Economic Forecast

Expert analysis on the outlook for the UK economy, so your business can plan for the future.

June 2025

UK economic outlook: muddling through

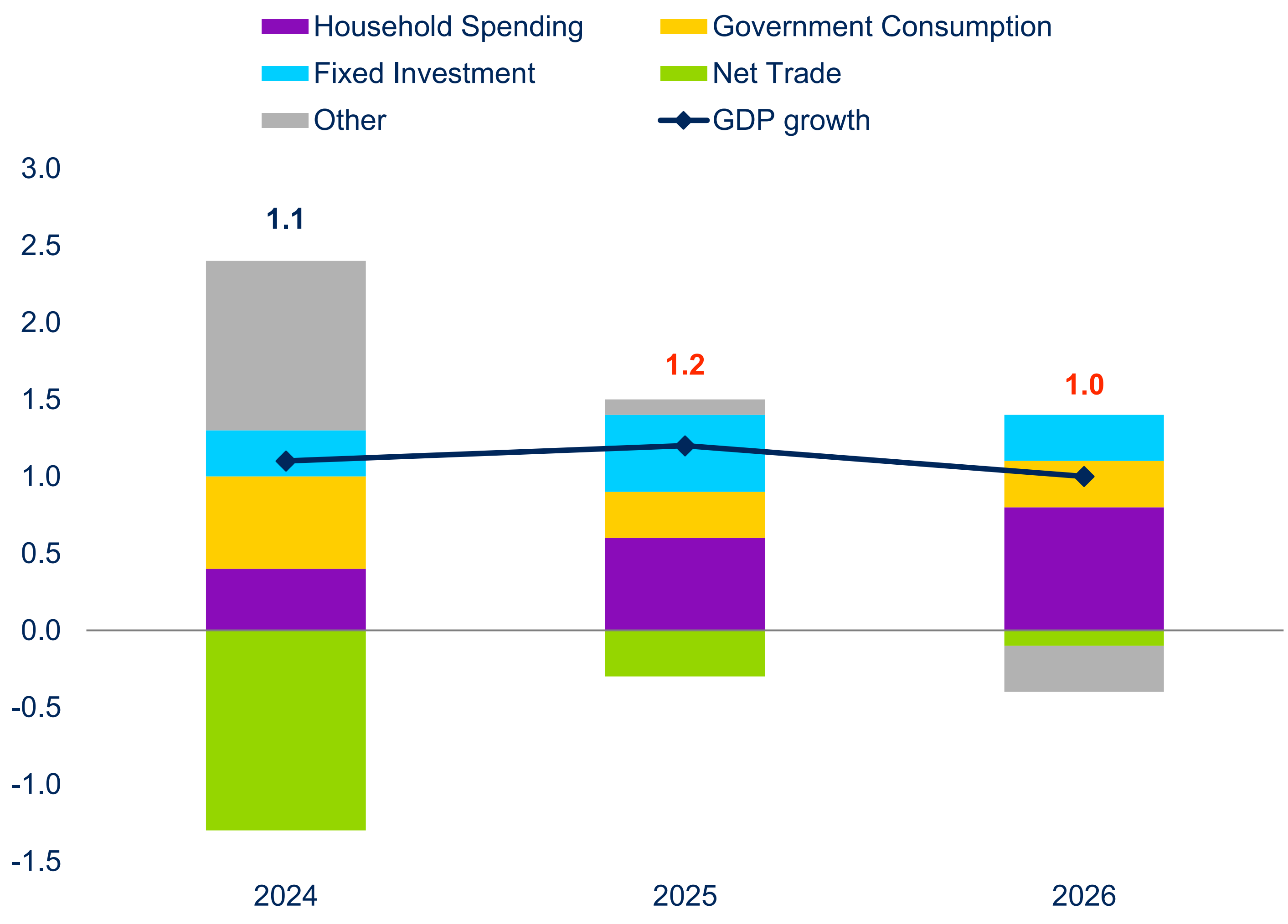
- The UK saw modest GDP growth of 1.1% over 2024, reflecting a mixture of cautious household spending behaviour, lacklustre business investment, and a drag from net trade. While the economy began 2025 on a strong note, business surveys suggest that underlying activity remains weak due to headwinds from Autumn Budget measures and global trade uncertainty.
- We expect that UK economic momentum will remain subdued through to 2026. Specifically, we project GDP growth of 1.2% in 2025 and 1.0% in 2026. The downgrades from our December forecast (-0.4pp for 2025 and -0.5pp for 2026) reflect a mix of weaker-than-expected outturn data and domestic & international headwinds. Despite the slowing pace of annual GDP growth, we expect UK economic activity to gradually strengthen on a quarterly basis through 2026. This reflects a steady pickup in consumer spending, supported by real incomes growth, lower interest rates, and reduced inflation next year.
- Our forecast assumes that US tariff rates will remain near 100-year highs, which will weigh on activity and trade in the US and global economy. Tariffs will pose a modest headwind to UK output in our forecast, mostly by dragging on business investment and exports. In a scenario where US "reciprocal" tariffs are reimposed and exemptions for certain goods are removed, we would expect to see the level of UK GDP be 1.1% lower than baseline in Q4 2026.
- We expect consumer spending to steadily pick up over our forecast. Consumption is supported by growth in real incomes and lower interest rates, but cooling labour market conditions will pose a headwind to spending. We anticipate that households will maintain some measure of cautious spending behaviour this year, but this eases off in 2026 as inflation falls back below 3%. Households are expected to start drawing on savings as income growth slows and lower rates curb the incentive to save.
- Business investment growth over 2025 is projected to be boosted by a sharp rise in Q1, which was partly due to a (likely temporary) increase in aircraft purchases. Underlying investment momentum remains poor, however, as reflected in the noticeable deterioration in capex plans across our surveys since the Autumn Budget. We expect this weakness in investment will become more noticeable in the coming quarters, reflecting the impact of higher labour costs and global economic uncertainty. These headwinds will be partly offset by momentum generated from modest GDP growth and lower interest rates.
- Inflation is expected to remain above 3% for the rest of 2025, mostly driven by higher energy and regulated prices (such as water bills). Subsequently, we anticipate that inflation will ease to an average of 2.5% in 2026 as these increases drop out of the annual comparison. Higher labour costs following the Autumn Budget will continue to put upward pressure on prices, particularly in labour-intensive sectors such as hospitality.
- Official labour market statistics remain impacted by sampling issues, but payrolls and survey data suggest that the jobs market has been cooling. We anticipate that weak activity and higher labour costs will weigh on private sector employment over our forecast. The unemployment rate is projected to pick up to 4.8%, but this is still low by historical standards. Wage growth remains firm for much of 2025, but it is expected to slow more noticeably next year due to easing inflation and a growing measure of labour market slack.
- We have maintained our previous forecast that the Bank of England's Monetary Policy Committee (MPC) will reduce Bank Rate by 25 basis points each quarter until it reaches a terminal rate of 3.5% in Q1 2026. This projection reflects the MPC's continued emphasis on a "gradual and careful" pace of loosening, in order to bring inflation sustainably down to its 2% target.
- Productivity (output per worker) is expected to remain weak over our forecast, lagging slightly below its lacklustre pre-COVID trend. The persistently poor performance of UK productivity continues to underline the need for policy measures that drive forward sustainable growth and prosperity for all.

UK economic outlook: muddling through

	CBI June 2025 Forecast (y/y%, unless otherwise stated)			Change from previous forecast (pp)		
	2024*	2025	2026	2024*	2025	2026
GDP growth	**1.1**	**1.2**	**1.0**	***+0.2***	***-0.4***	***-0.5***
Household spending	0.6	0.9	1.3	*-0.2*	*-0.8*	*-0.1*
Government consumption	3.0	1.3	1.4	*+0.4*	*-2.6*	*-0.1*
Business investment	2.0	4.7	1.0	*+0.4*	*+2.3*	*-1.1*
Inventories (pp contribution)	0.2	0.2	-0.1	*+0.1*	*+0.2*	*-0.1*
Exports	-1.2	0.9	-1.3	*+0.6*	*-1.1*	*-3.3*
Imports	2.7	1.6	-0.9	*+0.2*	*-1.6*	*-3.5*
Net trade (pp contribution)	-1.3	-0.3	-0.1	*+0.1*	*+0.2*	*+0.2*

**2024 is outturn data*

GDP Growth (Y/Y%) and Contributions (pp)



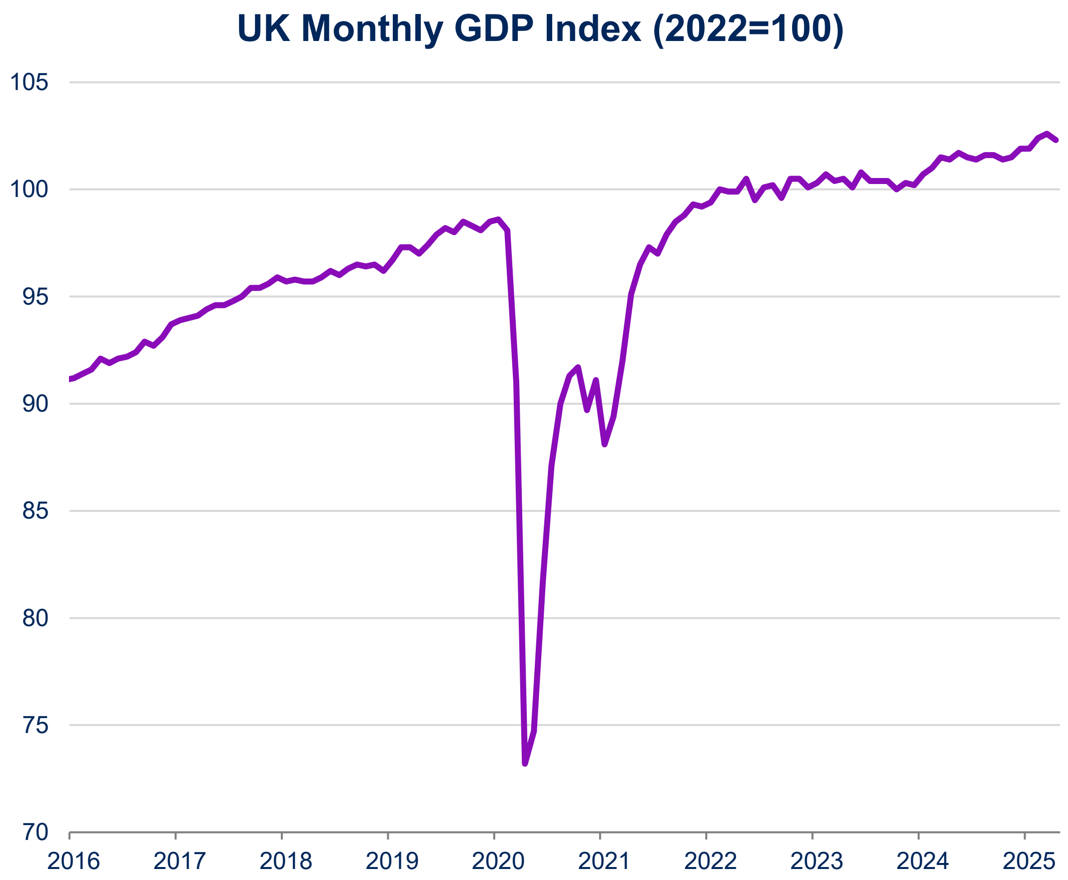
Source: ONS, CBI forecast

"Other" category includes contributions from inventories, net acquisition of valuables, and statistical discrepancy.

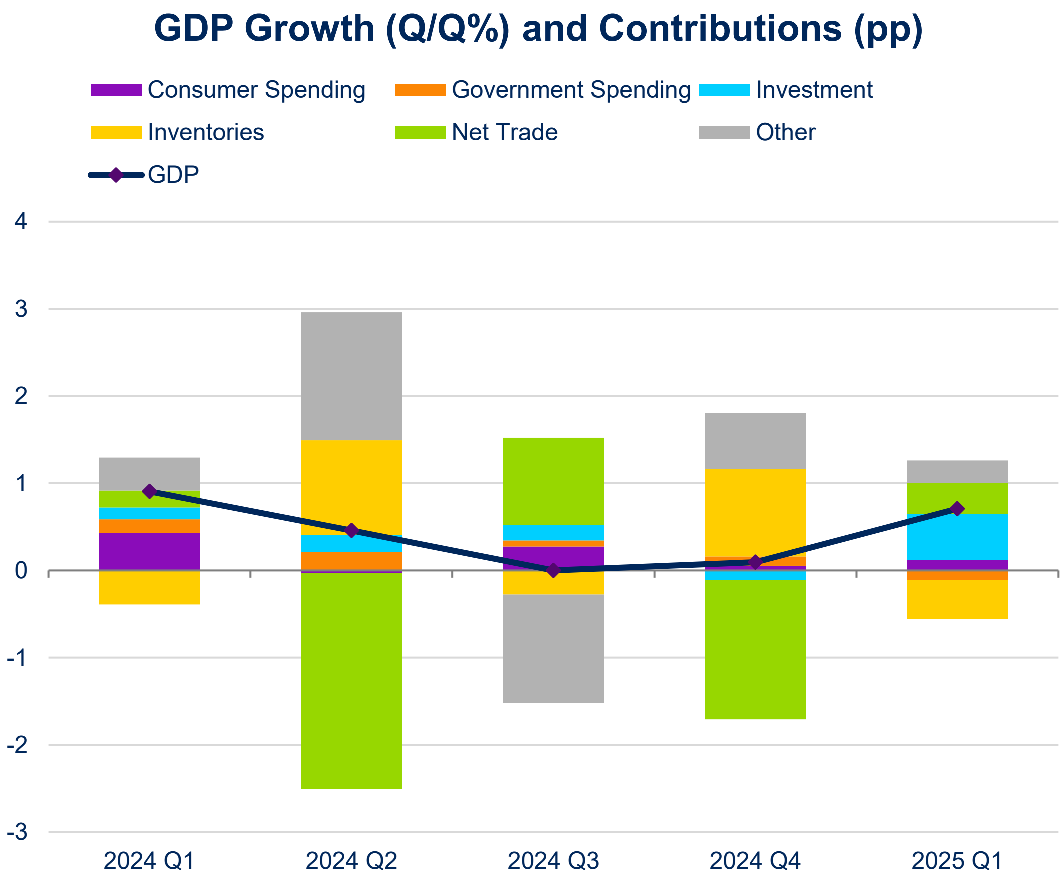
What does our forecast mean for your business?

- Our latest economic forecast expects that the UK will see modest GDP growth of 1.2% in 2025 and 1.0% in 2026. Household spending is projected to be the main driver of (subdued) growth over our forecast – supported by real incomes growth and lower interest rates. However, persistently cautious spending behaviour and a loosening in labour market conditions mean that consumption growth remains relatively subdued by pre-COVID standards.
- The increases in employer NICs and NLW in April 2025 following last year's Autumn Budget have led to a substantial hike in firms' labour costs, particularly in sectors like hospitality and retail. These measures have likely contributed to the recent deterioration in hiring and investment plans, and they are also expected to push up prices, reduce margins, and weigh on pay growth. These impacts are assumed to feed into higher inflation and lower business investment & employment growth over our forecast.
- We expect that higher US tariffs will pose a relatively limited headwind to the UK economy, reflecting the fact that goods exports to the US account for around 7% of UK total exports. Tariffs mostly weigh on activity through heightened economic uncertainty, weaker global trade, and financial market volatility. This impact will be greater in goods-producing sectors that are directly exposed to US markets. The UK-US trade agreement will provide some support for steel, aluminium, and car manufacturers, but the US effective tariff rate (on UK goods) will remain substantially higher than it was in our December forecast.
- Wage growth has started to slow but remains higher than what its underlying drivers would suggest. Recent business surveys indicate that private sector pay will increase by 3-4% over the next 12 months, and our forecast expects that lower inflation and a cooling jobs market will increasingly push down on wage growth in 2026. Surveyed investment intentions have deteriorated noticeably since the Autumn Budget, and we expect that higher labour costs and global economic uncertainty will weigh on investment over our forecast.
- We expect that the Bank of England MPC will cut Bank Rate by 25bp each quarter until it reaches 3.50% in Q1 2026, reflecting the Committee's "gradual and careful" approach to reducing interest rates. This cautious messaging is underpinned by what the MPC see as "two-sided" risks to the inflation outlook, which could result in rates being cut at a faster or slower pace (based on developments in the economy). The projected decline in interest rates should provide some support to household spending and investment over the forecast.

UK GDP growth picked up in early 2025…



Source: ONS, Macrobond

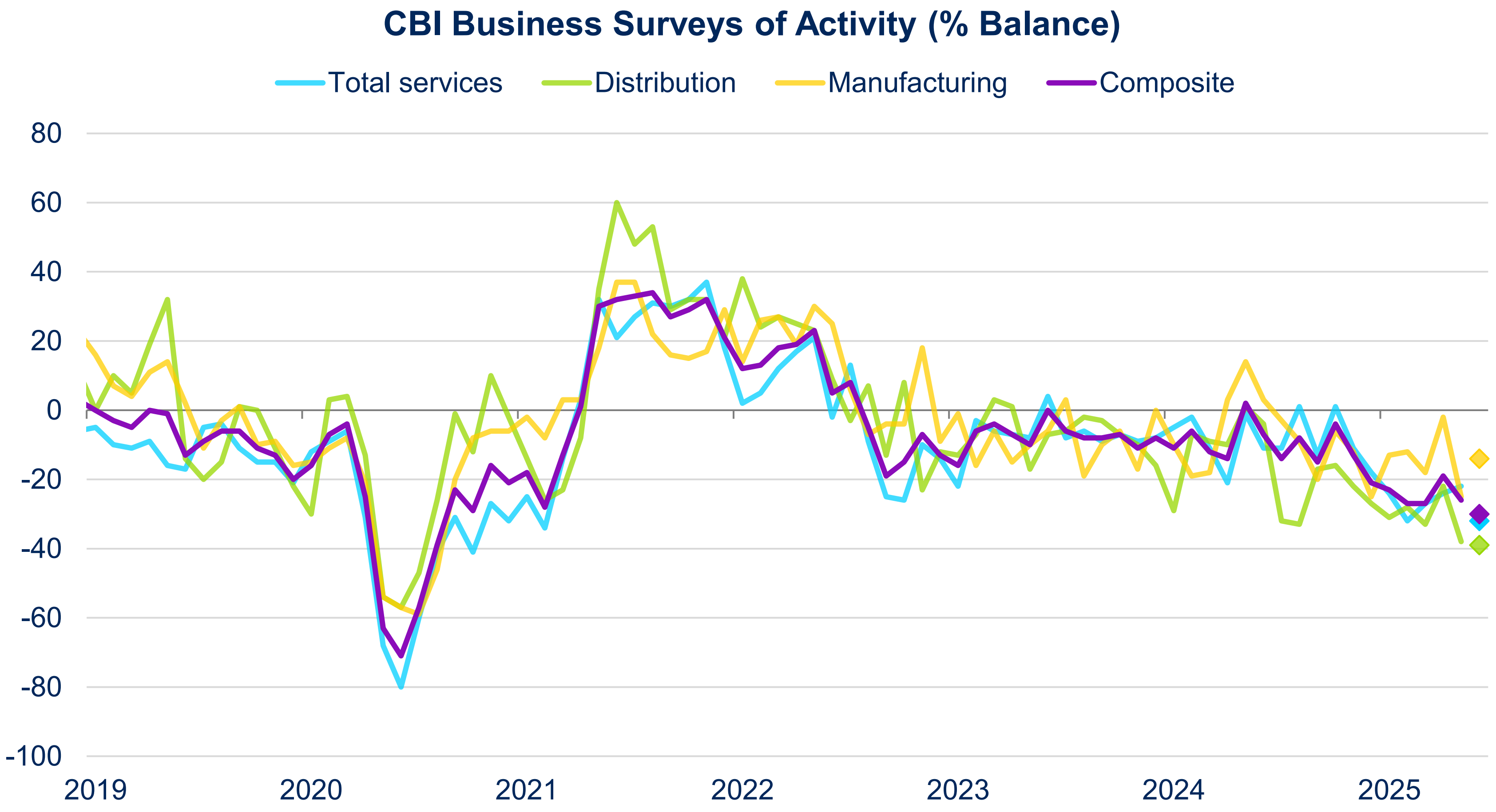


Source: ONS, Macrobond

"Other" category includes net acquisition of valuables and statistical discrepancy.

- The UK saw modest GDP growth of 1.1% year-on-year in 2024. Although activity started off strongly in Q1 and Q2, the economy effectively stagnated in the second half of the year. Government spending saw solid growth over the year, but this was not enough to make up for lacklustre consumer spending and business investment. Additionally, net trade posed a sizeable drag on output.
- The UK economy picked up steam at the start of 2025, with GDP rising by an impressive 0.7% quarter-on-quarter in Q1. However, the underlying drivers of this expansion were less encouraging. Household spending growth was still weak, while strong contributions from the volatile net trade and investment components may prove to be temporary. Business investment, in particular, was boosted by aircraft purchases, which seem unlikely to persist beyond Q1.

… but underlying momentum seems to be weaker



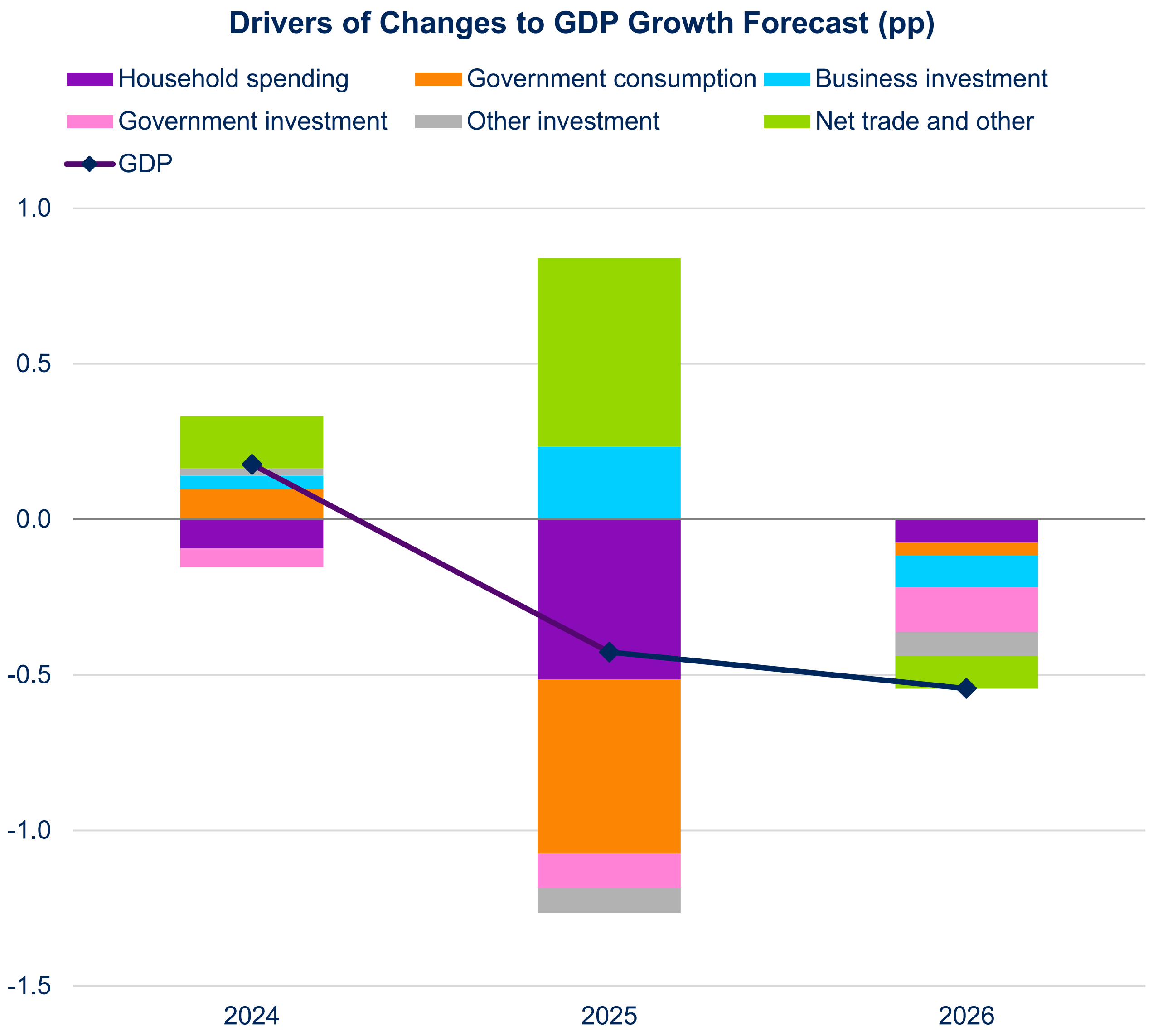
Source: CBI surveys

Business view

- Demand remains weak in consumer-facing services, reflecting low footfall, cautious consumer spending, and widespread concerns over rising costs, tax hikes, and economic uncertainty.
- Business-facing services firms have seen subdued activity amid delayed projects, reduced client budgets, and gloomy business sentiment following the Autumn Budget.
- Conditions are mixed in manufacturing. Many firms are facing weak demand, but defence, aerospace, and net zero are bright spots.

