UK Outlook

Insights into the UK economy

January 2025

Bank of Ireland

Growth stalls despite fiscal loosening

We have revised down our GDP forecast for 2024 to 0.8%, from 1.1% previously, on foot of weaker activity over recent months. With the outlook for H1 this year looking softer we have also reduced our 2025 forecast, from 1.4% to 1.2%. We expect a rebound in H2 and our projection for 2026 is unchanged at 1.6%, though risks are to the downside. We expect employment to expand by 0.6% in 2025 and 0.9% in 2026. We have pushed up our unemployment projections slightly, to 4.6% in 2025 and 2026 (from 4.4% previously). Price pressures are proving a bit more sticky than expected and we have revised up our 2025 and 2026 inflation forecasts to 2.6% and 2.2% (from 2.4% and 2.0%). We expect the BoE to cut the policy rate to 3.75% by the end of 2025.

Near term economic outlook has softened

Following a pickup in activity in H1 last year growth has slowed over recent months and sentiment has softened. GDP growth for 2024 will probably now come in at about 0.8%, lower than previously expected (1.1%). This deterioration has come despite a loosening of fiscal policy in the budget. The chancellor increased spending plans, partly financed by increased taxes, but also by higher borrowing. While increased public investment is welcome it may not impact growth materially until next year. Meanwhile, in the near term other factors are weighing on sentiment and activity, including the employer National Insurance hike, weak growth in European trading partners and uncertainty regarding US economic and trade policies. Furthermore, the recent increase in long term gilt yields is also a headwind.

GDP growth to recover from mid-2025 onwards

With weaker growth momentum entering 2025, we have marked down our forecast for the year to 1.2%, from 1.4% previously. Nonetheless, we expect the factors that are currently negatively impacting growth to gradually abate through the course of the year, with higher government spending and gradually easing monetary policy supporting a moderate pick-up in activity. As such we have left our projection for 2026 unchanged at 1.6%. Our central expectation is that US-UK and US-EU tariffs remain limited in scope, though some concessions may have to be offered to the Trump administration.

Unemployment to rise slightly

Recent data revisions from the ONS indicate employment growth has been stronger than was previously thought. We expect employment to continue expanding this year, slightly below the rate of labour force growth (the increase in employer National Insurance, effectively a tax on employment, is likely to weigh on jobs growth over coming quarters), leading to a slight rise in unemployment. We expect employment growth to rebound to 0.9% in 2026. Unemployment should stabilise at around 4.6%.

Progress on disinflation has slowed

Headline inflation and wage growth have both ticked up over recent months, though core inflation has continued to soften gradually. Forward looking indicators of price pressures are now more mixed, and energy prices have increased. As such we have nudged up our inflation projections. We expect headline CPI to average 2.6% in 2025 (revised up from 2.4%), declining to 2.2% in 2026 (revised up from 2.0%). Nonetheless, while we have also revised up our core inflation forecasts a bit, we believe underlying inflation remains on a gradual downward trend as the impact of the 2022-23 energy/supply chain shocks continues to diminish, and as wage growth slowly eases.

BoE to continue easing cautiously

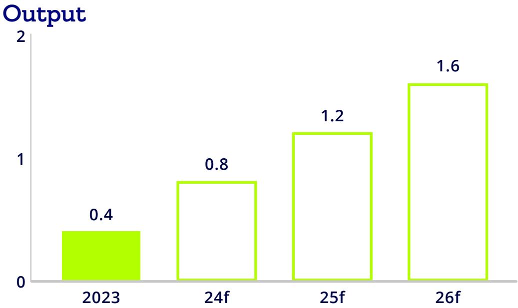
While CPI remains above the 2% target, the Bank has reiterated its expectation that inflation will continue to decline gradually. They are also cognisant that monetary policy remains restrictive while growth has weakened. As such we expect the BoE to continue cautiously easing the policy rate, taking it down to 3.75% (from 4.75% currently) by the end of this year.

Downside risks have increased

At this juncture downside risks look more prominent than upside risks, and they have increased of late. Geopolitical tensions remain elevated. In addition, while our central expectation is that trade barriers between the US and UK remain limited, the risks to this outcome are skewed to the downside. Furthermore, downside growth risks in relation to the UK's major European trading partners have also increased, while the recent rise in long term gilt yields, if sustained, could force the chancellor to scale back spending plans somewhat, as well as weigh on private sector investment.

