UNITED KINGDOM SCENARIO 2025-2026

TARIFFS AND UNCERTAINTY DARKEN THE OUTLOOK

April 2025

Slavena Nazarova

WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

GROUP ECONOMIC RESEARCH

U.S. TARIFFS AND RISING LABOR COSTS WEIGH ON ECONOMIC OUTLOOK

Scenario highlights

- **GDP growth is likely to be solid in the first quarter, but this strength is expected to be only temporary.**
- **Inflation is expected to rebound above 3% in April and peak in the third quarter. The impact of tariffs is ambiguous but should be disinflationary in the medium term.**
- **The *Bank of England* is expected to cut its key interest rate to 4.25% in May. It could accelerate its monetary easing in the second half of the year to support demand.**
- **While tariffs are a potentially significant negative shock to the UK economy, estimates of the impact are surrounded by a great deal of uncertainty.**
- **Labour market conditions are expected to deteriorate in the coming months.**
- **Finally, public finances are vulnerable to any increase in the cost of borrowing and/or weak growth. Fiscal policy will remain restrictive.**

	2023	2024	2025	2026
% annual change				
PIB	0.4	1.1	0.9	1.4
Household consumption	0.5	0.6	0.9	1.4
Government consumption	1.6	3.0	3.3	4.1
Investment	0.3	1.5	1.8	3.7
Inflation CPI	7.3	2.5	3.2	2.4
Unemployment rate (%)	4.1	4.3	4.6	4.7
Contribution to GDP growth, pp				
Domestic demand	0.0	2.4	2.8	2.4
Net exports	0.3	-1.3	-1.9	-1.0
Variation des stocks	-0.9	0.2	0.8	0.0

Forecast as of 30/03/2025

Sources: ONS, Crédit Agricole S.A./ECO

We expect GDP growth of 0.3% quarter-on-quarter in the first quarter of 2025 after +0.1% in the fourth quarter of 2024. But the recently released monthly GDP data for February suggest upside risks to our forecast. Growth in the first quarter could be close to 0.6% in quarterly variation.

Activity is expected to slow down in the second quarter. We expect growth of around 0.2% quarter-on-quarter due to increased global uncertainty, tighter financial market conditions following the imposition of tariffs by the White House, but also the rise in employer National Insurance contributions (NICs) by the UK government and in regulated energy prices in April.

Annual GDP growth is revised downwards to 0.9% in 2025 and 1.4% in 2026 (compared to 1.1% and 1.6% expected respectively three months ago), forecasts surrounded by a high degree of uncertainty due to the uncertain impact of tariffs. We have revised upwards our unemployment rate forecast to 4.7% in the second half of 2025 and in 2026, from 4.4% in the fourth quarter of 2024.

US tariffs on goods imported from the UK could subtract from 0.1% to 0.6% of UK real GDP, or even more in the event of retaliation or announcements of additional tariffs (notably those expected on pharmaceutical products); in the worst-case scenario imagined by the OBR, tariffs can subtract up to 1% of UK GDP in 2026-27. Such an impact is not factored into our forecasts. On the labour market, employment expectations were already deteriorating due to the rise in labour costs in April (employers NICs and the national living wage) and several tens of thousands of jobs could be lost as a result of the tariffs.

With the government having almost no room for manoeuvre, any support for the economy will have to be provided by a more aggressive easing of monetary policy. We expect the BoE to cut rates by 25 basis points per quarter this year (in May, August and November 2025) in our central scenario, which would bring the Bank rate to 3.75% at the end of the year (from 4.5% today). However, the BoE could accelerate its pace of rate cuts.

SUMMARY – GROWTH RATES REVISED DOWNWARDS AGAIN

Q1-2025 GROWTH IS LIKELY TO BE SOLID, BUT THIS IS NOT EXPECTED TO LAST

Q1-2025 growth could be close to 0.6%, then decline sharply in Q2

The UK economy stagnated overall in the second half of 2024, after a strong first half of the year, bringing the annual growth rate in 2024 to 1.1%, from 0.4% in 2023. GDP grew by 0.1% quarter-on-quarter in the fourth quarter of 2024, in line with our forecasts, but contrary to consensus forecasts and BoE expectations of a contraction of 0.1%. Strong changes in inventories largely explain this positive surprise, while household consumption was almost stable and business investment fell by 1.9% quarter-on-quarter. Net exports were weak, with a negative contribution to growth (-1.6 percentage points – pp), as exports contracted while imports increased (-1.8% and +2.9% quarter-on-quarter, respectively).

We expect GDP growth of 0.3% quarter-on-quarter in the first quarter of 2025, surrounded by upside risks. Indeed, activity increased by 0.5% month-on-month in February after 0.4% in December and 0.1% in January. The carry-over effect for the growth rate in the first quarter stands at 0.6%. However, activity is likely to slow down in the second half of the year due to the combined effect of rising labour costs and uncertainties related to Trump's trade policy.

Business confidence surveys in the private sector point to lower expectations for the next three months, according to the CBI, with declines in expected output volumes in services, particularly professional and business services, while expectations are stable in the manufacturing sector.

The main factor of gloom among the companies was the increase in employer NICs in April and the increase in the national living wage (NLW). However, more and more companies are reporting that uncertainty around US tariffs is impacting new orders and causing some projects to be suspended or delayed. The combination of all these factors is also weighing on consumer confidence.

Increase in business wage costs on 1st April

On 1 April, the rises in employer NICs (1.2 pp) and in the NLW (6.7% to £12.21), announced by the UK government in the Autumn Budget in October 2024, will come into force.

Companies will probably try to pass on some of the additional costs to prices, but profit margins are likely to be squeezed overall and headcounts are likely to be cut. Indeed, surveys of companies suggest increased pressure on prices as well as a decline in hiring intentions. Lower-paid jobs are particularly vulnerable due to the lowering of the threshold (from £9,000 to £5,000) at which companies pay NICs. Companies also risk lowering wages when they can, in order to compensate for the increase in the NLW. The economic impact is expected to be higher inflation, lower business investment, lower employment and lower wage growth.

While we already priced these negative effects into our scenario three months ago, surveys suggest that the impact on employment is likely to be more immediate than expected. We have revised up our unemployment rate forecast to 4.6% in the second quarter 2025 and to 4.7% in the second half of 2025, from 4.4% in the fourth quarter of 2024. The deteriorating outlook for the labour market poses downside risks to household consumption growth. In addition, regulated prices of gas, electricity and water rose in April, which should lead to an acceleration in inflation in the near term. After falling over the past two months to 2.6% in March, CPI inflation is expected to accelerate to 3.3% in April and peak in the third quarter at around 3.6%.

US tariffs increase in March and April[1]

The United Kingdom initially seemed to be one of the countries least at risk of being subject to tariffs due to its almost balanced trade balance in goods with the United States. It even had a kind of competitive advantage relative to most other countries since Donald Trump announced a “reciprocal” tariff of 10% for the United Kingdom, compared to 20% for the European Union.

While "reciprocal" tariffs have been suspended, the United Kingdom is now among the vulnerable countries due to tariffs on cars (25% from 3 April), steel and aluminium (25% from 12 March), the universal rate of 10% on other goods (from 5 April) and the expected "major" tariffs on pharmaceuticals.

(1) See pages 7 to 12

SUMMARY – GROWTH RATES REVISED DOWNWARDS AGAIN

A RESTRICTIVE POLICY MIX

Fiscal policy will remain restrictive[1]

In her first Autumn Statement on 30 October, Chancellor of the Exchequer Rachel Reeves announced a sharp increase in taxation (estimated at 1.1% of GDP according to the OBR) in order to finance significant increases in spending on public services and capital spending in infrastructure and the green transition. However, rising *gilt* rates and disappointing growth forced the government to tighten budgetary policy in March, this time largely through cuts in welfare spending (by £4.8 billion in 2029-30) and current departmental spending. Given the limited margin, or fiscal headroom, against the government's fiscal rules, the risks of a further tightening of the fiscal policy through spending cuts and/or tax increases are significant.

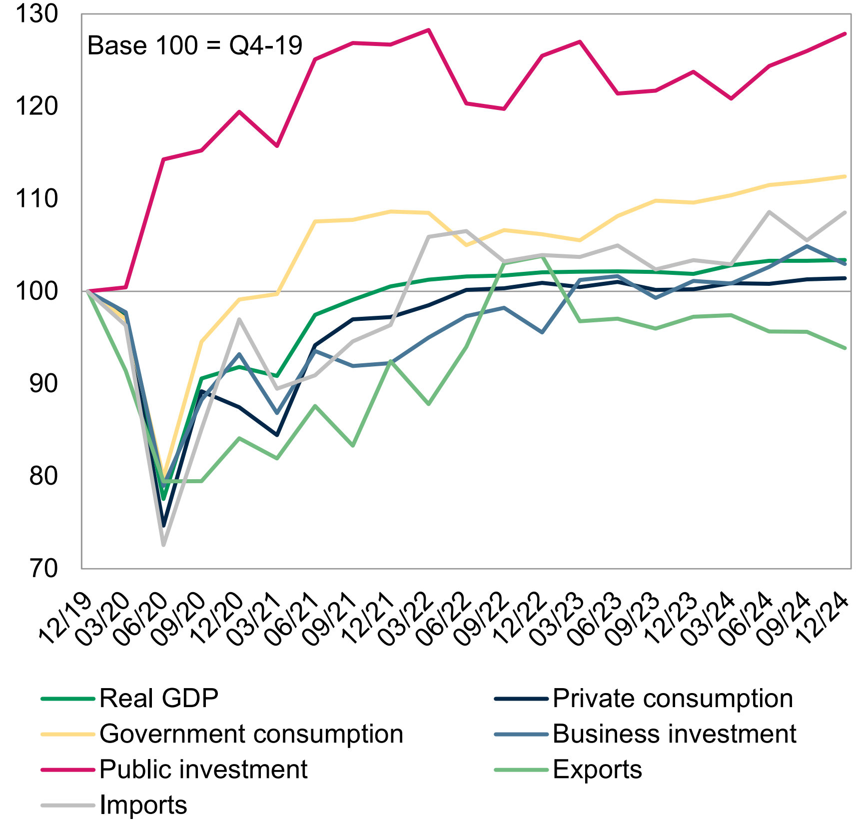
Over the next five years, the fiscal impulse will remain negative (-0.5% of GDP per year on average). Nevertheless, public investment growth is likely to be sustained, extending the post-Covid trend (see chart), as the governement plans a capital-heavy increase in defence spending to meet its commitment to spend 2.5% of GDP in 2027-28.

Monetary easing could be accelerated in the second half of the year[2]

The BoE has continued its monetary easing gradually with one rate cut per quarter, the last one being announced in February when the key policy rate was cut to 4.50%. Against a backdrop of above-target inflation and persistently high services inflation, the central bank continues to signal that "monetary policy will need to continue to remain restrictive for sufficiently long until the risks to inflation returning sustainably to the 2% target in the medium term have dissipated further".The BoE expects CPI inflation to rise quite sharply in the near term, to 3.7% in Q3. However, it judges that this would not lead to additional second-round effects on underlying domestic inflationary pressures as the recent slowdown in demand has led to a small margin of slack opening up in the economy. The uncertainties around the evolution of the balance between supply and demand in the economy warrant a "gradual and carreful" removal of monetary policy restriction. However, the risks to the UK economy stemming from Trump's tariffs could lead the BoE to accelerate its monetary easing in the coming months.

[1] See pages 20 à 22
[2] See page 23

Components of demand since Covid: an increased role for public investment

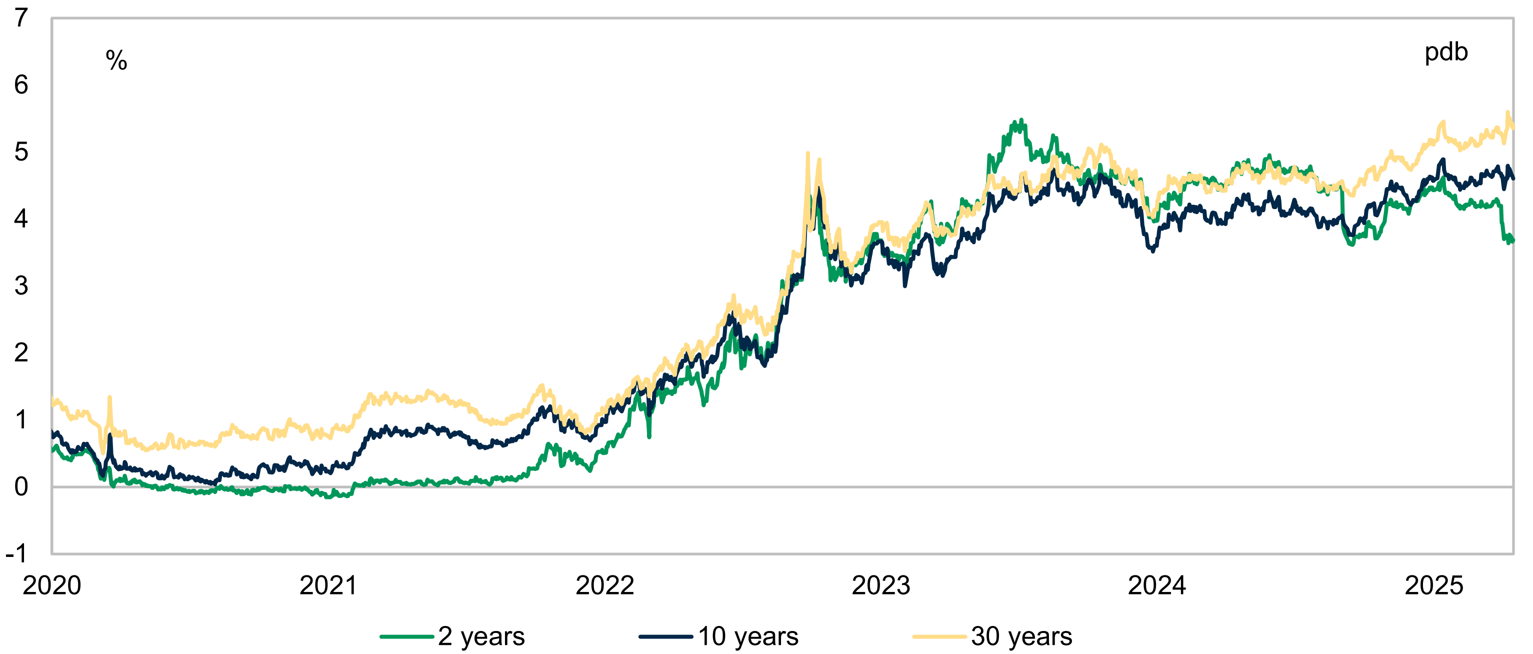


Sources: ONS, Crédit Agricole S.A./ECO

TIGHTENING OF FINANCIAL CONDITIONS

MARKET VOLATILITY HAS LED TO A RISE IN THE COST OF BORROWING FOR THE BRITISH GOVERNMENT

UK government bond yields



Sources: Refinitiv Eikon Datastream, Crédit Agricole S.A./ECO

Donald Trump's "*Liberation Day*" and his announcements of tariffs have brought American tariff policy back to the levels of the early twentieth century. Protectionist trade policy on the part of the world's largest economy will undoubtedly disrupt world trade. In addition to the direct impacts of the tariffs on trade, President Trump's chaotic approach has created enormous uncertainty. This increases the risks of a sharp global slowdown. Global stock markets have "crashed," oil prices have fallen sharply, and credit markets are showing early signs of distress, even after the pause in reciprocal tariffs. This volatility has also led to a rise in the cost of borrowing by the UK government – with 30-year yields at their highest level since 1998 – and threatens to dampen growth due to lower confidence and tighter financial conditions, compounding the impact of tariffs on trade. A 50 basis point hike in *gilt* rates is enough to erase the government's room for manoeuvre with its fiscal rules, which may force it to announce further tightening of fiscal policy *via* public spending cuts or tax increases.

