



UNITED KINGDOM 2026–2027 SCENARIO

Quarterly – April 2026



A new ‘stagflationary’ shock

The UK economy, still bearing the marks of the 2022 energy crisis, is confronting a fresh external supply shock stemming from the war in the Middle East. The economic situation prior to this conflict was fragile: GDP growth was still very modest in the second half of 2025; the unemployment rate had risen; and a surge in inflation eroded the household purchasing power against a backdrop of subdued wage growth. Rising gas and oil prices on global markets are expected to trigger an increase in consumer price inflation from March onwards, with more significant effects from the third quarter. We now anticipate inflation of close to 3.5% in the second half of the year, compared to forecasts below the 2% target three months ago. Higher inflation will weigh on real disposable income and household consumption. Investment prospects have also deteriorated. Business confidence will decline, hampered by uncertainty over the outlook for demand; production costs will rise and margins, already under pressure, will erode further. Against this backdrop, we believe the risk of a wage-price spiral is less likely to materialise than during previous shocks. We anticipate only one rate hike by the *Bank of England* (BoE) this year, in the second quarter, compared with the more than two hikes anticipated by the markets, and a resumption of monetary easing in the second quarter of 2027.

Economic situation prior to the war in the Middle East: growth was close to stagnation in H2 2025

GDP growth in the second half of 2025 was disappointing. GDP grew by 0.1% quarter-on-quarter, whilst GDP per capita contracted by 0.1% quarter-on-quarter. Nevertheless, thanks to a solid rebound in Q1 2025 (+0.7%), GDP grew by an annual average of 1.3% in 2025, following 1.1% in 2024.

The components of GDP relating to private demand were generally weak in Q4 2025. Household consumption slowed (+0.2% after +0.4% in Q3), business investment fell (-2.7%), as did dwellings investment (-0.1%). The trade balance and changes in inventories made a negative contribution to growth (-0.4 and -0.5 percentage points respectively). Growth was driven by government spending, particularly public investment, which grew by 11.6% over the quarter.

From a sectoral perspective, activity rebounded strongly in manufacturing (+1.2% over the quarter), partly due to a catch-up effect in the automotive sector following an unprecedented cybersecurity incident in September that disrupted production at Jaguar Land Rover. **Growth was flat in services** (accounting for 81% of value added), held back by business services in particular.

A combination of both global and domestic factors explains the weak growth at the end of last year. Uncertainty surrounding the government’s announcements ahead of the Autumn Budget on 26 November appears to have depressed business and consumer confidence in anticipation of further tax increases. Increased tensions on *gilts*, particularly on very long-term rates (30-year), was observed in the weeks leading up to the budget, which may have weighed on property investment. Rising labour costs, following the government’s increases in employer National Insurance Contributions (NICs) in April 2025,

weighed on corporate margins and business investment.

For households, the economic environment deteriorated in 2025, particularly in the labour market. The unemployment rate rose by 0.8 percentage points year-on-year, to 5.2% in Q4 2025, returning to its Q4 2020 level and exceeding its long-term equilibrium level. Wage growth moderated whilst remaining relatively high (at 4.1% in Q4 2025 compared with 5.9% in Q4 2024). A fresh surge in inflation (CPI inflation had reached 3.8% in Q3 2025 before falling back to 3% in January and February 2026) led to a significant slowdown in purchasing power. Real disposable income growth fell to zero in Q3 2025 after several quarters of relatively strong growth. The tax burden continued to rise due to the ongoing freeze on income tax thresholds, which is pushing more and more households into higher marginal tax rates.

	2024	2025	2026	2027
GDP (YoY, %)	1.1	1.3	0.8	1.2
Domestic demand excl. inventories (contribution to GDP, pps)	1.5	2.1	1.4	1.4
Change in inventories (contribution to GDP, pps)	0.1	-0.1	-0.3	0.0
Net exports (contribution to GDP, pps)	-0.5	-0.9	-0.4	-0.2
Private consumption (YoY, %)	-0.1	1.0	0.6	0.6
Investment (YoY, %)	1.7	3.4	0.2	1.4
CPI inflation (YoY, %)	2.5	3.4	3.2	2.6
Unemployment rate (%)	4.3	4.9	5.4	5.5
Fiscal balance (% of GDP)	-6.0	-5.4	-3.9	-3.5

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 valuables.



