UK Economic Outlook
Q1 2025

Cebr

Executive Summary – UK Economic Outlook

- The UK economy faltered in the second half of 2024, leading to the second consecutive year of negative GDP per capita growth. Consumer spending is weak despite strong wage growth, and business investment is falling due to low confidence.

- Headline inflation hit 3.0% in January and will pick up further in the near term due to increases in employer National Insurance Contributions and National Living Wage increases pushing up price and wage growth. Inflationary pressures will subside in the medium term due to weak household consumption and the continually easing labour market, which will gradually feed through to lower pay growth. This will lead the Bank of England’s Monetary Policy Committee to cut interest rates gradually, to 3.25% by the end of next year.

- We expect the UK economy to grow slightly faster in 2025 than last year, at 1.1%. This still represents a subdued level of economic activity. Government consumption will support growth after measures announced at the Autumn Budget led to a larger state, but private consumption will underperform again. The unemployment rate will continue to rise to a peak of 4.7%, before conditions improve due to easing core inflation and the lagged impacts of looser monetary policy.

- However, risks are weighted to the downside. It is likely that the government are not on course to meet its fiscal targets, due to worsening economic conditions. Therefore, the spring statement may bring further cuts to government spending. Uncertainty from US tariffs is hurting confidence and causing ongoing financial market volatility. We already expect worldwide growth to be lower, impacting global trade, including for the UK. In the US, interest rates are already higher than they might have been without tariffs, prices are expected to rise, and there is a sharp decline in near-term economic indicators.

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UK growth prospects

Growth expected to be below trend once again in 2025

The UK economy expanded by 0.9% in 2024, while GDP per capita fell for the second consecutive year. Notably, growth was concentrated in the year's first half, with the second half recording a near stagnation.

This spilled over to early 2025, with the economy shrinking slightly in January. However, momentum should return throughout the year with a slightly improved growth rate for 2025, amounting to 1.1% for the year.

There is notable divergence in our outlook when comparing components of GDP. Consumption is projected to grow at a slower pace than the economy as a whole, despite real wages continuing to grow at a robust pace. The savings ratio has increased over recent years, likely partly due to higher interest rates. It may also reflect a behavioural change in consumption after the pandemic and cost of living crisis.

Meanwhile, business investment is expected to contract in the year, reflecting weak confidence amidst rising employers' costs and upcoming policy changes. Conversely, growth is expected to be supported by government activity, with the state growing in size as a result of the Autumn Budget.

Beyond 2025, we expect the economy to grow at a faster rate, supported by lower interest rates and real disposable income growth, amongst other factors, but remain short of the pre-pandemic trend. The long-term growth rate is estimated to be around 1.6%.

Labour market

Employee confidence in the job market dips amidst despite cooling labour market conditions

The employment picture has become more difficult to read recently due to issues with the main survey used by the ONS. It shows unemployment ticking up over the second half of 2024 to 4.4%.

