UK Finance

October 2025

Monthly Economic Review

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This month we dig into the latest inflation developments, and what this means for upcoming interest rate decisions. In addition, the latest OECD growth forecasts point to a more stable outlook, but businesses still face challenges.

Cost of living pressures haven't gone away

UK inflation held steady at 3.8 per cent in August, as the Bank of England had forecast, and is expected to rise further to a peak of four per cent in September. After falling rapidly from double-digit highs in 2022, CPI has been steadily rising since last autumn and has remained above the Bank's two per cent target for 11 straight months.

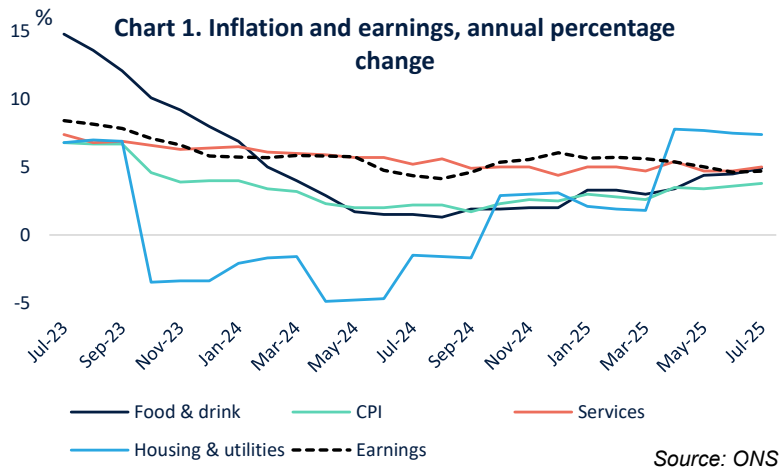


Chart 1. Inflation and earnings, annual percentage change

Source: ONS

Some of the factors pushing up prices are external, rather than a resurgence of domestic inflationary pressures – notably food prices, which accelerated by over five per cent in

August (of which more later) and regulated prices such as utilities (**chart 1**). Some of these factors combined with strong wage growth in recent years are also contributing to elevated services inflation, which continued to run at a little under five per cent in August.

While some of these factors will be transitory, for example the Bank expects some offset from moderating energy prices towards the end of this year, a number of CPI components including food, beverages, communication, housing and utilities, and education are outpacing earnings growth. This will be squeezing real income growth particularly for lower income households that spend a higher share of income on these essentials.

Moreover, the visibility of price rises of these goods and services is also pushing up households' short and medium-term inflation expectations. In a recent speech, MPC member Sarah Breedon flagged Bank Research showing that the sensitivity of household inflation expectations to food prices has almost doubled in recent years. The latest surveys show would suggest that rising food costs are flowing through to expectations that are elevated relative to historical averages. The Citi/YouGov measure of median one-year ahead inflation expectations stands at 4.0%.

The question for monetary policy makers is whether this will also lead to higher pay demands, keeping earnings growth higher for longer and potentially second round effects on inflation. A looser labour market this year implies that workers don't have the bargaining power they did a few years ago. In addition, firms' margins are under some pressure, including from April's NICs increases. Together, this may assuage concerns that wage growth will pick up again.

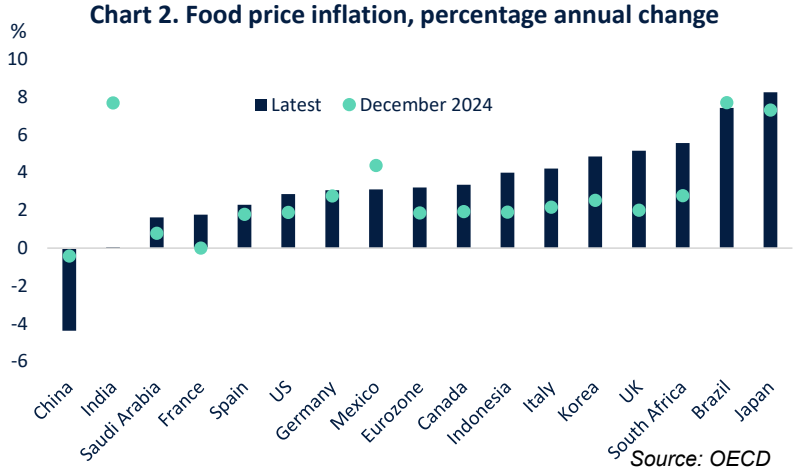
Nevertheless, with forecasts pointing to CPI still above target at the end of next year and concerns that inflation expectations have become unanchored MPC members may take a wait and see approach to further rate cuts. The minutes of the September meeting, which saw a couple of MPC members voting for a 25-basis point cut, point to the need for more data on how the balance of inflation risks is playing out. Indeed, markets are less convinced that the Committee will vote to cut again in November, instead looking at the next one coming in Q1 2026.

