KPMG

UK Economic Outlook

January 2025

Executive summary

- Robust household spending, underpinned by continued real wage growth, coupled with higher government spending are set to see growth accelerate this year to 1.7%.
- Public investment is projected to accelerate in the medium term, and if well designed it could encourage more private sector investment.
- UK businesses are set to pass on most of the costs associated with the higher National Insurance Contributions and the increase in the National Living Wage. Inflation is expected to remain above target over the next two years as a result, hovering in the 2-3% range during 2025 and 2026.
- The Bank of England is likely to persist with a cautious pace of interest rate cuts, owing to elevated inflation and increased uncertainty, with a series of gradual rate cuts taking the base rate to 4% by the end of 2025.
- The European Central Bank (ECB), the Federal Reserve (Fed) and other major central banks are similarly expected to continue with rate cuts, with the ECB taking a more aggressive posture owing to the ongoing weakness in the Eurozone economy.
- An escalation in trade frictions could lead to a more uneven outlook for global trade. Even in the absence of tariffs, policy uncertainty could have a dampening effect on global investment and cause higher levels of market volatility.
- In a scenario where tariff measures are imposed on the flows of goods trade; major global exporters could experience significant headwinds to growth from 2025 onwards, especially if escalation leads to tit-for-tat retaliation between trading partners.

Table 1: Summary of KPMG's latest forecasts for the UK economy

	2023	2024	2025	2026
Real GDP	0.4	0.8	1.7	1.4
Consumer spending	0.4	1	1.8	1.4
Investment	0.3	1.8	2.3	2.3
Unemployment rate	4.0	4.3	4.3	4.2
Inflation	7.3	2.5	2.4	2.4
Base interest rate	5.25	4.75	4.00	3.5

Source: ONS, Bank of England, KPMG forecasts. Average % change on previous calendar year except for unemployment rate, which is average annual rate, while interest rate represents level at the end of calendar year. Investment represents Gross Fixed Capital Formation, inflation measure used is the CPI and the unemployment measure is LFS.

Authors

Yael Selfin
Chief Economist, KPMG in the UK
T: +44 (0)7766 362 369
E: yael.selfin@kpmg.co.uk

Dennis Tatarkov
Senior Economist, KPMG in the UK
T: +44 (0)7468 711 320
E: dennis.tatarkov@kpmg.co.uk

Moustafa Ali
Economist, KPMG in the UK
E: moustafa.ali@kpmg.co.uk

Contents

UK economic outlook: Space to grow 2

UK fiscal policy: Prioritising public services 4

Monetary policy: More interest rate cuts to come 6

Global trade frictions: The potential impact of higher tariffs 7

© 2025 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

UK economic outlook: Space to grow

As the UK enters the new year, the Budget, delivered in late 2024 could prove a key driving factor for economic growth this year. The front-loaded increase in government spending is expected to create a temporary surge of demand, causing a brief acceleration in the pace of overall GDP growth in the short run.

Higher labour costs and elevated demand drive higher inflation

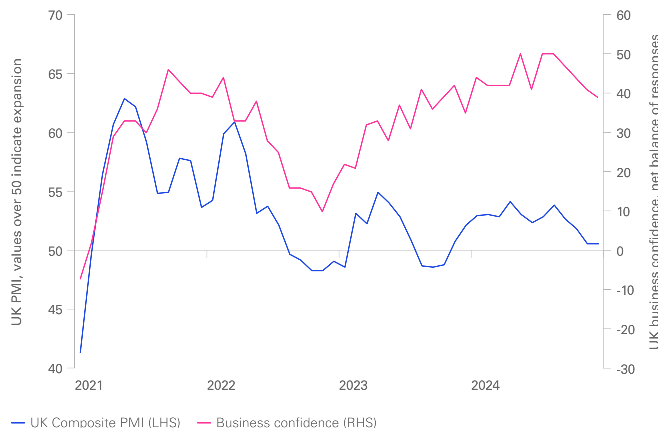
The increase to employer National Insurance Contributions (NICs), as well as a significant increase in the level of the National Living Wage (NLW), which accompanied the Budget, are expected to substantially raise costs of employing staff for UK businesses. Latest surveys show a modest deterioration in overall business confidence in the wake of the Budget (see Chart 1), as firms gauge the additional costs that the announced measures could generate. While over the long term, we would expect the majority of the additional costs to be passed on to employees through a slower pace of wage growth, this is not the case in the short term. Instead, we expect around half of the increase in costs to be passed on through higher prices during the early part of 2025 as well as through some softening in the pace of hiring over this period.

