

UK in Focus

Economics
United Kingdom

Global developments could add to UK fiscal troubles

- ◆ Global geopolitics drives economic uncertainty, adding to fiscal woes
- ◆ UK economic growth has disappointed and expectations for 2025 have been downgraded
- ◆ Despite the acceleration in inflation, interest rate cuts should continue over the next year

Global geopolitics has taken centre stage over the last month, from US tariff announcements, to the possibility of a Ukraine-Russia peace deal, a new German Chancellor, and an increase in UK defence spending. Positively, Prime Minister Starmer appeared to have a constructive meeting with President Trump, perhaps lessening the likelihood of direct tariffs on UK goods exports. That said, the UK remains exposed to broader global trade disruption, notably across Europe.

The increase in UK defence spending that brought forward plans to reach 2.5% by 2030 will be fiscally neutral due to a reallocation of overseas development aid funding (chart 1). However, further increases, such as ambitions to increase defence expenditure to 2.65% and then to 3% after the next election would, at this juncture, prove a challenge and likely require further spending trade-offs and/or accounting adjustments, such that defence spending is classified as investment spend and wouldn't fall under the Chancellor's fiscal mandate to balance current spending with revenues. Indeed, the UK may also participate in multilateral bond-financed funding programmes.

Undoubtedly, further increases in defence spending requirements would add to an already complicated fiscal landscape for the Chancellor further down the line. For the looming fiscal statement on 26 March, disappointing economic data since the October Budget and financial market volatility have raised the prospect that the fiscal 'headroom' afforded to Chancellor Reeves a few months ago may have been wholly or partially eroded. One response option would be to impose further 'efficiency savings' to unprotected departments, in addition to the 2% already announced.

Growth and inflation woes resurfaced

UK economic data has been mixed, while GDP data showed growth of 0.9% for 2024 overall, yet the private sector is reported to be in recession. Meanwhile, surveys have continued to point to a subdued start to the year, albeit appear to have stabilised. We recently revised down our UK GDP growth forecast for 2025 to 0.9% from 1.4% previously.

KEY UK DATA

▲ **0.1%**

GDP growth in 3m to December

▲ **3.0%**

Consumer Price Inflation, January y-o-y

▶ **4.4%**

Unemployment rate, November

▼ **4.50%**

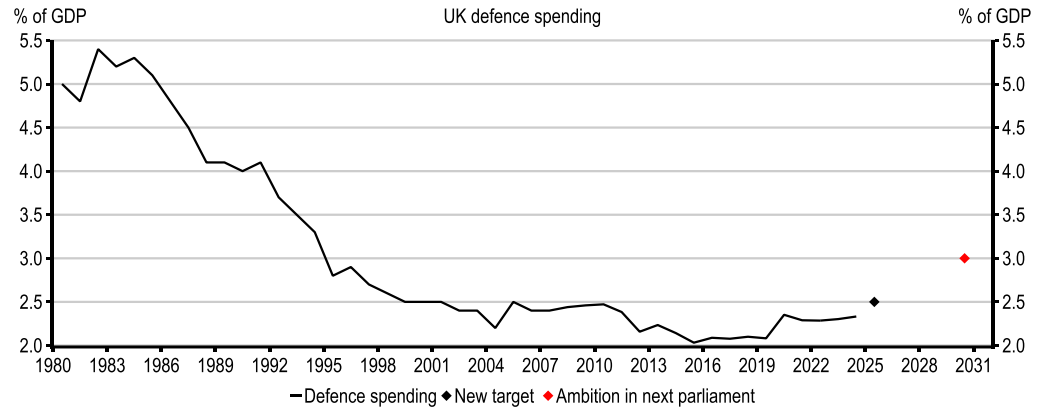
Bank of England Base Rate

Source: HSBC

For inflation, we have revisited our 2025 outlook and now see headline CPI peaking at 3.8% in September. However, the acceleration in price growth is largely externally driven via higher energy prices, water bills, and indexed linked services (chart 3). In contrast, services inflation – the proportion of inflation of most concern to the Bank of England (BoE) – should continue to moderate. As such the BoE continues to signal a gradual path for interest rate cuts as it looks through the “hump” in inflation.

