

# Economic Outlook

## Q2 2025

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Cebr



# Executive Summary – Economic Outlook

- The UK economy surpassed expectations in Q1, growing by 0.7% on the quarter. However, a collection of headwinds were encountered at the beginning of Q2 that are expected to slow growth. We project GDP to expand by 1.2% in 2025, slightly up on last year but firmly below the historical trend. A series of further sub-trend growth rates are expected over the medium-term forecast horizon, with the economy lacking momentum.
- UK CPI inflation rose to 3.5% in April, its highest reading since January 2024. The main driver of the acceleration was household bills, such as energy and water. In addition, employment cost increases may put further upward pressure on inflation. Between these factors, we expect inflation to peak at 3.7% mid-year and average 3.3% across 2025. As a result, we expect the Bank of England to maintain a cautious approach to monetary loosening, with only one further cut to interest rates this year.
- In terms of UK regions, London, the North East, and the North West are expected to lead growth in 2025. The devolved nations, particularly Wales, are projected to grow at a slower pace.
- Trade policy changes have driven a firm downgrade to our US growth forecast. We project GDP growth of 1.4% in 2025 and 1.6% in 2026, sharply down on recent history. The effects of these policy changes, and the uncertainty surrounding them, are also clouding the global outlook. Amongst other countries, our forecasts have also been downgraded for Canada and Mexico. Eurozone growth is also projected to be weaker, at 0.8% in 2025.

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# UK growth prospects

## Despite strong start to the year, UK growth is still expected to be meagre in 2025, with headline growth of just 1.2% projected

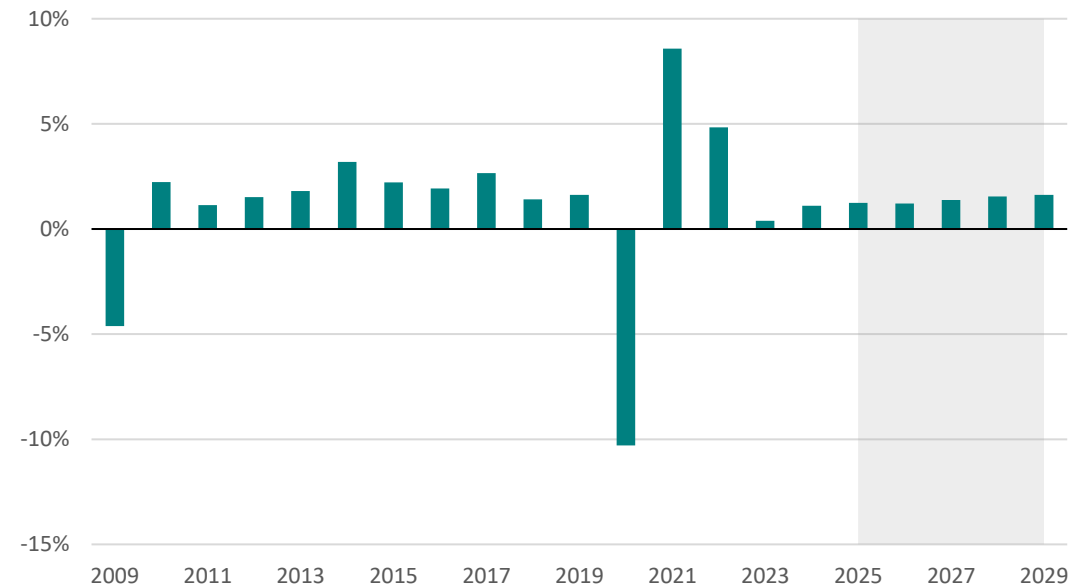
The UK economy surpassed expectations in Q1, growing by 0.7% on the quarter. Amongst components of GDP, there were particularly strong contributions to growth from business investment and exports.

The economy encountered a collection of headwinds at the beginning of Q2 that are expected to slow growth. Internationally, the imposition of tariffs from the US and subsequent changes to trade policy added significant uncertainty to the outlook for trade. The anticipation of such changes may have contributed to the strong export growth recorded in Q1, with businesses across both sides of the Atlantic frontrunning the disruption.

Meanwhile, domestic pressures are also mounting. On the consumer side, households are facing increased utility bills that will dampen spending power. Businesses also saw cost pressures rise, with changes to employers' National Insurance Contributions and the National Living Wage coming into effect, presenting a risk to investment and employment prospects.

