UK Economic Outlook

Quarterly Report
Q1 – 2025

Turning Point
INTERNATIONAL REWARD SPECIALISTS

Contents

Executive Summary

At the time of our last report, the UK economy was steadily returning to normal after the volatile post-pandemic years. Inflation, interest rates and wage growth had all fallen during 2024 and were set to continue stabilising through 2025 and beyond. GDP growth remained low and sluggish, but an anticipated 'sugar rush' of higher growth was due to hit the economy through 2025 and 2026.

So where are we today?

While the trends are still broadly on track, the economic outlook is now noticeably less rosy than it seemed three months ago. Now, the Bank of England has revised down its GDP growth forecasts and is predicting higher inflation rates through 2025. At the same time, wage settlements have risen faster than expected, and unemployment is now slightly higher.

These forecasts reflect a general reduction in the global economic outlook. With US and retaliatory tariffs now in effect (for now, at least), we can expect overall GDP growth and trade prospects to be lower. At the same time, the rise in global energy prices has already had an outsized influence on UK inflation rates.

But there are also other trends at play here that are far less global. In the UK, employers are facing significantly higher National Insurance costs from April 2025. At the same time, the National Minimum Wage and National Living Wage are both set to rise by the largest amount for some years. Together, these two factors have had a noticeable impact on the overall economic outlook.

But there are silver linings. Crucially, growth is still expected to increase in the short term, albeit by less than originally expected. At the same time, higher inflation and wage costs aren't predicted to continue past 2025. There are also increasing signs of life in sectors like construction, where direct Government investment is increasing.

Nonetheless, it's clear we're living through difficult and volatile economic times. For businesses across the UK, caution and restraint will remain the watchwords of 2025.

Introduction

According to recent Bank of England (BoE) forecasts, GDP is now expected to be lower than expected in 2025, and inflation will be higher.

As we can see in the following table, GDP growth is now predicted to be 0.4% in Q1 2025, before rising to 1.5% in Q1 2026, 1.3% in Q1 2027 and 1.8% in Q1 2028. This is a notable reduction from the estimates three months ago, when the figures were 1.4% for Q1 2025 and 1.6% for Q1 2026.

At the same time, CPI inflation rate forecasts have increased since the last report. Now, inflation is expected to hit 2.8% in 2025, before rising to 3% in 2026 and falling again in 2027. This is up from the forecasts of 2.4% and 2.6%, respectively, in last quarter's report.

Despite this surprisingly high inflation, interest rates are still expected to continue falling and are currently predicted to reach 4% at the start of 2028. This is largely because the Bank of England doesn't expect higher inflation rates to stick, and therefore hasn't raised interest rates in order to bring them back down.

In the labour force, supply and demand forces are broadly in alignment, but demand has reduced slightly since the last report. This reflects a general weakening in employment prospects ahead of April's rise in employment costs.

TABLE 1. Forecast summary, Q1 2025 - Q1 2028. *Source: World Bank.*

	2025 Q1	2026 Q1	2027 Q1	2028 Q1
GDP (c)	0.4 (1.4)	1.5 (1.6)	1.3 (1.1)	1.8
CPI inflation (d)	2.8 (2.4)	3 (2.6)	2.3 (2.1)	1.9
Unemployment rate (e)	4.5 (4.1)	4.5 (4.2)	4.8 (4.3)	4.8
Excess supply/**Excess demand** (f)	-¼ (0)	-½ (-¼)	-¾ (-½)	-¼
Bank Rate (g)	4.6 (4.4)	4.2 (3.7)	4.1 (3.6)	4

Economic Outlook

> ***"The level of GDP is estimated to have been broadly flat since March 2024, and a range of recent data suggests that the labour market is continuing to loosen.***
>
> ***Business survey indicators of output growth have deteriorated over recent months, as have broader metrics of business and consumer confidence, which would be consistent with a recent slowdown in demand."***
>
> Bank of England, Monetary Policy Report, February 2025

