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Slow growth and political alarms: 3 calls for the UK economy

Tighter fiscal policy means the UK economy is set to grow more slowly in 2026, even if falling inflation should open the door to further Bank of England rate cuts. For markets, politics is the biggest risk next year

Prime Minister, Sir Keir Starmer is on shaky political grounds in the UK

ING's base call: UK economy to grow more slowly in 2026

We expect growth to slow to 0.9% next year (from 1.4% this year), for three reasons.

First, spending power is expected to stagnate; real household disposable incomes are set to grow by 0.5% in 2026, versus 1.5% this year. Wage growth is falling quickly, while employment growth is likely to be negligible. Rate cuts are a slow burner. Most mortgages are fixed for five years, while savings income will decline more quickly.

Second, the public sector – having been a key offset to private sector weakness in 2025 – will be less supportive. Real departmental spending will grow at half the rate seen in 2024 and 2025, while income tax is rising as a share of GDP. The deficit is set to drop a full percentage point to circa 3.5%. Fiscal policy will be a drag in 2026.

Finally, business investment is likely to weaken, at least in the first half of the year. Confidence has fallen on the delivery of – and uncertainty about – future tax hikes. Global challenges aren't helping.

Our risky call: Bank of England hawks proven wrong as inflation recedes

We expect inflation to fall from 3.6% now to almost 2% in April. Food inflation has likely peaked. The marked fall in wage growth points to lower services inflation, helped by more contained regulatory price hikes and slower rental growth. The government's decision to lower energy bills should trim 0.3pp off headline CPI too.

Hawks at the Bank of England fear that elevated inflation rates in 2025 – particularly for food – will fuel a more sustained episode of price pressure akin to 2022. We disagree. The jobs market is considerably weaker. Firms' pricing power has receded. Though a risky call after several years of sticky inflation, we think 2026 will finally show the UK as less of an outlier. The Bank is set to narrowly vote on a December rate cut. And as the tide turns on inflation, we expect two more next year – and the risk is we get more.

Our bold call: Leadership risk sparks renewed UK bond sell-off

Twelve months ago, our bold call correctly argued that more tax rises were inevitable in 2025. The same isn't necessarily true in 2026. Adverse economic forecasts are less likely to force the chancellor's hand, given greater 'headroom' under the fiscal rules. The fact that issuance and the deficit will be falling next year is a reminder that the UK isn't the "next France".

Yet the Autumn Budget failed to address many longer-term challenges. Public spending pressures are growing. Taxes on average workers are comparably low. That, against a backdrop of mounting political pressure, means a change of political leadership can't be ruled out. May's local elections are a key flashpoint.

Changing leaders isn't easy; 20% of Labour MPs would need to back a rival candidate when none currently exists. But were it to happen – or even if the risk of it rises – bond yields would likely spike on the perception that a more left-leaning PM would hike borrowing. This would be against a backdrop of growing populism on the political right.

Politics is the biggest risk for UK bond markets in 2026.

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