Annual real growth rate of investment by asset type (1997 to 2023)



Source: ONS

Looking at investment by asset type again, the share of investment in transport, machinery, and intellectual property offset the drop in the share of investment in dwellings and other buildings. In particular, investment in intellectual property has grown by 5 percentage points in real terms, whilst experiencing a 119% growth in total; this is only exceeded (in percentage terms) by the 142% growth in investment in transport equipment over that period.

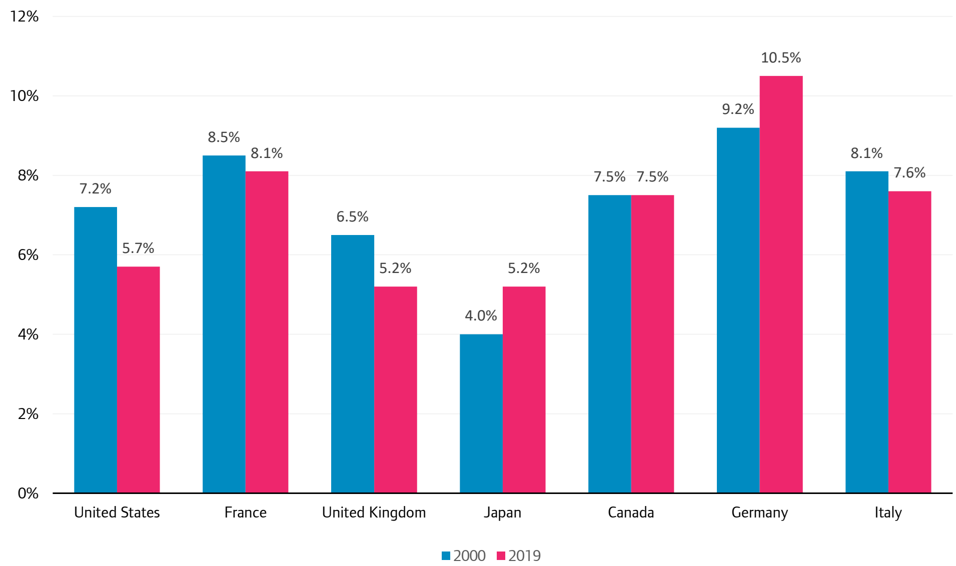
Finally, a comparison of investment breakdowns by asset across the G7 in 2000 and 2019 reveal a few interesting trends (see Figures A9 and A10):

While the share of UK investment in intellectual property has increased over the past 25 years, that investment as a share of total GFCF remains lower in the UK than it is in all G7 countries except Japan; that ranking has not changed in 2019 compared to 2000.

Investment in transportation as a share of total GFCF remains lower in the UK than it is in all other G7 countries (tied in last place with Japan).

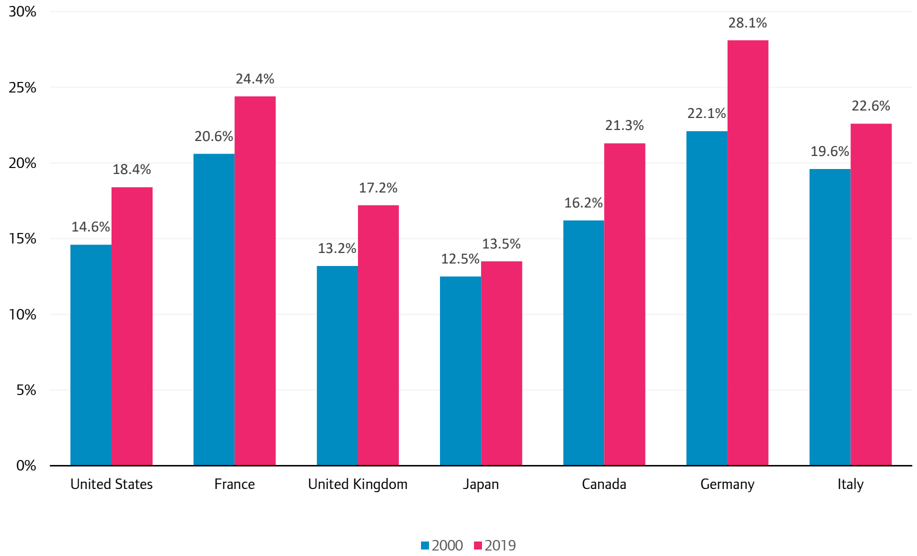
This would suggest that the UK relies more on investment in other building structures than other G7 countries.

Figure A9: Investment in transport as a % of total GFCF by G7 country (2019 vs. 2000)



Source: OECD

Figure A10: Investment in intellectual property as a % of total GFCF by G7 country (2019 vs. 2000)



Source: OECD

With all this in mind, there are a few takeaways:

- The asset composition of UK GFCF, while still disproportionately reliant on dwellings and other buildings, has shifted towards investment in transport, machinery and intellectual property over the past 25 years.
- That said, the asset composition of UK GFCF differs slightly from that of most other G7 countries. Building structures still compose a large share of total GFCF in the UK, and the country's share of investment in transport and intellectual property still lags that of most other G7 countries (as it has been since 2000).

The afore-presented takeaways potentially point to the challenges facing the UK as it attempts to promote productivity and growth via greater investment. While investment by asset type is transitioning away from dwellings and other buildings towards assets that lend themselves to supporting the country's service-based economy (especially transport and intellectual property), there has been little in the way of evolution by sector over the past 25 years, with government slightly increasing its share at the proportionate expense of private entities. That said, the challenges become more apparent when comparing UK GFCF with that of other G7 and OECD economies. In one sense, the UK differs from other G7 countries when it comes to the investment mix by sector and asset, with a reliance on asset types (e.g., other building structures) that these other countries broadly do not share. In addition, the amounts invested (whether as a percentage of GDP or per capita) tend to lag the averages for both the OECD and G7 economies.

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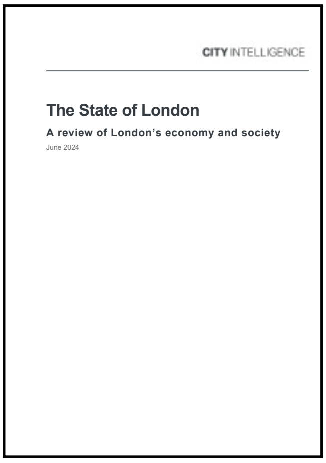

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