UK Economic Outlook

KPMG. Make the Difference.

March 2026

- The conflict in the Middle East has resulted in an energy price shock to the UK economy. Households will be partially shielded until July thanks to the Ofgem energy price cap but face a likely rise in household energy bills in the third quarter.
- Inflation is now expected to peak at more than 3.5% in the third quarter, with businesses likely to pass on price increases from higher energy costs to households. This could see the Bank of England cut interest rates only once this year, with additional cuts postponed until 2027.
- The energy shock is set to weigh on economic activity, with households cutting back on discretionary spending as their purchasing power falls, while businesses potentially scale back investment due to higher financing and energy costs.
- The UK's relatively weak growth over the past two decades has opened up a substantial gap in living standards compared with the US and, to a lesser extent, the Eurozone. With UK households more exposed to the latest spike in energy prices than in some of these economies, that gap could widen further this year.
- A largely uneventful Spring Forecast masked several competing pressures facing the government, with the weaker growth outlook and higher interest rates now emerging as an additional headwind to fiscal headroom. If the government acts to shield households from higher gas prices during the third quarter, we estimate the cost could be up to £5 billion.
- The increasingly widespread adoption of GLP-1 drugs as a treatment for weight management has the potential to reach a significant share of the UK adult population over the next five years. The drug's effect on appetite, appearance and overall preferences could drive significant shifts in spending away from out of home dining and grocery, and towards categories such as clothing and cosmetics. In addition, the current elevated cost of the drug could see a reduction of spent on goods and services deemed by consumers as non-essential as they find funds to cover it.

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

	2025	2026	2027
GDP	1.3	0.7	1.2
Consumer spending	1.0	0.7	0.9
Investment	3.4	1.0	2.1
Unemployment rate	4.8	5.3	5.3
Inflation	3.4	3.1	1.6
Base interest rate	3.75	3.50	3.00

Source: ONS, KPMG forecasts.

GDP, consumer spending and investment are all measured in real terms. 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
T: +44 (0)7935 352 083
E: moustafa.ali@kpmg.co.uk

Contents

Energy shock is set to see inflation rising this year

Headline inflation is expected to rise from the third quarter onwards as the spike in energy prices gradually feeds through. In the near term, inflation is expected to ease slightly, with the Ofgem price cap, which was set ahead of the rise in gas prices, to see household energy bills fall by 7% in the second quarter this year. Last year's sharp increases in utility prices are also unlikely to be repeated. However, the sharp increase in oil prices will feed through to higher petrol costs for households, potentially leaving inflation at 2.6% by June, above the Bank of England's 2% target.

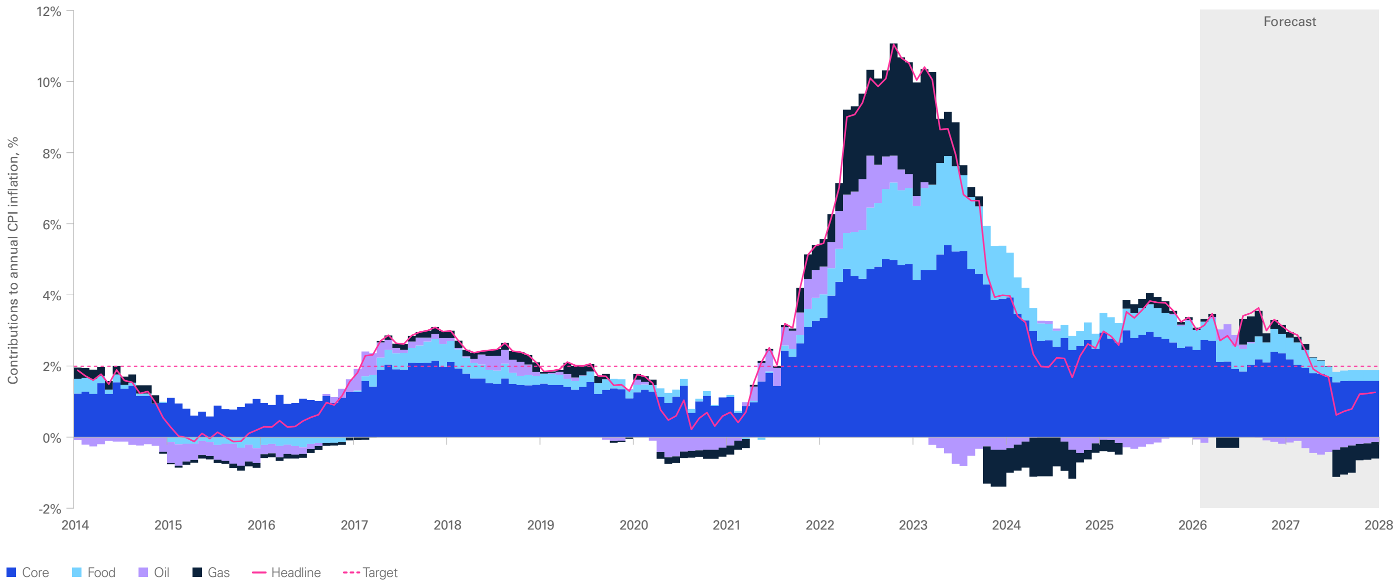
Inflation could continue to rise from July onwards as disruptions to oil and gas supplies in the Middle East have put upward pressure on energy prices. The impact of the increase in oil prices has quickly filtered through to higher prices at the pump for motorists, reversing the decline in fuel prices seen over the past year.

