

UK in Focus

Economics
United Kingdom

Higher energy prices could throw inflation and rates off course

- ◆ Business surveys showed improved demand and a more stable employment outlook in early 2026...
- ◆ ...but that, and the Chancellor's Spring Statement, was overshadowed by events in the Middle East...
- ◆ ...which are likely to delay inflation reaching 2.0% and create more interest rate uncertainty

Consumers remain cautious, while the Spring Statement was overshadowed

Official data published for 4Q25 confirmed the weak end to last year. GDP in the last quarter of the year grew 0.1% q-o-q, while on a per capita basis it fell 0.1%, the second consecutive quarterly decline. However, the turn of the year saw improved momentum and business surveys have pointed to the start of a demand recovery. Moreover, despite a higher unemployment rate, headcount growth appears to be at least stabilising. On the other hand, input prices, including labour costs, continue to squeeze margins.

Consumers have remained more cautious – GfK consumer confidence ticked down in February, while intentions to save rose against a backdrop of economic uncertainty, weaker job prospects, and squeezed household budgets. Chancellor Rachel Reeves was keen to remind voters of the measures to cut the cost of living from April 2026 in her Spring Statement. However, despite that, and a marginally better fiscal position expected by the OBR, the forecast update was not just a non-event, but was entirely overshadowed by the conflict in the Middle East.

Higher energy prices could throw inflation and rates off course

Although we never expected the improved momentum in the first two months of the year to persist at an ever-improving pace over 2026 – recent years have seen a short-lived post-Autumn Budget bounce-back in 1Q – our expected narrow path for greater optimism this year risks being thrown off course by the conflict in the Middle East. Underpinning our outlook for the UK was greater stability and confidence, for CPI inflation to fall to 2.0% (the Bank of England's (BoE) target), and for interest rates to be cut to 3.00% this year.

In light of the events in the Middle East, the Strait of Hormuz has been disrupted, some oil production halted, and energy prices have jumped. Although, HSBC Global Investment Research expects energy prices to moderate over the course of the year, with energy prices at current levels inflation will likely stay materially above 2% over the coming months, higher than previously expected. Importantly, the inflationary impact and subsequent interest rate response depends on any further oil and gas price spikes and how long energy prices stay elevated. Given the uncertainty and possible broader impacts on the economy, we expect the Bank of England to err on the side of caution and leave Bank Rate unchanged until 4Q26.

KEY UK DATA

▶ **0.1%**

GDP growth in 3M to December

▼ **3.0%**

Consumer Price Inflation, January y-o-y

▲ **5.2%**

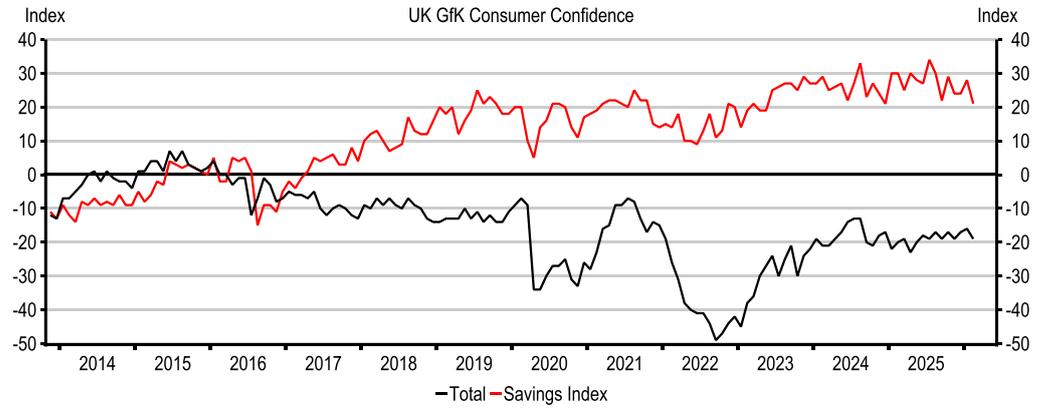
Unemployment rate, December

▶ **3.75%**

Bank of England Base Rate

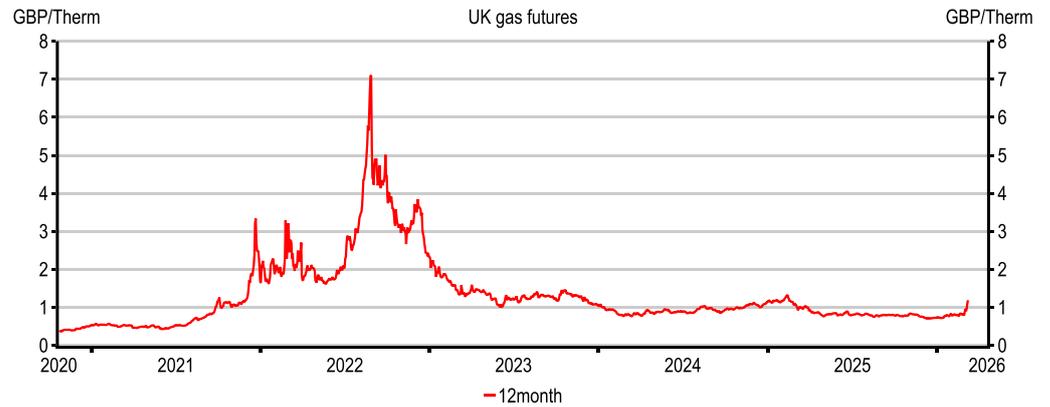
Source: HSBC

1. Consumers are more cautious; confidence remains low and savings intentions high



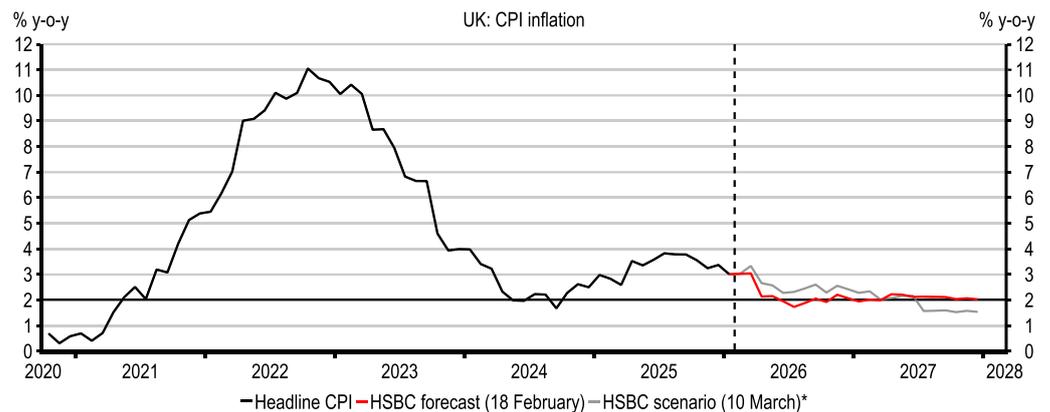
Source: Macrobond, S&P Global, HSBC

2. Gas prices have risen sharply, albeit the scale of the move is small relative to 2022



Source: Macrobond, Bloomberg, HSBC forecast

3. Energy prices to mechanically lift headline inflation higher over 2026



Note: *Scenario based on energy impact only.
Source: Macrobond, Bloomberg, HSBC forecast

Disclosure appendix

Important disclosures

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