The combination of a temporary boost to overall demand as well as the response of firms to higher costs could lead to a protracted period of elevated inflation. Our latest forecast shows inflation hovering in the 2-3% range during 2025 and 2026, before returning to the Bank of England's target of 2% in 2027. Volatile food and energy prices pose an additional upside risk, especially to the extent that these factors may be amplified by elevated geopolitical uncertainty, and while crude oil prices have remained stable so far, geopolitical developments could also see greater volatility in global oil prices this year.

Lower interest rates boost spending and investment

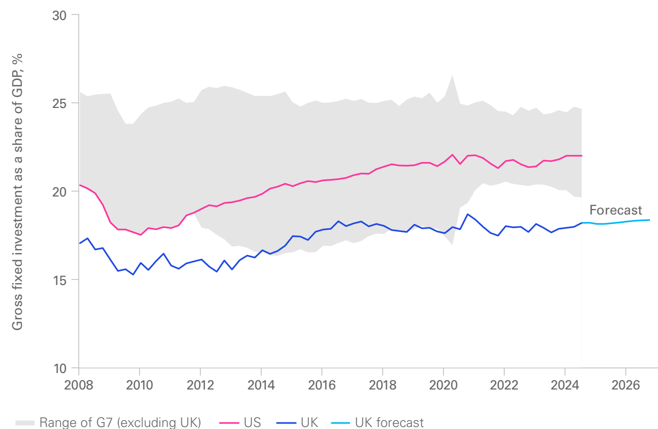
In response to a more persistent and elevated path of inflation, we expect the Bank of England to take a more cautious approach to rate cuts. However, we still expect three rate cuts to take place during 2025. This will contribute to a further easing in financial conditions, which has the potential to boost the pace of business investment in our forecast. Investment as a share of GDP has lagged behind in the UK compared to other advanced economies since the financial crisis (see Chart 2). Overall investment growth from both the public and private sector could reach 2.3% in 2025 and 2026.

Chart 1: UK business confidence deteriorated since mid-2024



Source: Lloyds TSB Bank, S&P Global

Chart 2: Investment set to remain weaker compared to other advancaed economies



Source: ONS, Eurostat, FRED, Government of Japan Cabinet Office, Statistics Canada, KPMG projections.

Consumer spending set to accelerate in 2025

Consumer spending is expected to become a key source of growth for the UK economy this year, underpinned by several factors. Household balance sheets are robust – the latest data for Q3 2024 showed savings stood at 10.1%. The rise in the savings rate over the past two years can be partly explained by elevated interest rates, with households moving their cash to deposit accounts yielding a modest return. However, with interest rates set to fall gradually over the coming year, this could see an unwind in the savings buffer built up by households. Although labour market activity weakened in 2024, relatively low unemployment – in addition to slowing, but robust pay growth – will also support consumer spending. As a result, workers are set to see a continued improvement in their purchasing power with pay growth expected to outstrip inflation in both 2025 and 2026. We expect this to boost consumption, with growth of 1.8% in 2025.

© 2025 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

External demand clouded by growing uncertainty

Net trade contributed negatively to growth last year and we expect that weakness to persist this year. The outlook for the UK's largest trading partner, the EU, is sluggish as its economy deals with a number of headwinds to growth. After contracting in 2024, the **German economy** is expected to rebound modestly this year. Activity is set to be supported by a more accommodative monetary policy, with the ECB expected to cut interest rates repeatedly this year. We expect this to support both households and businesses, particularly in the capital-intensive manufacturing and construction sectors. German fiscal policy could also loosen depending on the election outcome in February 2025. This could increase near-term government spending in addition to unlocking public investment, boosting longer term potential growth. Nonetheless, Germany will continue to face structural headwinds from high energy costs in addition to growing trade uncertainty, which will likely hamper its export dependent economy.

Meanwhile in **France,** political uncertainty stemming from stalled Budget negotiations has significantly impacted business confidence. The latest business climate index survey from the French statistical office, INSEE, showed business confidence fell for a third consecutive month in December. Sentiment fell to its lowest level since the summer, significantly below its long-term average, with a broad based decline across most sectors. Growth in 2024 was driven by loose fiscal policy, which is expected to have contributed to a budget deficit of 6% as a share of GDP. That is likely to moderate next year, with the looming risk of spreads between German and French bond yields growing further in the absence of a sustained fiscal consolidation. Tighter fiscal policy in addition to a weak investment outlook could see economic growth slow in France this year.