The sharp increase in gas prices pose a larger upside risk for inflation. If gas prices remain around their current level over the next few months, that could translate into an increase in the Ofgem price cap in Q3. Our current assumption sees deescalation in the conflict within the next few months causing oil and gas prices to gradually fall, although investors may continue to price in a risk premium until conditions fully stabilise. This has the potential to push inflation higher to a peak of around 3.6% by September this year.

The impact of the rise in wholesale gas prices is likely to be more immediate for businesses, given that they are not covered by the Ofgem price cap. This has the potential for second round effects if businesses choose to pass on this cost to customers in the form of higher prices for goods and services, raising the risk of more persistent underlying inflation. Furthermore, there is also a risk of a rise in food prices, as disruptions to fertiliser supplies, a significant input cost for farmers, are likely to increase production costs.

If the disruption to energy supplies from the Middle East proves relatively short-lived, and both oil and gas prices decline before the summer, weaker prices could push down on inflation, and see it fall from a peak in November close to the Bank of England's 2% target by Q2 in 2027 (see Chart 1).

Chart 1: Inflation is expected to rise as energy costs feed through



Source: ONS, KPMG projections.

Bank of England to keep interest rates on hold as it assesses outfall from the energy shock

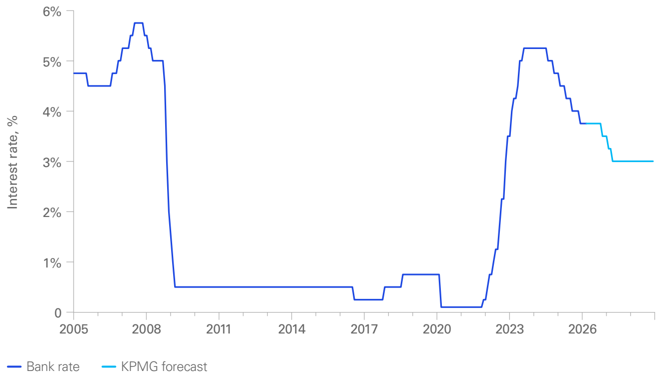
With the balance of risks to the inflation outlook tilting firmly to the upside, the Bank of England has been prompted into shifting to a more cautious stance. The Bank opted to keep interest rates unchanged in its March meeting, and signalled it is unlikely to cut interest rates in the near term.

A key concern for the Bank is the scale of the second-round effects from higher energy costs, and the possibility that businesses will accelerate price rises as they pass on costs to customers. Additionally, workers could look to cushion the shock to their real income by demanding higher pay settlements, though that risk is less likely to crystallise given the weak state of the labour market.

Against this backdrop, the Bank will be hesitant to cut interest rates until it is confident that headline inflation is on a clear downward path. This will mean keeping interest rates higher for longer to ensure that underlying price pressures do not become entrenched over the medium term. Nonetheless, the Bank will have to weigh the risk from higher energy prices against a weak labour market, and sluggish domestic economy.

Overall, we believe the Bank will lower interest rates by more than markets currently expect for this year. If the impact of energy supply disruptions fades, a cut later this year appears likely, paving the way for interest rates to fall to 3.5% by the end of 2026 (see Chart 2).

Chart 2: Bank of England could keep interest rates on hold until Q4 this year



Source: Bank of England, KPMG projections.

