

Bank of England

Mind the Gap

Unpacking the puzzle of
income growth and weak
consumption in the UK and
other mysteries

Swati Dhingra

Knoop Lecture (18 November 2025)

I would like to thank Donal McVeigh, Jack Welling and Emily Fry for their assistance in preparing these materials.



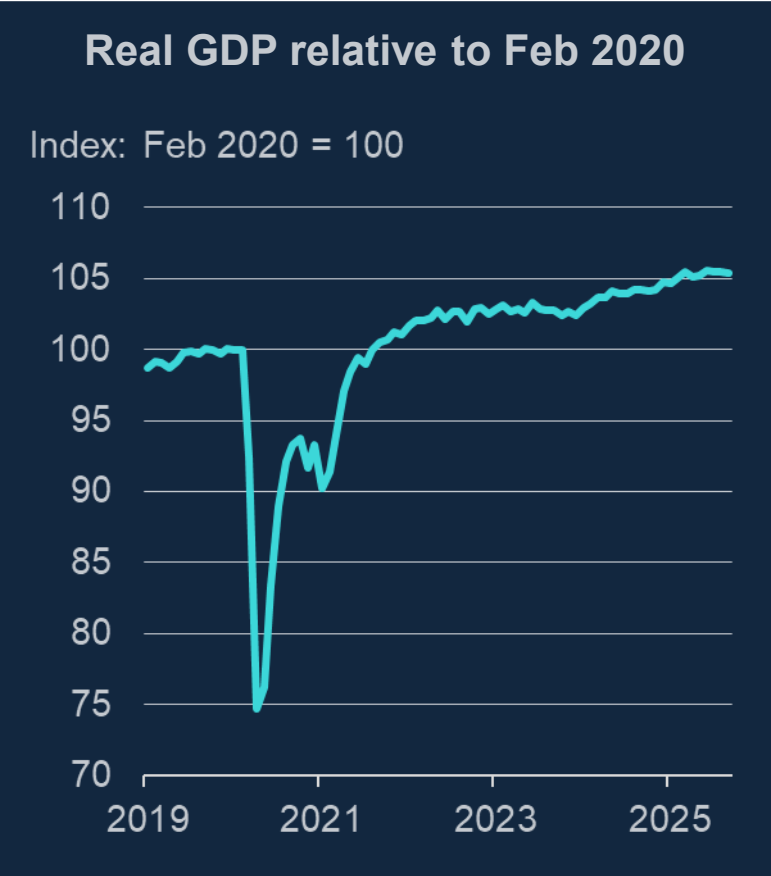


Mind the Gap

**Bridging evidence gaps through
research to inform policymaking**

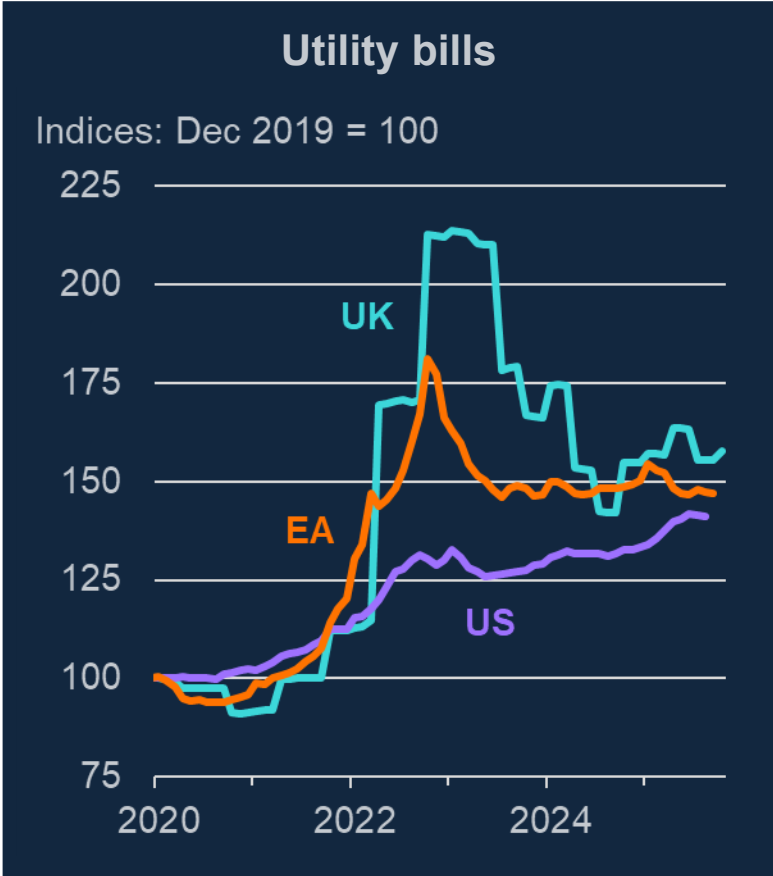
Understanding the economy and designing policy is hardest when it is needed the most – during turbulent times

Covid-19 pandemic



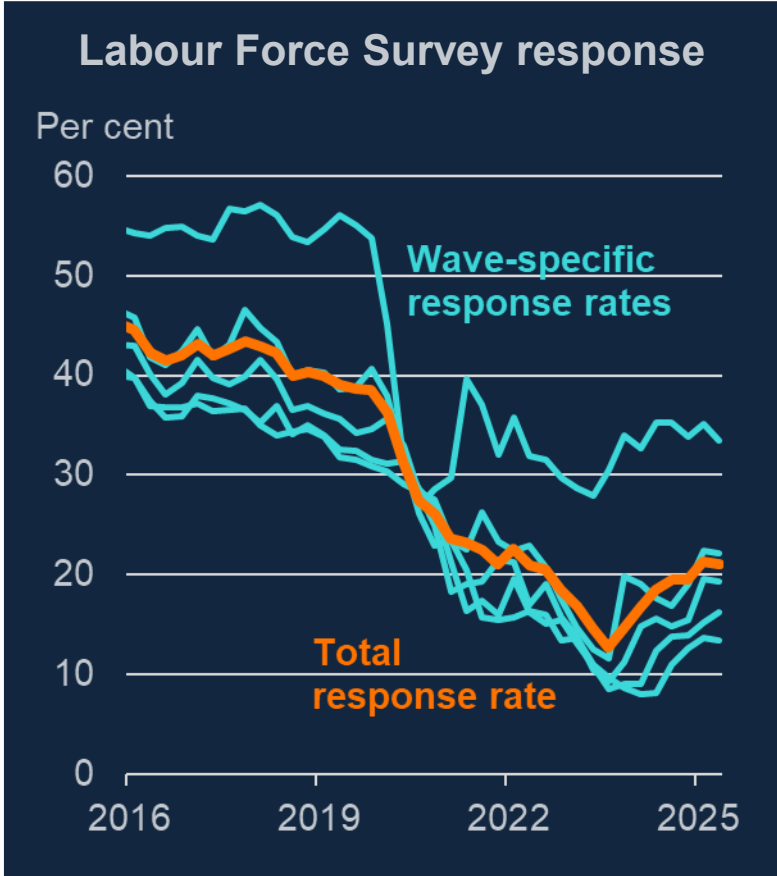
Source: ONS and Bank calculations.
Latest data: 2025 Q3.

Energy price shock



Source: LSEG Datastream, ONS and Bank calculations.
Latest data: September 2025.

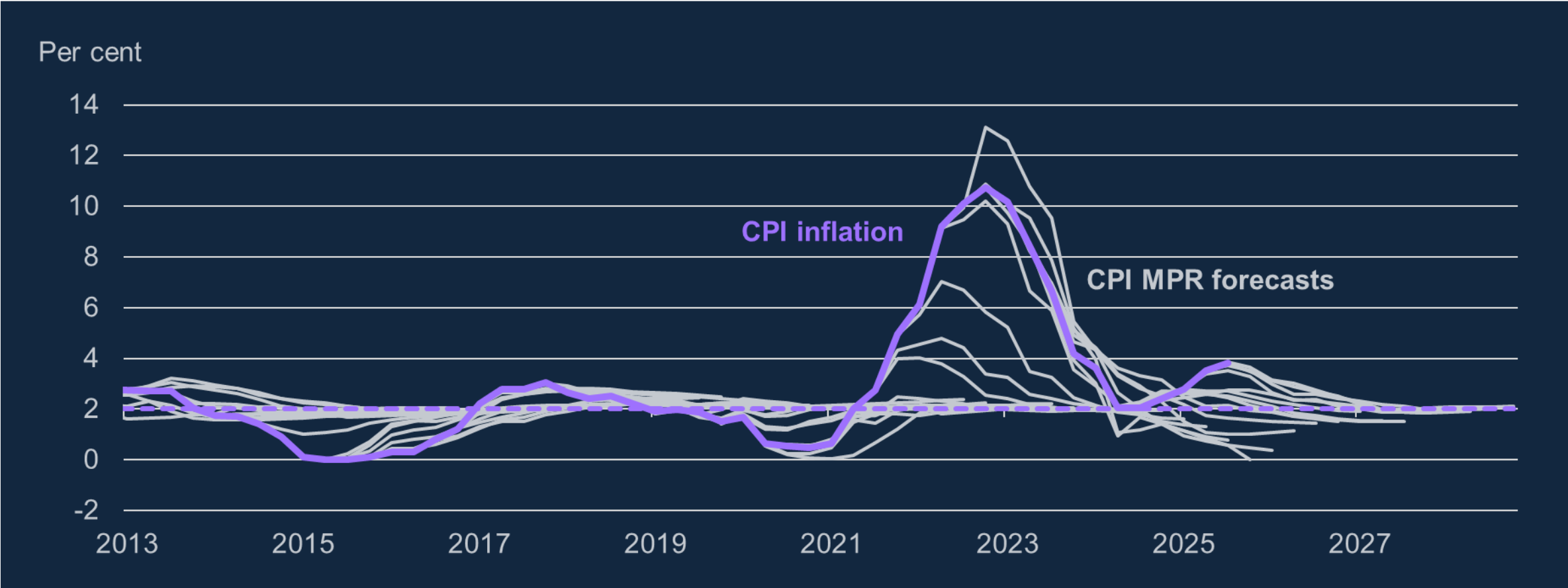
Data fog



Source: ONS and Bank calculations.
Latest data: 2025 Q2.

While the shocks could not have been anticipated, successive forecasts during the inflation surge consistently undershot outturns on the way up

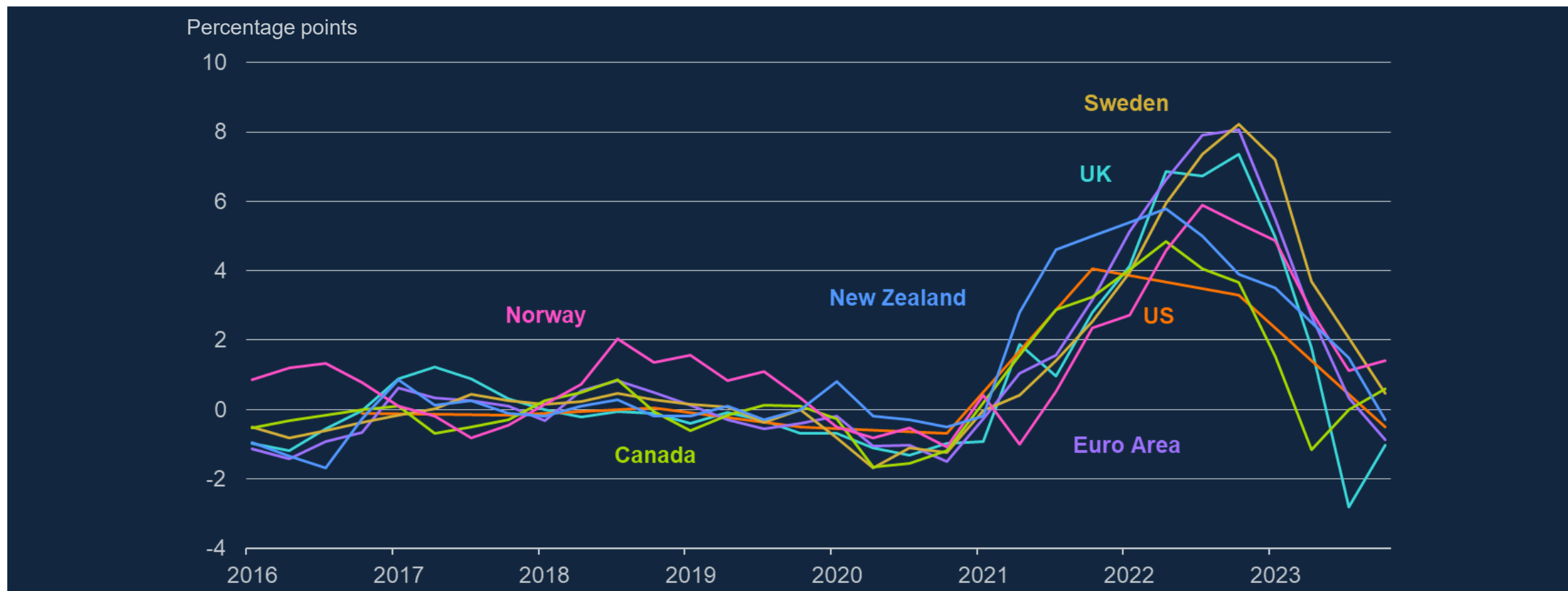
Successive CPI MPR forecasts, versus actual outturns



Source: ONS and Bank calculations. Latest data: November 2025 Monetary Policy Report (MPR).

