



United Kingdom – Slight Keynesian boost to growth in 2026 and an energy-driven fall in inflation

As anticipated, economic activity slowed after a very strong start to 2025. Exports decelerated, impacted by the US tariffs. Business investment suffered from rising labour costs following the increase in employer National Insurance contributions in April 2025 and margin erosion. Household consumption growth remained weak, burdened by uncertainty factors weighing on confidence, a new surge in inflation, and deteriorating labour market conditions. In 2026, consumers will benefit from government measures aimed at reducing the cost of living and an expected significant decline in inflation (return to target expected in Q2-2026). In 2027, however, the tax increases that were announced by the government in the Autumn Budget 2025 should once again weigh on private consumption growth. The BoE is expected to cut rates again in February, probably for the last time. Although the disinflation process looks to be faster than anticipated three months ago, persistently high core inflation is fuelling divisions within the MPC and makes any future monetary easing uncertain.

Growth has slowed over the course of the year and should be close to 0% QoQ in Q425

Uncertainty related to the Autumn Budget 2025, published on 26 November 2025, is expected to weigh on growth in Q425. Business and consumer confidence is low, indicating persistently weak underlying domestic demand in the private sector. GDP contracted by 0.1% MoM in October, following -0.1% MoM in September, bringing the carry-over-effect for QoQ growth rate in Q225 to -0.2 percentage points. We therefore anticipate a slowdown in GDP to 0% QoQ in Q425 after +0.1% QoQ in Q325. **A solid carryover effect left by the solid growth at the start of the year (+0.7% QoQ in Q125) should nevertheless allow GDP growth to accelerate to 1.4% on an annual average in 2025, up from 1.1% in 2024.**

Budgetary policy was loosened slightly for 2026

The Autumn Budget 2025 policy measures imply a small temporary boost to real GDP of +0.1ppt in 2026. This is slightly less than we had estimated in the immediate aftermath of the Budget (+0.15ppt) due to a downward revision to the OBR's fiscal multipliers. The Budget delivered a frontloaded increase in public spending (GBP16bn in 2026-27 and 2027-28), in the form of higher welfare spending (notably the reversals to previously announced cuts to winter fuel payments and health-related benefits, the removal of the two-child limit within the universal credit from April 2026) and measures aimed at tackling the cost of living (reduced household electricity bills). These are funded by more borrowing and by a backloaded increase in tax rises. Increased public spending will take effect immediately while personal tax measures take effect from 2027 onwards and more significantly from 2028 (higher tax rates on dividends, property and savings income in April 2027, a freeze in the tax thresholds from 2028 to 2031). Consequently, we raise our 2026 growth forecast from 1.1% to 1.2%, still below trend growth. For 2027, we forecast growth at 1.4% on

annual average, close to potential, but still soft on a quarterly basis.

Government capital investment growth is expected to remain robust. General government investment rose by 4.1% QoQ in Q225 and 3.6% QoQ in Q325. According to the OBR's estimates, general government investment is expected to grow by 7.8% in 2026 and 5.4% in 2027. The government confirmed its commitment to an over GBP120bn increase in department capital spending over the current Parliament to 2029-30 relative to the previous government's plans, in line with its [10-year Infrastructure Strategy](#), published in June. It covers both economic and social infrastructure (housing, transport, water, clean and nuclear energy, digital connectivity but also schools and hospitals) and introduced a new model of Public Private Partnerships in order to attract more private finance. It also confirms the government's commitment to increase defence investment to 2.6% of GDP by 2027 for NATO qualifying defence spending.

	2024	2025	2026	2027
GDP (YoY, %)	1.1	1.4	1.2	1.4
Domestic demand excl. inventories (contribution to GDP, pps)	1.5	1.8	1.6	2.2
Change in inventories (contribution to GDP, pps)	0.1	0.0	-0.1	0.0
Net exports (contribution to GDP, pps)	-0.5	-0.5	-0.3	-0.8
Private consumption (YoY, %)	-0.1	0.8	1.2	1.3
Investment (YoY, %)	1.7	3.5	3.1	3.3
CPI inflation (YoY, %)	2.5	3.4	2.1	2.0
Unemployment rate (%)	4.3	4.9	4.9	4.9
Fiscal balance (% of GDP)	-6.1	-4.8	-4.0	-3.6

Sources: ONS, BoE, Crédit Agricole SA

Note: The sum of the contributions does not round to GDP growth due to the acquisitions less disposable of valubles.