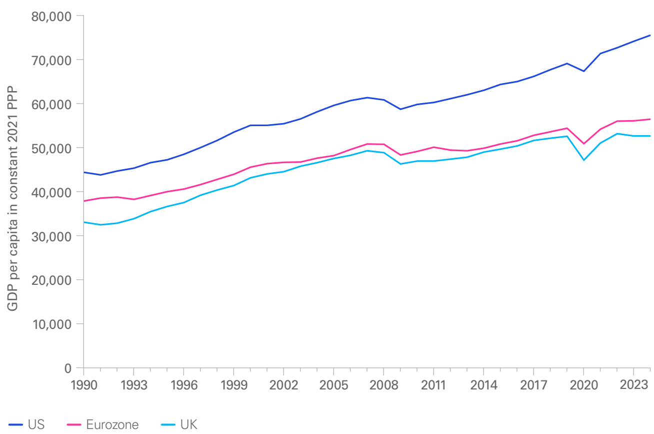
UK economy has underperformed its peers over the last decade

While the UK economy performed relatively well last year, expanding by 1.3%, the UK's growth trajectory over the past two decades has slowed, particularly in comparison to the US and, to a lesser extent, the Eurozone.

The UK economy has been hit by economic shocks both more frequently and more severely over the past two decades than many of its peers. These shocks include global events, such as the Global Financial Crisis and COVID-19 pandemic, to UK specific disruptions such as Brexit.

As a result, the gap in living standards between the UK and its peers has grown. In 2007, UK GDP per capita lagged behind the Eurozone by 3% and the US by 20%. By 2024, the gap with the Eurozone more than doubled to 7% and increased to 30% compared to the US (see Chart 3).

Chart 3: The gap between US and UK GDP has widened

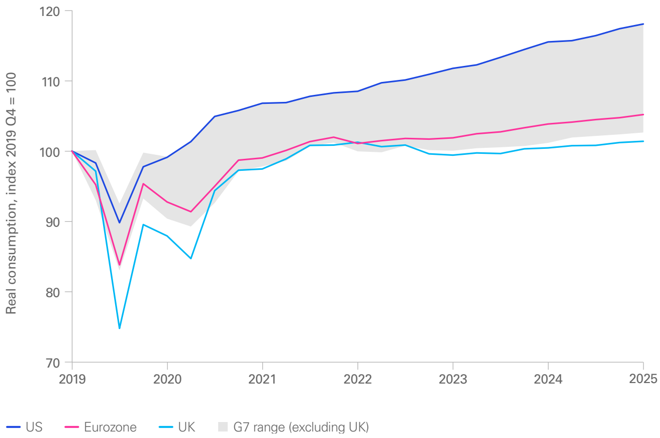


Source: World Bank, KPMG analysis.

Higher energy costs set to see consumer spending and GDP growth slow

The succession of shocks that have dented economic growth in recent years have also impacted households' ability and willingness to spend. Household spending in the UK has grown just 1.4% since the pandemic, in stark contrast to a nearly 20% growth in the US over the same period, and 5% growth in the Eurozone (see Chart 4).

Chart 4: UK consumer spending has underperformed other advanced economies



Source: ONS, Eurostat, Haver analytics, KPMG analysis.

Since the pandemic, there appears to have been a shift in UK households' preference towards higher saving. The UK savings ratio increased from 5.8% in 2019 to a peak of 11.3% in 2024 Q4, before falling to 9.5% as of 2025 Q3.

While the increase in household savings after the pandemic was prevalent across most advanced economies, more persistent cost pressures in the UK eroded purchasing power more severely, placing greater constraints on consumption. Higher cost pressures have also meant tighter financial conditions in the UK, which have increased the incentive to save rather than spend.

One clear sign of this greater propensity for saving is the rising use of Individual Savings Accounts (ISAs), a tax-free savings vehicle. The number of ISA holders increased from 11 million in 2019 to 15 million in 2024.

Over the same period, the total value of assets held in ISAs rose by 53%, from £67 billion to £104 billion. While historically, consumers represented the main growth engine of the UK economy, persistently higher savings would need to be paired with stronger business investment if the medium-term growth outlook is to benefit from this shift in behaviour.

Our outlook for consumer spending in 2026 is relatively weak, with expected growth of just 0.7%, a slowdown from the 1% recorded in 2025.