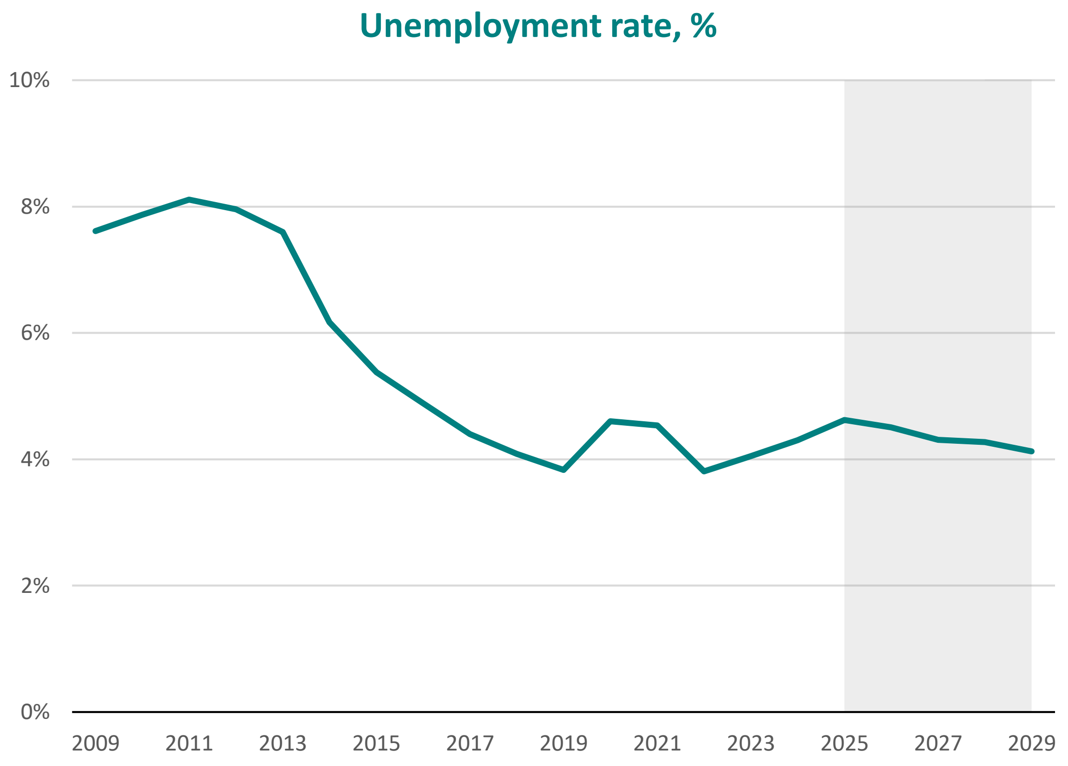
Looking instead at real-time payroll data from HMRC, employment growth has gradually slowed since mid-2022 to a near-standstill by the end of 2024. Vacancies have also been on a gradual downward path for the 31st consecutive period in January 2025. The vacancies-to-unemployment ratio has eased considerably from its post-pandemic high of 1.0 in Q3 2022 to 1.9 in Q4 2024. Overall, therefore, the labour market has been cooling.

This has dampened workers' confidence in job security and career progression, according to The Robert Half Job Confidence Index (JCI) in Q4 2024. In fact, the JCI fell to its lowest level since Q1 2023 in the same period, which nonetheless represents high confidence by historical standards.

Annual growth in total pay increased to 6.0% in Q4 2024, up from 4.4% in the previous quarter. However, this is largely due to the unwind of base effects, with the underlying trend continuing to be easing wage growth, in line with loosening market conditions.

There will be further upward pressure in the short term when minimum wage increases take effect in April, plus the increase in employer NICs, which will likely be partially passed on through lower employment and wage growth. The overall impacts of this tax rise remain uncertain and will likely be highly heterogeneous between different firms.

We expect the labour market to bottom out by the end of 2025, with unemployment peaking at around 4.7%. Wage growth will continue to ease, hitting 3.5% in the year to Q4 2025. This will remain well above inflation, supporting an ongoing recovery in living standards.



Inflation and interest rates

Inflation risks persist as inflation surpasses BoE's 2% target, despite progress in containment