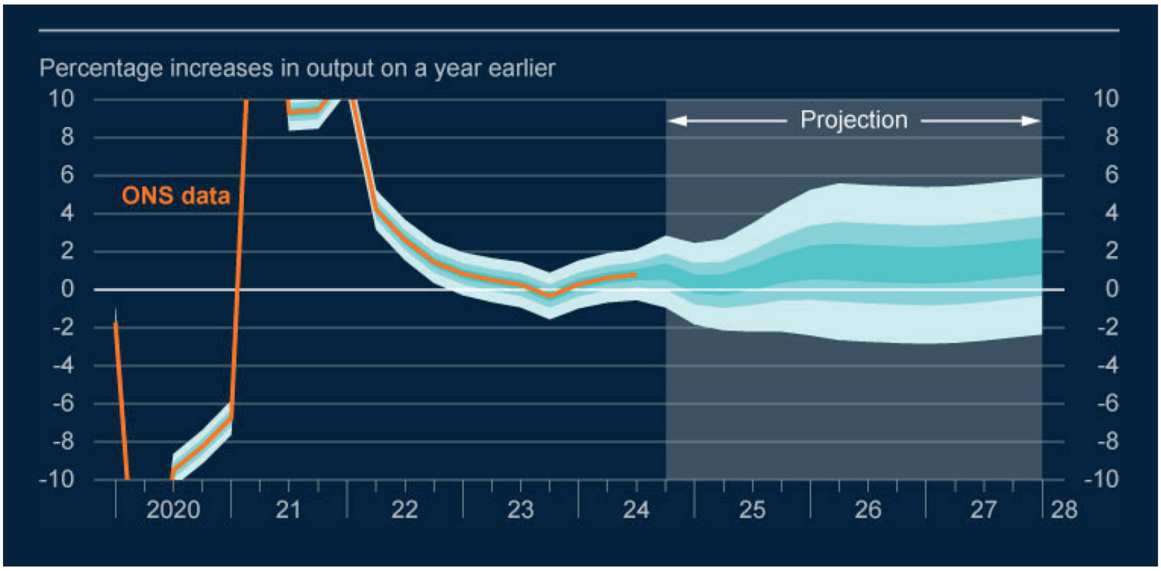
The economic outlook in the UK looks somewhat less optimistic than it did three months ago.

In its November report, the Bank of England forecasted economic growth of 1.4% for Q1 2025, 1.6% for Q1 2026 and 1.1% in Q1 2027. This is notably higher than the GDP growth we've seen in recent years. The predictions reflected an anticipated short-term 'sugar rush' effect, in response to increasing Government spending in the 2024 Budget.

On current projections, this short-term growth effect is now forecast to be lower than initially expected. While the Bank of England is still anticipating the 'sugar rush', the forecasts have been notably downgraded, to 0.4% in 2025, 1.5% in 2026 and 1.3% in 2027.

There are several reasons why the economic outlook is now less optimistic. Business and consumer confidence is weaker than expected, likely due to the volatile global trade situation. The rise in employment costs via National Insurance and the National Minimum/Living Wage has also likely contributed to a weaker economic outlook.

FIGURE 1. GDP growth projection, 2024-2028. *Source: World Bank.*



Inflation

Across 2024, inflation continued its trend of steadily climbing down from its 2022 peak of over 10%. By all accounts, CPI inflation was expected to continue stabilising around the Bank of England's 2% target through 2025.

Now, it seems inflation has taken a surprising turn back in the other direction. At the end of 2024, the CPI rate is forecast to have risen for the first time since 2022. This year, it's expected to continue rising, reaching 2.8% (Q1 2025), 3.5% (Q2 2025), 3.7% (Q3 2025) and 3.5% (Q4 2025).

TABLE 2: CPI inflation forecast overview, 2025-2028. *Source: World Bank.*

(a)