Growth in the **Swiss economy** was relatively strong last year, and we expect similar growth in 2025. The Swiss economy is exposed to developments in the Eurozone and the global economy; the outlook for both remains uncertain.

However, we expect the drag on the economy from external demand to be offset by looser financial conditions as the Swiss National Bank (SNB) continues cutting rates, driving growth in both household consumption and business investment this year.

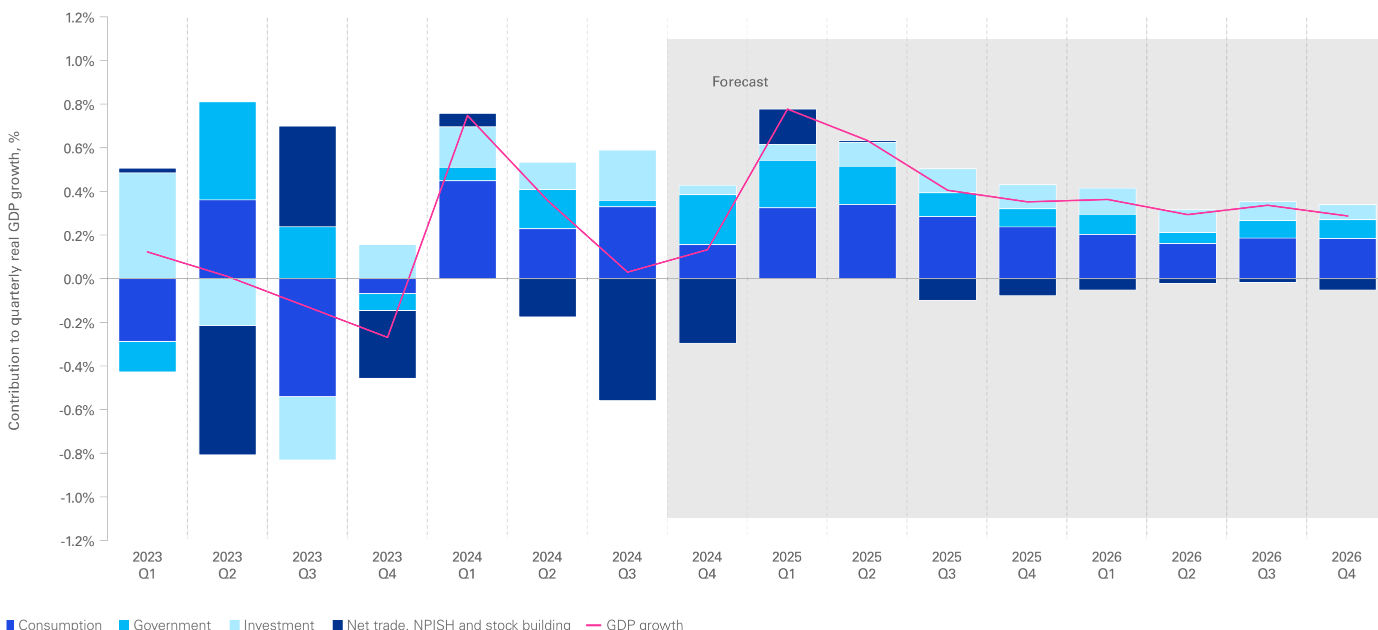
Near-term growth set to pick up, but productivity outlook remains weak

We expect overall GDP growth to rise to 1.7% in 2025 and 1.4% next year, up from an estimated 0.8% in 2024. Household consumption, government spending and investment are all expected to contribute positively to growth while net trade continues to be a drag (see Chart 3). Despite the welcome potential pick-up in growth over the next two years, downside risks to the outlook remain, including growing geopolitical tensions, in particular around trade, which could spark an increase in import prices and weaker global demand.

Despite the near-term pick-up in growth, the longer-term outlook for the UK economy is weak. Labour supply, which has been a key driving force of growth for the UK economy over the past five years is expected to slow markedly, with net migration potentially falling in the coming years.

Productivity growth, the other driver of long-term growth, can be boosted by capital deepening, but this will require an increase to both public and private sector investment, which have been sluggish since the financial crisis. The Government's recent Budget measures to boost public sector investment could represent an upside scenario for long-term growth prospects. However, public investment spending will need to be well targeted and crowd in private sector investment in order to make a significant dent on productivity performance. Additionally, investments may face long delays before becoming operational and impacts are seen on the ground, which would take time to translate into economic growth. While we expect long-term growth to be higher than the post-2008 average, it is unlikely to return to the growth levels seen prior to the financial crisis unless a more sustained adoption of new technologies takes place.

