UK Outlook

Insights into the UK economy

May 2026

Growth Outlook Deteriorates Amid Energy Shock

We have reduced our growth forecasts due to the negative impact of the US-Iran conflict and higher energy prices on the UK economy. We now expect GDP growth of 0.8% this year and 1.0% next year (versus 1.1% and 1.4% previously). Inflation, which had been easing, now looks set to increase and remain above 3% into next year, putting pressure on consumers and businesses. Unemployment is likely to rise to around 5 ½% over the coming quarters, remaining close to that level in 2027. Given weak demand and labour market slack we expect the BoE to leave rates on hold for the balance of this year, before easing a bit in 2027. There are a number of downside risks to the outlook, most obviously an escalation of the conflict in the Middle East, while domestic political uncertainty has increased.

GDP forecasts downgraded

While the macro data from Q1 suggested UK growth was picking up, the outlook has deteriorated following the outbreak of hostilities between the US and Iran. The closure of the Strait of Hormuz and regional infrastructure damage have caused energy prices to surge. This represents a 'stagflationary' shock for the UK economy which will result in both lower growth and higher inflation. Our forecasts are based on the current oil and gas price forward curves. The direct and indirect effects of the increase in energy prices are likely to ultimately shave around ½% off the level of GDP over the next year and we have revised our output forecasts accordingly. Consumer spending, business investment and exports are all likely to weaken.

Energy shock to push inflation back up

The rise in oil and gas prices is likely to push inflation pressures - which had been easing – back up again. This reflects both the direct effects on fuel and utility bills, and broader second round effects, as businesses pass on higher operating costs to consumers. We now expect headline inflation of 3.3% this year (revised up from 2.3%) and 2.7% next year (2.0% previously). Given this weaker outlook for demand, unemployment is likely to continue rising. We expect the jobless rate to reach 5 ½% later this year, remaining at around that rate for most of 2027. With the labour market loosening further, wage growth should continue to cool, leaving household incomes under pressure from rising prices.

The BoE faces a balancing act, while political uncertainty has increased

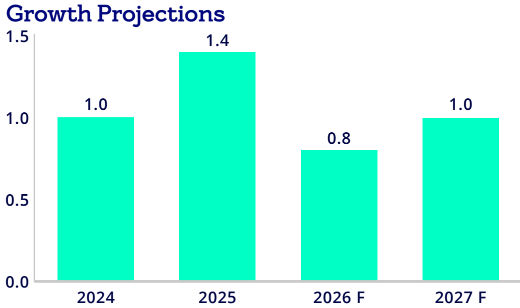
The BoE held Bank Rate steady at 3.75% at their end April meeting. The MPC now faces a challenging policy dilemma as growth slows and inflation rises. We expect the committee to ultimately opt to maintain the current (still slightly restrictive) policy rate for the balance of this year, as weaker growth, tighter financial conditions and rising spare capacity counteract the inflationary impulse. We are pencilling in 50bp of cuts next year as inflation falls back. Concurrently, the challenges facing the chancellor are mounting - the conflict's economic fallout threatens to put pressure on tax revenues, increase spending demands and raise debt service costs. Compounded by domestic political uncertainty, this environment has kept Gilt yields elevated. Ultimately, while fiscal headroom should prove sufficient to avoid the need for significant budgetary adjustments, there are clearly some risks on that front.

US-Iran conflict the key risk

The primary risk to our outlook is that the current fragile ceasefire falls apart and the US-Iran conflict escalates. A prolonged conflict would drive energy prices even higher, sending growth lower and inflation up further. This would likely force the BoE to tighten monetary policy while placing the fiscal position under more intense pressure. On the other hand should the crisis resolve rapidly with a sharp retrenchment in energy prices then there may be some upside risks relative to our projections. Domestically, political risks are becoming more prominent as uncertainty mounts over the government's leadership and strategic direction. Any policy pivot toward some combination of higher spending, taxation, and borrowing could trigger a rise in Gilt yields and prove negative for growth. Finally, additional external risks include a potential correction in equity markets and further destabilising US foreign or trade policies.