- The CBI's Growth Indicator, a composite measure of private sector activity, suggests that underlying momentum in the economy has been weaker than what official data would indicate. Activity declined across the distribution, manufacturing, and non-financial services sectors in the three months to May.
- Many private sector firms remain gloomy about the outlook going forward, highlighting persistent headwinds such as weak consumer demand, higher labour costs following the Autumn Budget, and elevated global economic uncertainty. In our surveys, these factors contributed to the weakest expectations for private sector activity since September 2022.

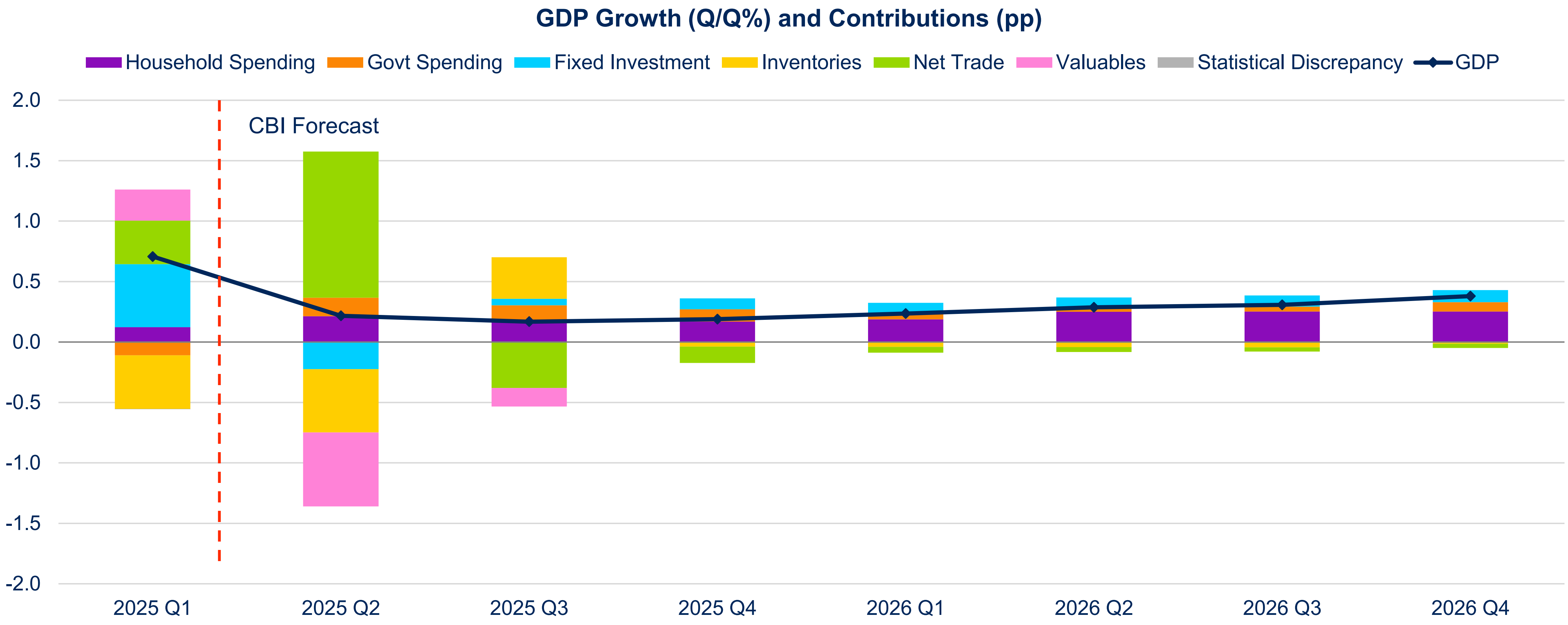
Domestic & international headwinds contribute to forecast downgrades



Source: ONS, CBI forecast
2024 changes represent difference between outturn data and December 2024 forecast

- Our GDP growth projections for 2025 and 2026 have been noticeably downgraded from our December 2024 forecast. We now expect growth of 1.2% in 2025, from 1.6% previously, and 1.0% in 2026, down from 1.5%.
- These downgrades reflect a mix of outturn data and judgement-driven changes to the forecast, the latter stemming from a mix of domestic and international factors.
- We assume that consumer spending growth in 2025 will face headwinds from higher inflation, a cooling labour market, and persistently lacklustre sentiment. An easing in inflation next year, alongside recent income gains and lower interest rates, will support a modest pick up in household spending.
- Higher labour costs – following increases in employer NICs and the National Living Wage – and global economic uncertainty are expected to weigh on business investment over our forecast. While a (likely temporary) boost to investment in Q1 supports growth over 2025 as a whole, the aforementioned factors more noticeably drag on capital expenditures in 2026 compared to our previous forecast.

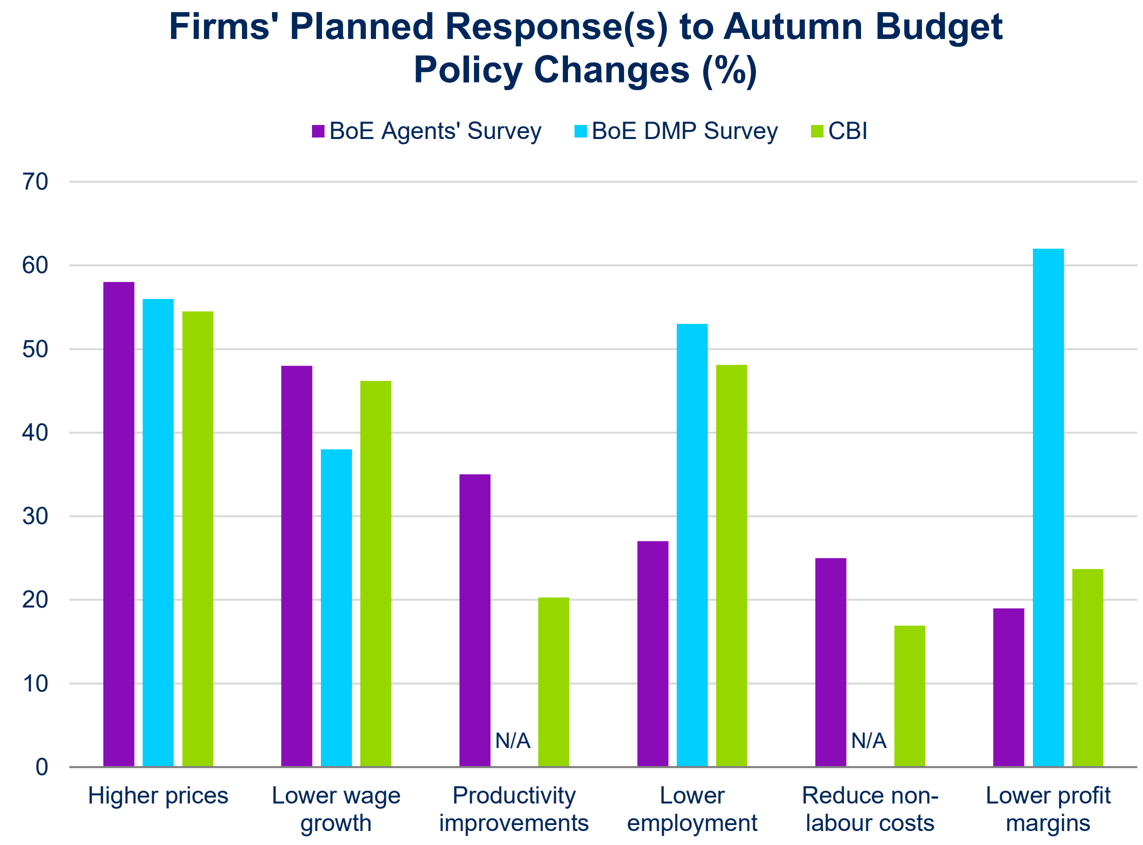
Quarterly growth will gradually firm over the forecast



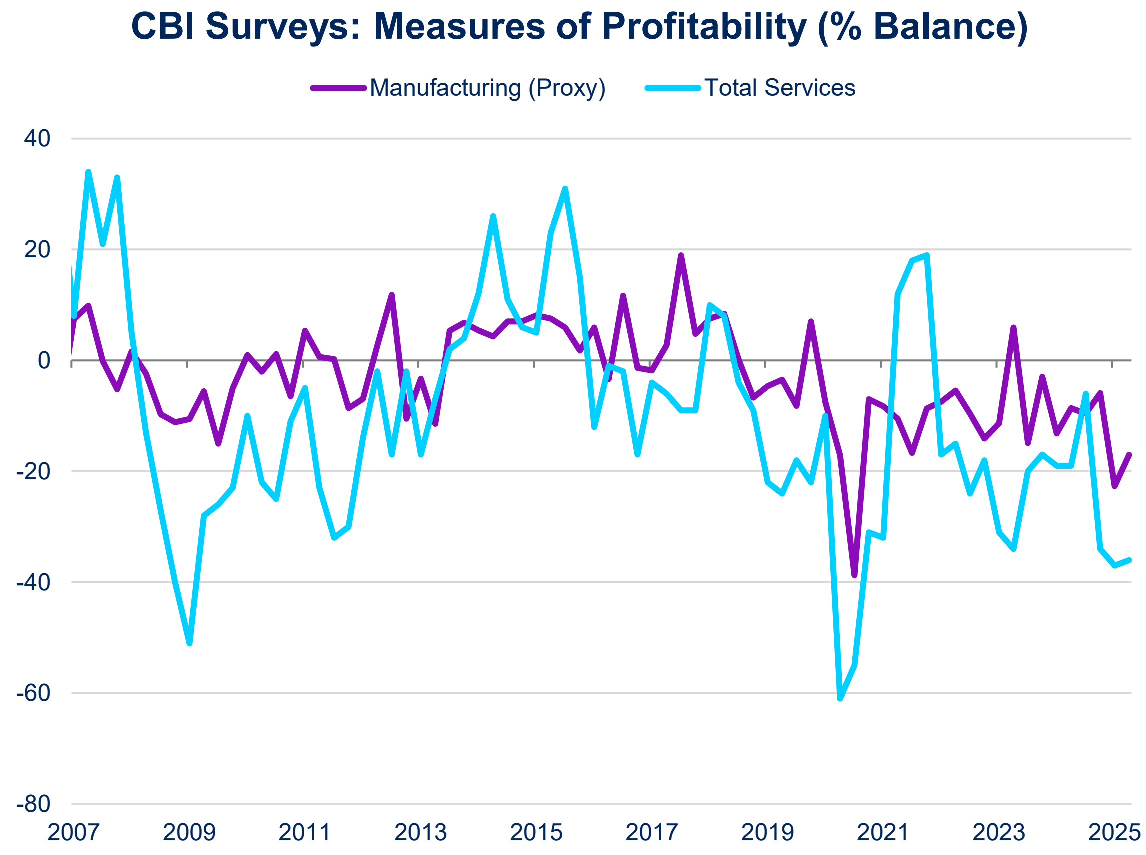
Source: ONS, CBI forecast

- Following a strong increase in GDP in Q1 (of 0.7% q/q), our forecast expects that quarterly economic growth will shift down to a modest pace of 0.2% for the rest of the year. Putting aside volatile components (such as valuables and inventories), we expect household spending to be weak and government consumption to only contribute marginally to growth. Business investment is projected to temporarily dip in Q2, largely as a pullback following an unusually strong Q1 that was likely boosted by one-off factors (such as aircraft purchases).
- Economic momentum begins to gradually pick up on a quarterly basis next year, reaching 0.4% q/q in Q4 2026. This improvement is driven by firming household spending growth, supported by recent income gains, slowing inflation, and lower interest rates. Business investment, meanwhile, remains weak due to ongoing headwinds from higher labour costs and global economic uncertainty.

Businesses are using different methods to respond to Budget measures



Source: Bank of England Agents, Bank of England DMP, Bank of England Monetary Policy Report (Feb 2025), CBI surveys

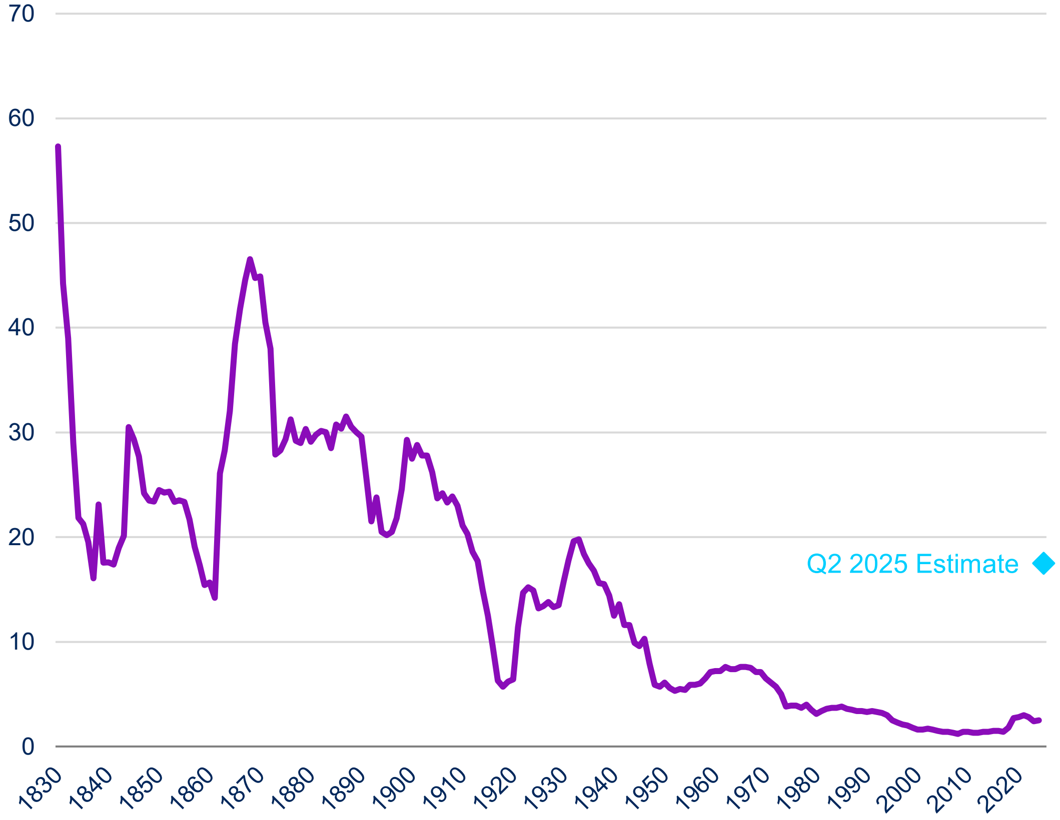


Manufacturing proxy constructed from ITS costs and prices data
Total services represents profitability growth in the past three months
Source: CBI surveys, CBI analysis

- The Autumn Budget in October 2024 included measures that added significant costs to businesses through higher employer NICs rate, lowering of the secondary employer NICs threshold, and a significant rise in the National Living Wage. Survey and anecdotal evidence suggest that firms have responded to the increase in labour costs through measures such as higher prices, reduced pay growth, and pulling back on hiring/investment plans.
- It's important to note that firms have limited space to absorb the increase in labour costs through lower profit margins. According to CBI surveys, services firms have seen falling profitability since February 2022, while manufacturers have reported shrinking margins in all but two quarters since the end of 2018. This persistent decline in profits will impact firms' ability to invest and create new jobs going forward.

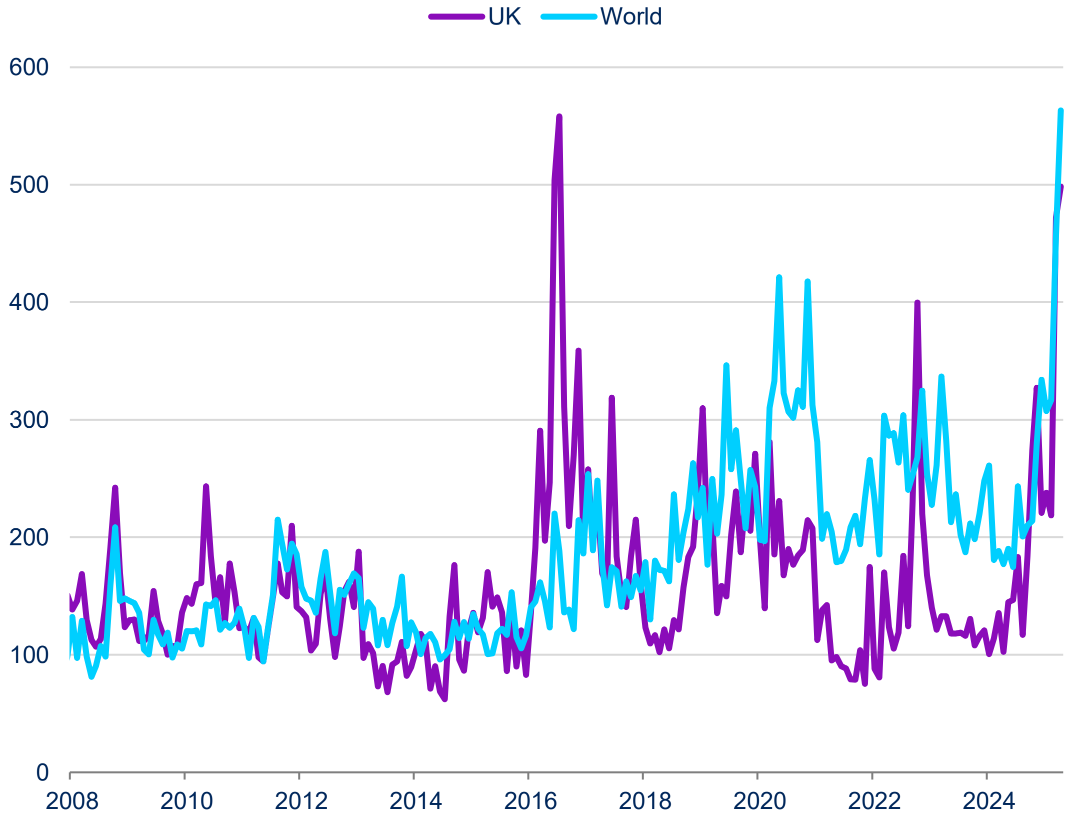
US tariff hikes expected to weigh on global outlook

US Average Effective Tariff Rate (%)



Source: Tax Foundation, Macrobond, Oxford Economics Global Model

Economic Policy Uncertainty Indices

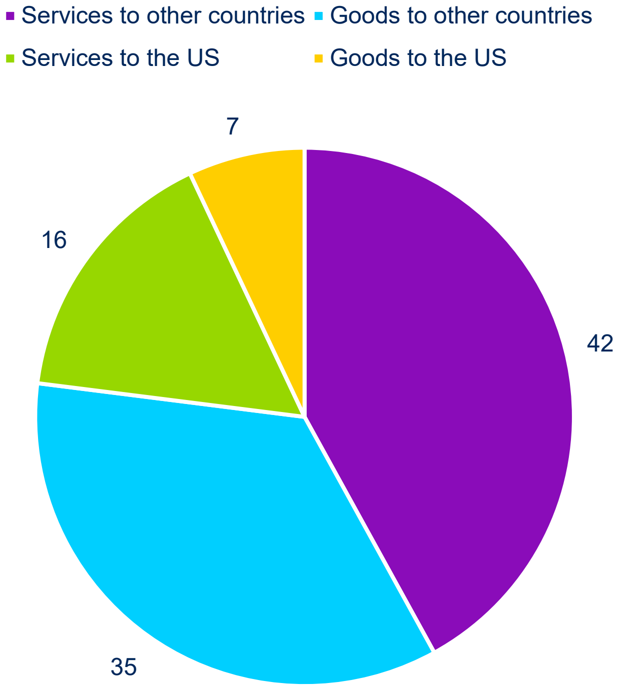


Source: Economic Policy Uncertainty, Macrobond

- In early 2025, the newly elected Trump administration in the US introduced sweeping tariff hikes on imports from practically every country in the world. The imposition of these tariffs (and multiple changes in rates over the last few months) has triggered an unprecedented increase in global economic uncertainty, heightened volatility in global markets, and raised concerns about a potential slowdown in global trade and economic activity.
- Our baseline forecast assumes that US tariff rates gradually ease over the forecast but remain at levels not seen since the 1940s. However, risks remain elevated around this assumption. There is also a large degree of uncertainty around the expected impact of tariffs, reflecting the potential degree of retaliation from other countries, the longevity of US tariffs themselves, and the scope for trade flows to be diverted and supply chains to be re-routed.

