

# Prospects

No. 26/019 – 30 January 2026

## UNITED-KINGDOM – Inflation rebounded at the end of 2025, a lull is expected for 2026

- UK inflation measured by the Consumer Price Index (CPI) rebounded in December, reaching 3.4% YoY, after 3.2% YoY in November. This figure is slightly above the consensus forecast of 3.3%, but below the Bank of England's (BoE) projection of 3.5% (which we also shared).
- Core inflation remained unchanged at 3.2% YoY. Services inflation accelerated from 4.4% YoY in November to 4.5% YoY in December, largely due to higher airfares.
- A sharp decline in inflation is on the horizon for 2026, with inflation falling below the 2% target as early as Q226. This expected improvement is mainly due to lower energy prices, combined with below-potential economic growth and labour market spare capacity. Our projections point to CPI inflation averaging around 2% for 2026 and 2027.
- Although underlying inflation is also trending downwards, it is expected to remain above target for most of our forecast period, supported by wage dynamics that are struggling to normalise completely.
- Wage growth declined to 4.5% YoY in September-November, compared with 4.6% YoY in August-October. The memory of recent supply shocks remains fresh in the minds of households, whose inflation expectations remain high. This phenomenon suggests that wage disinflation will continue to stretch out over time.

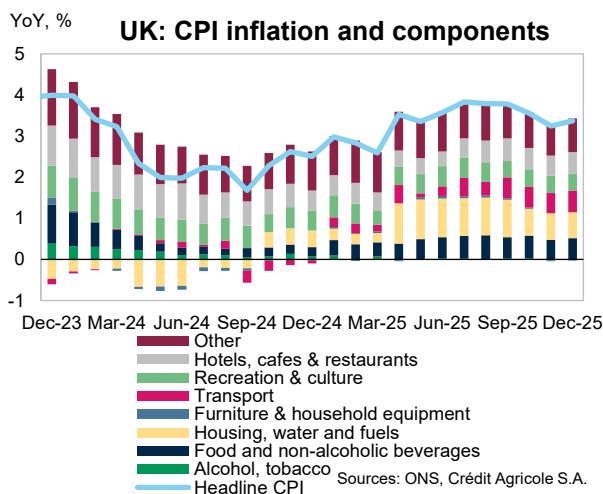
### CPI inflation remains above 3%, driven by services and food

The consumer price inflation rate (CPI index) rebounded in December to 3.4% year-on-year (YoY), up from 3.2% YoY in November and slightly above the 3.3% YoY consensus forecast. The index rose 0.4% MoM in December. The rebound in CPI inflation is the first since last July, when it peaked at 3.8% YoY.

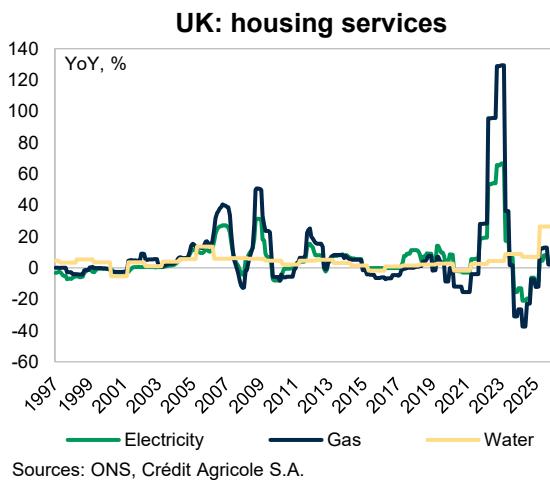
Core inflation (CPI excluding energy, food, alcohol and tobacco) remained at 3.2% YoY, unchanged from November and 0.1 percentage point (pp) below the consensus forecast. On a monthly basis, this index rose by 0.3% MoM, in line with its historical average for the months of December in the decade before the pandemic. In Q425 on average, core inflation continued to decline, reaching 3.3% YoY, down from 3.6% YoY in Q325.

Several items contributed to the rise in CPI inflation in December: "alcohol and tobacco" (on account of higher tobacco duty), "transport" (due to an increase in air fares), "restaurants and hotels" (due to base effects linked to a fall in prices in November 2024 compared with a modest rise in December 2025), "clothing and footwear" (also base effects) and "food and non-alcoholic beverages" (up by 0.8% MoM in December). These upward pressures were partially offset by negative contributions from "housing and household services", "recreation and culture" and "furniture and household equipment".

For the ninth consecutive month, "housing services" – including water, electricity, gas and other fuel bills – made the largest contribution to inflation, 0.62 pp. This contribution is down for the third consecutive month but still well above its pre-April 2025 levels.



While gas and electricity inflation rates have returned to reasonable levels (2.1% YoY and 2.7% YoY, respectively), water prices have soared dramatically this year, jumping 26.4% YoY.