Forecasts	2024f	2025f	2026f
GDP Growth	0.8%	1.2%	1.6%
Employment Growth	0.7%	0.6%	0.9%
Unemployment Rate	4.3%	4.6%	4.6%
Inflation Rate	2.5%	2.6%	2.2%

Output



GDP (annual % change)
Source: ONS and Bank of Ireland

Economy

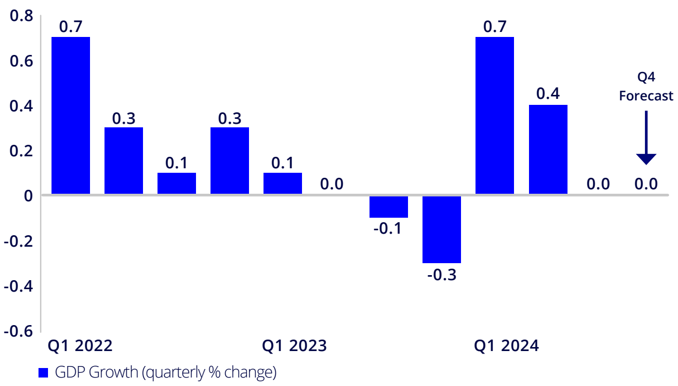
Growth Weakens

Recent signs point to softer sentiment and slower growth

The improvement in growth evident in H1 last year looks to have stalled. After cumulative growth of 1.1% over the first half of the year output was flat in Q3. Although consumer spending, government consumption and investment spending all expanded in Q3, overall GDP was dragged down by weakness in exports and other components. From a sectoral perspective the public sector was up, while construction rebounded from weakness in the first half of the year, but private sector services and industry struggled. The signs for Q4 and Q1 are not looking much better. GDP was down 0.1% on a monthly basis in October, before expanding by 0.1% in November, though this was below expectations. Retail sales for the key Christmas period disappointed. Other high frequency indicators have also weakened, with the Composite PMI back close to the 50 level in November, while the Confederation of British Industry's growth indicator has deteriorated.

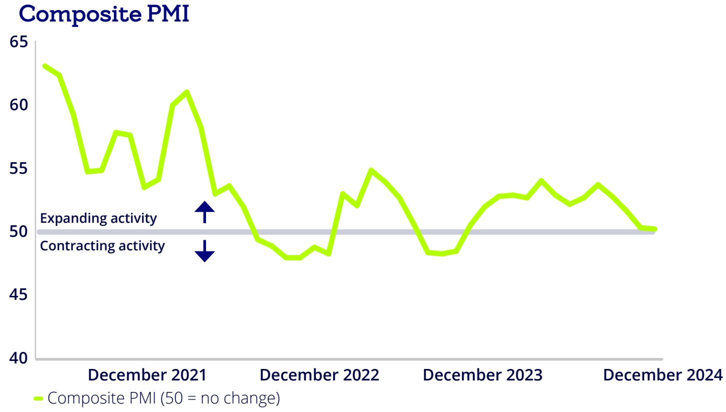
Overall, interpreting the recent slowdown is not straightforward. While it is possible the weak print in Q3 is revised up a bit, it is harder to dismiss the softness evident in the latest monthly GDP data and across a range of survey data. Uncertainty in the run up to the budget may have played a role, as may a negative reaction to the employer National Insurance increase. Concerns regarding the external environment may also have risen following the election of Donald Trump in the US and the poor growth performance of key European trading partners. On foot of these developments we have pulled down our near term growth projections and expect growth of 0% quarter-on-quarter in Q4. This would leave overall growth for 2024 at 0.8%, down from our prior expectation of 1.1%.