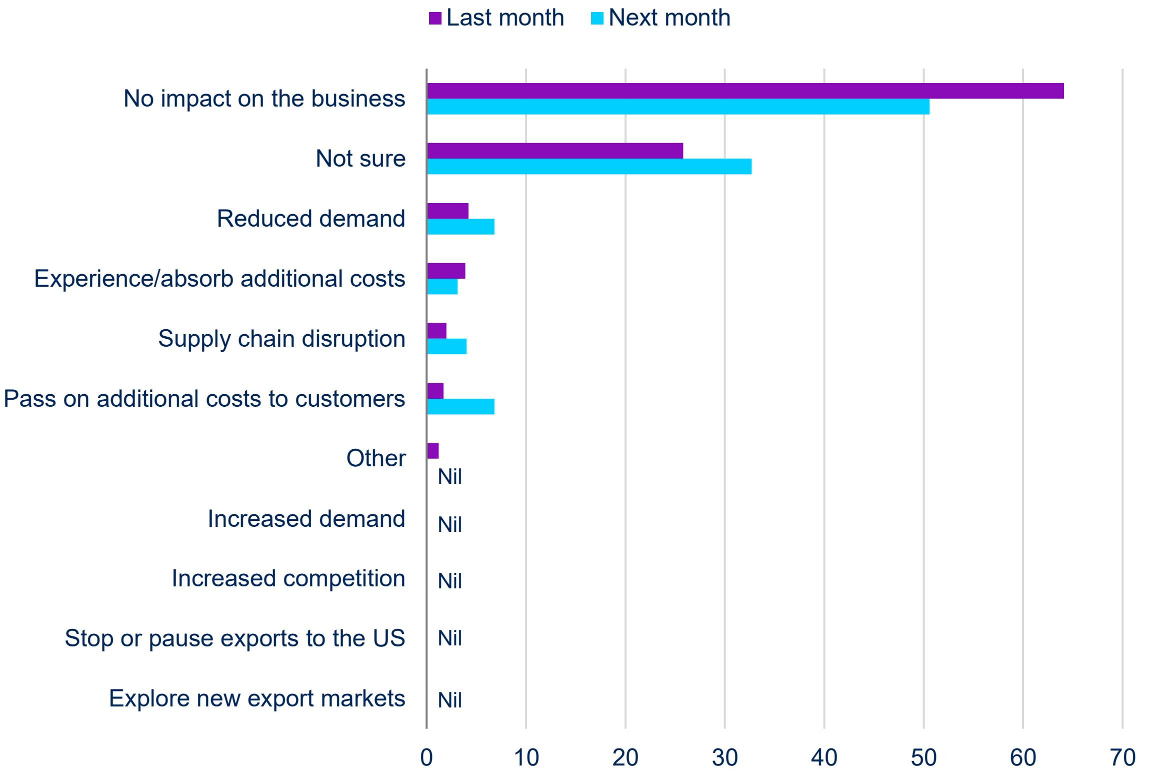
Higher US tariffs will pose a limited headwind to UK activity

Composition of UK Exports (% of Total Nominal Value, 2024)



Source: Oxford Economics, ONS

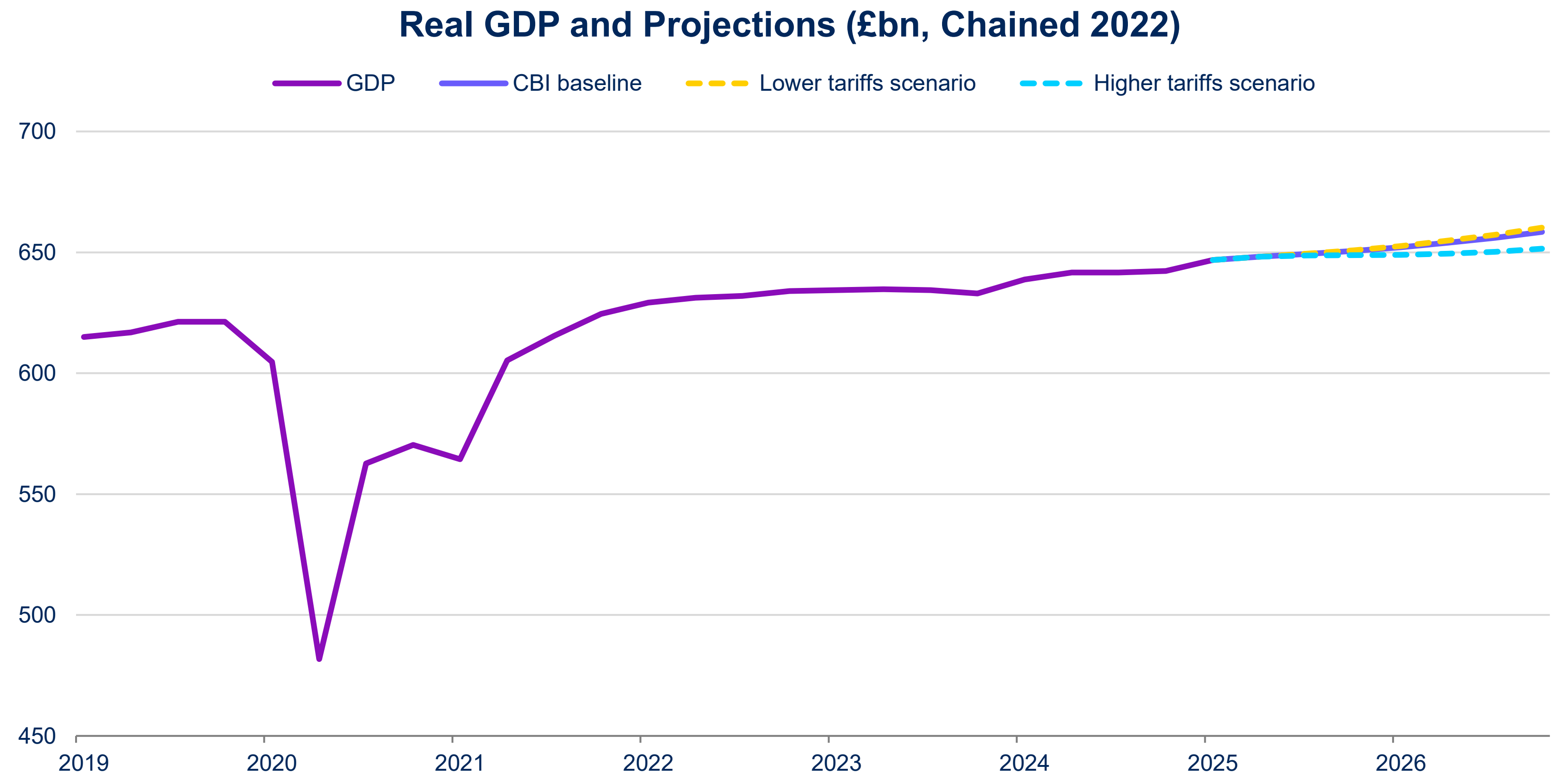
Impact of US Tariffs on Business (%)



Source: ONS BICS
Data represents responses of firms with 10 or more employees (22 April to 2 May 2025).

- Higher tariffs are expected to push up US prices, which will weaken US demand and hit global trade more broadly. The direct impact on the UK, however, will be limited by the fact that goods exports to the US account for around 7% of total exports. Overall, the main channels through which US tariffs are expected to hit UK activity are weaker exports, financial market volatility, and uncertainty – the latter particularly impacting business investment
- The UK-US trade agreement will mitigate the impact of tariffs for the UK steel, aluminium, and automotive sectors. However, the agreement only covers less than 1% of total UK exports. This means that products accounting for around 5% of total UK exports will face the new 10% tariff rate, while a further 1% will be left at risk to potential future tariffs (e.g. pharmaceuticals). As a result, we expect that the agreement will have a minimal impact for the UK at a macroeconomic level.

Further tariffs would pose a downside risk to GDP growth



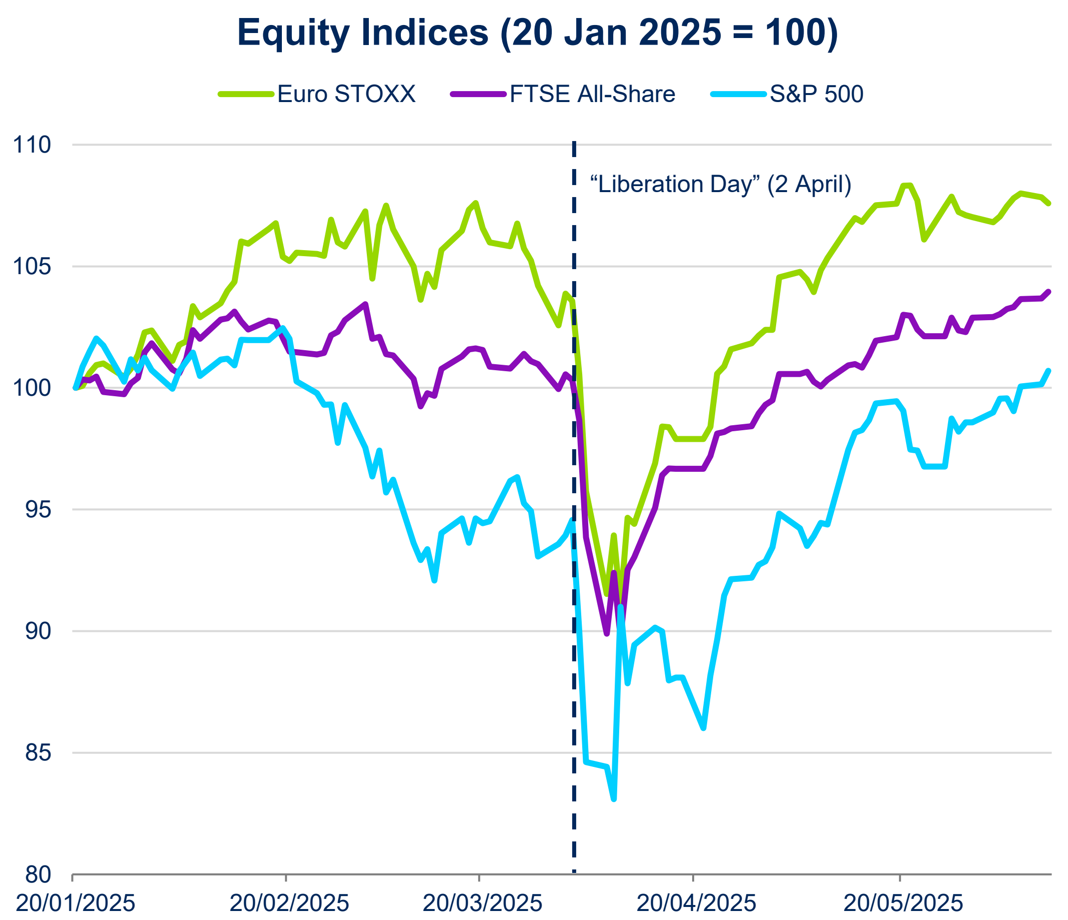
Source: ONS, Macrobond, CBI forecast, Oxford Economics Global Model, CBI analysis

GDP Growth Projections (Y/Y%)			
	CBI baseline	***Lower tariffs scenario***	***Higher tariffs scenario***
2025	1.2	*1.2*	*1.1*
2026	1.0	*1.1*	*0.3*

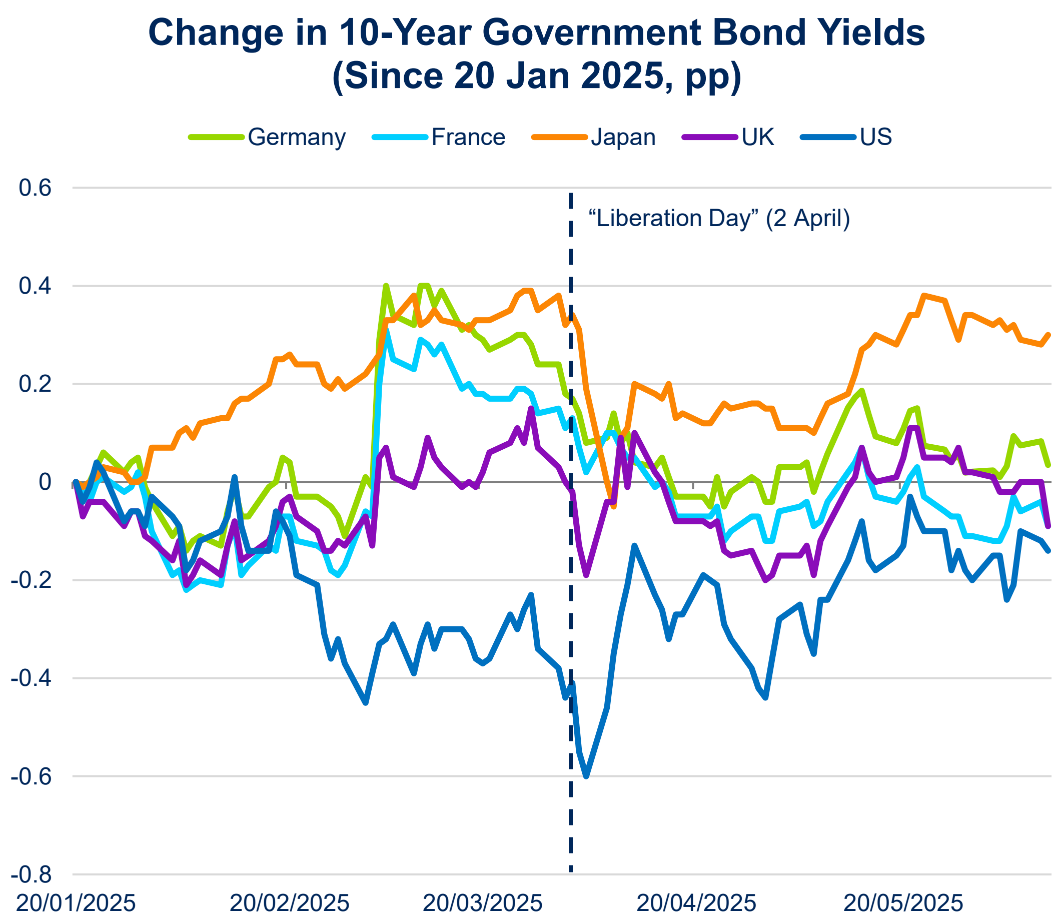
Detailed tariff assumptions are listed in Appendix A

- Our baseline forecast incorporates US tariff policies through May 2025, in addition to the China-US and UK-US trade agreements. The forecast assumes that the US maintains a baseline tariff rate of 10% on imports from most countries, with the main exemptions being comparatively higher tariffs on China, Canada, and Mexico. The EU is assumed to retaliate with 10% tariffs, and China maintains an effective tariff rate of around 30% on imports from the US. The additional "reciprocal" tariffs on the US' trading partners are assumed to not go ahead, following the 90-day pause (which expires on 9 July).
- Given the uncertainty surrounding US and global trade policy, we have set out two scenario projections to illustrate potential alternative trajectories for the UK economy (in line with Oxford Economics' scenario assumptions). The "lower tariffs" scenario sees most US tariffs being negotiated down, while the "higher tariffs" scenario expects the US to reimpose "reciprocal" tariffs and remove exemptions for specific goods.
- Under the higher tariffs scenario, the level of UK GDP would be expected to 1.1% lower than our baseline in Q4 2026. While the economy would avoid recession, growth would slow to a crawl. Meanwhile, the lower tariffs scenario would provide a modest boost of 0.3% to the level of GDP. Inflation would be broadly similar to baseline under both scenarios.

US tariffs have generated financial market volatility



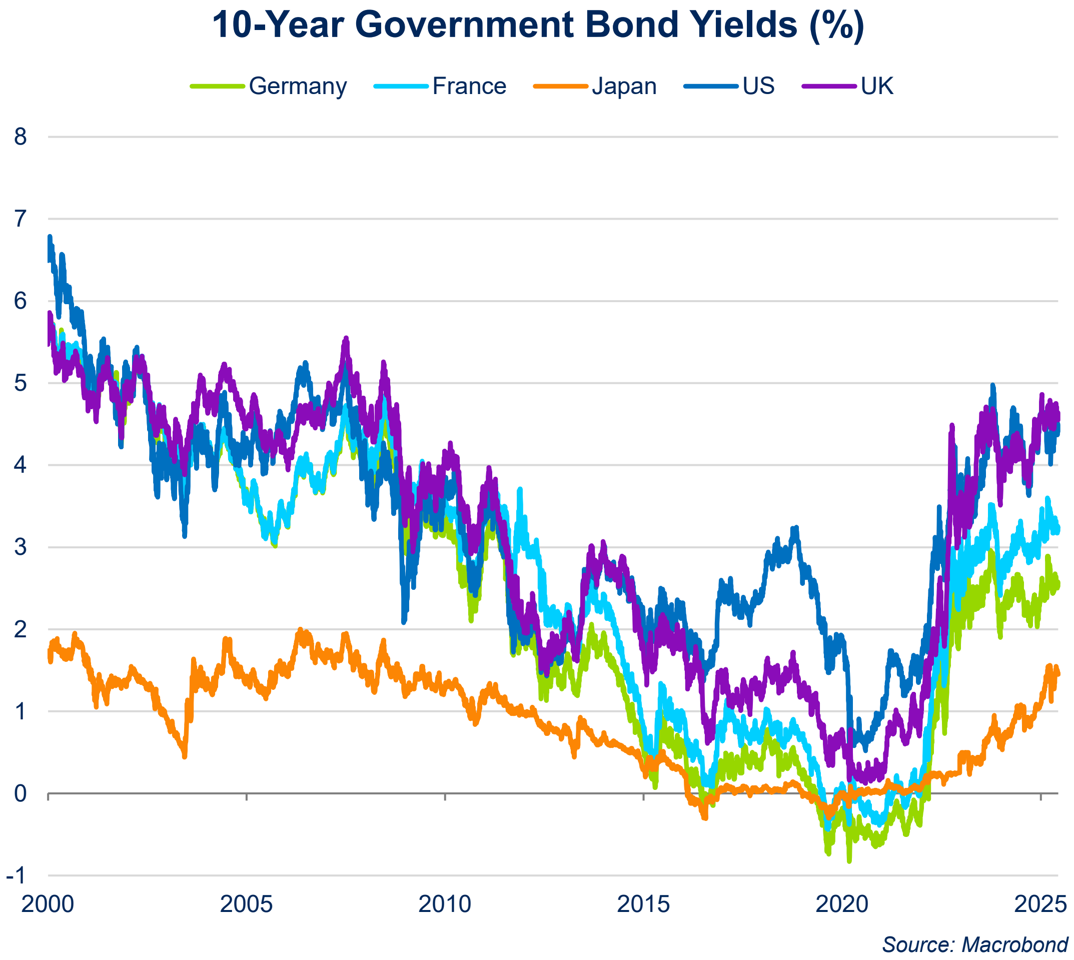
Source: Macrobond, CBI analysis

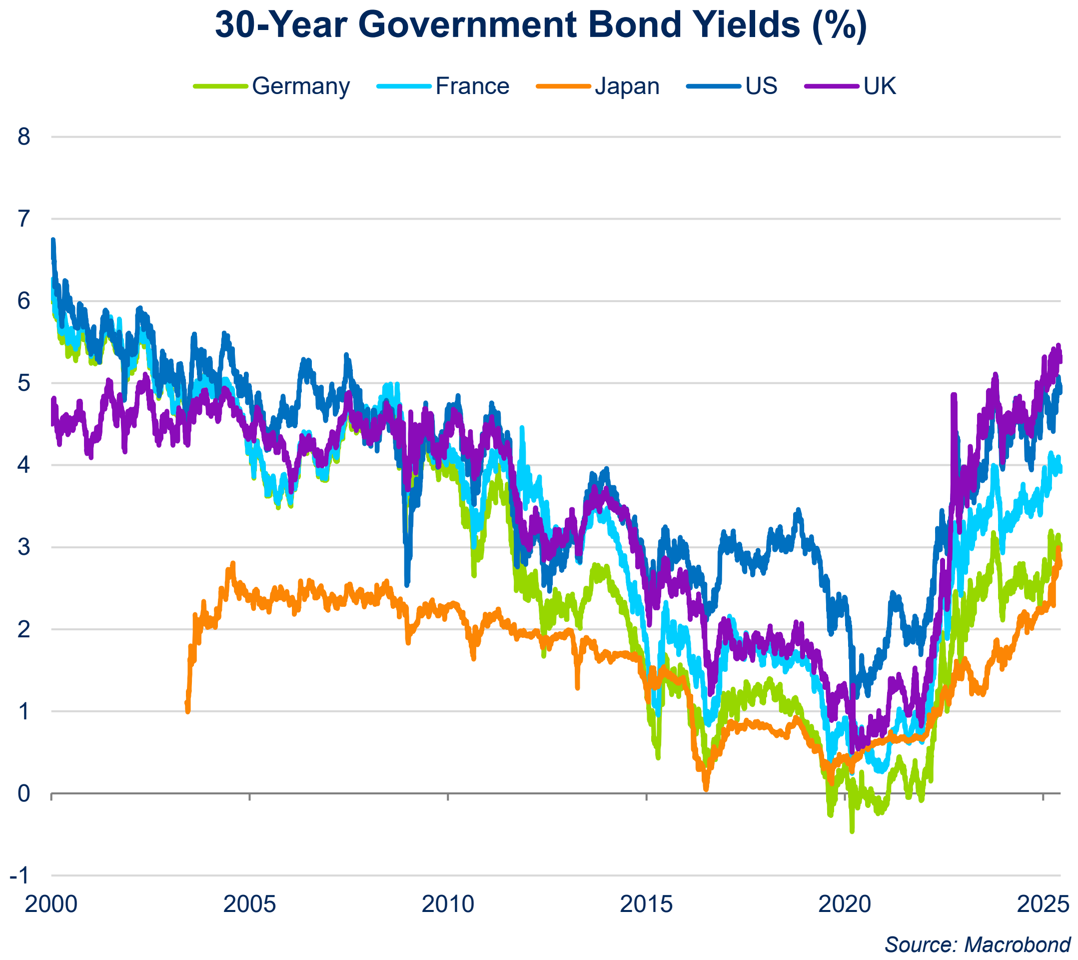


Source: Macrobond, CBI analysis

- Global financial markets have seen elevated levels of volatility since President Trump took office for his second term on 20 January 2025. These movements have been primarily been driven by reactions to Trump's various tariff announcements, which have raised concerns about the possibility of a US and global economic slowdown.
- The announcement of "reciprocal" tariffs on 2 April led to an 11% drop in the S&P 500 over two days and a fall in government bond yields as investors sought safety. Since then, equity indices and yields have gradually risen, but ongoing US policy uncertainty will continue to impact investor sentiment going forward.