The start of 2026 was moderately encouraging

The outlook seemed brighter at the start of this year, although the risks had not entirely disappeared (the Trump administration's tariffs, geopolitical uncertainty). Before the outbreak of war in Iran, business surveys suggested an improvement in confidence and a rebound in activity, partly due to the easing of uncertainty surrounding the Autumn Budget. The government has managed to significantly increase its fiscal target headroom (to GBP22bn, 0.6% of GDP, compared with GBP9bn, 0.3% of GDP in March 2025), which has restored investor confidence. The government was even able to announce a modest short-term fiscal stimulus in its budget last November. This includes plans for increased social spending and measures to tackle the cost of living from April 2026, funded by tax and duty increases in the final years of the parliamentary term.

Prior to the war in the Middle East, CPI inflation (3% year-on-year in February 2026, stable compared to January) was expected to decline sharply in the near term and reach the 2% target in April, for the first time since September 2024, thanks to government measures announced in the Autumn Budget aimed at reducing household electricity bills. In turn, the fall in inflation was expected to allow the BoE to continue easing its monetary policy with two rate cuts anticipated by markets this year (including one in March). A fall in inflation is not only welcome for households, but is also crucial for the government, since high inflation increases inflation-indexed expenditure such as social spending and debt-servicing costs (a large share of the public debt being composed of inflation-linked gilts).

However, GDP continued to disappoint in January

GDP remained stable in January compared with December, falling short of expectations of a slight expansion suggested by business surveys. Stagnation in the services sector continued. Industrial production fell by 0.1%. **We nevertheless still anticipate GDP growth of 0.3% quarter-on-quarter in Q1, expecting a rebound in activity following the Autumn Budget and an acceleration in household consumption at the beginning** of the year (retail sales rose sharply in January, +1.9%).

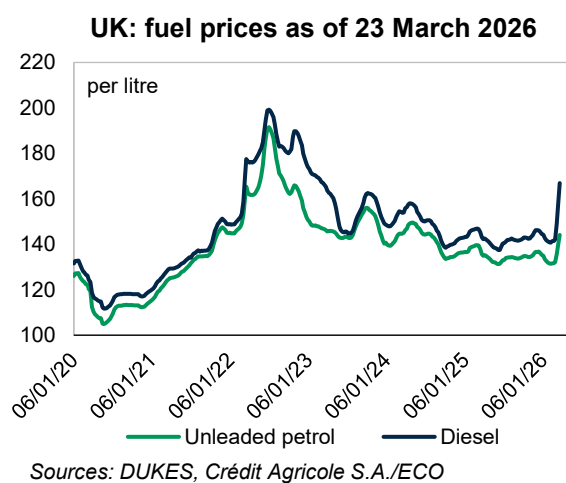
The labour market is showing some signs of stabilisation, though these are unlikely to last

The unemployment rate remained stable at 5.2% over the three months to the end of January compared with the three months to the end of December. The number of employees subject to the PAYE (*Pay As You Earn*) system (and therefore subject to withholding tax) rose for the third consecutive month. The number of job vacancies has broadly stabilised in recent months, following several years of decline. The ratio of

unemployed to vacancies (the BoE's preferred measure of labour market slack) remained unchanged at 2.6 over the month.

The new energy price shock delays inflation's return to the 2% target

The war in the Gulf will have a negative impact on the UK economy primarily through inflation. Energy prices will rise following the surge in global oil and gas prices (up 55% for Brent crude and 72% for European natural gas since the start of the conflict). Food prices and core industrial goods prices will also increase, as the conflict is also affecting other commodities such as fertilisers and aluminium.