Quarterly GDP Growth



Source: ONS

Composite PMI



Source: S&P Global

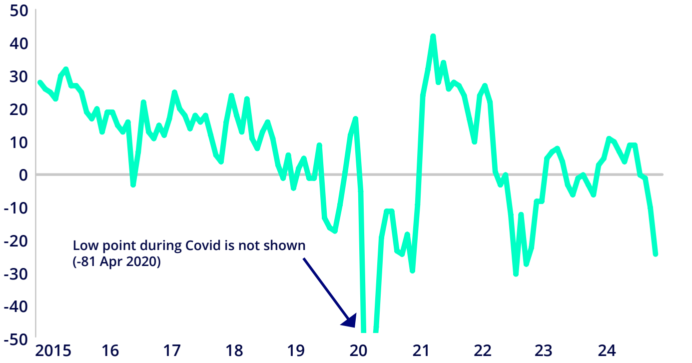
Growth to pick up from mid-2025 on

While we have marked down the near term outlook we expect growth to pick up again from the middle of this year onwards. This expectation is driven by two factors. Firstly, some of the headwinds currently restraining activity may well prove temporary. The government will no doubt seek to diffuse tensions with the Trump administration to ensure trade barriers are as limited as possible, while growth in Europe should pick up as the ECB eases monetary policy. Secondly, the loosening of fiscal policy in the budget should support growth. Indeed the OBR marked up their 2025 GDP forecast to 2.0% on foot of the increase in government spending, while the Bank of England indicated they expect the budget measures to boost growth by about 0.75% over the next year. In addition, although inflation and wage pressures are proving a bit more sticky than expected, and CPI is likely to remain above the 2% target throughout 2025, underlying inflation should continue to gradually ease, enabling the BoE to ease monetary policy further. As such, we expect output growth to improve in H2 and into 2026. This should leave growth for the year as a whole at around 1.2%, slightly lower than our prior forecast of 1.4%. We are retaining our expectation for GDP growth of 1.6% in 2026.

We continue to expect household consumption to be a key driver of growth, but have pulled our 2025 forecast down marginally due to higher inflation. Disposable income growth remains solid, with both wage and non-wage income (e.g. self-employed earnings, investments) making gains. There is also room for the household savings rate to fall back a bit, supporting spending, though perhaps not until late this year or into next year. These factors, allied to healthy household balance sheets, point to an ongoing solid expansion of consumer spending. We expect consumption growth of 0.9% for 2024, rising to 1.3% this year (revised down from 1.4%) and 1.6% in 2026 (unchanged). We have pulled up our government consumption forecasts significantly on foot of the loosening of fiscal policy.

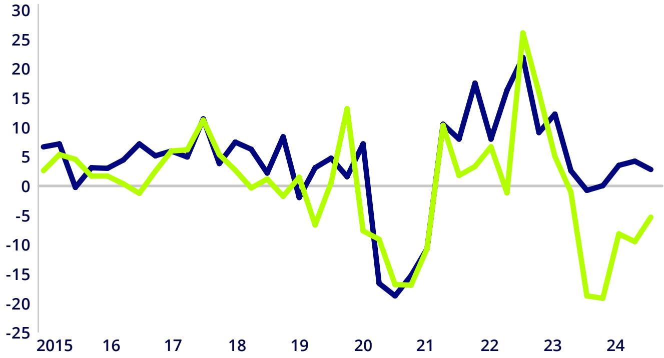
Turning to investment – government investment is set to ramp up into 2026, though business investment is likely to expand at a soft pace in the near term (given weaker survey data of late) before picking up somewhat in 2026. With house prices rising and sentiment improving housing investment should pick up a bit later in 2025 following its recent weak patch. We expect overall investment growth of 1.7% in 2025 and 2.2% in 2026, revised up from 1.5% and 2.0%. However, exports have continued to struggle. The underperformance is concentrated in goods, while services exports have performed better. It seems likely the ongoing adjustment to Brexit continues to weigh on goods exports, though manufacturing throughout Europe has been soft, perhaps partly due to competition from China. We have revised down our 2025 and 2026 export growth forecasts to 0.6% and 1.2% from 1.2% and 1.6%.

