15 September 2026

UK in Focus

Economics
United Kingdom

The summer of 2026

- Growth improved over the summer of 2026…
- …led by services and activity linked to artificial intelligence
- Yet a softer labour market, higher energy costs, and rising bond yields leave the outlook finely balanced

Growth proves more resilient than expected

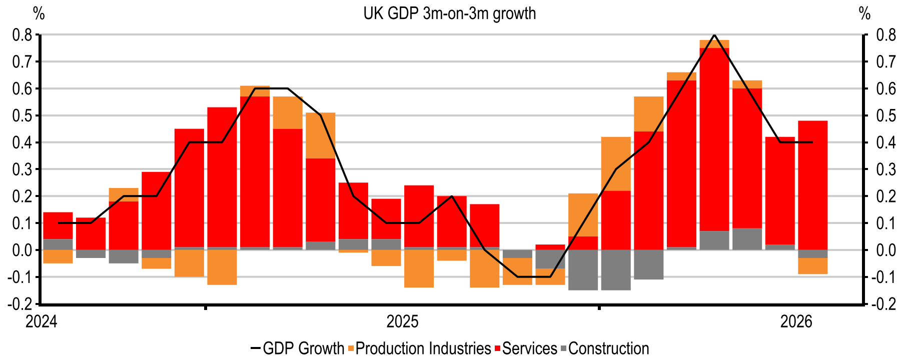
Over the summer, the UK economy quietly shifted tone. Economic growth has been resilient and in July the UK economy grew 0.4% m-o-m, despite expectations of no growth. Interestingly, the resilience in the UK economy appears to have been supported by a cluster of sectors investing into Artificial Intelligence (AI) or benefitting from greater demand for AI hardware. Admin and support services, professional services, and tech-adjacent manufacturing have all been outperformers.

A two-tiered labour market

Broader economy-wide benefits of AI are still early, but AI could worsen job-worker mismatch during the transition and potentially reinforce the "two-tier" labour market dynamic. Although the labour market has softened in recent years, younger workers, and related sectors, have been disproportionately impacted by the broad-based softness in employment growth. That means spare capacity is concentrated in a small segment of the labour force, and could mean slack and shortages of labour can coexist.

Despite weak employment, consumer confidence and spending have risen as saving has fallen. However, the summer housing market remained subdued and uneven, mainly because homes were less affordable.

1. UK GDP has been resilient, but growth is concentrated in a few services sub-sectors



Source: ONS, Macrobond, HSBC

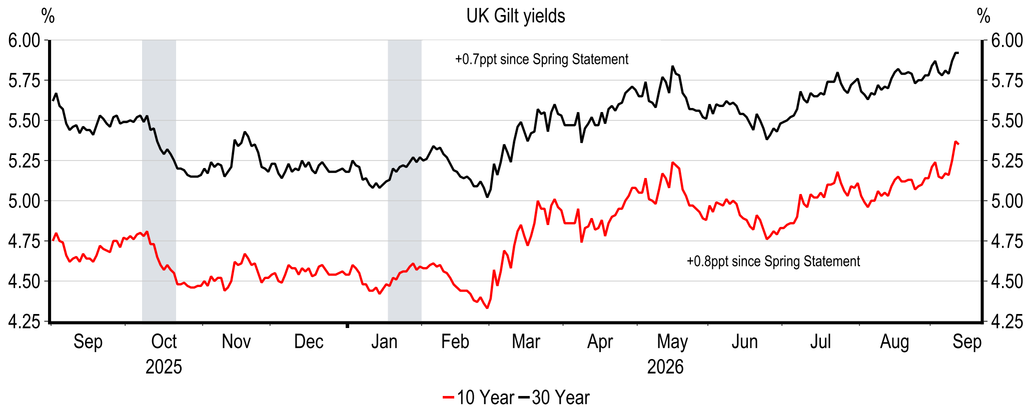
A complicated inflation and rates outlook…

Indeed, financial conditions have tightened, bond yields have moved sharply higher over August, with the 10-year gilt yield reaching 5.37% (its highest since 2007) and markets at one point were pricing in four Bank of England (BoE) rate rises. Higher bond yields reflect global developments: an ongoing conflict in the Middle East has seen energy prices rise again (adding to upside risks to the inflation outlook), and a renewed focus on the risks of fiscal credibility given high debt levels across developed economies.

More reassuringly on inflation, higher energy prices are not, yet, translating into broader, domestic inflation pressures. A higher headline rate of inflation has been accompanied by a moderation in services inflation and private sector pay growth, the latter slowed to 2.8% (3m/yr) in July, the weakest since 2020. That will provide some comfort to BoE policymakers.

The key risk for the BoE is the longer an energy shock persists, the greater the risk it stops being "just energy" and feeds into wage demands and pricing behaviour. Against this backdrop, the November BoE policy meeting is "live" if energy stayed elevated and inflation expectations firmed.

2. UK bond yields have moved higher since March, putting pressure on the public finances



Source: ONS, Macrobond, HSBC

…is making fiscal choices harder for the government

Higher bond yields also weigh on the government's fiscal position, adding to the challenges for the new Prime Minister and Chancellor. More broadly, the new government signalled it would stick to fiscal rules but use "any flexibility within them" pointing to the desire to borrow more to invest into the UK. While that approach can be positive if higher borrowing and investment creates additional growth, any additional borrowing will add to debt servicing costs at a time when yields are high, limiting what the government can do.

An uncertain future

Taken together, summer 2026 was about an economy that looked a bit stronger on growth, more uncertain on inflation because of energy, and structurally tricky on hiring. Looking ahead, the near-term outlook is uncertain, from interest rates, geopolitical tensions, and a UK Autumn Budget; how these develop and interact with each other will be crucial for confidence and UK growth in 2H26.

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