

UNITED KINGDOM

22

NEW GROWTH DRIVERS TO BE SEIZED

Growth is expected to reach 1.1% in 2026, down from 1.4% in 2025, the latter benefiting from a particularly strong first quarter. However, GDP growth is likely to be unevenly distributed. On the one hand, the service sector should benefit from the development of AI. On the other hand, households will suffer from the deterioration of the labour market, and industry will be penalised by a decline in competitiveness and increased competition from China. Disinflation is expected to remain gradual, limiting the BoE's scope for easing. The policy mix will be more accommodative, with part of the fiscal consolidation effort postponed until the end of the decade. We anticipate a slight depreciation of the sterling against the euro and the dollar in 2026, driven by lower key interest rates in the United Kingdom.

GROWTH: INVESTMENT MORE DYNAMIC THAN CONSUMPTION

A cyberattack at Land Rover penalised Q3 growth (-0.06 pp, +0.1% q/q), masking the otherwise resilient economy. Investment in machinery and equipment excluding transport rebounded strongly (+10.1% q/q). Furthermore, the return of the manufacturing PMI to expansion territory in November (50.2) bodes well for Q4, when GDP growth is expected to rebound (+0.3% q/q). Growth is expected to reach 1.4% in 2025 on an annual average. It would be lower in 2026 (at 1.1%), but mainly due to the exceptional performance in Q1 2025 (+0.7% q/q) supported by volatile components (mainly investment in aeronautics). Quarterly growth is expected to remain at +0.3% q/q on average, which is the rate anticipated for Q4 2025.

In 2026, the UK will benefit from renewed growth in the major eurozone countries (led by Germany and France, which accounted for 15% of UK exports in Q3), particularly through increased defence budgets. Investment momentum is expected to continue. The British economy is benefiting from the boom in digital and tech services, where the country remains competitive (investment in intellectual property amounted to more than 5% of GDP in Q3 2025) and generates added value (+6.3% y/y in the information and communication sector), as well as major trade surpluses (GBP 207 billion in Q3 2025, year-on-year cumulative). Nevertheless, this investment momentum will be slowed by declining investment in struggling industrial sectors with production overcapacity (chemicals, plastics, steel). More broadly, business activity remains constrained by rising labour costs and persistent margin erosion (23.7% of value added in Q3 2025, the lowest since 2007).

Household spending intentions (consumption and investment) are also less positive. They are being penalised by the deterioration in the labour market the climate of uncertainty (fiscal policy, trade tensions) which is weighing on household confidence.

LABOUR MARKET: DETERIORATION EXPECTED TO CONTINUE

The unemployment rate reached 5% in October – its highest level since 2021. The deterioration has been significant since the beginning of the year (+0.6 pp) and the unfavourable trends in various surveys (REC/KPMG, Deloitte CFO) suggest that the jobless rate could continue to rise, towards 5.5% in 2026, especially as growth is expected to be unevenly distributed across sectors. The United Kingdom is also experiencing specific sectoral dynamics following Brexit: unlike the eurozone, traditionally buoyant industries such as finance and insurance have suffered net job losses in the UK. The rise in unemployment is also expected to weigh on wages: wage growth in the private sector excluding bonuses (which stood at 3.8% year-on-year in September) is expected to slow gradually to between 3.0% and 3.5% in 2026. This will support disinflation and companies seeking to rebuild their margins, while household purchasing power gains are expected to remain positive in 2026 (around 1%), with lower inflation offsetting slower wage growth.

GROWTH AND INFLATION (YEARLY AVERAGE)

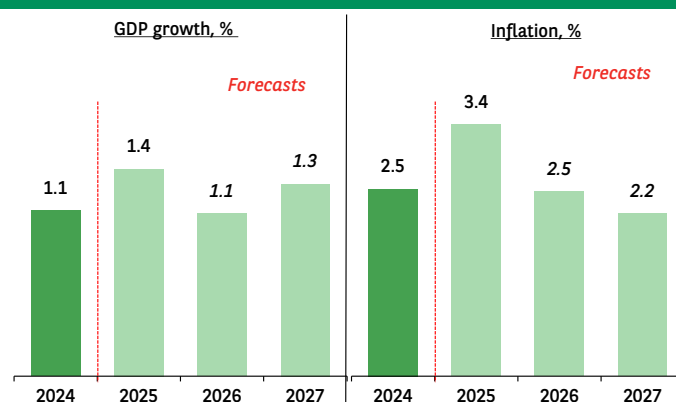


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

DISINFLATION IS EXPECTED TO ACCELERATE

Inflation remains relatively widespread, with nearly 60% of the components of the consumer price index above 4% y/y in October. However, according to our forecasts, inflation is expected to decline quite sharply by the end of 2026 (to 2.2% in Q4 from 3.6% y/y in October 2025), thus moving closer to the BoE's target. Inflation in services – the main driver of price rises – is expected to slow, more significantly from April 2026 onwards due to favourable base effects (the dissipation of the effects of the April 2025 fiscal measures, notably the tax on electric vehicles; and the sharp past increase in airfares).

An earlier and more pronounced slowdown in inflation cannot be ruled out (see chart). Faced with weak demand and international competition (this autumn, the United Kingdom became the first export market for Chinese car manufacturers), companies' pricing power has indeed been eroded, according to companies surveyed in the November PMI report. This constitutes a downside risk to inflation, which our scenario of stable energy prices on international markets is unlikely to counteract.