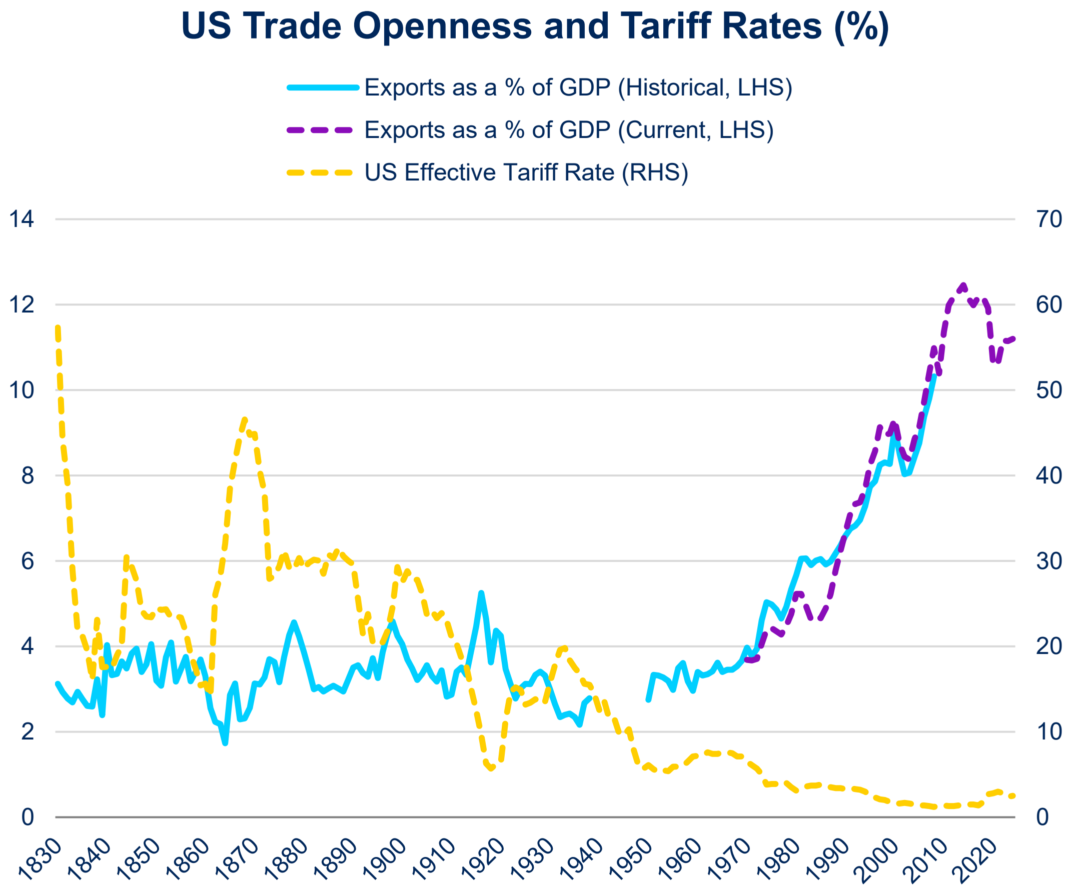
Higher bond yields will put pressure on fiscal outlook



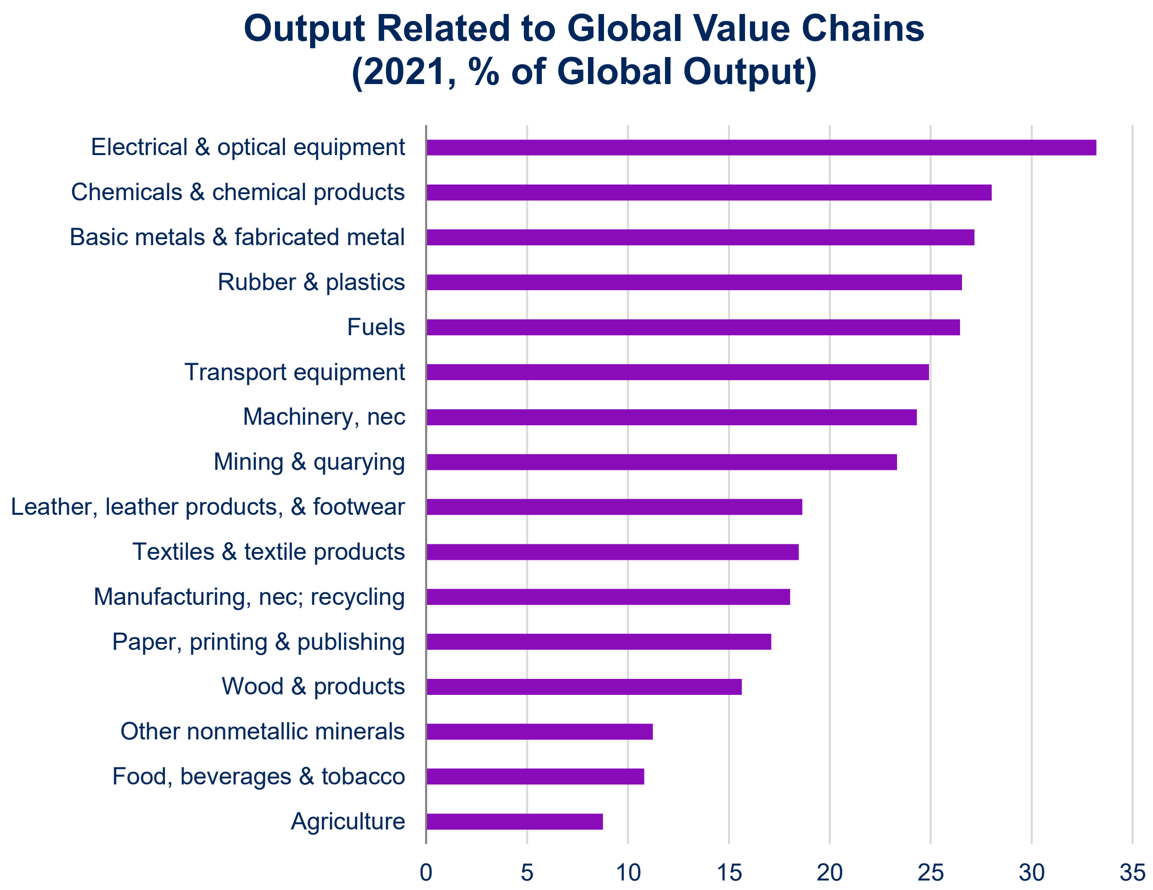


- Looking beyond the latest market movements, yields on long-term government bonds in advanced economies have risen significantly over the last few years. As of early June 2025, the UK had the highest yields out of the G7 for both 10-year and 30-year bonds.
- UK bond yields have been driven up by a combination of increased government borrowing, persistent inflation concerns, and global market influences.
- Higher yields will increase government debt servicing costs, which will put additional pressure on fiscal sustainability. Business and households may also see an increase in longer-term borrowing costs as a result.

Tariffs threaten highly integrated global supply chains



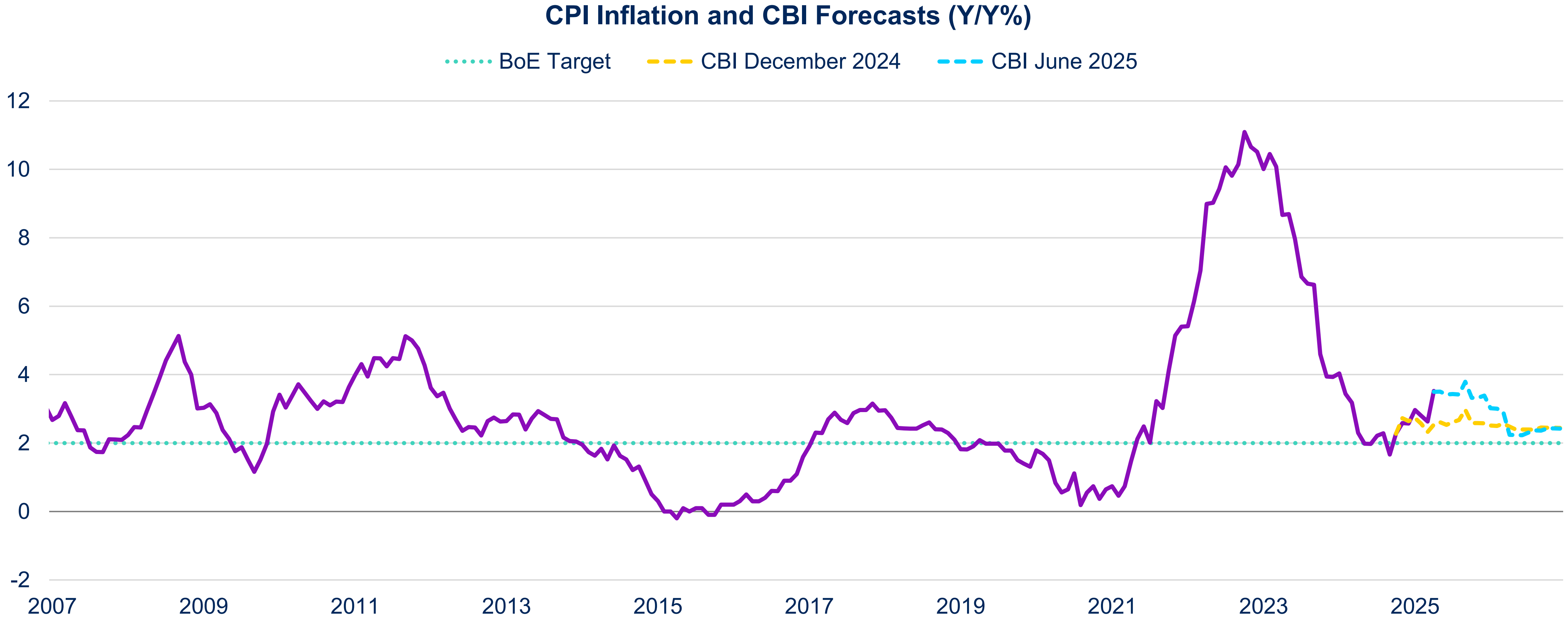
Source: Federico-Tena World Trade Historical Database, US Bureau of Economic Analysis, Tax Foundation, Macrobond



Source: WITS, CBI analysis

- The recent US tariff escalation harks back to an age when the global economy was far less integrated than it is currently. While the US is more self-reliant and less open compared to many advanced economies, its integration in the global economy has reached unprecedented levels in recent years. Indeed, the US' export-to-GDP ratio in 2024 was more than four times higher than it was in the 1930s, back when the Smoot-Hawley Tariff Act pushed tariff rates up to around 20%.
- Higher US tariffs risk distorting production patterns and driving a reconfiguration of global supply chains, which would likely result in a less efficient global trading system. This would particularly be a risk for highly integrated goods sectors like electrical & optical equipment, where global value chains account for one-third of output. Services like shipping and air transport could also be affected by trade disruptions.

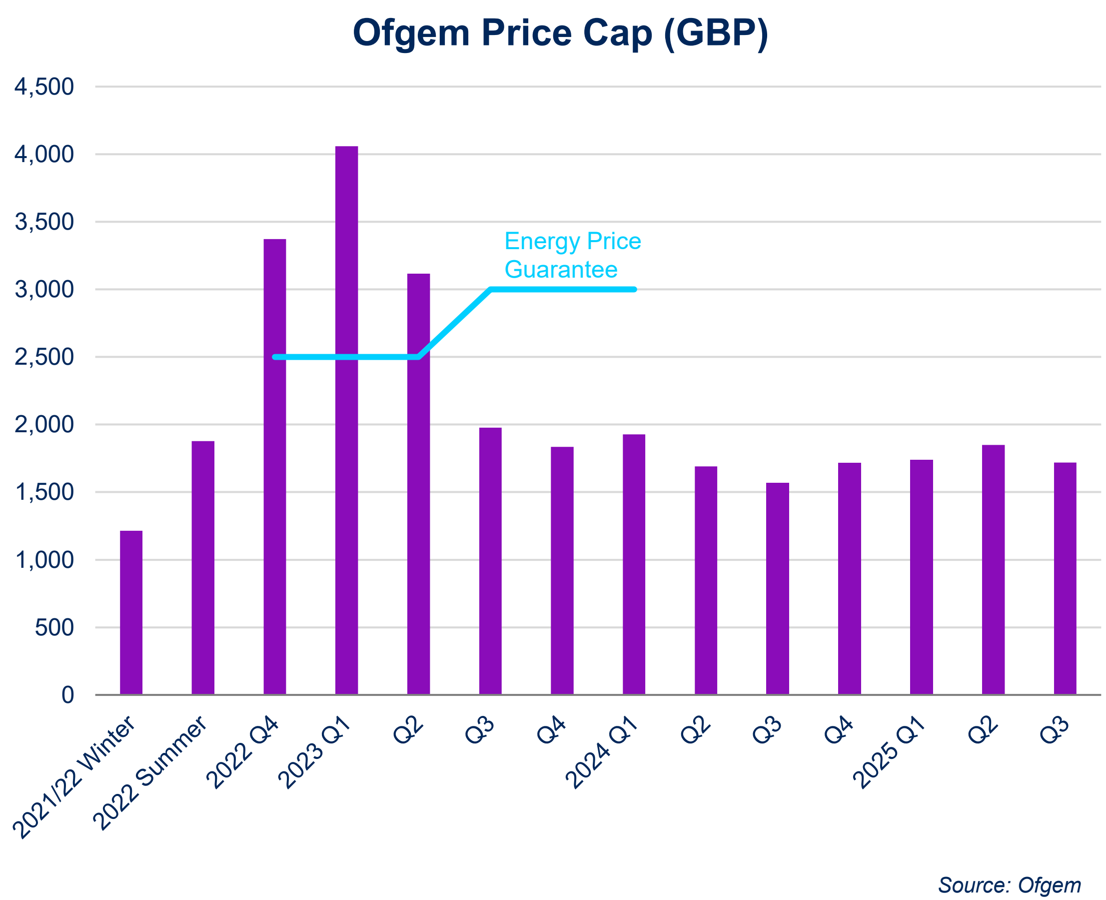
Inflation expected to stay above 3% for rest of 2025

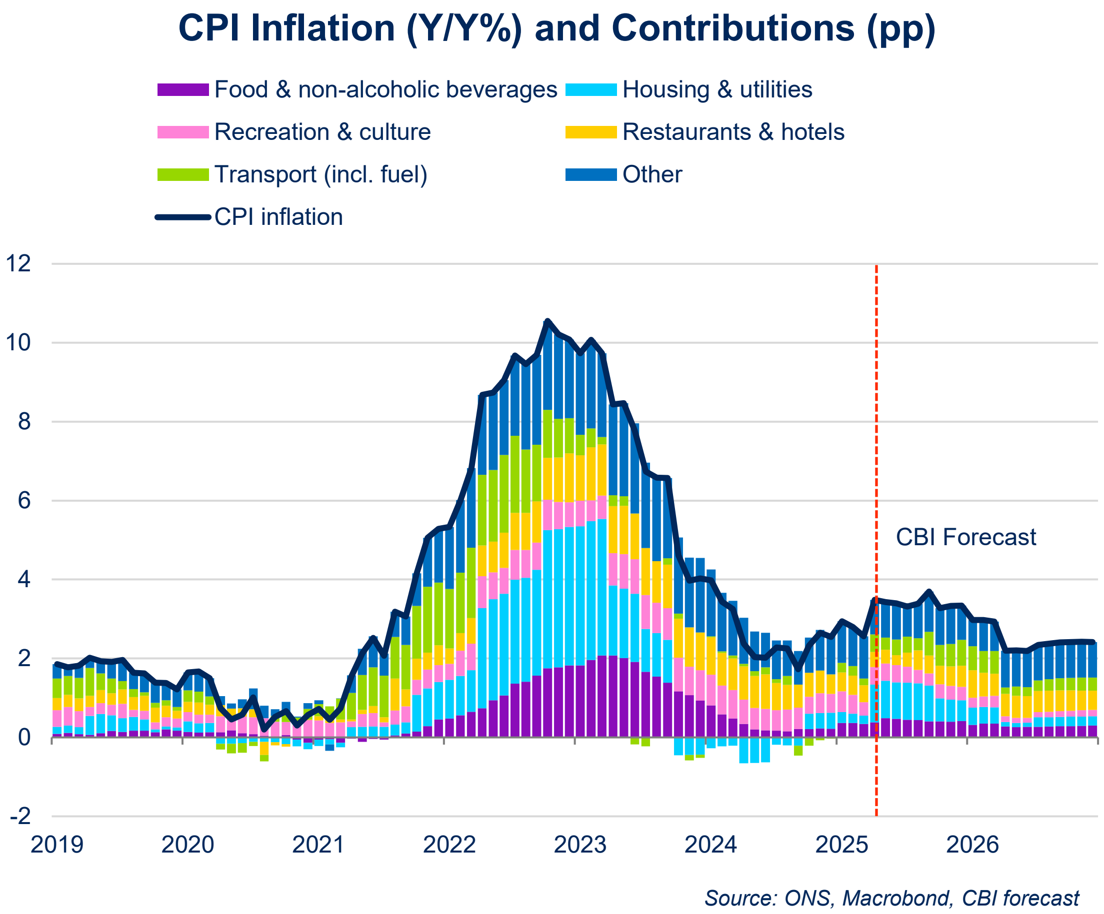


Source: ONS, Bank of England, Macrobond, CBI forecasts

- CPI inflation began rising over the second half of 2024 and early 2025, reflecting a mix of energy base effects and sticky services inflation. In April, inflation rose to 3.5% - its highest rate since January 2024. This pick-up was widely expected, however, as it was driven higher by increases in Ofgem's energy price cap and other regulated prices (e.g., water bills). This was compounded by passthrough of the rise in employer NICs and NLW to prices.
- We expect inflation to average 3.3% in 2025, with a peak of 3.8% in September. Housing & utilities prices are the main drivers of inflation over the year, with price pressures also remaining elevated in categories like hospitality, food & drink, transport, and recreation & culture.
- Inflation then eases to 2.5% (on average) over 2026, broadly in line with our previous forecast. The slowdown mostly reflects this year's rises in energy and regulated prices falling out of the annual comparison.

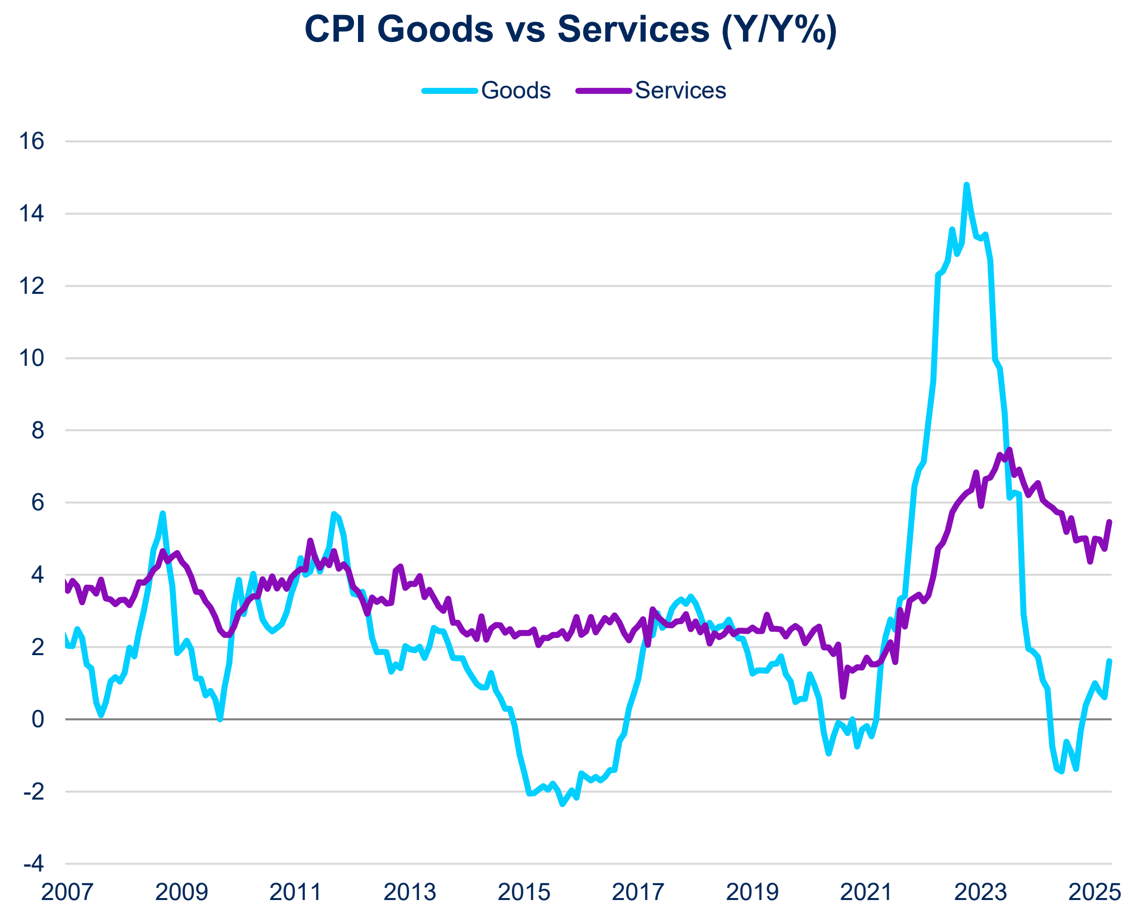
Housing & utilities drive temporary uptick in inflation



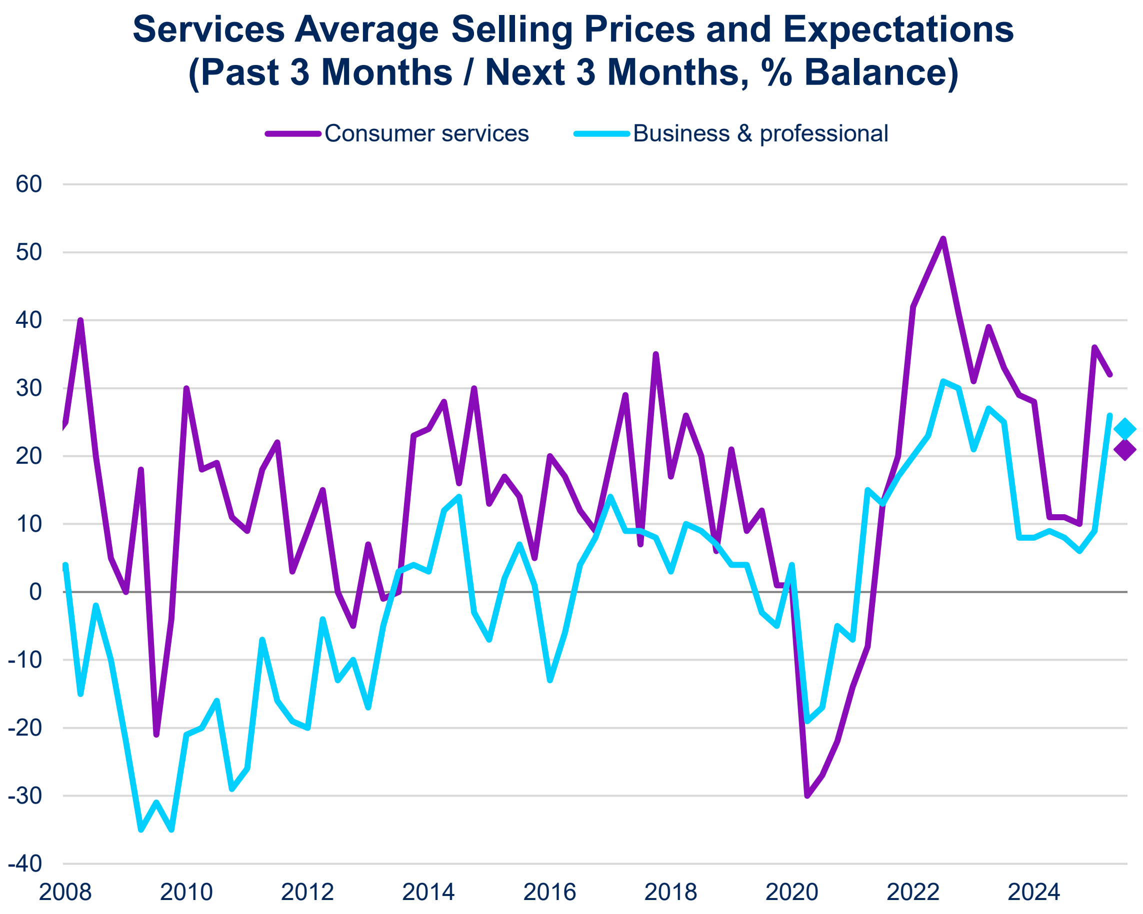


- Our forecast expects that housing & utilities costs will be the main driver of inflation over 2025. Specifically, a higher Ofgem price cap and a rise in water bills push up inflation for most of this year. The contribution from energy costs fades away in Q4 2025, but base effects from water bills will continue to put upward pressure on inflation through Q1 2026. Energy prices subsequently drag on inflation in the first half of 2026, which helps push the headline rate down to 2.2% in Q2 of that year.
- Transport prices are also expected to put upward pressure on inflation through Q1 2026. This reflects, at least in part, the recent increase in Vehicle Excise Duty, which helps to offset a drag from lower fuel pump prices.