Activity Expectations



CBI Growth Indicator - Expected Private Sector Growth, Next 3 Months (% balance, positive versus negative responses)
Source: Confederation of British Industry

Exports



Goods Export Growth (annual % change)
Services Export Growth (annual % change)
Source: ONS

Downside risks have increased

Unfortunately, risks to the outlook look skewed to the downside. Geopolitical tensions remain elevated and a deterioration in any of the flashpoints would clearly be negative for world growth. There are also now clear risks in relation to US trade policy. An escalation of trade tensions could hurt the UK economy both directly and indirectly – directly via lower UK exports to the US, and indirectly via slower overall world growth and deteriorating global financial conditions. While we ultimately expect an accommodation to made with the Trump administration, limiting the extent of UK-US tariffs, there are clearly risks to this. In addition, long term gilt yields have risen of late – while some of the increase may be attributable to UK specific factors (fiscal loosening), it is likely mostly due to global factors, particularly rising US long term rates. Nonetheless, should it be sustained, or deteriorate further, this could require the chancellor to scale back spending or increase taxes, either of which would be negative for growth.

Finally, in addition to short/medium term risks the economy continues to face a range of longer term structural challenges. These include an aging population, inactivity in the labour force, sluggish productivity growth, stretched public services and insufficient investment in infrastructure and housing. The Chancellor's recent budget has at least commenced work to address some of these issues, with increased public capital investment. Following through on much needed planning reform in order to speed up the delivery of housing and other infrastructure will also be key.

Annual % Change	2023	2024 F	2025 F	2026 F
Consumer Spending	0.5%	0.9%	1.3%	1.6%
Government Consumption	1.0%	2.0%	3.2%	2.2%
Investment	0.3%	1.5%	1.7%	2.2%
- Business Investment	4.6%	2.7%	1.5%	2.0%
- Government Investment	0.0%	0.8%	2.0%	3.3%
- Housing Investment	-7.1%	-0.5%	1.5%	2.0%
Exports	-3.2%	-1.8%	0.6%	1.2%
Imports	-4.5%	1.2%	2.3%	2.5%
GDP	0.4%	0.8%	1.2%	1.6%

Labour Market

Employment growth to soften

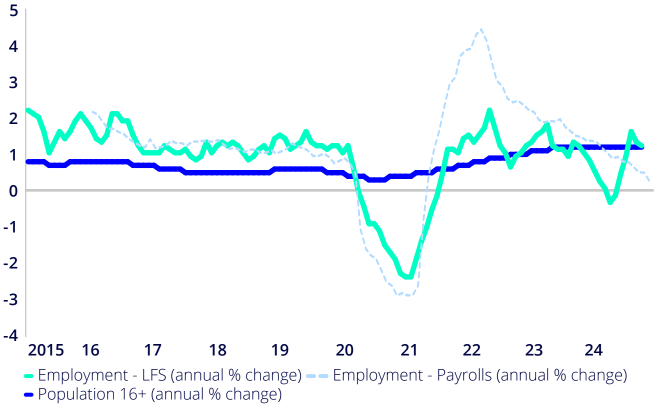
National insurance hike negative for jobs growth

Getting a clear picture of developments in the UK labour market last year was challenging - the main ONS labour market data showed surprisingly weak jobs growth, which somewhat conflicted with other data sources. However, recent ONS revisions, which took into account new demographic data (showing stronger than previously thought population and labour force growth, driven by strong inward migration flows) have partly resolved these discrepancies. The new data shows solid employment growth during January-October last year. We expect full year annual employment growth of 0.7% for 2024. Estimates of the unemployment rate were not changed much however, the jobless rate fluctuated around an average of 4 ¼% over the course of the year, up from an average of about 4% in 2023.

We expect employment growth to slow moderately in the first half of this year, though the labour market will remain reasonably resilient. The weaker outlook for output growth in H1 would on its own tend to lead to a slight slowing of jobs growth. This is likely to be amplified somewhat by the effects of the employer National Insurance hike introduced in the budget, which will probably lead to some firms scaling back their employment plans at the margin. Indeed, BoE survey data shows that over 50% of firms plan to reduce employment as a result of the hike, while separate BoE data shows a drop off in employment growth expectations for the next 12 months amongst firms.