### Food inflation remains high

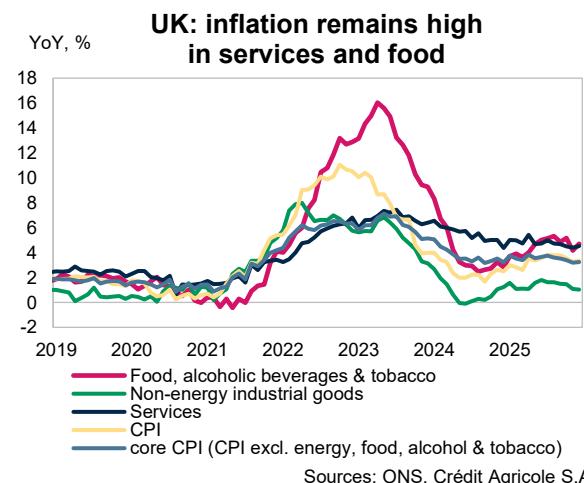
Goods inflation rose slightly from 2.1% YoY in November to 2.2% YoY in December, mainly due to food prices, whose inflation rate rose to 4.5% YoY from 4.2% YoY in November. High food inflation is largely due to higher agricultural prices on the global markets, but domestic factors are also playing a significant role. These include the increase in the National Living Wage (NLW), which has led to relatively strong wage growth in the food and retail sectors, where a significant proportion of the workforce is paid the NLW. Furthermore, according to the BoE, the implementation of Extended Producer Responsibility (EPR) regulations has likely increased production costs in the food industry by shifting the burden of waste management from local authorities to producers.

### Inflation in services rebounded slightly in December, driven by airfares

In the services sector, inflation rose from 4.4% YoY in November to 4.5% YoY in December (consensus: 4.6% YoY). This was due to an acceleration in

prices in the "transport" division, which was itself attributable to higher airfares, and a rebound in inflation in leisure and personal services. Indeed, airfares jumped 28.6% MoM in December, bringing their annual increase to 11% YoY, compared with 0.3% YoY in November. This component, known for its volatility, is expected to see its December increase quickly fade away.

During 2025, service inflation was down only slightly, from 5% YoY in January to 4.5% YoY in December. This slow deceleration is mainly due to a relative stickiness in wage growth and increases in non-wage business costs consecutive to the rise in employer National Insurance Contributions (NICs) by the government in April 2025.



### Core goods inflation moderates thanks to low imported inflation

Energy inflation fell to 1.7% YoY in December from 1.9% YoY in November, benefiting from lower oil prices and a slowdown in fuel inflation. Inflation in industrial goods excluding energy also fell, reaching 1% YoY, its lowest level since October 2024.

This moderation in core goods prices is largely due to particularly subdued imported inflation, a phenomenon to which two major factors are contributing: US tariffs and the GBP appreciation. Although it is still too early to fully assess the impact of US tariffs on UK inflation, they appear to be having a slightly disinflationary effect by causing a shift in global trade flows from Asia to Europe. Indeed, trading partners such as China, faced with higher US tariffs, have increased their exports of goods to the UK and the eurozone. This redirection of trade flows is helping to maintain downward pressure on the prices of imported goods in the UK.

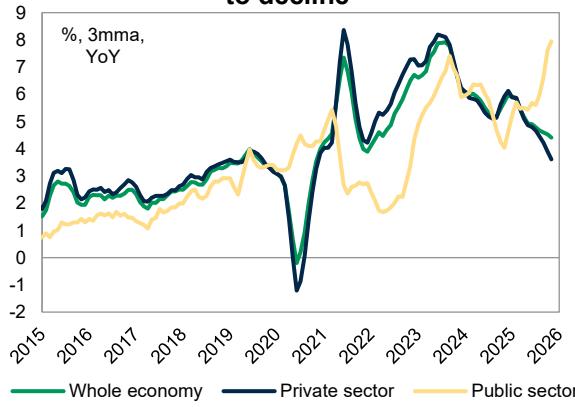
### Increasing labour market spare capacity and a gradual decline in wage growth

The unemployment rate stabilised at 5.1% in September-November relative to August-October, remaining above its long-term equilibrium level. It rose by 0.3 pp over the last three months and by 0.7

ppp on the year. This deterioration can be explained by an increase in redundancies, weak employment growth and a rise in the participation rate. Administrative data from the HM Revenue and Customs (HMRC) show payrolled employment fell both in November (-33,000) and December (-43,000), which brings the contraction of payrolled employees to 184,000 (0.6%) employees on the year. The participation rate remains on upward trend, reaching 64% of the working-age population, up 0.7 pp year-on-year.