Outlook	2025	2026 F	2027 F
GDP Growth	1.4%	0.8%	1.0%
Employment Growth	1.6%	0.4%	0.6%
Unemployment Rate	4.8%	5.3%	5.5%
Inflation Rate	3.4%	3.3%	2.7%

Growth Projections



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

Economy

Growth set to weaken

Q1 rebound in economic activity likely to prove short lived

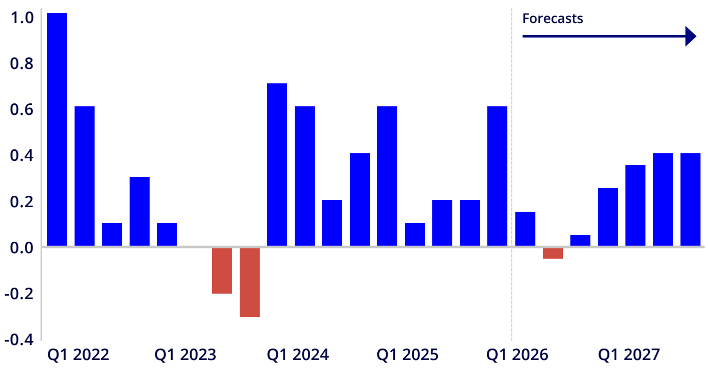
After a weak second half to 2025, the data suggests the UK economy staged a bit of a rebound at the start of this year. Q1 GDP rose by a fairly robust 0.6% quarter-on-quarter (although this may partly reflect seasonal factors not adequately captured by the ONS, and underlying growth was likely softer) and 1.1% year-on-year. The expenditure breakdown showed consumer spending rising by 0.6% quarter-on-quarter, with government consumption up 0.4% and total investment down 0.6% (though business investment was up). Looking at the monthly GDP profile, the ONS noted that in March some firms reported they had brought activity forward in anticipation of future price increases. Other indicators (PMIs, business surveys, tax revenues, retail sales) on balance improved relative to Q3 and Q4 last year.

However, the picture has clearly changed considerably since Q1. The war between the US and Iran commenced on February 28th, with the closure of the Strait of Hormuz and a sharp spike in global energy prices following shortly thereafter. Brent crude oil prices have risen from about $60 to over $100, with UK gas prices up over 40% as well. As things stand the situation remains volatile – while there is a ceasefire (of sorts) in place, there is no resolution and Iran continues to keep the Strait closed. The net effect of all of this has been to reduce the flow of global oil supplies significantly. While some factors, such as the drawing down of stocks on land and sea, have prevented an even sharper rise in oil prices, the clock is very much ticking.

The situation in the Middle East is obviously not the only issue at play globally or domestically. US trade policy remains a source of uncertainty, with the US Supreme Court striking down the original Trump tariffs in February. The political situation in the UK is becoming more fraught - following a series of controversies and a weak result in recent local elections there is now increased uncertainty regarding the future of Prime Minister Starmer and a leadership challenge is now a possibility. On a more positive front equity markets have largely shaken off the Middle East situation so far, buoyed by tech stocks, with AI related investment providing an offset to the negative growth effects of the conflict, particularly in the US.

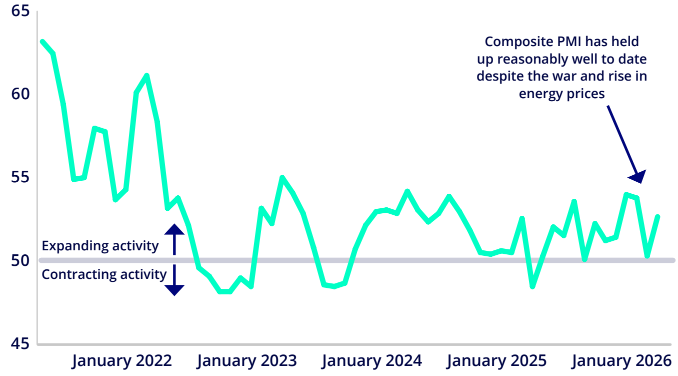
So what does all this mean for the UK economy this year and next? Our forecasts are predicated on current oil and gas forward curves, which show prices remaining high for some time before easing back later this year and in 2027 (though remaining well above pre-war levels). Economic modelling of supply shocks such as this, for example recent IMF and Bank of England work, suggests the impact on growth will be material, but not enough to lead to recession globally or in the UK. In relation to tariffs, we assume that legal arrangements will be found in the US to give effect to the agreed trade deals.