Cost pressures remain prevalent, with further increases set to come in categories such as energy and food. Consumer sentiment also remains weak by historical standards, and that is likely to keep savings rates elevated. The latest GfK consumer confidence survey also pointed at households planning to prioritise saving over the coming year, with savings intentions remaining above their pre-pandemic average. Furthermore, the impact of interest rates remaining high is likely to incentivise households to continue to keep saving, despite the impact of higher costs. Taken together, we expect the savings rate to remain broadly unchanged over the coming year.

UK GDP growth is expected to moderate to 0.7% in 2026, reflecting the loss of momentum at the end of 2025 and the impact of rising energy prices. Business investment is set to weaken, but the UK's relative lower energy intensity compared to other economies should partially shield many firms.

Given this weak backdrop, government spending is expected to be the main driver of growth, with more modest contributions coming from consumer spending and investment. Net trade is likely to remain weak, as recent changes in US tariff policy will, on balance, make UK exporters less competitive in the face of higher trade barriers.

Wage growth expected to moderate further but upside risks remain

The weakening of the labour market over the past year has seen pay pressures moderate for businesses, and we expect further easing over the coming year. Labour market conditions have improved on the supply side, with a sustained increase in the number of people returning to the workforce.

A key driver of higher pay pressures in the years following the pandemic was the fall in the participation rate, as the UK saw a substantial increase in the number of people leaving the labour market, mainly due to long-term sickness. However, from mid-2024 this trend began to reverse with participation rising (see Chart 5). This rise in workforce participation has been the main driver of the sustained increase in the unemployment rate seen since early 2025, rather than a rise in redundancies, which have remained relatively low.

Looking ahead, although the participation outlook remains uncertain, the recent rise should be enough to ease wage pressures over the coming year. We expect any further falls in inactivity to be limited, as most categories of working age inactivity are already back to, or below, their pre-Covid levels. Achieving further meaningful progress in reducing inactivity will require a sustained fall in the number of people outside the labour force because of long-term sickness, which remains nearly 40% higher than its pre-pandemic level. However, given persistently high NHS waiting lists, such a reduction appears unlikely in the near term.

A combination of slowing hiring activity in addition to an uptick in labour supply could cap workers' ability to negotiate higher wages. The latest Decision Maker Panel survey from the Bank of England shows that firms expect pay settlements to fall to 3.5% over the coming year, down from 4% a year ago.

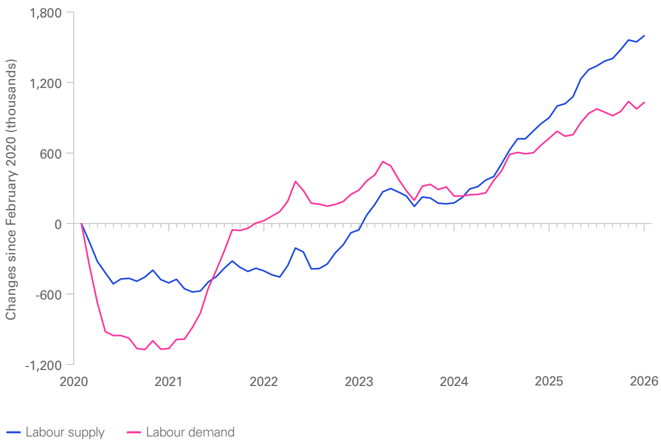
Smaller rises in the minimum wage over the medium term could also contribute to an easing in wage pressures more widely. The government announced that the minimum wage will rise by 4% from April 2026, well below the 7% increase implemented last year. The government has also announced a delay to the planned increase in minimum wage for young workers.

UK government changes to visa rules have led to a substantial fall in net migration. However, we do not see this as an upside risk to our wage growth outlook. The recent decline in net migration has been driven mainly by a reduction in students and dependants, most of whom were not active participants in the labour market.

While there was also a fall in worker visas, much of this reduction was concentrated in sector-specific routes, particularly within the care sector. As a result, these changes may not materially impact the near-term outlook for overall labour supply. Over the long term, however, persistently lower levels of migration are likely to reduce the participation rate and put upward pressure on average wages. In the short term, headline wage growth could fall from 3.8% in January 2026 to around 3% by the end of 2026, broadly in line with where the Bank of England assesses target consistent wage growth to be.