THE INTERNATIONAL ENVIRONMENT

GLOBAL ECONOMIC SLOWDOWN

Global economic growth is expected to slow in 2025 and accelerate modestly in 2026, mainly due to the dynamics of advanced economies. As for emerging countries, growth is expected to rise from 4.3% in 2024 to 4% in 2025 and 2026. We expect growth in China to continue to slow in 2025, with exports likely to be severely dampened by higher US tariffs and the gradual recovery in domestic demand. GDP growth is expected to slow to 4.6% in 2025 and 4.3% in 2026, from 5.0% in 2024.

US growth is expected to slow in 2025 to a pace of 1.7% in 2025, before rebounding to 2.2% in 2026. Inflation is expected to follow this slowdown in early 2025 before rebounding at the end of the year with an annual average of 2.7% in 2025 and 2026. The Fed, after a pause, should eventually restart its rate cut process with two more 25 bps cuts in June and September, before starting an extended pause with a ceiling set at 4.00%. Long-term rates could fall slightly in the second quarter of 2025 in response to the negative impact of tariffs on growth and the resumption of rate cuts by the Fed expected in June.

Yields on 10-year *Treasuries* are expected to be 4.45% at the end of 2025 and 4.75% at the end of 2026.

The ECB's easing is nearing its end and we expect a final rate cut, of 25 basis points in June 2025, after which the deposit rate would be kept at 2.00% until the end of 2026. The German ten-year yield is expected to remain above 3% (3.1% at the end of 2026). The steepening of the German curve and the prospects of increased growth in the Eurozone suggest a further tightening of sovereign spreads, with the OAT premium at 55bp at the end of 2026 and the BTP premium at 105bp. The euro could reach 1.12 against the dollar in the fourth quarter of 2025, a level that is not expected to be exceeded due to an expected new rebound in the US economy, Treasury yields and therefore the dollar in the second half of 2026.

OPEC+'s recent announcement to increase production is expected to cause prices to drop moderately to $71 per barrel on average in 2025 and $70 per barrel in 2026. The use of natural gas inventories during this colder winter than the previous ones is expected to strain the liquefied natural gas market in the coming months.

International background assumptions

	2023	2024	2025	2026	2023				2024				2025				2026			
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP Euo area (YoY, QoQ, %)	0.9	0.9	1.0	1.5	0.5	0.1	0.0	0.1	0.3	0.2	0.4	0.2	0.2	0.1	0.3	0.6	0.3	0.3	0.3	0.3
GDP United States (YoY, QoQ, annualised, %)	2.9	2.8	1.7	2.2	2.8	2.4	4.4	3.2	1.6	3.0	3.1	2.4	0.8	1.5	1.2	1.8	2.5	2.5	2.4	2.4
GDP China (YoY, QoQ, %)	5.4	5.0	4.6	4.3	1.7	1.2	1.5	0.9	1.5	0.9	1.3	1.6	1.3	0.7	0.9	1.0	1.3	1.1	1.0	1.0
GDP World (YoY, QoQ, %)	3.3	3.1	2.8	3.0	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
ECB Deposit rate (period end, %)	4.00	3.00	2.25	2.50	3.00	3.50	4.00	4.00	4.00	3.75	3.50	3.00	2.50	2.25	2.25	2.25	2.25	2.25	2.25	2.50
Fed Funds rate (period end, %)	5.50	4.50	4.00	4.00	5.00	5.50	5.50	5.50	5.50	5.50	5.00	4.50	4.50	4.25	4.00	4.00	4.00	4.00	4.00	4.00
Exchange rate (average, EUR/USD)	1.08	1.08	1.10	1.11	1.07	1.09	1.09	1.08	1.09	1.08	1.10	1.07	1.11	1.08	1.10	1.12	1.12	1.11	1.10	1.10
Brent (average, USD/barrell)	82.2	79.9	71.3	69.3	82.2	77.9	85.9	83.0	81.9	85.0	78.9	74.0	75.1	73.0	70.0	67.0	65.0	70.0	70.0	72.0

Sources: BEA: BEA, ECB, Eurostat, IMF, Refinitiv, Federal Reserve, Crédit Agricole S.A./ECO

FOCUS – IMPACT OF US TARIFFS ON THE UK ECONOMY

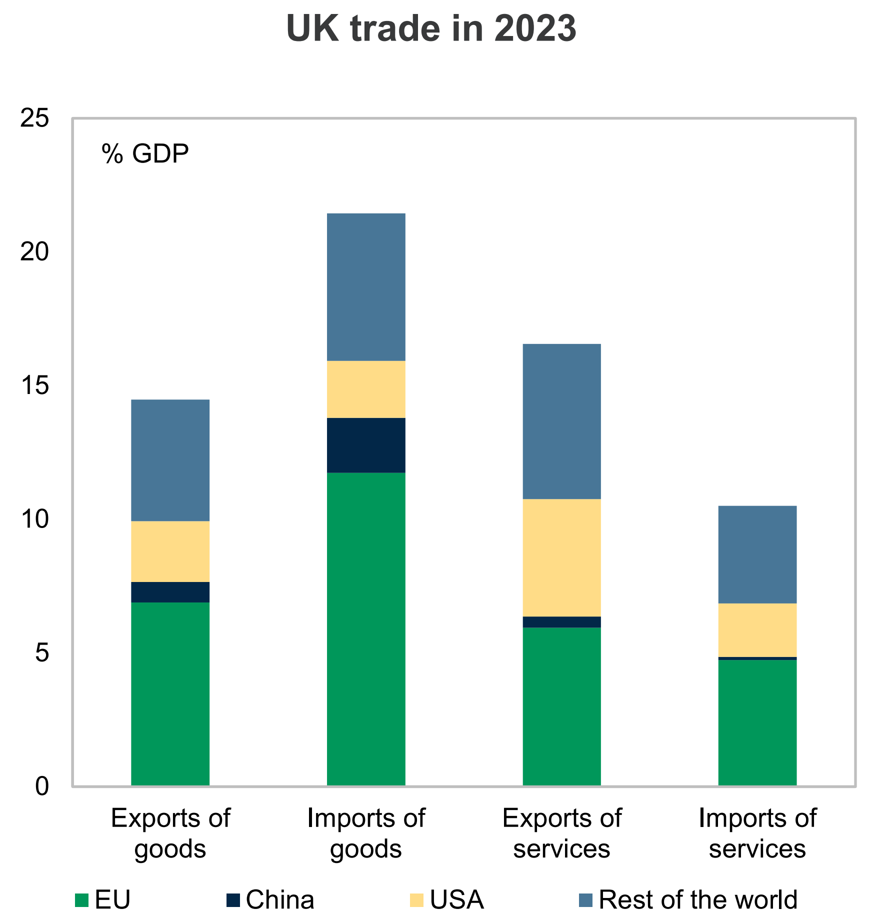
THE UNITED STATES PLAYS AN IMPORTANT ROLE IN UK TRADE

The United States is the UK's largest trading partner after the European Union. For goods, the United States is the first destination for UK exports and the third largest source of imports (after Germany and China). According to the ONS, in 2023, the UK imported £58 billion worth of goods from the United States (10% of all UK goods imports, or 2.1% of UK GDP) and exported £60 billion worth of goods (15.3% of all goods exports, or 2.2% of GDP). The trade balance in goods with the United States is therefore almost balanced (and even in deficit of USD 11.9 billion in 2024, according to data from the *US Census Bureau*).

In 2023, the United States was the UK's largest import and export partner for services. The UK trade balance in services with the United States is in large surplus, with services exports to the United States amounting to £126 billion (or 27% of all UK services exports) against £57 billion of services imports (19.5% of all UK services imports).

Machinery and transport equipment are the UK's top exports of goods to the United States, amounting to £27 billion in 2023, accounting for almost half (45%) of all goods exports to the United States. With £6.4 billion in car exports (18.4% of all UK car exports), the United States is the UK's top export partner for cars, ahead of Germany and the Netherlands.

Chemicals are the second most exported product, with around £14 billion in exports to the United States in 2023, accounting for almost a quarter of the UK's total chemical exports. This figure mainly included £8.8 billion worth of medicinal and pharmaceutical products. The United Kingdom is thus among the countries most exposed to Donald Trump's trade war due to the imposition of a 25% tariff on cars, future tariffs on pharmaceutical products as well as a "universal" tariff of 10% on the rest of US goods imports from the UK.

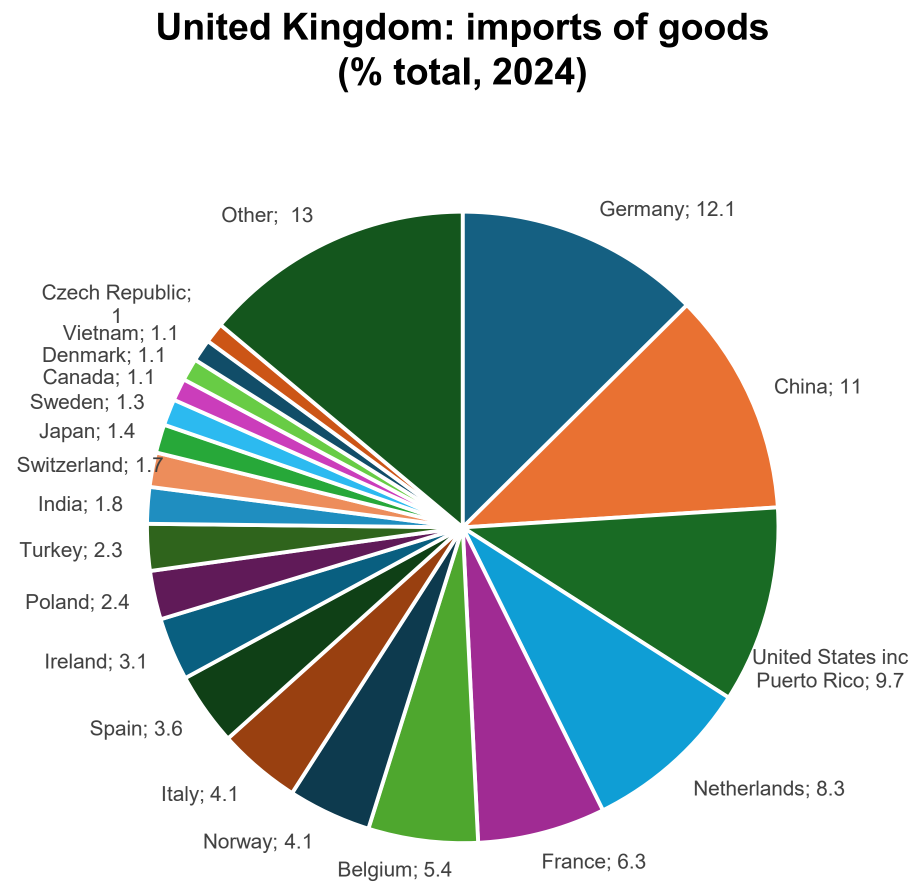


Sources: ONS, Crédit Agricole SA / ECO

FOCUS – IMPACT OF US TARIFFS ON THE UK ECONOMY

THE UNITED STATES PLAYS AN IMPORTANT ROLE IN UK TRADE

Sources: ONS, Crédit Agricole SA / ECO

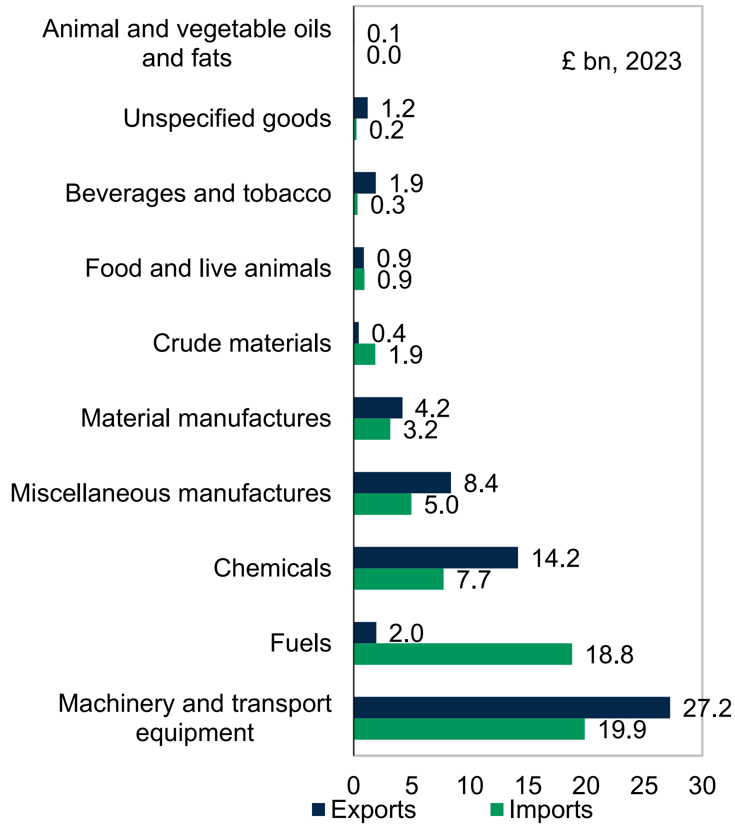


Sources: ONS, Crédit Agricole SA / ECO

FOCUS – IMPACT OF US TARIFFS ON THE UK ECONOMY

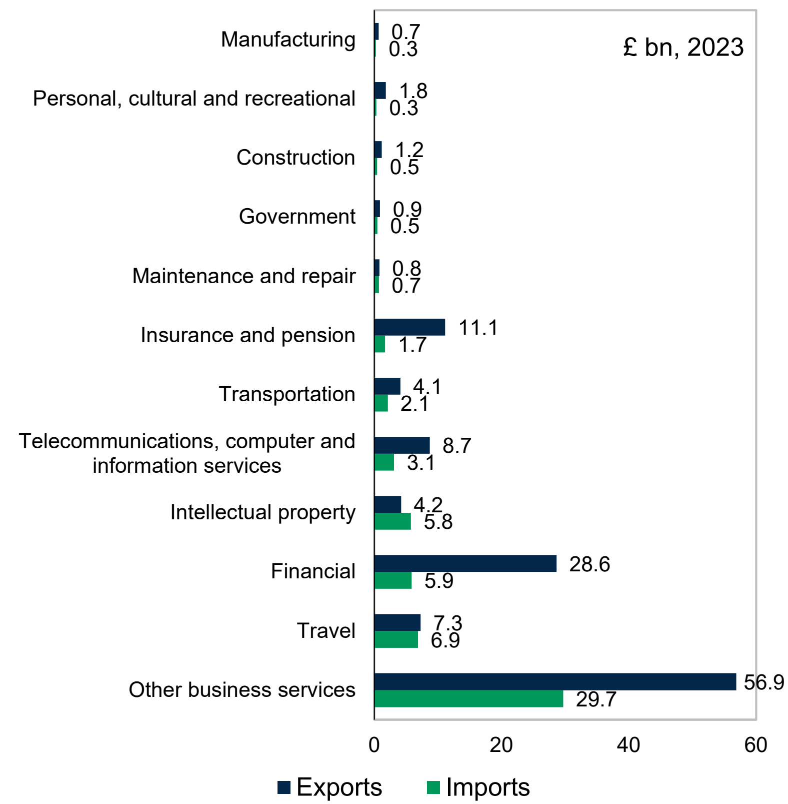
THE UNITED KINGDOM MAINLY EXPORTS BUSINESS SERVICES TO THE UNITED STATES

United Kingdom trade with the United States by type of goods



Sources: ONS Crédit Agricole S.A.