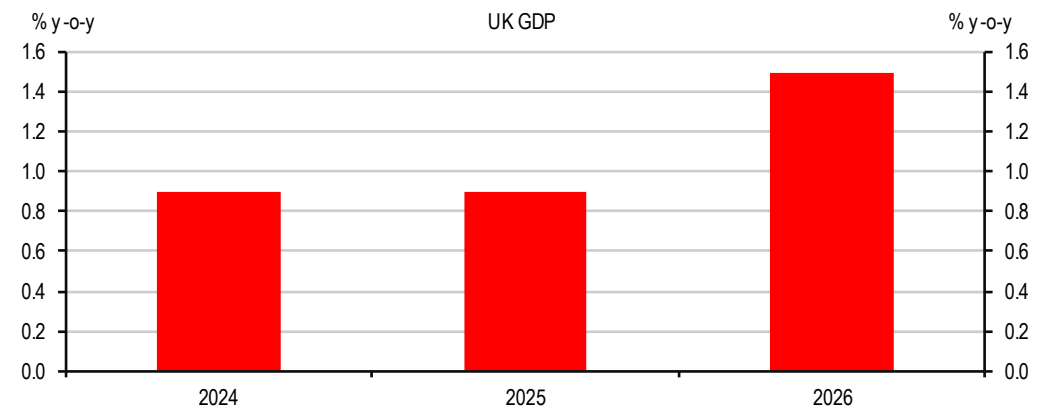
The BoE has judged that the risk of second-round inflationary effects is lower than in the last couple of years. However, uncertainty in labour market data continues to be a headache for policymakers in judging the degree to which structural factors have – and could continue to – influence domestic inflationary pressures. At the most recent monetary policy meeting (6 February 2025), the committee seemed to place greater weight on that scenario and a need to be “careful” in cutting Bank Rate. From our perspective, labour market slack is likely to continue to build over 2025, pay growth settlements should ease, while business investment and consumption growth will be modest as global uncertainty and inflationary pressures drag on activity.

1. Rise in defence spending shouldn't impact fiscal policy, for now at least



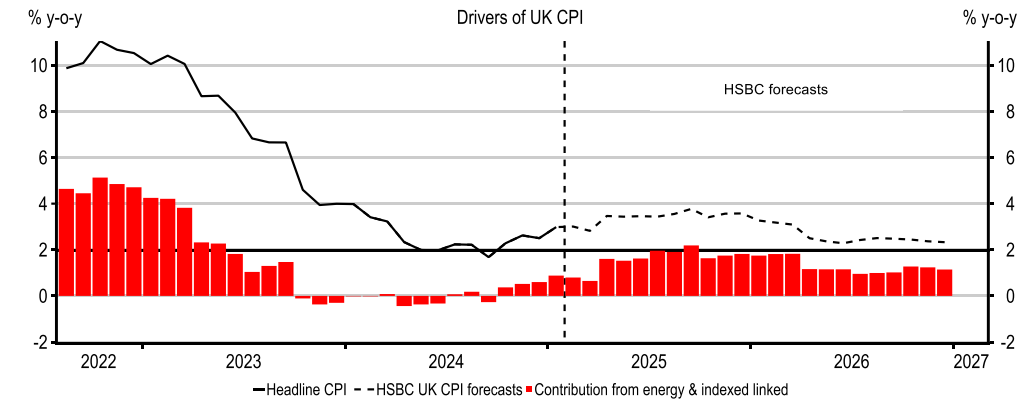
Source: Macrobond, NATO

2. GDP growth forecasts for 2025 downgraded after a weak 2024...



Source: Macrobond, ONS, HSBC forecasts

3. ...and inflation forecasts raised, although almost entirely driven by external shocks



Source: Macrobond, ONS, HSBC forecasts

Disclosure appendix

Important disclosures

- 1 This report is dated as at 04 March 2025.
- 2 All market data included in this report are dated as at close 03 March 2025, unless a different date and/or a specific time of day is indicated in the report.
- 3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking, Principal Trading, and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.
- 4 You are not permitted to use, for reference, any data in this document for the purpose of (i) determining the interest payable, or other sums due, under loan agreements or under other financial contracts or instruments, (ii) determining the price at which a financial instrument may be bought or sold or traded or redeemed, or the value of a financial instrument, and/or (iii) measuring the performance of a financial instrument or of an investment fund.