Our inflation forecasts are based on the assumption of a progressive opening of the Strait of Hormuz in the coming months, but still an incomplete normalisation of the maritime traffic by the end of our forecast horizon (Q4 2027). As a result, oil and gas prices are expected to fall, whilst remaining above their pre-conflict levels (+20% for Brent, +60% for European natural gas in Q4 2027 compared to February 2026).

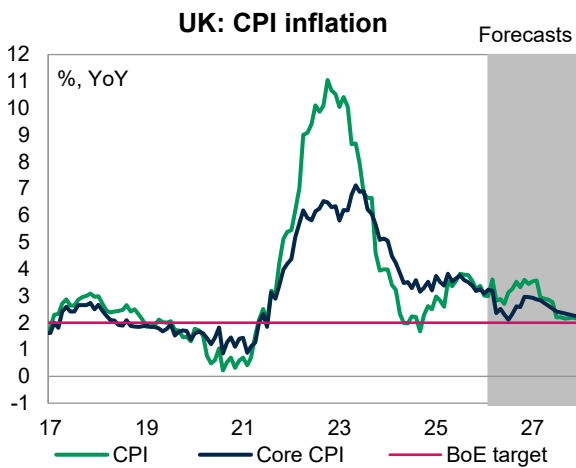
UK CPI inflation will rise in March (to 3.6% year-on-year expected) as fuel prices increase (+9.5% for petrol, +18% for diesel over one month to 23 March). However, the government measures announced in the Autumn Budget and taking effect in April (reduction in household electricity tariffs, an extension of the freeze on fuel taxes until September 2026, as well as a freeze of rail fares and prescription charges for one year) will temper the rise in inflation in Q2 2026. Indeed, gas and electricity prices will fall by 7% on 1 April, as previously announced by the regulator Ofgem (the price cap will fall from GBP1,758 to GBP1,641 and remain at that level until 30 June). Ofgem updates its energy price cap every three months; the next review will take place on 1 July, based on market price movements over the previous three months. We are assuming a 15% increase in gas and electricity prices in July. Against this backdrop, according to our forecasts, inflation is not



expected to accelerate significantly until Q3, with a peak expected in Q4 2026. Furthermore, the rise in energy prices will drop off the annual inflation rate in one year, allowing, thanks to base effects, for inflation to fall significantly from Q2 2027 onwards, provided that second-round effects remain limited.

Some second-round effects on service prices and wages are possible, but these are likely to be more limited than during the energy shock of 2022. Demand is significantly weaker and the labour market is no longer overheating, with the unemployment rate having risen sharply. Consequently, firms are unlikely to be able to fully pass on rising production costs to their selling prices or meet new wage demands.

“Firms are unlikely to be able to fully pass on rising production costs to their selling prices or meet new wage demands.”



According to our forecasts, UK inflation will peak at 3.5% year-on-year in Q4 2026 (in November). Core inflation (3.2% year-on-year in February) will continue to moderate until July, before rising again in H2 2026 to reach a peak of 3% year-on-year in December. In 2027, base effects linked to the dissipating energy price shock, the anticipated economic slowdown and restrictive fiscal and monetary policies are expected to bring inflation back down to levels close to the target by the end of 2027 (2.2% in Q4 2027).

Rising living costs are casting a shadow over households

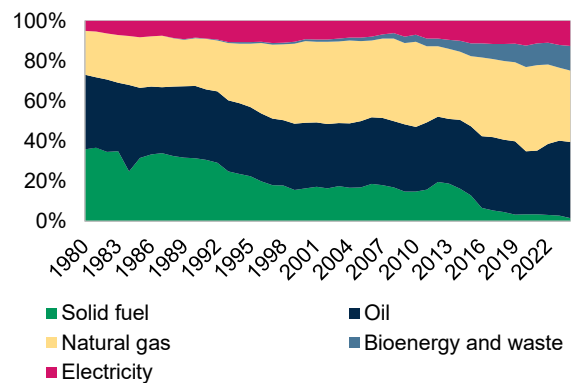
The war in the Gulf is casting a shadow over household consumption prospects, particularly for those on the lowest incomes, whose standard of living has deteriorated significantly in recent years. According to the Resolution Foundation, incomes for the poorest half of households (excluding pensioners) have remained virtually stable over the last twenty years (rising by just 0.5% per year compared with 4%

in the decade prior to 2005). Energy and food account for the bulk of these households’ expenditure, and they have little savings to maintain their purchasing power.