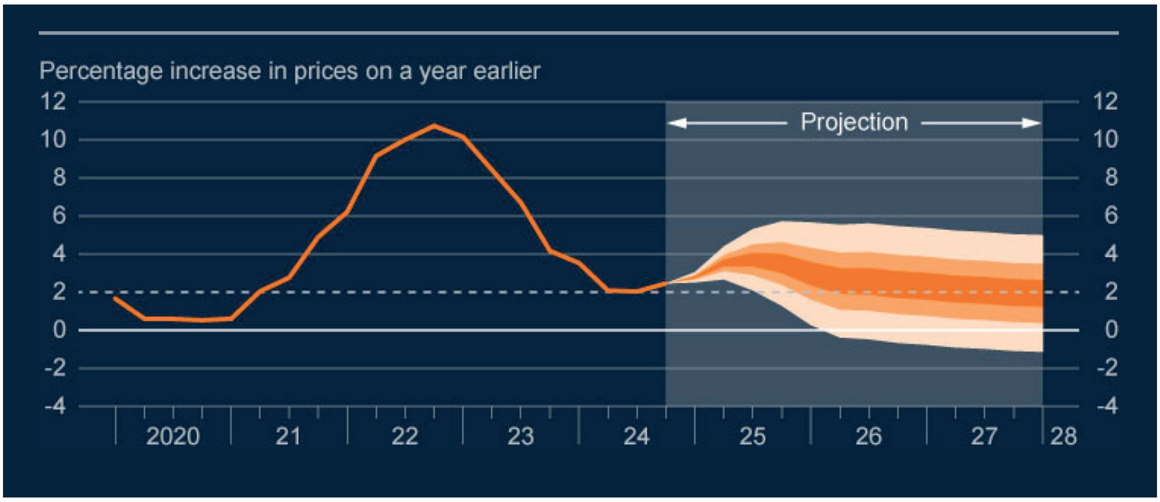
	2025 Q1	2025 Q2	2025 Q3	2025 Q4	
CPI inflation	2.8	3.5	3.7	3.5	
	2026 Q1	**2026 Q2**	**2026 Q3**	**2026 Q4**	
CPI inflation	3.0	2.6	2.6	2.4	
	2027 Q1	**2027 Q2**	**2027 Q3**	**2027 Q4**	**2028 Q1**
CPI inflation	2.3	2.2	2.1	2.0	1.9

(a) Four-quarter inflation rate.

> ***"The direct energy price contribution to 12-month CPI inflation is expected to increase from -0.6 to a positive contribution of 0.4 percentage points in 2025 Q3.***
>
> ***This reflects the increases since the November Report in wholesale gas futures and oil prices, and therefore household energy bills, on which the MPC's forecast is conditioned."***
>
> Bank of England, Monetary Policy Report, February 2025

These predictions are notably higher than recent projections. According to the Bank of England, this is largely due to increasing global energy prices. In the UK, these are regulated by the Ofgem energy price cap, which means changes to energy prices often have a sharp and noticeable impact on inflation.

FIGURE 2. CPI inflation forecast, 2024-2028. *Source: World Bank.*

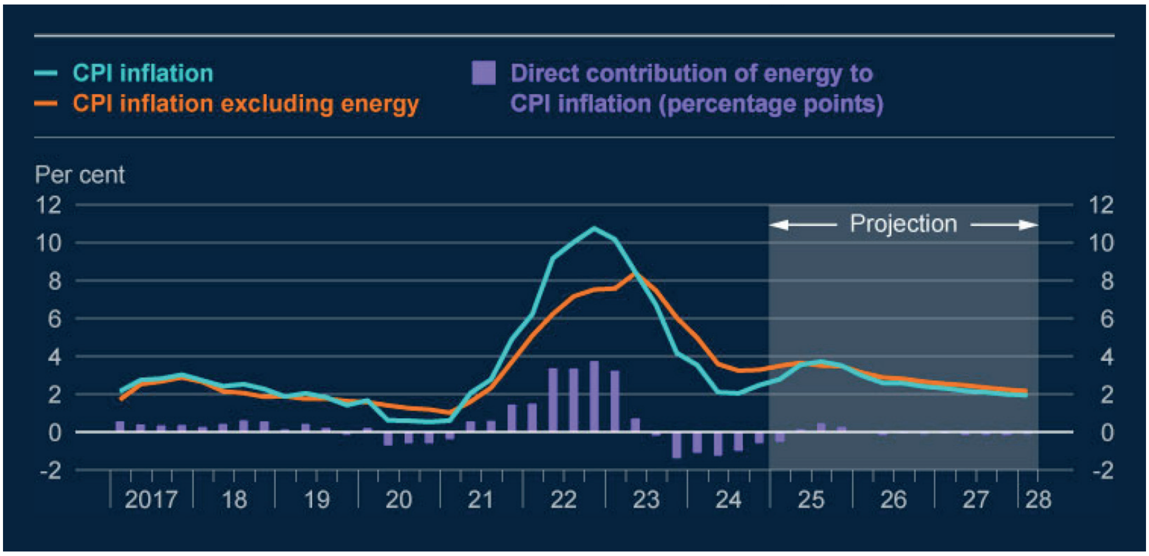


We can see this steep rise in inflation (including energy) in Figure 2. But when we compare it to the inflation rate excluding energy, we see a much more modest rise, suggesting energy is the main contributing factor to higher-than-expected inflation.