Services inflation has remained firm



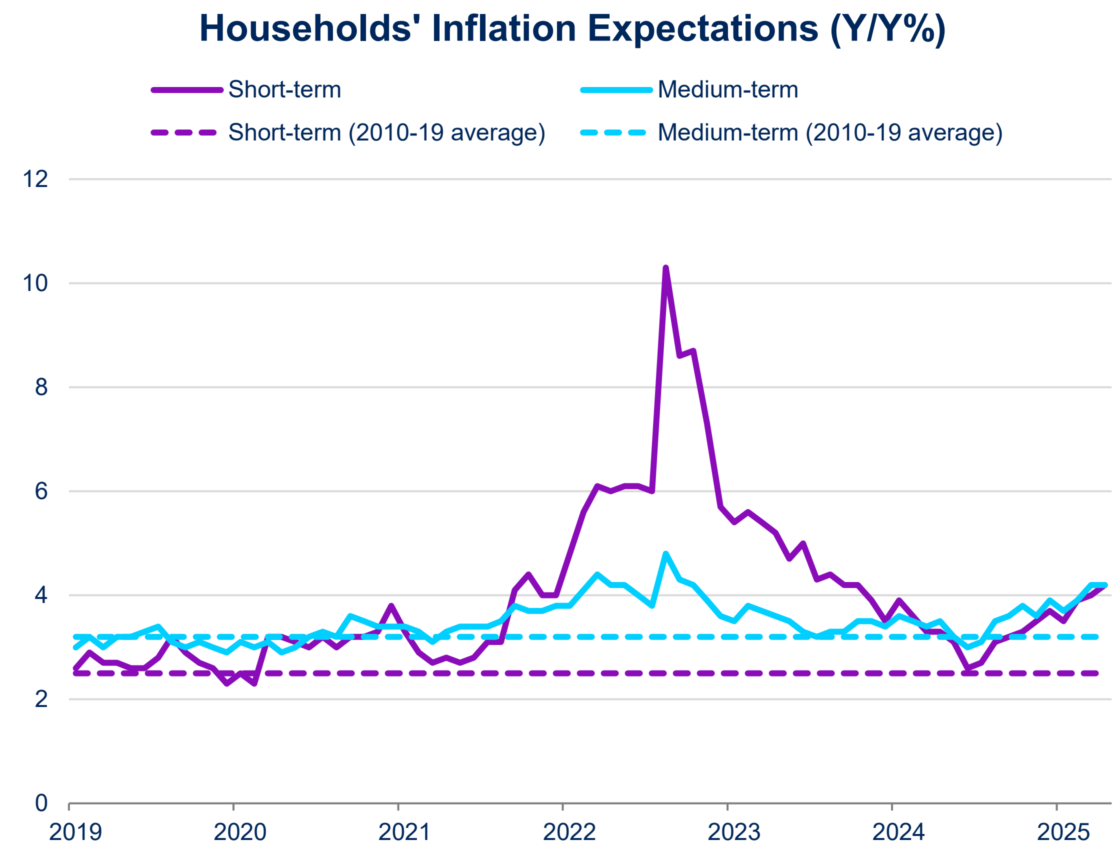
Source: ONS, Macrobond



Source: CBI surveys

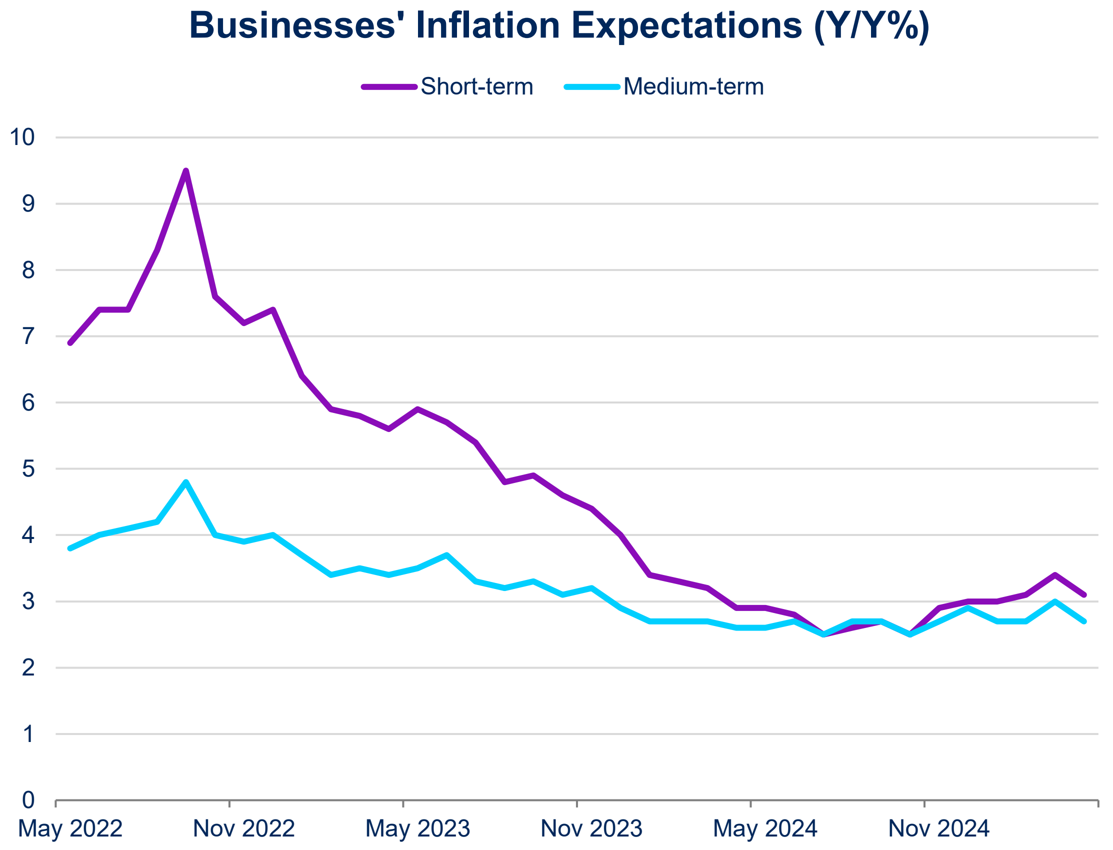
- Services inflation, which is an indicator of domestic price pressures, has stayed elevated by recent historical norms (despite easing from its highs in Q3 2023). This reflects, at least in part, the passthrough of high labour costs to prices – particularly as wage growth remains firm.
- Autumn Budget measures have put upward pressure on prices in labour-intensive sectors such as restaurants & hotels. This chimes with the recent pick-up in services firms' price growth in CBI business surveys, which was particularly sharp for consumer services. Looking ahead, we expect that some of this pressure should gradually subside as wage growth slows going into 2026.

Household inflation expectations have risen recently



Medium-term expectations: households (5-10 years ahead)

Source: YouGov/Citi, Bank of England (May 2025 MPR)

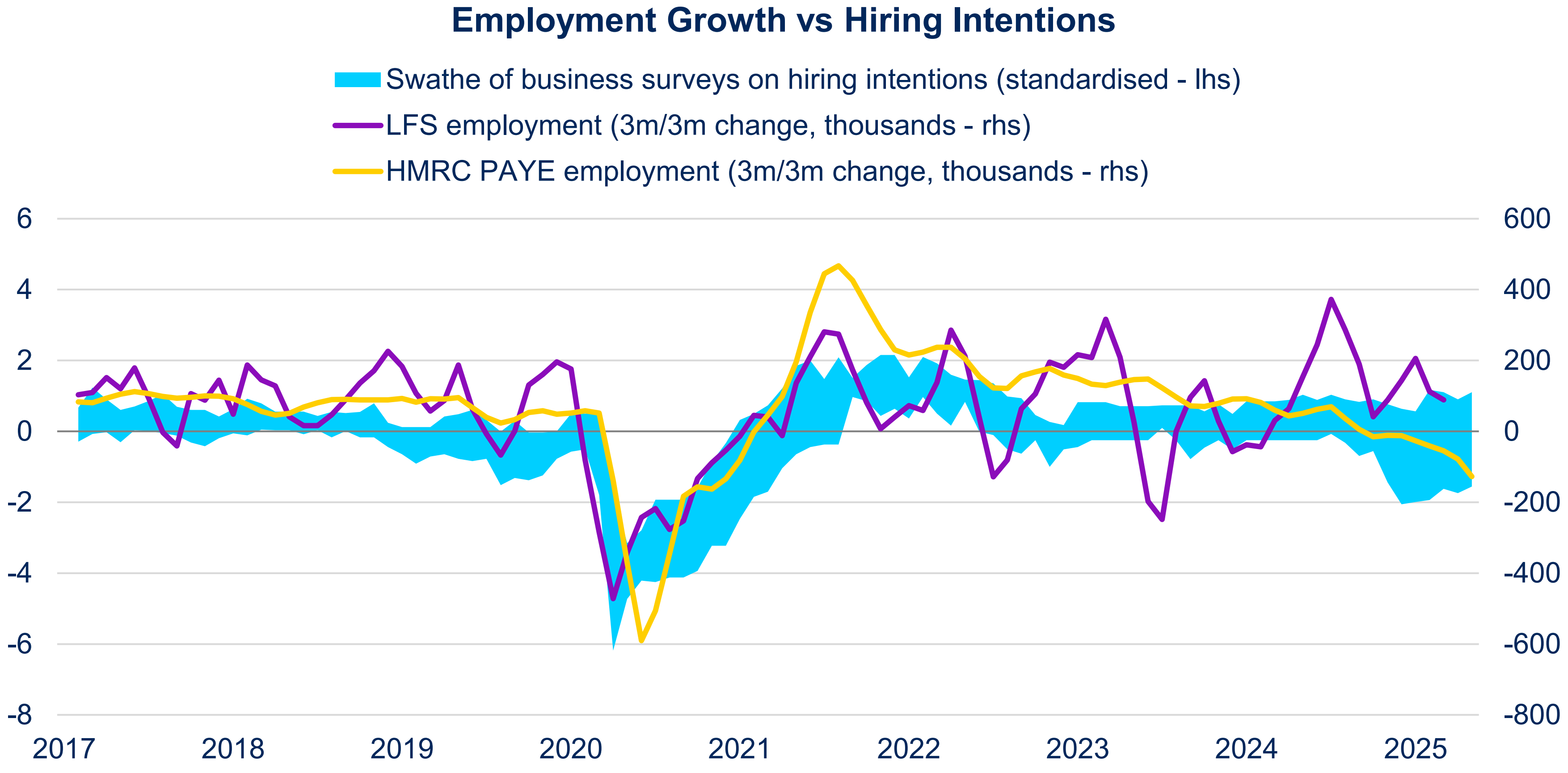


Medium-term expectations: businesses (3 years ahead)

Source: Bank of England DMP, Bank of England (May 2025 MPR)

- Inflation expectations have fallen from recent highs for both businesses and households. However, the recent increase in inflation seems to have fed through to a pick-up in households' expectations.
- Expectations for inflation are a key influencing factor for purchasing, pricing, and wage setting behaviour. Therefore, the firming in household expectations underlines the potential risk of price pressures remaining stickier for longer.

Surveys point to a cooling jobs market



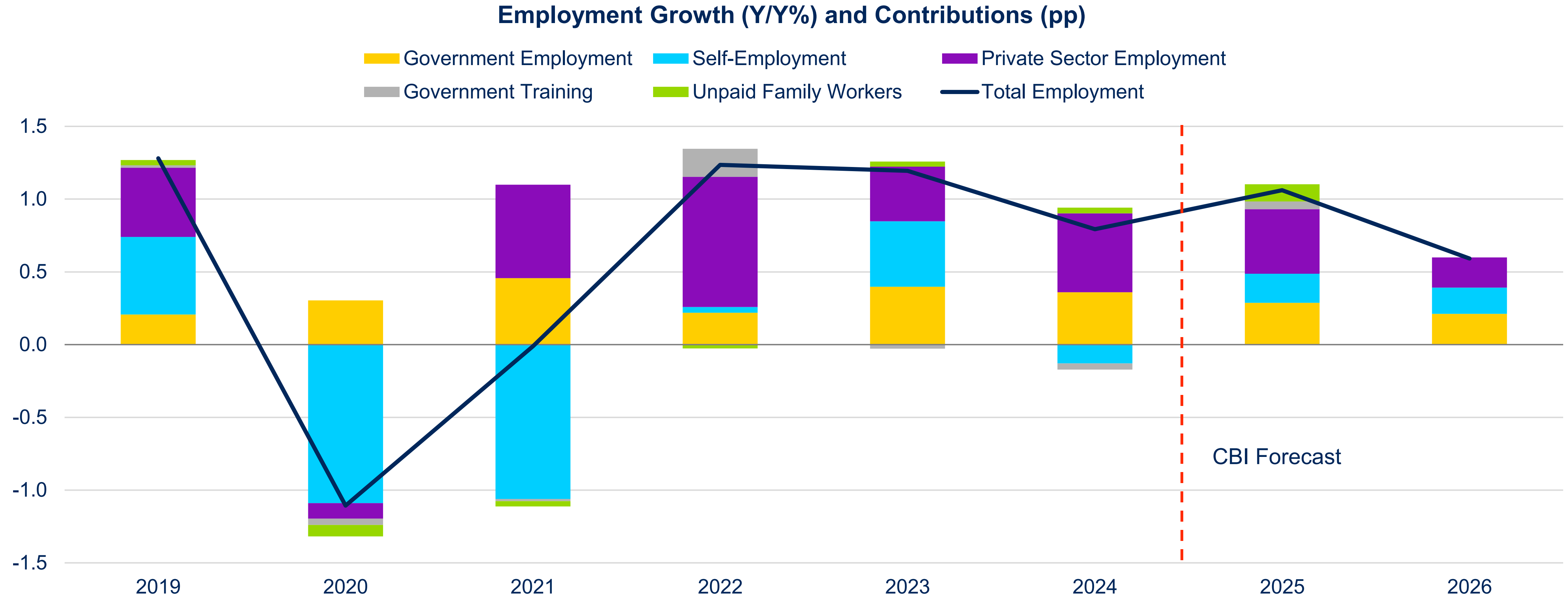
Source: Bank of England Agents' Survey, Lloyds Business Barometer, Bank of England DMP, BCC, S&P Global, CBI surveys, ONS, HMRC, Macrobond, CBI analysis

Business view

- Hiring freezes and cautious recruitment plans are widespread across sectors, driven by higher labour costs post-Budget and economic uncertainty.
- Wage pressures are significant, leading some firms to shift towards automation or offshoring to manage their cost base.

- Official employment data from the ONS' Labour Force Survey (LFS) remain distorted by sampling issues. A broader swathe of measures – including CBI surveys – suggest that firms have been cutting back on hiring, which chimes with recent declines in HMRC payroll data.
- The CBI's surveys have reported considerably negative hiring intentions across the distribution, manufacturing, and non-financial services sectors following the Autumn Budget in October 2024. This suggests that firms began to adjust their workforce plans ahead of the increase in employer NICs and the NLW in April 2025.

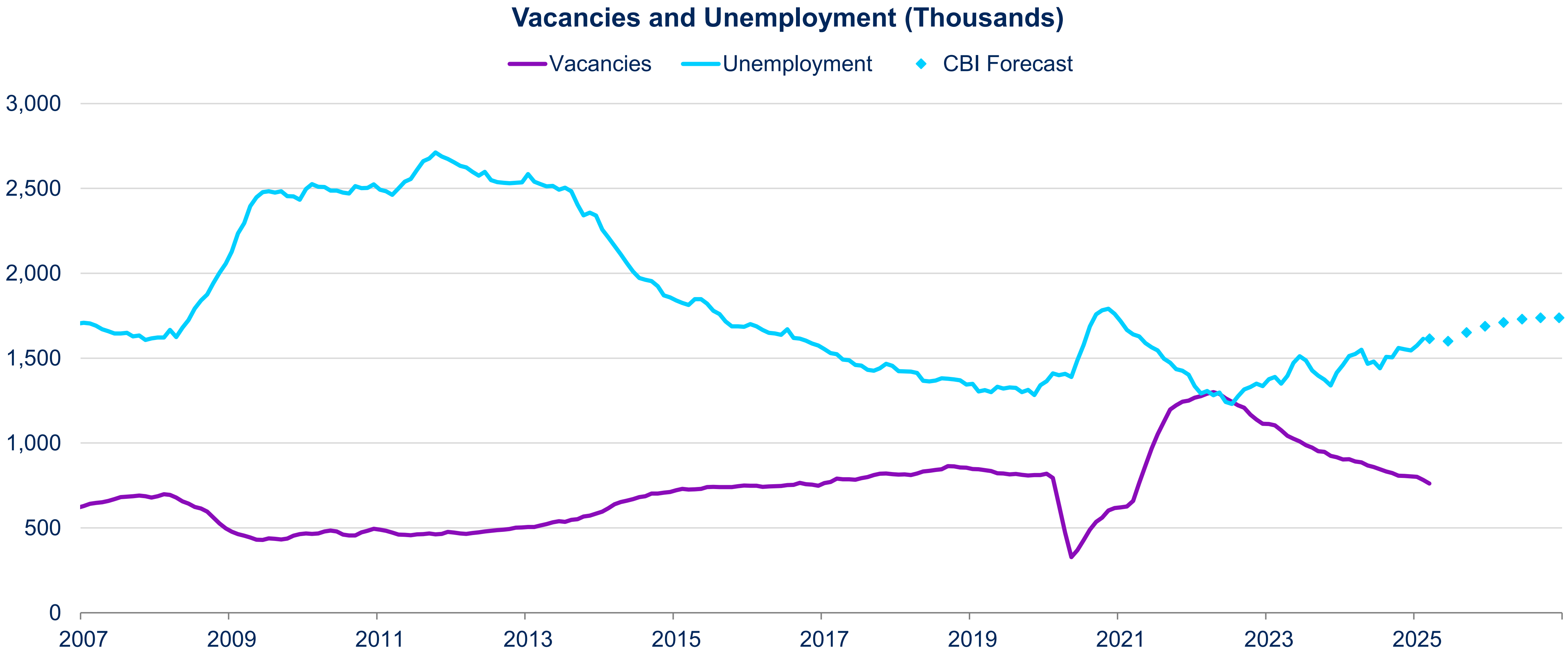
Weak outlook for private sector employment growth



Source: ONS, Macrobond, CBI forecast

- Private sector employment growth is expected to slow over our forecast, reflecting weak private sector activity and increased labour costs. The impact of higher employer NICs, lowering of the secondary threshold, and the rise in the NLW are anticipated to disproportionately impact lower-paid roles in labour-intensive sectors. This is exacerbated by the fact that firms have limited capacity to absorb increased costs due to squeezed margins.
- Self-employment is projected to see modest growth through 2026. We expect that self-employment as a share of total employment remains below its pre-COVID level.

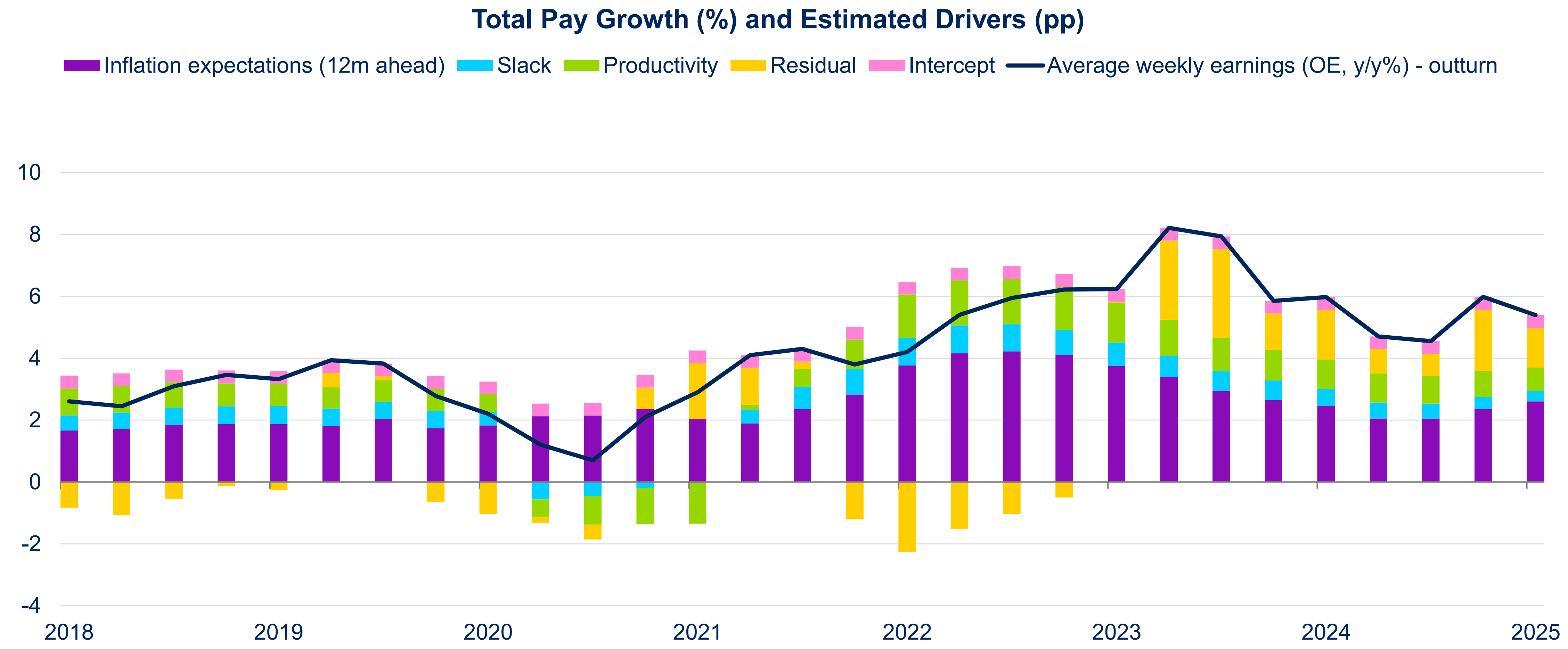
Unemployment set to rise, but remains low by historical norms



Source: ONS, Macrobond, CBI forecasts

- The ratio of job vacancies to unemployed persons has continued its downward trend in early 2025, which suggests that the labour market has been loosening.
- Looking ahead, we project that the unemployment rate will steadily increase over 2025 and then remain steady at 4.8% in 2026. This uptick in unemployment this year reflects labour supply growing to a greater extent than employment. The increase in labour supply is mostly driven by continued population growth (based on ONS projections).

