CBI Economics

Economic Deep Dive

For CEOs, FDs, and business leaders

Your quarterly guide to the UK economy; making sense of the key trends and what's driving them.

Q2 2025: Apr - Jun

Quarterly economic highlights

1

Mixed messages on economic momentum over early 2025

The UK economy posted strong growth in Q1 2025, with GDP expanding by 0.7% quarter-on-quarter. However, this sat somewhat at odds with business surveys (including our own), which pointed to weaker momentum over the quarter. The latest CBI Economic Forecast projects that growth will be more subdued going forward, averaging 1.2% in 2025 and 1.0% in 2026.

2

Inflation remained elevated, and above the Bank of England's 2% target, in Q2

CPI inflation remained elevated in recent months, reaching 3.5% in April and 3.4 % in May. Price pressures came from higher energy prices (following a 6% increase in Ofgem's energy price cap), alongside an increase in number of regulated prices. Pass-through of higher business costs may also have played a role, as the rise in employer NICs and the National Living Wage came into effect. The lingering impact of all these factors means that inflation is likely to remain above the Bank of England's 2% target this year and next.

3

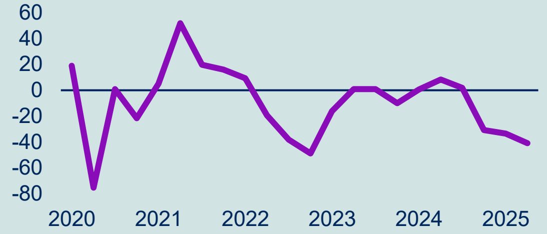
Bank of England set to maintain path of gradual interest rate cuts

The Bank of England's Monetary Policy Committee (MPC) have cut UK interest rates by a cumulative 100bps over the past year, bringing Bank Rate to 4.25%, reflecting an easing in inflationary pressures. We expect that the MPC will reduce Bank Rate by a further 25 basis points each quarter until early next year, until reaching a terminal rate of 3.50% in Q1 2026.

Business confidence index

Business optimism (vs 3m earlier) fell at a steep pace in Q2 2025.*

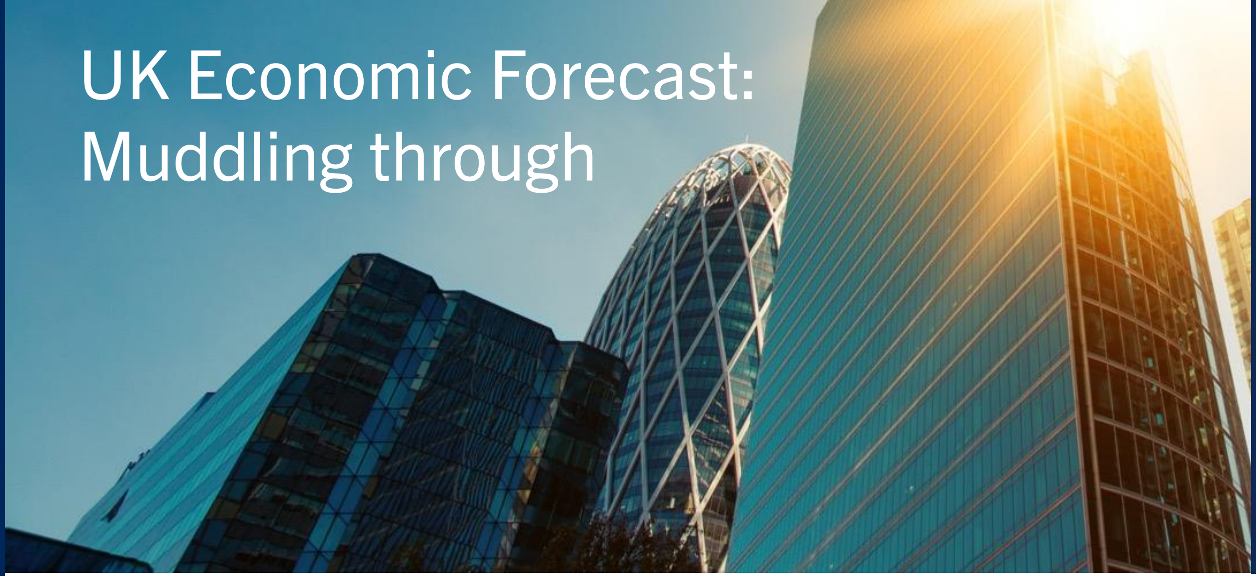
-41%



* Balance between % of firms reporting they were "more" or "less" optimistic than 3m earlier. The index is a weighted average of the CBI's surveys for manufacturing, distribution and services sectors (excl. public and financial services).