Forecast errors across central banks (and private forecasters) were relatively similar despite differences in modelling

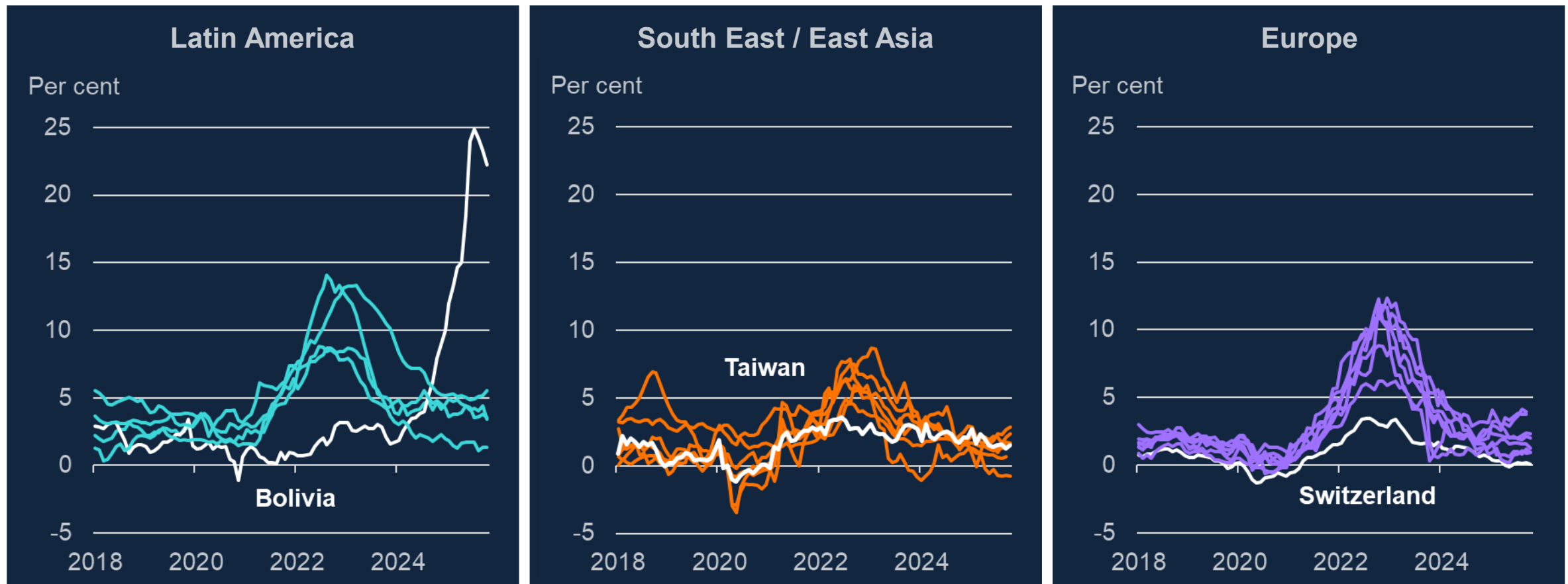
Inflation, one year ahead forecast errors, 2015-23



Source: [Forecasting for monetary policy making and communication at the Bank of England: a review | Bank of England](#)

Unconventional policy tools performed better in some cases in containing the inflation surge

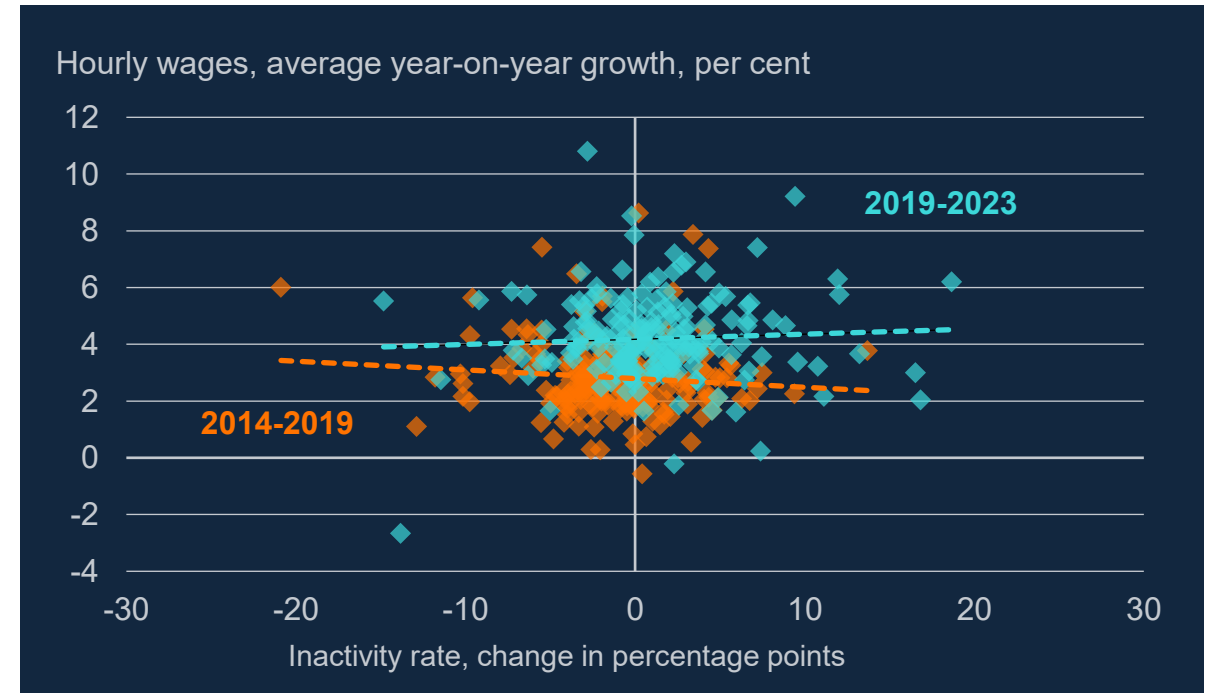
Headline consumer price indices' growth, international comparison



Source: LSEG Datastream and Bank calculations. See Coibion and Gorodnichenko (2025) for more detail. Latest data: September 2025.

Research can bridge evidence gaps that distort policy: Example

- “The Bank of England appears to pin rising inactivity on a ‘change to the supply of labour, independent of demand’. According to this view, such a fall in labour supply would then put upward pressure on wages. This could in turn contribute to further cost-push inflation at a time of already double-digit inflation. If true, this can be seen as justification for a policy of raising interest rates.”
- In fact, areas where inactivity rose by more experienced smaller wage growth, not larger.



Notes: Each dot in the scatter plot represents a Travel to Work Area in the UK: shows rise in inactivity (from APS) on the x-axis and average growth rate in hourly wages (from ASHE) on the y-axis (2013-2023).

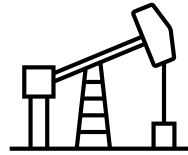
A Rich Vein or Fool's Gold? Research, not tweaks to forecasts or communications, can bridge evidence gaps that distort policy

- Experimenting with different assumptions and risks in a forecasting apparatus can help think through uncertainties, but forecasts are even more error-prone in turbulent times.
- **Credible research design and measurement**, not tweaks to **forecasting models or communications**, can bridge evidence gaps that distort economic policy and skew narratives.
- As the Bank undertakes reforms, this is an appropriate place to reiterate this message and highlight where research could bridge the evidence gaps that obscure our understanding of the economy today.

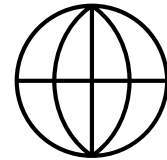
Three areas of discussion today for bridging evidence gaps



Unpacking the puzzle of income growth and weak consumption in the UK



Developing central bank toolkits to assess and prepare for global shocks and supply shocks



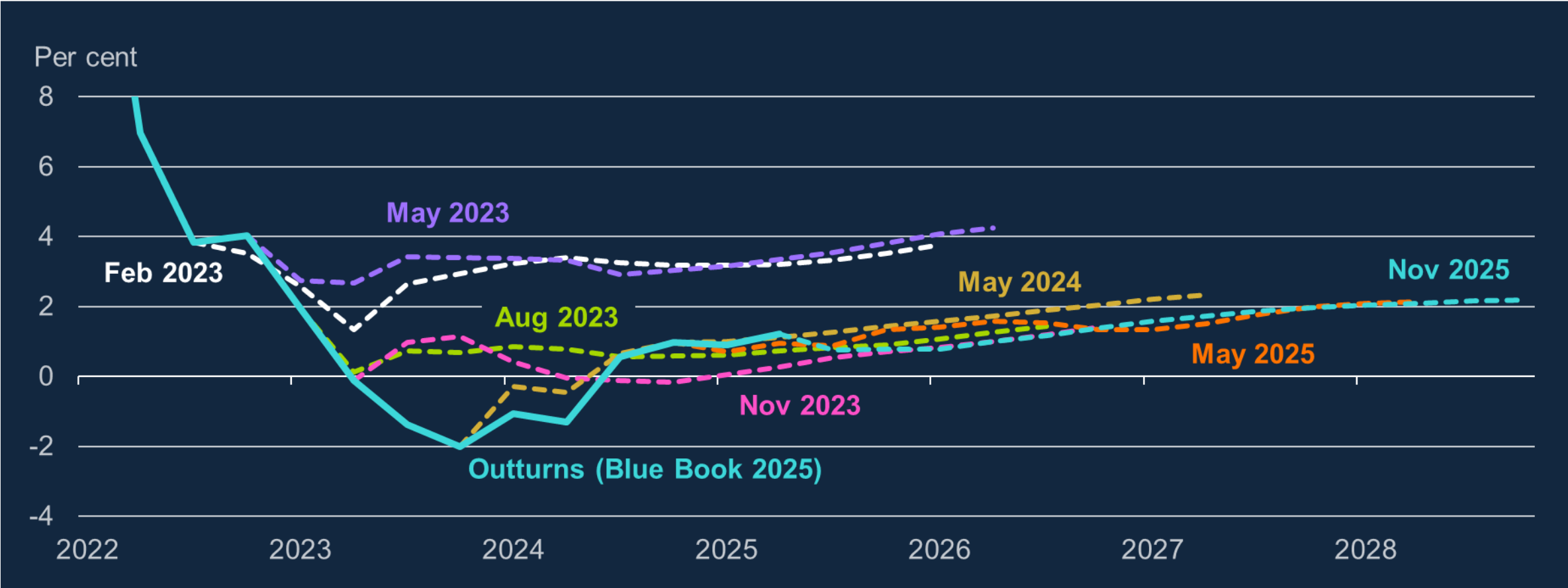
Understanding the effects of deglobalisation and the new world economic order



The puzzle of income growth and weak consumption in the UK

Consumption growth has been consistently weaker than forecast

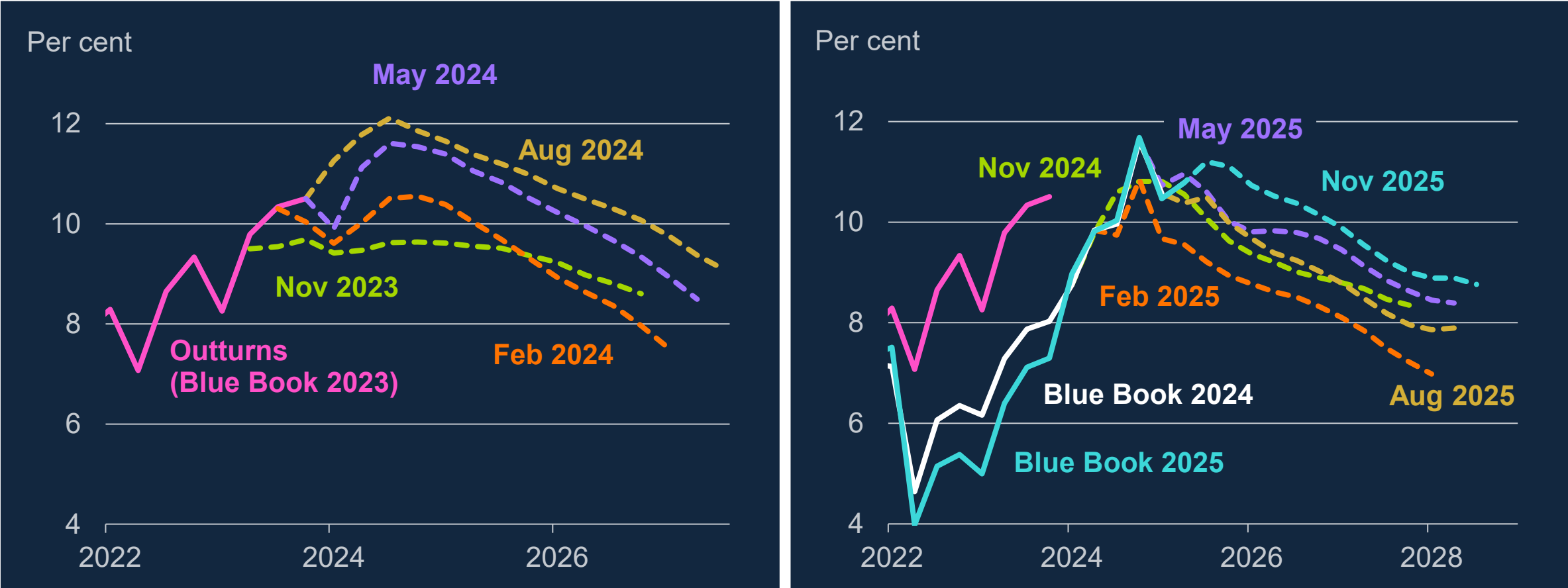
MPR consumption forecasts, year-on-year growth



Source: ONS and Bank calculations. Latest data: November 2025 Monetary Policy Report.