For this reason, the Bank of England expects the higher inflation rates to be temporary. Indeed, CPI inflation is expected to drop again to below 3% in 2026 and return finally to the 2% target in 2027.

In summary, current forecasts expect a short-term spike to inflation through 2025, but the medium/long term outlook still expects inflation to return to normal in the coming years.

FIGURE 3. CPI inflation and CPI inflation excluding energy, 2017-2028. *Source: World Bank.*



Labour Market

> *"Annual private sector wage growth in the MPC's baseline projection is expected to slow to around 3.75% by the end of 2025, as the easing in the labour market and past falls in inflation expectations feed through to lower wage growth.*
>
> *That is ½ of a percentage point higher than the November 2024 Report projection."*
>
> Bank of England, Monetary Policy Report, February 2025

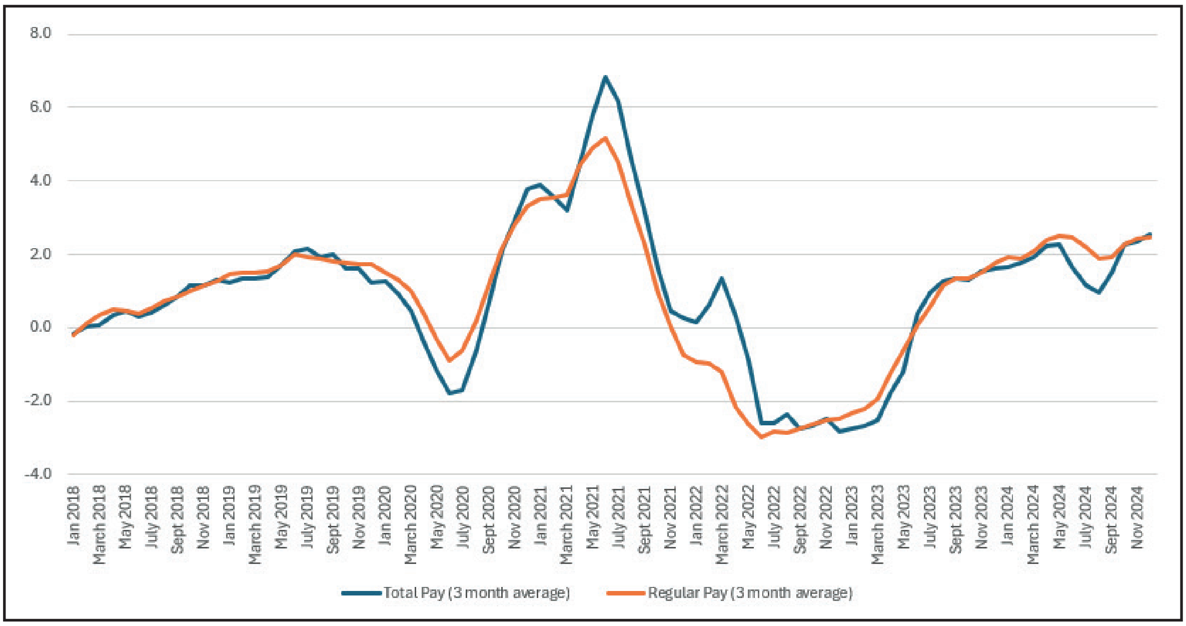
Wage growth

Across 2024, the labour market steadily began to stabilise after a volatile few years. At the time of the last report, nominal wage growth had slowed down from its recent peaks and was projected to settle around 2% between 2025 and 2027. This is down from its recent peak of 7.9% in September 2023.

Again, we've seen a surprising reversal of this trend in the last quarter, even when inflation is accounted for. Now, growth in regular average weekly earnings (AWEs) is forecast to have risen from 1.9% in September 2024 to 2.5% in December 2024.

At the same time, private sector AWEs rose by an average of 6.2% in the final quarter of 2024. According to Bank of England projections, it is now predicted to stabilise around 3.75% by the end of 2025.