Quarterly Growth



Source: ONS

Composite PMI



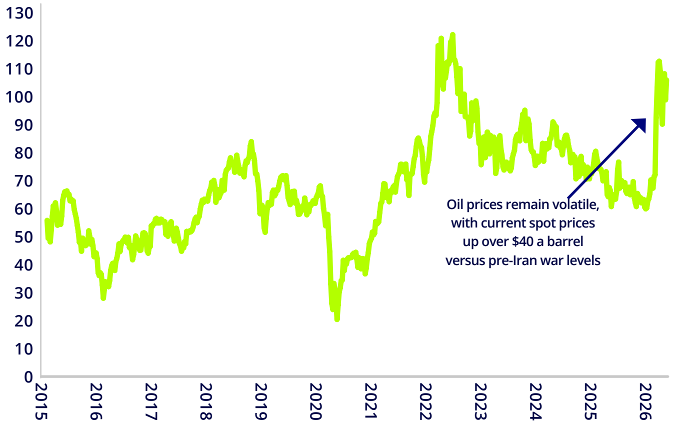
Source: S&P Global

Overall, taking all factors into account, we believe growth could be cumulatively ½% or thereabouts lower in 2026 and 2027, with inflation and unemployment higher. We do not expect fiscal or monetary policy to be able provide much of an offset to this, as both are constrained (monetary policy by the rise in inflation, fiscal policy by the deficit and Gilt yields), though we also don't expect them to amplify the shock with procyclical measures. As such we have cut our 2026 growth forecasts to 0.8% (from 1%) and our 2027 forecast to 1.0% (from 1.4%), broadly in line with movements in consensus expectations. However, these annual average rates do hide the quarterly profile somewhat. We expect weakness to be concentrated in Q2-Q4 this year, after the solid outturn in Q1. Quarterly growth should accelerate into 2027, but the annual average for the year will be held back by base effects. On a Q4 over Q4 basis we expect growth of 0.8% this year and 1.4% next year.

Higher inflation set to weigh on consumer spending

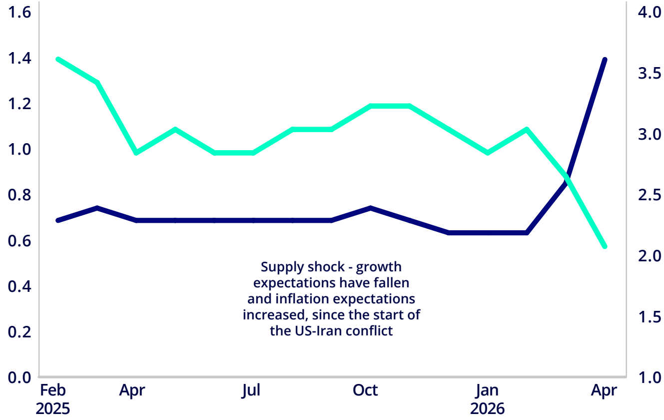
As regards the expenditure components, consumer demand is likely to be dampened by higher inflation, though households may dip into their savings to a degree, limiting the damage. Business investment is also likely to be lower, due to softer growth and higher costs. Exports will be held back by weaker global demand. Government current and (particularly) capital spending is likely to drive growth over coming quarters, though we have pared back our government consumption numbers a little (as higher prices will depress growth in volume terms). As we move into 2027 demand should begin to recover as energy prices fall back and confidence picks up, with consumption, business investment and exports rebounding.