CBI surveys: Key indicators

UK Economic Forecast: Muddling through



What does this mean for business?

- Our forecast expects that the UK will see subdued growth over the next two years. Activity is expected to gradually strengthen on a quarterly basis over 2026, as household spending is supported by real incomes growth, lower interest rates, and easing inflation.
- Higher labour costs following the Autumn Budget have hit firms' hiring and investment plans, and are expected to push up prices, reduce margins, and weigh on pay growth. These impacts are assumed to feed into higher inflation and slower growth in business investment and employment.
- We expect that higher US tariffs will pose a relatively limited headwind to the UK economy. Tariffs will mostly weigh on business investment and exports due to heightened economic uncertainty, weaker global trade, and financial market volatility.
- We expect the Bank of England MPC to reduce Bank Rate each quarter until it reaches 3.50% in Q1 2026. Lower interest rates should provide some support to household spending and investment over the forecast.

Our latest economic forecast expects that the UK economy will grow at a modest pace over the next two years. Following an increase of 1.1% over 2024, we expect that GDP will grow by 1.2% in 2025 and 1.0% in 2026. Our latest projections represent downgrades from our December 2024 forecast (-0.4pp for 2025 and -0.5pp for 2026), reflecting a mix of weaker-than-expected outturn data and domestic & international headwinds.

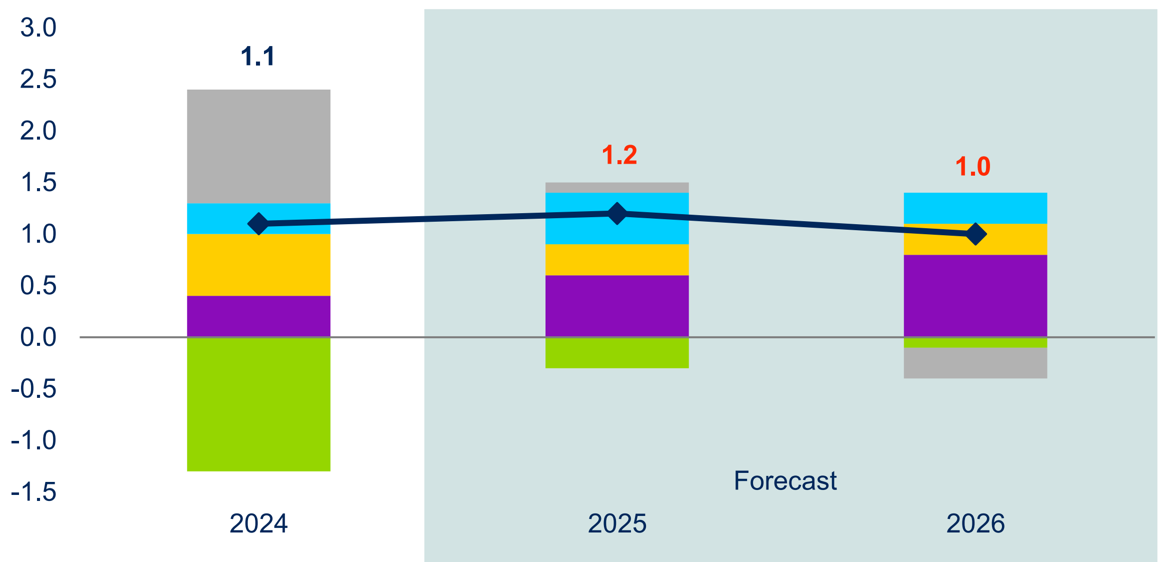
Growth in consumer spending is expected to be the main driver of growth over our forecast, supported by real incomes growth and lower interest rates. However, consumption will be held back by a cooler labour market and persistently cautious spending behaviour.