On the positive side, after contracting sharply for 39 consecutive quarters, the number of job vacancies has stabilised over the last six months, at levels comparable to those seen before the pandemic. Nevertheless, the deterioration in the labour market has led to an increase in the ratio of unemployed people to job vacancies to 2.5, compared with 2.4 in the previous quarter and 1.9 a year ago. The redundancy rate, a highly volatile series, fell in November to 4.9 per 1,000 employees, after reaching 5.3 in October, its highest level since 2013 (excluding Covid).

### UK: wage growth continues to decline

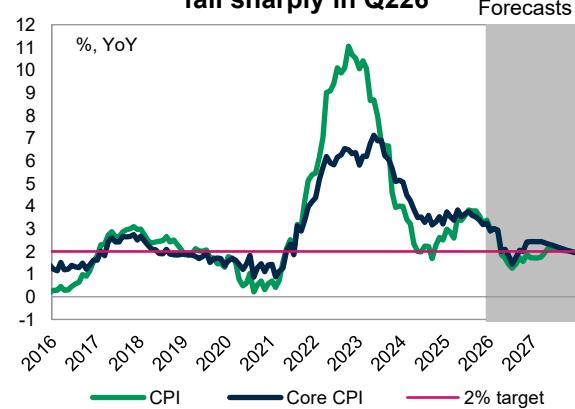


Sources: ONS, Crédit Agricole S.A.

Regular pay growth continued to decline in November, reaching 4.5% YoY in September-November, down from 4.6% YoY in August-October and 5.6% YoY a year earlier. The public sector as well as the wholesaling, retailing, catering and hospitality activities continue to show the strongest wage dynamics, with year-on-year increases of 7.9% and 5.1 respectively.

In the private sector, wage growth declined to 3.6% YoY in September-November, compared with 3.9% YoY in the preceding three months and a peak of 6.1% YoY in December 2024. Although this rate of wage growth is in line with the BoE's forecasts (3.5% on average for Q425), the central bank still expressed concerns in its December minutes about the continuing high levels of leading wage indicators. Its DMP (*Decision Maker Panel*) survey for Q425, incorporating results up to November, highlighted a slight strengthening in the expectations of the companies surveyed: they forecast wage growth of 3.8% for the coming year, up 0.2 points from the previous quarter. This comes against a backdrop of gloomy employment forecasts: companies anticipate virtually no recovery in employment over the next twelve months.

### UK: CPI inflation should fall sharply in Q226



Sources: ONS, Crédit Agricole S.A.

**Our opinion** – In 2025, CPI inflation is up to 3.4% annual average after 2.5% in 2024. This acceleration is the result of a combination of specific factors: unusually high increases in administered prices (energy bills, water, sewerage charges, excise duties on vehicles), sharp increases in food and tobacco prices, and higher labour costs following the government's increases in employer NICs and the NLW in April 2025. The latter have particularly fuelled inflation in services and, to a lesser extent, in goods. Against this backdrop, underlying inflation has only fallen slightly, standing at 3.5% in 2025 on annual average, compared with 3.7% in 2024.

Inflation appears to have peaked Q325. It is expected to be around 3% Q126 before falling well below the 2% target in Q226, driven by favourable base effects (as the impact of administered price increases Q225 drops out of the twelve-months comparison) and by a series of government measures aimed at reducing household energy bills from April 2026 onwards. According to OBR estimates, these measures should help reduce CPI inflation by 0.5 pp in Q226 and subtract 0.3 pp from average annual inflation in 2026. At the same time, the gradual moderation in wage growth and the fading effects of increases in employer NICs should help to reduce inflation in services, which is expected to fall from 4.5% YoY in December to 4.3% YoY in March.

*For the BoE, the December figures come as no real surprise. At its last monetary policy meeting in December, the central bank had anticipated a temporary rebound in inflation in December, attributable to the increase in tobacco tax and higher airfares. The Monetary Policy Committee (MPC) was deeply divided on the level of the Bank rate: five members voted in favour of 0.25 pp rate cut to 3.75% in December, while four preferred to maintain the status quo. These divisions reflect the tensions between, on the one hand, the economic slowdown and the rise labour market slack, and, on the other hand, persistently high inflation in services, sustained wage growth, still high household inflation expectations and pay settlement surveys that are incompatible with the 2% inflation target.*

*Our central scenario is for a final 0.25 pp rate cut at the monetary policy meeting on 5 February to 3.50%, but the decision is likely to be particularly close once again. Forward-looking wage indicators, especially the 2026 Agents' annual pay survey, are set to play a crucial role for the next monetary policy decision. In December, the BoE remained worried by the latest available results, which suggested that pay settlements were expected to be around 3.5% in 2026. Wage growth may not slow significantly next year, which would help keep inflation in services at elevated levels, complicating the full normalisation of monetary policy.*

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