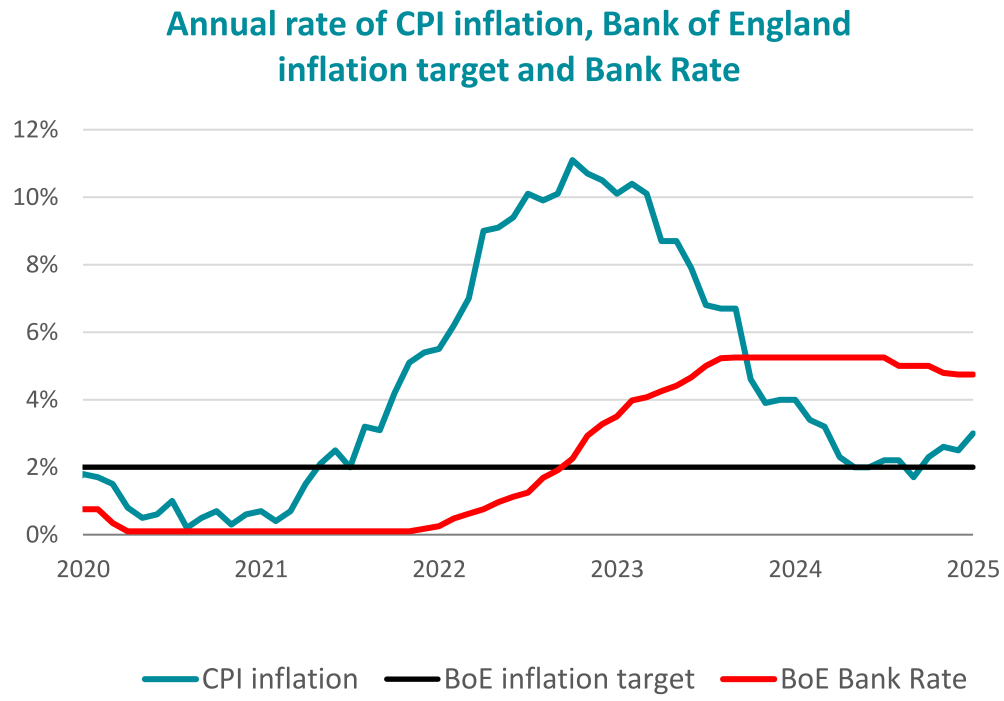
CPI inflation rose to 3.0% in January, above expectations. The rate of inflation has nearly doubled since a trough of 1.7% in September. The drivers of the increase in inflation have been broad, with overall goods price growth rapidly accelerating but services inflation growth remaining elevated at 5%.

Nonetheless, in February, the Monetary Policy Committee (MPC) voted to reduce the Bank Rate by 0.25pp to 4.5%, although two members advocated for a larger cut of 0.5pp to 4.25%.

Looking ahead, we expect inflation to peak at 3.8% over the summer, pushed up by April’s Ofgem price cap rise and pass-through of the employer NICs hike. Thereafter, weak demand conditions will start to push inflation back down gradually, returning to target some time in 2027.

Given the two years or so it takes for interest rate changes to fully feed through. The Bank of England is currently trying to balance the need to keep rates restrictive in the short term and the need to ensure they aren’t overly restrictive in the medium term.

Nonetheless, Cebr expects the Bank to delay further rate cuts until the second half of the year, in light of the recent upside surprises to inflation and upside risks from current geopolitical issues. We are pencilling in one more rate cut this year, with rates ending up at 2.75% by early 2028.