Business investment growth over 2025 is projected to be boosted by a sharp rise in Q1, which was partly due to a (likely temporary) increase in aircraft purchases. Underlying investment momentum remains poor, however, as reflected in the noticeable deterioration in capex plans across our surveys since the Autumn Budget. We expect that this will become more noticeable in the coming quarters, reflecting the impact of higher labour costs and global economic uncertainty. These headwinds will be partly offset by momentum generated from modest GDP growth and lower interest rates.

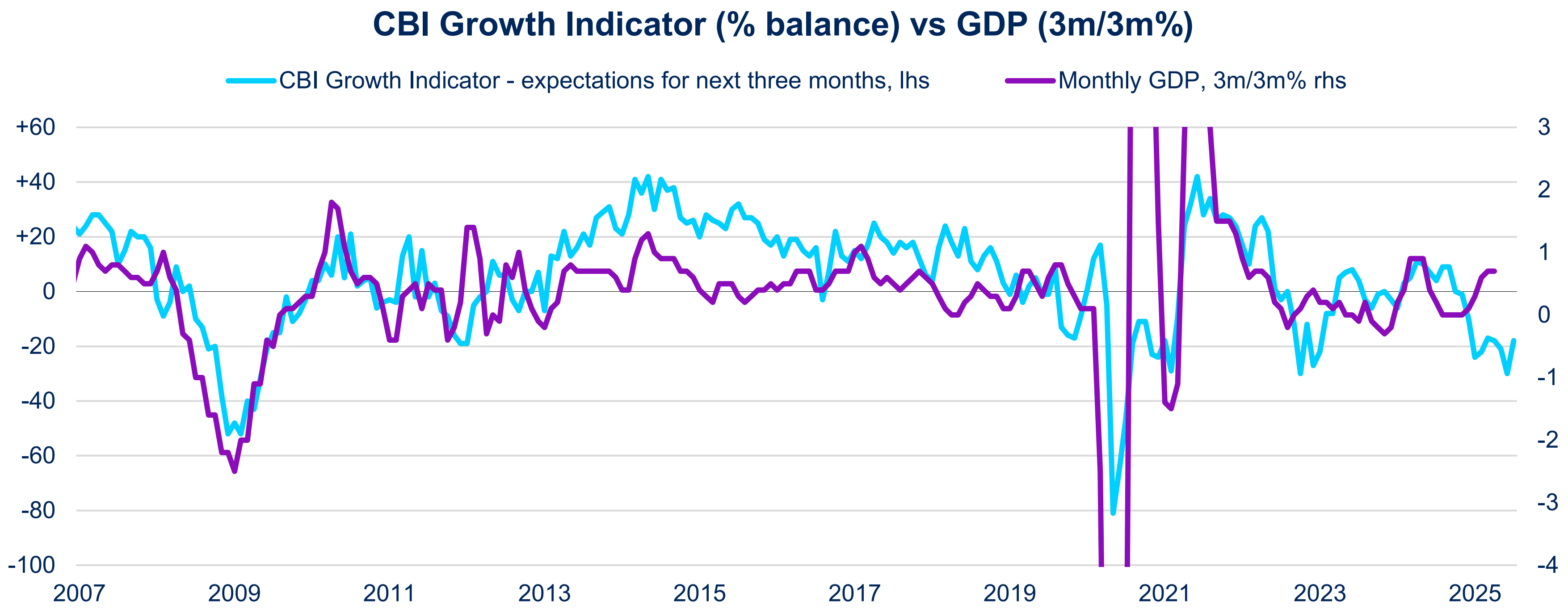
We expect that productivity (output per worker) will lag slightly behind its lacklustre pre-COVID trend through to 2026. The persistence in weak productivity growth will weigh on the UK's long-term growth prospects and living standards.

GDP Growth (Y/Y%) and Contributions (pp)

Household Spending
Government Consumption
Fixed Investment
Net Trade
Other
GDP growth



Mixed messages on momentum at the start of 2025



Source: ONS, Macrobond, CBI surveys

CBI Growth Indicator

Private sector activity is expected to fall at a firm pace in the quarter to September, though expectations have improved relative to last month.