Disclaimer

This document is prepared by The Hongkong and Shanghai Banking Corporation Limited ("HBAP"), 1 Queen's Road Central, Hong Kong. HBAP is incorporated in Hong Kong and is part of the HSBC Group. This document is distributed by HSBC Continental Europe, HBAP, HSBC Bank (Singapore) Limited, HSBC Bank (Taiwan) Limited, HSBC Bank Malaysia Berhad (198401015221 (127776-V))/HSBC Amanah Malaysia Berhad (200801006421 (807705-X)), The Hongkong and Shanghai Banking Corporation Limited, India (HSBC India), HSBC Bank Middle East Limited, HSBC UK Bank plc, HSBC Bank plc, Jersey Branch, and HSBC Bank plc, Guernsey Branch, HSBC Private Bank (Suisse) SA, HSBC Private Bank (Suisse) SA DIFC Branch, HSBC Private Bank Suisse SA, South Africa Representative Office, HSBC Financial Services (Lebanon) SAL, HSBC Private banking (Luxembourg) SA and The Hongkong and Shanghai Banking Corporation Limited (collectively, the "Distributors") to their respective clients. This document is for general circulation and information purposes only. This document is not prepared with any particular customers or purposes in mind and does not take into account any investment objectives, financial situation or personal circumstances or needs of any particular customer. HBAP has prepared this document based on publicly available information at the time of preparation from sources it believes to be reliable but it has not independently verified such information. The contents of this document are subject to change without notice. HBAP and the Distributors are not responsible for any loss, damage or other consequences of any kind that you may incur or suffer as a result of, arising from or relating to your use of or reliance on this document. HBAP and the Distributors give no guarantee, representation or warranty as to the accuracy, timeliness or completeness of this document. This document is not investment advice or recommendation nor is it intended to sell investments or services or solicit purchases or subscriptions for them. You should not use or rely on this document in making any investment decision. HBAP and the Distributors are not responsible for such use or reliance by you. You should consult your professional advisor in your jurisdiction if you have any questions regarding the contents of this document. You should not reproduce or further distribute the contents of this document to any person or entity, whether in whole or in part, for any purpose. This document may not be distributed to any jurisdiction where its distribution is unlawful.

The following statement is only applicable to HSBC Bank (Taiwan) Limited with regard to how the publication is distributed to its customers: HSBC Bank (Taiwan) Limited ("the Bank") shall fulfill the fiduciary duty act as a reasonable person once in exercising offering/conducting ordinary care in offering trust services/business. However, the Bank disclaims any guaranty on the management or operation performance of the trust business.

The following statement is only applicable to by HSBC Bank Australia with regard to how the publication is distributed to its customers: This document is distributed by HSBC Bank Australia Limited ABN 48 006 434 162, AFSL/ACL 232595 (HBAU). HBAP has a Sydney Branch ARBN 117 925 970 AFSL 301737. The statements contained in this document are general in nature and do not constitute investment research or a recommendation, or a statement of opinion (financial product advice) to buy or sell investments. This document has not taken into account your personal objectives, financial situation and needs. Because of that, before acting on the document you should consider its appropriateness to you, with regard to your objectives, financial situation, and needs.

Important Information about the Hongkong and Shanghai Banking Corporation Limited, India ("HSBC India")

HSBC India is a branch of The Hongkong and Shanghai Banking Corporation Limited. HSBC India is a distributor of mutual funds and referrer of investment products from third party entities registered and regulated in India. HSBC India does not distribute investment products to those persons who are either the citizens or residents of United States of America (USA), Canada or New Zealand or any other jurisdiction where such distribution would be contrary to law or regulation.

Mainland China

In mainland China, this document is distributed by HSBC Bank (China) Company Limited ("HBCN") and HSBC FinTech Services (Shanghai) Company Limited to its customers for general reference only. This document is not, and is not intended to be, for the purpose of providing securities and futures investment advisory services or financial information services, or promoting or selling any wealth management product. This document provides all content and information solely on an "as-is/as-available" basis. You SHOULD consult your own professional adviser if you have any questions regarding this document.

The material contained in this document is for general information purposes only and does not constitute investment research or advice or a recommendation to buy or sell investments. Some of the statements contained in this document may be considered forward looking statements which provide current expectations or forecasts of future events. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors. HSBC India does not undertake any obligation to update the forward-looking statements contained herein, or to update the reasons why actual results could differ from those projected in the forward-looking statements. Investments are subject to market risk, read all investment related documents carefully.

© Copyright 2025. The Hongkong and Shanghai Banking Corporation Limited, ALL RIGHTS RESERVED.

No part of this document may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior written permission of The Hongkong and Shanghai Banking Corporation Limited.

Important information on sustainable investing

"Sustainable investments" include investment approaches or instruments which consider environmental, social, governance and/or other sustainability factors (collectively, "sustainability") to varying degrees. Certain instruments we include within this category may be in the process of changing to deliver sustainability outcomes.

There is no guarantee that sustainable investments will produce returns similar to those which don't consider these factors. Sustainable investments may diverge from traditional market benchmarks. In addition, there is no standard definition of, or measurement criteria for sustainable investments, or the impact of sustainable investments ("sustainability impact"). Sustainable investment and sustainability impact measurement criteria are (a) highly subjective and (b) may vary significantly across and within sectors.

HSBC may rely on measurement criteria devised and/or reported by third party providers or issuers. HSBC does not always conduct its own specific due diligence in relation to measurement criteria. There is no guarantee: (a) that the nature of the sustainability impact or measurement criteria of an investment will be aligned with any particular investor's sustainability goals; or (b) that the stated level or target level of sustainability impact will be achieved.

Sustainable investing is an evolving area and new regulations may come into effect which may affect how an investment is categorised or labelled. An investment which is considered to fulfil sustainable criteria today may not meet those criteria at some point in the future.

[1253690]