Global prospects

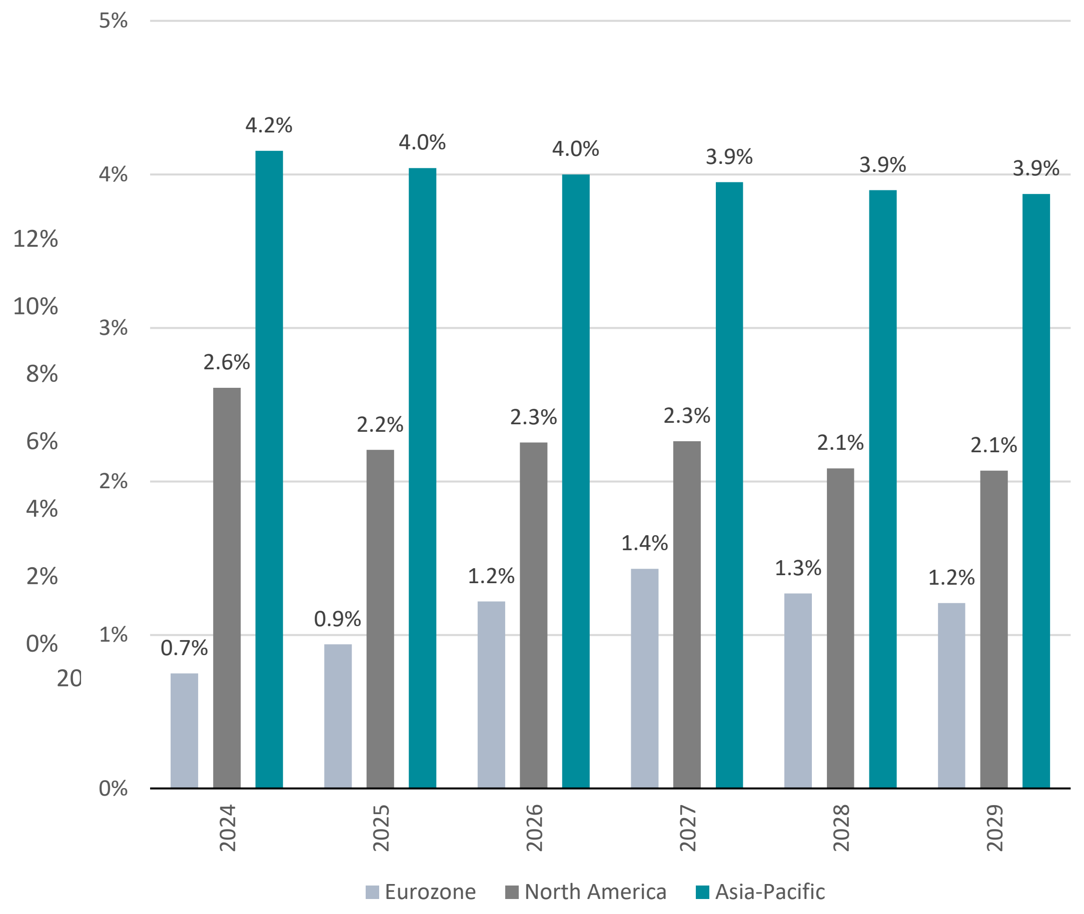
Downward revisions to US and Eurozone GDP growth, amid wider uncertainty

Economic growth in the Eurozone edged up 0.1% quarter-on-quarter in Q4 2024, according to second estimates. Weak activity persists, however, with Germany contracting for a second consecutive year, reflecting broader structural challenges. Trade uncertainty poses additional risks to growth. Meanwhile, the latest inflation data indicates continued disinflation, with core and services inflation easing, prompting another rate cut by the ECB in March. Nonetheless, Cebr is of the view that the ECB will take a pause in its rate loosening cycle, amidst upside risks to inflation. Delayed policy loosening and wider uncertainty have led to a downward revision in our growth forecasts, to 0.9% in 2025.

The US economy expanded by an annualised 2.3% in Q4 2024, bringing full-year growth to 2.8%. Strong consumer demand was a key driver of growth once more, surging by an annualised 4.2%. However, leading indicators suggest that domestic consumption, and activity more broadly, is easing, not least due to persistent inflation and uncertainty surrounding trade policy. Downside risks stemming from recent protectionist measures remains a key determinant to the US' economic outlook. We now expect US GDP growth at 2.3% in 2025, down on the 2.5% in our previous forecast.

Economic activity in China has seen a modest uptick, bolstered by the Lunar New Year festival, which typically is a period of heightened consumer spending. Underlying weaknesses in domestic demand remain apparent, however. China's National People's Congress announced its growth a growth target of 'around 5%' for 2025 and hinted at a stronger fiscal policy push. That said, details on such policies were limited, and it is to be seen whether such measures can rejuvenate consumer and business confidence.

