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Monthly Economic Review

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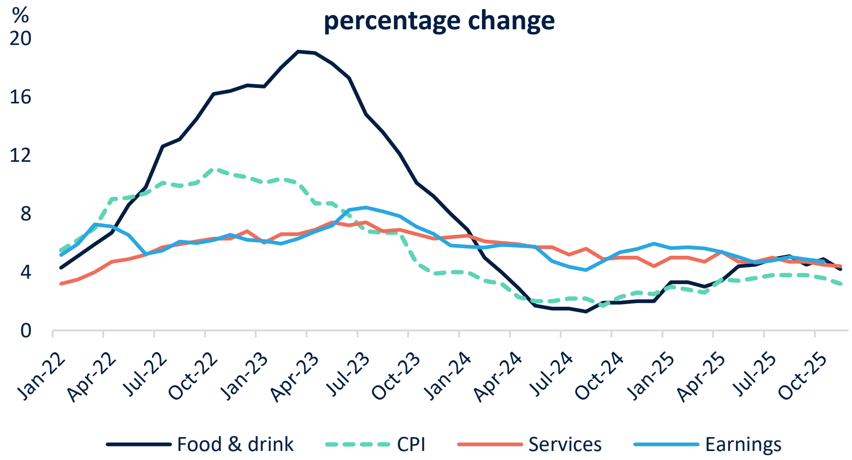
As we enter 2026, the monthly round up takes a look at how the data and policy decisions shaped up at the end of last year and what this might mean for the outlook in the year ahead.

December rate cut another close call

As was widely expected and following a bigger than predicted drop in CPI in November to 3.2 per cent (**chart 1**), the Monetary Policy Committee (MPC) voted, narrowly, for a quarter point cut to Bank Rate at its final meeting of 2025. The cut takes interest rates to a 33-month low of 3.75 per cent.

Chart 1. Inflation and earnings growth, annual percentage change



Source: ONS

As was the case in November, however, the decision wasn't clear cut with four of the nine MPC members voting to maintain Bank Rate at four per cent. Only Governor Bailey changed his view from the previous meeting to secure a majority for the reduction.

The minutes of the meeting noted continued positive developments on disinflation and pointed to the recent Budget announcements on administered prices and indirect taxes further bearing down on inflation, such that CPI is now expected to fall more rapidly from April to close to the two per cent target. Labour market data also point to increasing slack which should lead to a further easing in pay growth. In addition, near term activity indicators remain subdued which should limit inflation persistence.

Despite the split vote there was caution across the Committee in declaring victory in the battle against inflation. Two interlinked sources of uncertainty are the still-elevated inflation expectations and the evolution of pay settlements in the coming months. The prolonged period of above target inflation has pushed up households' expectations of future inflation and, as one MPC member noted, the Budget announcements on administered prices may not rein these in.

More significant, is survey data on business expectations for pay growth remain above that consistent with the Bank's inflation target. There are still concerns that structural changes in pay setting are a bigger upside risk to inflation than weak demand leading to inflation undershooting the target. With most firms agreeing annual wage settlements in January and April, the evolving data on actual pay growth in the coming months will be key.

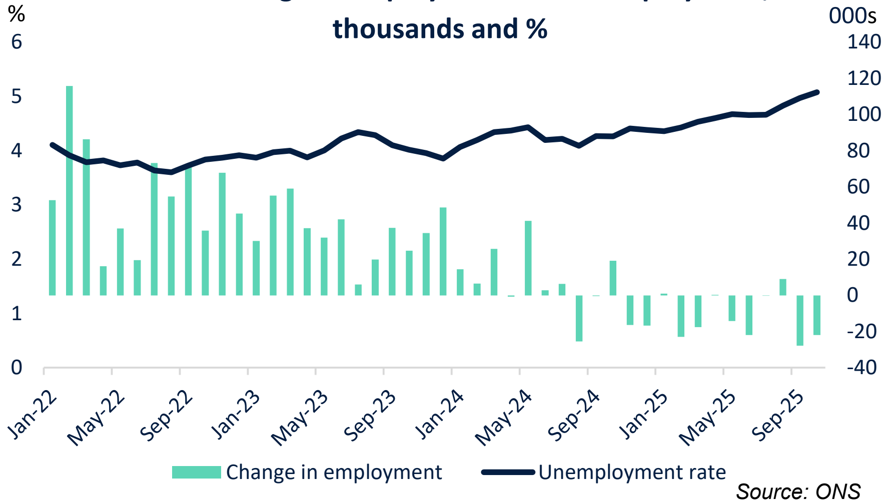
The UK is not alone in its continued vigilance for an inflation resurgence. The OECD's December economic update highlights a global divergence in inflation developments; the four largest eurozone economies have seen inflation drop below two per cent, but services inflation remains sticky in many economies and in the US tariffs have also pushed up on some consumer goods prices. Echoing the Bank of England's concerns the OECD notes risks from high inflation expectations in UK, US and eurozone and urges Central Banks to '*react promptly to shifts in the balance of risks to price stability.'*