Chart 3: Consumption and government spending set to drive UK growth this year



Source: ONS, KPMG projections

© 2025 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

UK fiscal policy: Prioritising public services

The Budget, unveiled by Chancellor Rachel Reeves on the 30 October, oversaw a significant uplift in public spending compared to plans made by the previous Government, but leaves spending broadly in line with levels since the pandemic (see Chart 4).

Public services receive a front-loaded boost in day-to-day budgets

The bulk of the spending increases were frontloaded to 2024/25 and 2025/26, the years covered by the Spending Review published alongside the Budget. Over this period, day-to-day departmental budgets are set to rise by 3.3% in real terms compared to potentially only 1.3% between 2025/26 and 2029/30. As noted in our outlook section, this has the potential to drive stronger growth in 2025 and 2026.

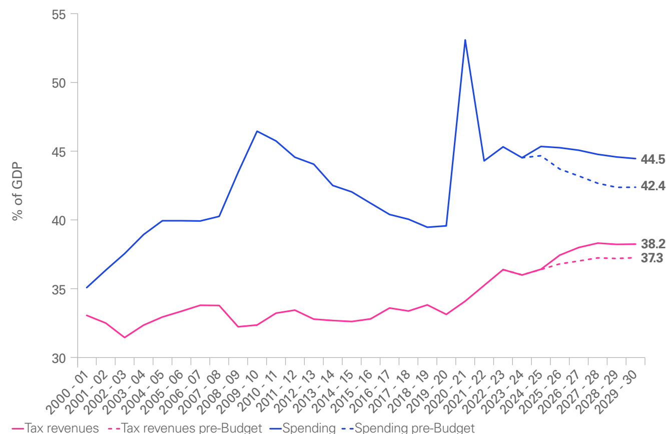
A large part of the budget increases in day-to-day spending is allocated towards public services, where acute pressures have led to a deterioration in the quality of service. A majority of the increase in extra funding is directed towards health and social care as well as education, while local government funding sees the most rapid rises in the spending review, albeit from a relatively low base.

However, to avoid cuts to unprotected departments, which exclude the departments for health, defence and overseas aid, a top-up to the overall budget envelope may be needed after 2025/26. Spending allocations for 2026/27 – 2028/29 are due in phase two of the spending review, expected to be announced in 2025. As it stands, if health and social care spending continues to increase by over 3% per year, while growth in defence spending matches the pace of GDP growth, that would imply cuts to some unprotected departments unless further funding can be found.

Fiscal arithmetic necessitates higher taxes

The increases in current spending were partly funded by higher taxes, with UK tax revenue as a share of GDP now set to rise to 38.2% of GDP by 2029/30, around 1p.p. higher than plans by the previous government. This scale of tax rises ensures that the Government is able to meet its fiscal target in eliminating the current spending deficit by the target year of 2029/30. The historically low level of headroom against this target, of just £9.9bn, presents a risk. A potential deterioration in economic conditions, such as a slowdown in nominal GDP growth by 0.7% in 2029/30 could eliminate the headroom entirely. A similar decline compared to the OBR's March forecasts took place in 2023/24 so this is not an unreasonable scenario to contemplate. Should the Government choose to top-up current spending plans in later fiscal events, it would quite probably have to contemplate further tax increases to meet its deficit related fiscal target.

Chart 4: Autumn Budget oversaw a large uplift in spending and taxation



Source: OBR

The bulk of tax increases in the Budget come from a substantial uplift in employer National Insurance Contributions (NICs), projected to raise an additional £16.1bn by 2029/30. Analysis by the OBR suggests that around three-quarters of this increase would be passed to employees through a slower pace of wage increases in the coming years. However in the short term, while wages are not able to adjust, the increased cost for businesses could see higher prices as well as a potentially slower pace of hiring. With self-employed workers still exempt from employer NICs, this tax change widens the gap with employees, creating additional incentives for self-employment.

Other tax measures included a further uplift to stamp duty rate for second homes, which could have the effect of discouraging the supply of rental properties, adding to the shortage in the private rental market, leading to greater pressures on renters.

