

Economic Outlook Q2 2026

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Executive Summary – Economic Outlook

- UK real GDP grew by 0.6% in Q1 2026, a stronger start to the year than anticipated, but potentially a high-water mark given the headwinds caused by escalating conflict in the Middle East. The disruption, particularly to global energy supply, is expected to weigh significantly on growth over the rest of the year, as rising input costs are increasingly passed onto consumers, putting pressure on discretionary spending.
- The UK's labour market troubles persist, with the unemployment rate still elevated in Q1 2026 and job vacancies falling. Rising slack in the job market is contributing to a deceleration in earnings growth, placing pressure on real incomes and households' spending power.
- Headline CPI inflation came in at 3.1% in Q1 and is expected to have eased in Q2. The Ofgem price cap, set before the start of the ongoing energy crisis, will temporarily insulate UK consumers from significant gas and electricity inflation. That said, inflation is forecast to remain elevated in Q2 compared to pre-war forecasts.
- The conflict in Iran is expected to weigh on near-term growth prospects in both the Eurozone and the United States, as renewed inflationary pressures constrain the ability of the European Central Bank and the Federal Reserve to adopt a more expansionary monetary policy stance. China posted robust growth in Q1, but early estimates point to Iran-related disruption weighing heavily on economic output in Q2.
- London, the North East, and the South East are projected to be the fastest-growing regions in the UK this year, while the devolved nations and Yorkshire and the Humber are expected to grow at the slowest pace.

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UK growth prospects

Subdued growth expected over the remainder of 2026 following a stronger-than-expected Q1

The UK economy grew by 0.6% quarter-on-quarter in Q1 2026, accelerating markedly from subdued growth of 0.2% in the previous quarter. This included growth of 0.3% month-on-month in March, following the outbreak of war in the Middle East at the end of February.

Household consumption was a key contributor to the robust Q1 result, rising by 0.6% on the previous quarter. Elsewhere, business investment grew by 0.7%, although it remains lower than in Q1 2025, following a particularly weak year for investment in the UK.

While outturn data provide welcome signs of UK economic resilience, the impact of the conflict is not yet fully reflected. Q1's growth likely captures a degree of front-loading, as businesses and consumers bring forward planned expenditures in anticipation of rising costs later this year. As evidence of this, inventory growth accelerated markedly year-on-year compared to Q4 2025.

Cebr forecasts that the UK economy will expand by 1.1% in 2026, weaker than 2025. The ongoing energy volatility, combined with considerable and growing labour market slack, are expected to weigh heavily on demand. Interest rates may also act as a drag on growth, with the Bank of England likely to keep policy more restrictive than it otherwise would have been in the absence of the conflict.



Labour market

Vacancies slip and wage growth slows as conditions in the job market soften

The UK labour market continued to soften in Q1 2026. Compared to the same quarter a year prior, payrolled employment was down 94,000 (0.3%). The unemployment rate moved down slightly on the previous quarter, but at 5.0%, remains 0.5 percentage points higher than the same quarter last year.

After several quarters of stability, the first quarter saw a decline in job vacancies, pointing to a further weakening in hiring appetite. Declines were broad-based across sectors and firm employment bands, though the most pronounced declines were concentrated in low-paying sectors, including retail and wholesale trade and accommodation and food services.

Earnings growth continues to cool, especially in the private sector where regular earnings growth most recently fell to 3.0%. Real earnings are increasingly coming under pressure and grew by just 0.1% in Q1 2026.

Looking ahead, the labour market is expected to remain on the backfoot, as uncertainty stemming from renewed inflationary pressure weighs on hiring appetite among firms. Cebr forecasts the unemployment rate to remain elevated. Meanwhile, average weekly earnings growth is expected to slow from 4.8% in 2025 to 3.4% in 2026.