Labour market outlook

Labour market weakening is clear from the drop in the number of payrolled employees and the tick up in the unemployment rate in the second half of last year to a post-pandemic high of 5.1 per cent (**chart 3**). Good news in some respects if it leads to moderation in pay pressures. But the pickup in the unemployment rate does seem to have spurred a gloomier assessment of job prospects in the year ahead.

The usual round of new year forecasts indicates economist expect the unemployment to stick at a bit over the five per cent mark this year. Last year's NICs increase, another minimum wage rise in the pipeline, sluggish demand, and the forthcoming Employment Rights Bill are all playing a part in cautious hiring intentions by firms.

Chart 2. Change in employment and unemployment, thousands and %



Source: ONS

While purchasing managers' indices for the private sector point to a modest expansion of activity at the end of last year, respondents across manufacturing and services reported a sharp drop in employment. In addition, the new year has also brought worries about the viability of some high street retailers and the possible risk of job losses.

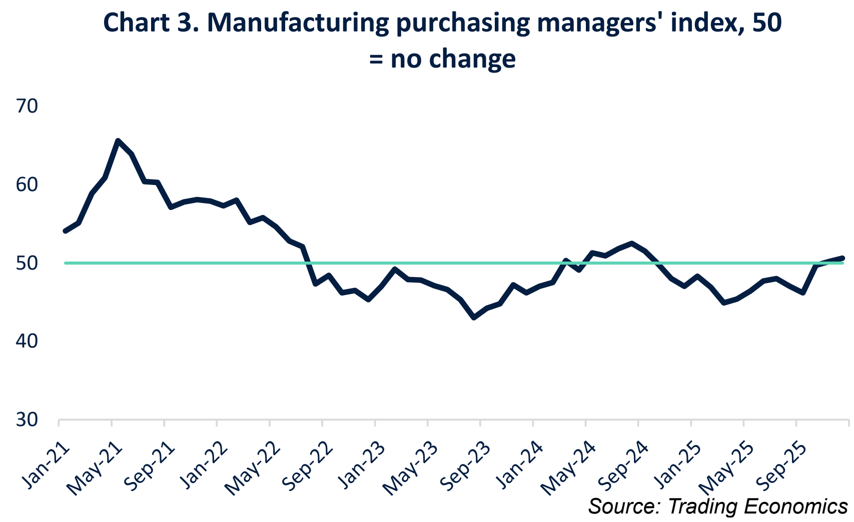
Might the gloom be overdone? The labour market has demonstrated significant resilience in the face of some of the domestic and global challenges firms have faced in recent years. The National Institute for Economic and Social Research also notes that ONS data points to a drop in inactivity rates in the latter part of 2025, which is increasingly the supply of labour and the rate of vacancy decline has eased.

The Resolution Foundation[1] also see something of a silver lining – albeit a medium term one. As jobs are lost through the closure of some firms, there is some reallocation to new and growing firms – ultimately a positive for the UK's sluggish productivity record.

UK manufacturing, down but not out

Manufacturers have had a challenging few years, with the post-Covid recovery derailed by the Russian invasion of Ukraine, a spike in energy costs, sluggish global demand, new frictions in EU trade and, most recently, an extended period of tariff related uncertainty. During this time survey indicators of activity (**chart 3**) have been largely negative and official index of production data from ONS have pointed to flat quarterly average growth rates since the start of 2024.