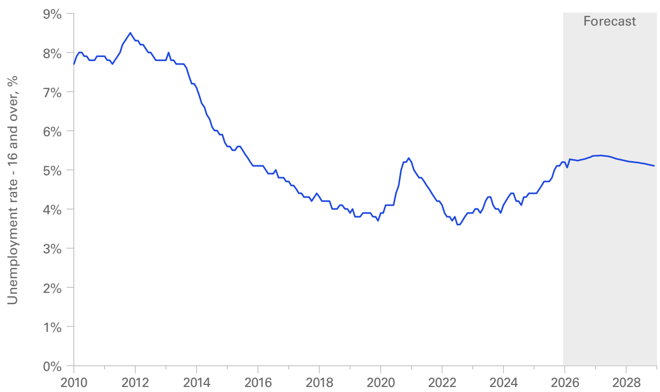
The overall labour market outlook remains weak, but the worst of the downturn may have passed. Vacancies have remained stable over the past 6 months, while the forward looking indicators from the latest KPMG/REC survey point to a tentative recovery in hiring intentions from their summer lows, although they remain slightly negative. As a result, we expect the unemployment rate to rise slightly and average 5.3% in 2026 and 2027 (see Chart 6).

Chart 5: More people returning to the labour market and sluggish demand set to constrain wage growth



Source: ONS, KPMG analysis.
Supply is total workforce participation. Demand is the sum of employment and vacancies.

Chart 6: UK unemployment is set to stabilise over the next two years



Source: ONS, KPMG projections.

Defence spending commitments leave the government facing painful fiscal trade offs

The March 2026 Spring Forecast was largely uneventful, with the government seeing its fiscal headroom slightly increased to nearly £24 billion while announcing no major policy changes.

However, the Spring Forecast masked several spending pressures, including the rising costs associated with meeting the UK's expanding defence commitments.

The increase in global energy prices has also emerged as a fiscal risk for the government. If the Chancellor opts to shield households from the impact of higher energy prices in the third quarter, we estimate that this could cost around £5 billion. However, as this measure would likely only be temporary and limited to the third quarter, it would not affect the Chancellor's medium-term fiscal targets, though it would lead to a modest increase in borrowing.

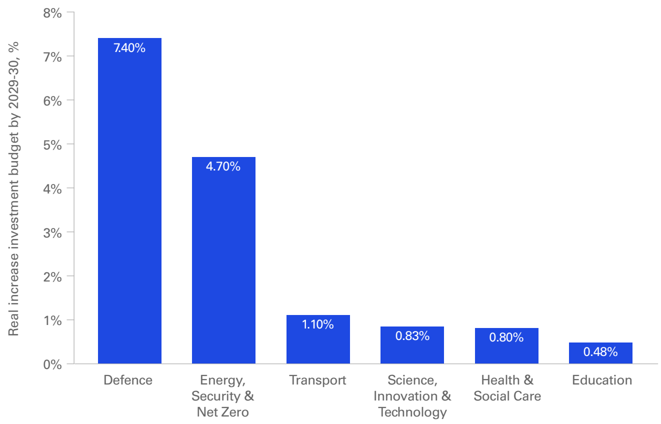
The downgrade to this year's growth forecasts and higher interest rates could see the Chancellor's headroom fall by £10bn in the autumn. Other revisions to the longer-term forecast, incorporating revised migration outlook for example, could also eat into the buffer the Chancellor has.

A longer-term spending pressure that will need to be addressed in the autumn will be the defence budget. While the government has not outlined a detailed roadmap for increasing defence spending, it has committed in the Strategic Defence Review to meeting the NATO target of 3.5% of GDP by 2035. Credibly reaching this goal would require a steady, linear rise in spending, with defence expenditure reaching around 3% of GDP by the end of the decade.

According to the Office for Budget Responsibility (OBR), this trajectory would entail an additional £12 billion in spending by 2029-30, which may leave the government in a difficult position. Raising taxes to close the gap would be politically challenging, while investors are likely to be cautious about any further borrowing to finance the shortfall, particularly in light of the recent increase in government borrowing costs.

A potential solution could be to redirect spending from other departments, as seen last year, when the government reduced the Overseas Development Assistance budget to fund an increase in defence spending. However, doing so will be difficult as capital budgets across Whitehall are already tight. Current spending plans indicate that most departments are set to experience a real term reduction in their investment allocations by 2029-30. At the same time, the defence investment budget is already projected to record the largest real-terms increase over the period, rising by more than 7% (see Chart 7).