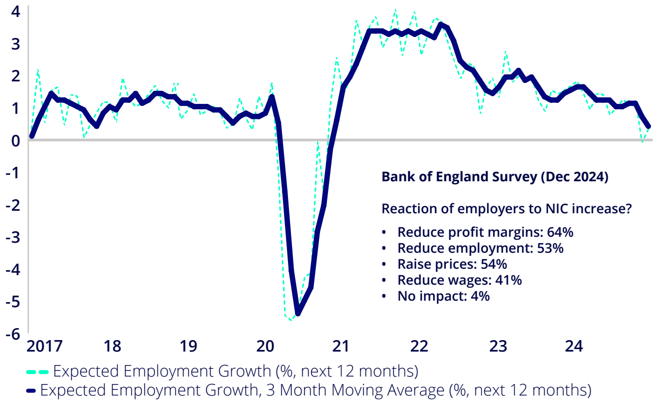
For the year as a whole we expect employment growth of 0.6%. We expect growth to pick up to 0.9% in 2026. Unemployment is projected to tick up from 4.3% in 2024 to an average of 4.6% in 2025 (up from our prior forecast of 4.4%) before stabilising at that rate as labour supply and demand growth come into balance in 2026.

Labour Force and Employment



Source: ONS

Employment Expectations



Source: Bank of England

The declining trend in wage inflation, which has been evident for some time, has somewhat stalled of late. Average weekly earnings growth (three month average basis) ticked up to 5.2% in October, from 4.4% in September, the highest reading since May. Private sector earnings growth also rose, to 5.4% from 4.6% in September. However, forward looking indicators, such as the Bank of England survey of wage expectations, continue to point to a gradual deceleration of wage growth. We have revised up our wage growth forecasts to 4.8% for 2024 (from 4.5%), 3.7% this year (from 3.3%) and 3.2% next year (from 3.0%). Higher near term wage growth than previously anticipated is likely to push up on services sector inflation somewhat.

Reversing the rise in the numbers who are economically inactive and therefore outside the labour force, particularly due to long term illness, remains a key challenge. This will take some time to achieve but could boost labour supply a bit and help to modestly raise the economy's growth potential.

	2023	2024 F	2025 F	2026 F
Labour Force Growth	1.4%	1.0%	0.9%	0.9%
Employment Growth	1.2%	0.7%	0.6%	0.9%
Unemployment Rate	4.1%	4.3%	4.6%	4.6%
Wage Growth	7.0%	4.8%	3.7%	3.2%

Inflation

Progress on disinflation slows

Headline inflation has risen back above the 2% target

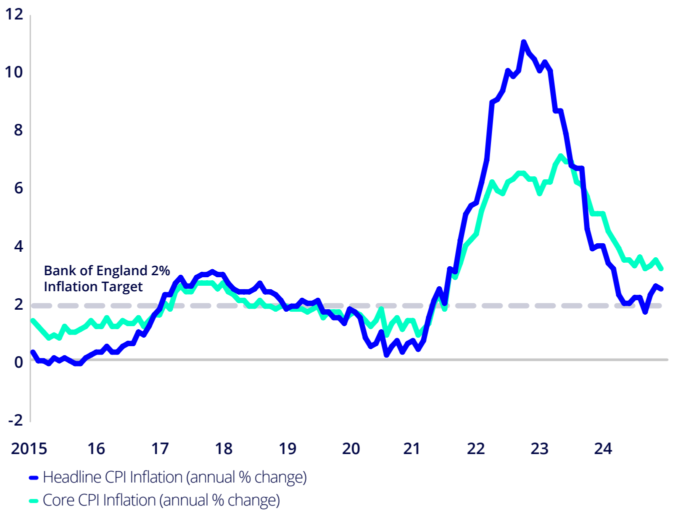
Headline inflation has ticked up over recent months, partly due to increases in energy prices (the OFGEM energy price cap increased almost 10% in October), coming in at 2.5% in December, up from a recent low of 1.7% in September, albeit down from 2.6% in November. Overall, headline inflation was marginally higher than the Bank of England had expected in Q4. Core inflation, which had risen to 3.5% in November, fell back to 3.2% in December, helped by a lower reading for services inflation, which eased to 4.4% from 5.0% in November.