Household consumption should benefit from a sharp decline in inflation in 2026 and a still high wage growth

We expect a sharp fall in total inflation below target in Q226 thanks to lower energy prices. Aiming to reduce the cost of living, the government introduced a package of measures which will reduce household electricity bills; it also announced a temporary extension of the fuel duty freeze until September 2026, and a one-year freeze to rail fares and prescription charges. Those measures are expected to reduce CPI inflation by 0.5ppt in Q226 and by 0.3ppt in 2026, according to OBR estimates. Furthermore, our oil strategist has revised his oil forecasts down. As a result, we now expect CPI inflation below target as soon as in Q226 at 1.9% on average¹ (down from 3.8% YoY in Q325). With the fall in CPI inflation being driven mainly by energy prices, core inflation is much stickier and remains above target for the major part of 2026 and 2027.

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Household consumption is expected to accelerate slightly next year (1.2% annual growth in 2026 after 0.8% in 2025) thanks to this more rapid fall in inflation, a further increase in the National Living Wage (NLW) and higher welfare spending. However, we expect household consumption growth to remain overall weaker than implied by real income growth and to decelerate in H227 as tax rises start to come in effect. Furthermore, households are likely to continue to save some of their disposable income from the near-term fiscal loosening in anticipation of higher taxes. As a result, the saving ratio would likely fall only gradually and would remain higher than its pre-Covid levels.

Business investment remains constrained by weak profit margins

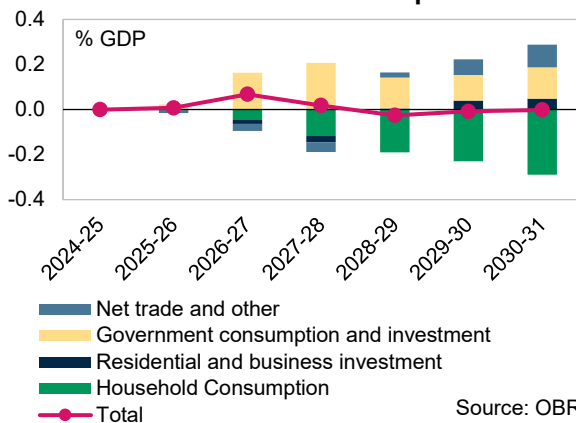
Business investment contracted in Q225 and Q325, likely suffering from the squeeze in business margins following the April 2025 increase in the employer National Insurance Contributions (NICs). It is likely to rebound in the near term as business confidence will probably improve thanks to dissipating uncertainty about tariffs and the budget, fiscal loosening and the BoE’s monetary easing. However, the outlook remains challenging. The impact of the April 2025 increase in NICs on business labour costs will be compounded by another increase in the National Living Wage in April 2026, while productivity growth remains weak. As a result of those government policies, profit growth is expected to decline, contradicting the government’s own strategy to encourage private investment.

Weakness in export expectations

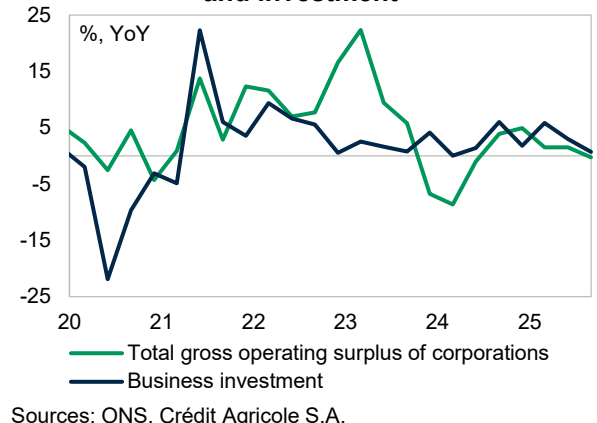
Finally, net exports remain the biggest drag on growth in our scenario, as export growth would remain hampered by the US tariffs, while import growth would likely get a slight boost from the positive impact from the Autumn Budget on domestic demand.