United Kingdom trade with the United States by type of services



Sources: Eurostat, Crédit Agricole S.A

FOCUS – IMPACT OF US TARIFFS ON THE UK ECONOMY

A POTENTIALLY SIGNIFICANT IMPACT ON UK GROWTH

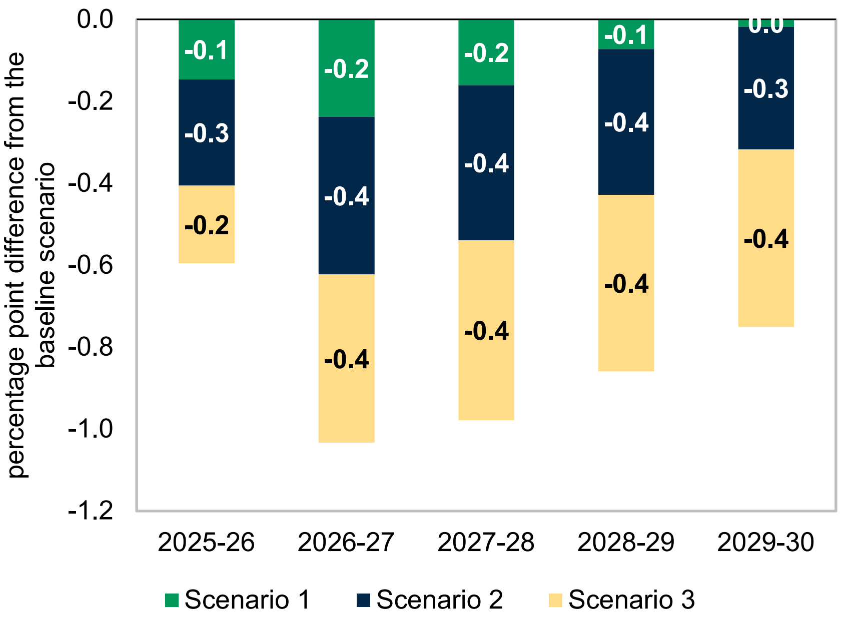
The impact of US tariffs on an open economy like the United Kingdom, whose foreign trade (imports plus exports) represents more than two-thirds of GDP, should be significant. While the *direct* impact of tariffs on UK GDP could be relatively limited[1], taking into account all the potential transmission channels of the shock (see the table on next page), the overall impact could be significantly amplified: weaker US and global global growth, possible disruptions to global value chains, the impact of uncertainty on confidence and business investment, the volatility in financial markets, rising interest rates and echange rate movements.

In a scenario based on the assumption of a universal 20% tariff from the United States on all other countries, including the United Kingdom, the OBR estimates that the overall impact on UK GDP would be 0.6% in 2026-2027, the peak year of the impact. In the medium term (by 2029-30), reduced trade openness leads to a permanently lower GDP level by around 0.3%. In a more severe scenario where all US trading partners, including the UK, retaliate by imposing there own equivalent tariffs on US goods, the peak impact on UK GDP could be around 1% in 2026-27. In the medium-term the OBR estimates that UK GDP would be around 0.75% lower than in its central scenario (which assumes no changes to US tariffs).

The impact of tariffs is likely to be very heterogeneous across sectors, with pharmaceuticals, the automotive sector and chemicals being the most exposed. The impact on the labour market could be in the tens of thousands of job losses. The automotive sector, which faces a 25% tariff, employs some 260,000 people alone. Related services such as professional services, consulting and support providers would also suffer.

[1] Using a price elasticity of -0.4 implies that for a 10% increase in the prices of imports of US goods (assuming that the increase in tariffs is fully passed on to consumer prices), US demand for UK goods would fall by 4%, all other things being equal. In the UK, where exports of goods to the US account for 2.2% of GDP, this equates to just under 0.1% of GDP.

Impact on UK GDP of three tariff scenarios



Scenario 1: The US increases tariffs levied on goods from China, Canada, and Mexico by 20%, and these countries retaliate with reciprocal tariffs.

Scenario 2: The US goes further by increasing tariffs on goods from all other countries, including the UK, by 20%.

Scenario 3: In addition to the measures in Scenarios 1 and 2, all US trading partners, including the UK, retaliate by imposing their own equivalent tariffs on US goods.

Sources: OBR EFO March 2025

FOCUS – IMPACT OF US TARIFFS ON THE UK ECONOMY

TRANSMISSION CHANNELS

Transmission channel	UK activity	UK inflation	Explanation
US demand	↓	↓	US demand for goods imported from the UK weakens (substitution effects).
Global demand	↓	↓	The trade war is weighing on global trade and global growth prospects. Foreign demand to the United Kingdom weakens.
Supply chains	↓	↑	Supply chain disruptions due to rising global trade barriers could lead to shortages of some components, which could push up global and UK prices.
Reorientation of global trade flows	↔	↓	Other countries lower the prices of exports previously destined for the US.
Uncertainty	↓	↓	UK business and household confidence deteriorates, leading to a drop in investment intentions and consumer spending.
Exchange rate movements	↓ ↑	↓ ↑	Sterling may appreciate or depreciate depending on other countries’ trade policies and changes in global risk sentiment.
Fragmentation of global trade in the long term	↓	↔	Barriers to free trade are likely to weigh on global potential growth, through lower competition and reduced knowledge spillovers.

Sources: BoE, Crédit Agricole SA / ECO

FOCUS – IMPACT OF US TARIFFS ON THE UK ECONOMY

MORE AMBIGUOUS EFFECTS ON INFLATION, BUT DISINFLATIONARY OVERALL

Impact on inflation: disinflationary in the medium/long term

The impact of the trade war on UK inflation is more difficult to estimate. Several factors are at play: the anticipated decline in global demand and oil prices, the appreciation of the pound sterling (close to 2% in effective terms since the end of January) and the possibility of a rerouting of Asian export flows to Europe should have disinflationary effects in the United Kingdom in the short and medium term. In addition to these effects, there is the weakening of demand and the rise of spare capacity, particularly on the labour market, which would result.

On the other hand, any disruption to global supply chains could lead to supply difficulties for UK companies and an increase in their production costs. This increase in production costs would come at a time when corporate margins are already under pressure due to weak domestic demand and rising labour costs. Companies will seek to pass any increase in production costs on to their selling prices. The impact of the trade war could be inflationary in this case. Thus, the OBR anticipates an impact on UK inflation of +0.3% in 2025-26, followed by a negative impact in 2027-2028 and 2028-2029 as spare capacity opens up. In the worst-case scenario assuming retaliatory measures by all US partners (tariffs at 20%), the impact on UK CPI inflation would double to almost 0.6% in 2025-26. For the time being, the UK government has chosen not to take retaliatory measures, seeking to negotiate a free trade agreement with the United States.

A more accommodative monetary policy as a result

For the BoE, it is the inflation outlook over the next two to three years, determined by the balance between supply and demand, that is key for the conduct of its monetary policy.

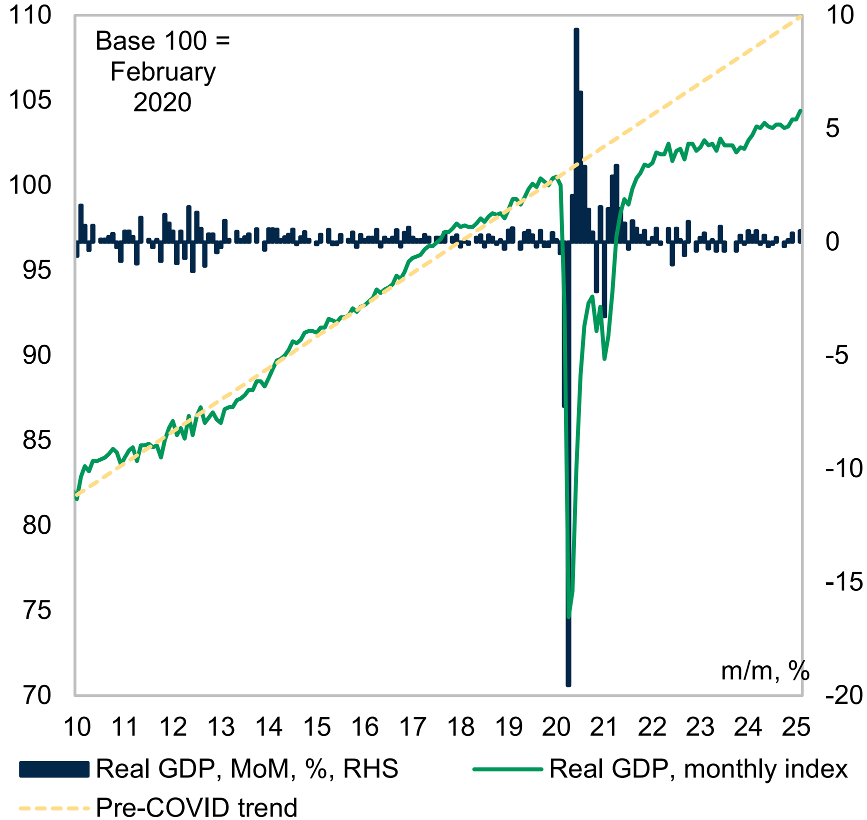
The BoE is likely to react to weakening demand and the emergence of labour market slack that could result from the trade war. We currently expect a rate cut per quarter of 25 basis points each, with the next rate cut scheduled for May, but it is possible that there are already *dovish* voices in favour of a 50 bps rate cut (and not just from Swati Dhingra).

The tariff shock also represents a supply shock due to the decline in trade, a deterioration in productivity and negative impacts on investment. In an alternative, but less likely, scenario, the BoE may decide to tilt hawkish, especially if household inflation expectations drift higher.

RECENT ECONOMIC DEVELOPMENTS

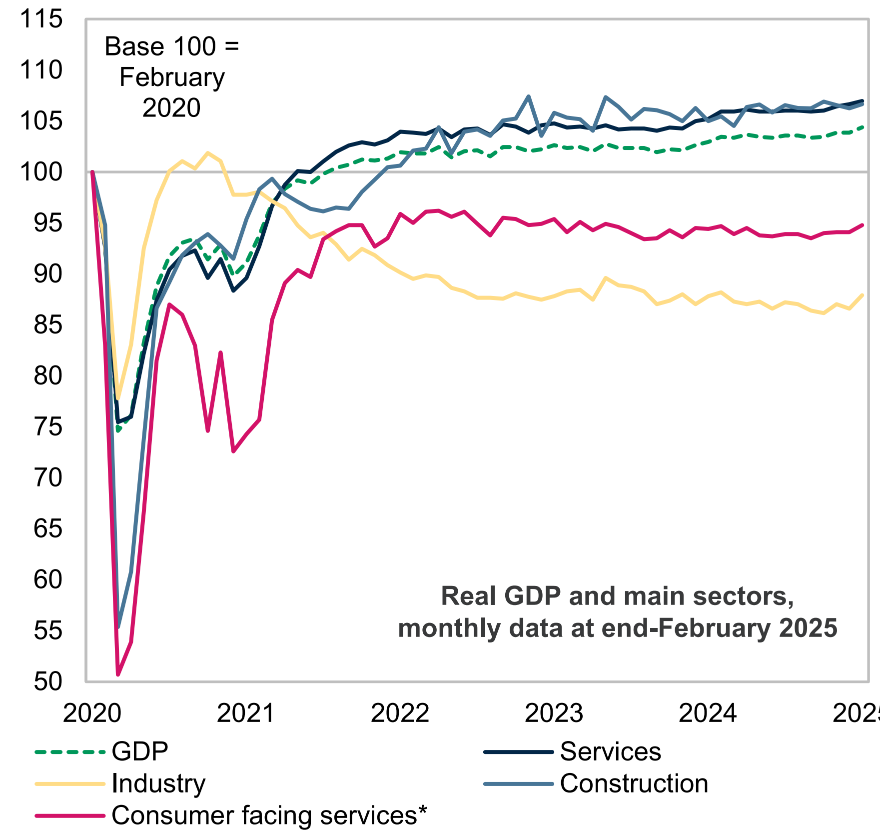
A GOOD START TO THE YEAR FOR ACTIVITY, BEFORE THE IMPLEMENTATION OF THE TARIFFS

Real GDP (monthly index) grew by 0.5% MoM in February and by 0.6% in the 3 months to February



Sources: ONS, Crédit Agricole S.A./ECO

A rebound driven by services and industry (+0.6% and +0.7% respectively over the 3 months to February)



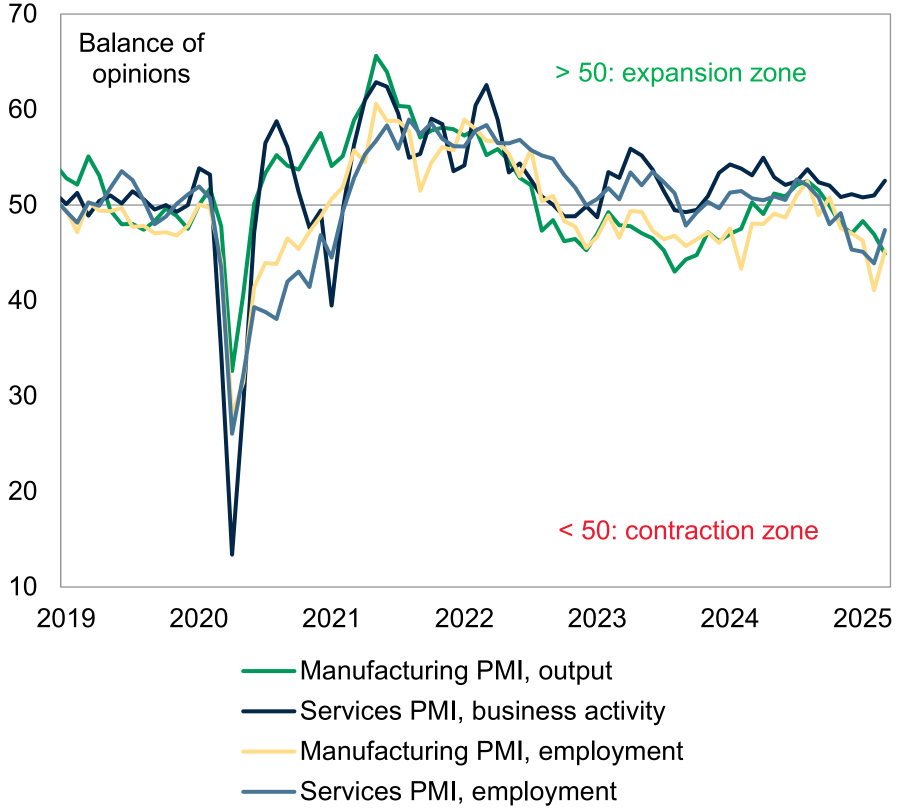
* Consumer facing services refer to retail trade, food and beverage serving activities, travel and transport, entertainment and recreation.