Expectations balance (next 3m)*

-18%

*Balance between % of respondents reporting output/business volumes were "up" and those saying they were "down". The long-run average balance is +2%. The index is a weighted average of responses from the CBI's surveys for the manufacturing, distribution and services sectors (excl. public and financial services).

GDP growth in the first quarter of 2025 marked a solid start to the year, with the economy expanding by 0.7% quarter-on-quarter – the fastest pace of growth in a year. Business investment and net trade were the main drivers of growth in Q1; there was a more modest boost from household spending, and government spending fell slightly on the quarter. A series of one-off factors may have boosted GDP over the quarter: the strong rise in business investment partly reflected a purchase of aircraft, and the bump from net may have reflected at least some front-loading of business activity in anticipation of higher US tariffs on inbound goods.

Indeed, CBI business surveys pointed to much weaker momentum over Q1 than implied by official GDP data, which seems to have continued since. Businesses continue to contend with the challenges of rising labour costs from Autumn Budget measures, high energy costs and an ongoing volatile global economic environment. The CBI's Growth Indicator, a composite measure of private sector activity, highlights broad-based weakness in the three months to June, and responses from firms also suggest a subdued outlook for the three months to September.

Looking ahead, growth over the rest of 2025 is expected to be driven primarily by household spending, which will be supported by continued (albeit slower) real incomes growth, lower interest rates and households dipping into their savings buffers. While price pressures have eased considerably from the highs of 2023, inflation is nonetheless expected to remain above the Bank of England's 2% target over 2025, which will likely feed through to cautious consumer sentiment. Increased labour costs from Autumn Budget measures and ongoing global economic uncertainty from US tariffs will also weigh heavily on the UK's business confidence and investment outlook.

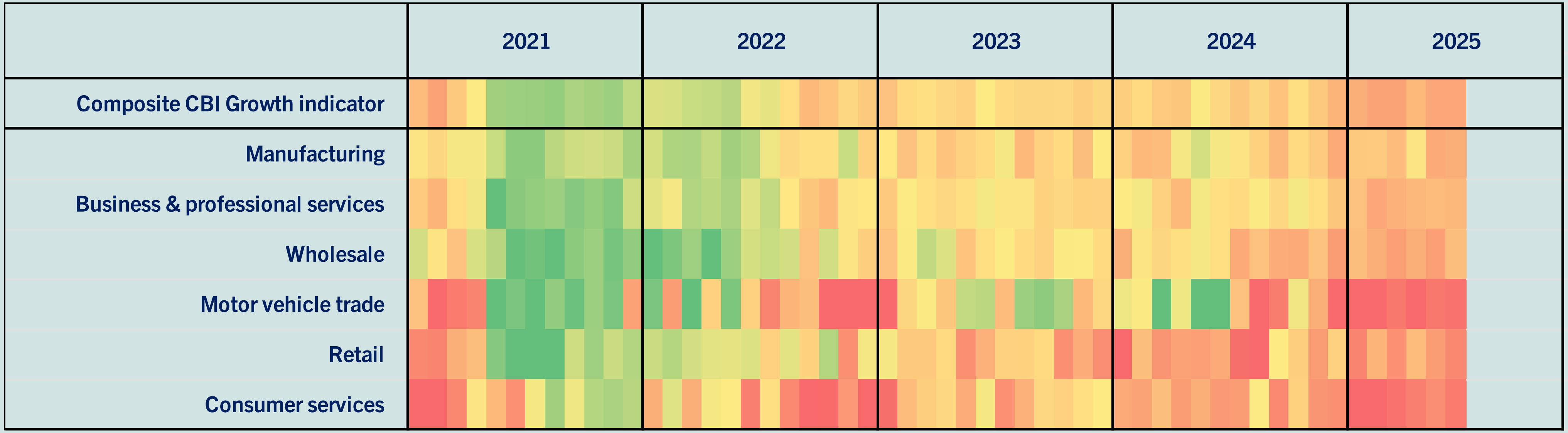
CBI surveys: Private sector activity remains subdued

The latest CBI Growth Indicator showed that private sector activity is expected to fall at a firm pace in the quarter to September. The near-term outlook looks weak across the board: business volumes are anticipated to decline in services, due to predicted falls in both business & professional services and consumer services volumes – albeit with expectations at their least negative since late 2024. But distribution sales are also expected to fall, with expectations at their weakest since September 2022, while manufacturers expect only a slight fall in output.