Alongside expectations for the saving ratio to fall back, which hasn't materialised

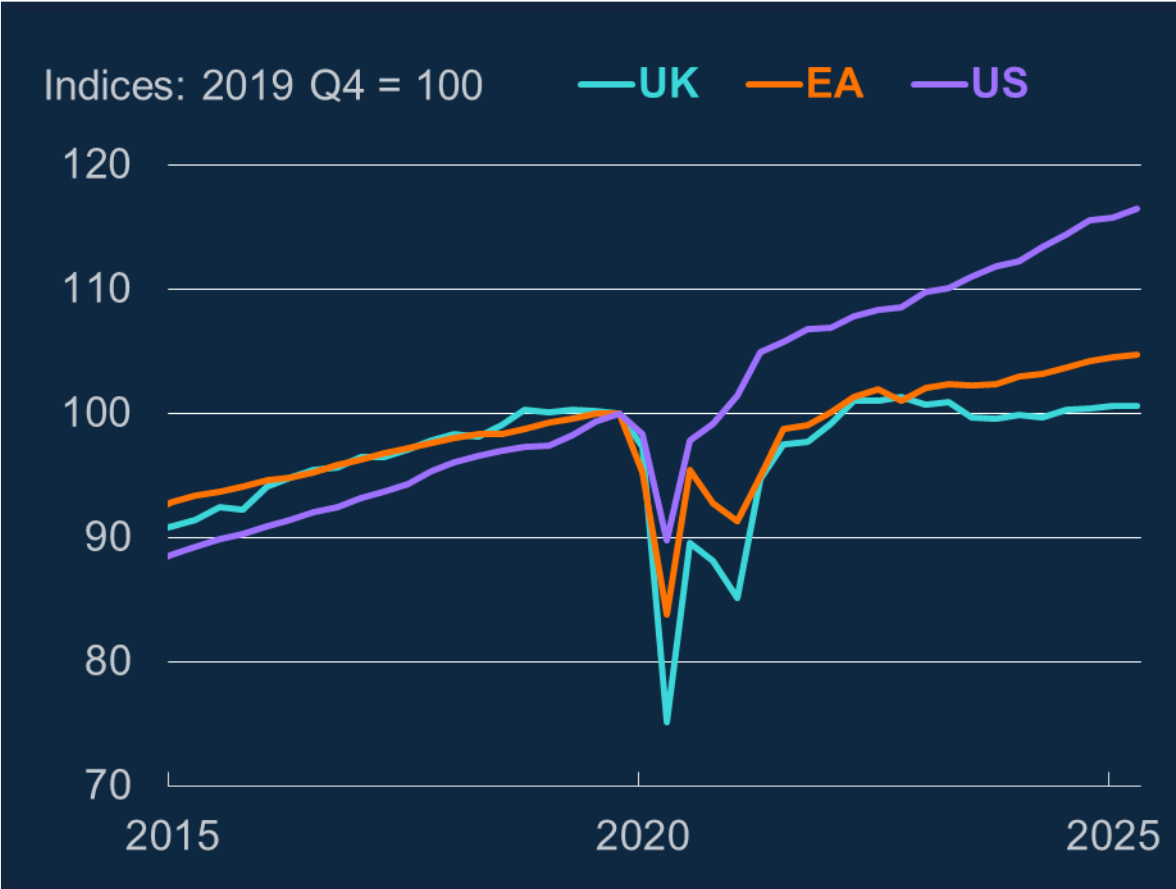
Households' saving ratios across Blue Book and forecast vintages, per cent



Source: ONS and Bank calculations. Updated chart from Mann (2025). Latest data: November 2025 Monetary Policy Report.

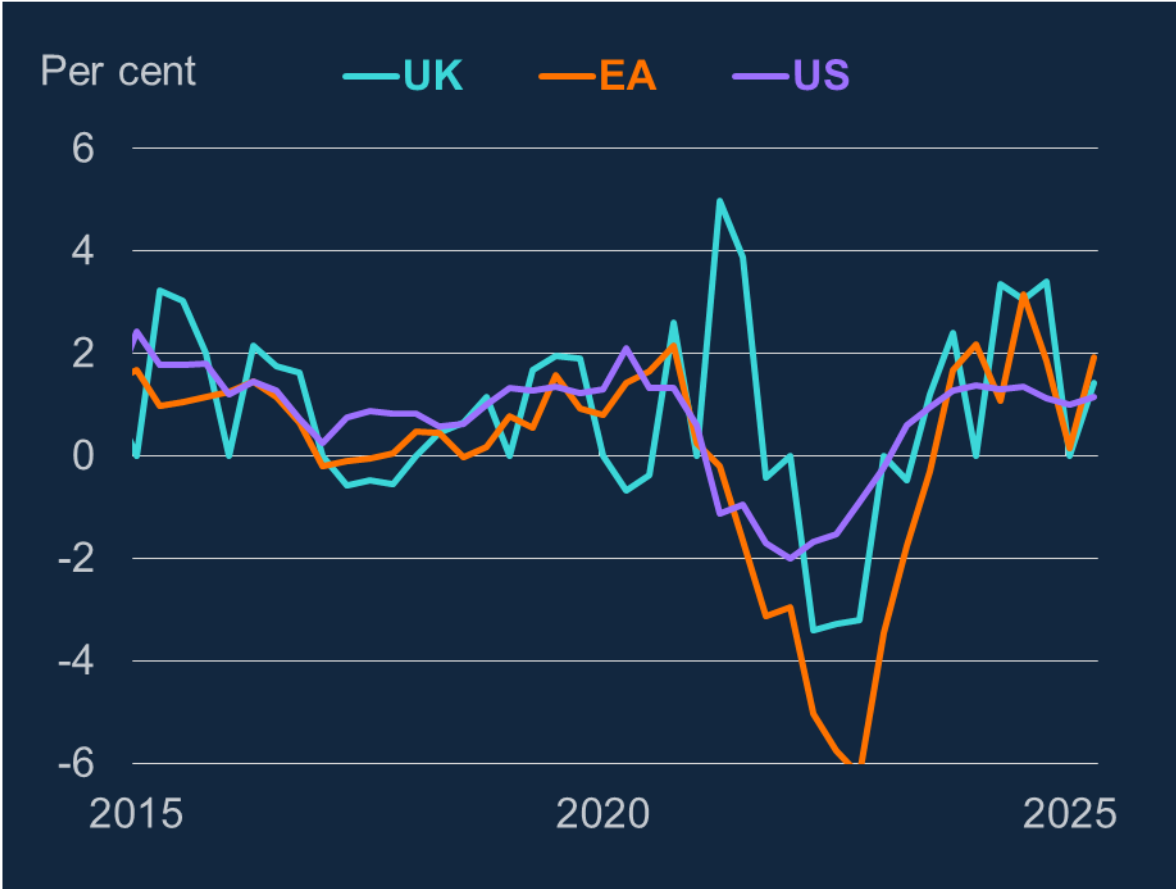
Consumption has been weaker than peers, despite similar real wage growth

Real consumption evolution



Source: Bureau of Economic Analysis, Eurostat, ONS and Bank calculations.
Latest data: 2025 Q3 (UK), 2025 Q2 (EA, US).

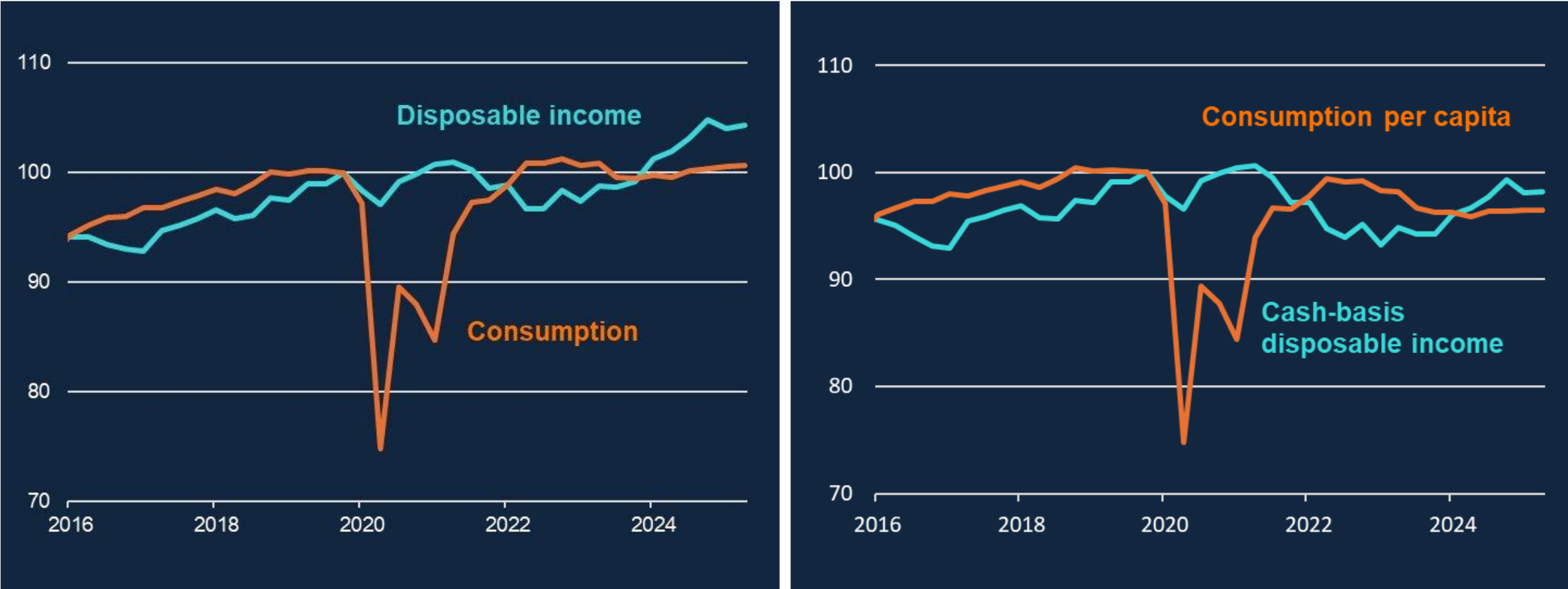
Real private sector / negotiated wages, four-quarter growth



Source: Bureau of Economic Analysis, Eurostat, ONS and Bank calculations.
Latest data: Q3 2025 (UK), Q2 2025 (EA, US).

And persistently diverged from households' disposable income

Households' consumption and disposable income, inflation-adjusted levels



Source: ONS and Bank calculations. Latest data: Q2 2025.

Why does understanding the consumption puzzle matter?



Channels through which Bank Rate impacts consumption

Intertemporal substitution

Cash-flow

Housing channel

Financial wealth effect

**Value of debt
Fisher effect**

Indirect labour income

How do the explanations matter for the outlook for consumption?



Tighter monetary policy, and so will pick up with lower interest rates



Past high inflation experience causing persistent, maybe even structural changes, in consumption/saving behaviour



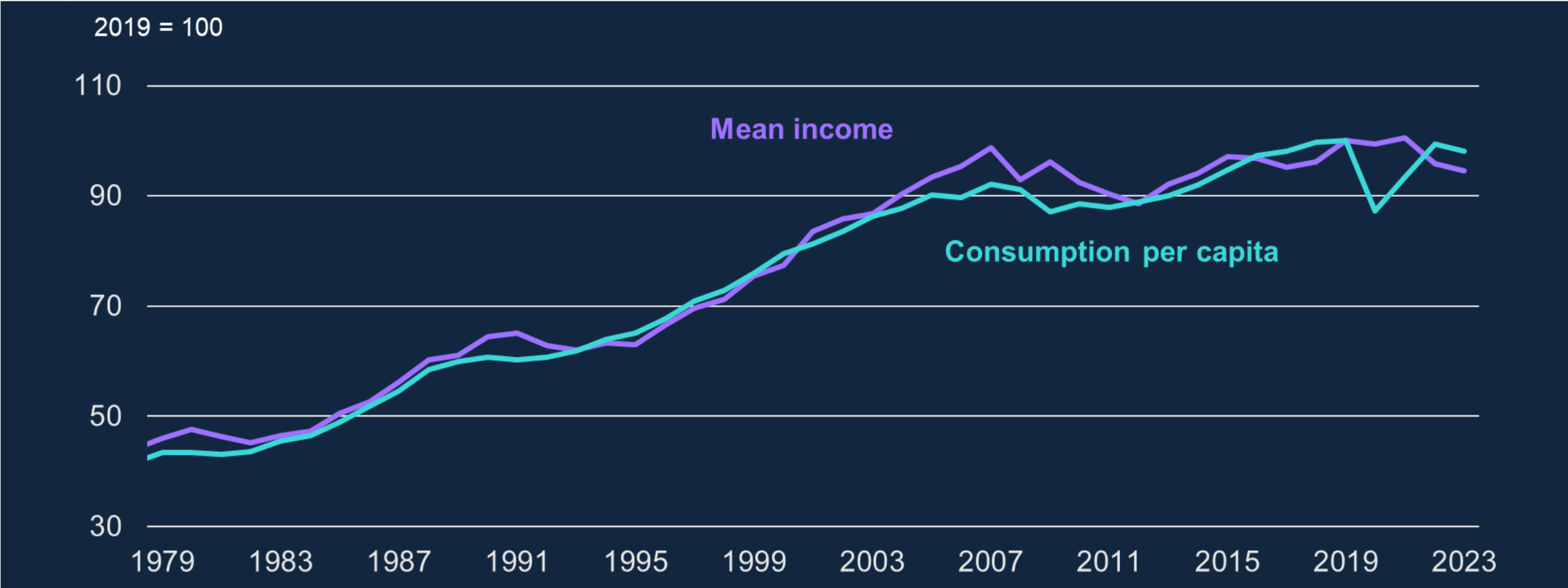
Increased uncertainty/risk causing households to do more precautionary saving, so likely to not pick up if uncertainties continue



Re-building wealth that has been eroded by inflation, and so should pick up as inflation falls

Is there really a consumption puzzle? Not in the microdata where disposable incomes are just as weak as consumption

Real disposable income and real household final consumption (per capita)

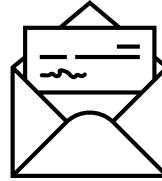


Source: ONS and Bank calculations. Latest data: 2023/24.