Sources: ONS, Crédit Agricole S.A./ECO

RECENT ECONOMIC DEVELOPMENTS

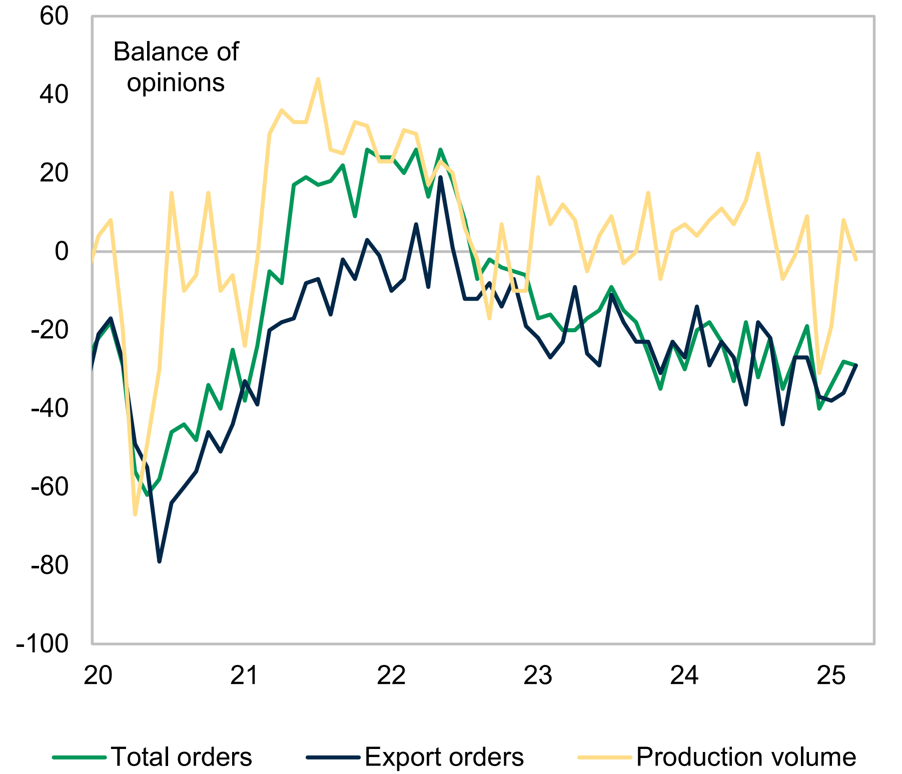
BUSINESS CONFIDENCE: RESILIENCE IN SERVICES, DETERIORATION IN INDUSTRY

Business confidence improves in services, but manufacturing activity falls



Sources: S&P Global, data at the end of March, Crédit Agricole S.A./ECO

Industry surveys: still depressed

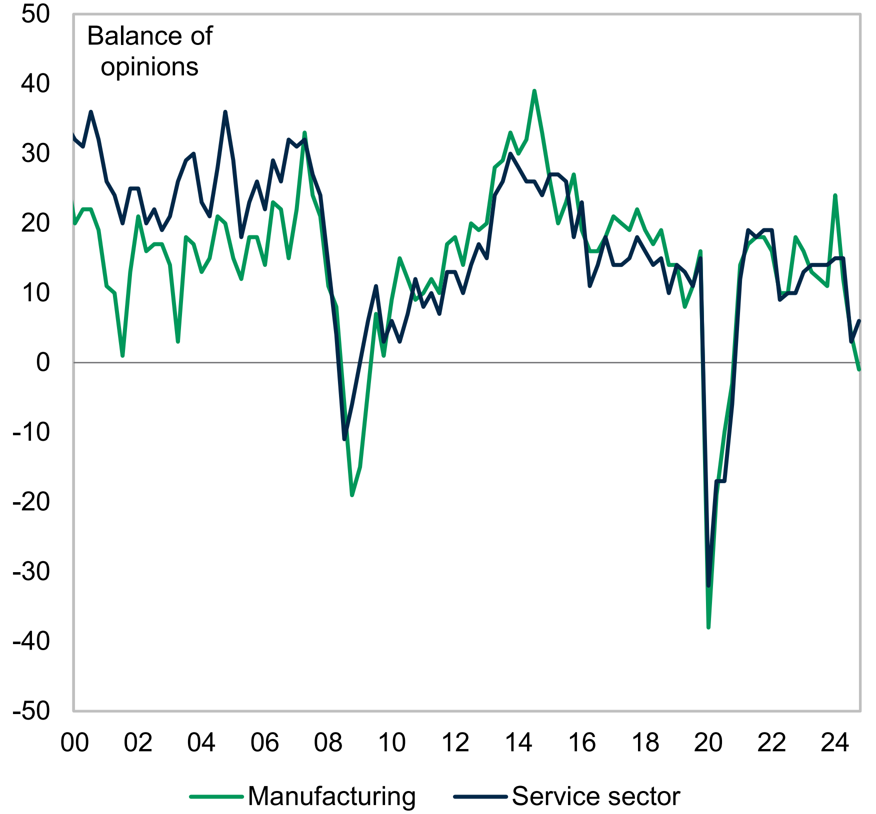


Sources: CBI, data at the end of March, Crédit Agricole S.A./ECO

RECENT ECONOMIC DEVELOPMENTS

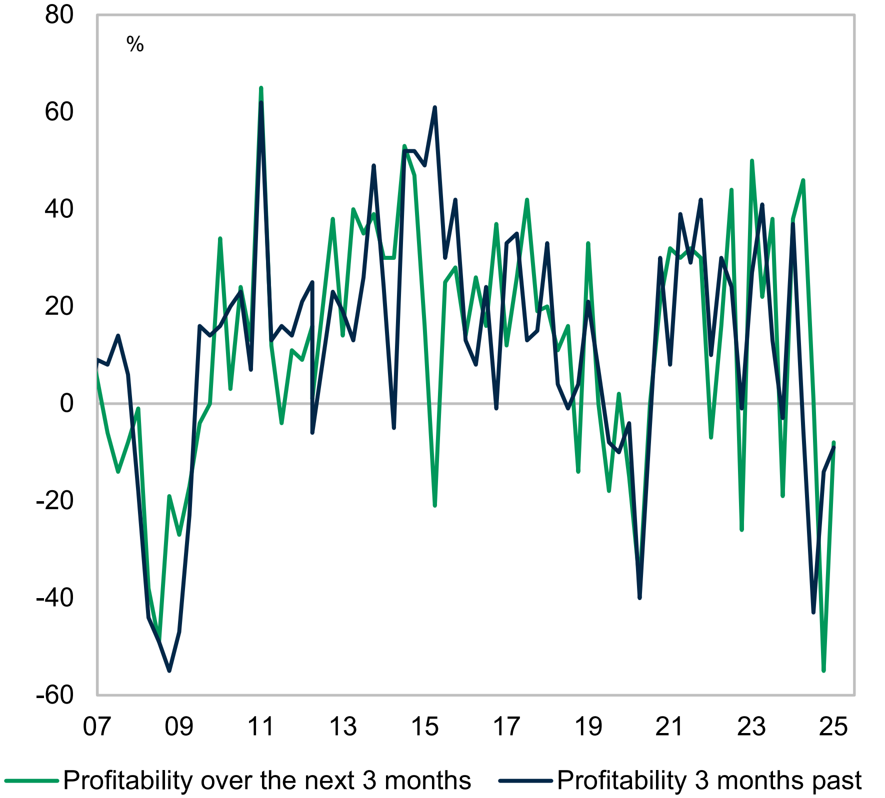
DETERIORATING INVESTMENT OUTLOOK

Weak investment intentions



Sources: BCC surveys, Q1-2025 data, Crédit Agricole S.A./ECO

Sharp deterioration in past and expected corporate profitability before a rebound in Q1



Sources: CBI surveys, Q1-2025 data, Crédit Agricole S.A./ECO

HOUSEHOLDS

CAUTION IS WARRANTED, LABOUR MARKET IS DETERIORATING

Real incomes continued to grow strongly in the fourth quarter of 2024 (+5% year-on-year for real gross disposable income, +2.4% for real wages), but households preferred to accumulate savings instead of spending. Indeed, household consumption grew by only +0.1% QoQ in the fourth quarter of 2024, after +0.5% QoQ in the third quarter, while their savings rate increased to 12%, its highest level since the pandemic.

This caution on the part of households reflects weak confidence and probably precautionary saving behaviour motivated by deteriorating labour market conditions. The unemployment rate rose to 4.4% in the fourth quarter after having fluctuated between 4.1% and 4.4% since the beginning of 2024, an increase that appears modest, but which probably underestimates "real" unemployment. Indeed, the ONS continues to warn that LFS (Labour Force Survey) data should be interpreted with great caution due small achieved sample sizes. Complementary indicators released by the ONS as well as PMI surveys and the BoE's *Decision Maker Panel* show a marked slowdown in employment growth in the second half of 2024. This is due to rising labour costs, a weak economic outlook and geopolitical uncertainty. Business surveys point to a drop in hiring intentions and plans to reduce headcount.

The labour market is now juidged to be in a slight excess of capacity. The demand for labour continued to decline in the first quarter, while the participation rate increased (to 63.4% for the population over sixteen years of age). The number of job vacancies fell to 781,000 in the first quarter (-13.8% year-on-year), below its pre-Covid level for the first time since May 2021. There are now two unemployed people per job vacancy, compared to 1.6 a year ago, the highest since April 2021.

Despite the easing of the labour market, wage growth has risen over the last three months, to 5.9% in the three months to February against 5.6% in the three months fo November. **Wage growth is expected to slow by the end of the year as the employment outlook darkens**. The BoE expects wage growth to fall below 4% by the end of the year.

Retail sales data at the end of February suggest a good start to the year for household consumption: a strength that will probably only be temporary. Retail sales volume rose 1% month-on-month in February, following a solid 1.4% increase in the previous month. The carry-over effect amounts to a solid 1.6% for the first quarter. In February, the increase was particularly strong in non-food stores (+3.1% month-on-month). Interestingly, as reported by the ONS, demand for jewellery and watches is said to have risen sharply due to economic uncertainty, while in clothing stores sales have been supported by increased discounts and price cuts. Despite the rebound, retail sales remain below their pre-Covid level. The index of activity in consumer facing services rose by 0.7% month-on-month in February after being stable in January; Its carry-over effect for the first quarter is also very strong (+0.7%).

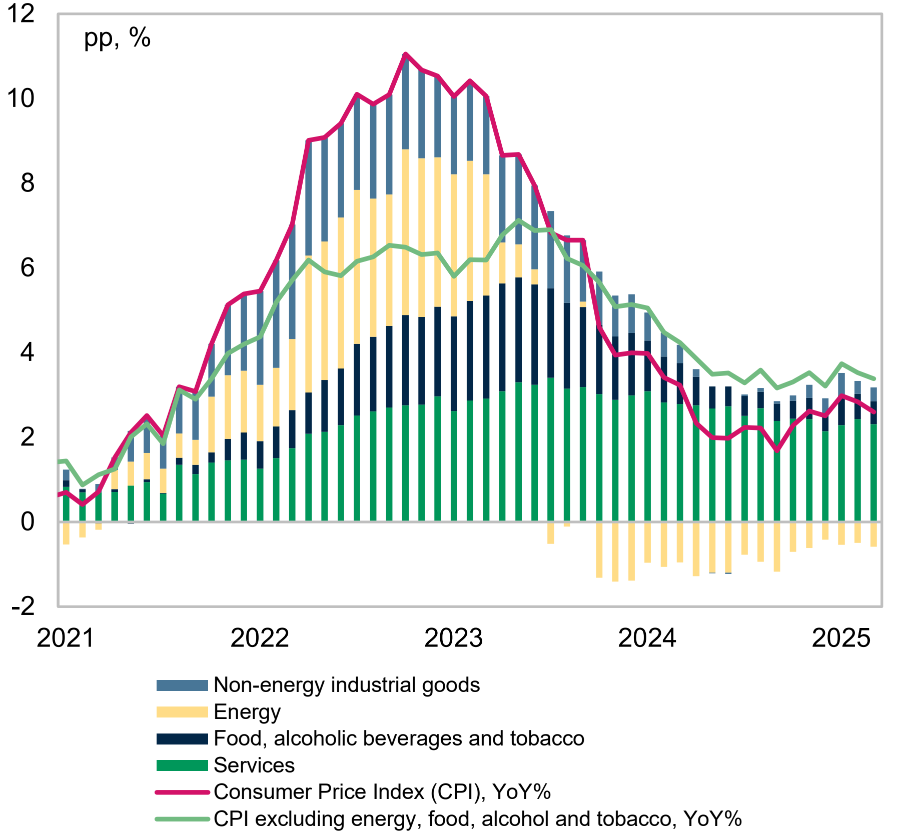
Another factor weighing on the outlook for household consumption is the persistently high levels of interest rates. According to the BoE's November 2024 Financial Stability Report, almost half of the existing stock of mortgages are expected to experience increases in interest payments by Q4-2027: some households with fixed-rate mortgages will have to refinance their loans at higher rates once they reach maturity.

We have revised downwards the growth forecasts for private consumption. Slower wage growth and faster inflation are expected to lead to a slowdown in real income in 2025. The labour market is also expected to deteriorate further amid rising business costs and uncertainty over tariffs. **We have revised up our unemployment rate forecast to 4.6% in the second quarter 2025 and 4.7% in the second half of 2025, from 4.4% in the fourth quarter of 2024.** In total, after 0.6% annual growth in 2024, household consumption is expected to increase by 0.9% in 2025 and 1.4% in 2026 (compared to 1.5% and 1.9% forecast three months ago for 2025 and 2026 respectively). The risks around our forecasts seem balanced: the deterioration in the economic outlook linked to US tariffs implies downside risks, but the high savings rate and still very strong wage growth could support household consumption more than expected.