[1] https://www.resolutionfoundation.org/publications/new-year-outlook-2026/



According to UNIDO this performance is roughly on a par with North America and a bit weaker than the average across high-income industrialised countries (a quarterly average of 0.2 per cent).

Despite some of the gloomy UK numbers of recent years, further depressed last autumn in the aftermath of the cyber-attack at Jaguar Land Rover, there were some tentative signs of improvement as 2025 drew to a close. The S&P Global PMI tipped into expansionary territory in November, for the first time since autumn 2024 and strengthened a little in December. The report noted an improvement in both output and new orders – mainly domestic – at the end of last year, and notably the increase in output was broad based across all segments – consumer, investment, and intermediate goods. Firms noted that pressures from government policy and tariff uncertainty had begun to fade.

The purchasing managers' index tallies with the quarterly *Manufacturing Outlook*[2] survey from Make UK, which also produces forecasts for output and employment across manufacturing and key sub-sectors in the year ahead. Its forecasts suggest there could well be some parts of the industry seeing a stronger outlook, but its likely to be patchy and overall Make UK expects overall production to be down by 0.5 per cent this year.

Areas of potential strength include the automotive sector in which lost production from last year's cyber-attacks and the fading impact of tariff uncertainty – assuming this doesn't flare up again and global demand holds. Other transport and defence are also expected to see growth next year after a solid performance in 2025. Food and drink manufacturers (by far the largest sub-sector) are also expected to post modest growth in 2026.

The forecasts for sectors linked to construction and infrastructure supply chains, for example non-metallic minerals, are quite bullish given weak sentiment levels seen in

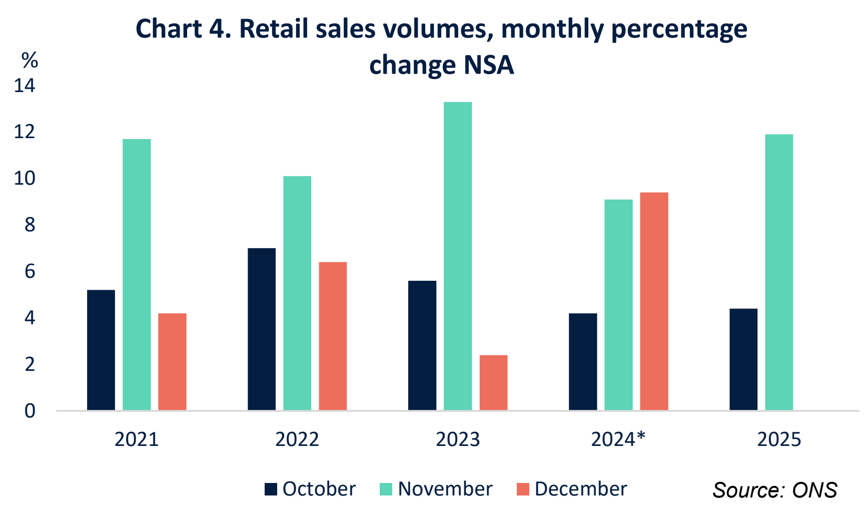
[2] https://www.makeuk.org/insights/reports/manufacturing-outlook-2025-q4

surveys of construction businesses. If infrastructure and new house building does indeed come on stream this year, some foundation industries could support broader growth.

Make UK is more downbeat about prospects for basic metals, which has been under the cosh for some years and sectors linked to business investment, which is expected to struggle this year.

Black Friday business as usual

Last month we noted that despite the sombre mood amongst UK consumers they were still planning to hit the Black Friday sales at the end of last year. We'll have more detail on this from our own card spending data in the coming months. But ONS retail sales data for November does suggest it was business-as-usual for spending on the sales. The non-seasonally adjusted data (**chart 4**) shows monthly growth in sales volumes last November was on a par with that seen in previous years (note: in 2024 Black Friday sales were captured in ONS's December release).