We project GDP to grow by 1.2% in 2025, slightly up on last year but firmly below the historical trend. A series of further sub-trend growth rates are expected over the medium-term forecast horizon.

UK annual GDP growth



# Labour market

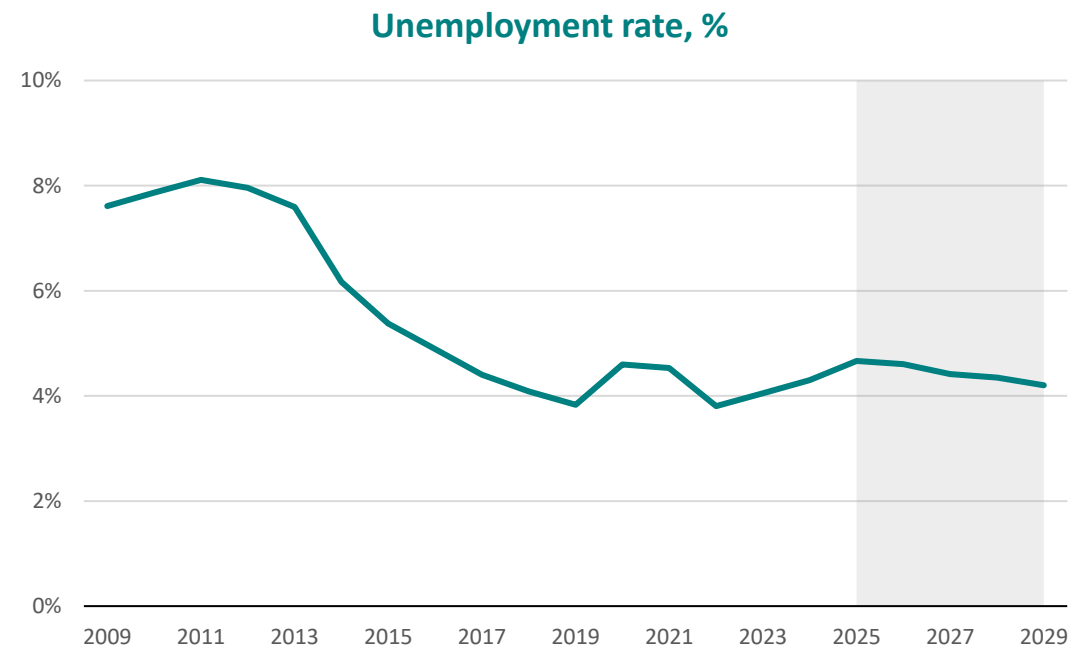
## The labour market softened in Q1 ahead of April's increases to the National Living Wage and employers' NICs

Employment in the UK was 34.0 million in Q1 2025, up by 1.9% on the year. Despite employment increasing, the unemployment rate also rose, reaching 4.5%. This was up from 4.3% in the same period last year.

Vacancies declined for a 34<sup>th</sup> consecutive period in the three months to April. The ratio of unemployed people to vacancies is now 2.1, the highest it has been since the three months to January 2017, excluding pandemic-affected periods. This emphasises the easing of the labour market.

Wage growth has also moderated. Average total pay across the economy rose by 5.5% in Q1, down from 6.1% in the previous quarter. Nonetheless, earnings growth remains historically elevated and the recent increases to wage floors are expected to put some upward pressure on this metric in upcoming data releases.

Looking ahead, Cebr anticipates a rising unemployment rate over the remainder of 2025, in line with softening labour market conditions. Earnings growth is also predicted to slow, despite upward pressure from the wage floor effect. These dynamics are likely to be further reinforced by rising employment-related costs stemming from the recent changes to National Insurance Contributions, which may constrain hiring intentions and limit employers' ability to raise wages.



