

# UNITED KINGDOM

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## A FRAGILE REBOUND

After solid growth in H1 2025, the second half of the year is expected to see a slowdown (under the weight of US trade policy and UK fiscal policy). Despite the downside risks on the labour market and industry difficulties, growth is expected to be at a higher and stable rate in 2026 (+0.3% q/q on average) thanks to monetary easing. However, the policy mix will remain moderately restrictive, constrained by high inflation and gilt market pressures. Striking a balance between fiscal consolidation and growth remains a challenge in the UK.

### ↑ A MORE CHALLENGING H2 2025, BUT A STRONGER RECOVERY IN 2026

After a good first half of the year (+0.7% q/q in Q1 and +0.3% q/q in Q2), growth is expected to be more moderate in H2 (+0.1% q/q in Q3 and 0.3% in Q4), before stabilising close to its potential rate in 2026 (+0.3% q/q per quarter). On annual average, however, growth is expected to slow between 2025 (1.3%) and 2026 (1%), with 2025 benefitting from a more favourable carryover effect. On the positive side, household consumption has been rising for the past four quarters, helped by increasing real wages, even if this growth in real wages is slowing (+1.2% y/y in June). However, the likely rise in unemployment could adversely affect consumer choices. A fall in the savings rate, currently high compared with its historical average (10.9% of disposable income in Q1 25), would help to cushion part of the shock. However, there is no guarantee that this will materialise, as the continuing high level of uncertainty is likely to keep precautionary saving high.

Overall, the strength of activity in the services sector (PMI index of 54.2 in August) should act as a buffer for an economy that is exposed to a number of vulnerabilities. Industrial activity is still depressed (PMI index down to 47.0 in August). The slowdown in growth in the United States, the UK's biggest export market after the eurozone, will have an immediate impact, while the positive effects of strengthening activity in the eurozone should materialise later (especially in early 2026). Therefore, the outlook for 2026 is still ambivalent, as there is a risk that fiscal consolidation will weigh more heavily on growth or that, in order to support growth, this consolidation will be delayed, which would add to the pressure on long-term interest rates (and would also affect growth).

### 📊 RELATIVE INCREASE IN UNEMPLOYMENT

The unemployment rate continued to rise in the first half of 2025, reaching 4.7% in June (+0.6 points higher than the low point in July 2024), while the volume of job vacancies fell back to its lowest level since 2017. The rise in labour costs, exacerbated by the April Budget measures, is weighing on British businesses. Up until now, they have been squeezing their margins, but this approach is reaching its limits, with margins falling to 43.2% in Q2 2025, their lowest level in 15 years. Employment could now become the main lever for adjustment. Some surveys point in this direction (see chart 2). A sharper slowdown in the labour market would dampen wage growth. The latter has already slowed (+4.5% y/y in June, the slowest pace since the end of 2021), but it remains above inflation, which is supporting purchasing power.

### 📈 INFLATION: A MODERATE REBOUND IN 2025 AND A LIMITED SLOWDOWN IN 2026

After rising again to 4.2% y/y in July, inflation is expected to remain at a high level until May 2026. Inflation in services should remain close to

#### GROWTH AND INFLATION (YEARLY AVERAGE)

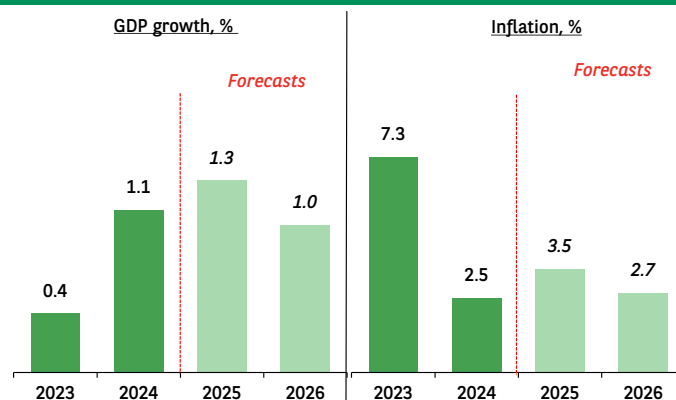


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

5% until that date, when the base effect linked to the introduction of the April 2025 tax hikes fades. The trajectory will then depend on developments in the labour market, where the anticipated deceleration should lead to a slowdown in wages and prices in services. While a return to the 2% inflation target will not occur, in our view, in 2026, inflationary pressures should be gradually less widespread. Following a 6.4% increase in Q2, the rise in the energy price cap for unregulated tariffs will slow in Q4 (+2%, according to Ofgem), which will limit energy inflation thereafter. Another positive development is that the rise in rents has slowed since the start of 2025, from a peak of 7.8% y/y in January to 4.5% in July, and could fall back below the services component (excluding rents) this autumn for the first time since the summer of 2023.

### 🏠 TWO FURTHER RATE CUTS AND LESS PRONOUNCED QUANTITATIVE TIGHTENING

After a 125-bp cut in the policy rate in one year, two further rate cuts (each of 25 bps) are expected in Q4 2025 and Q1 2026, according to our forecasts. The landing point for rates (3.5%) will be higher than in the eurozone (2% for the deposit facility rate), reflecting higher and persistent inflation. Furthermore, against a backdrop of pressure on sovereign long rates and an expected rise in UK government bond issuance in 2026, the BoE is likely to opt for more fine-tuned and regular management of its quantitative tightening (QT), both in terms of the size and structure of the central bank's balance sheet. The decision to slow the pace of reducing the BoE's balance sheet (from £100 bn (October 2024–September 2025) to £70 bn (October 2025–September 2026), at the 18 September meeting, is a first step in easing the quantitative tightening programme,


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which could continue to evolve in 2026, depending on how gilt market pressures develop. Nevertheless, the reduction in QT implies heavier losses on the BoE's gilt portfolio, losses which must be compensated by the Treasury, thereby increasing the Treasury's financing requirements.