A change in debt target allows for more borrowing to support higher investment

The Budget also oversaw a significant increase in borrowing, by an average of £32bn over the next five years. The main constraints to higher borrowing come from the second fiscal rule, which requires for the level of debt to be falling initially in the fifth year of the OBR forecast and from 2026/27 by the third year. This increase in borrowing was made possible by a change to the debt measure used in the rule. The switch from Net Public Sector Debt to Public Sector Net Financial Liabilities (PSNFL), which is a wider measure of public assets and liabilities that also covers some financial assets, has added an additional £50bn of headroom of borrowing for the Chancellor. The change stops short of using a measure of net worth, which would also include the value of physical assets, but opens up the option for the Government to provide loans rather than outright fund projects, with relatively little impact on the fiscal target.

© 2025 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The higher level of borrowing has enabled the Government to fund a large uplift in public sector investment compared to the steady declines that had been pencilled in under the previous government's plans. Budget plans imply that public sector investment levels would now be maintained close to their estimated level in 2024/25 of around 2.6% of GDP.

Current plans see the majority of public sector investment spending directed towards four spending areas: transport, defense, science, and health and social care. Among these four areas, investment in health and social care is set to rise at the fastest rate, up by 12.8% in real terms between 2024/25 and 2025/26. This aligns with the overall goal of addressing shortfalls in the capital stock used in the provision of public health services, including the estimated £13.8bn cost of maintenance backlog of the NHS estate in 2023/24.

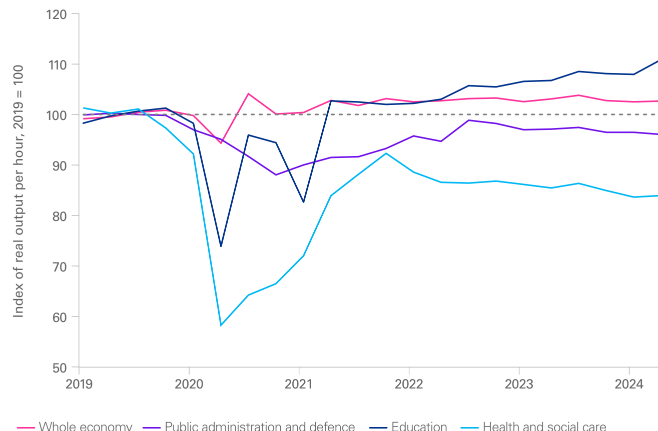
Raising public sector productivity through higher public investment, especially in health and social care could generate a boost to the level of overall GDP, by increasing the output of the public sector. Productivity in the health service has seen marked declines since 2019, with the level of output per hour in the second quarter of 2024 down by 16% compared to the year before the pandemic. By comparison, hourly productivity in the economy as a whole increased by 2.7% over the same period. Simply raising productivity in the health and social care sector to 2019 levels could lead to a one-off increase in overall GDP of 1.5%, equivalent to more than a typical years' worth of economic growth.

Can public investment deliver on higher sustained economic growth?

With much of the public sector investment directed towards shoring up public services, it is not clear how much the Budget would contribute to stronger long-term growth in the wider economy. The OBR's assessment, which accompanied the Budget, points to long lags before the impact of higher investment can translate into higher economic growth, with the net effect of crowding out private investment due to higher costs more than offsetting the positive contribution from higher investment before 2032/33.

However, further policies aimed at enhancing growth may develop through the Government's Modern Industrial Strategy, with more details due to be unveiled later this year. So far, eight broad sectors have been identified as potential targets for growth: advanced manufacturing, clean energy industries, creative industries, defence, digital and technologies, financial services, life sciences, and professional and business services. The wide range of sectors points to a number of objectives –from enhancing security to increasing economic opportunity across different parts of the UK, as well as to achieving net zero targets and accelerating the pace of economic growth.

Chart 5: Productivity across large parts of the public sector has underperformed the wider economy



Source: ONS, KPMG analysis

A large part of achieving the objectives of the Industrial Strategy falls to the newly-established National Wealth Fund (NWF), which takes over and builds on the UK Infrastructure Bank (UKIB). Rather than a traditional Sovereign Wealth Fund, it would serve as a government-owned financial institution investing in projects which align with the Government's growth and industrial strategy objectives. An additional £5.8bn funding announced ahead of the Budget raised the capitalisation of the NWF to £27.8bn with the extra funding expected to be committed over the course of this parliament.

There is scope to further ramp up the activities of the NWF, as they are broadly neutral with respect to the new fiscal rule. This offers a potential upside to growth, provided markets are not spooked by the additional borrowing. Although it remains to be seen whether the industrial strategy can reach the scale sufficient to move the dial on productivity growth in the UK.

© 2025 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Monetary policy: More interest rate cuts to come

A backdrop of moderating inflation, in addition to growth concerns in a number of advanced economies, has seen the start of a global loosening cycle. Since last summer, major central banks, with the exception of Japan's, have begun lowering interest rates.