Downside risks to our scenario persist, especially in relation with fiscal policies. Even though the Chancellor doubled her “headroom” against her fiscal mandate, reassuring the markets about its fiscal credibility, the government is not out of the woods yet. Budget execution risks persist, especially regarding the implementation of the tax rises in the later years of this parliament. The government chose to spend more in the near term and to leave the painful decisions until ahead of the next elections in 2029. Higher public sector net borrowing and public debt in the coming years are likely to maintain upward pressure on long-term interest rates.

UK: Autumn budget policy impacts on real GDP and its components



UK: business profitability and investment



¹ Our inflation forecasts were established before the November CPI figures (published on December 17th), which surprised on the downside. Our forecasts therefore carry downside risks.



Bank of England: nearing neutral levels of Bank rate

The Bank of England (BoE) decided to pause its monetary policy easing cycle in November and left its Bank rate on hold at 4.00%. A tight majority of the MPC (5 against 4) was worried about the risk of higher household inflation expectations resulting in greater inflation persistence. However, since then, economic developments have generally come on the softer side: inflation (3.2% YoY in November) has surprised to the downside and the labour market has deteriorated. Consequently, at its meeting on 18 December, the MPC resumed its monetary policy easing voting for a 25 basis points (bp) reduction of Bank rate to 3.75%, once again by a narrow majority (5 to 4).

Our scenario anticipates one last 25 bp rate cut in the first quarter of 2026 (February), which would bring the Bank rate to 3.50%. Subsequently, given expectations of labour market stabilization in 2026 and persistently high core inflation, the BoE will likely see its capacity for easing limited. The Autumn Budget also provides for a slight fiscal easing for next year, which should somewhat support domestic demand in the short term.

Core inflation, albeit also declining sharply in the coming year, is generally higher than the BoE's 2.0% target throughout 2026 and 2027. Services inflation, largely determined by wage growth, will likely remain elevated, preventing the BoE from cutting more aggressively. Indeed, early indications from the Bank Agents suggest that settlements could average around 3.5% in 2026. The most recent DMP Survey even expected wage growth of 3.7% over the next year on average, still above the level compatible with a sustainable return of inflation back to target.

The unemployment rate reached 5.1% in July-October 2025, slightly higher than expected. Private sector

wage growth moderated to 3.9% from 4.8% in Q225. Vacancies have broadly stabilised but fell by 9.6% in September-November relative to the same period one year ago. The number of unemployed people per vacancy, the BoE's preferred measure of the degree of loosening in the labour market, increased to 2.5, its highest level since Q121. Redundancies increased by 50% in the three months to October relative to the three months to July, also reaching their highest level since early 2021. Businesses have been cutting employment due to rising non-wage costs in relation with the increase in April 2025 of employer NICs. This negative trend has been exacerbated by the uncertainty in relation to the Autumn Budget, as shown by the sharp decline in employment in the November business surveys. On the supply-side, the participation ratio has been increasing since early 2024, reaching 63.9% vs 63.3% one year ago and back to its pre-pandemic levels. The BoE judges that it is likely to remain broadly flat in the coming years. We expect the unemployment rate to peak at 5.2% in Q425, before falling back below 5% in the course of the year thanks to the dissipation of the impact of the April increase in employer NICs and of the uncertainty related to the Budget.

Admittedly, the recent acceleration in the labour market's deterioration has raised the question of faster rate cuts. The BoE will likely need to see more evidence of softening domestic prices pressures, such as a downward revision to Bank Agent's private sector pay settlements, before envisaging cutting rates more aggressively. This may materialise in H226 if household expectations are adjusted to the downside in reaction to lower short-term CPI inflation.

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UK: wages in the private sector and inflation in the services



UK: CPI inflation