Food prices rising (almost) everywhere

It's not just in the UK that consumers have seen the cost of their food shop increase. As the OECD noted in its interim forecast update, food price inflation has been on the rise this year across most of the OECD bloc, notably in the UK, Italy, South Africa and Korea (**chart 2**).

The OECD points to particularly large price rises in dairy products and vegetable oils. More recent data from the UN Food and Agriculture Organisation's (FAO) food price index some relief on sugar and cereals prices from better-than-expected production. But commodities such as meat continue to rise.

Chart 2. Food price inflation, percentage annual change



Source: OECD

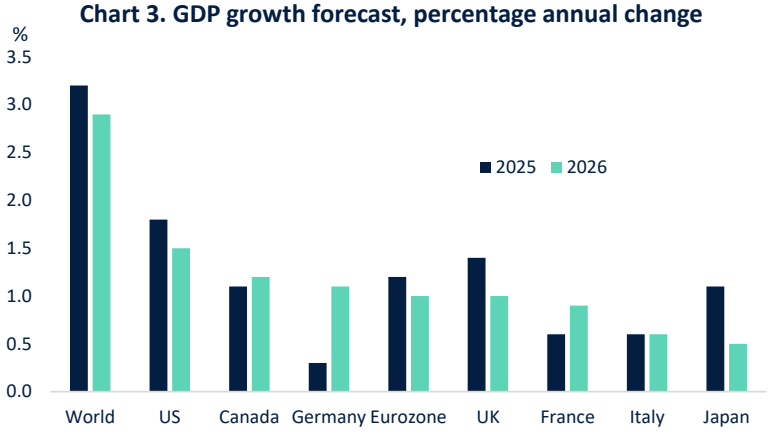
In addition, new packaging regulations – Extended Producer Responsibility (EPR) – which puts more responsibility on producers to reduce packaging waste, could also be passed onto shoppers. A survey from the British Retail Consortium showed that 80 per cent of costs of the new packaging tax, which came in earlier this month, are likely to be passed onto consumers.

As with the UK, the OECD highlights that rising food prices have slowed disinflation, and together with muted confidence, are moderating consumer spending. It sees persistently high food price inflation as a risk for policy makers in the year ahead – *"given the salience of food (and energy prices) for household consumption baskets, higher price rises for these items could raise short-term inflation expectations and result in policy interest rates being higher than would otherwise have been the case."*

Steady growth expected

Elsewhere in the OECD's interim forecast update there were some slightly better news. The global economy has been more resilient than expected in the first half of this year, leading to a modest uprating to the growth outlook for 2025 (**chart 3**). Global GDP growth is now expected at 3.2 per cent, up from the 2.9 per cent growth forecast in June.

Chart 3. GDP growth forecast, percentage annual change



Source: OECD

Similar to the trends we noted in the UK last month, some of the strength at the start of the year was activity brought forward ahead of US tariffs with the full effects of trade measures still to be felt. Government spending increases in China have also helped to offset some of the tariff headwinds, while a surge in AI investment has buoyed growth in the US.

There are signs that activity is moderating in the second half of this year. International surveys such as purchasing manager's indices (PMIs) have weaken across developed economies and in the UK and eurozone manufacturing activity is stuck in contractionary territory. Consumer spending has slowed and policy uncertainty, particularly relating to tariffs, is weighing on investment.

However, the list of risks identified by the OECD continues – uncertainty in financial markets as concerns mount about future fiscal risks; other financial stability risks stemming from, for example, the rapid expansion of private debt markets, crypto-asset price volatility, and sector-specific shocks in equity markets.

Assuming the global economy navigates these risks, GDP is expected to expand at a slightly slower 2.9 per cent in 2026. And there is some potential upside from higher defence spending and stronger investment and productivity growth flowing from technology investment, such as AI.

Tough trading environment for SMEs

The loss of momentum seen across OECD countries is certainly evident in UK survey indicators. After mounting a recovery over the summer, the UK services PMI fell back sharply in September, signalling the slowest pace of expansion since April. New order inflows slowed with respondents noting a reticence to commit to orders due to rising economic and political uncertainty, with some waiting to see what the autumn budget contains.

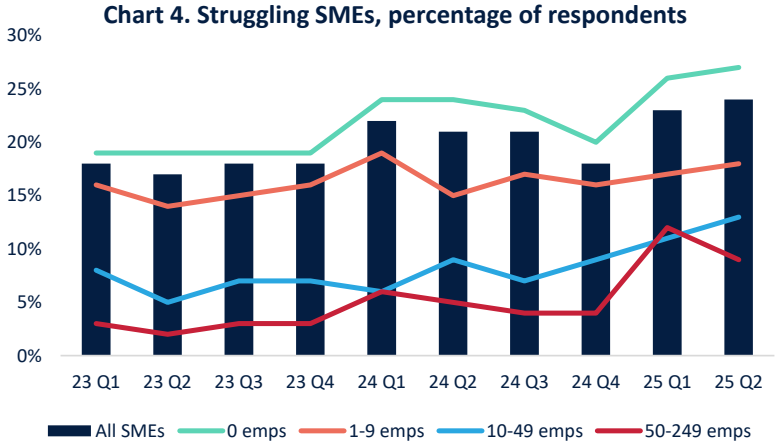
The manufacturing PMI made for similarly gloomy ready, also dropping to a five-month low in September and the index has been below the 50-no change mark for a year. In addition to the uncertainty noted by firms in the service sector, the impact of the recent cyber attack on Jaguar Land Rover was further dragging on demand.