Inflation and interest rates

Near-term energy price relief masks resurgence in inflationary pressure

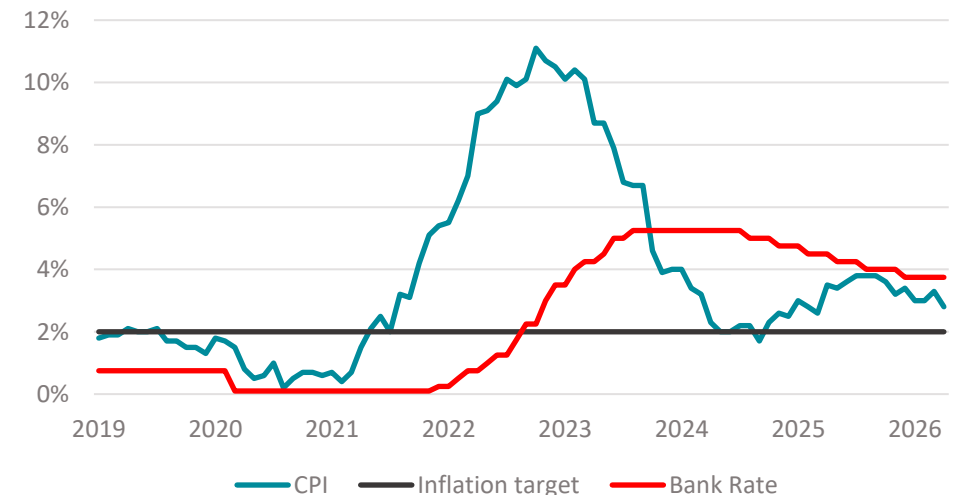
CPI inflation eased to 3.1% in Q1 2026, down from 3.4% in the previous quarter. This decline reflects the easing of inflationary pressures prior to the outbreak of the Iran war in late February, which has significantly altered the inflation outlook for the latter half of 2026.

Headline inflation is set to ease marginally in Q2 2026, supported by the new Ofgem energy price cap – which was set prior to the Iran war and is down both quarter-on-quarter and year-on-year. However, the cap will rise again in Q3, significantly increasing inflationary pressure as it adjusts to reflect elevated wholesale energy prices.

Moreover, the cap does not apply to businesses, where input price rises have already taken place and are set to be passed through to consumers. According to the ONS's Producer Prices Index (PPI), annual input price growth accelerated to 7.7% in April 2026 from 5.3% in March, reflecting rising inflationary pressures.

Prior to the surge in global energy prices, monetary easing through 2026 had been broadly anticipated. With the inflation outlook now materially higher, Cebr expects the Bank of England to keep interest rates on hold for the remainder of the year, delaying the stimulus that lower rates would have provided.

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



Global prospects

Middle East conflict materialises as central drag on global outlook

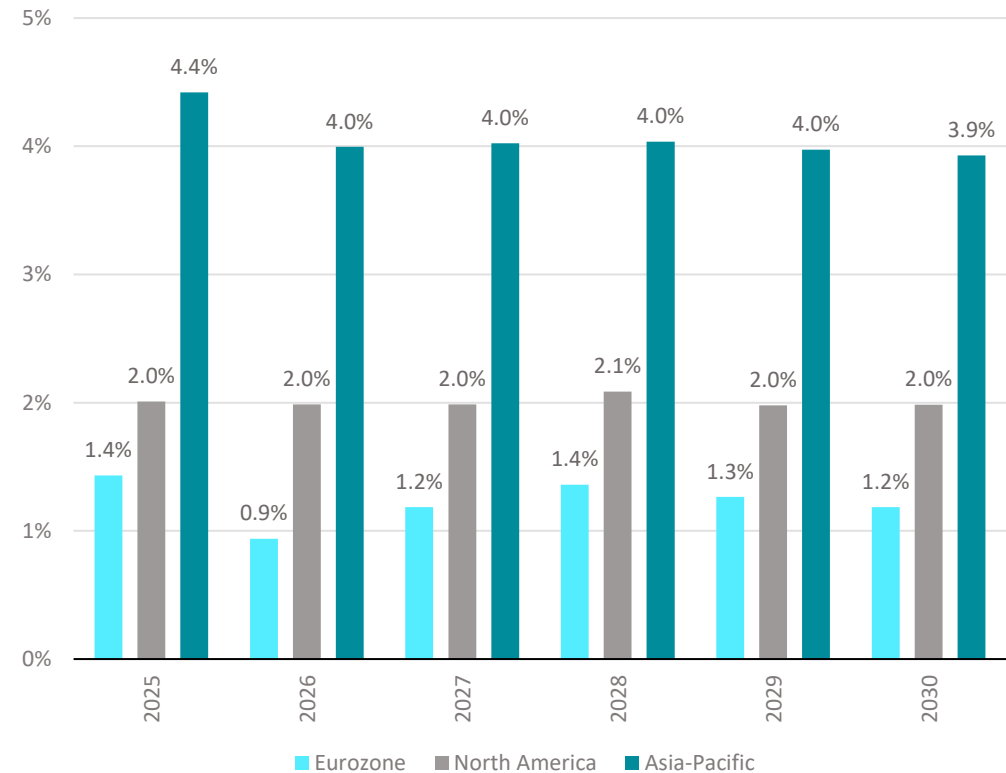
Eurozone GDP contracted by 0.2% in Q1 2026, revised down from an initial 0.1% growth estimate. The revision was largely driven by a plunge in Irish GDP. Headline inflation jumped to 3.2% in May amidst a double-digit surge in energy inflation. The European Central Bank (ECB) held rates at its April meeting, though given the significant pass-through to consumer prices, our central case is now for hikes at both the June and July meetings.

