Allianz

Allianz Trade

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?
Find out how Allianz Trade can help you safeguard cash flow and make confident growth decisions in any economic climate: Request a call back

JULY 2026