

Q3 UK economic outlook: AI holds the score, but inflation bites back

Executive summary

The global economy is navigating disruptions caused by the US-Iran conflict and rising trade tensions, but AI investment is providing a strong economic cushion. For the UK, the picture is one of resilient but sluggish growth, sticky inflation, and a Bank of England forced into action. The baseline remains intact – and we've set out clear steps to help you stay ahead this quarter.

1 Growth holds, but modestly

We forecast **UK GDP growth of +1.0% in 2026** (down from +1.3% in 2025), recovering to +1.4% in 2027.

- Government infrastructure spending is providing a floor, but private sector activity remains weak
- Household spending (around +1.0%) is supported by public sector wage hikes – a welcome near-term boost, though not yet a structural recovery
- The residential sector faces notable headwinds from elevated input costs and higher mortgage rates

2 Inflation: The late sting

Although the UK's inflation path is stickier than the Eurozone's, it's still heading in the right direction.

- **Headline inflation: +2.9% in 2026**, easing to +2.5% in 2027, reaching +1.9% by Q4 2027
- Ofgem utility price cap hikes in July and September 2026 will delay the pullback of energy inflation
- Wage growth is proving more persistent than expected, and inflation expectations have started to drift upward

3 Bank of England: One more hike, then hold

A 25bps hike is expected in September, pushing Bank Rate to 4.00%. Rates may then hold through to September 2027, with two cuts in H2 2027 bringing Bank Rate to 3.50% by year-end. UK monetary policy is already more restrictive than the Fed or ECB in real terms. The September hike is more about anchoring expectations than catching up.

4 AI & the UK labour market: The structural offset

- AI is expected to lift UK labour productivity by +3.4% over the next decade, one of the strongest gains in Europe
- Total AI-driven GDP impact over the next 10 years: +1.7%
- Employment effect is moderately negative at -1.1%, meaning AI is expected to displace some roles over the decade

The 'So What?' for UK businesses

- 1. Budget for sticky inflation:** Ofgem hikes mean H2 may feel worse than H1. Plan for 2.9% average inflation and borrowing costs at or above 4%.
- 2. Stress-test your rate exposure:** With Bank Rate at 4.00% and Gilt yields at 4.80%, any refinancing or variable-rate debt is materially more expensive.
- 3. Manage credit risk proactively:** Insolvencies remain elevated across Western Europe (+2% in 2026). A proactive approach to managing customer credit risk is now essential.

Not sure how the UK outlook could impact your business this quarter?

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