HOUSEHOLDS

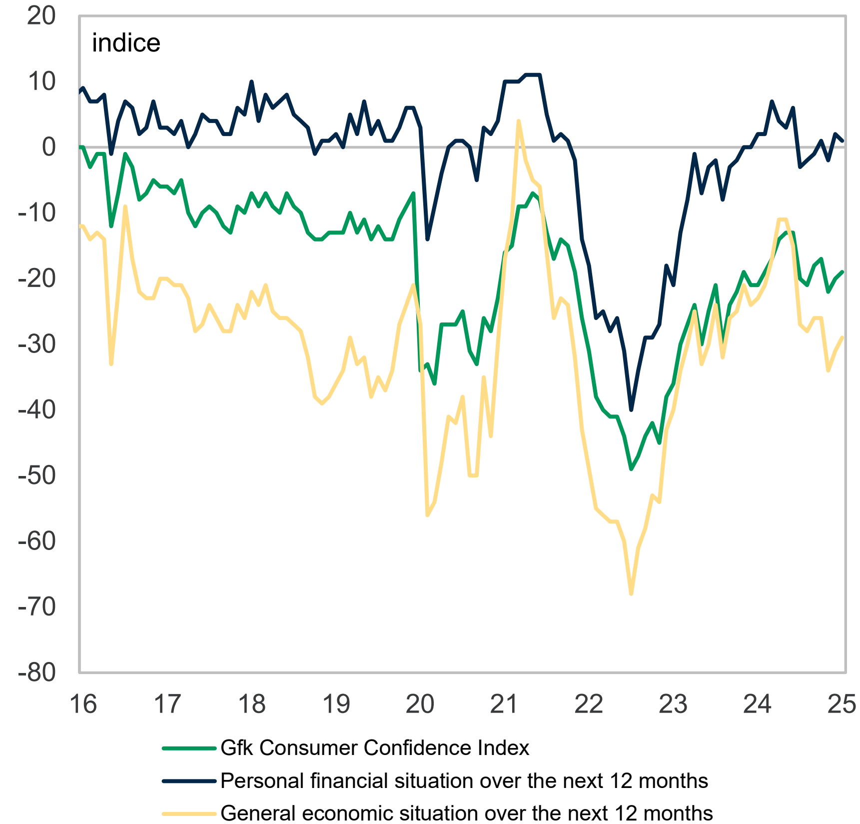
AFTER THE PRICE AND INTEREST RATE SHOCKS, HOUSEHOLDS REMAIN CAUTIOUS

The Consumer Price Index (CPI) accelerated to 2.8% YoY in Q1-2025 from 2.5% YoY in Q4-2024



Sources: ONS, Crédit Agricole S.A./ECO

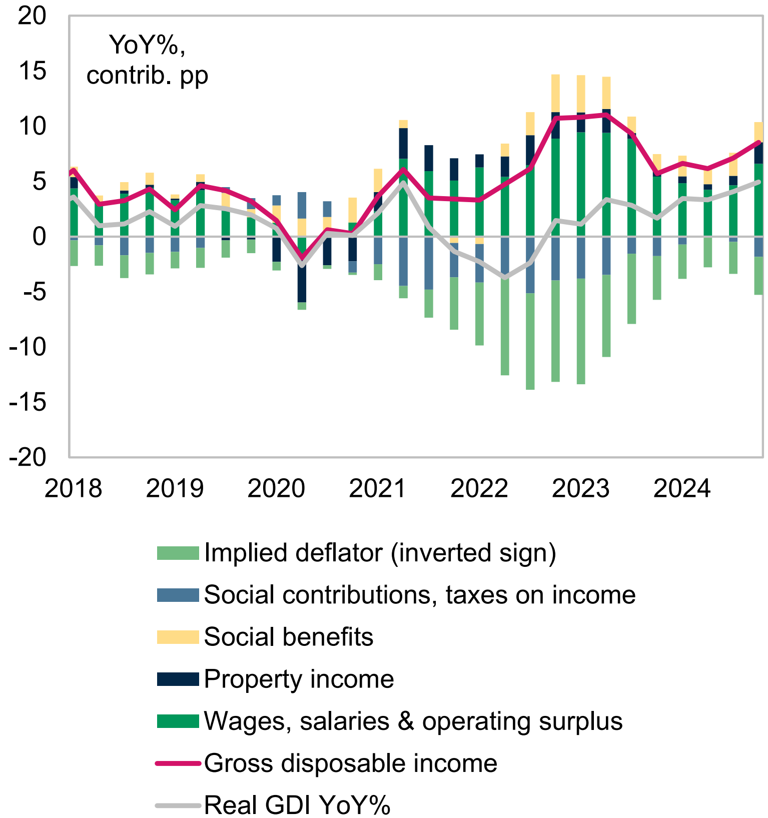
Consumer confidence recovered in March but remains mixed



Sources: Gfk, Crédit Agricole S.A./ECO

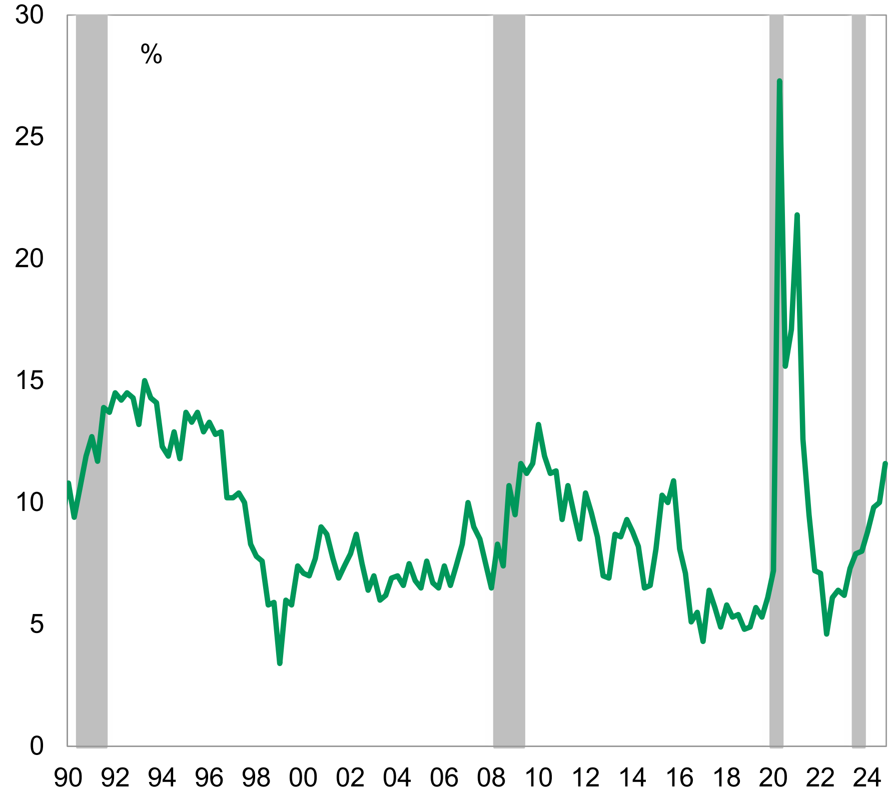
THE SOLID GAINS IN PURCHASING POWER HAVE NOT BENEFITED CONSUMPTION: HOUSEHOLDS HAVE INCREASED THEIR PRECAUTIONARY SAVINGS

Real incomes continue to rise significantly



Sources: ONS, Crédit Agricole S.A./ECO

The savings rate reached 12% in Q4-2024, its highest level since the pandemic

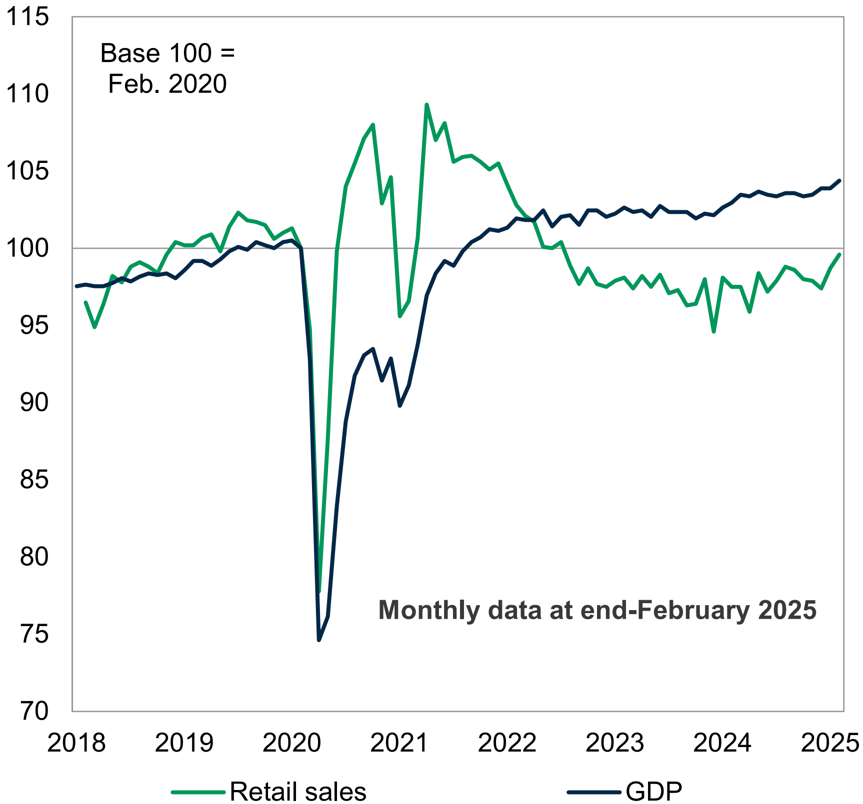


Sources: ONS, Crédit Agricole S.A./ECO

HOUSEHOLDS

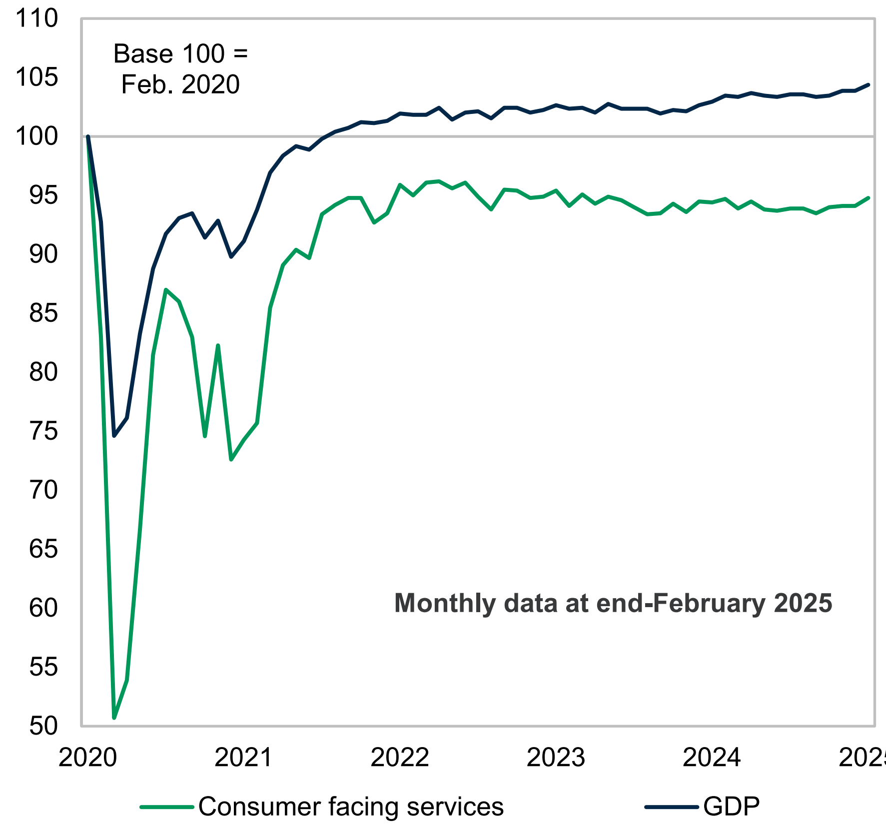
LEADING INDICATORS SUGGEST A RECOVERY, PROBABLY TEMPORARY, IN HOUSEHOLD CONSUMPTION IN Q1-2025

Retail sales increased in January and February (1.6% carry-over effect in Q1-2025)



