# 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.

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