The European Central Bank (ECB) was among the first of the major central banks to cut interest rates. Inflation has hovered around the target range since the start of last year; meanwhile, economic activity has underperformed expectations. This has allowed the ECB to cut rates by 100 basis points since June 2024.

In the US, the Federal Reserve has also cut rates by 100 basis points since September 2024. The Fed's unique position amongst major central banks, with its dual mandate of guarding price stability as well as promoting maximum employment, allowed it to start cutting rates on the front foot as concerns around the US labour market grew.

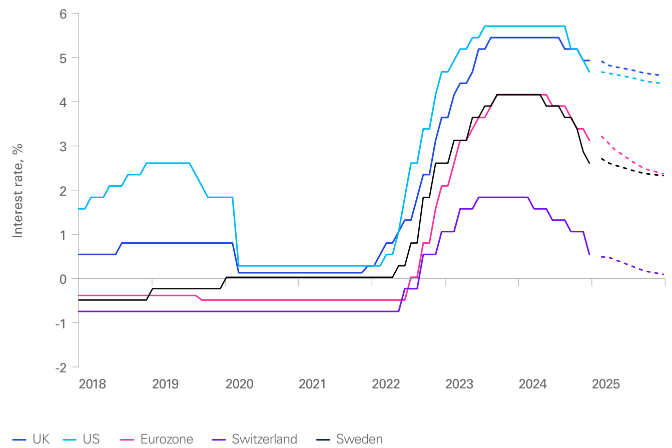
The Bank of England (BoE) kept interest rates on hold in its December meeting. This has been in line with the more cautious approach it has taken compared to its peers, cutting only twice in 2024. Continued concerns around persistence in domestic inflation have limited the BoE's scope to cut interest rates.

In Switzerland, geopolitical uncertainty has put upward pressure on the Swiss franc over the past few months, adding further downward risk to the inflation outlook. This set the stage for a 50 basis points cut by the Swiss National Bank (SNB) at the end of 2024. Meanwhile, the Riksbank in Sweden oversaw one of the most aggressive easing cycles amongst European central banks. A sharp fall in inflation alongside lacklustre economic activity saw the Swedish central bank cut interest rates by 150 basis points in 2024 (see Chart 6).

We expect to see policy rates continue to fall across Europe in 2025, but for the pace of cuts to vary, particularly between the Eurozone and the UK. As discussed in the outlook section, the balance of risks for the Eurozone economy are skewed to the downside. The ECB's December meeting saw it downgrade both its growth and inflation outlook for 2025 and 2026, arguing that risks to the inflation outlook are becoming more two sided. The decision to cut interest rates combined with the more dovish tone taken by President Lagarde, underscores the shift in strategy by the ECB. With the growing risk of inflation undershooting its target in the medium, the ECB has now turned its focus to ensuring the economic outlook does not weaken further.

Given the relatively weak outlook for growth and inflation, the ECB will have room to cut rates significantly next year, potentially by 50 basis points in the first two quarters of the year, down to a rate of 2%. Beyond that, however, the path for Eurozone interest rates is more uncertain. Our current view is that interest rates will fall below the ECB's neutral rate estimate of around 2% by the end of 2025 to 1.75%.

Chart 6: US and European Central Banks have been easing rates



Source: BIS, FRED, LSEG Datastream, Bank of England, ECB, SNB , Riksbank, KPMG analysis. Yield curves shown as of 2 January 2025

In the UK, the picture is markedly different due to stronger growth and higher inflation in the near term. The BoE opted to hold interest rates at 4.75% in its December meeting. Underlying inflationary pressures remain elevated, with inflation not expected to return to target until the first half of 2027. This will likely see the BoE continue with its gradual approach to cutting interest rates. Market pricing currently suggests the BoE will only cut interest rates twice next year (see Chart 6). However, we think the BoE will have slightly more room and expect the BoE to cut interest rates three times in 2025, leaving rates at 4% by the end of this year.

In Switzerland, faced with a rising Swiss franc as a result of growing geopolitical uncertainty, the SNB has reiterated its willingness to return to lower interest rates below zero if necessary to stave off pressure on the currency.

The Swedish central bank is set to continue its easing cycle this year, although at a slower pace, with inflation expected to remain significantly below target. In its December meeting, it signalled it would be ready to cut interest rates further if domestic weakness in the Swedish economy persists and the risk that inflation remains below target in the medium term. Market pricing currently suggests the Riksbank will cut interest rates by up to 50 basis points this year.