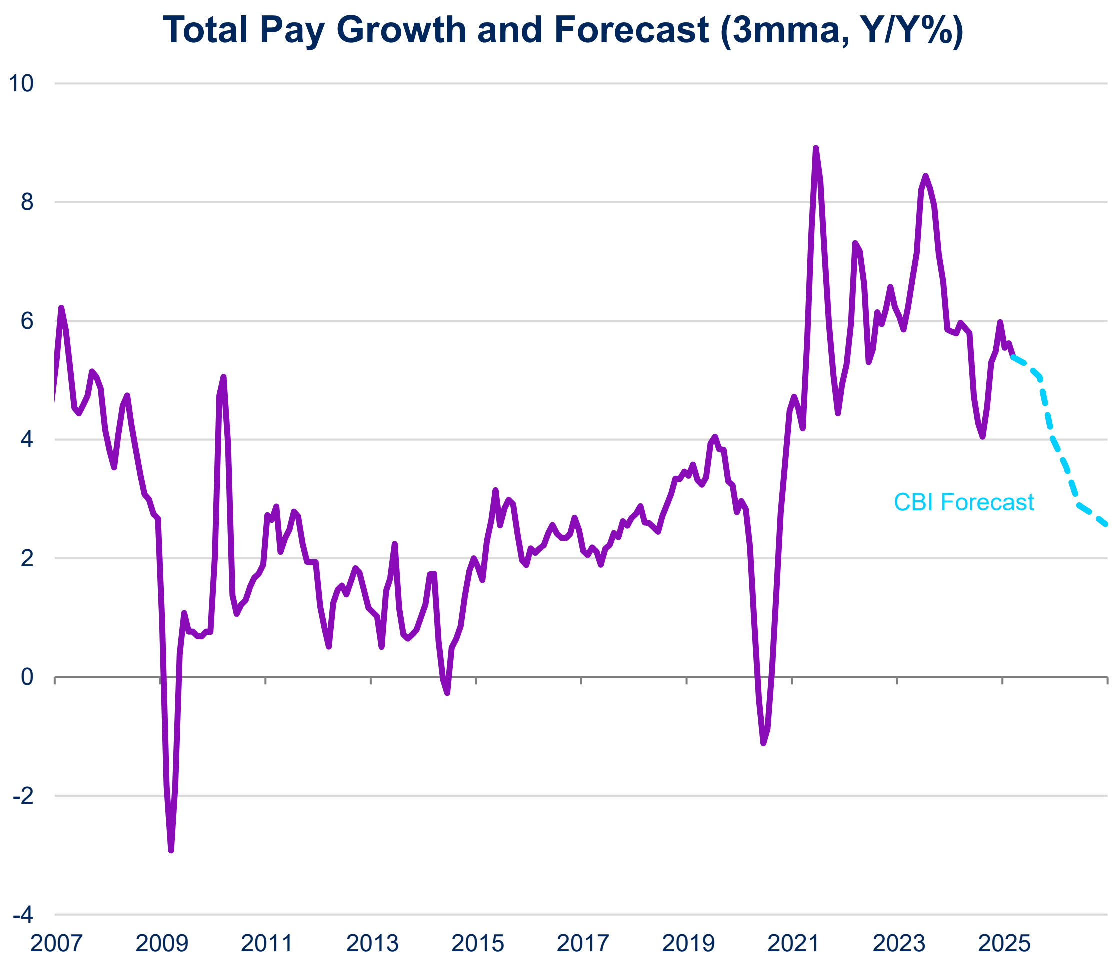
Recent pay growth has been stronger than expected



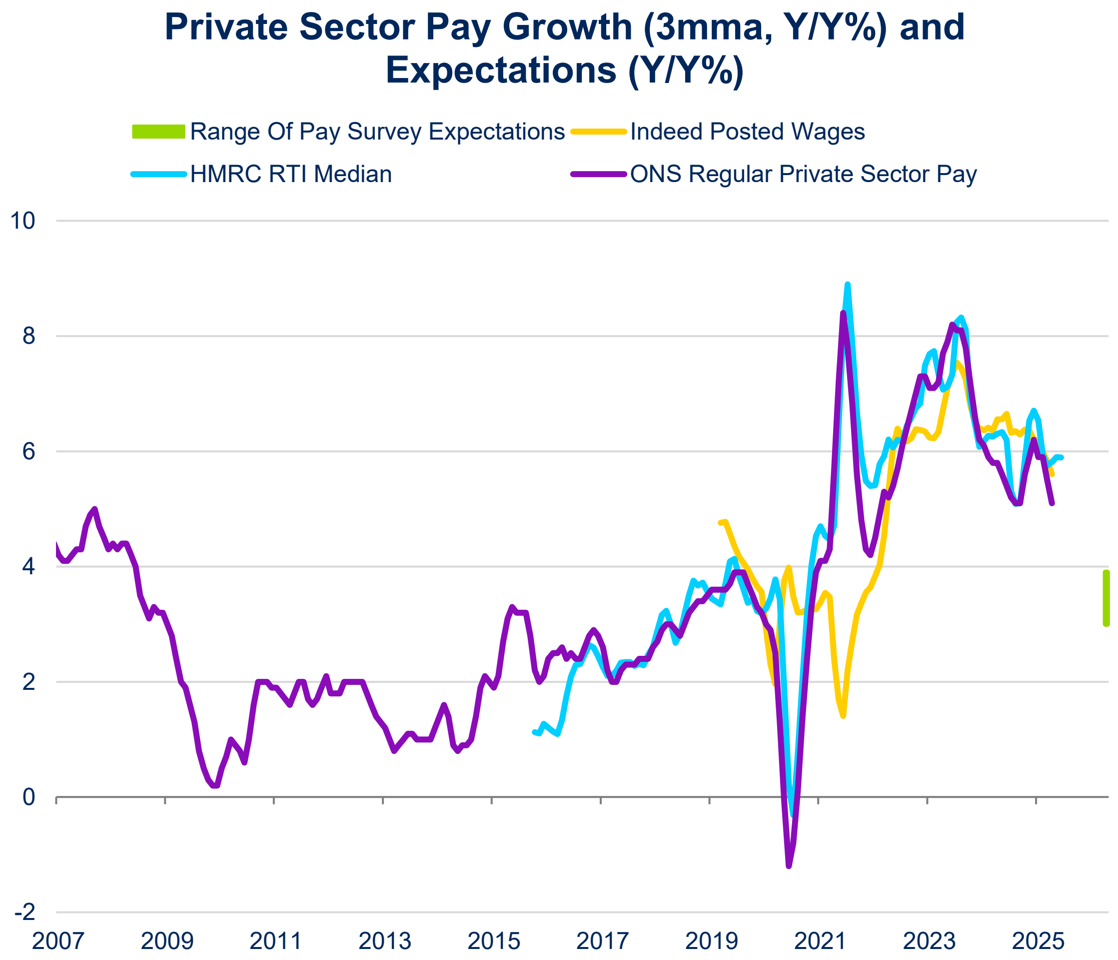
Source: ONS, YouGov/Citi, Oxford Economics Global Model, Bank of England, Macrobond, CBI analysis
Pay growth in 2020/2021 is represented by the Bank of England's estimate of underlying private sector wage growth

- Wage growth has started slowing, but it remains higher than its underlying drivers would suggest. Our analysis indicates than an "unexplained" component has kept pay growth elevated since the beginning of 2023. Bank of England research has suggested that this could be partly explained by "changes in the sectoral and full-time mix of employees" and base effects from pay growth in the past year.
- While we expect that wage growth will ease over our forecast, this "unexplained" component could put continued upward pressure on pay in the near-term.

Wage growth is still expected to slow going forward



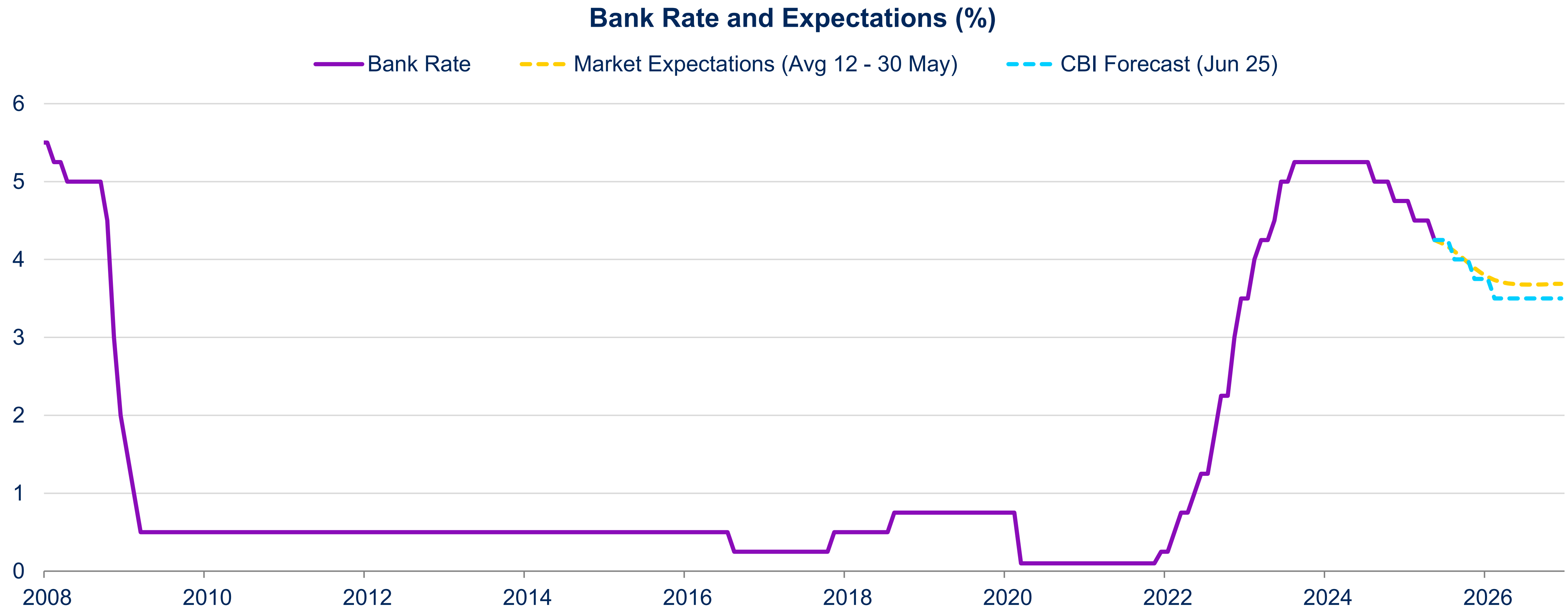
Source: ONS, Macrobond, CBI forecast



Source: ONS, Indeed, CBI, CIPD, Bank of England DMP, HMRC, Macrobond
Range of pay survey expectations indicates anticipated pay growth in next 12 months (to October 2025)

- Our forecast expects that total pay growth remains relatively firm for much of 2025 but starts to slow more noticeably from Q4 2025 onwards. The near-term persistence in pay growth reflects the (lagged) strength of recent wage increases and higher inflation expectations. Business surveys suggest private sector pay growth will be between 3-4% in the next 12 months.
- We expect that total pay growth will ease from 4.9% in 2025 to 3.0% in 2026. This slowdown reflects the combined drag from lower inflation next year, a growing measure of labour market slack, and weak potential productivity. Higher employment costs following the Budget will also likely weigh on pay growth.

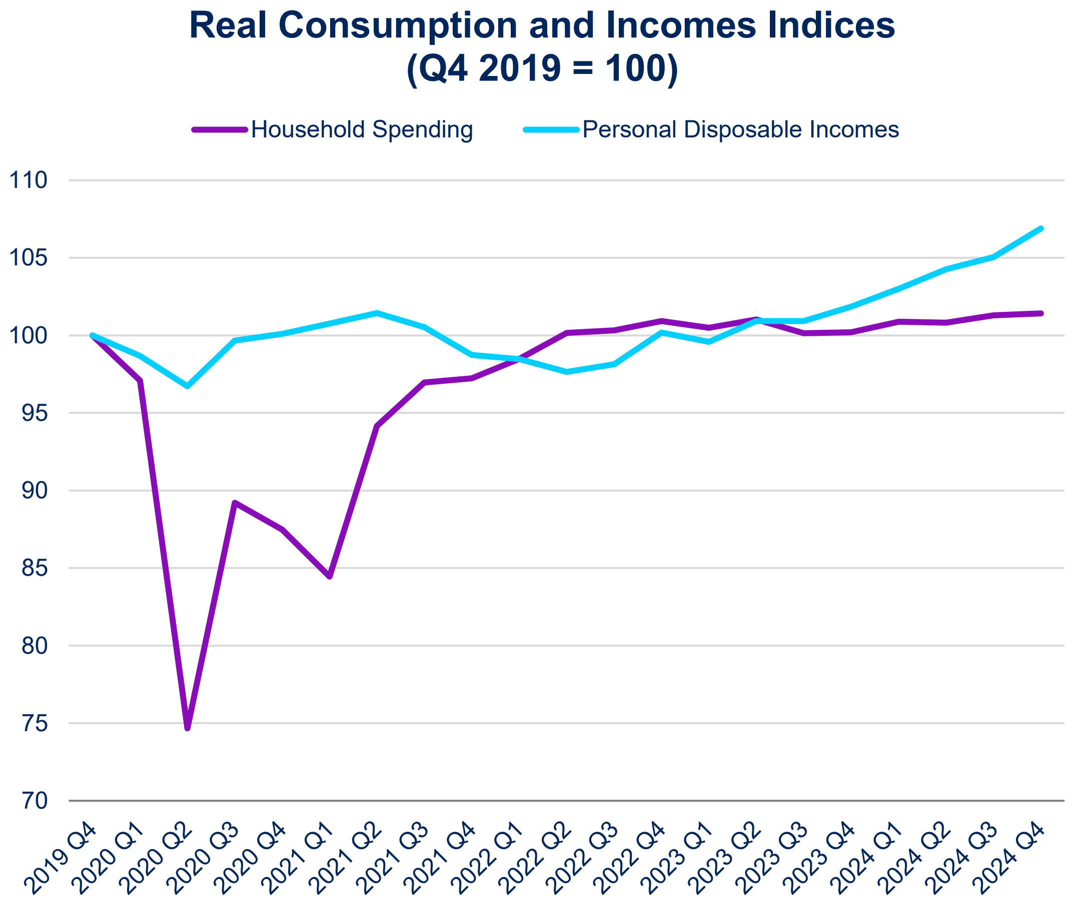
Bank Rate will be cut at a “gradual and careful” pace



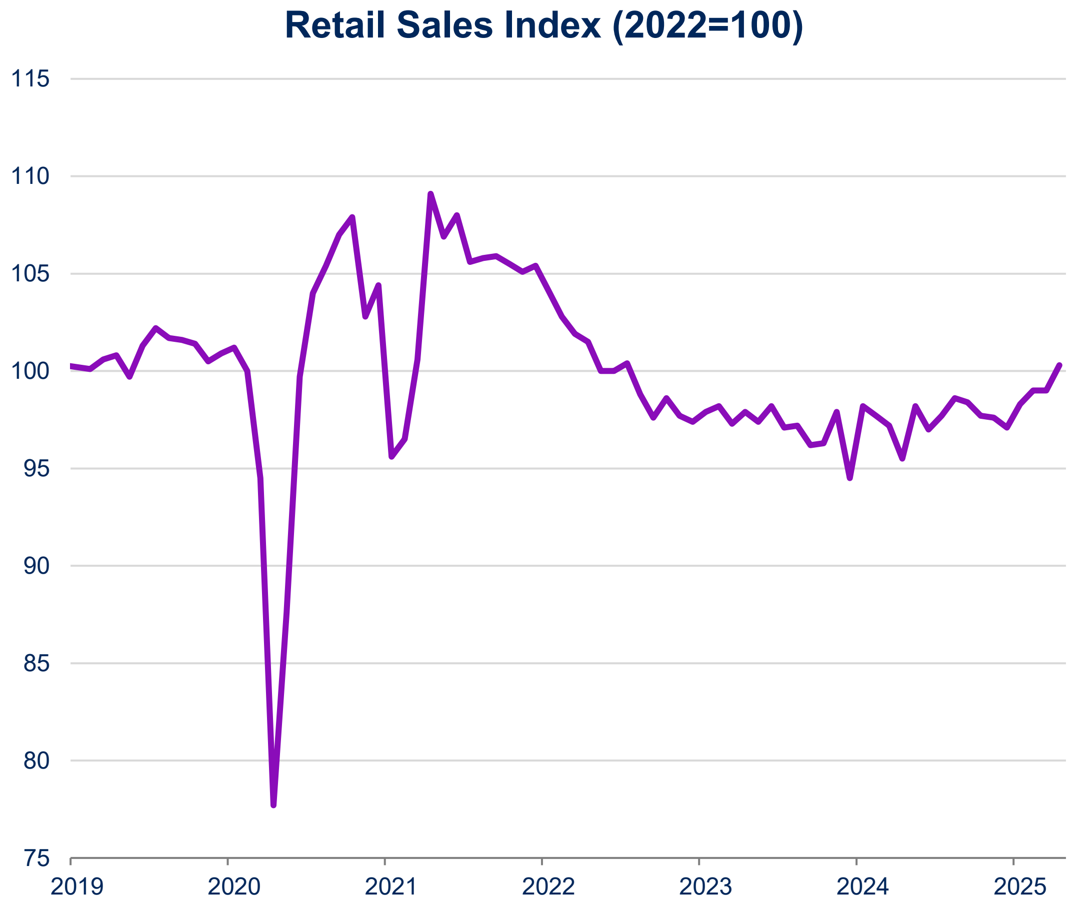
Source: Bank of England, Macrobond, CBI forecasts

- The Bank of England’s Monetary Policy Committee (MPC) has cut Bank Rate over the past year by a cumulative 100bp to reach its current level of 4.25%. The MPC has maintained its forward guidance of a “gradual and careful approach” to loosening policy in order to bring inflation back sustainably to the 2% target.
- Our forecast expects that the MPC will continue reducing Bank Rate by 25bp each quarter until it reaches a terminal rate of 3.50% in Q1 2026. The Committee has noted that it believes the near-term increase in inflation will prove to be temporary (broadly in line with our own forecast), which means that it can continue to (cautiously) cut rates this year.
- The MPC has stated that it sees “two-sided” risks to the monetary policy outlook, which could alter the pace of interest rate cuts. On the one hand, if domestic wage and price growth remain elevated, then interest rates could remain higher for longer to squeeze out inflationary pressures. On the other hand, if growth is weaker than expected, then rates could be reduced faster to support economic activity.

Mixed signals for consumer spending



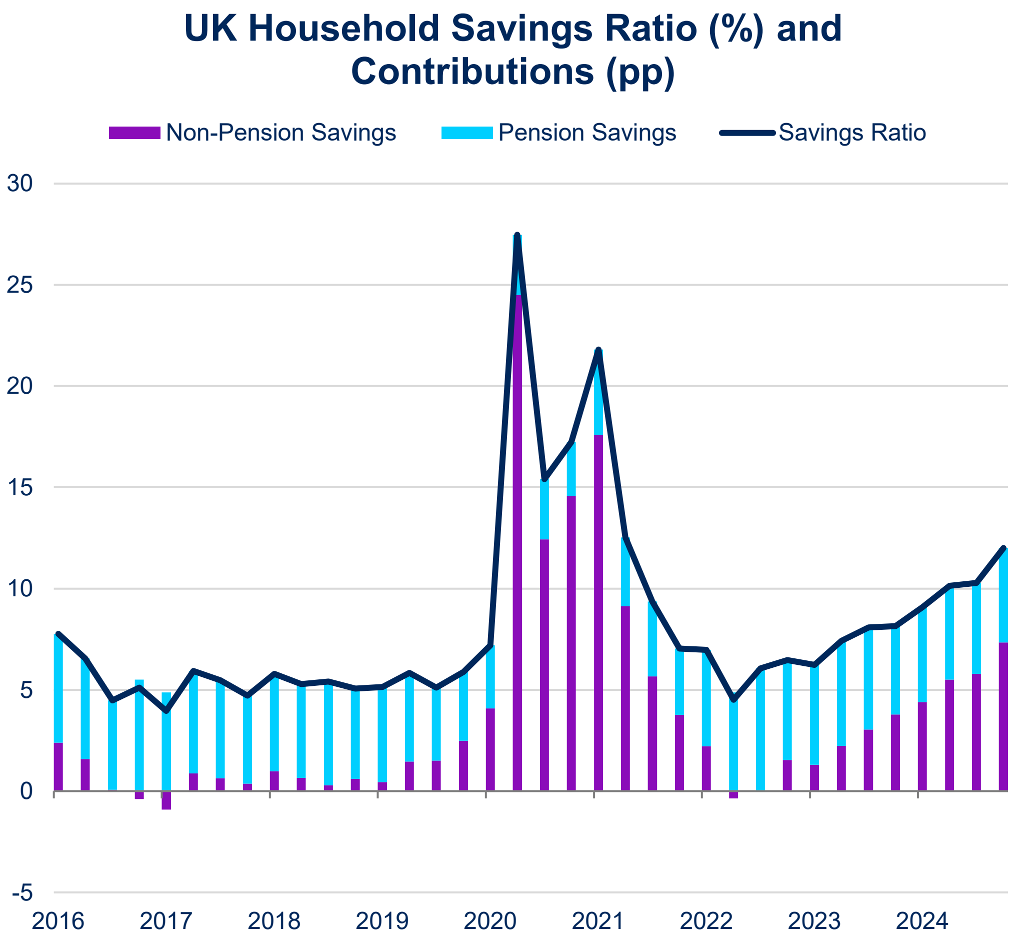
Source: ONS, Oxford Economics Global Model, CBI analysis



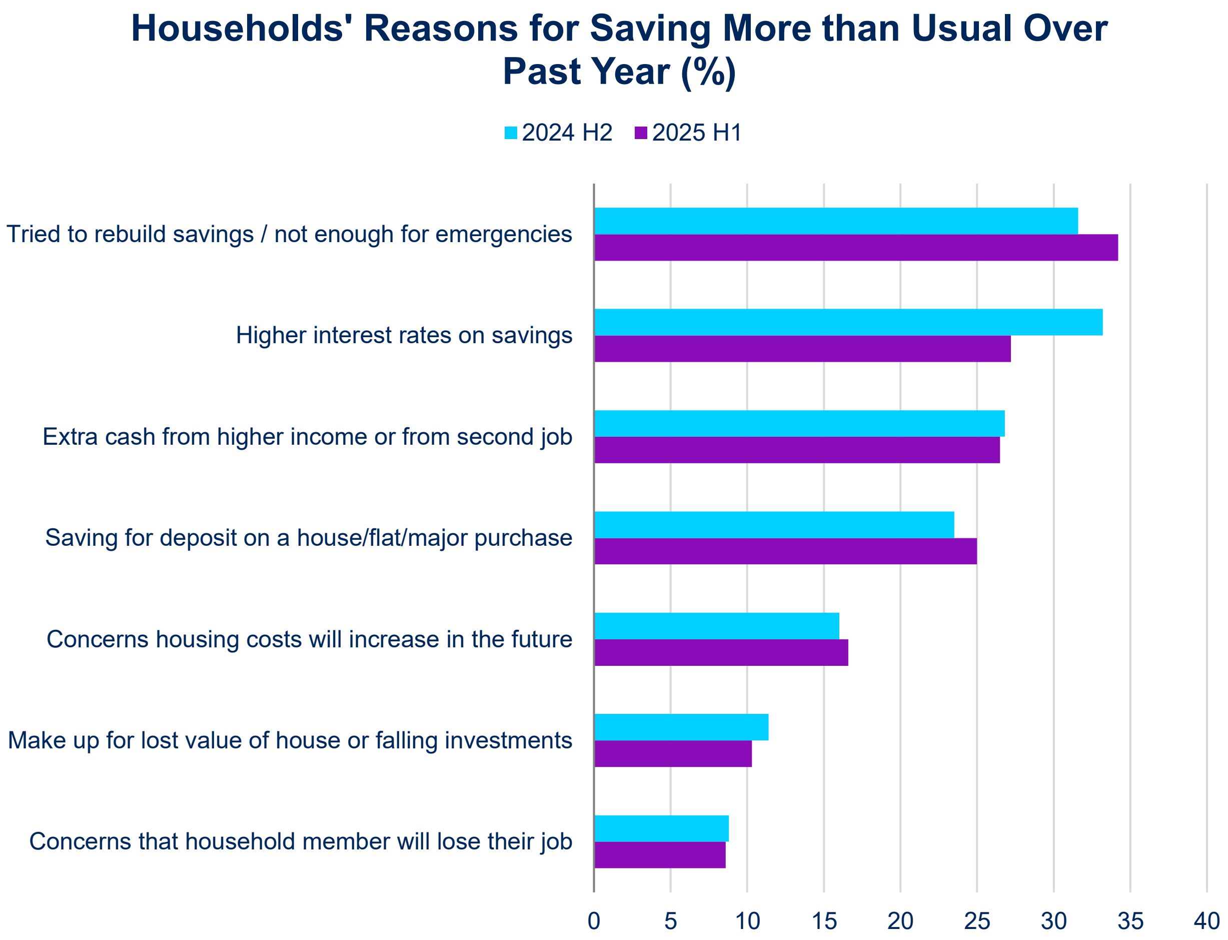
Source: ONS, Macrobond

- High interest rates and the lingering impact of elevated inflation led to many households holding back on spending in 2024. This is despite robust gains in real incomes over the past couple of years.
- Recent data on consumer spending have been giving mixed signals on the outlook. Overall expenditure figures remain weak, but retail sales growth has picked up noticeably in the last few months. Anecdotally, firms in consumer-facing sectors continue to report that gloomy sentiment is affecting demand.