Chart 7: Tight spending envelope means only six departments are seeing a real-terms increase in capital budgets



Source: OBR, HMT.

After the Ministry of Defence, the Department for Energy Security and Net Zero and the Department for Transport are set to receive the largest increases in capital budgets. With the overall spending envelope tight, this also places them most at risk if the government chooses to redeploy investment spending to help close the defence budget shortfall. Such a shift would be difficult to justify, as both departments are central to the government's growth strategy, which relies heavily on accelerating major infrastructure projects in energy and transport. Nonetheless, given the constraints on capital spending across Whitehall, reallocation from these areas may be one of the few realistic routes to raising the Ministry of Defence's investment budget.

A cut to public investment in transport and energy infrastructure would also have knock-on effects for businesses, particularly in the construction sector which could face delays or cancellations to planned works. Evidence from Germany shows that increased defence spending may produce positive spillovers, and support manufacturing activity. With around 35% of the Ministry of Defence's budget allocated to capital spending, any further uplift is likely to be directed towards equipment and procurement programmes, providing a potential boost to UK defence manufacturing.

The rise of slimming drugs and their impact on consumption habits

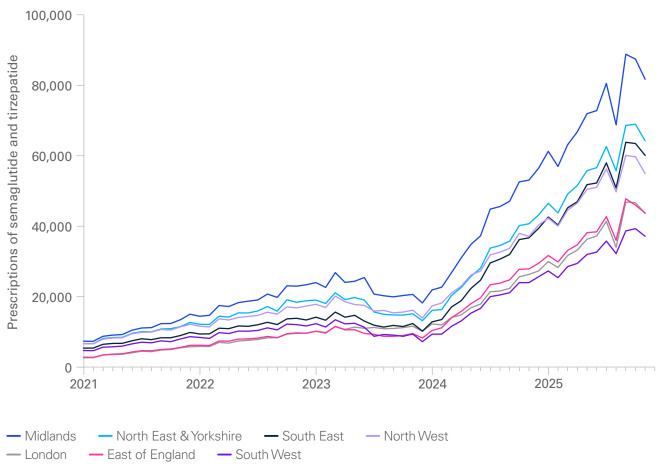
GLP-1 drugs could see widespread adoption as a route for weight-loss, potentially reaching a significant share of the UK adult population over the next five years.

The drug's effect on appetite, appearance and overall preferences could drive a shift away from categories such as out of home dining and grocery, towards categories such as clothing and cosmetics.

The high cost of the drug, unless it becomes freely and widely available through the NHS, could magnify a reduction in spending on goods and services that consumers consider non-essential as they find funds to cover it.

After demonstrating their effectiveness in inducing weight-loss, the use of drugs such as Wegovy and Mounjaro has risen rapidly in the UK. While NHS England prescriptions have almost quadrupled since January 2024 (see Chart 8), a larger share of the drugs has been procured through private prescriptions, with reported private users across the UK reaching 2.4mn by mid-2025[1], up by almost 400% in the preceding 12 months. We expect the usage of these drugs to continue to rise and explore here the implications of rising adoption across different categories of UK consumer spending.

Chart 8: NHS prescriptions for weight-loss drugs



Source: OpenPrescribing.net, Bennett Institute for Applied Data Science, University of Oxford, 2026.

Semaglutide brand names: Wegovy, Ozempic, and Rybelsus;
Tirzepatide brand names: Mounjaro and Zepbound.

Due to their effect on appetite, consumers using these drugs experience a significant shift in their consumption patterns. Studies have shown a range of impacts arising from adoption of GLP-1 drugs, with a 5% reduction of purchases of groceries, and a larger 10% fall in the consumption of high-calorific items, as well as a 9% fall in spend on dining out[2]. Other impacts affect clothing spending as new sizes are needed, and cosmetics spending from increased confidence, as well as an increase in gym and fitness spending. Typically for users of these drugs weight loss occurs over a period of 18 months from the date of initial adoption, and discontinuing treatment leads users to regain weight over a similar timeframe[3].

Given a rapid increase in the number of users over the past two years, future growth in user numbers is difficult to assess. Available data shows that 4.3 million people have already used weight loss drugs by December 2025 while 7.6 million would consider using weight loss drugs in the future[4].