Forward looking indicators of inflation are also a bit more mixed than they were previously. Bank of England surveys of firms show that expectations for both the prices they charge and overall CPI inflation increased in December. Global food prices have started to rise again following a period of deflation. The price of a barrel of Brent crude oil has risen quite sharply over the past month and is now trading at over $80, while sterling has depreciated versus the dollar over the period, pushing up the sterling price of commodities priced in dollars. Natural gas prices have also trended up over the past several months, while gas storage levels are low. The OFGEM energy price cap is set to rise a further 1% in January. Furthermore, a Bank of England survey has indicated that about half of firms plan to pass on the increase in employer National Insurance to some degree. Producer price inflation does remain low however, with input PPI registering -1.5% year-on-year in December, and output PPI basically flat.

Given the slightly higher recent inflation prints, still fairly robust wage growth, and the possible effects of the National Insurance hike, we have increased our inflation forecasts a bit. We now expect headline inflation to register 2.6% this year - upwardly revised from 2.4%. However, with growth a bit softer core inflation is likely to continue to decline in our view and should drop below 3% later this year. By mid-2026 both headline and core inflation should be back close to the 2% target (our forecast for the yearly averages for both is 2.2%, revised up from 2.0% previously).

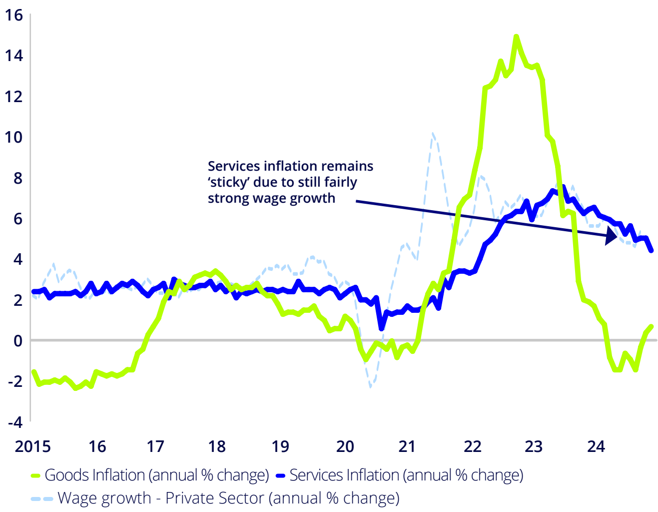
Upside risks to this outlook have increased of late though. Robust wage growth is proving somewhat sticky, while the rise in global energy and other commodity prices could push inflation back up. In addition, any trade and/or global supply chain disruptions due to the policies of the incoming US administration, such as tariffs, could put upward pressure on the prices of traded goods globally. On the other hand, the slower pace of near term GDP growth could put more downward pressure on prices than expected.

Headline and Core Inflation



Source: ONS

Goods and Services Inflation



Source: ONS

Overall, while the Bank of England is likely to continue to expect ongoing gradual disinflation, they are likely to be slightly more concerned than they were a few months ago, though the lower December readings for core and services inflation should calm nerves somewhat.

	2023	2024	2025 F	2026 F
Inflation Rate (CPI)	7.3%	2.5%	2.6%	2.2%
Core Inflation Rate (CPI ex-Energy)	7.3%	3.8%	2.8%	2.2%

Fiscal Policy

Chancellor loosens the purse strings

Government spending to increase, though recent gilt yield rise a concern

Chancellor Reeves delivered her first budget on Oct 30th. While prior to the budget both the Chancellor and PM were keen to sound cautious, in the end the budget delivered a fairly significant change in fiscal strategy. The Chancellor increased both current and capital spending materially relative to previous plans, funded roughly evenly by increased taxes and by new borrowing, the latter enabled by a recalibration of the UK's fiscal rules to free up fiscal space. The most important revenue raising measure was an increase in the rate of employer National Insurance. Both the OBR and the Bank of England have indicated the fiscal measures should boost growth somewhat in the coming 12-18 months. The increase in investment should also boost the level of potential output in the longer run.

However, it should be borne in mind that while the budget measures are expansionary relative to previous plans, the fiscal deficit is still forecast to decline over time, and as such fiscal policy will still be a slight drag on growth from 2026 onwards (although perhaps to a lesser degree than current plans indicate, as spending may be revised up somewhat). In addition, the increase in employer National Insurance is likely to weigh on wages and employment. Furthermore, if the additional borrowing was to push up interest rates sufficiently it could more than offset the positive growth affects, as private sector activity, particularly investment, is squeezed. As such the recent rise in long term gilt yields is a concern and represents a downside risk to growth. If sustained it could force the Chancellor to scale back the spending plans somewhat.