Despite the expansion of renewable energy in recent years, natural gas remains crucial for the UK. Around 85% of households use natural gas for heating, and it accounts for 30% of the energy used to generate electricity. The price of electricity continues to be largely determined by the price of natural gas due to the marginal pricing system (where the market price is determined by the cost of producing the last unit of electricity needed to meet demand at any given time).

Natural gas also remains a major source of energy for the economy as a whole (36% of demand).

UK: Energy consumption by type



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

The government has stated its intention to protect the British public from rising prices, but the Chancellor Rachel Reeves has firmly ruled out providing universal support on energy bills, citing risks to public finances, inflation and interest rates. She criticized the Liz Truss’s energy bailout of 2022 (a key element of which was the “energy price guarantee”), which was untargeted and gave support to the wealthiest of households. According to press reports, the government is considering targeted support for the most disadvantaged households which could be delivered by local councils. More broadly, the government will tackle abusive pricing practices and work with supermarkets, banks and regulatory authorities on consumer protection measures. In the immediate term, the government has begun releasing 13.5 million barrels of oil from the country’s strategic reserves. As part of a long-term strategy, it plans to accelerate the development of renewable and nuclear energy in order to reduce the economy’s dependence on natural gas.

The anticipated rise in inflation will weigh on real disposable income, which had already slowed sharply last year (to 0% year-on-year in Q3 2025) as wage growth declined and inflation rose. A further



erosion of household purchasing power is in turn expected to weigh on consumption.

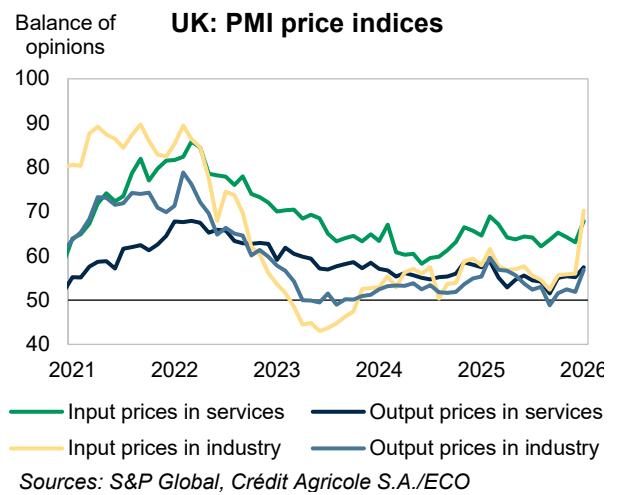
Labour market conditions are expected to continue deteriorating (the unemployment rate is forecast to rise to 5.6% by the end of the year), which will weigh on consumer confidence and further limit their ability to renegotiate wages.

Households are facing restrictive fiscal and monetary policies. The tax burden continues to rise, mainly due to the ongoing freeze on the income tax scale. Furthermore, past increases in BoE rates continue to impact households as some of them have to refinance fixed-rate loans taken out before 2022 (when rates were lower).