Sources: ONS, Crédit Agricole SA / ECO

Consumer services also grew at the beginning of the year

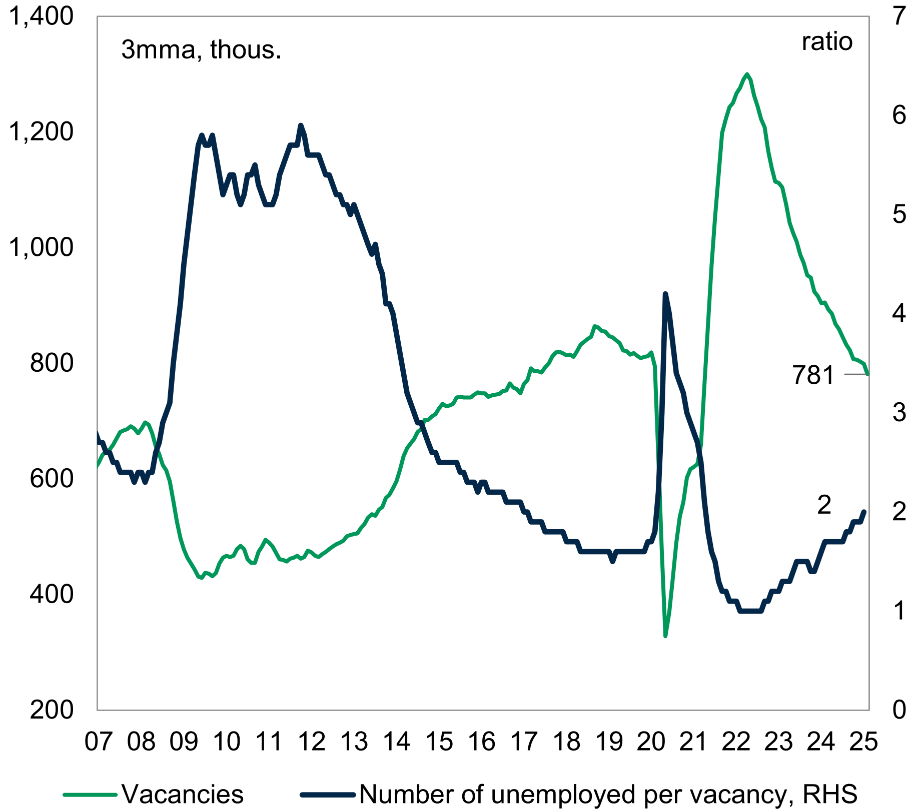


Sources: ONS, Crédit Agricole SA / ECO

LABOUR MARKET

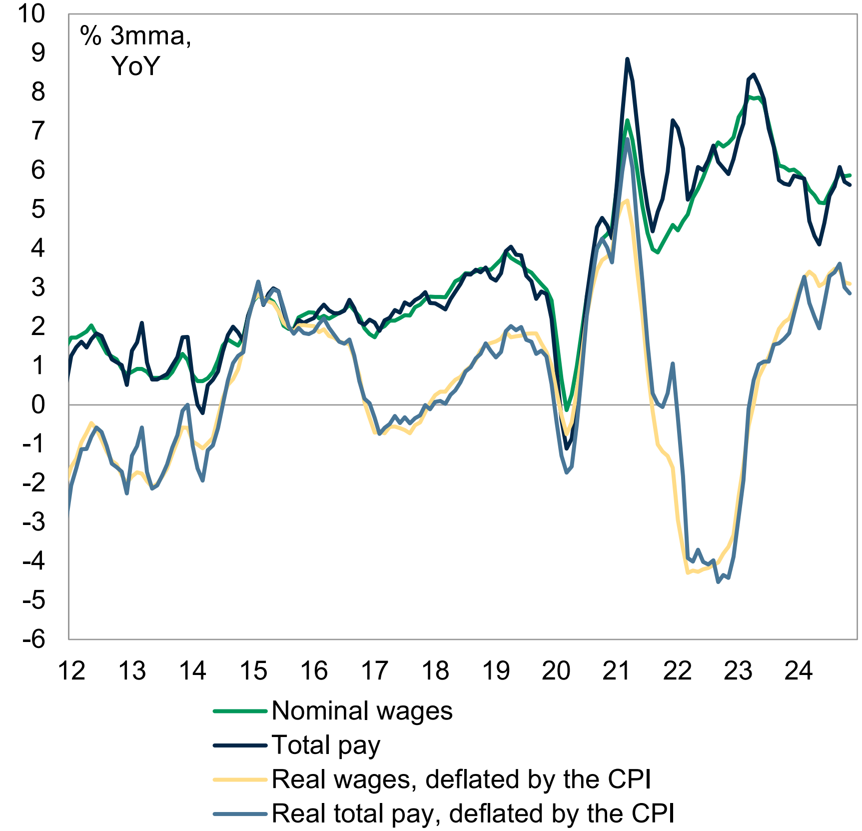
THE LABOUR MARKET CONTINUES TO EASE

Job vacancies fall back below the pre-Covid level



Sources: ONS, Crédit Agricole S.A./ECO

Nominal and real wage growth remains strong (close to 6% and 3% respectively)



Sources: ONS, Crédit Agricole S.A./ECO

RESTRICTIVE FISCAL POLICY

SPRING STATEMENT: A ROLLBACK ON THE FISCAL EASING ANNOUNCED LAST OCTOBER

Rachel Reeves, Chancellor of the Exchequer, presented her Spring Statement to the House of Commons on Wednesday 26 March. Faced with the unprecedented increase in uncertainties linked to the global trade and the stagnation of the UK economy, ten-year government bond yields had risen sharply in recent months to reach 4.89% in January, the highest in sixteen years. Lower-than-expected tax revenues and soaring debt costs had more than erased the limited room for manoeuvre the government had in October (0.3% of GDP or £9.9 billion) against its fiscal rule. **By announcing cuts in social benefits and current spending as well as some additional tax increases, R. Reeves has managed to restore exactly the same room for manoeuvre as in October (with an estimated probability of only 54%).**

Decrease in disability benefits

The flagship measure of the March budget is to find savings in social benefits to the tune of £4.8 billion by 2029-2030, including record cuts in disability benefits. The aim of the reform is to create employment incentives for those who can work, while protecting those who are unable to return to the labour market. The measures include changes to the eligibility criteria for health and disability benefits, while increasing the standard allowance by £775 a year in real terms and providing a £1 billion employment plan to help people who are ill or disabled, whose health conditions allow, to find work.

The reforms increase standard allowance in Universal Credit (UC), which is not linked to health, by £1.9 billion per year, benefiting around 6.8 million families at an average of £280 per year each. On the other hand, a tightening of the eligibility criteria for the personal independence payment (PIP), which is the main disability benefit for people of working age, is expected to save £3.9 billion a year for the 800,000 people concerned. The government also announced cuts to the health component of Universal Credit, saving £3bn a year on 3 million people, and reversed the previous government's reforms on the eligibility of future applicants at a cost of £1.6bn a year.

Rising defence spending

In addition to these cuts, there is a reduction in the overall envelope of departmental current expenditure (by £3.6 billion in 2029-2030). On the other hand, capital expenditure is planned to be risen (+£4.4 billion), mainly due to increases in defence spending. More specifically, the government will increase defence spending by £2.2 billion this year and £3.1 billion next year, bringing it to 2.5% of GDP in 2027 (compared to 2.3% in 2024-2025 and a 2% commitment within NATO), three years earlier than planned by the previous Conservative government. This spending will be financed in part by cuts in overseas aid. The government reaffirmed its ambition to increase defence spending to 3% of GDP over the next five years if "economic and fiscal conditions allow it". However, it would be difficult to achieve this objective without further increases in taxes or additional cuts in public spending: the OBR estimates the cost of such a rearmament effort at £17.3 billion in 2029-2030.

On the tax side, the government has announced some small-scale measures, including an increase in visa and passport taxes, which is expected to bring in £2.2 billion for the state in 2029-2030.

PUBLIC FINANCES UNDER PRESSURE

PUBLIC DEBT-TO-GDP RATIO EXPECTED TO RISE

Impact of government policies on GDP

Despite the £100 billion increase in capital investment announced in the October 2024 budget, the impact on GDP of all the supply-side measures announced so far by the government is expected to be slightly negative in the short-to-medium term due to the increase in employer NICs effective 1 April and the crowding-out effect on private investment (*via* rising interest rates).

On the other hand, the impact of policies would be significant on potential growth, estimated at +0.2% by 2029-2030. This is thanks in part to the planning system reform announced in December 2024 which aims to significantly accelerate the pace of annual housing construction (to more than 305,000 net additions of housing per year, a forty-year high) and an additional £2 billion investment in the social housing sectors for 2026-2027.

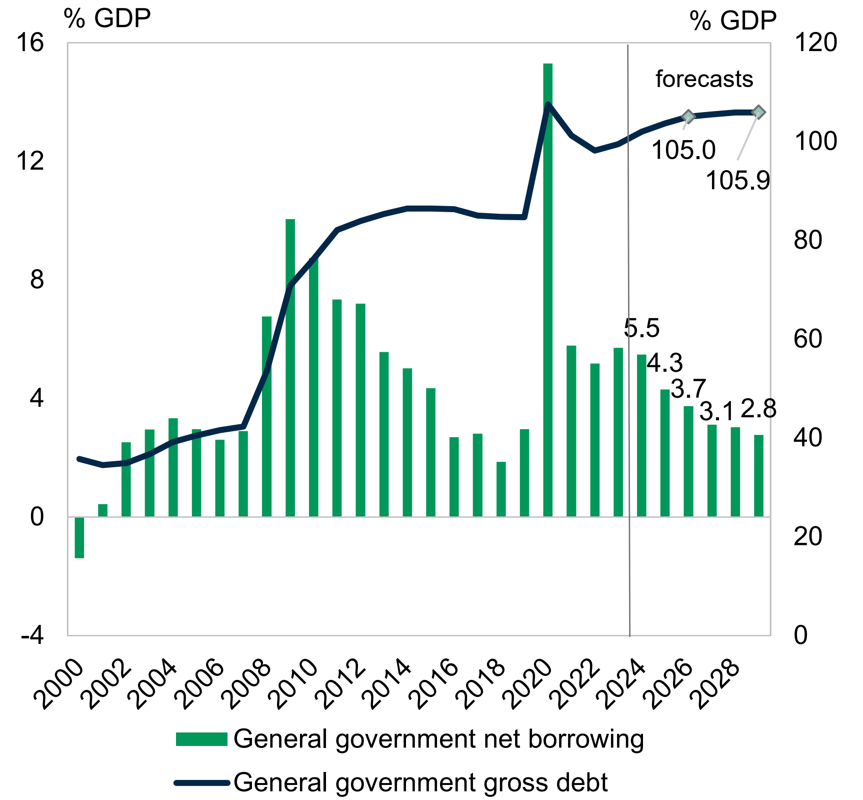
Deteriorating economic forecasts

The OBR (*Office for Budget Responsibility*) has noted the deterioration of the short-term economic outlook: the growth forecast for 2025 has been halved, to 1% annual average, inflation forecasts have been revised upwards (by +0.6 percentage points to 3.2% in 2025 for the CPI), as well as those of the unemployment rate (+0.4 percentage points to 4.5%). Households will see weaker-than-expected growth in their real incomes despite upward wage growth. The OBR estimates that a third of the weakness in growth is due to structural factors, in particular low productivity, the trajectory of which has been revised downwards by 1.3% compared to the autumn forecast.

Upward revisions to forecasts for budget deficit and public debt-to-GDP ratio

The budget deficit (measured by public sector net borrowing) is revised upwards for each of the next five years (+0.4% to 3.9% in 2025-2026, +0.3% to 3.1% in 2026-27) as well as the public debt-to-GDP ratio (public sector net debt excluding BoE) which now stands at 95% in 2029-2030, compared to 92% in 2025-2026.

United Kingdom: public deficit and debt-to-GDP ratio

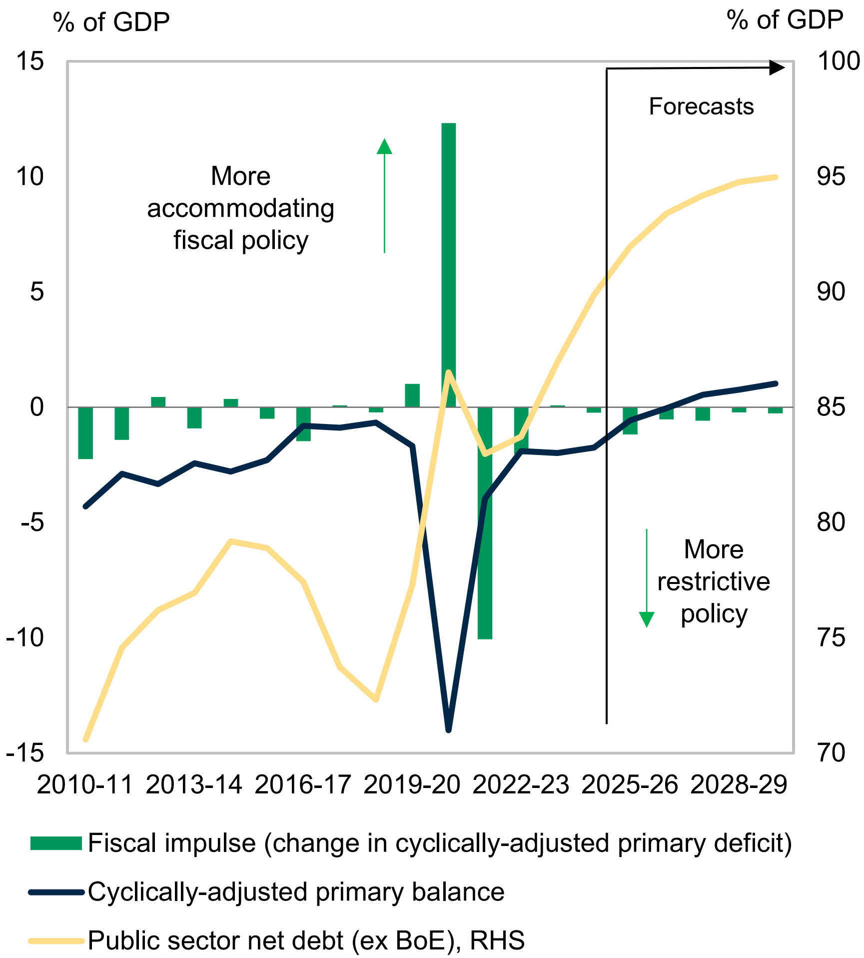


Sources: OBR, Crédit Agricole SA / ECO

PUBLIC FINANCES UNDER PRESSURE

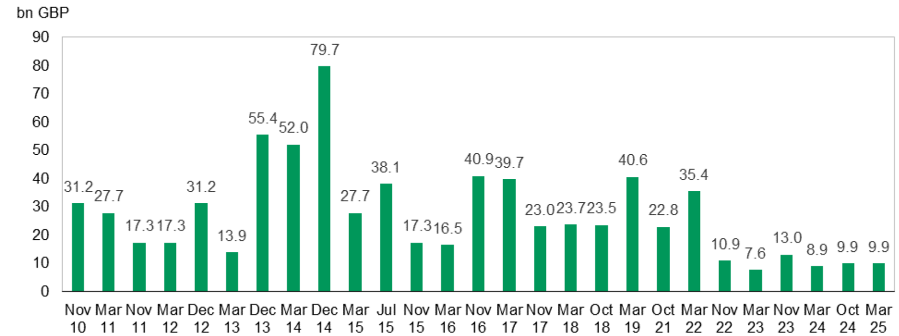
ADDITIONAL FISCAL TIGHTENING WILL PROBABLY BE ANNOUNCED IN JUNE

The fiscal impulse will remain negative without stabilizing the debt-to-GDP ratio



Sources: OBR EFO March 2025, Crédit Agricole S.A./ECO

Historically low headroom against the fiscal rules



Fiscal policy remains restrictive and the government has tightened slightly with its latest spending cuts announced in March.

The forecasts for the cyclicaly-adjusted primary deficit have been revised downwards (by 0.2% on average per year over the next two years), implying a slightly more negative fiscal impulse than previously forecast. The cyclicaly-adjusted primary deficit (-1.8% of GDP in 2024-2025) is expected to be eliminated by 2026-2027 and move to surplus in the following years.

Given the limited room for manoeuvre left by the fiscal rules, the risks of a further fiscal tightening by the governement are significant. Public finances remain vulnerable to weaker-than-expected growth, to rising gilt rates or to a further downward revision of productivity.

If these risks materialise, it would force the Chancellor to announce further spending cuts and/or tax increases (the next budgetary event is the multi-annual spending review that will be published on the 11th of June).