OBR Projections	2024/25 F	2025/26 F	2026/27 F
Revenue Growth	4.4%	7.0%	5.0%
Expenditure Growth	4.3%	4.6%	3.3%
- Current Spending Growth	4.2%	4.3%	3.1%
- Capital Spending Growth	5.0%	7.4%	4.1%
Fiscal Balance* (% GDP)	4.5%	3.6%	2.9%
Government Debt-to-GDP** (% GDP)	98.4%	96.9%	97.0%
Departmental Spending Growth***	3.9%	3.1%	0.5%

*Public Sector Net Borrowing
**Public Sector Net Debt
***Adjusted for inflation and population growth

Monetary Policy

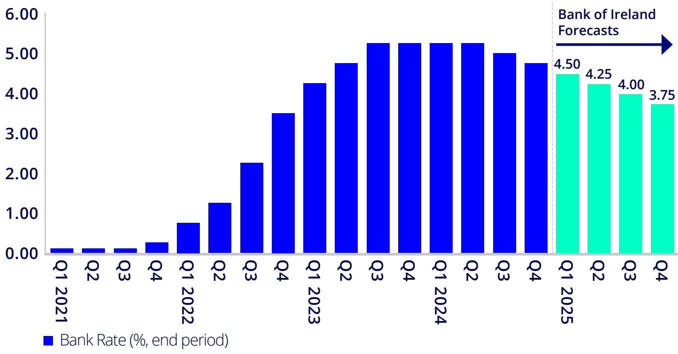
BoE to continue easing, albeit cautiously

BoE to cut the policy rate 100bp over the course of 2025

The Bank of England cut rates by 25bp in November, taking Bank Rate down to 4.75%, but held policy unchanged in December on foot of concerns regarding still above target and somewhat 'sticky' inflation and wage growth. However, with growth weakening, financial conditions tightening somewhat, and price pressures ultimately likely to resume their downward trajectory, the Bank is likely to continue easing policy in a gradual manner. We expect the Bank to cut by 100bp over the course of the year, taking the policy rate down to 3.75%. The possibility of a sharp rise in energy prices, with attendant first and second round effects on headline and core inflation, represents a risk to this outlook – the BoE will be monitoring this given the recent rise in oil and natural gas prices.

UK 10 year government bond yields have risen over the past month or two, from roughly 4.0% at the end of Q3 last year to over 4.6% now. Sterling has lost ground against the dollar, down to $1.22 from a recent high of $1.33 just before the US election. Sterling is currently trading at just under £0.84 versus the euro.