The disappointing outlook comes after private sector activity fell again in the three months to June. Underlying momentum in the economy was weak, with the decline in activity broad-based across all sectors.

Business view

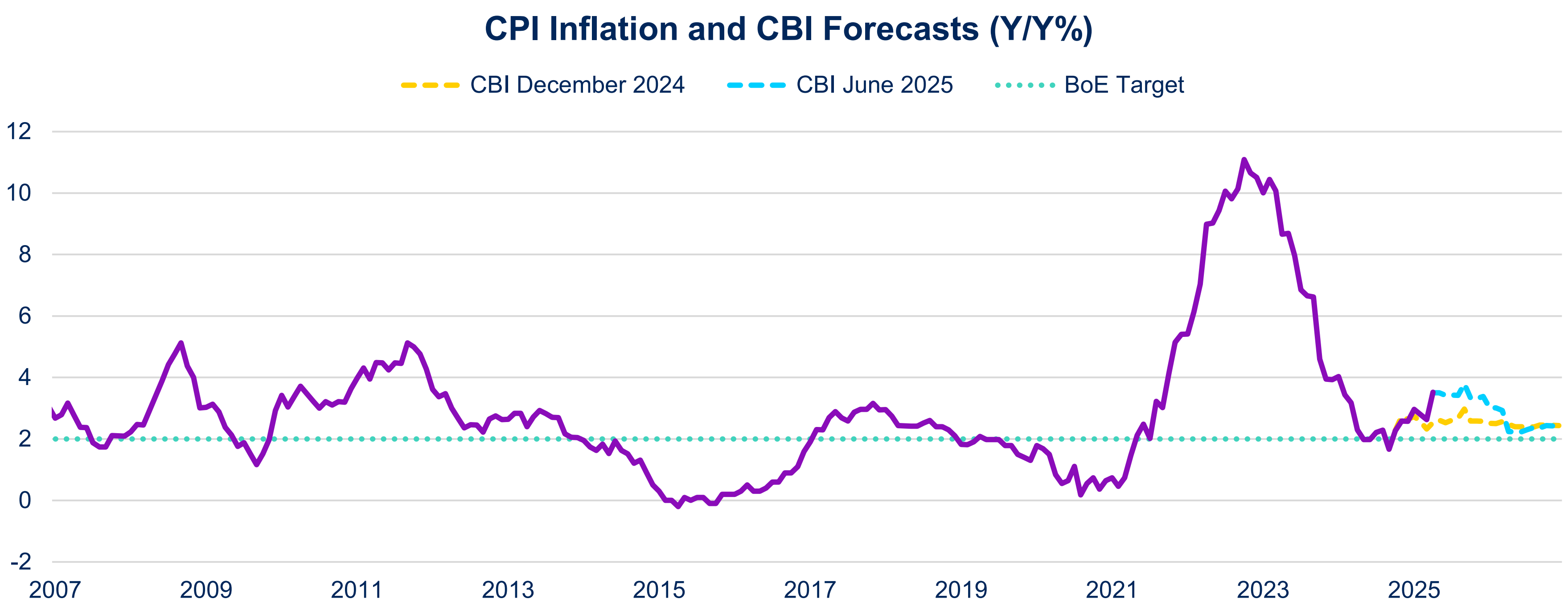
- Conditions across manufacturing are mixed. Firms in net zero, and in aerospace manufacturing are benefitting from long-term trends. Demand for construction materials is soft, but firms are optimistic. High energy costs and global competition continue to weigh on chemicals firms.
- There are tentative signs that consumer spending has turned a corner, with distribution firms reporting increased footfall. However, baskets remain under pressure from above-target inflation.
- Business-facing services firms remain cautious. Cost pressures are causing some projects to be delayed or deferred, though demand for net zero and tech-related work persists.