## THE DEFICIT TARGET WILL BE DIFFICULT TO ACHIEVE

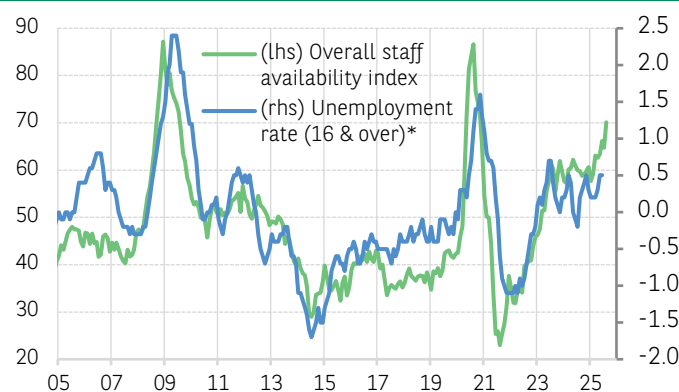
Bond-market pressures (which have caused 30-year yields to rise by around 30 bps since the start of the year) and the downturn in the labour market are complicating fiscal consolidation. On the one hand, despite sustained inflation and the April Budget measures, which increased some revenues (stamp duty and employer contributions), VAT receipts are growing at a limited rate (+3.9% year-on-year in July), which is also limiting the rise in current receipts (+5.3%). On the other hand, public sector wage increases and higher debt servicing costs are pushing up current expenditure (+7.3% year-on-year). As in 2024, the deficit target for the 2025 financial year (which runs from April to March) of 3.9% of GDP targeted by the OBR (March forecasts) will be difficult to achieve. Therefore, an upward revision of the deficit is likely this autumn (the autumn Budget will be announced on 26 November), which will further force the government to step up its fiscal consolidation measures. Nevertheless, according to our estimates, the gap between the primary balance and the balance needed to stabilise the public debt ratio is smaller than in France; the rise in the debt ratio should therefore be more moderate in the UK. Debt servicing, which stood at 2.9% of GDP in 2024, is expected to increase, but only moderately (to around 3.2% of GDP at the end of 2026). The high average residual maturity of government securities (14 years) means that refinancing phases can be spread out over time.

## EXTERNAL ACCOUNTS: FALLING EXPORTS TO ASIA

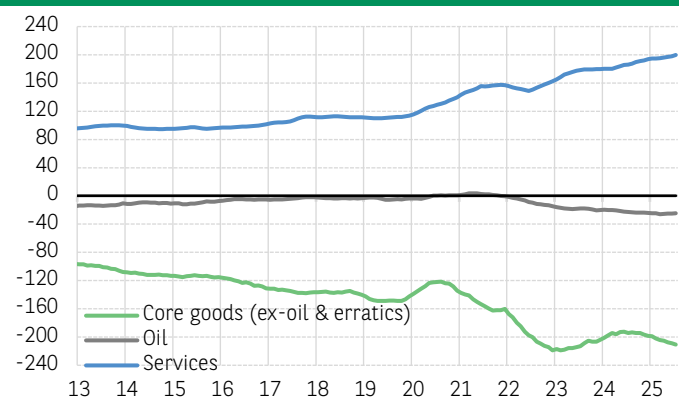
There is a high risk that the trade deficit (GBP 243 b in July, cumulative year-on-year) will continue to deteriorate in 2026. While the UK has managed to limit the tariff shock with the United States, notably by negotiating an export quota for the automotive industry, the fall in exports from the sector, one of the largest export items (over 10% of the total), is structural and stems mainly from a drop in demand from the Asian market. The decline in hydrocarbon exports, which is due to energy transition efforts, and which once accounted for 13% of the UK's exports of goods (2012), now only account for half of exports. This is also contributing to the higher trade deficit. The UK's share of global exports, which fell below 2% in 2024, continues to decline in 2025 (1.9% in May on a 12-month moving average basis, which is lower than in France (2.5%), Italy (2.7%) and *a fortiori* Germany (6.8%)). Nevertheless, the surplus in services continues to grow, offsetting a large part of the goods deficit, a trend that should continue in 2026 (see chart 3).

While Brexit will leave a lasting mark on trade between the EU and the UK, exports of goods to the EU (in volume terms) rose by 11% over the first seven months of the year, however. As a result, the share of UK exports to the EU-27 rose back above the 50% mark this summer. While it is too early to start talking about a recalibration in trade, the UK will need to strengthen its trade links with its European neighbours. This would enable the UK to take advantage of the expected rise in investment in Europe, while increasing its resilience to future shocks to global trade.

### UNITED KINGDOM: REC/KPMG SURVEY AND UNEMPLOYMENT RATE



### UNITED KINGDOM: GOODS AND SERVICES BALANCES (£ BN, 12-MONTH MOVING TOTAL)



UK's participation in the SAFE European rearmament programme (which has not yet been formalised, but is in the final stages of negotiation), which should actually come into effect in 2026, would bring the two zones even closer together.

Article completed on 18 September 2025

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