While the pace of cuts will differ across Europe this year, the broad direction is likely to be towards a return to neutral territory. Central banks are likely to maintain their current limited forward guidance and uphold their data-dependent approach, reassessing the balance of risks to their respective inflation outlooks at each meeting. For the ECB, SNB and Riksbank, keeping rates in restrictive territory for too long could risk inflation falling below their respective targets in the medium term and potentially contributing to weaker economic growth. Others, such as the BoE, will continue with a more gradual approach, as upside risks to the inflation outlook continue to persist.

© 2025 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Global trade frictions: The potential impact of higher tariffs

Escalating trade frictions could become a key theme of the economic outlook in 2025 and 2026 as the incoming US administration has repeatedly signalled a willingness to use tariff measures to achieve policy goals. Trade tensions had already been rising prior to the outcome of the US presidential election, with both the US and the EU taking a series of measures against China in 2024, including tariffs on automotive exports and export controls on specific technologies.

Tariffs as a negotiating tactic

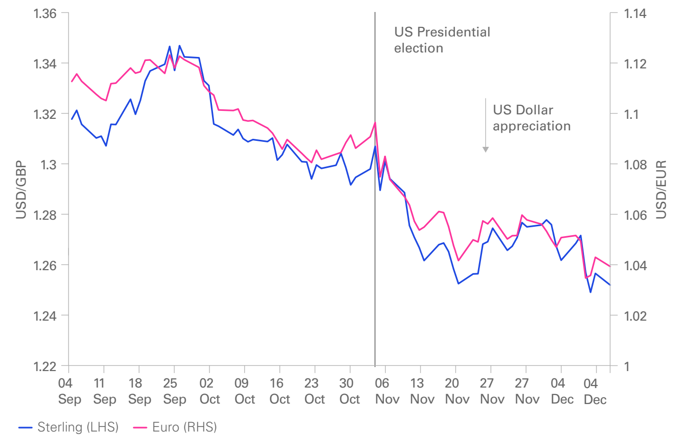
The goals of the potential incoming tariff measures remain unclear, as they could be used by the US administration to achieve a range of differing aims: from simply raising additional revenues to creating a more supportive environment for domestic producers, and lastly to aid in achieving much broader geopolitical goals.

The imposition of tariffs is not inevitable, and it may be the case that the threat of potential tariffs is used as a negotiating tactic by the incoming US administration. In this way it could form a part of a strategy to reach concessions from trade partners. In such a scenario, while there would be no direct economic impact from tariff measures, the economy could still be affected by the heightened state of economic uncertainty until the threat of new tariffs is removed.

The US could aim to address trade imbalances between the US and the EU. The EU maintains a significant trade surplus with the US, in part due to activities of multinational corporations shifting profits towards jurisdictions with more favourable tax regimes. A potential agreement between the EU and the US, aimed at creating a more even corporate tax landscape vis-à-vis the US could help close a large part of the bilateral trade deficit. This could have significant implications for some economies, such as Ireland, which host a large number of multinationals. However, changes to the tax regime would likely leave the location of economic activity and sources of added value unchanged, which would serve to limit the scale of the overall impact.

The US administration may also seek to compel European governments into raising defence spending. If an agreement is reached in 2025/26, this may ease the risk of tariffs and see a more sustained ramping up of public spending on defence in Europe. The need to increase defence spending while maintaining other commitments could create a risk for public finances, especially if increased outlays cannot be accommodated by spending cuts in other areas or by higher tax revenues.

Chart 7: US Dollar appreciated against a basket of other currencies following the US Presidential election



Source: LSEG Refinitiv

The case of universal tariffs

However, given the emphasis that tariff measures have received during the US presidential campaign, an agreement that avoids tariffs entirely may not be feasible. Regardless of the scale and timing of proposed tariff measures, some general conclusions can be made.

Firstly, the US dollar is likely to see an appreciation which would offset part of the increase in import costs caused by the higher level of tariffs on goods sold into the US. While a large part of the increase in the value of the US dollar in the last quarter of 2024 was due to the expectations of changes in domestic policy, this also partly reflects an anticipation of potential tariff measures as shown in Chart 7.

Once tariff measures are in place, we would expect a more pronounced appreciation of the US dollar, which would act to both offset the impact of tariffs while also damaging the competitiveness of US exports abroad.