How to assess the evidence? Let's look at each component of **Consumption + Savings = Disposable Income/Price**



Let's get the denominator right:
Prices faced by households for their consumption baskets



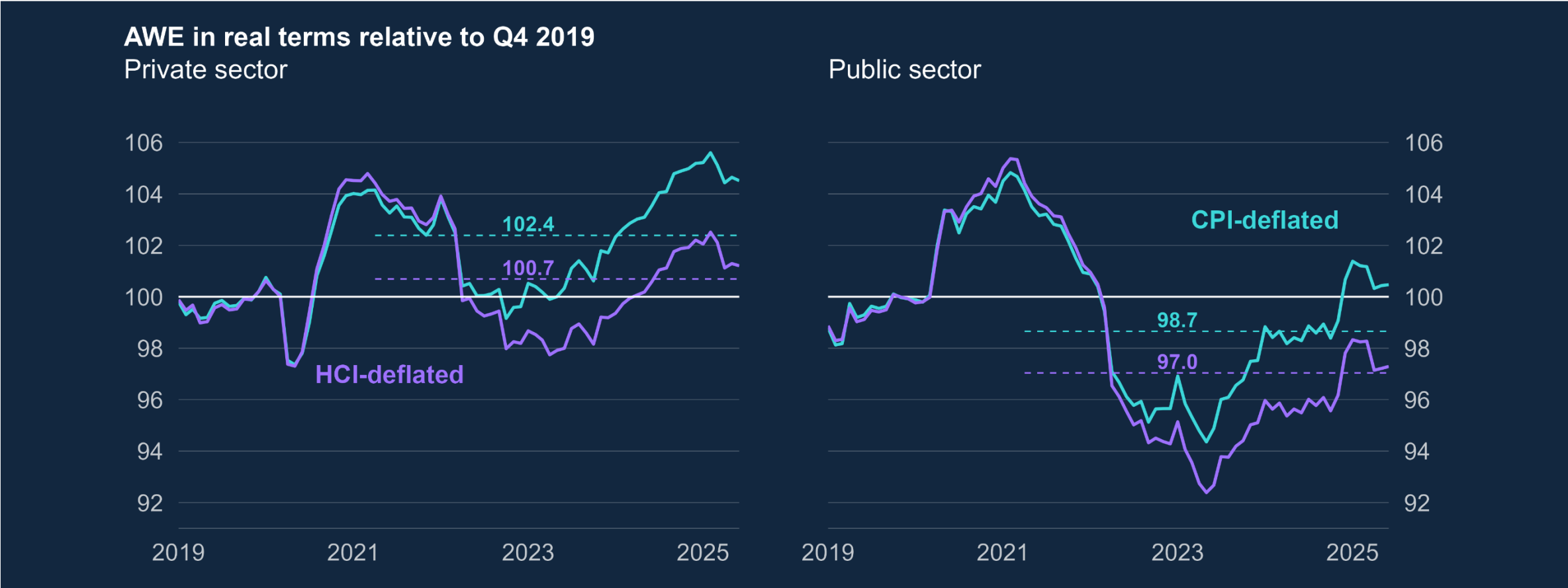
Let's get the numerator right: Incomes are not just from wages, but also from benefits and other sources



Let's use Savings as a cross-check on real income minus consumption

Let's get the denominator right: Household costs from spending microdata is less optimistic on a real wage recovery

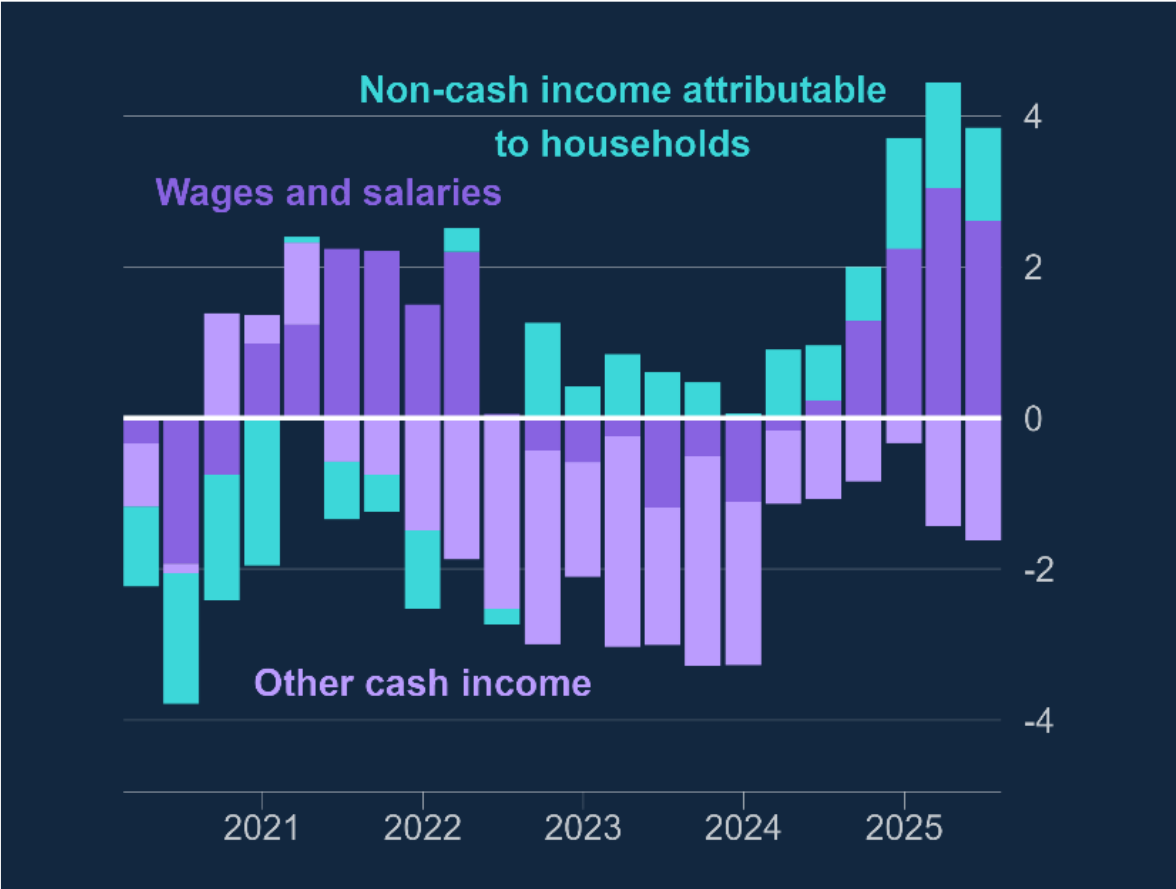
Level of real AWE relative to Q4 2019



Source: ONS and Bank calculations. Latest data: June 2025.

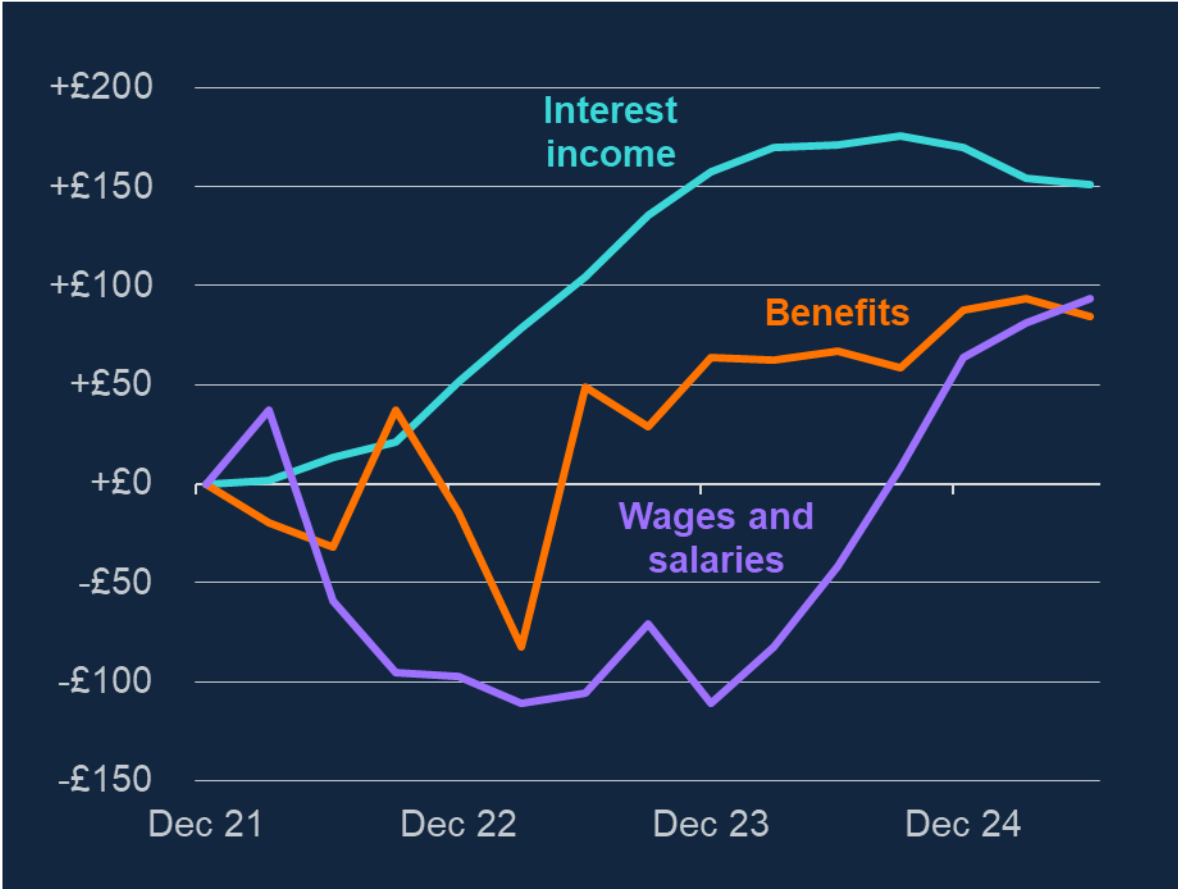
Let's get the numerator right: Only interest income has grown consistently during the consumption puzzle period

Contributions to growth in real income since 2019 (per cent)



Source: ONS and Bank calculations. Latest data: Q2 2025.

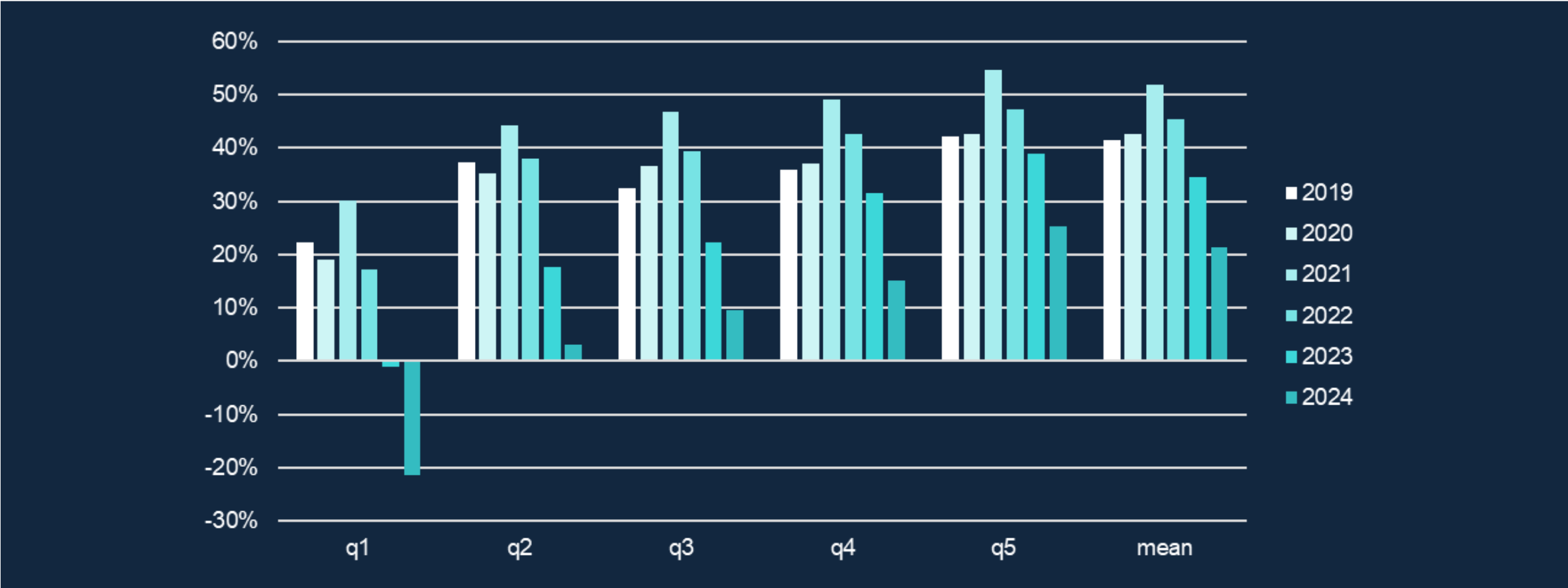
Real change in income per person by source (since Q4 2021)



Source: ONS and Bank calculations. Latest data: Q2 2025.