Cebr GDP growth forecast



Deep dive: Trump uncertainty undermining US soft landing

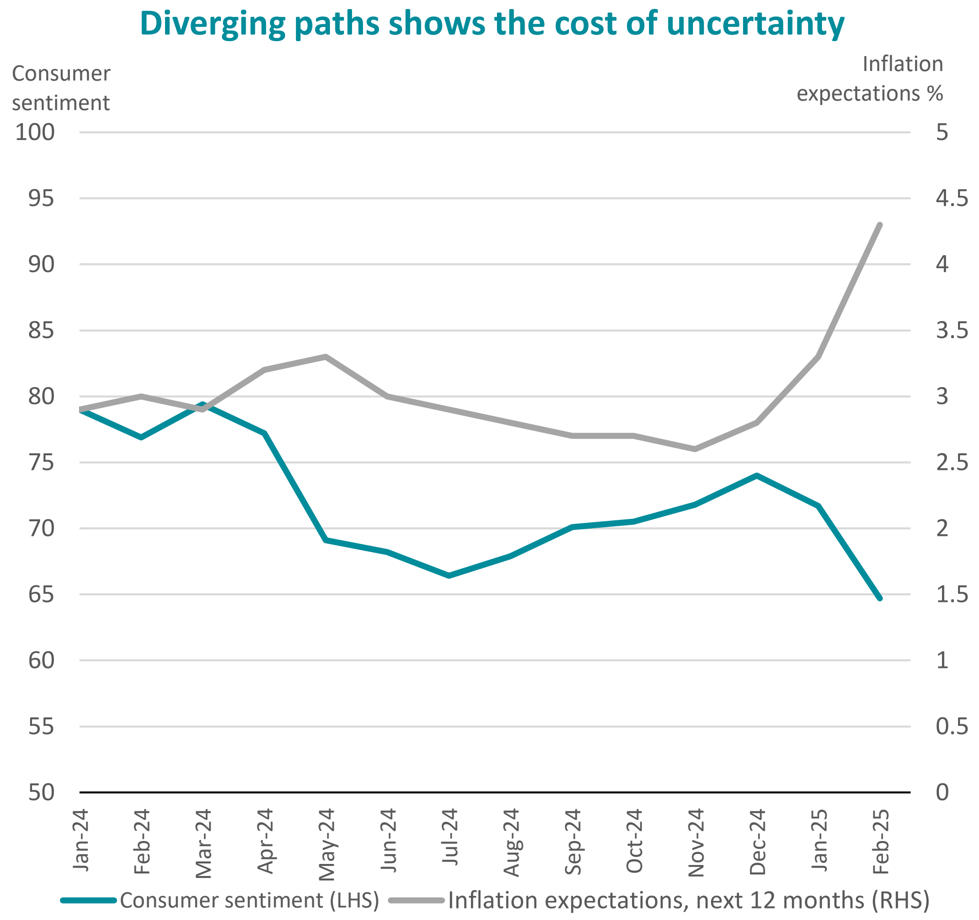
US Consumer sentiment at its lowest level in over a year and inflation expectations surging amid frenetic Trump administration. Back and forth on tariffs leaves consumers cautious.

Over the past three years, the US economy has roared ahead of other advanced economies. The strength of the US consumer and robustness of household consumption have supported growth rates well in excess of 2.0%. With inflation having receded from its recent peak of 7.2% back to 2.1% in September, the possibility of a soft landing morphed into near certitude.

However, tariffs placed on Mexico, Canada and China from the US, plus the threat of more tariffs placed on countries across the world, looks set to undo this economic momentum. The Boston Fed estimated the tariffs announced so far could increase core CPI by 0.8pp alone, before considering the impacts of other tariffs, including retaliatory ones by Canada, China and Mexico. This would have significant impacts on interest rates, with the Fed already pausing its rate-cutting cycle.

The level of impact this will have on growth remains unclear. The Atlanta Fed's GDP nowcast is pointing to roughly a -0.4% growth rate for Q1, with estimates of the chance of recession rising. Nonetheless, the current tariffs will likely impact Mexico and Canada more than the US. The OECD cut their 2025 forecast for the US by 0.2pp to 2.2%, but Mexico is expected to see a contraction of 1.3% compared to 1.2% forecasted previously, while Canada's expected growth rate has more than halved.

However, the long-term impact for the US could be much greater. The impact of tariffs on China is already lessened by the country pivoting away from the US following the previous trade war, while the current uncertainty seems to be driving other trade partners (such as the UK and Canada) closer together. Therefore, the UK has both upside and downside risks from the current geopolitical environment.



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