MONETARY POLICY: GRADUAL EASING

The BoE is expected to continue its gradual easing of monetary policy. Two further cuts are expected in December 2025 and then in Q1 2026, reflecting a cautious approach in a context of still relatively high inflation. Monetary policy would thus remain restrictive: an interest rate of 3.5% at the end of Q1 2026 would be above our estimated neutral rate range (2.25-3.25%). With more pronounced disinflation, two further


BNP PARIBAS

The bank
for a changing
world

cuts would occur in H1 2027. Some members of the Monetary Policy Committee already believe that monetary policy is now too restrictive in view of the economic slowdown. The risks are therefore on the downside compared to our central scenario for key interest rates.

As announced in September, the BoE will continue to reduce the size of its balance sheet in 2026 (by GBP 70 billion over the period October 2025–September 2026), but at a slower pace than in 2025 (GBP 100 bn between October 2024 and September 2025), given the tensions on the long end of the yield curve. Unlike other central banks, the BoE does not limit itself to maturing maturities but actively sells its securities on the secondary market. While short-term UK bond yields are likely to remain on a downward trend due to monetary easing, long-term rates would remain constrained at the start of the year (4.5% in Q1 for 10-year rates) by political uncertainty linked to the local elections in May, before easing more markedly in the second half of the year (4.3% in Q4 2026).

PUBLIC FINANCES: THE BUDGET PASSES, UNCERTAINTIES REMAIN

Fiscal policy will remain moderately restrictive in 2026. However, this will not be enough at this stage to stabilise the debt ratio, which is expected to reach 103.3% of GDP (compared with 101.3% in 2024). Nevertheless, the debt trajectory remains under control and continued fiscal consolidation efforts would limit the increase in this ratio in the coming years.

However, with the autumn budget, the government has not managed to rule out the possibility of resorting to new consolidation measures in the near future in order to comply with its own budgetary rules. The fiscal headroom available to the government to bring the current budget balance back into equilibrium by 2029–2030 has increased (from GBP 9.9 bn to GBP 21.7 bn), but it remains limited given the OBR's strong assumptions on i/ the growth scenario (+1.5% in 2026 and +1.4% in 2027, compared with +1.1% and +1.3% in our scenario, respectively) and ii/ the expected evolution of certain indicators (decline in the savings rate, drop in the unemployment rate, rebound in residential construction in 2027).

The announced tax increases (GBP 28 bn by 2029–2030) will mainly materialise at the end of the decade, while spending will increase from 2026 onwards. While the end point is reassuring, with marked consolidation by 2030 (the OBR expects a deficit of 2.4% of GDP at that date, compared with 5.0% in 2025 and 4.1% in 2026), this asymmetry carries the risk of delaying and making consolidation even more difficult, with the forthcoming rise in the apparent interest rate (which we estimate will exceed nominal growth from 2029 onwards). The OBR scenario forecasts that the public deficit will fall to 3.6% of GDP in 2027. Given our lower growth scenario, the risks point to a worsening deficit in the short term.

FOREIGN TRADE WILL BENEFIT FROM THE RISE OF AI AND TECHNOLOGY

The trade deficit continues to worsen (GBP 235.4 bn in Q3 on a twelve-month cumulative basis, a record high). Exports to the United States, particularly automobiles, have suffered from increased tariffs. However, bilateral negotiations are progressing and certain sectors will benefit from more favourable conditions in 2026, notably pharmaceuticals (the exemption from US tariffs on imports of British pharmaceutical products has been made permanent), which account for 10% of UK exports. Trade agreements with India and Europe (rearmament, including the SAFE programme, on which discussions are not progressing) are not sufficient, as they stand, to offset the impact of Brexit.

UNITED KINGDOM: MANUFACTURING PMI AND CONSUMER/PRODUCER PRICES

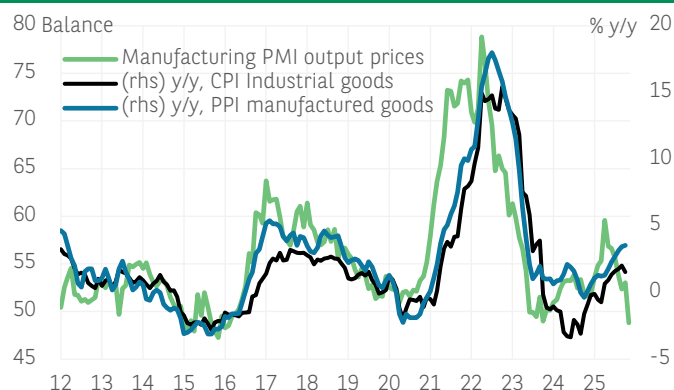


CHART 2

SOURCE: ONS, MARKIT, BNP PARIBAS

Nevertheless, the surplus in services continues to expand (GBP 206.9 bn in Q3) and offset much of the goods deficit. As a result, the current account deficit (2.6% of GDP in Q2 2025) is under control and will remain so in 2026. Exports of services, one of the UK's strengths, will continue to play an important role as a shock absorber, increasingly so thanks to the boom in digital and tech investment on both sides of the Atlantic.

Exports in this area (information and communication services, royalties, management/consulting services) accelerated in 2025 (+11.4% year-on-year, cumulative for the first nine months of 2025 compared to the same period in 2024), and the ambitious national strategy for component manufacturing and quantum computing should support an increase in exports.

Article completed on 3 December 2025

Guillaume Derrien (with the assistance of Benjamin Puiseux, intern)

guillaume.a.derrien@bnpparibas.com



BNP PARIBAS

The bank
for a changing
world