We expect cost, availability and public perceptions of risks and benefits could all be relevant drivers of future adoption. Additional uncertainty comes from the fact that users may influence the consumption patterns of a wider household, potentially shifting the buying behaviours of non-users. Meanwhile overall obesity prevalence in the UK has steadily risen to around 27% of adults, with a further 41% classified as overweight, both of these categories correspond to more than 37mn adults in the UK.

1 Written evidence submitted by Manesha Banwait at IQVIA

2 Hristakeva, Sylvia and Liaukonyte, Jura and Feler, Leo, The No-Hunger Games: How GLP-1 Medication Adoption is Changing Consumer Food Demand (December 27, 2024). Cornell SC Johnson College of Business Research Paper

3 West S, Scragg J, Aveyard P, Oke J L, Willis L, Haffner S J P et al. Weight regain after cessation of medication for weight management: systematic review and meta-analysis BMJ 2026; 392

4 YouGov, 2026

Given the complexity in estimating how widespread the use of GLP-1 drugs may be, our scenarios are intended to be illustrative and correspond to a concurrent drug usage reaching a third of all obese and overweight adults, which could be achieved over the next five years (see Table 2)[5]. This is consistent with a total of 12.4mn concurrent users. This represents a mix of usage patterns, evenly split between a population of users who remain on the drugs continuously, and intermittent users.

If GLP-1 medications are made widely available through the NHS, the positive impacts on clothing, cosmetics and fitness spend largely offset the reductions in dining and grocery spending, leading to a modest fall in overall consumer spending of only 0.1% (see Scenario 1, Table 2). Dining out is the most affected category of spend, which sees a 1.2% fall in this scenario, followed by a 0.4% decline in grocery spending. This is partially offset by a 0.7% increase in cosmetics spending, and 0.5% higher spending on clothing as well as a smaller 0.2% rise in recreation and entertainment spending driven by an increase in gym membership.

An alternative scenario where 90% of prescriptions are paid for out-of-pocket at the current price of £52 per week leads to a larger decline in consumer spending (excluding the medicine) of -0.6% (Scenario 2).

The cost of treatment currently represents around 8% for an average UK household expenditure in 2025, which in this scenario leads households to reallocate spending to accommodate the additional cost. The effect is concentrated on non-essential categories of spending, such as dining out, which declines by an additional 1.4ppt from -1.2% to -2.6% relative to the scenario where medication is provided through the NHS. In contrast, grocery spending remains unchanged from Scenario 1 due to the lower sensitivity with income.

The availability of generic substitutes and lower cost formulations has the potential to reduce the cost of the medication for users, which could drive a smaller reduction in overall non-medical spending of only -0.3% (Scenario 3). We considered a 60% fall in pricing from an average £52 per week currently to £21 per week. We found the effect across spending categories follows the pattern in Scenario 2, allowing for a lesser impact on overall spending due to the lower cost of the medicine.

Table 2: Indicative impacts on spending from GLP-1 adoption
(% change)

	Scenario 1 Available through NHS at nominal cost	**Scenario 2** Available through private prescription at current pricing levels	**Scenario 3** Available through private prescription, but generics drive down costs
Clothing	0.5	-0.6	0.0
Cosmetic	0.7	-0.6	0.2
Dining	-1.2	-2.6	-1.9
Recreation & entertainment	0.2	-1.2	-0.3
Grocery	-0.4	-0.4	-0.4
Holidays & travel	0.0	-1.3	-0.5
Home & furnishing	0.0	-0.3	-0.1
Insurance	0.0	-1.0	-0.4
Transport	0.0	-1.6	-0.7
Other	0.0	-0.9	-0.3
Total spending (excluding medical)	**-0.1**	**-0.6**	**-0.3**
Total spending (including medical)	-0.1	1.9	0.7

Source: ONS, NHS, KPMG analysis.