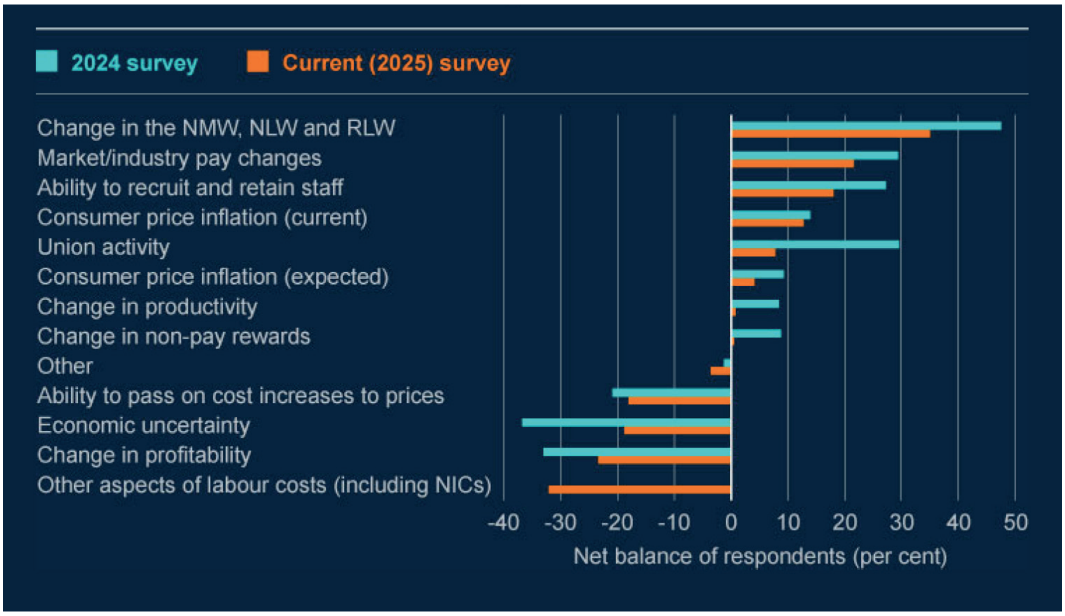
FIGURE 4. Real AWE growth, 2018-2024. *Source: OBR.*



If we look at the long-term, the effect of this trend isn't huge - and wage rises aren't likely to return to their post-pandemic peak any time soon. But nonetheless, this is a surprise to most of the economic community, since wage growth was expected to slow down through 2025.

Crucially, this data is adjusted for inflation, meaning it's not just a reflection of the higher CPI inflation rates we discussed in the last chapter. To understand these reasons in more detail, we can look at the Bank of England's analysis of factors affecting pay settlements.

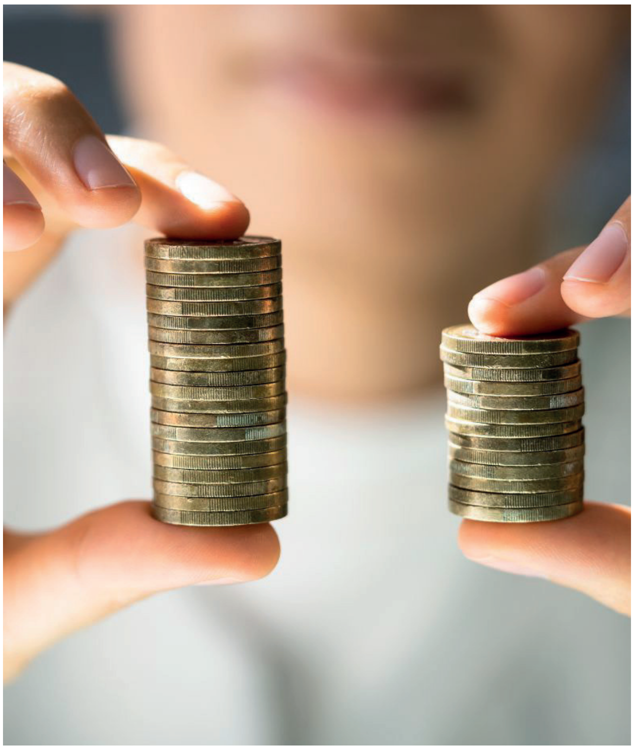
FIGURE 5. Factors affecting pay settlements, 2025. *Source: World Bank.*



The highest single factor here is the change in National Minimum Wage, National Living Wage and Real Living Wage costs. This suggests that these higher-than-expected pay settlements have already started taking the upcoming changes into account. It also suggests that higher pay settlements will be a largely short-term phenomenon, and that the chances of a long-term wage price spiral remain limited.