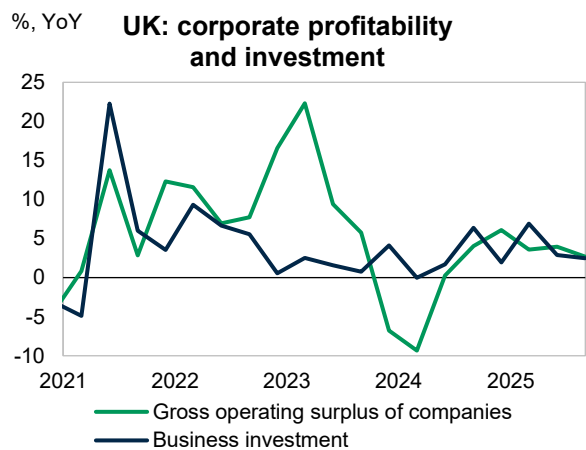
Against this deteriorated economic and inflation outlook, we anticipate a slowdown in household consumption to 0.6% this year, following 1.0% in 2025. A number of supportive factors could mitigate this slowdown: a savings rate that remains high, albeit falling (to 9.7% in Q3 2025, down from a peak of 11.3% in Q4 2024), wage growth that remains relatively strong in the private sector (3.6% forecast), a 4.1% increase in the *National Living Wage* (NLW) in April 2026, and the rise in social spending announced by the government in the latest budget (including the removal of the cap on child benefit for two children).

A major blow to investment

The investment outlook appeared more favourable at the start of the year, with the bulk of the impact of past shocks on corporate profitability now behind us. **The conflict in the Middle East is a game-changer: production costs are set to rise further and weigh on corporate margins, causing business confidence to deteriorate once again.** Indeed, the March PMI surveys of businesses highlight a significant rise in the ‘input prices’ indices: +14 points in the manufacturing sector – the sharpest monthly rise since 1992 – and a 5-point increase in ‘output prices’ index, suggesting a sharp erosion of margins. In the services sector, the rise in input and output prices is smaller but nonetheless significant (+4.8 and +2.2 points respectively).



We have revised down our forecasts for total investment growth to 0.2% for 2026 and 1.4% for 2027, following 3.4% in 2025. Heightened geopolitical and domestic political uncertainty, the weaker outlook for demand, increased interest rates, continued restrictive monetary policy and margins under pressure will weigh on business investment and housing investment.



Public investment is nevertheless expected to continue growing strongly, driven by the government’s plans to expand capital expenditure (+2% in real terms during the current fiscal year and +6.2% in 2027–28) with a special focus on the green transition and defence. In theory, the fiscal rule aimed at balancing the current budget balance (excluding capital expenditure) by 2029–2030 allows the government to increase its capital investment without reducing its headroom, all else being equal. However, rising debt servicing costs will likely strain the government’s ability to invest in growth projects. It may threaten or delay project timelines and force the government to difficult trade-offs, where clean energy and defence may be prioritised over housing or social infrastructure for instance.

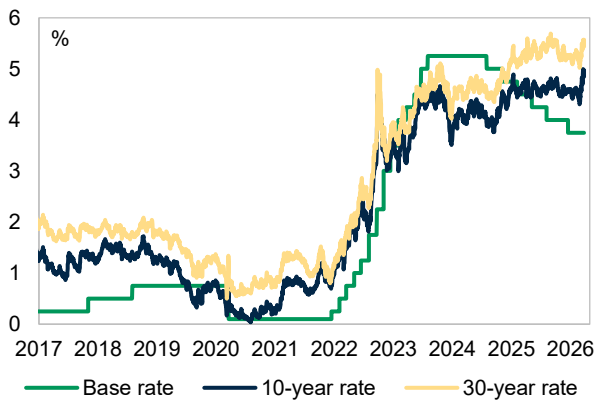


Pressure on gilts could persist before and after the local elections in May

Risks linked to domestic politics could put further pressure on government bond yields. The Labour government is highly unpopular, and it seems unlikely that Keir Starmer will remain as party leader and Prime Minister by the end of the year. The upcoming local elections on 7 May are set to be critical: Labour is expected to lose ground to the Reform Party and the Greens in England, Plaid Cymru in Wales and the SNP in Scotland. It is unlikely that Keir Starmer will retain his position as party leader should such a defeat materialise.

The risk of a cost-of-living crisis could prompt the government to introduce further measures to support households in the short term, particularly in the run-up to the elections, which could be perceived by investors as a relaxation of fiscal discipline. Finally, the deterioration in the economic outlook will reduce the government’s headroom against its fiscal targets this autumn, which risks making investors nervous once again.