Oil Prices



Source: Bloomberg

GDP & Inflation Expectations



Source: UK Treasury Survey of Forecasters

Downside risks have intensified amidst ongoing US-Iran conflict

However, there are clear downside risks to this outlook should the situation in the Gulf deteriorate. An escalation could prolong the war and keep the Strait closed for longer, driving global oil and gas prices sharply higher. While some analysis, such as the Bank of England, suggests even higher energy prices would have a contained effect on growth, wider effects on confidence and world growth could amplify the shock and push UK growth sharply lower (and inflation and unemployment higher). While uncertainty regarding tariffs remains, due to legal issues in the US, the risk of a very negative outcome now seems lower for the UK. However, political risks have surely increased. Any major developments, in particular if they led to a new direction with regard to fiscal and economic policy that could either slow growth and/or increase the deficit in the medium term could potentially lead to pressure on the Gilt market. There are some upside risks however – the US-Iran conflict could end more rapidly than anticipated leading oil and gas prices to undershoot the current forward curve – this would dampen price pressures and boost sentiment and growth. In the medium term productivity growth could rise as new technologies, such as AI, are rolled out across the economy.

Longer term structural challenges remain, including an aging population, structurally high energy costs, sluggish productivity growth, a slow planning system and insufficient investment, while geopolitical changes point towards increases in defence spending. Unfortunately, progress remains limited.

Annual % Change	2024	2025	2026 F	2027 F
Consumer Spending	-0.2%	1.0%	0.7%	1.0%
Government Consumption	2.9%	1.6%	1.5%	1.3%
Investment	1.7%	4.3%	1.5%	1.7%
- Business Investment	2.6%	4.3%	-0.7%	0.7%
- Government Investment	4.2%	4.9%	7.0%	3.5%
- Housing Investment	-1.6%	3.7%	2.5%	2.5%
Exports	1.3%	2.1%	0.7%	1.0%
Imports	2.7%	4.2%	0.4%	1.3%
GDP (annual growth rate)	1.0%	1.4%	0.8%	1.0%
GDP Growth (Q4/Q4)	2.0%	1.0%	0.8%	1.4%

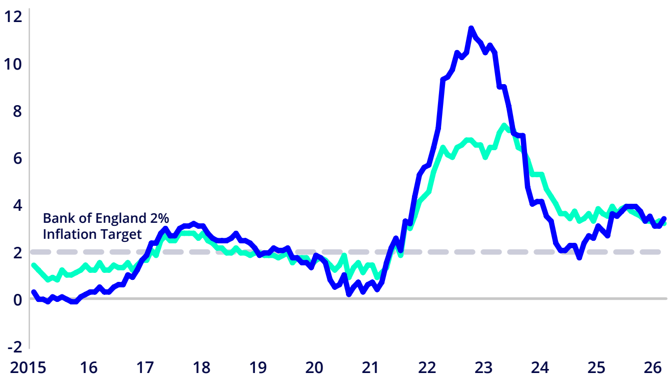
Inflation

Resurgent inflationary pressures

We expect inflation to average 3.3% this year, 2.7% next year

Having looked like it was about to ease after a period above target, the energy price shock is set to push inflation pressures back up. Headline inflation ticked up to 3.3% in March, from 3.0% in February, largely as a result of higher fuel prices. While inflation may pull back in April, due to base effects and a fall in the OFGEM energy price cap, it is likely to move up again after. The magnitude of any further increase in inflation is now going to depend on the path for energy prices and the extent of second round effects onto other prices and wages. While labour market slack may limit wage increases, rising business costs will likely be passed on (though perhaps less vigorously than in 2022/23 due to weaker demand), while household energy bills are set to rise quite a bit in July as the price cap resets. Food prices are also set to rise. As such we expect inflation to increase to around 3 ½% through the second half of this year, averaging 3.3% for the year as a whole, before easing back in 2027 in line with falling energy prices. This projection is based on current oil and gas futures – should the conflict escalate there are obviously upside risks to energy prices and therefore for inflation as well.