The Bank of England noted in its September MPC that is expects underlying growth to tick over at around 0.25 per cent per quarter in the latter half of 2025 (though headline GDP growth is expected at 0.4 per cent in Q3). And the Agents' network reports that a substantial pickup in activity was not expected by businesses until 2026.

While businesses hope for better times ahead, the recently published 2025 H1 SME Finance Monitor shows a gradual upward drift in the proportion of SMEs that say they are struggling financially; that is monthly revenue does not meet need and there are

limited savings to draw on (**chart 4**). In H1, one in four businesses were struggling up from 18 per cent in 2023. While the biggest uptick in the proportion of struggling businesses in the past year is amongst sole traders, there has also been a gradual increase across those with <50 employees. In addition, newer businesses are also more likely to say they are struggling.

Chart 4. Struggling SMEs, percentage of respondents



Source: BVA/BDRC SME Finance Monitor

Elsewhere in the SME Finance Monitor, the proportion of SMEs planning to apply for finance has remained stable in the first half of this year at around one in ten, with around one in six classified as a 'future would be seeker' of finance; this group have plans to apply but are currently being held back by external factors. Within this latter group, more than half feel it's not the right time to borrow, but stronger demand, lower borrowing costs, and more clarity about government policies would help many pull the trigger on taking on finance to support growth.

While UK Finance and Bank of England data show a recent increase in lending to SMEs, borrowing remains significantly lower than pre-pandemic. If SMEs continue to demonstrate resilience and we do see an improvement in activity next year, this could pave the way for an increased appetite for finance to support growth and investment.

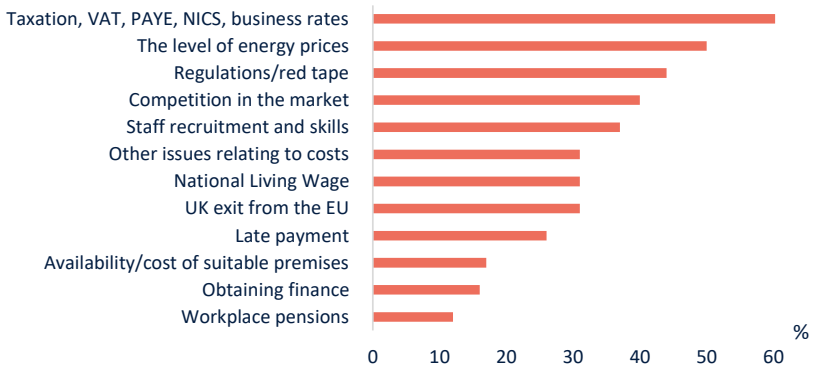
Tax tops list of challenges

One further unknown for SMEs awaits this year – the autumn budget, scheduled for November 26th. Next month's briefing will look at the state of play in the public finances and some of the choices facing the Chancellor. Ahead of the statement bodies representing small businesses, such as the British Chambers of Commerce, have called for no new tax increases that add to labour costs.

The release of the 2024 longitudinal small business survey by the Department for Business and Trade last mont, also highlights concern about taxation, with more than three in five SMEs (with employees) citing taxation as an obstacle to their business success (**chart 5**). Between 2015 and 2017, this proportion was hovering around 40 per cent.

Cost pressures also remain dominant in the latest survey with energy costs, other cost pressures, and the national living wage all cited by more than 30 per cent of firms as a business challenge.

Chart 5. Obstacles to business success, percentage of respondents



Source: Department for Business and Trade

ICYMI and coming up…

Last month we published our quarterly **Household** and **Business** Finance Reviews as well as our latest **later life lending dashboard**.

The next mortgage data release will be our buy to let dashboard on 22nd October. You can find that with all our data publications **here**.

The UK Finance half-year fraud report is due to be published on w/c 20th October, where we look at developments in unauthorised and authorised push payment fraud in the first six months of 2025.

Key indicators

Indicator	Period	Value	Change	2025 Forecast
GDP	Q2 2025	0.3%	↓	1.2%
CPI inflation	Aug 2025	3.8%	↔	3.6%*
Unemployment rate	Jul 2025	4.7%	↔	4.9%*
Average earnings	Jul 2025	4.7%	↑	4.0%
Brent crude	Sep 2025	$67.99	↑	-
$ Exchange rate	Sep 2025	$1.35	↔	-
Bank Rate	Sep 2025	4.0%	↔	3.9%*

Source: ONS, HM Treasury, Bank of England, EIA

*Q4 2025