UK: interest rates



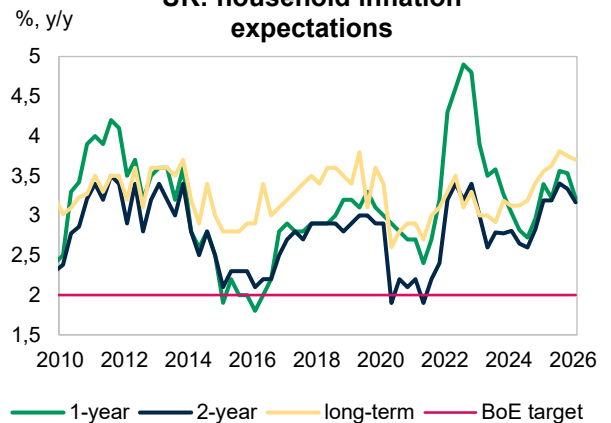
Sources: Datastream, Crédit Agricole S.A./ECO

Bank of England: “ready to act”

Before the outbreak of war in the Middle East, a further rate cut in March was considered the most likely outcome by the markets (in line with our December scenario). Faced with this new shock to energy prices, the BoE decided unanimously to leave its key policy rate unchanged at 3.75% at its monetary policy meeting on 18 March. **It now forecasts inflation of around 3% in Q2 2026 and 3.5% in Q3 (compared with 2.1% and 2% respectively in its February forecasts) and is concerned about the risks of second-round effects on wage and price-setting in**

a context where household inflation expectations remain elevated.

UK: household inflation expectations



Sources: BoE Inflation Attitude Survey, Crédit Agricole S.A./ECO

While acknowledging that the economic situation differs from that of 2022, the BoE fears that, following the successive supply shocks of recent years, households and businesses may have become more sensitive to any new inflationary shock, and that a wage-price spiral could be triggered. The BoE appears upset with a recent upward revision of estimates for private-sector pay settlements: these now point to an average annual increase of 3.6% for 2026, compared with the 3.4% estimated in February.

At the same time, the institution highlights the risk of a weakening in economic activity that could result from higher energy prices. The negative output gap is expected to widen, but the BoE appears to be downplaying the downside risks to inflation relative to the upside risks.

We now anticipate a 25bp rate rise in Q2 2026 (taking the policy rate from its current 3.75% to 4%), followed by a hold through to year-end. This single rate hike in our scenario is justified by the BoE’s desire to anchor inflation expectations and prevent a further increase in pay settlements. However, we are considerably less hawkish than markets, which are currently pricing in 2.5 rate hikes this year. Indeed, we believe that weak demand and rising unemployment will prevent the BoE from tightening as aggressively as market expectations. For 2027, as growth remains below potential and inflation normalises, we anticipate a return to a gradual monetary easing from Q2 2027 onwards. We expect three rate cuts in 2027 that would bring the policy rate down to a terminal rate of 3.25%.