BoE Policy Outlook



Source: Bloomberg, Bank of Ireland

Gilt Yields

Source: Bloomberg

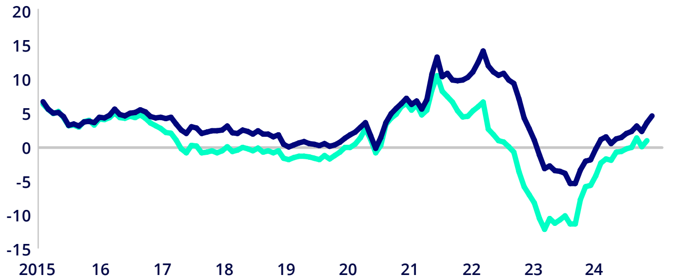
Housing Market

House price growth picks up

Most indicators point to a strengthening of housing market conditions

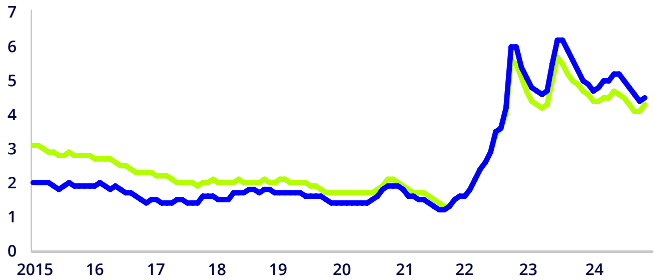
The rebound in house prices that commenced early last year has continued over recent months, with annual house price growth ending the year at about 4%. House price gains are therefore now outstripping the rate of inflation for the first time in several years, and are close to the rate of wage growth. The RICS survey of property professionals continues to point to strengthening market conditions. Buyer demand and instructions from sellers have continued to trend upwards, as have sales expectations. Expectations for house price growth have also strengthened, both over 3 and 12 month horizons, and the rental market remains tight. While the knock on effects of the recent increase in long term gilt yields is a near term upside risk for mortgage rates, looking further out Bank of England rate cuts should eventually feed through. We expect house price growth of about 3% this year, modestly above the rate of inflation and broadly in line with wage gains. However, the weakening of the near term growth picture is a downside risk. Mortgage lending should strengthen a bit also – with monthly mortgage approvals rising towards 70k per month. A longer term structural challenge that the new government must grapple with is increasing the supply of new housing, which remains far too low and is a constraint on UK growth.

House Prices



House Prices (annual % change) House Prices Adjusted for Inflation (annual % change)
Source: Nationwide, ONS, Bank of Ireland

Mortgage Rates



Average Mortgage Interest Rate, 2-Year (%)
Average Mortgage Interest Rate, 5-Year (%)
Source: Bloomberg, Bank of England

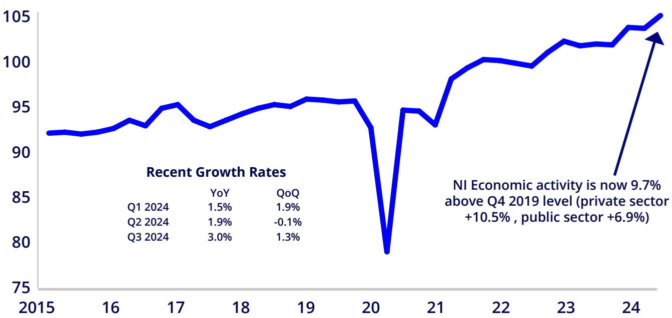
Northern Ireland

Economic activity softens

The latest survey data suggests growth has slowed recently

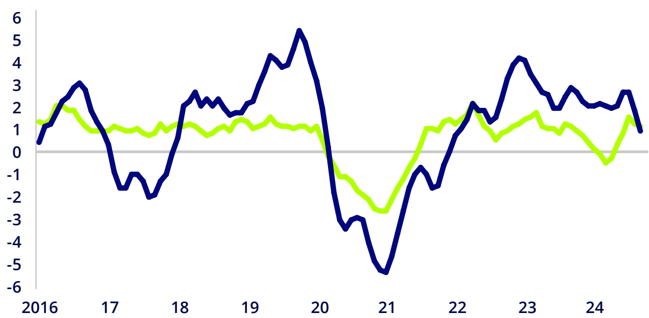
The latest data indicates that the Northern Ireland economy looks to have slowed, in line with wider trends seen in the UK. The Composite Economic Index registered year-on-year growth of just over 2% in the first three quarters of last year. However, survey data points to a slowing of activity coming into year end. The Composite PMI fell to 47.7 in December, below the 50 growth-contraction level and down from approximately 55 where it sat for most of 2024. While the services and manufacturing sectors remained in growth territory in December, retail and construction were contracting. Consistent with these trends in economic activity, the latest labour market data has softened marginally, though employment continues to expand and unemployment remains low. Turning to the outlook, it seems likely the headwinds which have slowed growth in the UK more widely (employer National Insurance increase, trade uncertainty, slower trading partner growth) will slow growth in H1 this year as well. However, we expect growth to pick up gradually in H2 as these headwinds fade and the positive effects of looser fiscal policy and easing monetary policy are felt on the ground. There are however downside risks to this outlook, mainly related to global factors (geopolitics, trade disruption).

NI Economic Activity



Northern Ireland Composite Economic Index
Source: NISRA

NI Labour Market



Northern Ireland Employment Growth (annual % change, 3 month moving average)
UK Employment Growth (annual % change)
Source: ONS

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