US GDP growth was revised down to an annualised quarter-on-quarter rate of 1.6% in Q1 2026 from 2.0% in the advance estimate, reflecting weaker consumer spending and softer investment. April CPI accelerated to 3.8% year-on-year, contributing to the Federal Reserve holding rates in an 8-4 vote in April's meeting. Our central case is for rates to be on hold through 2026, amidst hints of a divergence in labour market and inflationary dynamics.

China posted Q1 2026 GDP growth of 5.0% year-on-year, at the top of Beijing's target band. That said, activity data for April showed a sharp deterioration as the Iran war's pass-through to the real economy materialised, with industrial output decelerating and retail sales growth collapsing to its weakest since December 2022. More broadly, the recent Trump-Xi summit in Beijing extended the existing trade truce, hinting at a stabilisation in relations.

The Iran war is now the dominant near-term driver of the global outlook. Higher energy prices and softening sentiment are feeding through to activity data across all three regions discussed here. As such, risks remain skewed firmly to the downside until a credible resolution path emerges.

Annual GDP growth by region



Regional prospects

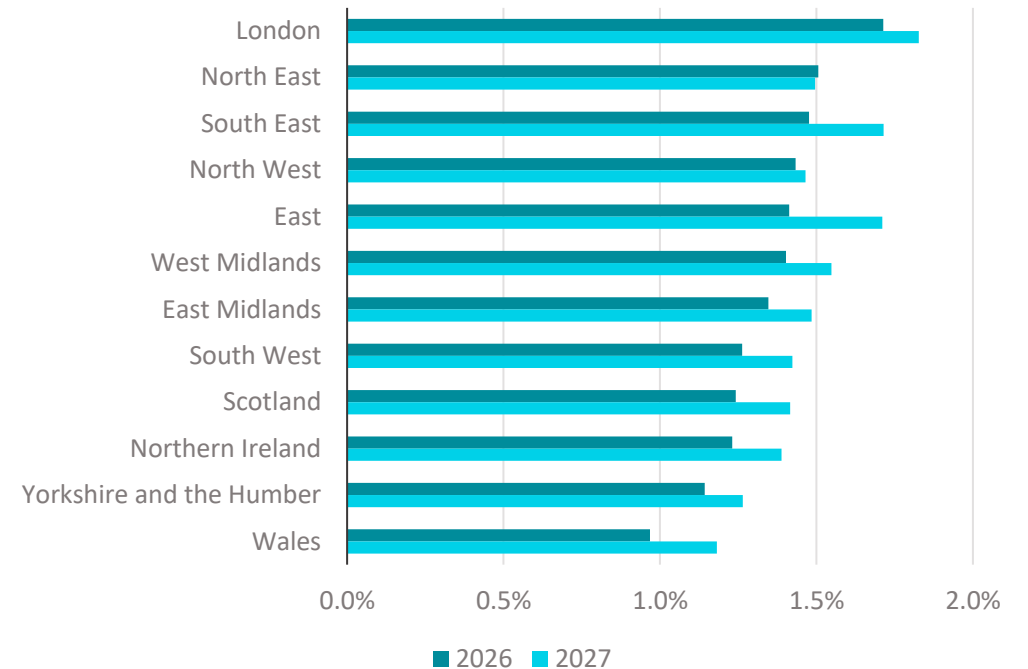
Most UK regions to see slower growth this year with a broad-based improvement expected for 2027

All regions are forecast to see either slower or broadly unchanged GVA growth in 2026 relative to 2025. Elevated input costs, softening labour market conditions and heightened uncertainty will all weigh on business activity and investment. However, the regional outlook is expected to improve across almost all regions in 2027, supported by more favourable macroeconomic conditions.