MONETARY POLICY

MONETARY EASING COULD ACCELERATE

Expectations of accelerating inflation in the near term keeps the BoE on the defensive

Faced with intensifying uncertainties, both global and domestic, the BoE left its Bank rate unchanged at 4.50% at its last meeting on 20 March. Eight members voted in favor of the *status quo* against only one for a 25 basis point cut. The minutes of the meeting highlighted the increase in uncertainty around global trade linked to the US president's tariff announcements as well as the increase in geopolitical uncertainties and volatility in financial markets. **However, the BoE has not yet factored in the impact of higher tariffs by the US on imports from its trading partners in its forecasts.**

On the domestic front, although the good monthly GDP figures in December and January led the BoE to revise upwards its GDP growth forecast for the first quarter (to +0.25% against +0.1% previously forecast), the weakness of confidence surveys indicated "underlying" growth still close to zero, at 0.1%, according to the BoE. As for prices, CPI inflation rose slightly more than expected by the BoE in January (to 3% from 2.5% in December) and the BoE anticipates an acceleration with a peak of 3.7% in the third quarter. The labour market is judged to be "broadly on balance": the ratio of job vacancies per unemployed person is at its equilibrium level and surveys of recruitment difficulties have normalised. The wage indicators monitored by the BoE continued to moderate, while remaining at high levels and contrasting with the acceleration of the official wage growth figures published by the ONS (to 5.9% in the three months to January for the total economy, 6.1% in the private sector). According to the BoE, this divergence between official data and alternative pay indicators is explained by composition and volatility effects in certain sectors.

In February, the *forward guidance* was changed and the word "careful" was added to "gradual" to describe the upcoming monetary easing: **"a gradual and careful approach to the further withdrwal of monetary policy restraint is appropriate"**. The main justification for this caution is the expected acceleration of inflation and the need to avoid the risk of second-round effects. Furthermore, inflation expectations by households and businesses have increased, while the BoE must keep long-term inflation expectations anchored at 2%.

The MPC will continue to closely monitor the risks of inflation persistence and the evolving evidence about the balance between aggregate supply and demand in the economy.

The BoE envisages two scenarios for the economy and for the conduct of monetary policy: on the one hand, a scenario where demand weakens more than supply and leads to lower inflationary pressures, which would require a less restrictive monetary policy; on the other hand, a scenario of persistent pressures on prices and wages, with the emergence of second-round effects linked to higher inflation in the short term, in which case monetary policy will have to be more restrictive. Faced with these two scenarios, the BoE considers that *"monetary policy will need to continue to remain restrictive for sufficiently long until the risks to inflation returning sustainably to the 2% target in the medium term have dissipated further. The Committee will decide the appropriate degree of monetary policy restrictiveness at each meeting."*

We continue to expect three more rate cuts this year, with a cut of 25 basis points per quarter (100 bps in total in 2025), which would bring the policy rate to 3.75% by the end of 2025. This path would be in line with the BoE's new estimate of the long-term equilibrium real interest rate (R*). In view of different empirical approaches, the bank considers that the R* has increased by 25 to 75 basis points compared to the estimates published in 2018, when the R* was estimated to be between 0% and 1% (2%-3% in nominal terms).

The BoE could accelerate its pace of rate cuts in the second half of the year

While higher tariffs are a direct shock to companies exporting to the US, the weaker global growth that would result from US tariffs will likely weigh on overall foreign demand adressed to the UK. Business and consumer confidence will suffer from the heightened uncertainty, triggering lower domestic demand, particularly investment. In a context of thin corporate margins, companies that export to the US would not be able to lower their prices to preserve their market share in the US. There is a risk that spare capacities within firms will appear. The labour market, whose outlook was already deteriorating in line with the rise in labour costs put in place by the UK government in April, will ease further, leading to sharper declines in employment. The emergence of more slack in the labour market could prompt the BoE to cut rates more aggressively, especially if inflation expectations fall, which is likely given the fall in oil prices.

A DOWNSIDE RISK TO GROWTH AND INFLATION LINKED TO THE RISK OF A GLOBAL RECESSION

Downside risks to activity

Uncertainty related to US trade policy and its impact on confidence and investment

Risk of reciprocal tariffs being imposed by the White House on 2 July

Risk of a sharp slowdown in the global economy due to the trade war

Tightening financial conditions and rising *gilt rates*

More agressive fiscal tightening in the UK

Escalating geopolitical conflicts and new prices shock, fewer rate cuts by the BoE

Upside risks to activity

Labour government quickly negotiates a trade deal with White House to remove tariffs

The 90-day truce leads to tariff cuts for most countries

Stronger-than-expected growth in the United States

Significant easing of financial conditions

Rapid recovery in confidence, private investment and household consumption

Diminishing geopolitical risks

THE SCENARIO IN NUMBERS

UK FORECAST

	annual average, %				quarterly variation, %											
United Kingdom	**2023**	**2024**	**2025**	**2026**	**2024**				**2025**				**2026**			
					Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
GDP (%)	0.4	1.1	0.9	1.4	0.9	0.5	0.0	0.1	0.3	0.2	0.3	0.4	0.4	0.4	0.4	0.4
household consumption	0.5	0.6	0.9	1.4	0.7	-0.1	0.5	0.1	0.3	0.1	0.2	0.4	0.4	0.4	0.4	0.4
public consumption	1.6	3.0	3.3	4.1	0.7	1.0	0.3	0.5	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
investment	0.3	1.5	1.8	3.7	0.8	1.1	1.0	-0.6	0.6	0.4	0.8	0.8	1.0	1.0	1.0	1.0
change in inventories*	-0.9	0.2	0.8	0.0	-0.4	1.1	-0.3	1.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
net exports*	0.3	-1.3	-1.9	-1.0	0.2	-2.5	1.0	-1.6	-0.4	-0.1	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3
Unemployment rate (ILO)	4.1	4.3	4.6	4.7	4.4	4.2	4.3	4.4	4.4	4.6	4.7	4.7	4.7	4.7	4.7	4.7
Inflation (CPI, YoY%)	7.3	2.5	3.3	2.4	3.5	2.1	2.0	2.5	2.8	3.3	3.6	3.4	2.9	2.3	2.2	2.2
Core CPI (YoY%)	6.2	3.7	3.3	2.5	4.6	3.6	3.3	3.3	3.6	3.3	3.1	3.2	3.0	2.4	2.3	2.3
Current account (% GDP)	-3.5	-2.7	-2.2	-2.5	-2.3	-3.7	-1.7	-2.9	-	-	-	-	-	-	-	-
General gov. balance, % GDP	-6.0	-6.0	-4.1	-3.6	-	-	-	-	-	-	-	-	-	-	-	-
Public debt % GDP	100.4	101.3	103.0	104.3	-	-	-	-	-	-	-	-	-	-	-	-
Bank rate**	5.25	4.75	3.75	3.75	5.25	5.25	5.00	4.75	4.50	4.25	4.00	3.75	3.75	3.75	3.75	3.75

** Contributions to GDP growth*

*** End of period*

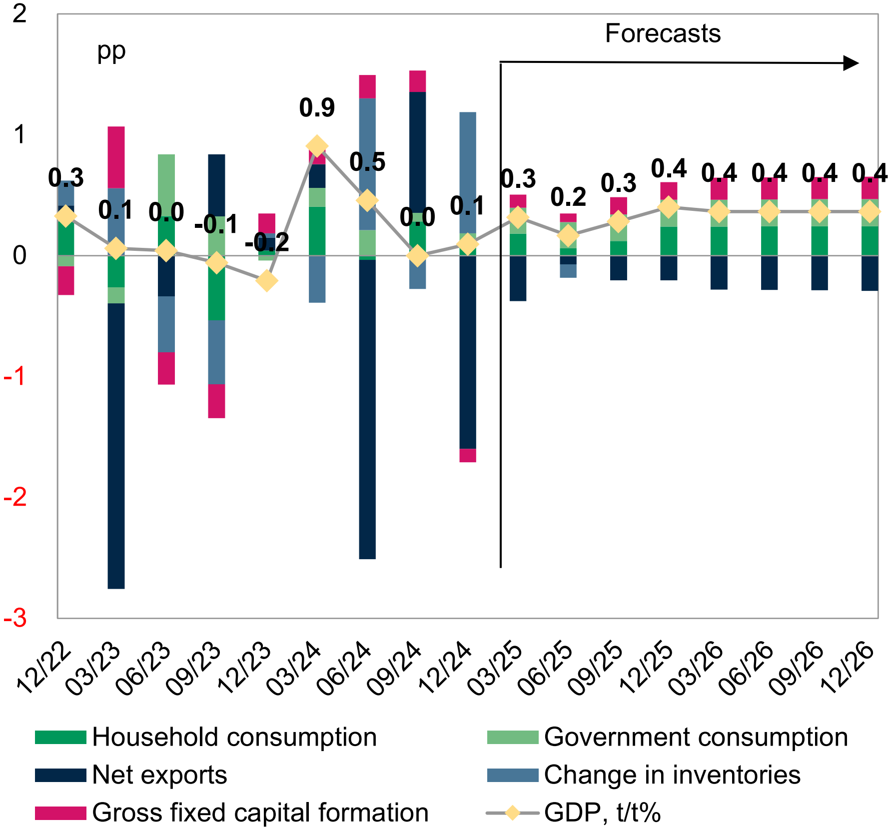
Forecast as of 30/03/2025

Sources: ONS, BoE, Crédit Agricole S.A./ECO

THE SCENARIO IN PICTURES

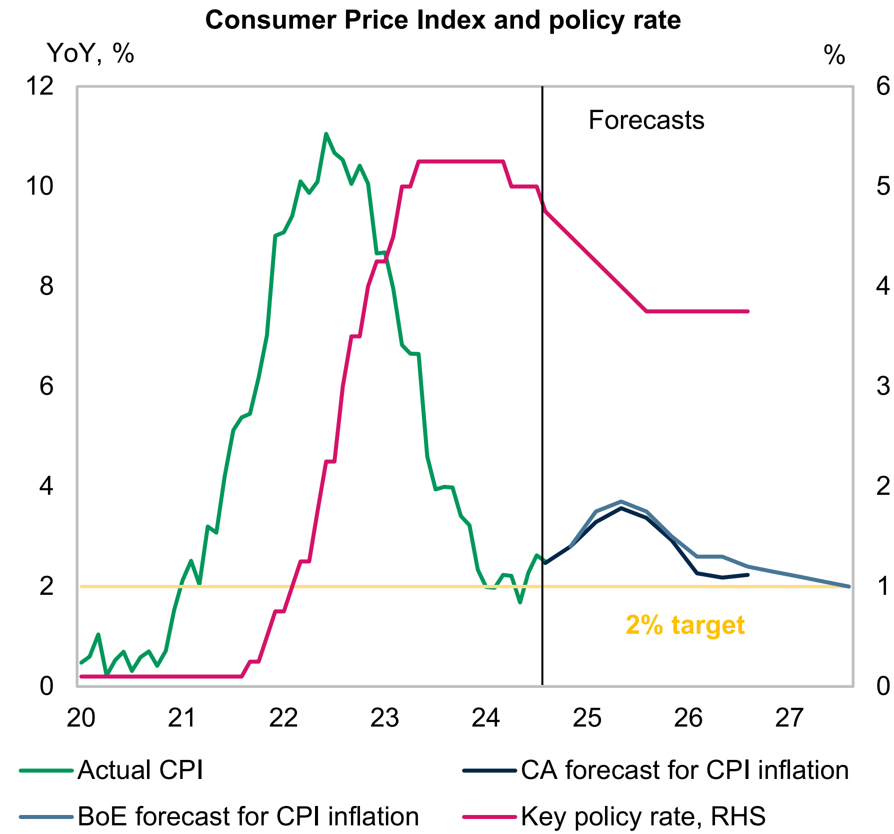
DOMESTICALLY DEMAND-DRIVEN GROWTH, ACCELERATING INFLATION IN THE SHORT TERM

Growth is expected to be driven by household consumption and investment...



Sources: ONS, Crédit Agricole S.A. / ECO forecasts

... thanks to lower inflation and monetary easing

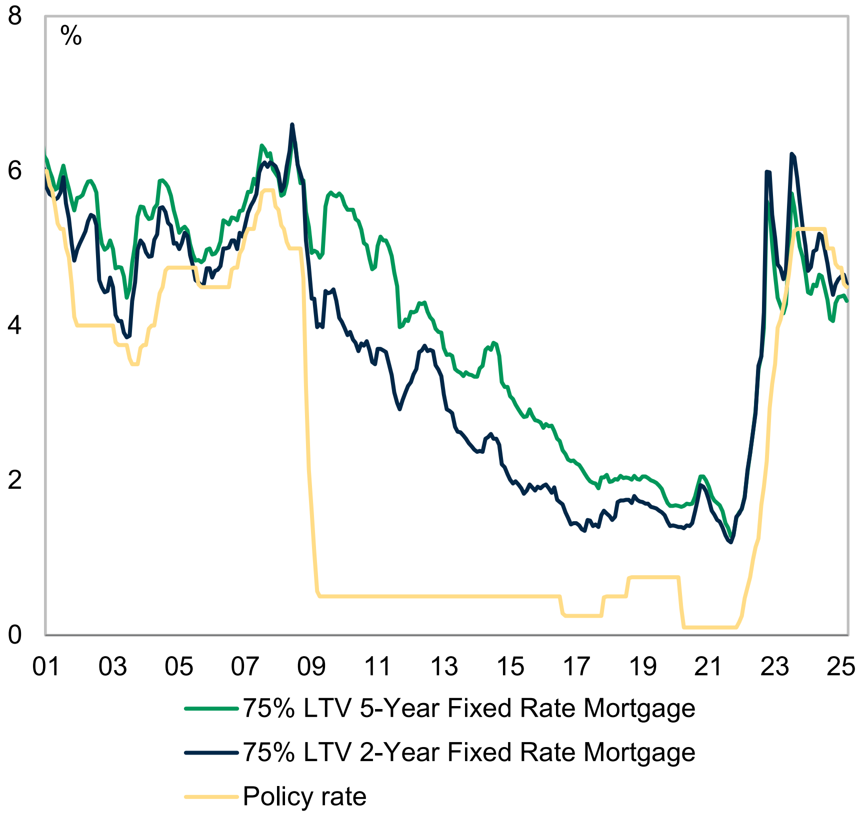


Sources: ONS, BoE Monetary Policy Report February 2025, Crédit Agricole S.A./ECO

THE SCENARIO IN PICTURES

THE IMPACT OF PAST RATE HIKES WILL LAST

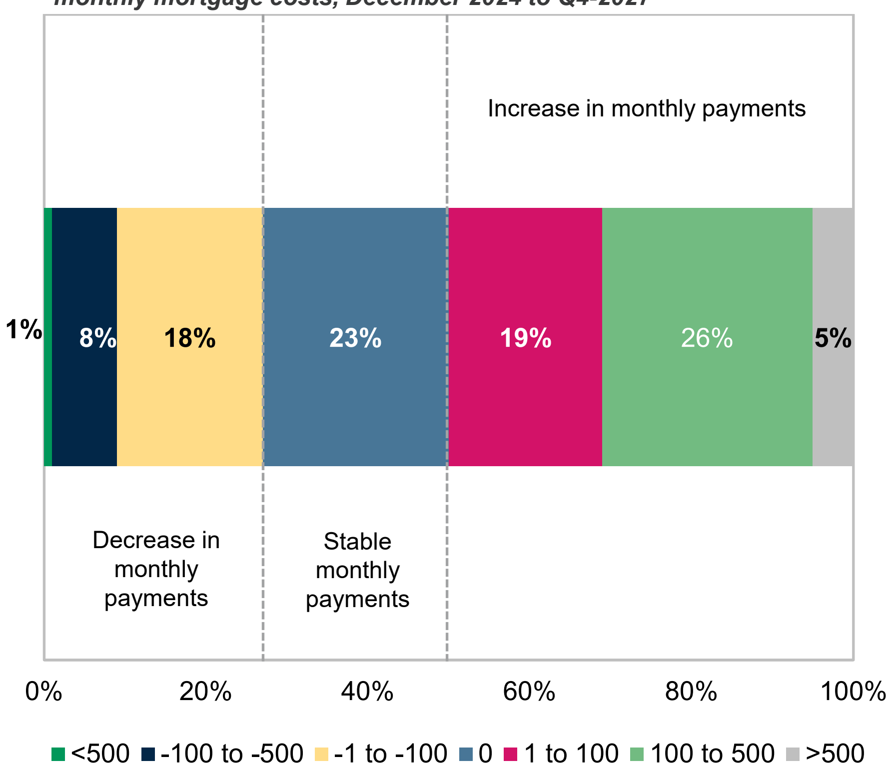
Mortgage rates remain high



Sources: BoE, Crédit Agricole S.A. / ECO

Around half of mortgages are expected to see payment increases during the next three years

