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INVESTMENT INSIGHT UK

- ✓ **Slowing services sector clouds the outlook**
- ✓ **End of resilience in the labor market**
- ✓ **Household confidence erodes**
- ✓ **Inflation shows insufficient signs of easing**
- ✓ **BoE set to change tone**

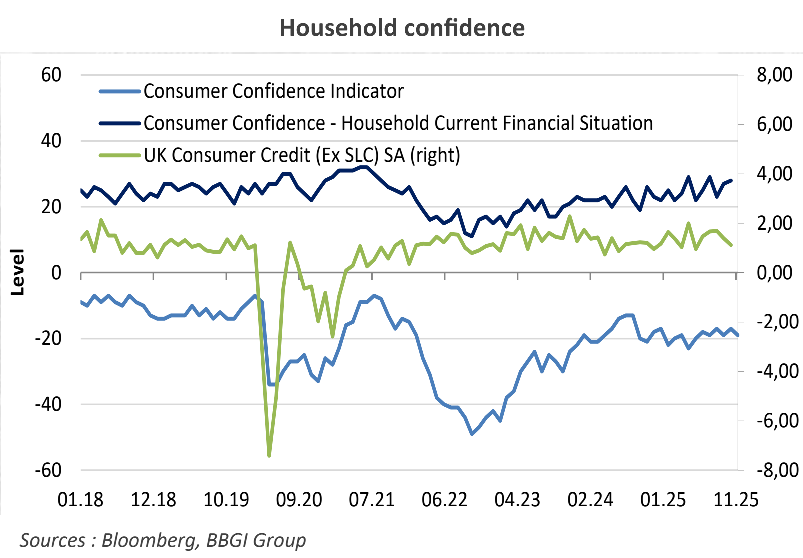
THE BOE WILL LOWER ITS KEY INTEREST RATES SOONER THAN EXPECTED

Sectoral convergence toward stagnation

The latest S&P Global/CIPS PMI indices for November reveal a decisive shift in the UK's economic trajectory. The dynamic service-led growth observed in early 2025 has largely dissipated, replaced by a convergence toward stagnation. While the composite PMI remains marginally resilient, the services sector—the primary engine of the UK economy representing 80% of GDP—has stalled at a PMI of 50.5. This notable break in momentum suggests that post-election euphoria has been superseded by the cold reality of budgetary constraints and global headwinds, leaving the outlook for the fourth quarter hanging by a thread.

Fragile manufacturing rebound vs service stalling

In a rare reversal of recent trends, the manufacturing industry has returned to expansion territory for the first time in 14 months with a PMI of 50.2. This technical rebound is supported by necessary inventory rebuilding and a slight uptick in domestic demand for goods. However, this recovery is inherently fragile and insufficient to offset the significant slowdown in services. Service providers appear to have adopted a cautious "wait-and-see" posture, primarily due to the uncertainty surrounding the Autumn Budget and the imminent increase in National Insurance Contributions.



Sources : Bloomberg, BBGI Group

Erosion of labor market resilience

Qualitative surveys indicate a marked deterioration in the employment landscape. Job vacancies have hit a four-and-a-half-year low after four consecutive months of decline, shifting bargaining power back to employers. This is no longer mere cost management; the manufacturing sector's 13th month of job losses suggests a structural hemorrhage. Companies are reluctant to hire as they anticipate the massive cost shock of April 2026, where the combined impact of increased employer contributions and a 4.1% minimum wage hike will act as a direct tax on employment, forcing firms to treat headcount as a primary adjustment variable to protect margins.

Deteriorating household confidence and discretionary spending

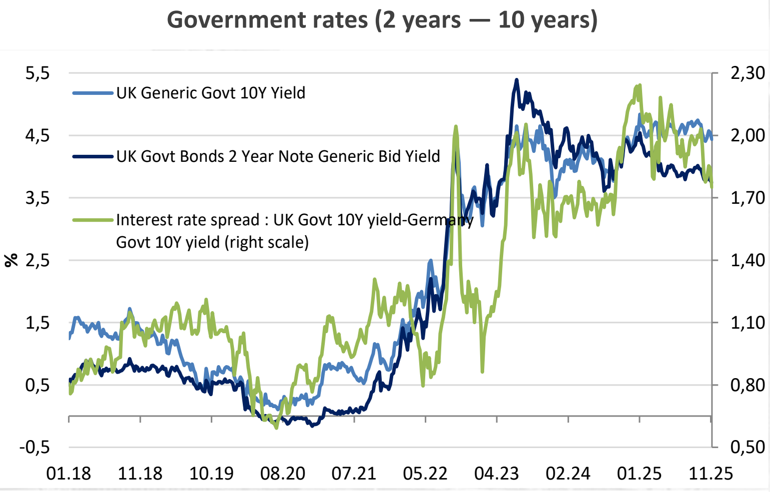
Consumer morale has been severely impacted by fiscal realities, with the GfK NOP index falling to -19 in November. This decline is particularly concerning as it occurs during the traditionally optimistic pre-holiday season. Discretionary spending is being postponed, as evidenced by a 3-point drop in the Major Purchases Index. Households are caught between the "reality shock" of the new budget and persistent inflation anchored above 3.5%. Consequently, the savings rate is approaching 10%—well above the historical 6-8% average—as the public prioritizes precautionary liquidity over consumption, a trend reflected in disappointing early Black Friday volumes.

Sticky service inflation and collapsing pricing power

While the headline battle against hyper-inflation appears won, the UK has entered an insidious phase of "core stickiness." CPI remains at 3.6%, masking a dichotomy where goods prices are falling due to weak demand, while service inflation remains stubbornly near 5%. More worrying is the Producer Price Index (PPI) trend: import costs are rising due to energy spikes and a weaker pound, yet factory gate prices remain stagnant. This suggests a total collapse in pricing power; companies are being squeezed by rising inputs but cannot pass costs to a fragile consumer base, leading to a significant contraction in corporate profitability.

Monetary policy pivot: The BoE crossroads

The Monetary Policy Committee (MPC) is approaching a definitive crossroads as restrictive interest rates create a high real-rate environment that actively holds back economic activity. We anticipate a fundamental shift in the Bank of England's (BoE) tone, as the risks to growth now demonstrably outweigh the risks to inflation. While a rate cut is necessary to inject liquidity and lower Gilt yields, the persistence of service inflation remains the final hurdle. We expect the BoE to lay the groundwork for easing at its December meeting, with a 25-basis point cut likely deferred until February 2026 to ensure inflationary stability.



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