

Three calls for the UK: What's that over there?

The UK is set to outpace the eurozone next year as Britain rides the wave of the recent government spending bonanza. Interest rates should fall more quickly than they have this year, too. But if you think the controversial tax rises are done, perhaps you need to think again



UK Chancellor Rachel Reeves, with PM Keir Starmer in the background

1 Call 1: UK growth to pick-up in 2025, although the jobs market is a wild card

The UK economy has performed better than many of its Western European neighbours so far in 2024, though growth has been less impressive since the summer. Quarterly growth rates should pick up again through the spring as the avalanche of extra government spending is deployed. The government plans to spend an extra 1.5% of GDP (£40bn) in current spending in the next financial year, and given much of that ends up as salary rises and employment, the multiplier effect is likely to be pretty strong. Admittedly, though, we think the £18bn extra pledged for capital projects may be left underspent. We expect 1.4% growth in 2025.

If we're wrong, it's likely to be to the downside. Jobs data is proving unreliable, but vacancies are below pre-Covid levels and outside of government, payrolled employment is falling. Layoffs are still

low, but the risk is that they increase, perhaps on the back of the rise in employer taxation. A more immediate and far-reaching trade war with the US would be an issue, too. Around a fifth of UK exports head to the States, the UK's biggest trade partner, though most of this is services. Services fall out of the scope of tariffs but could be impacted if trade tensions spill into the regulatory arena.

2 Call 2: Services inflation to fall back, prompting faster rate cuts

Services inflation will fall in 2025; the question is how fast. The Bank of England expects it to float around its current 5% level for the next four to five months, and we tend to agree. That's why markets expect much more gradual rate cuts in the UK relative to the eurozone. But that service sector stickiness is increasingly concentrated in several key categories which the Bank has explicitly said it pays less attention to. Rental growth is the leading example of this and is showing little sign of easing off.

Volatile travel-related categories don't help either. Strip those out, and our own calculated measure of 'core services' inflation is set to fall close to 3% by April, from 4.5% in October. If we're right, that heralds faster rate cuts in the spring. We expect a rate cut in February to be followed in March, and at every meeting until rates reach 3.25% later next year.

3 Our bold call: More big tax rises could be coming

The Chancellor's 'one-off' tax and spend budget is likely just the beginning. Expect more tax hikes next Autumn. Fiscal targets were barely met this October, and those targets aren't especially taxing by historical standards. They also rest on the shaky assumption that spending will rise by less than 1% per capita in real terms beyond the next fiscal year. A big top-up is inevitable.

What's more, the low-hanging fruit on tax has already been picked. And unlike the previous government, Chancellor Rachel Reeves is unlikely to be able to ride the wave of lower gilt yields. Reeves is banking on higher growth, but the risk is that this disappoints and the Office for Budget Responsibility revises down its relatively upbeat GDP assessment.

Could the UK become the next France in terms of government borrowing fears? Possibly, though the UK's tax burden is considerably lower and below the European average, offering more obvious scope for further increases. And given Reeves has ruled out rises on 'working people', we wouldn't be surprised to see the employer National Insurance hikes repeated in 2025.

Author

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an

investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.