Headline and Core Inflation



Headline CPI Inflation (annual % change) Core CPI Inflation (annual % change)
Source: ONS

	2024	2025	2026 F	2027 F
Inflation Rate (CPI)	2.5%	3.4%	3.3%	2.7%
Core Inflation Rate (CPI ex-Energy)	3.8%	3.7%	3.0%	2.8%

Labour Market

Unemployment to rise further

Jobless rate to hit 5 ½% this year before stabilising

In our view the latest data continues to point to gradually increasing slack in the labour market, despite a slightly unexpected pullback in the unemployment rate in December-February (it fell from 5.2% in the prior period back to 4.9%). The LFS (survey) data on employment, which had been showing surprisingly strong growth, has slowed, while the alternative payrolls (tax return) data continues to point to year-on-year employment declines. With the labour force continuing to expand a bit, unemployment is likely to resume its upward trend. With output growth set to be soft over coming quarters we anticipate that the jobless rate will hit 5 ½%, or a little above, before levelling off, remaining close to that rate until later in 2027, when it should begin to decline. Wage growth has continued to ease, with private sector pay growth now down to 3.5%, from nearly 6% at the start of last year (though total pay growth has decelerated less due to strong public sector wage growth, while some other measures of wage inflation are a bit higher). Rising levels of spare capacity in the labour market means that, in contrast to 2022/23, we don't expect the pick-up in inflation pressures to lead to a rise in wage growth (as workers 'bargaining power' has diminished).

Unemployment and Vacancies

Unemployment Rate (%, LHS) Vacancies (% of Labour Force, RHS)
Source: ONS

	2024	2025	2026 F	2027 F
Labour Force Growth	1.1%	2.2%	0.8%	0.7%
Employment Growth	0.8%	1.6%	0.4%	0.6%
Unemployment Rate	4.3%	4.8%	5.3%	5.5%
Wage Growth	5.3%	4.8%	3.5%	3.2%

Fiscal Policy

Fiscal challenges mount alongside increased political uncertainty

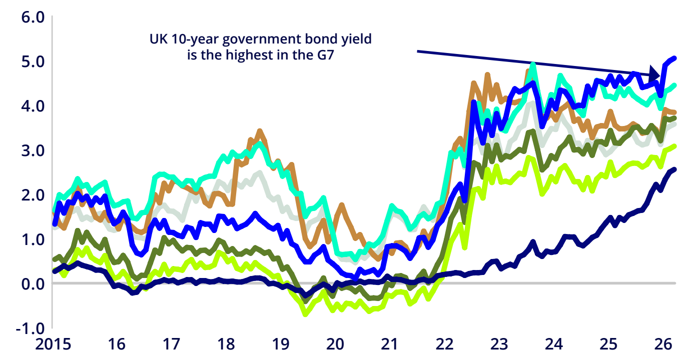
Weak growth and higher Gilt yields to put further pressure on government finances

The challenges facing Chancellor Reeves have increased further in recent months. While tax revenues have performed reasonably well in the year to date, the outlook for receipts now has downside risks due to lower growth prospects (though higher inflation may provide a bit of an offset), while spending pressures are likely to mount. Gilt yields have also risen materially, which will push up debt service costs if sustained. However, the Chancellor built fiscal headroom into her budget last November and this should prove sufficient to absorb the shocks, enabling her to avoid significant budget adjustments later this year, though some smaller measures may be needed. Speculation regarding the position of Prime Minister Starmer has increased significantly, which has introduced another layer of uncertainty over and above the volatile external situation. Any perception of a shift in government priorities away from the current path towards some mix of higher current spending, higher taxation and higher deficits could destabilise markets and push Gilt yields up further.