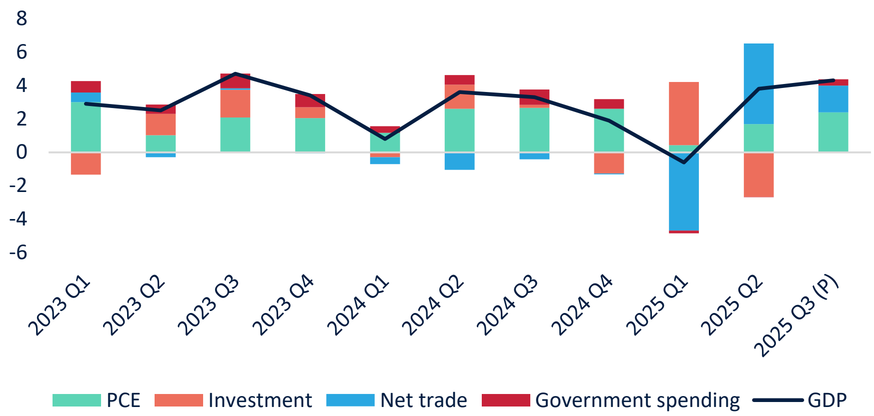


December's consumer sentiment index from GfK pointed to a further modest gain in confidence overall and the plans to make major purchases also picked up to stand at -11, compared with -16 in December 2024. It is far from clear that this is the start of UK consumers shaking off past cost-of-living concerns and potential job market worries. Bank of England data also point to consumers continue to boost savings at the end of 2025 and forecasts of disposable income growth in the year ahead are meagre. While the high street will no doubt welcome a solid festive spending spree, household spending is unlikely to be the motor of growth this year.

US growth accelerates

After the US shutdown delayed the production of key US indicators, statistics agencies are back up and running and the provisional Q3 GDP numbers were released at the end of last year. Initial estimates point to a strong performance for the US economy in the three months to September, with GDP accelerating by a little over one per cent on the quarter (or 4.3 per cent annualised – **chart 5**) and the fastest pace of increase in two years.

Chart 5. Contributions to US GDP growth, percentage points



Source: BEA

Consumer spending did a lot of the heavy lifting in Q3, accounting for more than half of the increase in output over the period. Services were a bigger driver of growth than consumption of goods, though the latter was also positive and a little improved on previous quarters. Notably, a good chunk of the growth on services expenditure was accounted for by healthcare.

Whether we see US consumers continuing to be an engine for growth in the coming quarters is open to question. Confidence remains wobbly, jobs growth has slowed, and pre-Christmas polling by Gallup showed that households had materially reduced plans for spending on festive celebrations and gifts between October and November (more so than any other year since the GFC). As noted above inflation and cost-of-living concerns persist in the US and increases in healthcare costs will only add to consumer caution.

Elsewhere GDP data pointed to a flat picture on investment, with a bit of growth in intellectual property products and IT partially offset by falls in residential investment. Government spending, notably defence, and net trade were also positive contributors to Q3 growth.

Other indicators for US activity at the end of last year haven't been quite so buoyant. The ISM Manufacturing PMI for in December to the lowest level since October 2024, unemployment also edged higher in November. The current consensus forecast is for US GDP growth of around two per cent in 2026, but with ongoing policy uncertainty on any number of fronts and an eye to the mid-term elections at the end of the year, almost anything could happen.

ICYMI and coming up…

In December we published the Q3 Household Finance Review and Business Finance Review.

We also released our mortgage forecasts for 2026/7, which were covered in the Independent and LBC radio (from 02:48:43), among others. Our Q3 regional mortgage factsheets are also available.

In January our quarterly Buy-to-Let dashboard and monthly card spending update will be available. All our data releases can be found here, with full member data available on the UK Finance portal.

Key indicators

Indicator	Period	Value	Change	2026 Forecast
GDP	Q3 2025	0.1%	↓	1.1%
CPI inflation	Nov 2025	3.2%	↓	2.2%*
Unemployment rate	Oct 2025	5.1%	↑	5.0%*
Average earnings	Oct 2025	4.7%	↓	3.2%
Brent crude	Nov 2025	$63.80	↓	-
$ Exchange rate	Dec 2025	$1.34	↑	-
Bank Rate	Dec 2025	3.75%	↓	3.4%*

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

*Q4 2026