Households have been building up savings buffers



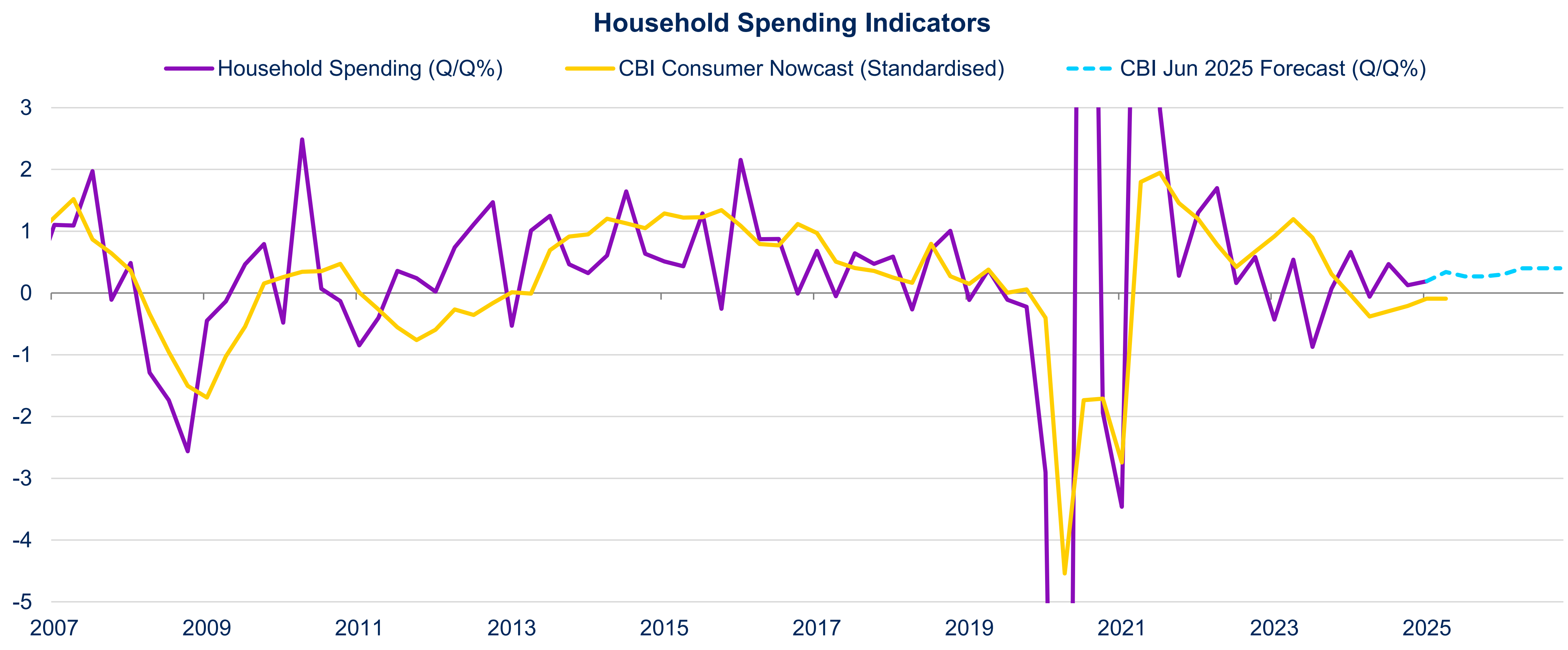
Source: ONS, Macrobond, CBI analysis



Source: Bank of England NMG Survey, Bank of England Monetary Policy Report (May 2025)

- The household savings ratio picked up noticeably over 2024, driven mostly by non-pension savings.
- Survey evidence from the Bank of England suggests that the increase in savings reflects higher interest rates and households trying to rebuild savings buffers for emergencies. There were also large shares of respondents that cited saving extra cash and keeping money aside for a large purchase as reasons for saving more than usual over the past year, which chimes with recent gains in real incomes.

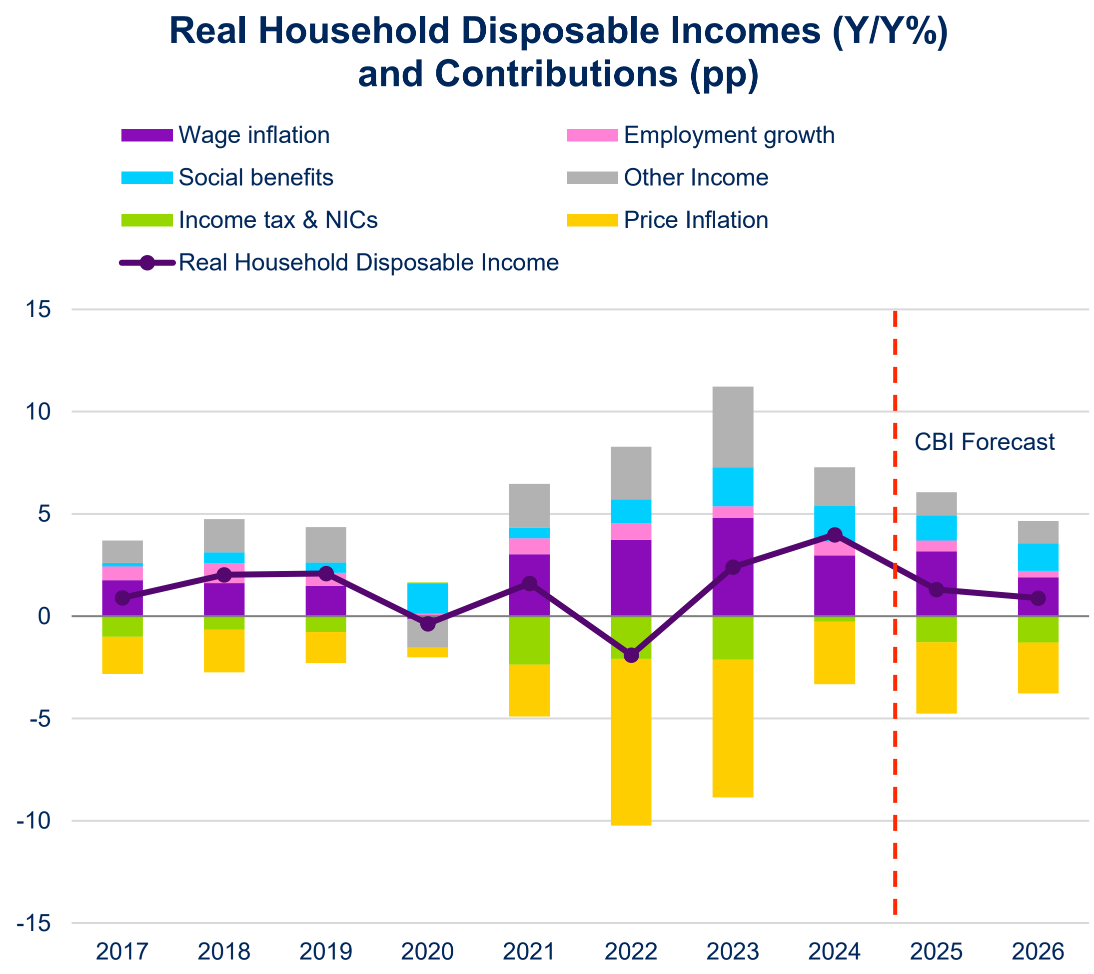
Household spending growth is expected to remain modest



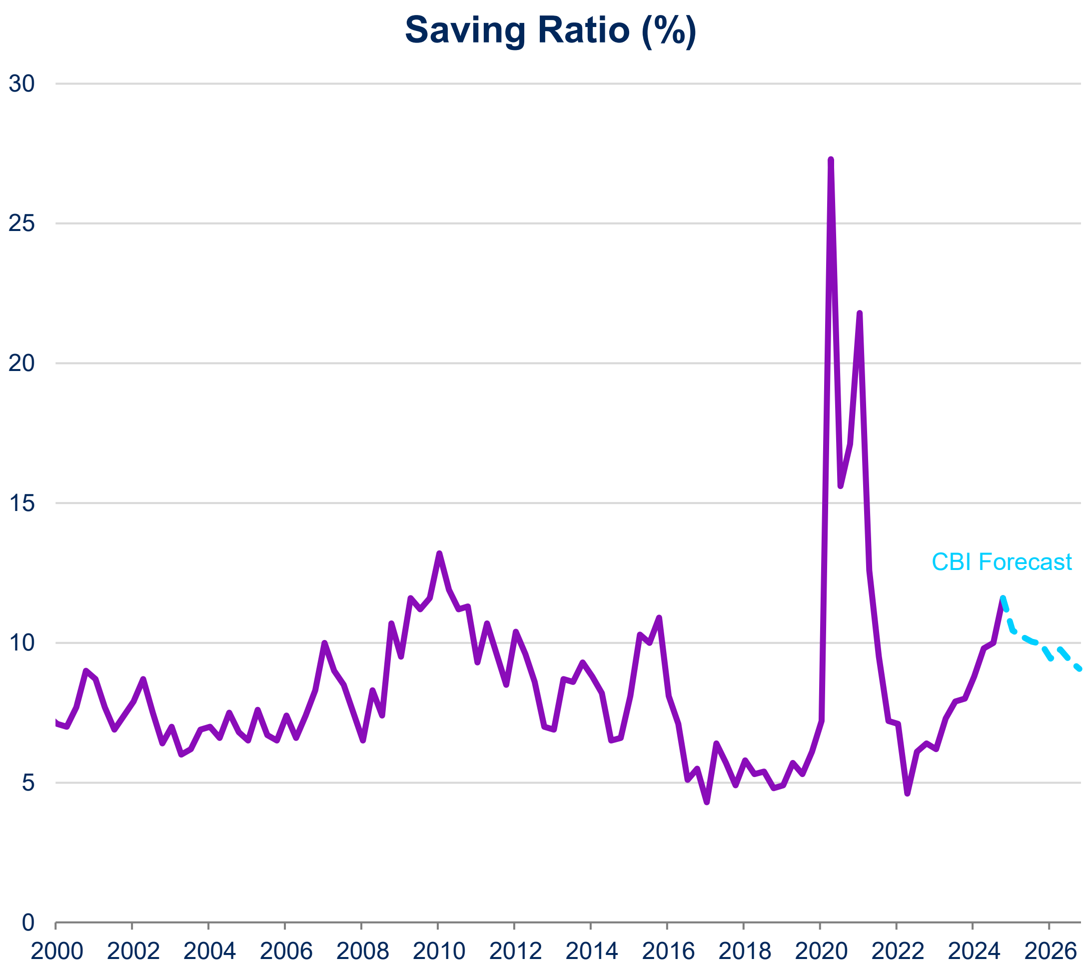
Source: ONS, CBI surveys, Bank of England, SMMT, GfK, Macrobond, CBI analysis, CBI forecast

- We expect consumer spending to pick up to a modest pace in 2025, supported by real incomes growth (on the back of real wage gains) and lower interest rates. However, labour market loosening weighs on consumption, and we expect some measure of cautious spending behaviour to persist this year.
- Spending continues to gradually gather pace in 2026, reflecting continued tailwinds from lower interest rates and incomes growth (alongside reduced inflation). However, consumption growth remains weak compared to pre-COVID norms.

Households will dip into savings as incomes growth slows



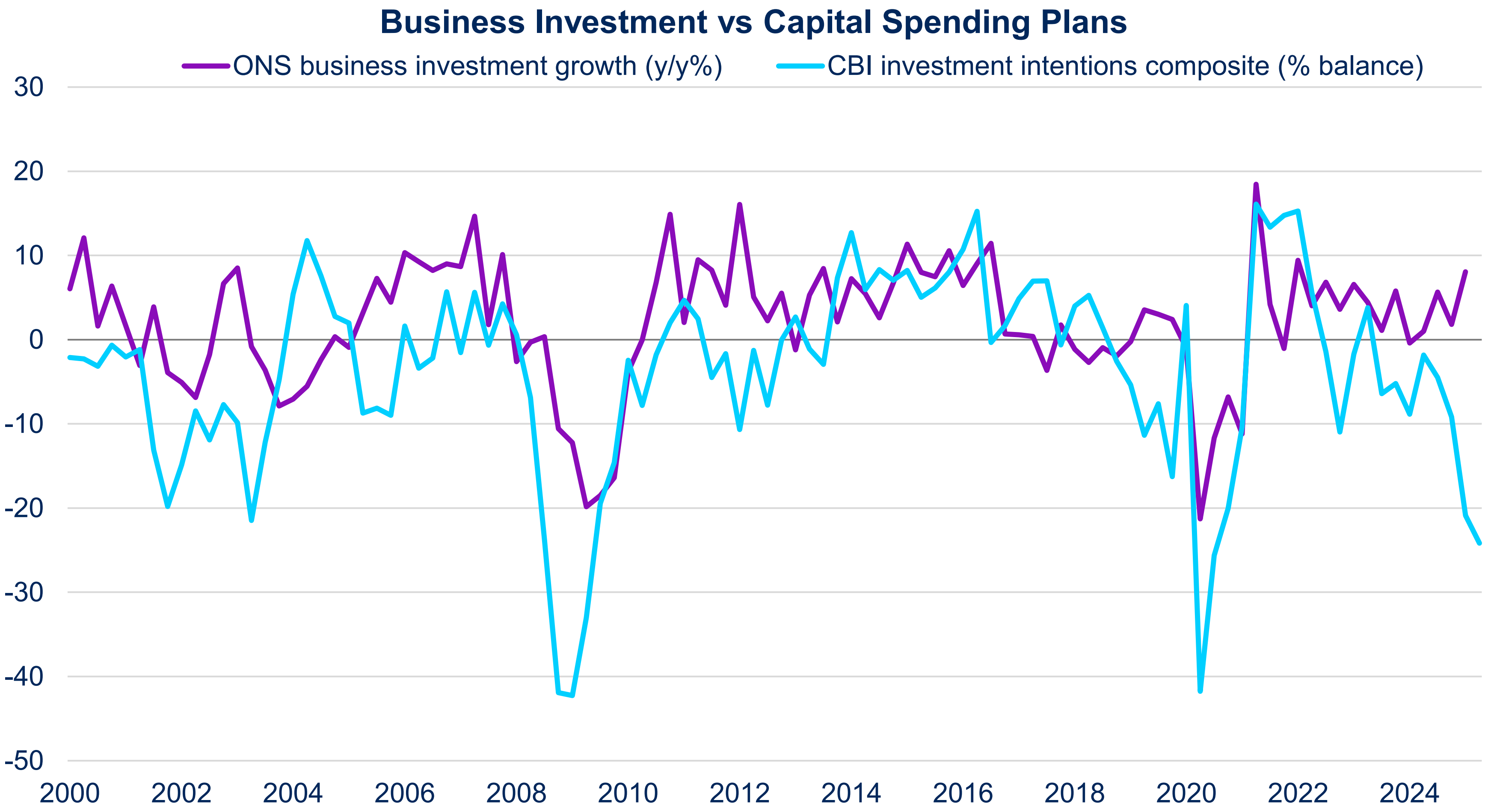
Source: ONS, Macrobond, CBI forecast



Source: ONS, Macrobond, CBI forecast

- After a strong increase in 2024, we expect real incomes growth to slow over our forecast. The main driver of incomes growth over both 2025 and 2026 is wage inflation, while price inflation is the primary drag.
- Our forecast expects that the savings ratio will gradually decline through 2026, as consumption grows by more than incomes and lower interest rates help to disincentivise saving. However, households may maintain a preference for a measure of precautionary saving going forward due to heightened global economic uncertainty.

Investment intentions have deteriorated significantly



Source: ONS, Macrobond, CBI surveys, CBI analysis

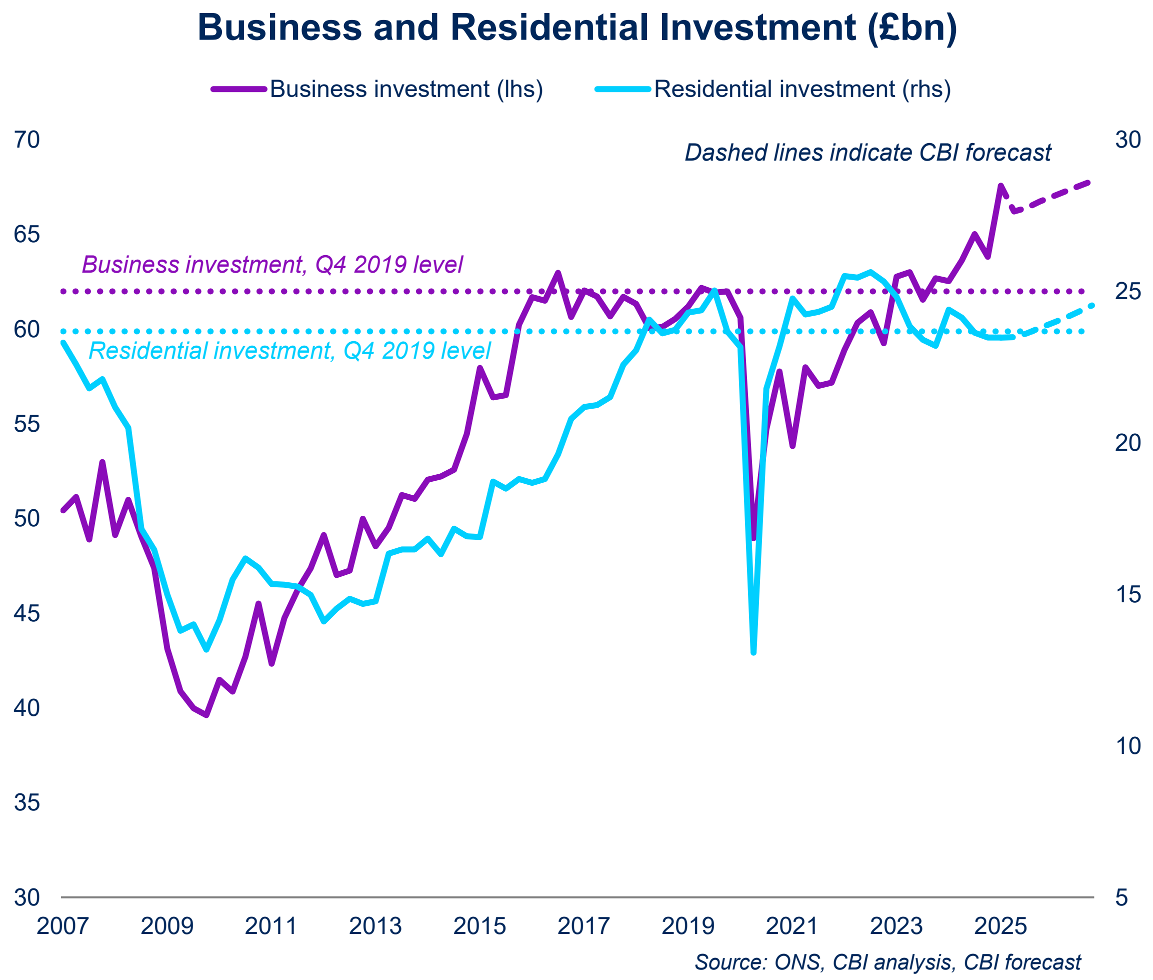
CBI investment intentions data is a composite of our manufacturing, distribution, and non-financial services surveys, weighted by each sector's share of business investment

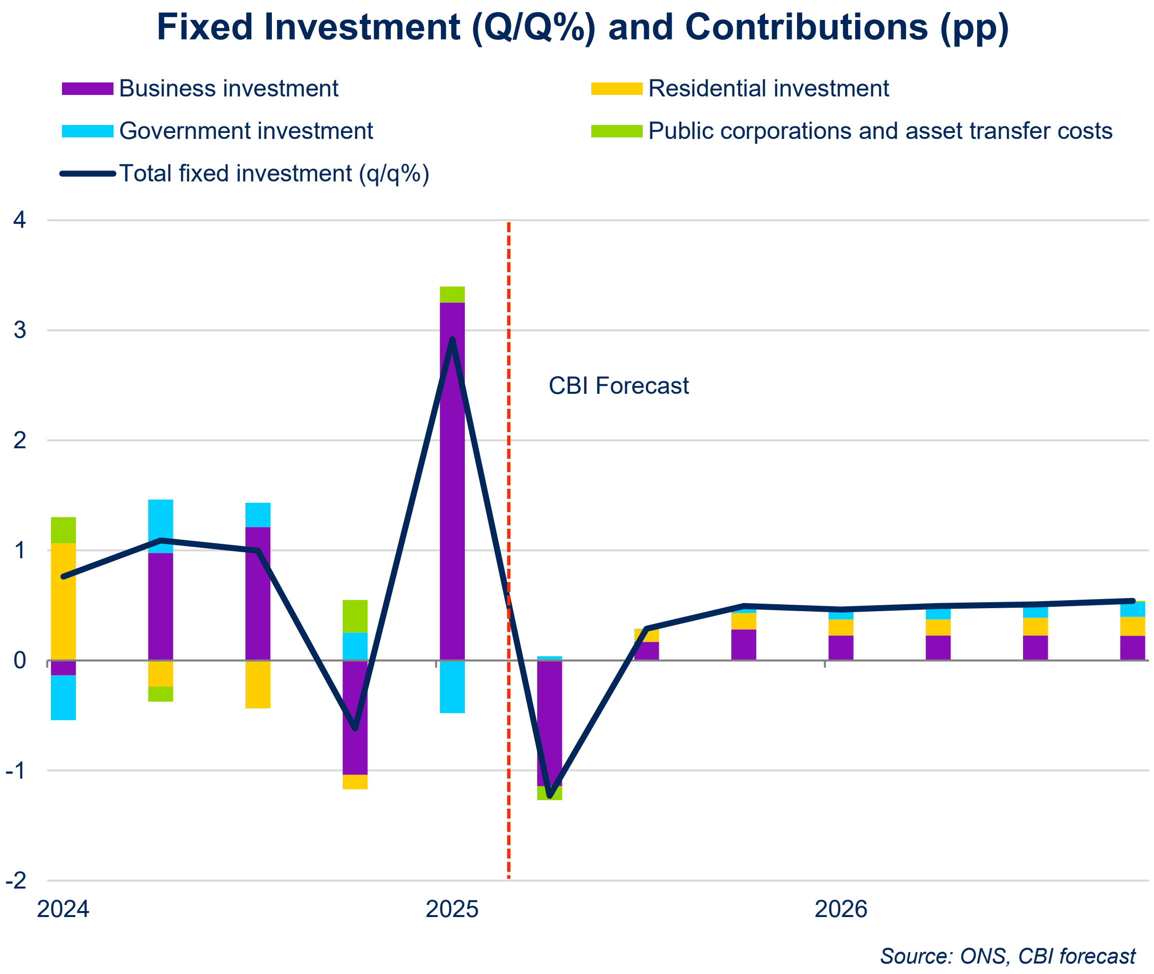
Business view

- Investment is generally subdued, with many firms in a risk-averse mindset as they face higher employment costs and tariff-related uncertainty.
- Where investment is occurring, it is generally targeted in automation, AI, or international expansion to offset domestic cost pressures.

- CBI surveys suggest that private sector investment intentions have deteriorated significantly in recent quarters. In Q2 2025, firms reported that they expected to reduce capital spending over the next 12 months (compared to the last 12 months) to the greatest extent in nearly five years. These survey data point to a noticeably gloomier picture for investment compared with official data.
- According to CBI survey data, uncertainty about demand is the most common factor expected to weigh on investment going forward. Cost of finance concerns remain elevated by historical standards, likely reflecting higher interest rates. Anecdotal evidence suggests that increased employment costs (following the Autumn Budget) and economic uncertainty are also dragging on investment plans.