Let's cross-check with savings: no uptick in savings during the consumption puzzle period in income and spending microdata

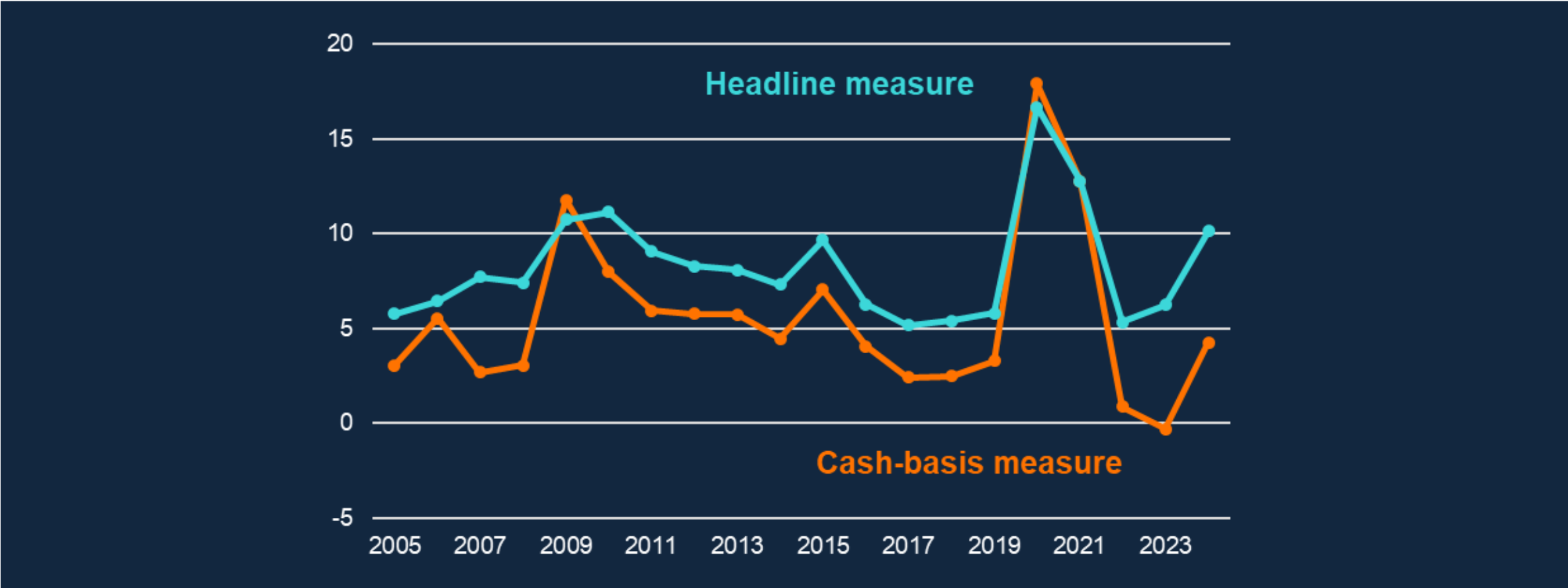
Household saving ratio, by income quintile, financial year



Source: ONS and Bank calculations. Latest data: FYE 2024.

And seemingly high saving ratios look more muted for cash measures of incomes less spending

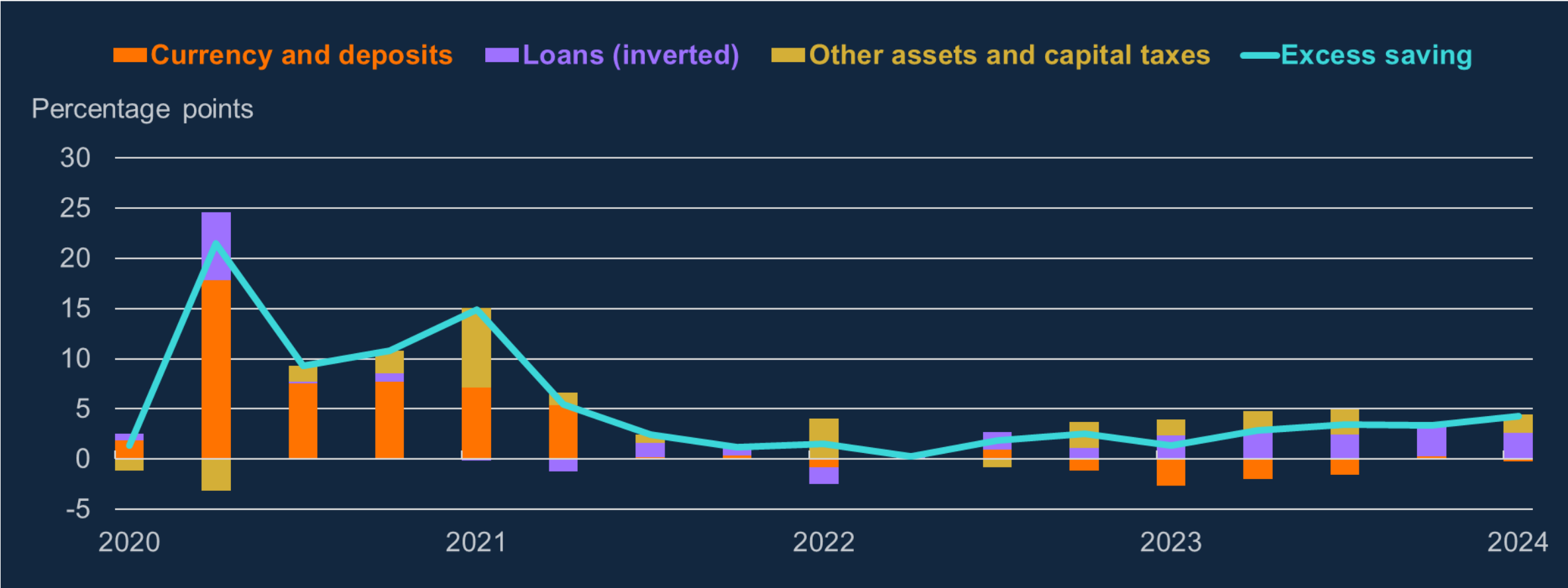
Household saving ratio, per cent



Source: ONS and Bank calculations. Latest data: 2024.

Financial counterpart of savings shows paying down of debts, not accumulation of liquid assets for future consumption

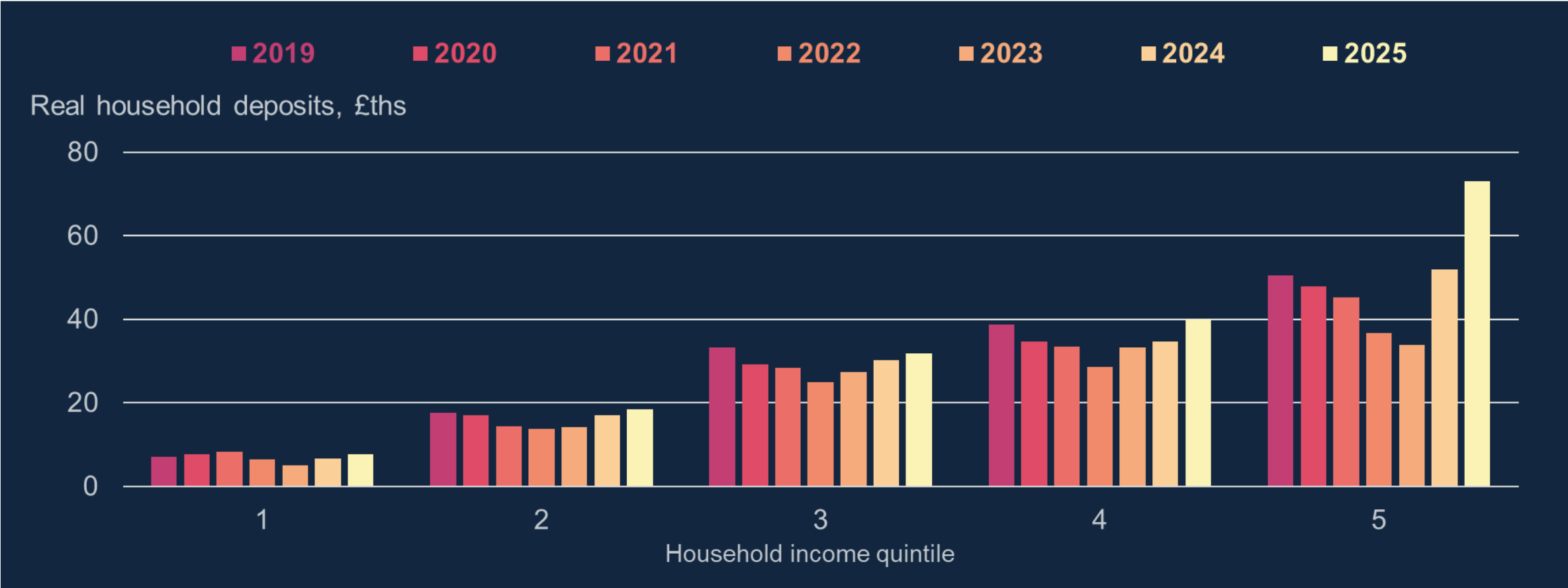
Difference in actual and trend household savings ratios (percentage points), since 2020 Q1



Source: [ONS Households' finances saving saving, UK: 2020 to 2024 \(Figure 5\)](#). Latest data: Q1 2024.

Correspondingly deposits are stable, except for the top quintile

Household deposits by income quintile, deflated by quintile-specific inflation indices



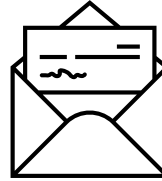
Source: Bank of England/NMG Survey of Household Finances, ONS and Bank calculations. Latest data: H2 2025.

How to assess the evidence? Real consumption weakness seems to be reflecting real disposable income weakness



Let's get the denominator right:
Prices faced by households for their consumption baskets

Real disposable incomes are weaker



Let's get the numerator right: Incomes are not just from wages, but also from benefits and other sources

Nominal disposable incomes are weaker



Let's use Savings as a cross-check on real income minus consumption

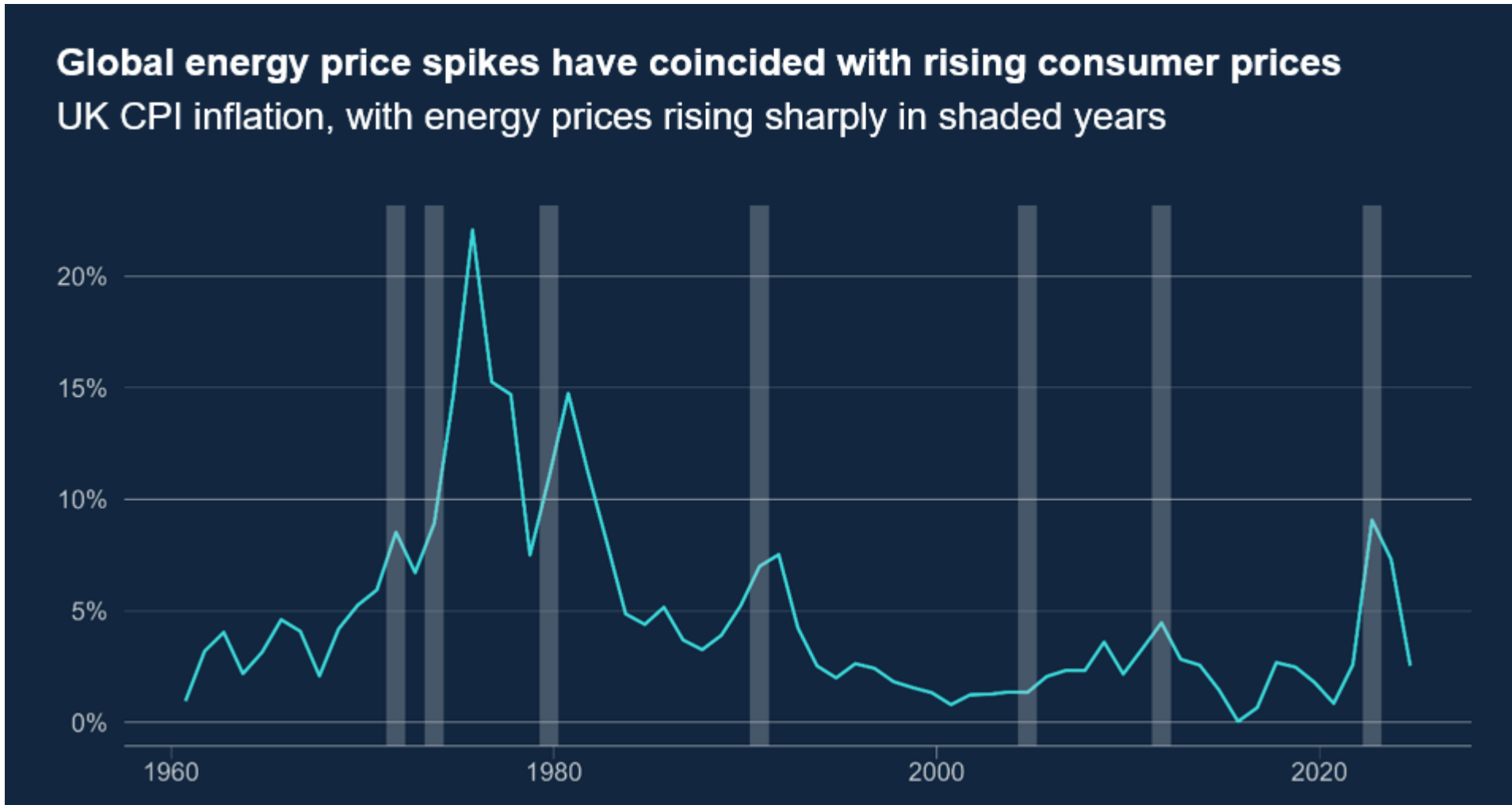
Excess liquidity at the top, who marginally consume less



...and other mysteries

Large global supply shocks

A small open economy like the UK is exposed to global shocks



Global and supply factors are key drivers of inflation



Monetary policy

focus has been on domestic and demand-driven price dynamics in recent decades and over the last few years global and supply factors have seen a resurgence