But, when we look at the factors reducing pay settlements, we can see another trend at play. While minimum/living/real wage changes are the biggest single factor increasing wages, the opposite is true of National Insurance. Here, it's the single biggest factor pulling wages down.

This suggests an essentially two-tier system at play here. Employees on minimum wage are seeing their wages rise, as we would expect. But elsewhere, it's clear that businesses are seeking to offset tax rises through lower wage growth, wherever possible.

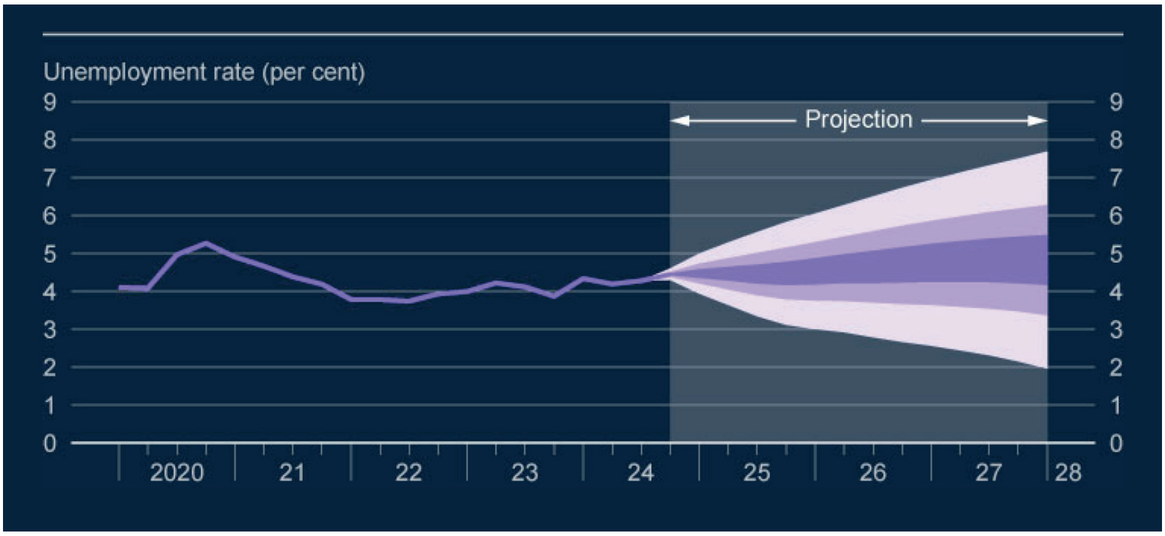


Unemployment

> *"Overall employment intentions have softened further and are now broadly flat, in part reflecting companies' response to the forthcoming rise in employers' National Insurance contributions (NICs) and National Living Wage (NLW)."*
>
> Bank of England, Monetary Policy Report, February 2025

When we look at the unemployment figures, we can see a similar picture at play. In fact, the upcoming employment cost rises seem to have already contributed to higher-than-expected unemployment rates.

FIGURE 6. Unemployment rate projection forecast, 2024-2028. *Source: World Bank.*