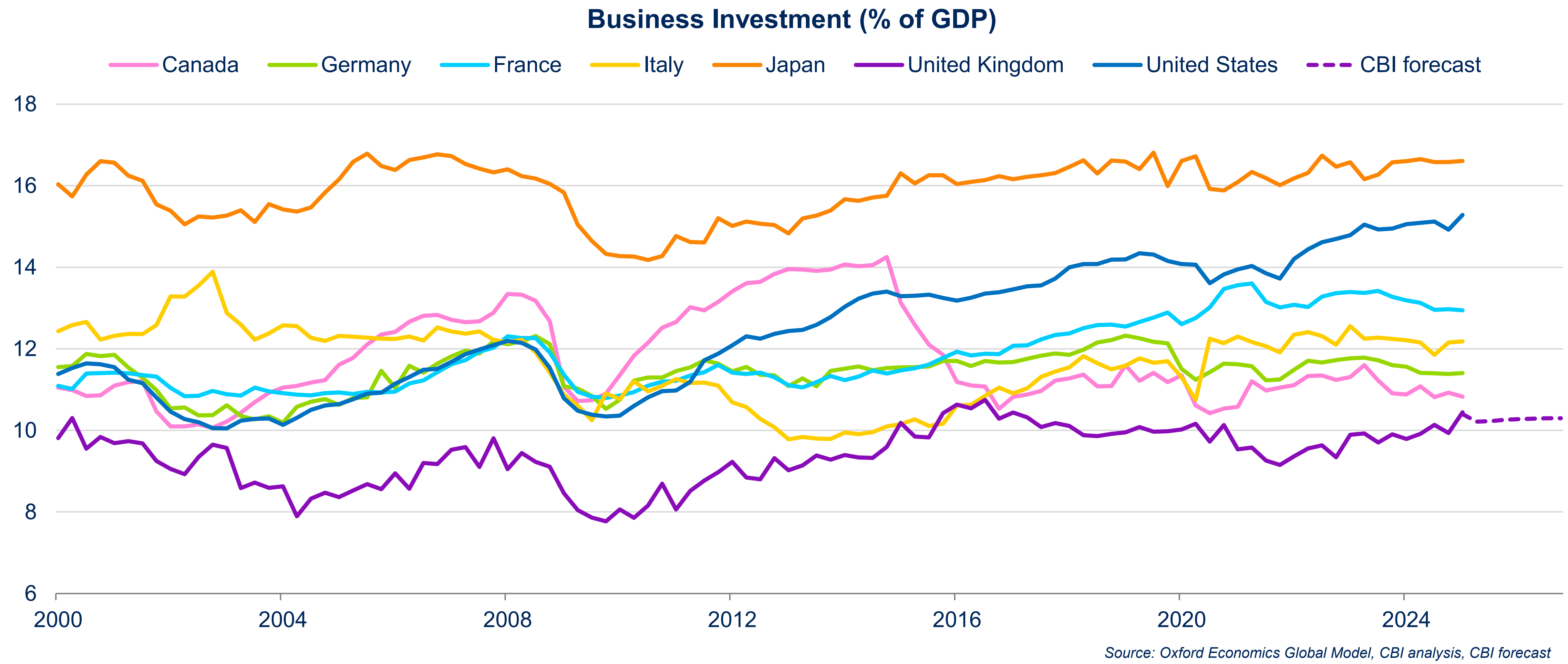
Business investment growth is expected to be modest





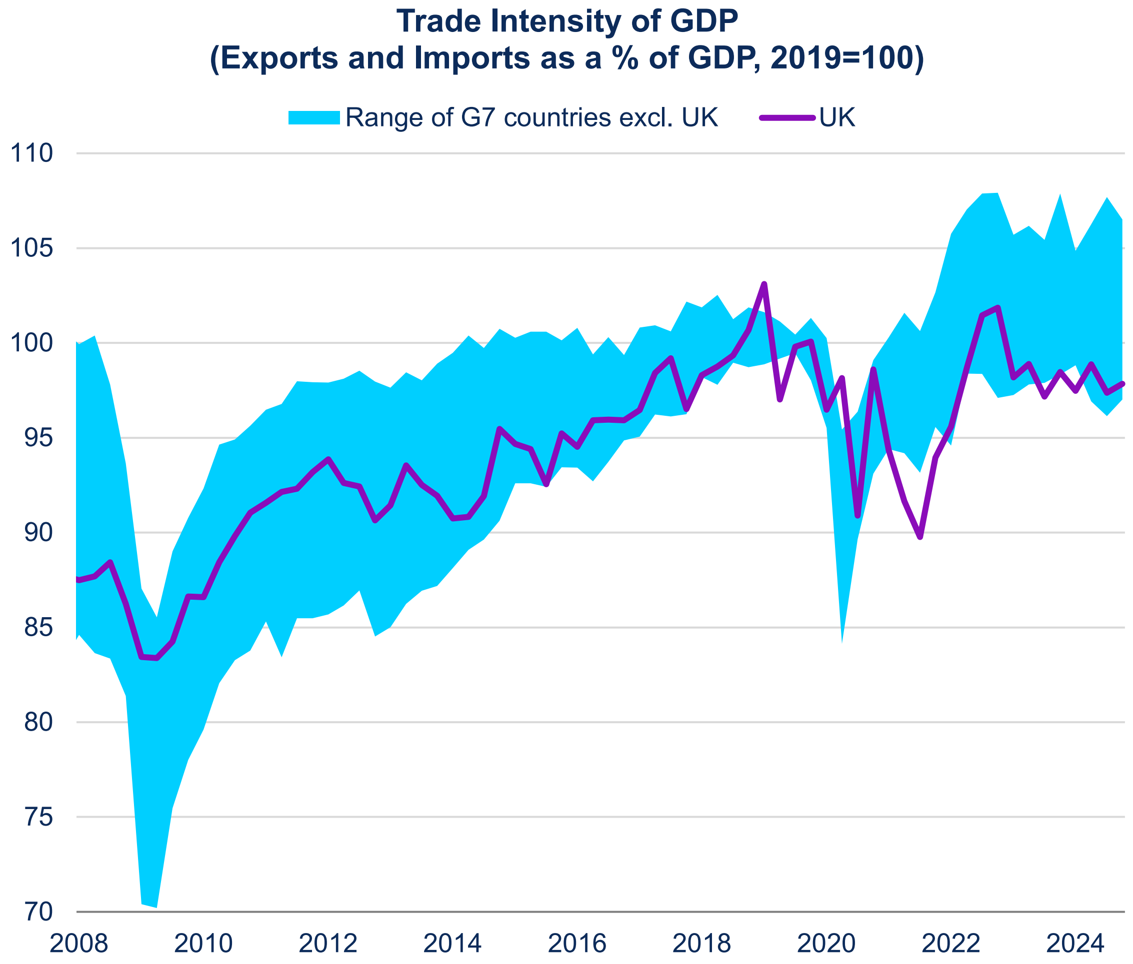
- Annual business investment growth over 2025 in our forecast is boosted by a significant increase in Q1, which was mostly due to temporary factors like aircraft purchases. Following a partial pullback in Q2, our forecast expects that investment growth will be more modest going forward. This reflects a balance of tailwinds, such as subdued GDP growth and lower interest rates, against headwinds from higher employment costs and global economic uncertainty.
- Residential investment is projected to decline slightly over 2025, before recovering next year. Government capital expenditures stagnate this year but then grow moderately in 2026.

UK business investment will remain subdued relative to peers

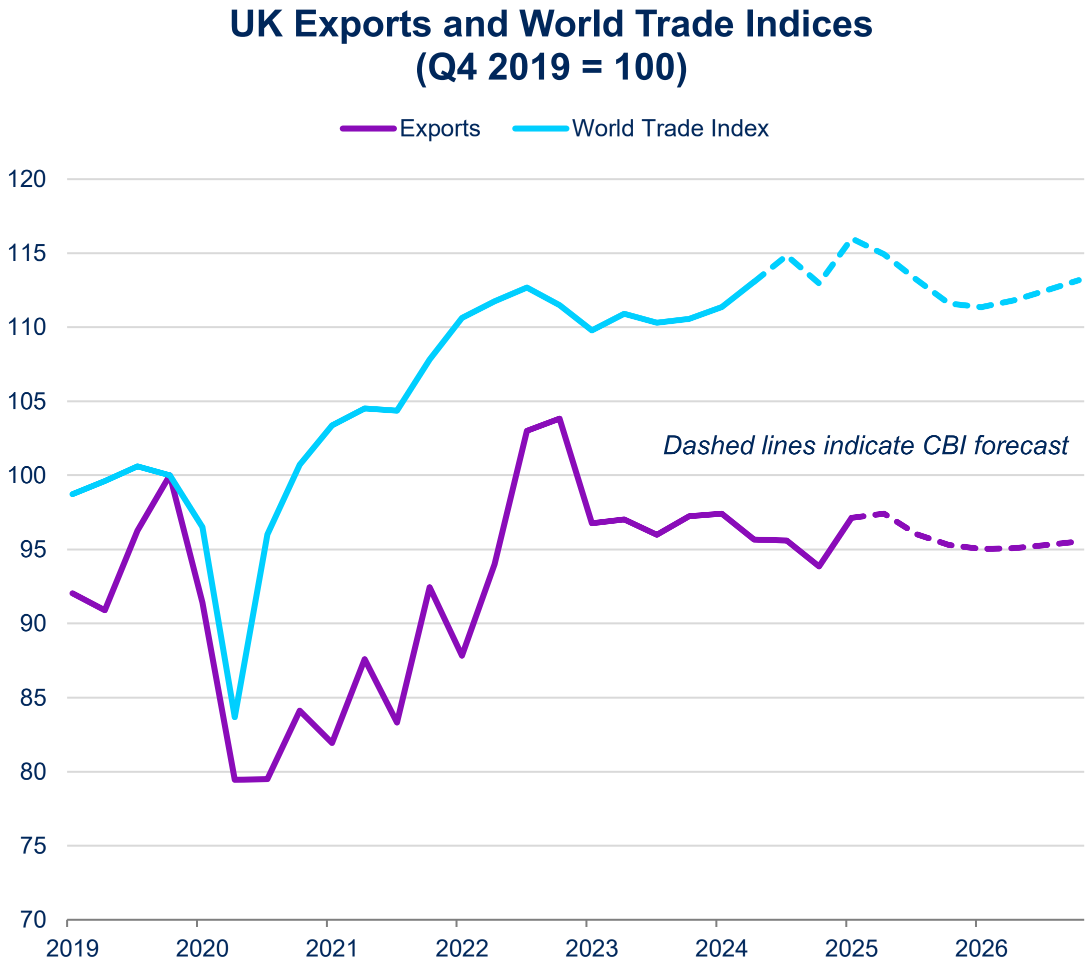


- The UK has continued to lag its G7 counterparts in business investment as a proportion of GDP. Subdued capital spending has likely acted as a drag on UK productivity and potential growth.
- We project that the UK's underperformance in business investment will continue through 2026.

Downturn in world trade will lower UK exports



Source: Oxford Economics Global Model, ONS, Macrobond, CBI analysis



Source: Oxford Economics Global Model, ONS, CBI forecast, CBI analysis

- We expect that higher US tariffs and global trade tensions will result in a downturn in world trade over our forecast. This will translate into lower UK exports growth this year and a contraction in 2026, driven by weaker non-fuel goods exports.
- Imports are also expected to soften and then fall next year, which means that net trade is projected to pose a slight drag on GDP growth through 2026.

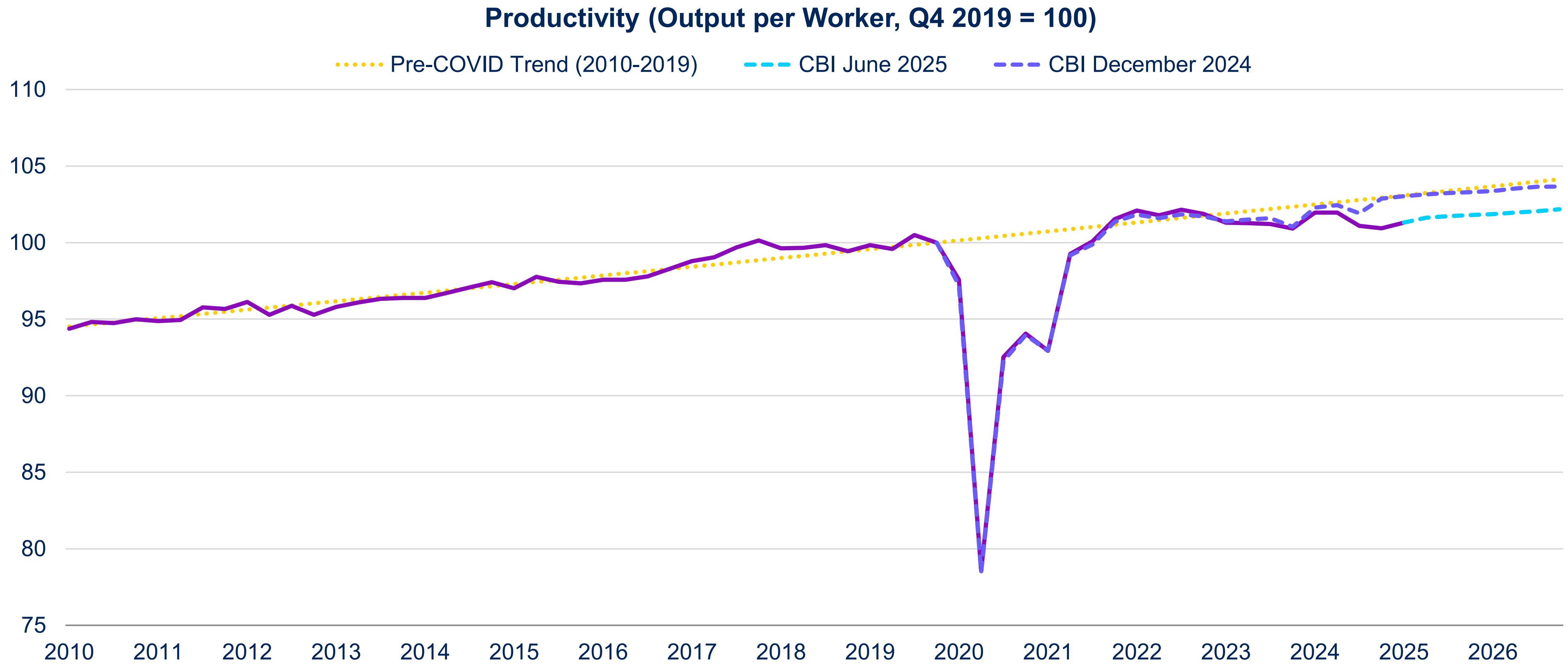
US tariffs are projected to weigh on global growth

	GDP Growth (Y/Y%) *Oxford Economics May 2025 forecast (unless otherwise stated)*		
	2024	**2025**	**2026**
Canada	1.5	0.9	0.3
Eurozone	0.8	0.9	0.9
France	*1.1*	*0.5*	*0.7*
Germany	*-0.2*	*0.0*	*0.9*
Italy	*0.5*	*0.5*	*0.5*
Japan	0.1	0.8	0.3
UK (CBI forecast)	1.1	1.2	1.0
US	2.8	1.5	1.9
China	5.0	4.3	4.0
India	6.6	6.4	6.5
World (purchasing power parity)	**3.2**	**2.8**	**2.9**

Source: Oxford Economics Global Model, CBI forecast

- We assume that the rise in US tariffs will result in a global economic slowdown through 2026. The US itself will see weaker growth due to lower demand, supply chain stress, economic policy uncertainty, and tighter financial market conditions. However, it is still projected to have the strongest growth rates in the G7 in both 2025 and 2026. The Eurozone is set to see slow but steady growth, although higher tariffs pose a downside risk to the outlook. China, meanwhile, is expected to undergo a slowdown in growth due to tariffs and trade tensions, which will be partially offset by government stimulus measures.
- Despite the modest outlook, the UK is projected to be the second-fastest growing G7 economy through 2026.

Productivity set to remain slightly below pre-COVID trend



Source: Oxford Economics Global Model, ONS, CBI forecast

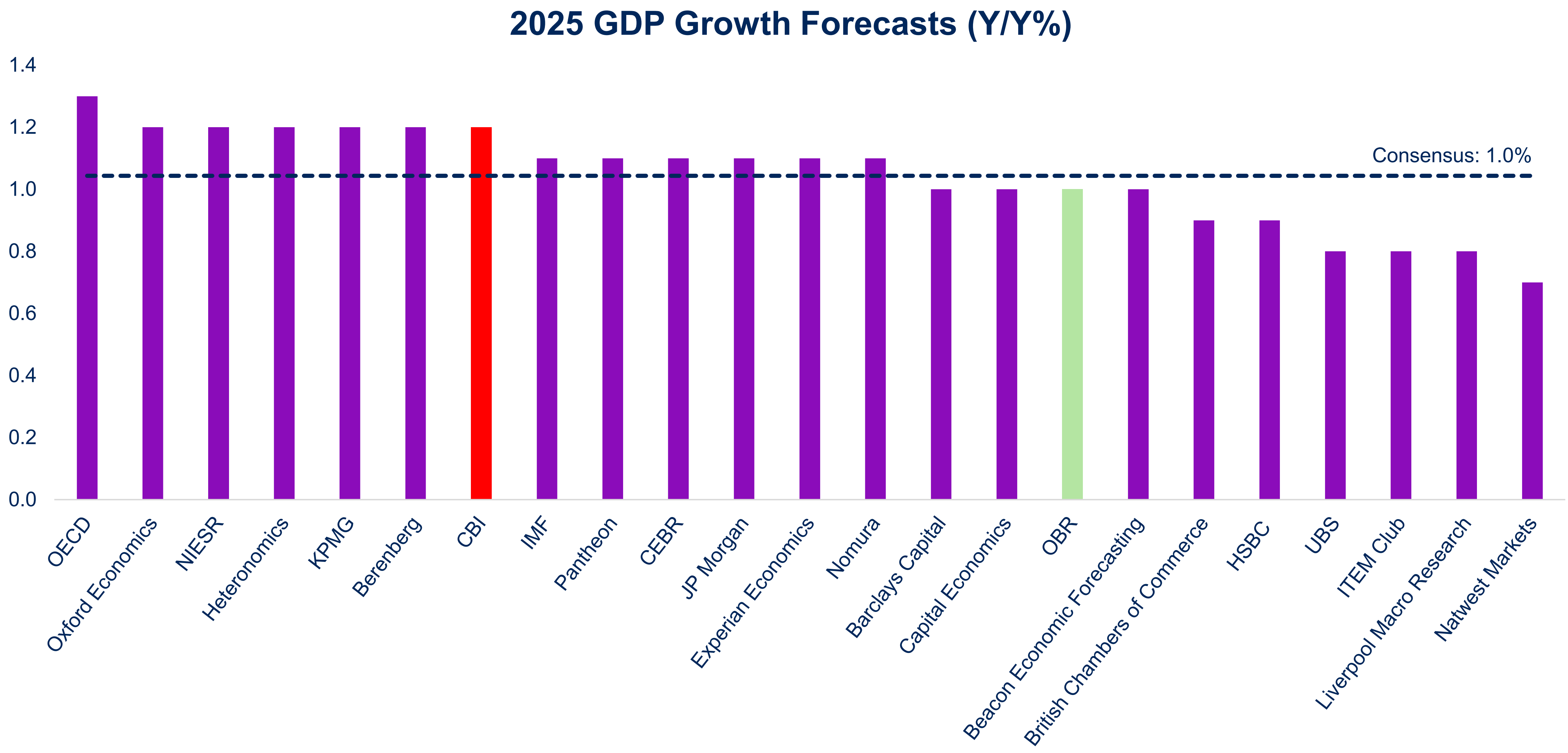
- Productivity (measured as output per work) is expected to see sluggish growth over our forecast. This weak momentum means that productivity remains 2% below its lacklustre pre-COVID trend in Q4 2026. The gap with the pre-2008 financial crisis trend is projected to persist over our forecast (24% below in Q4 2026).
- The continued trend of lacklustre productivity growth will weigh on the UK's long-term growth prospects and living standards.

CBI Economics

Martin Sartorius
Principal Economist, CBI

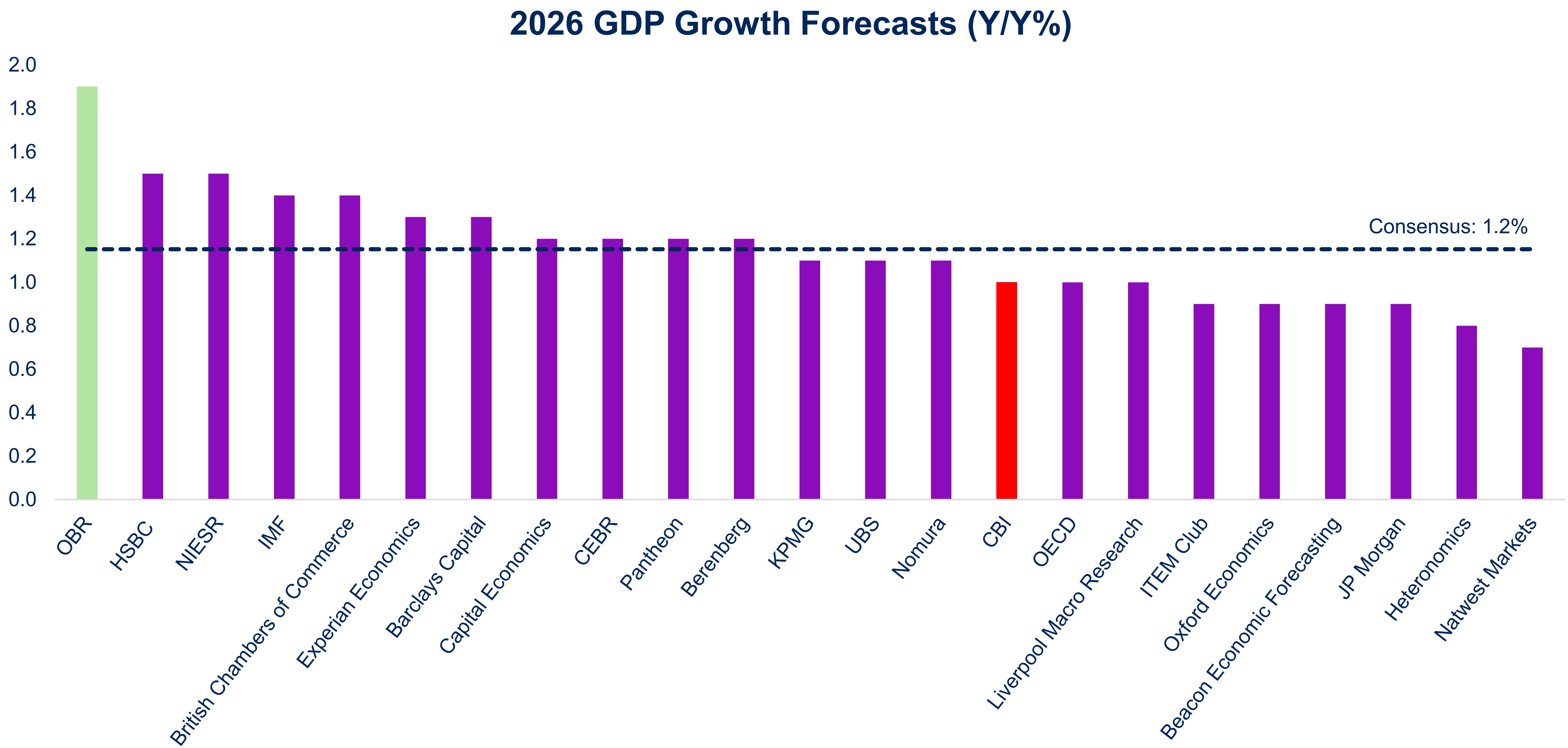
Email: martin.sartorius@cbi.org.uk
@CBI_Economics
@cbieconomics.bsky.social

CBI vs External Forecasts: 2025



Source: HM Treasury, CBI forecast

CBI vs External Forecasts: 2026



Source: HM Treasury, CBI forecast

CBI Economics

Appendix

Appendix A: Detailed Tariff Assumptions

Baseline

- US effective tariff rate declines from 18% in Q2 2025 to 14% in Q3 2025, mostly reflecting a reduction in the average tariff rate on Chinese imports (due to the China-US trade agreement). Tariff rates decline again in Q3 2026 to 11% following the renegotiation of the USMCA.
- US baseline tariffs on the rest of the world are maintained at 10%. Exemptions and universal tariffs on certain goods are expected to be maintained throughout the forecast period, at their rates as of 21 May 2025.
- China is assumed to reduce its effective tariff rate on US imports from 106% in Q2 to 30% in Q3 2025. The EU retaliates with its own 10% tariff on US imports from Q2 2025 onwards.

Lower tariffs scenario

- This scenario assumes a similar reduction in US tariffs on Chinese imports to the baseline, but it also expects the US to remove other country-specific tariffs and reduce it baseline 10% “reciprocal” tariff. This results in the US effective tariff rate declining to 7.5% by Q3 2026.
- The EU is assumed to lower its own retaliatory tariffs in response.

Higher tariffs scenario

- The US reimposes Chinese and other country-specific “reciprocal” tariffs, and it also removes exemptions for key goods. USMCA renegotiations are assumed to not materialise. As a result, the US effective tariff rate rises to 32% by Q3 2025.
- The EU, North American, and Asian economies respond with corresponding tariffs on US exports.

Source: Oxford Economics Global Model and Scenarios