© 2025 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Secondly, some degree of trade rerouting could also be expected to take place – particularly if some countries, such as China are singled out for higher tariff measures. This could benefit other exporters, especially in Europe and the UK, as producers in these countries would become relatively more competitive in the US market. There are initial reports that trade flows from China have already risen in anticipation of potential tariff increases.

Lastly, the appreciation of the US dollar could lead to a more wide-ranging acceleration in global inflation, due to the higher cost of exports denominated in US$. For the BoE and the ECB, the additional inflationary pressure is likely to lead to an initially slower pace of interest rate cuts compared to our baseline scenario outlined in the monetary policy section above, especially as the heightened level of economic uncertainty may lead central banks to be more cautious in their decision-making.

Should tariffs lead to a significant worsening of economic growth, the ECB and the BoE could switch towards a more supportive stance, likely later in 2026, by accelerating the pace of rate cuts. This could also lead to an initially higher path of global inflation, followed by a gradual return to target.

Baseline forecast

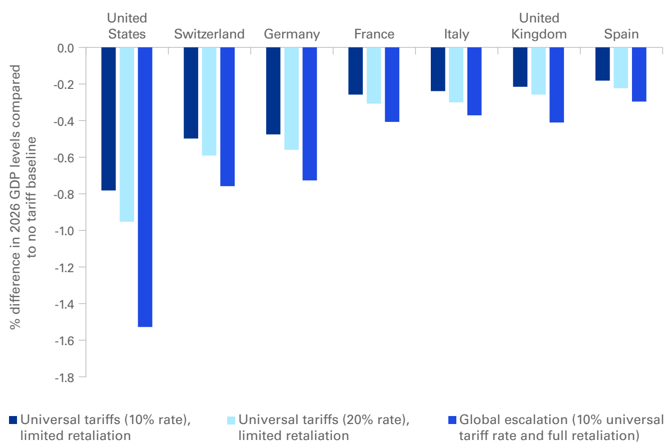
In our outlook for 2025-26[1] the US is expected to gradually ramp up tariffs from spring 2025 until early in 2026. This follows a typical pattern of US tariff measures and can include delays of up to a year to allow for implementation of tariffs as well as an allowance for a comment period for waiver petitions. The gradual ramping up of tariff measures would still see Eurozone GDP expanding by 1% in 2026 and 1.1% in 2027, while inflation remains below 2%. The UK economy evolves in line with the forecast described earlier in this report.

Tariff scenarios

In order to gauge the magnitude of the risk of further trade frictions on the UK and European economies this year, we have modelled a set of scenarios, featuring a more rapid tariff implementation as well as varying degrees of retaliation between trading partners.

In our first scenario, we assume that tariff measures are in place as early as the second quarter of 2025. We have modelled a 10% import tariff covering all US trading partners, and a larger 60% tariff on US imports from China. For the purpose of this scenario, we assume that any retaliation, if it takes place, is limited in scope and targeted on very specific sectors of the US economy. While this may have significant political and economic consequences for that sector, we assume that the retaliation measures are chosen to have a relatively limited impact on aggregate economic performance. We consider the case of more significant retaliatory measures in an alternative scenario.

Chart 8: GDP impact of tariff scenarios on selected economies



Source: KPMG analysis and assumptions modelled using the Oxford Economics Global Economic Model

The overall impact on UK and European economies could be relatively modest, with GDP down by 0.2-0.5% in 2026 compared to the baseline case of no tariffs (see Chart 8). The impact is somewhat higher at 0.2-0.6% if the universal tariff is applied at a 20% rate.

Higher reliance on exports, as the case for Germany and more generally for smaller open economies, which naturally tend to be more trade intensive, as in the case of Switzerland, tend to see larger economic impacts from trade restrictions. This pattern holds across all scenarios we have modelled, although this pattern may not hold if incoming tariff measures are skewed towards specific sectors.

The third scenario we modelled looks at a more widespread retaliation scenario to the initial US tariffs, with tit-for-tat tariffs imposed on the US, leading to a larger impact on global economic growth. We assume that as in the previous scenario, US tariffs are imposed from the second quarter of 2025, with retaliatory measures imposed in the following quarter. The economic fallout from a global escalation of trade frictions is more significant, with the level of GDP in Switzerland down by 0.8% relative to baseline in 2026, and a 0.7% reduction in Germany. The UK could see a still significantly lower level of 0.4% of GDP in 2026, as shown in Chart 8.

1 For more details on the outlook for the US economy, see Turning Points: 2025 Annual Outlook

© 2025 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

kpmg.com/uk/en/**macroeconomics**

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2025 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organisation.

CREATE | CRT158752A | January 2025