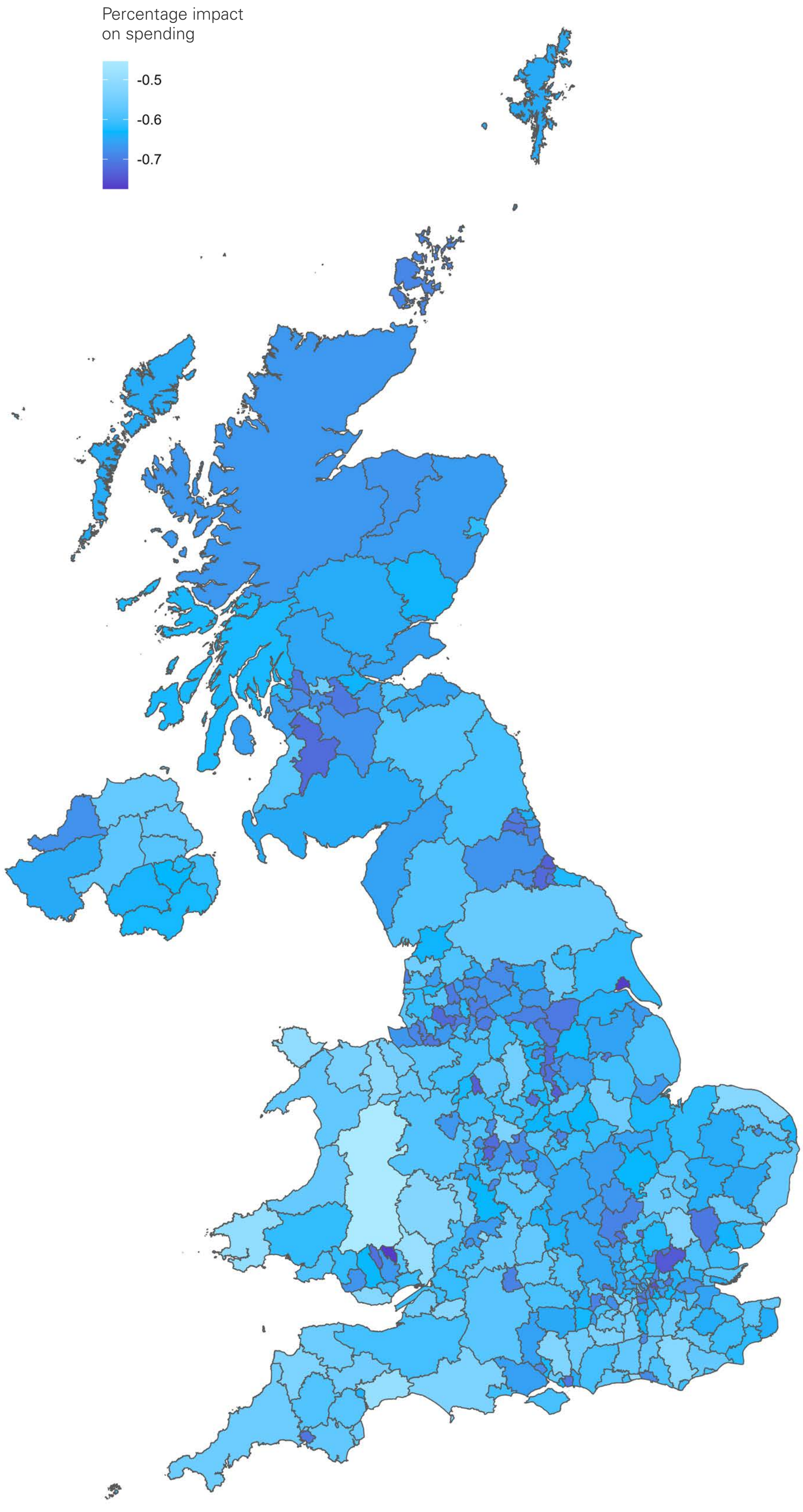
Note: Total spending excludes mortgage capital payments as this is classified as an accrual of wealth.

5 Intermittent use corresponds to one in three obese and overweight adults using the medication around 50% of the time. This may be a potentially harmful pattern of treatment as weight loss and subsequent regain may lead to a long-term loss of muscle mass.

Our findings suggest that, owing to regional variation in obesity/overweight prevalence and the regional variation in incomes, the drop in total non-medical consumer spending could range from -0.5% to -0.8% across regions of the UK (see Chart 9).

Poorer regions are disproportionately affected because medication costs represent a larger share of household incomes, necessitating greater reductions in consumption elsewhere. At the national level, this adjustment is most pronounced in discretionary categories, with spending on dining out potentially falling by between 1.6% and 3.7% whilst necessities such as groceries have both a smaller decline and range, falling between 0.3% and 0.6%.

Chart 9: Regional variation in GLP-1 impact on consumer spending



Source: ONS, NHS, KPMG analysis.

Results depict reduction in overall spend excluding medical spending, arising from GLP-1 adoption as per Scenario 2 above.

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

CREATE | CRT166209 | March 2026