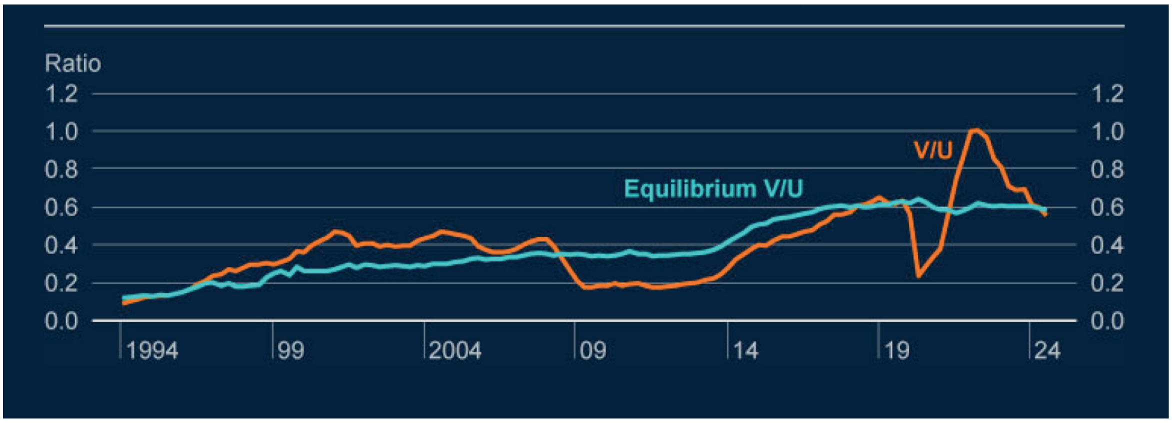
According to current projections, unemployment will reach 4.5% (Q1 2025), 4.5% (Q1 2026) and 4.8% (Q1 2027). In all cases, this is about half a percentage point higher than the same predictions last quarter, which were 4.1%, 4.2% and 4.3%, respectively.

This tracks with other Bank of England metrics that suggest vacancies fell overall by about 24,000 in the three months to December.

Bank of England investigations suggest that the upcoming rise in employment costs is also a significant contributing factor here. In many cases, businesses are looking to reduce short-term headcount through attrition - though there isn't huge evidence for widespread redundancies planned at present.

At all levels, therefore, we can see that employment prospects and demand for labour are softening. But if we compare the current outlook to the previous few years, we can see that the effect remains fairly muted, and that labour market forces remain much more balanced today than they were in the aftermath of the pandemic.

FIGURE 7. Tightness in the labour market, 1994-2024. *Source: World Bank.*



This graph compares the vacancies/unemployment ratio with an equilibrium model, which is the theoretically ideal balance of vacancies to unemployment over time.

As we can see, the vacancies/unemployment line has fallen beneath this ideal equilibrium for the first time since 2020, clearly showing the softening demand for employment at the end of 2024. But nonetheless, the forces remain much more balanced than they have for some years. This suggests that the overall effect of this trend is limited and that long-term high unemployment remains unlikely.

Wage growth by sector

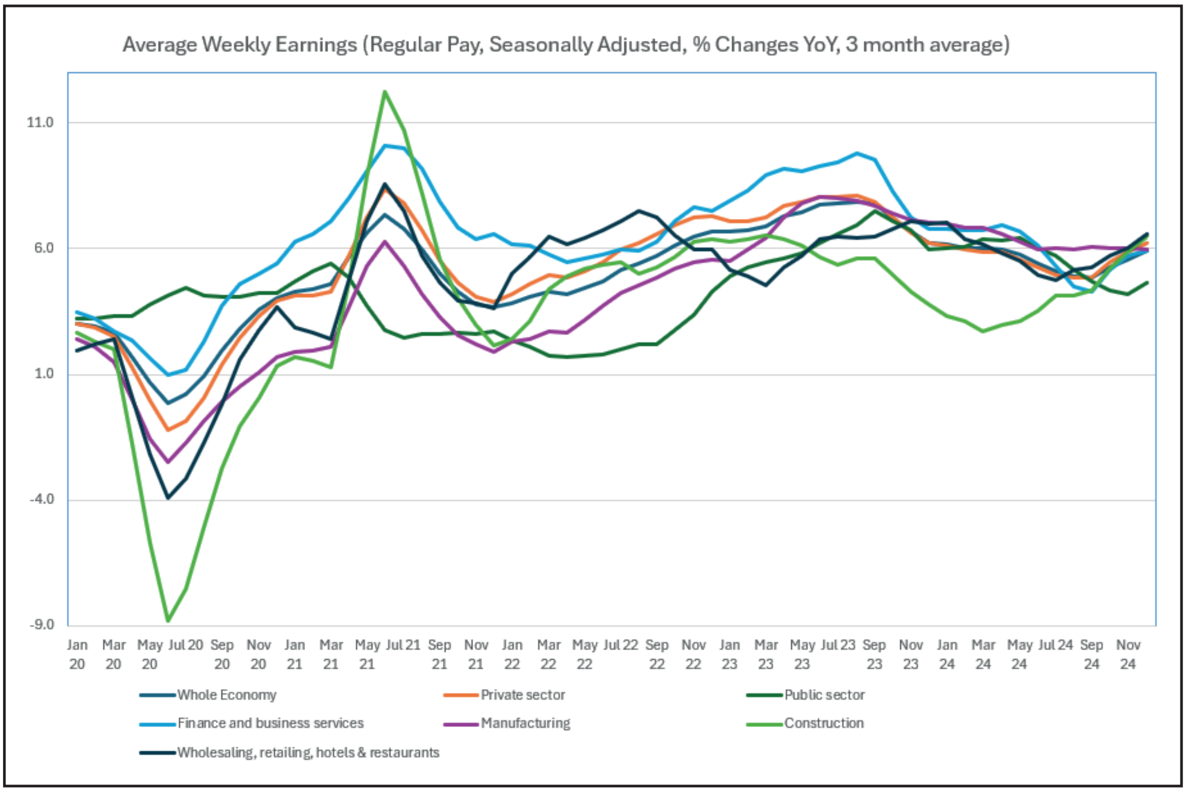
When we break the economy down by sector, we start to see far greater variation in the headline trends. While wages in general rose noticeably at the end of 2024, the effect was much wider in some industries than others.