# Inflation and interest rates

## Inflation is facing upward pressure from household bills and rising employment costs, but trade impact could be partially offsetting

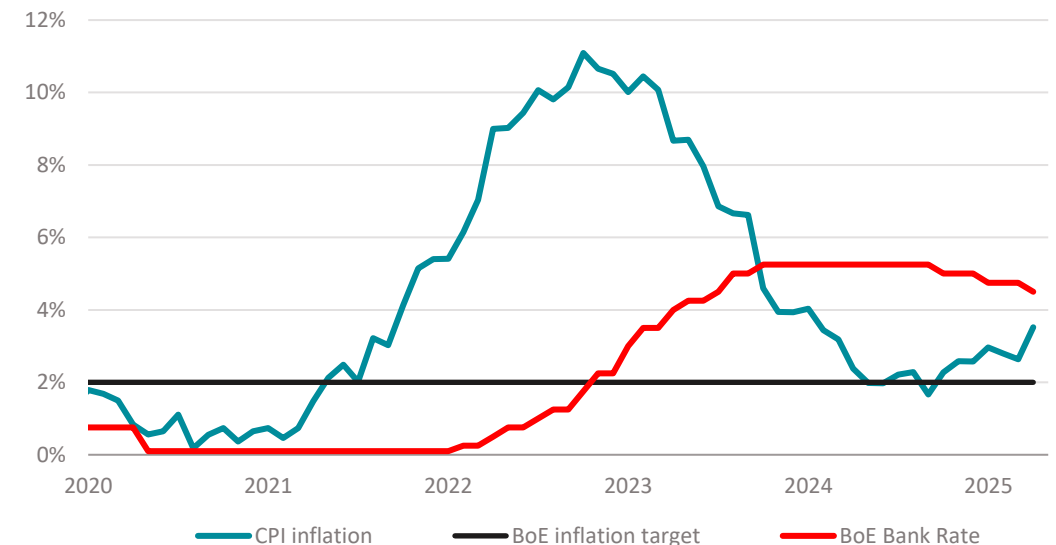
CPI inflation rose to 3.5% in April, its highest reading since January 2024. The rise was driven by an increase to the Ofgem energy price cap, alongside higher water bills and council tax rates.

This rise in household bills is expected to keep inflation firmly above the Bank of England's 2% target in the near term. Additional upward pressure may come from rising employment costs, a portion of which will likely be passed through to end prices in order to protect margins. Between these factors, we expect inflation to peak at 3.7% mid-year and average 3.3% across 2025.

Partially offsetting the upward pressures, volatility in global trade policy is expected to have a deflationary impact on the UK economy. The main transmission for this will be weaker demand, as lower trade volumes and dampened investor sentiment weigh on activity. Another channel could be cheaper imports from other markets that would previously have been directed towards the US.

The Bank of England is facing a balancing act between curbing above-target inflation and stimulating poor growth prospects, which are now further exacerbated by trade uncertainty. On net, Cebr expects the Bank to maintain a cautious approach to monetary loosening, with only one further cut to interest rates this year.

Annual rate of CPI inflation, Bank of England inflation target and Bank Rate



# Global prospects

## Signs of easing activity emerging as trade policies come into effect, with particular impact on the outlook for North America

The Eurozone economy grew by 0.6% in Q1 2025. Growth was supported by easing inflation and looser monetary policy, alongside a temporary boost from exporters rushing shipments ahead of President Trump's April 2nd announcements.

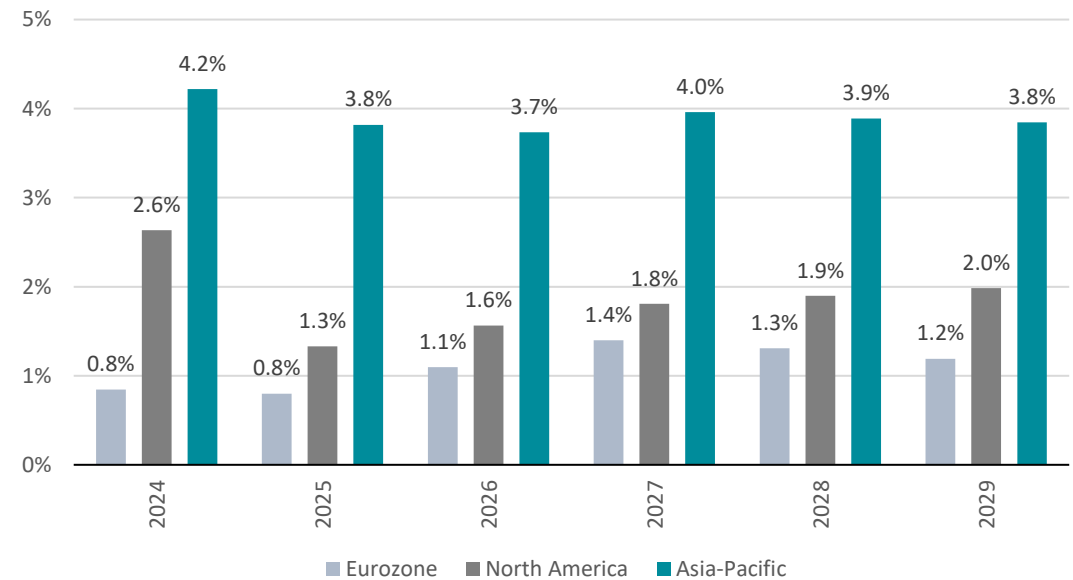
With inflationary pressures moderating, it was little surprise that the European Central Bank (ECB) cut rates again in June. However, a pause to loosening is now on the cards. Overall, we forecast Eurozone growth at 0.8% for 2025.