*Forecasts finalised on 26/03/2026
Article completed on 26/03/2026*



ECONOMIC & FINANCIAL FORECASTS

MACROECONOMIC SCENARIO

International assumptions

	2024	2025	2026	2027	2024				2025				2026				2027			
					T1	T2	T3	T4	T1	T2	T3	T4	T1	T2	T3	T4	T1	T2	T3	T4
Eurozone GDP (y/y, q/q, %)	0.9	1.5	0.8	1.1	0.5	0.1	0.0	0.1	0.6	0.1	0.3	0.2	0.2	0.1	0.2	0.3	0.3	0.3	0.4	0.4
United States GDP (y/y, q/q, annualised, %)	2.8	2.1	2.4	2.0	2.8	2.4	4.4	3.2	-0.6	3.8	4.4	0.7	3.0	1.8	2.1	2.1	2.0	2.1	1.9	1.8
China GDP (y/y, q/q, %)	5.0	5.0	4.7	4.5	1.7	1.2	1.5	0.9	-	-	-	-	-	-	-	-	-	-	-	-
ECB deposit rate (end of period, %)	3.00	2.00	2.75	2.50	3.00	3.50	4.00	4.00	2.50	2.00	2.00	2.00	2.00	2.00	2.50	2.75	2.75	2.75	2.50	2.50
Federal Reserve funds rate (end of period, %)	4.50	3.75	3.75	3.50	5.00	5.50	5.50	5.50	4.50	4.50	4.25	3.75	3.75	3.75	3.75	3.75	3.75	3.50	3.50	3.50
Exchange rate (average, EUR/USD)	1.08	1.13	1.14	1.15	1.07	1.09	1.09	1.08	1.05	1.13	1.17	1.16	1.16	1.14	1.12	1.13	1.13	1.14	1.16	1.17
Brent (average, USD/barrel)	81.2	69.3	96.0	85.0	82.2	77.9	85.9	83.0	76.0	68.0	69.0	64.0	89.0	110.0	100.0	85.0	85.0	85.0	85.0	85.0

United Kingdom

United Kingdom	annual average, %				quarterly variation, %											
	2024	2025	2026	2027	2025				2026				2027			
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP (%)	1.1	1.3	0.8	1.2	0.7	0.2	0.1	0.1	0.3	0.2	0.2	0.2	0.3	0.3	0.4	0.4
Internal demand incl. stocks*	1.6	2.0	1.2	1.4	0.8	0.2	0.2	0.5	0.5	0.2	0.1	0.1	0.4	0.5	0.6	0.6
Household consumption	-0.1	1.0	0.6	0.6	0.3	0.0	0.4	0.2	0.3	0.1	-0.1	-0.1	0.2	0.3	0.4	0.4
Public consumption	2.9	1.7	2.7	3.2	-0.1	1.0	0.3	0.4	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Investment	1.7	3.4	0.2	1.4	3.4	-0.8	1.1	-0.1	0.5	-0.4	-0.4	-0.2	0.7	0.7	0.8	0.8
Change in inventories*	0.1	-0.1	-0.3	0.0	-0.3	0.1	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net exports*	-0.5	-0.9	-0.4	-0.2	-0.4	0.0	-0.1	-0.5	-0.1	0.1	0.1	0.1	-0.1	-0.2	-0.2	-0.2
Exports	1.4	1.6	1.0	2.8	0.2	-0.3	0.2	-0.6	0.5	0.6	0.6	0.6	0.8	0.8	0.8	0.8
Imports	2.7	4.2	2.1	3.2	1.2	-0.2	0.5	0.8	0.8	0.4	0.2	0.2	1.0	1.2	1.2	1.2
Unemployment rate (ILO)	4.3	4.9	5.4	5.5	4.6	4.7	5.1	5.2	5.2	5.4	5.6	5.6	5.6	5.6	5.5	5.4
Inflation (CPI, YoY%)	2.5	3.4	3.2	2.6	2.8	3.5	3.8	3.4	3.2	2.8	3.3	3.5	3.4	2.8	2.2	2.2
Core CPI (YoY%)	3.7	3.5	2.7	2.5	3.6	3.7	3.6	3.3	3.2	2.4	2.3	2.8	2.9	2.6	2.4	2.3
Current account (% GDP)	-3.0	-2.4	-4.0	-4.3	-3.0	-2.8	-1.6	-	-	-	-	-	-	-	-	-
General gov. balance, % GDP	-6.0	-5.4	-3.9	-3.5	-	-	-	-	-	-	-	-	-	-	-	-
Public debt % GDP	99.9	102.3	103.6	104.2	-	-	-	-	-	-	-	-	-	-	-	-
Bank rate**	4.75	3.75	4.00	3.25	4.50	4.25	4.00	3.75	3.75	4.00	4.00	4.00	4.00	3.75	3.50	3.25

* Contributions to GDP growth

** End of period

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

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