Construction has seen a particularly sharp and sudden rise in wages. In fact, the sector went from having the lowest year-on-year wage growth in August 2024 (4.2%) to the second highest in December 2024 (6.5%).

This is likely a result of the Government's housebuilding drive, which has created extra demand for construction workers.

The effect is particularly pronounced, since as recently as July 2024, AWE growth in the construction sector was considerably slower than average - and lagged behind every other sector being analysed.

FIGURE 8. Real AWE growth, 2018-2024. *Source: OBR.*



Elsewhere, wholesale, retailing, hotels and restaurants saw the highest single growth of any sector, at 6.6% respectively. This presumably reflects the increased exposure to minimum wage in these sectors. Manufacturing also saw relatively high wage growth, at 6%.

However, the biggest outlier to this trend is in the public sector. In Q4 2024, public sector AWE growth was at 4.7%, noticeably lower than the national average of 5.9% and the private sector average of 6.2%. This is likely because significant public sector pay settlements had already taken place earlier in 2024, which means the effect of public sector AWE growth had already been 'front-loaded' in the earlier months of 2024.

Conclusion

In the post-pandemic years, developed economies in the UK have fallen into a familiar economic pattern. GDP growth is consistently lower than during the pre-2020 era. Inflation has recovered from the shocks of 2022-23 but has settled at a higher rate, and isn't likely to return to the Bank of England's 2% target for some time. Likewise, there seems to be no return to the ultra-low interest rates of 2010-2020 on the cards.

However, there is good news: Higher-than-expected inflation and wage growth look set to be a short-term phenomenon. At the same time, growth is still expected to rise over the next few years, if not less than originally anticipated.

But while there were some surprises in the data this quarter, the wider narrative remains unchanged. With increasing trade volatility and the upcoming rise in employment costs, there's every reason to expect this tricky economic landscape to continue. For today's businesses, the imperative is clear: buckle up, prepare your budgets and proceed with caution.

Luckily, we've all had a lot of practice at this by now.

About Turning Point

We are international pay and reward specialists headquartered in the UK with a global team.

Our data and insights help organisations build the best reward strategy for their business and their people, enabling them to attract, retain and motivate exceptional talent.

We offer comprehensive reward consulting services as well as our Orbit™ software suite,empowering organisations to stay at the forefront of competitive pay and reward.

How We Can Help

We understand the challenges that you are facing in the current economic climate. We bring insight and experience to help you design and implement a sustainable reward strategy tailored to your organisation's needs.

Working in partnership with you, we make the complex simple. We provide bespoke solutions informed by strong data, proven methodologies, and the wide-ranging capabilities of our team.

Please contact us to find out more.

Key Contacts

Peter Brauer, CEO
peter.brauer@turningpointhr.com

Jo Roadnight, Director of Client Services
jo.roadnight@turningpointhr.com

T: +44 (0)203 475 2270
E: info@turningpointhr.com
www.turningpointhr.com

Turning Point
INTERNATIONAL REWARD SPECIALISTS