Uncertainty over global trade policy continues to cloud the outlook. In the US, the economy shrank at an annualised rate of 0.2% in Q1, largely due to trade distortions. Core GDP, a better gauge of domestic demand, grew steadily, signalling underlying strength before tariff tensions escalated.

Signs of cooling are emerging, however, with job openings down and underemployment rising. We forecast US GDP growth of 1.4% in 2025 and 1.6% in 2026, rates firmly down on recent history. Our outlook for Canada and Mexico has also been revised downwards.

We expect China to fall short of its 5% growth target, expanding by 4.3%. Challenges include trade uncertainty and soft global demand.

Annual GDP growth by region



# Regional prospects

## London and the North to outperform this year, as devolved nations of Wales, Scotland and Northern Ireland to trail behind

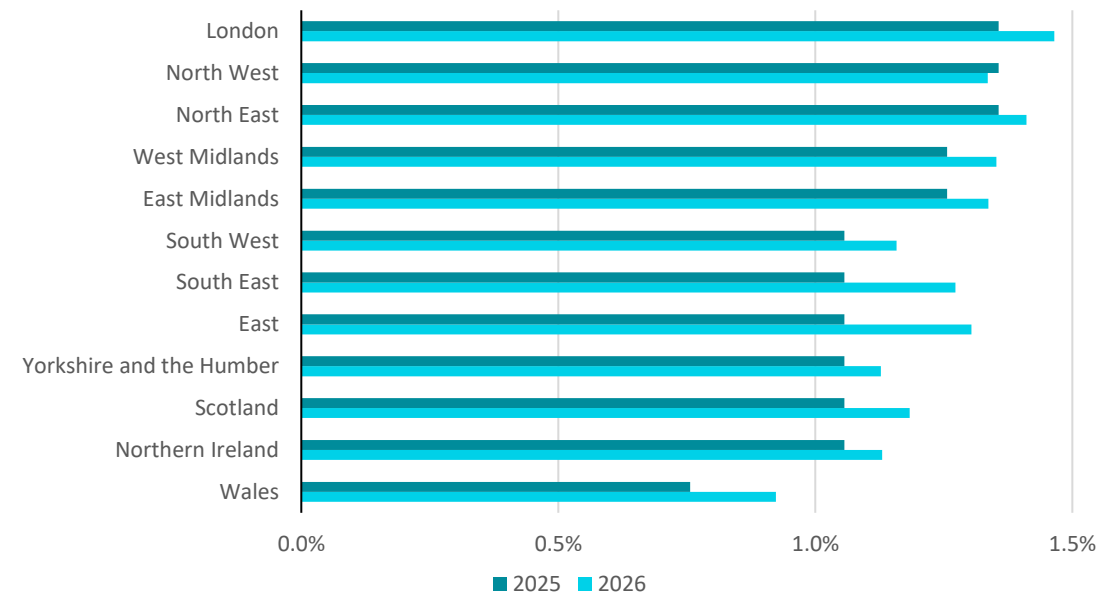
London, the North East, and the North West are expected to lead regional growth in 2025. In the North West, this will be underpinned by strong productivity gains, while the North East and London will benefit from significant employment growth. This trend is projected to continue into 2026, with the Midlands also posting strong expansions.

In contrast, Wales is projected to see the slowest growth over the next two years, held back by subdued productivity and employment gains that are expected to lag far behind the UK average.