Proportion of owner-occupied mortgages by estimated change in monthly mortgage costs, December 2024 to Q4-2027

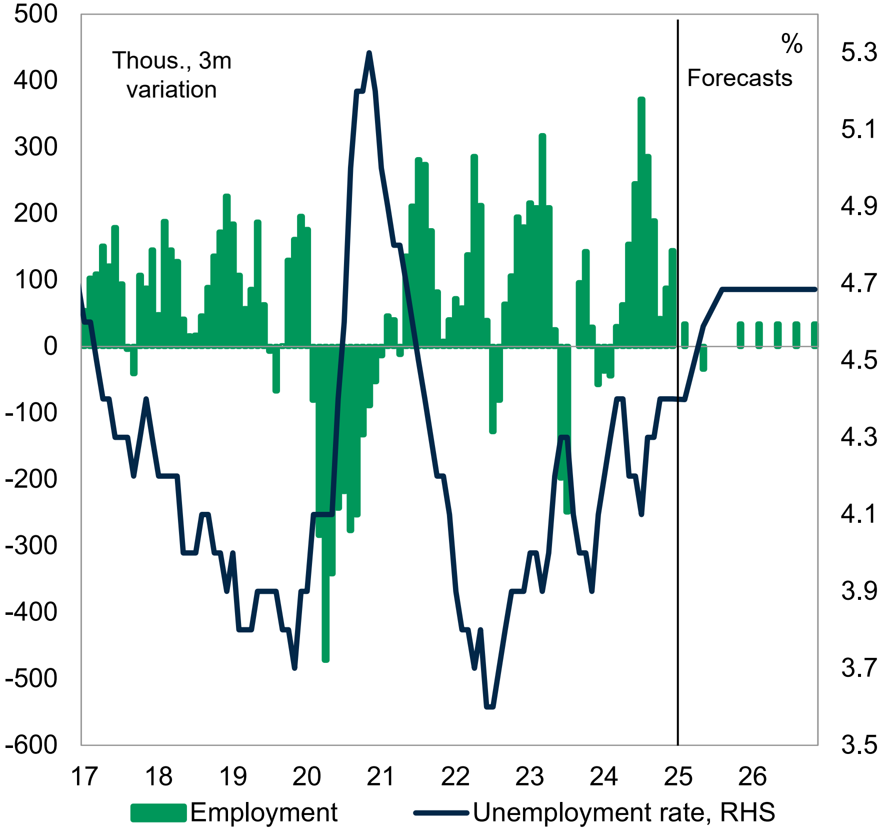


Sources: BoE Financial Stability Report - November 2024, Crédit Agricole S.A. / ECO

THE SCENARIO IN PICTURES

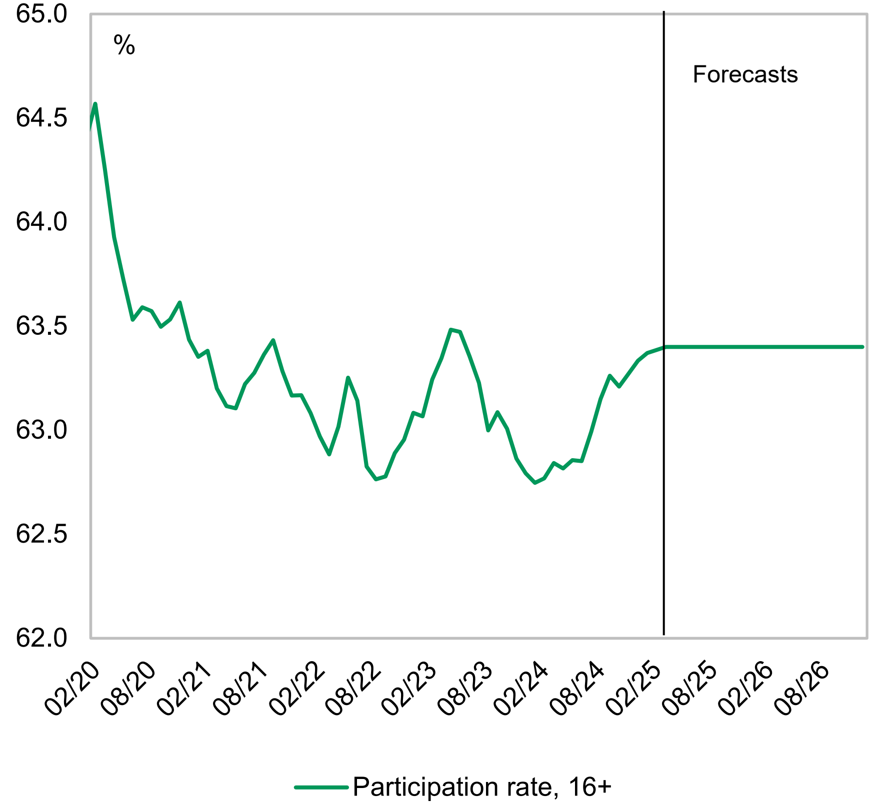
THE UNEMPLOYMENT RATE IS EXPECTED TO RISE ABOVE ITS EQUILIBRIUM RATE, ESTIMATED AT 4.5% BY THE BOE

We expect an unemployment rate of 4.7% over the course of 2025, risks are tilted to the upside



Sources: ONS, Crédit Agricole S.A./ECO

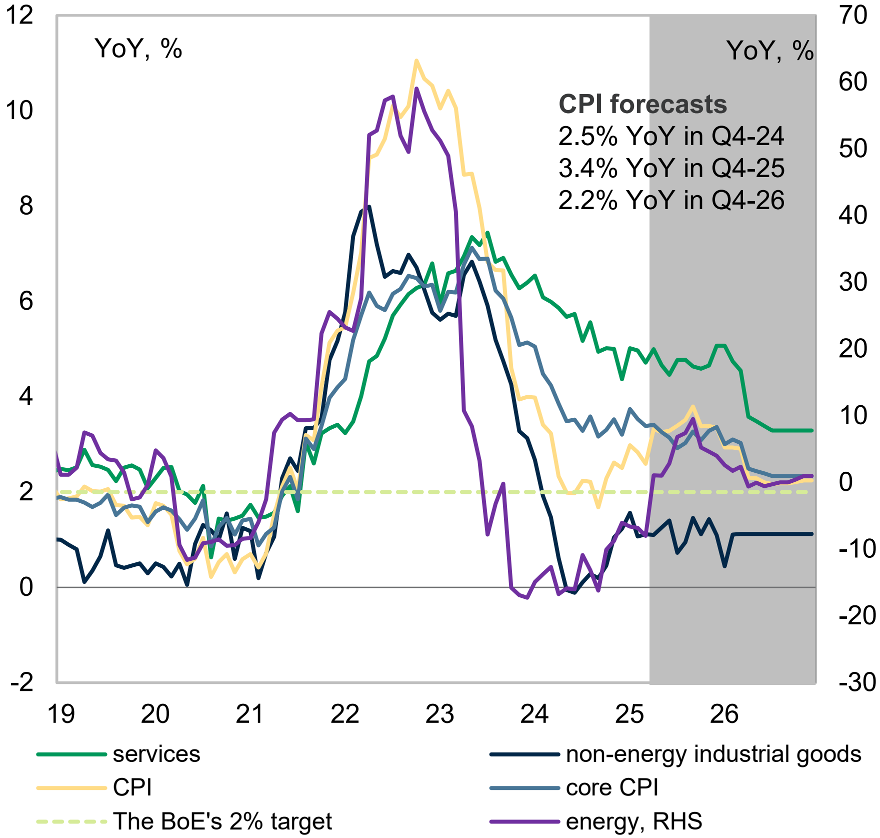
Any further increase in the participation rate, which is expected to be stable, implies upside risks to the unemployment rate



Sources: ONS, Crédit Agricole S.A./ECO

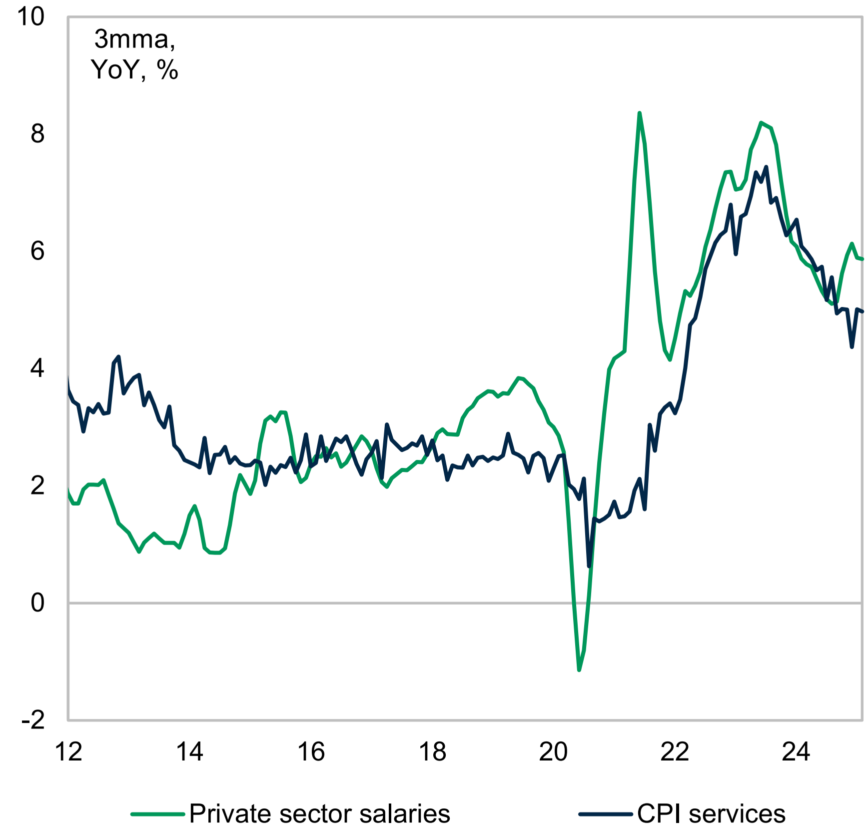
INFLATION: PEAK AT 3.8% IN SEPTEMBER BEFORE A GRADUAL DECELERATION
MEDIUM-TERM DISINFLATIONARY RISKS OF TRUMP'S TRADE POLICY

Inflation will remain around target during the forecast period



Sources: ONS, Crédit Agricole S.A./ECO

Wage growth and services inflation: still too high



Sources: ONS, Crédit Agricole S.A./ECO

CONSULT OUR LAST PUBLICATIONS

Date	Title	Theme
22/04/2025	Spain –2025-2026 Scenario: dynamic growth in an uncertain environment	Europe
17/04/2025	Eurozone – 2025-2026 Scenario: between new divides and new convergences	Europe
17/04/2025	South Korea: what with fires, martial law and trade tariffs, the Year of the Blue Snake has not had the most auspicious start	Asia
04/04/2025	World – 2025-2026 Scenario: place your bets	World
27/03/2025	China: will the change in the authorities' rhetoric be enough to restore confidence?	Asia
20/03/2025	France: Banque de France says slightly lower growth and inflation in 2025 and 2026	France
13/03/2025	Mexico: an economy endangered by US trade tensions	Latin America
06/03/2025	China: is DeepSeek Chinese markets' salvation or death knell?	Asia
05/03/2025	Mexico – An overview of three decades of free trade	Latin America
04/03/2025	China – Growth is a "positive surprise", but serious questions remain	Asia
03/03/2025	Low-code and AI: the revolution in software development	Technology/telecom
20/02/2025	China: growth is a "positive surprise" but serious questions remain (abridged version)	Asia
13/02/2025	Everything is now related…	Geopolitics
06/02/2025	France – 2025-2026 Scenario: in search of political stability, with growth weakened by uncertainty	France
06/02/2025	Slowing growth is making trade-offs more complicated in India	Asia
06/02/2025	Germany – 2025-2026 Scenario: Europe's locomotive at a standstill	Europe
31/01/2025	Italy – 2025-2026 Scenario: the curse of weak growth in an uncertain world	Italy
31/01/2025	Eurozone –2025-2026 Scenario: a sluggish recovery at a slower pace than potential	Europe
23/01/2025	Spain – 2025-2026 Scenario: Growth keeps pace	Europe
23/01/2025	United Kingdom – 2025-2026 Scenario: unwelcome policies in the autumn budget 2024 complicate the economic outlook	United Kingdom
23/01/2025	K-drama in Seoul	Asia
21/01/2025	Brazil – The shadow of fiscal imbalance looms over a fast-growing economy	Latin America
20/01/2025	Argentina – Some progress but it seems reasonable to wait	Latin America
16/01/2025	Trump and fear : the new alliance between mercantilism and geopolitics	Geopolitics

ECO
ÉTUDES ÉCONOMIQUES GROUPE

Slavena Nazarova
+33 1 43 23 21 40
slavena.nazarova@credit-agricole-sa.fr

Completed on April 18, 2025

THANKS FOR YOUR ATTENTION

YOU CAN SUBSCRIBE TO OUR PUBLICATIONS ON OUR WEBSITE :
http://economic-research.credit-agricole.com/

Access and subscribe to our free online publications:
application available in App Store and in Google Play

Crédit Agricole S.A. — Group Economic Research
12 place des États-Unis – 92127 Montrouge Cedex

Publication Manager: Isabelle Job-Bazille - **Chief Editor:** Armelle Sarda
Information centre: Elisabeth Serreau - **Statistics:** Datalab ECO
Editor: Fabienne Pesty
Contact: *publication.eco@credit-agricole-sa.fr*