Fiscal Deficit

Public Sector Net Borrowing (% of GDP, 4Q rolling)
Source: ONS, OBR

Gilt Yields



10-Year Gilt Yield (%) US Japan Germany France Italy Canada
Source: Bloomberg

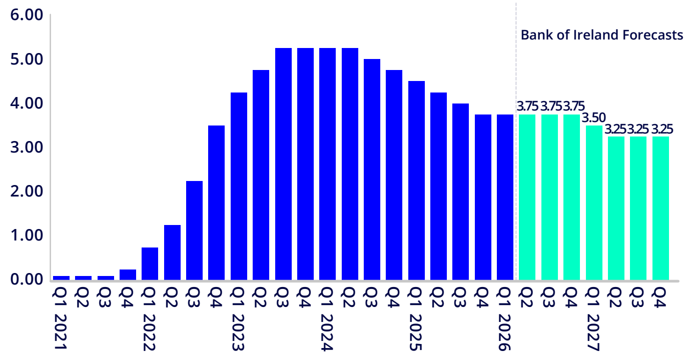
Monetary Policy

The BoE faces a difficult balancing act

Bank of England to opt to keep policy rates unchanged for the rest of the year

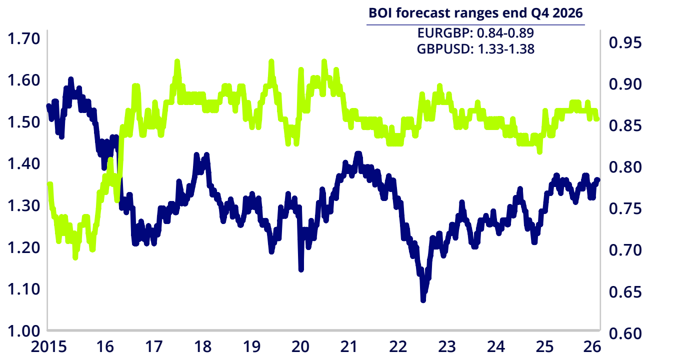
The Bank of England held Bank Rate unchanged at 3.75% at its end April meeting, keeping the policy rate in (mildly) restrictive territory. The Bank now faces a challenging situation as the UK economy confronts a sizeable supply shock. Higher energy prices will push growth down (pointing to rate cuts) and inflation up (pointing to hikes). The Bank's response will reflect their assessment of the risk of second round effects onto other prices/wages and inflation expectations. We expect the slowdown in growth, rising unemployment and tighter financial conditions (mortgage rates have increase quite a bit) will be enough to persuade the Bank to keep rates on hold over the balance of this year, before they resume easing early next year as inflation falls back and labour market slack increases. However, should the conflict escalate and energy prices ultimately end up higher than current oil/gas futures, and/or should second round effects prove stronger, then the MPC is likely to implement several precautionary hikes. UK long term Gilt yields have risen since the conflict began, with the 10-year yield (as of the date of publication in mid-May) climbing to over 5.1%, the highest rate in the G7. Sterling has been under some pressure in recent sessions on foot of political tensions.

