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ECONOMIC RESEARCH – DECEMBER 2025

INVESTMENT INSIGHT UK

- ✓ The UK misses out on the hoped-for rebound in Q3
- ✓ A difficult end to the year for UK growth

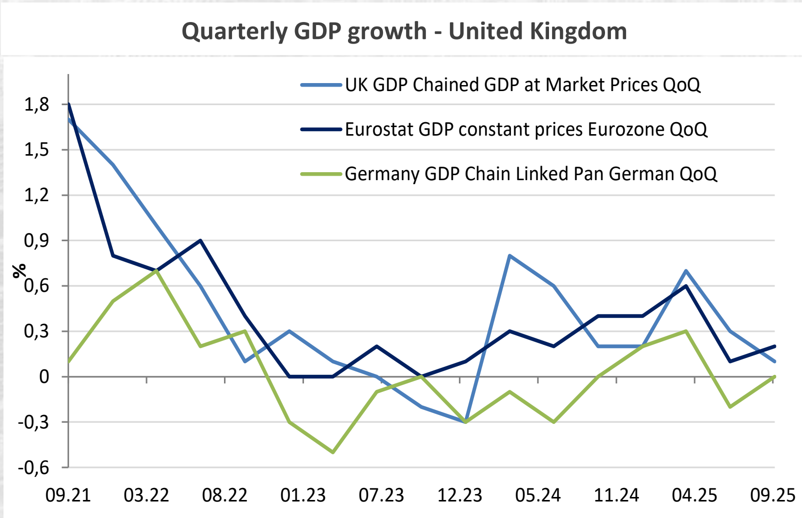
THE BOE WILL LOWER ITS KEY INTEREST RATES SOONER THAN EXPECTED

UK growth deceleration unexpected stalling in Q3

The UK economy stalled sharply in Q3, with GDP growth falling to just +0.1%, well below the +0.2% consensus and the BoE's +0.4% expectation. This reversal follows a strong first half of the year and is primarily driven by global trade tensions and weak external demand affecting the productive sector. Consequently, we have revised our 2025 annual growth forecast downward to a range of +0.9% to +1.0%.

Industrial contraction vs service sector resilience

A deep divergence has emerged between the UK's core economic segments. While the services sector managed a marginal expansion of +0.2%, industrial production suffered a sharp decline of -0.5%, acting as a significant drag on the broader economy. Manufacturing activity was further hampered by idiosyncratic shocks, including a prolonged five-week cyberattack on Jaguar Land Rover, which exacerbated existing supply chain vulnerabilities. This industrial fragility highlights the UK's susceptibility to both external demand fluctuations and operational disruptions in a high-interest-rate environment.



Sources : Bloomberg, BBGI Group

Investment paralysis geopolitical and fiscal uncertainty

Business investment remains a critical weak spot, showing no signs of recovery after a significant -4.0% drop in the preceding quarter. Geopolitical instability and domestic fiscal concerns have effectively frozen large-scale capital projects. Business sentiment was particularly impacted by anticipated tax increases, which created a "wait-and-see" attitude among corporate leaders. This marks the second consecutive quarterly decline in investment, suggesting that the private sector is currently unwilling to commit capital until there is greater clarity regarding the government's long-term fiscal trajectory and global trade relations.

Consumption headwinds and real income erosion

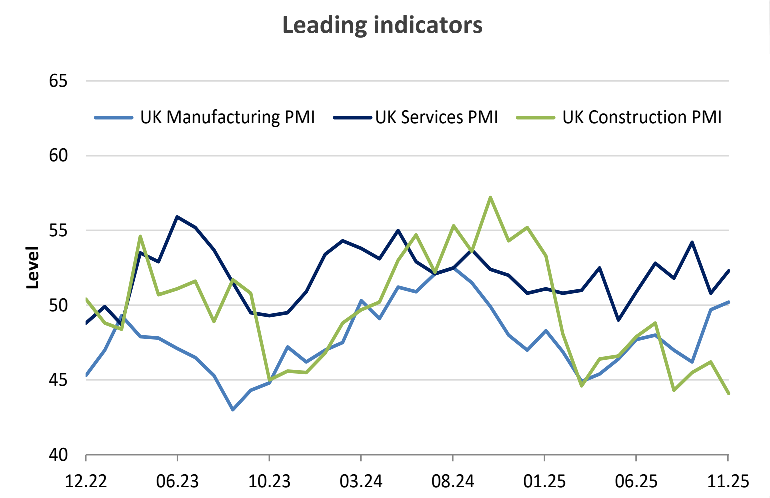
Household consumption, traditionally a reliable engine of growth, is showing signs of exhaustion. Despite an estimated 6% increase in real income over the last two years, actual consumption grew by only 1%, suggesting a significant shift toward precautionary savings. Retail sales plummeted by 1.5% in October alone, while net consumer credit and mortgage approvals both registered declines. This caution is reinforced by a cooling housing market, with property prices falling 1.8% in November according to Rightmove data. The erosion of purchasing power, driven by persistent inflation and high debt-servicing costs, remains the primary risk for the final quarter.

Labor market cooling and services sector slide

The UK labor market is beginning to show tangible signs of stress, with October reporting a loss of 32,000 jobs and a rise in unemployment benefit claims from 25,800 to 29,000. This cooling is mirrored in the services sector PMI, which slipped from 52.3 to 50.5 in November, nearing the threshold of contraction. As the labor market loses its tightness, the virtual safety net that supported domestic demand is fraying. This shift suggests that the UK is entering a period of near-stagnation, where the lack of employment growth could turn a cyclical slowdown into a more entrenched downturn.

Inflationary pressures and the BoE dilemma

Although inflation moderated to +3.6% in October due to base effects, the underlying trend remains worrying with a month-on-month increase of +0.4%. Price levels remain well above the Bank of England's target, complicating the path for monetary easing. The BoE finds itself in a precarious position: maintaining high rates to combat stubborn inflation risks stifling the remaining life in the economy, while cutting rates prematurely could de-anchor inflation expectations. While a December rate cut might not alter Q4 figures, it is increasingly seen as a necessary psychological tool to restore momentum for the start of 2026 and prevent a technical recession.



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