Over the longer term, the East of England is expected to record the strongest growth of any UK region, with output projected to rise by 7.1% between 2025 and 2029. This is expected to be driven by robust consumption growth, supported by strong productivity gains feeding through into higher wages.

Despite the positive growth outlook, business sentiment remains subdued across all regions. According to the latest FSB Small Business Index (SBI), produced in collaboration with Cebr, small firms in every region were net pessimistic about the next three months when asked in Q1 2025. This likely reflects broader national challenges, including the increase in employment costs from April and ongoing uncertainty related to international trade.

Annual GVA growth by region



# Deep dive: Components of inflation

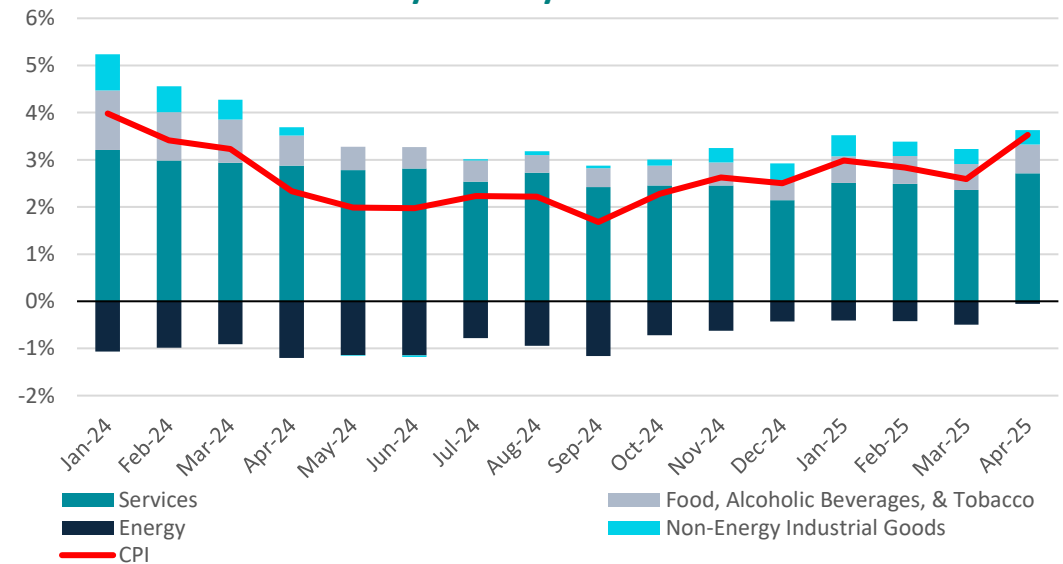
## The end of energy price deflation reveals little progress on underlying price pressures and leaves headline inflation vulnerable to upside movements in natural gas prices

Energy contributed negatively to annual headline inflation in 2024, helping to offset price pressures in services. Yet, since autumn last year there has been a reversal in these price dynamics. Energy deflation has slowed dramatically, coinciding with a re-emergence of non-energy industrial goods inflation and stalling progress in services disinflation. Headline inflation is now back over 3%, having dropped below target as recently as September.

Cebr projects that services inflation will remain sticky over the remainder of 2025. Wage growth continues to place upward pressure on labour costs, while recent policy changes are expected to exacerbate this further. There will be a degree of pass through from businesses to end consumers in an attempt to maintain margins, contributing to further price pressures.

The UK also remains especially vulnerable to an energy price shock. Storage levels of natural gas, which tend to set wider energy prices, are extremely low, leaving the UK highly dependent on international prices. Relatively high levels of storage across Europe should temper the UK's competition for natural gas. Yet, in an uncertain world with elevated geopolitical tensions, the UK is risking another inflation shock, this time with greater entrenched inflation still in the economy.

Select categories percentage point contribution to headline year-on-year CPI inflation\*



\* Due to rounding, columns may not sum exactly to CPI.

# About

This report has been compiled by Cebr's Forecasting and Thought Leadership team.

Cebr's forecasts cover every national economy, with particular focus on the UK, US, and Eurozone. Forecasts are updated on a regular basis.

Our next Economic Outlook document will be published in September.

For more information on our forecasts or other research enquiries, please contact [forecasting@cebr.com](mailto:forecasting@cebr.com).

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