BoE Policy Outlook



Bank Rate (%, end period)
Source: Bloomberg, Bank of Ireland

FX Forecasts



GBPUSD (LHS) EURGBP (RHS)
Source: Bloomberg, Bank of Ireland

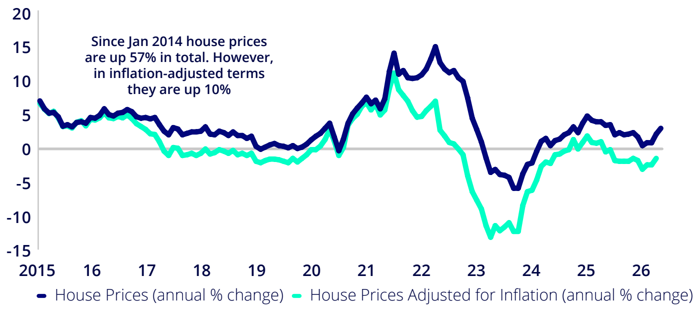
Housing Market

Headwinds for prices and activity strengthen

Mortgage rates have increased materially

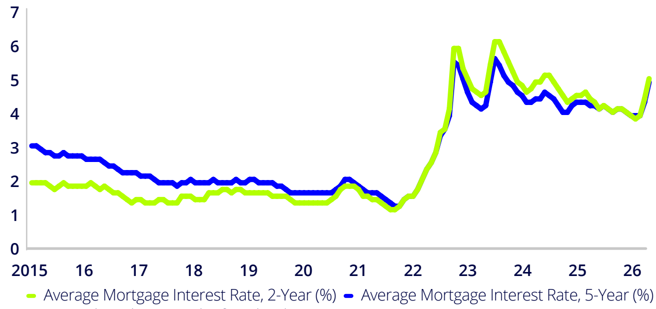
After weakness towards the end of last year, house prices have picked up a little in the year to date according the Nationwide measure, with prices up 3% year-on-year in April (though the Halifax Index has been less positive). However, the outlook has darkened over recent months due to the effects of the US-Iran conflict and the rise in global energy prices, which has damaged the prospects for output growth and household incomes. The RICS Housing Market Survey largely confirms this, with new buyer enquiries and expectations for prices down of late. Furthermore, after falling through much of last year mortgage rates have moved back up quite a bit, to above 5% for both 2-year and 5-year maturities. Overall, we expect prices to largely move sideways over coming quarters – with annual price inflation ending the year a bit lower than currently (between c. 1% and 2.5%). Mortgage approvals may also soften somewhat. The market should start to recover in 2027, albeit only gradually.

House Prices



Source: Nationwide, ONS, Bank of Ireland

Mortgage Rates



Source: Bloomberg, Bank of England

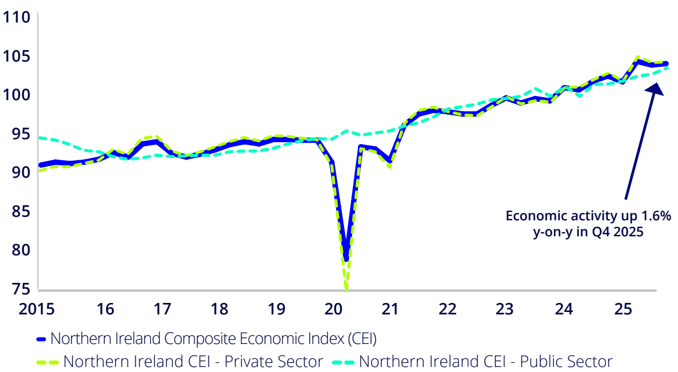
Northern Ireland

Softer macro conditions ahead

Higher energy costs to weigh on consumer spending and increase business costs

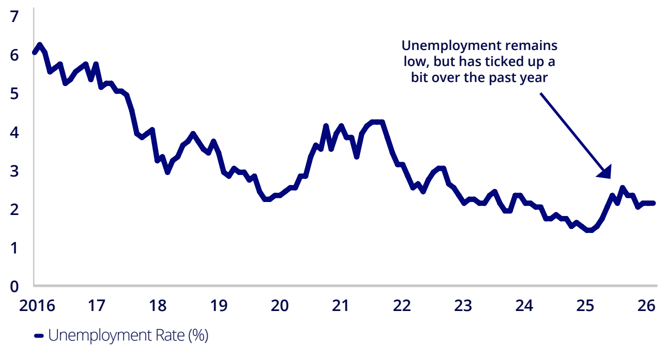
The Northern Ireland economy put in a relatively solid and resilient performance in 2025, with the Composite Economic Indicator up 2.1% annually for the year, outpacing the UK as a whole, while unemployment remained low. However, the external picture has now clearly changed significantly and weaker growth seems likely. Survey indicators available over recent months have softened a little, with the April PMIs showing slowing activity growth and rising costs, though there were some bright spots in the data too. The latest data from the property market remains reasonably healthy, with prices up 5.2% annually in Q1, though higher mortgage rates and lower consumer confidence may be a headwind over coming quarters. We expect output growth this year to slow to 1% or below, before it recovers a bit next year. Labour market conditions are likely to cool, but a significant increase in unemployment seems unlikely at this juncture. However, as with the overall UK and global outlooks, risks are to the downside due to the ongoing US-Iran conflict.

NI Economic Activity



Source: NISRA

NI Labour Market



Source: ONS

Bank of Ireland

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