Inflationary dynamics

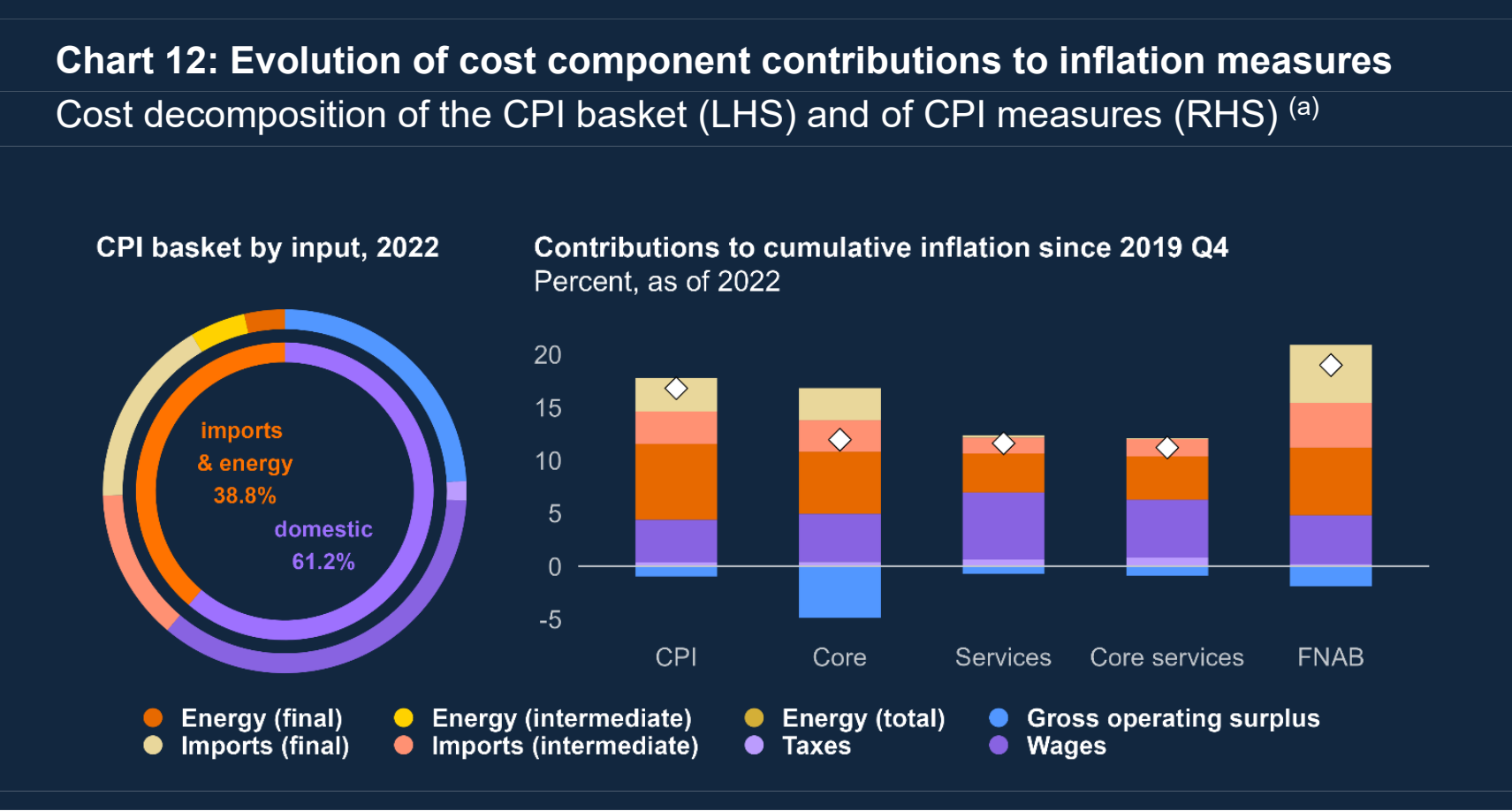
can differ when inflation is driven by global and supply side factors
Example, global prices transmitting through longer supply chains



Central Bank toolkits

need to assess and respond to the drivers of inflation in real time amid less developed global and supply side modelling and data

Global price shocks manifest in "domestic" inflation metrics

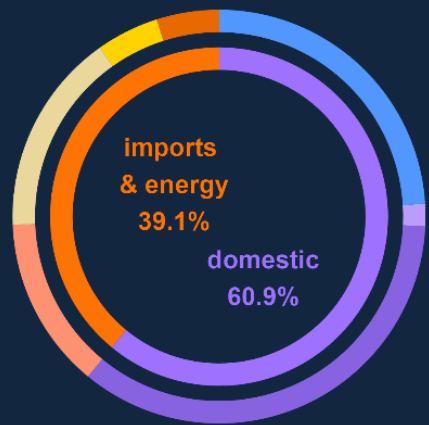


Global price shocks manifest in "domestic" inflation metrics

Chart 12: Evolution of cost component contributions to inflation measures

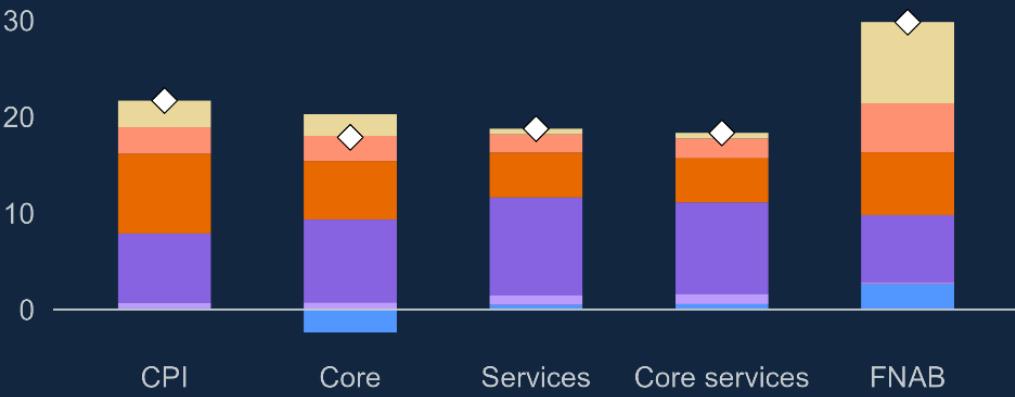
Cost decomposition of the CPI basket (LHS) and of CPI measures (RHS) ^(a)

CPI basket by input, 2023



- Energy (final)
- Energy (intermediate)
- Energy (total)
- Gross operating surplus
- Imports (final)
- Imports (intermediate)
- Taxes
- Wages

Contributions to cumulative inflation since 2019 Q4
Percent, as of 2023

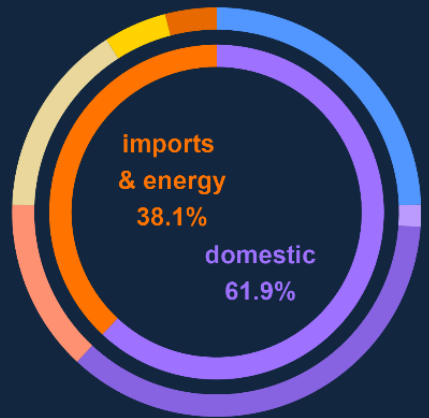


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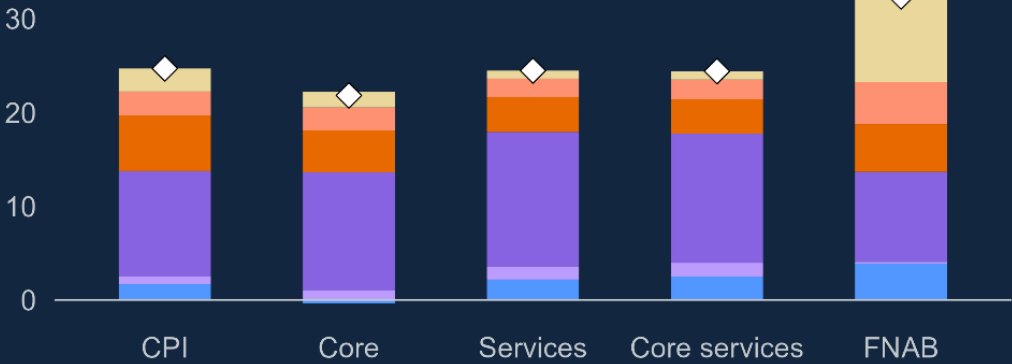
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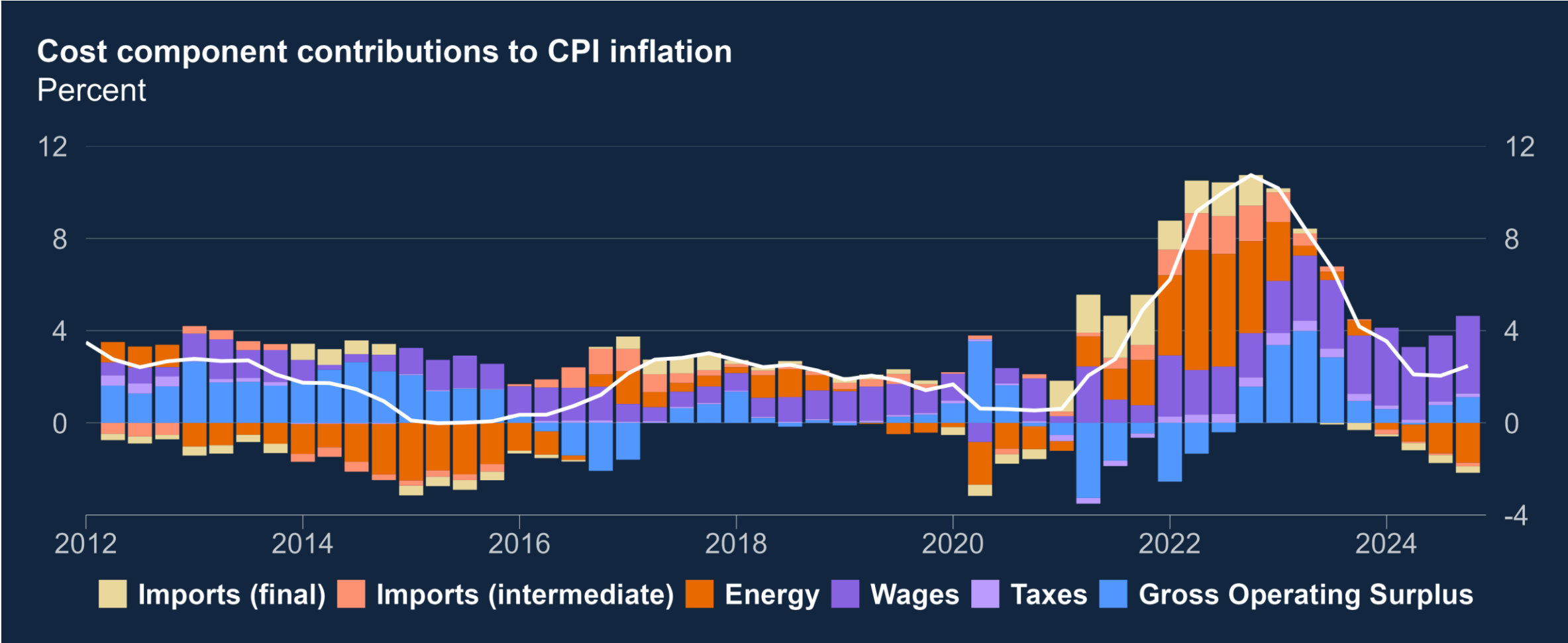


- Energy (final)
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- Wages

Contributions to cumulative inflation since 2019 Q4
Percent, as of 2024



Energy and imports are key contributors to inflationary dynamics

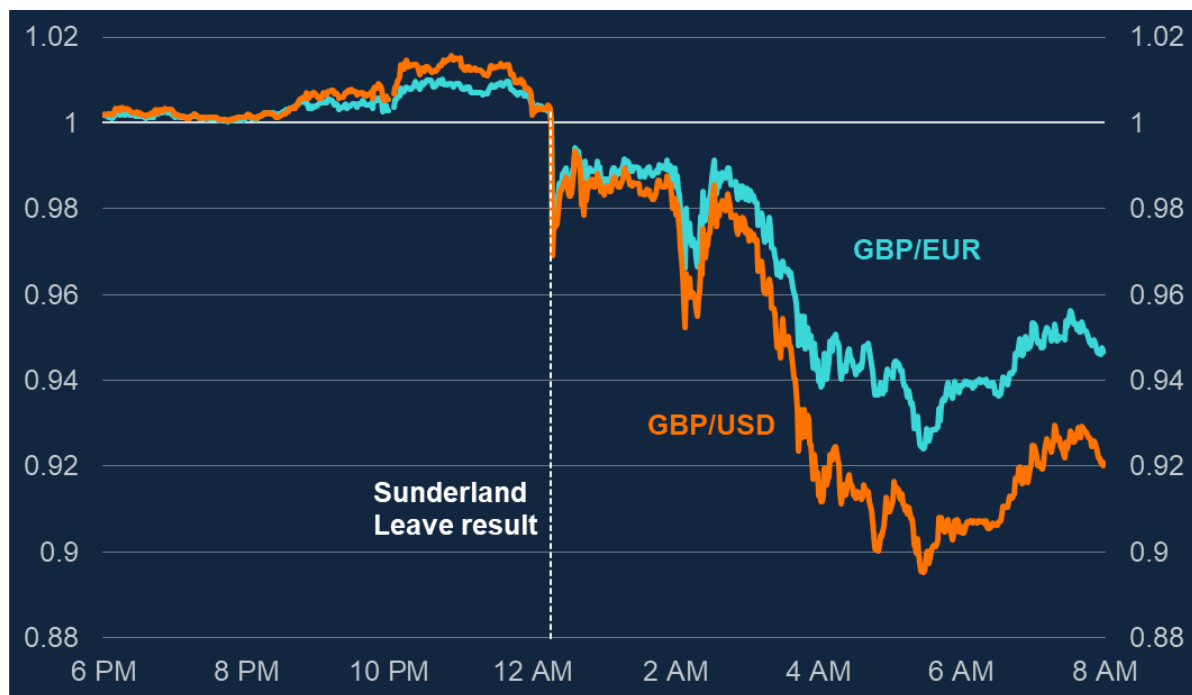




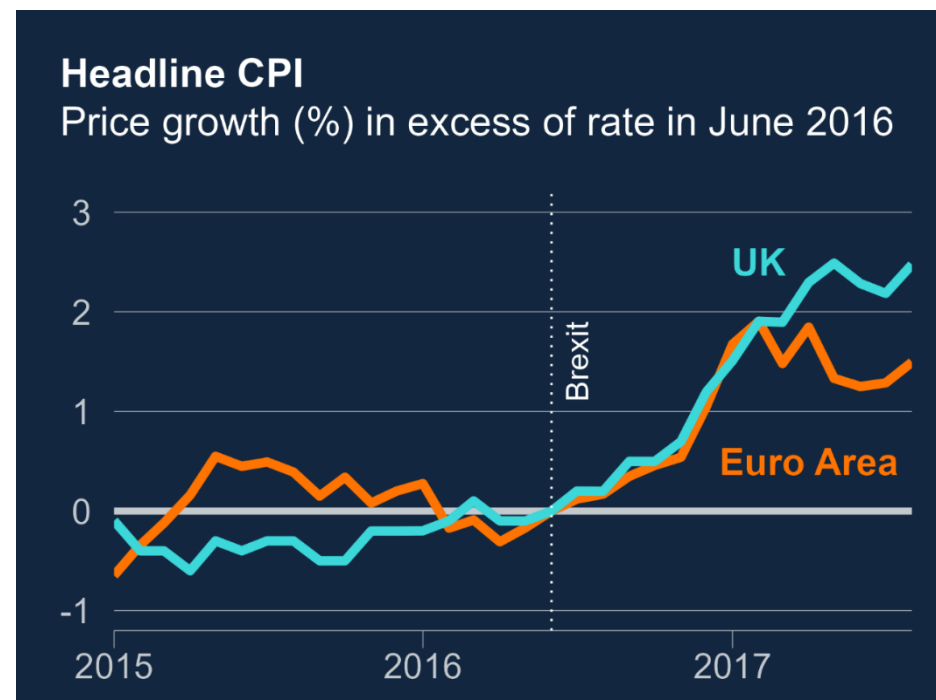
...and other mysteries
A new world economic order

Brexit was the first major reset of trade relations. Sterling depreciated. Import cost increases – outputs and inputs – caused real wage stagnation till 2019.