In 2026, GVA growth is forecast to be led by London, the North East, and the South East. Survey data for London continue to point to stronger-than-average business activity and a degree of confidence in future activity. Cebr forecasts London to outperform all other regions, recording an annual growth rate of 1.7% in 2026 and 1.8% in 2027.

At the other end of the scale, the devolved nations and Yorkshire and the Humber are forecast to see the slowest growth this year and in 2027. Wales, in particular, is expected to underperform, with GVA growth forecast at just 1.0% in 2026 and 1.2% in 2027. This largely reflects persistent labour market weakness and subdued productivity growth. Q1 labour market data reinforce this, showing Wales had the second highest economic inactivity rate and one of the lowest employment rates among UK regions, limiting labour supply and constraining potential output.

Annual GVA growth by region



Deep dive: Housing market

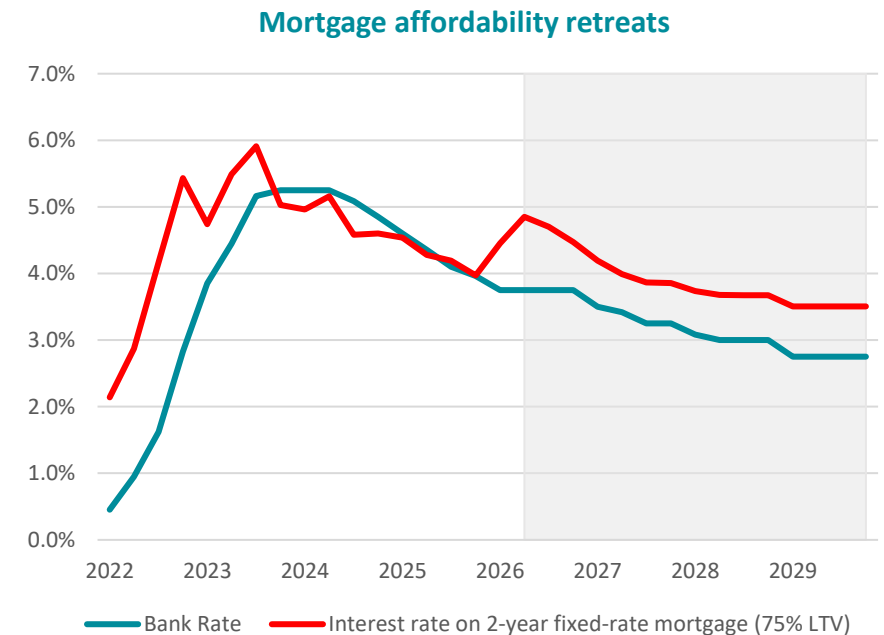
Conflict clouds a tentative recovery as rising mortgage costs drain homebuyer demand

Prior to the outbreak of hostilities in Iran, conditions were gradually aligning for a modest revival in UK housing activity. Successive interest rate cuts, easing inflation, and a Budget whose measures proved less disruptive than feared had begun to restore consumer confidence. That outlook has since deteriorated as the conflict's macroeconomic consequences ripple through the channels that matter most to prospective buyers and developers.

The most direct transmission mechanism runs through mortgage rates. Expectations of further monetary easing, the primary catalyst for recovering demand, have been pushed back as energy-driven inflation complicates the Bank of England's path. Fixed-rate mortgages at 75% loan-to-value (LTV) have risen since the outbreak of the conflict, unwinding the affordability gains accumulated since 2023. This is weighing on homebuyer demand with RICS UK Residential Market Survey showing a decline in new buyer enquiries.

Softer demand is weighing on transactions, with subdued sales activity expected to mute price growth through the year. On the supply side, a weakening sales-to-stock ratio is dampening developer appetite. Early signs point to weak housing starts in Q1 2026, which continue to be outpaced by completions indicating a tightening housing supply pipeline.

In the rental market, rising demand spurred by an increase in would-be homebuyers priced out of ownership is colliding with falling landlord instructions following recent policy changes, pointing to further upward pressure on rents in the near term.



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 July.

For more information on our forecasts or other research enquiries, please contact forecasting@cebr.com.

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