Minute-by-minute sterling depreciation on the night of the Brexit referendum (Costa et al. 2022)

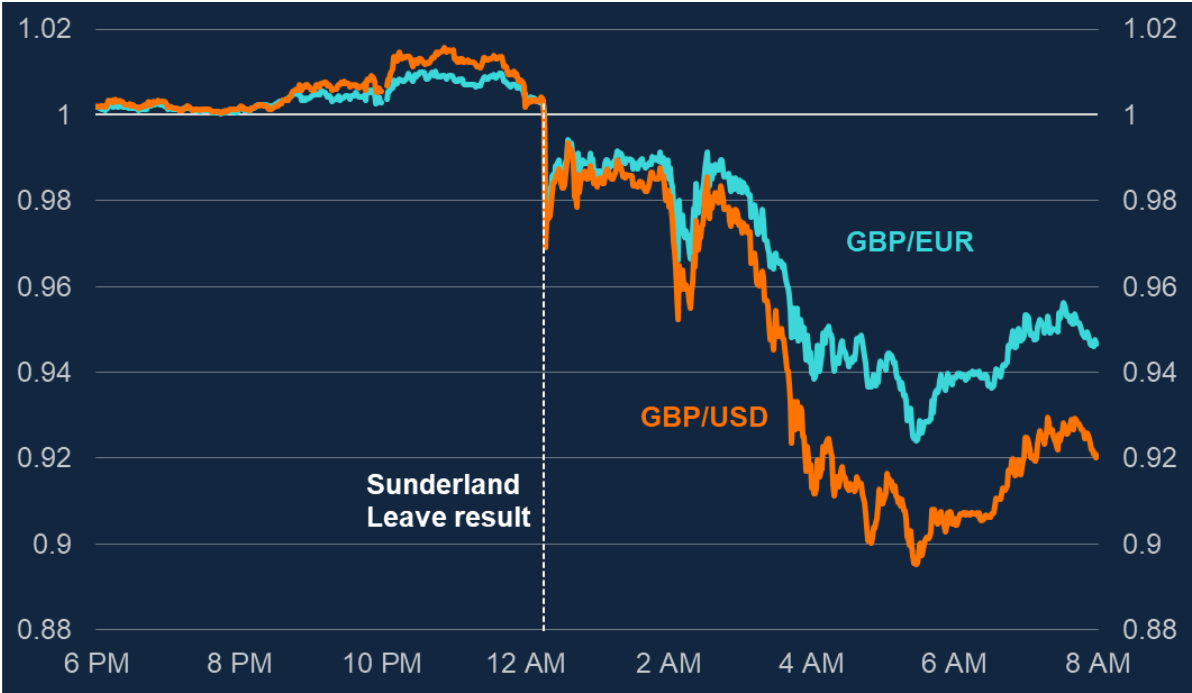


Headline inflation rose, particularly in food (De Lyon, Dhingra and Machin 2017)

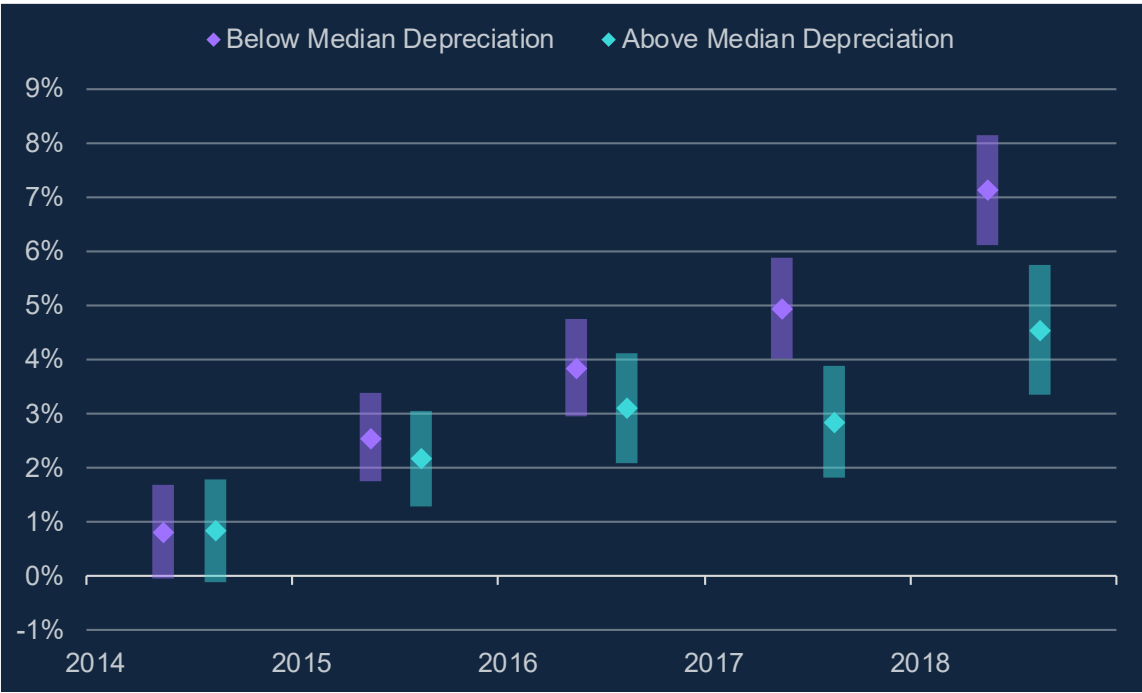


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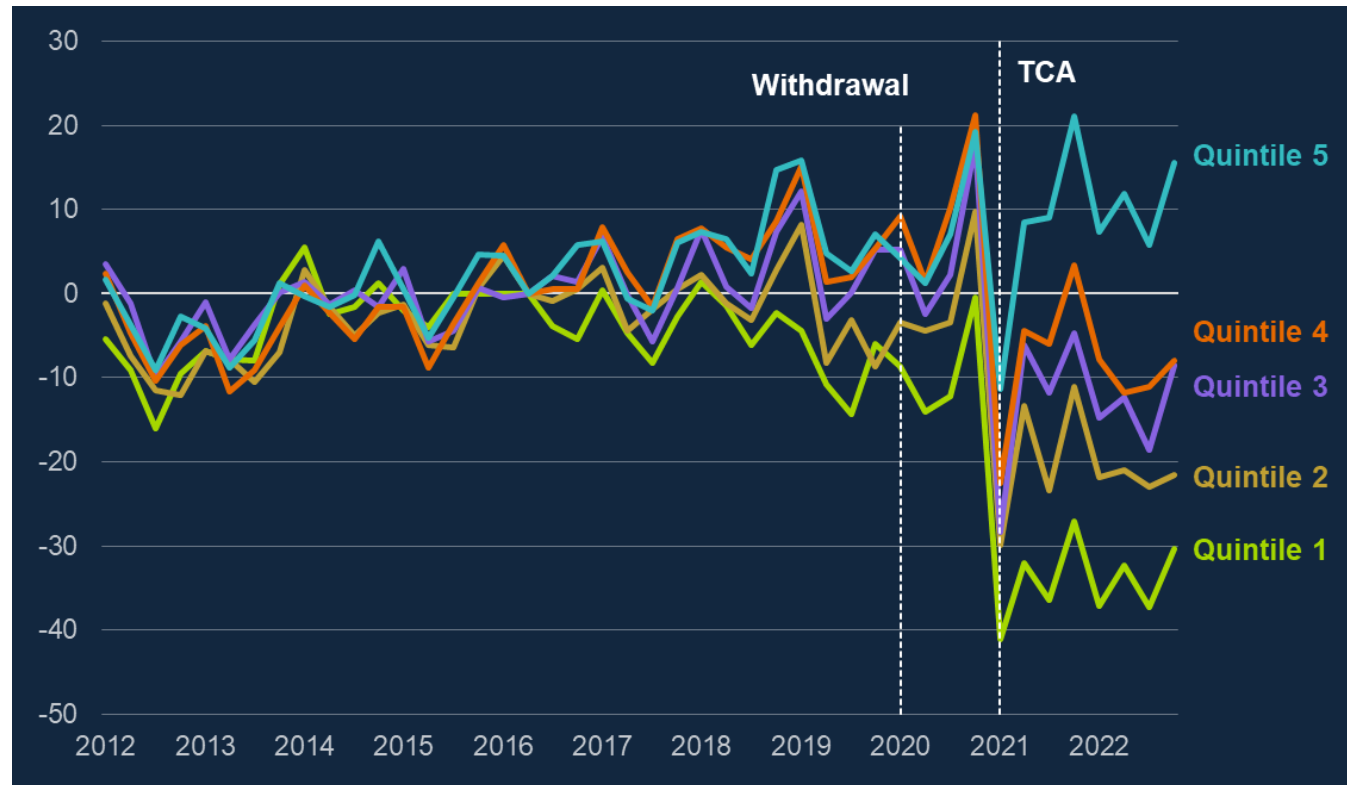


Real wage growth in sectors more and less exposed to the sterling depreciation through imported inputs



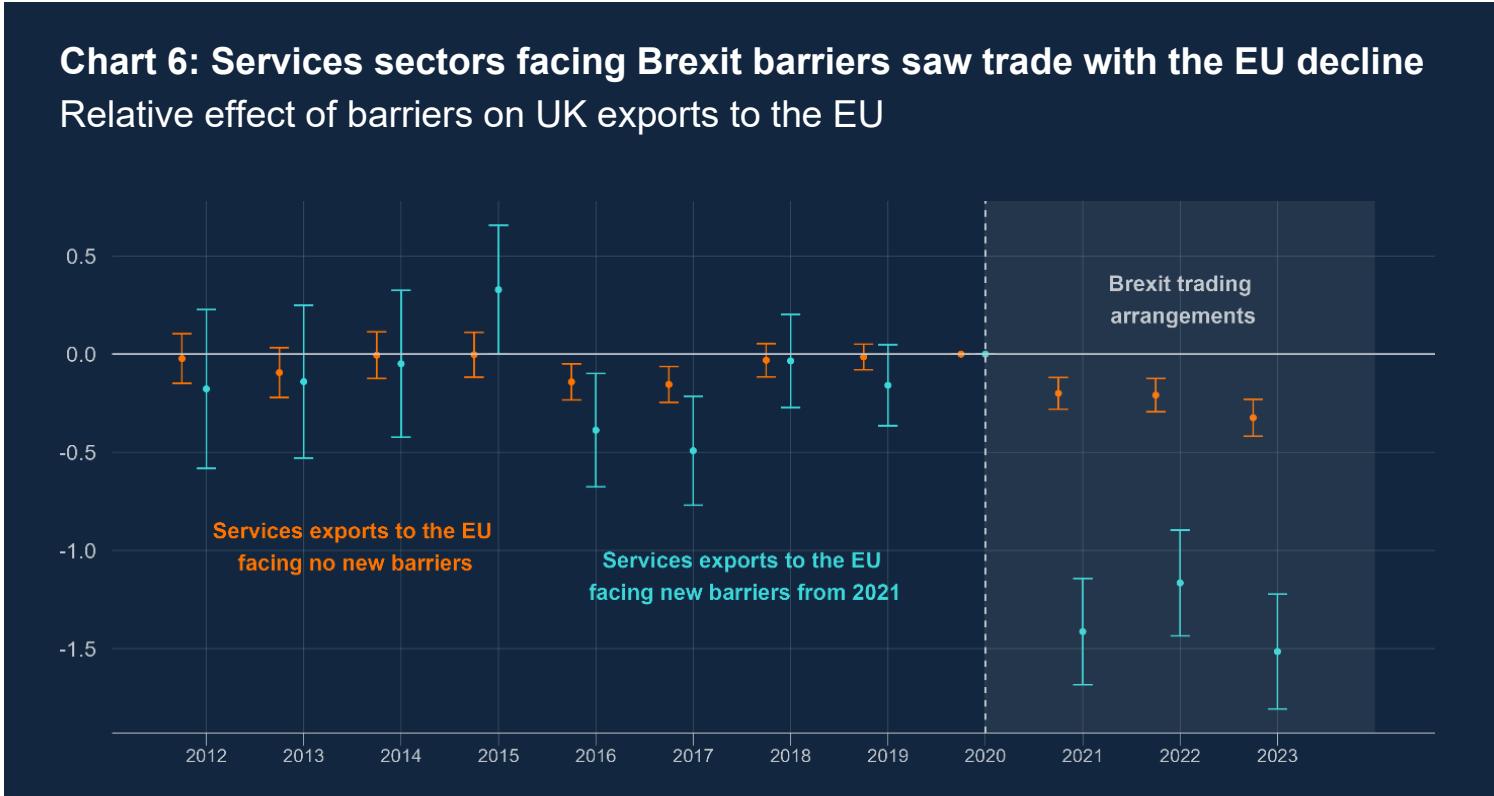
UK goods exports to the EU fell after Brexit

Goods exports of small firms (quintile 1 by initial employment) to EU fell relative to exports to the rest of the world (Freeman et al. 2025), but not necessarily in ways that were expected at the outset.



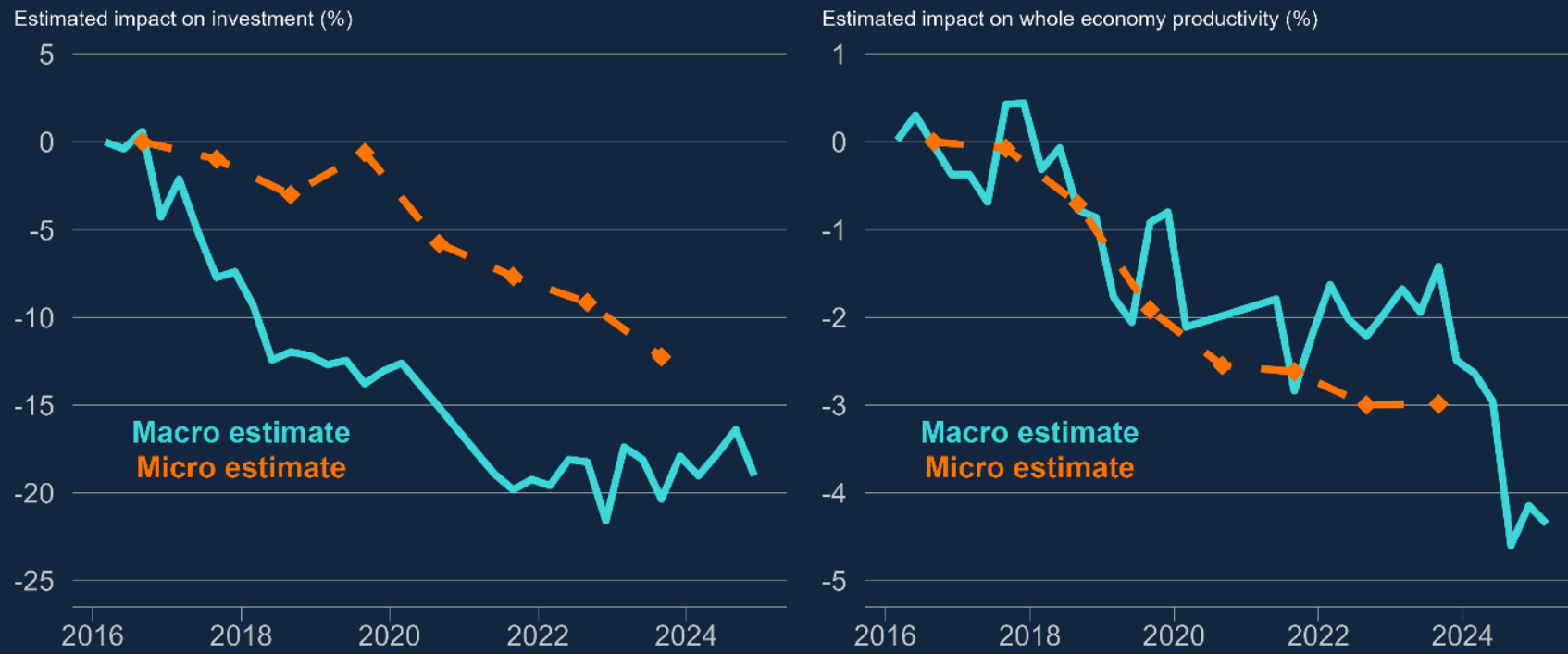
UK services exports to the EU fell due to Brexit barriers

Services exports of the UK to the EU fell in services affected by Brexit barriers relative to bilateral exports of other countries (Bhalotia et al. 2025), despite broad strength in services exports worldwide.



Brexit effects are large in firm surveys, so likely not just working through trade effects

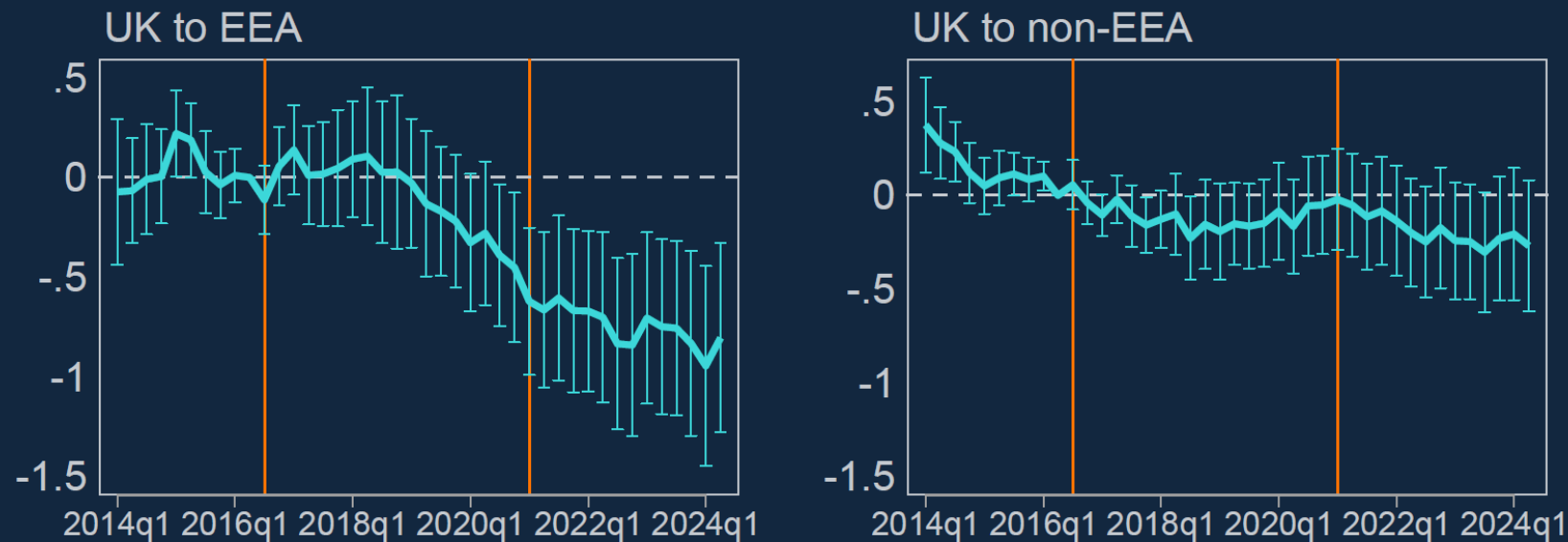
Chart 8: Brexit reduced firms' investment and the economy's productivity
Estimated impact on investment (LHS) and whole-economy productivity (RHS) (%)



The dog that has barked: Financial services exports have dipped

Banks in the UK that had passporting rights before Brexit had 80% less loans to EEA, relative to other banks (Bhalotia et al. 2025)

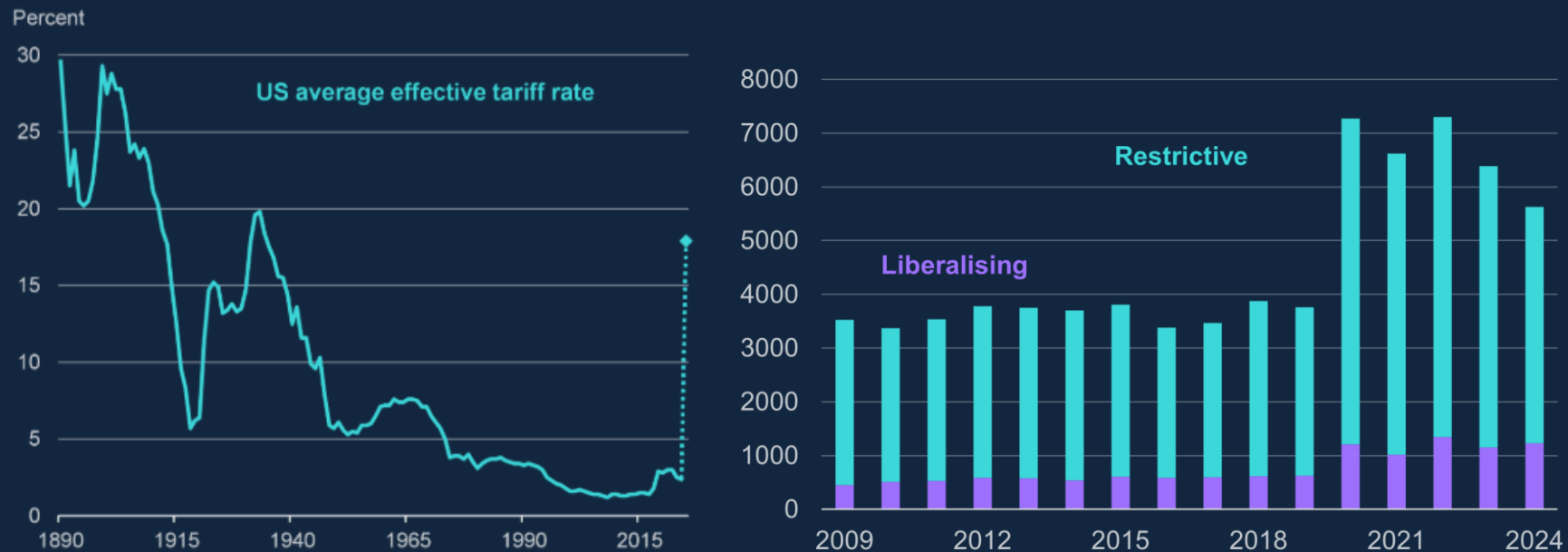
Chart 7: Loss of passporting for UK banks has been a drag on EEA loan activity
Event study estimates ^(a)



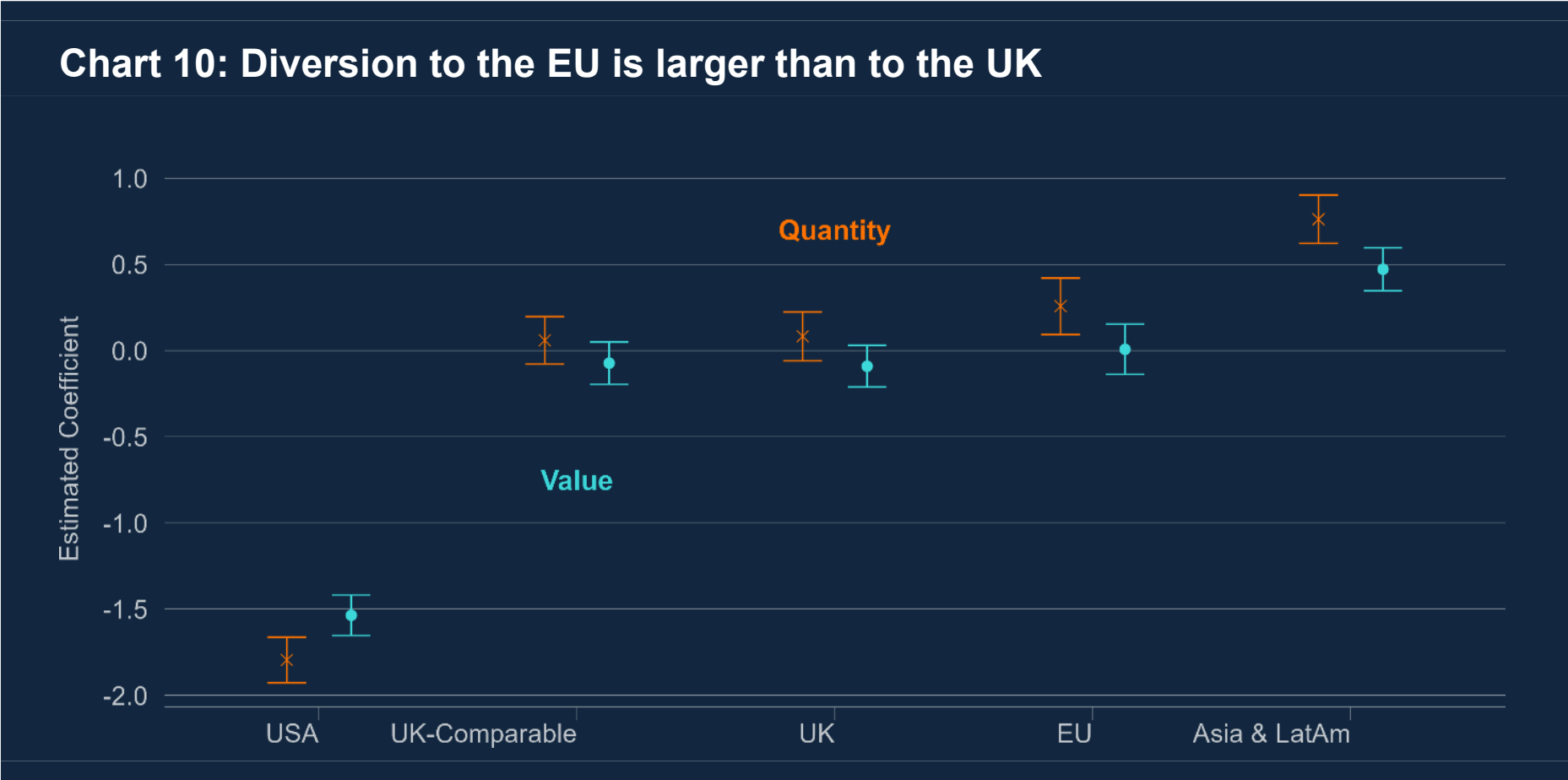
The US is back to Smoot-Hawley tariffs and trade policy has become more restrictive in recent years

Chart 1: Trade policy has become more restrictive in recent years

US average effective tariff (left) (%) and trade policy actions taken globally (right)



Effects of US-China tariffs on imports from China differed across countries, and we can draw lessons from this experience





Mind the Gap(s)

Research must step in to bridge evidence gaps that distort policy and skew narratives