	June surveys*	
	Past 3m	Next 3m
Composite CBI Growth indicator	-26	-18
Manufacturing	-23	-5
Business & professional services	-20	-10
Wholesale	-35	-36
Motor vehicle trade	-41	-27
Retail	-38	-48
Consumer services	-43	-31

*Balance between % of respondents reporting output/business volumes were “up” and those saying they were “down”.

Price pressures expected to continue through 2025



Source: ONS, Macrobond, CBI forecast

CBI Selling Prices Expectations

Firms expect selling prices to rise in the three months to September, reflecting higher regulated prices and passthrough from Autumn Budget measures.

Expectations balance (next 3m)*

+24%

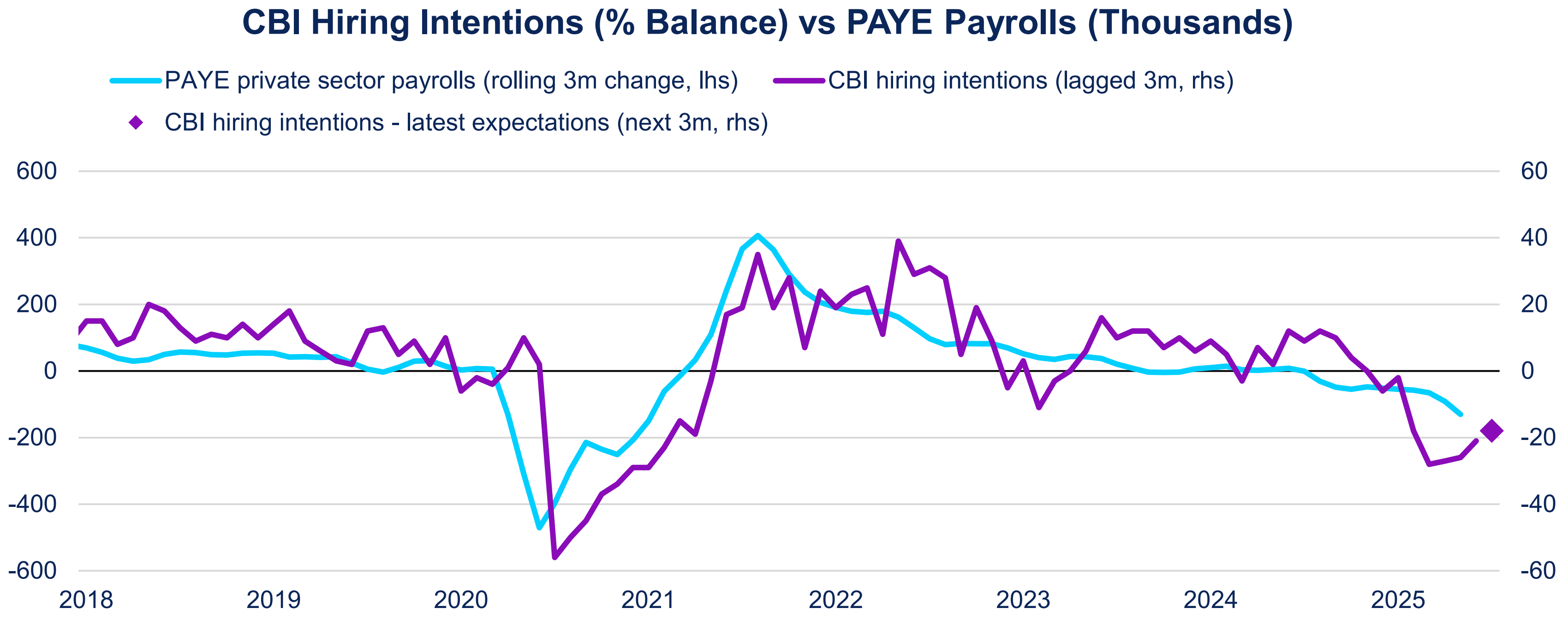
*Balance between % of respondents reporting selling prices were "up" and those saying they were "down". The long-run average balance is +12%. The index is a weighted average of responses from the CBI's surveys for the manufacturing, distribution and services sectors (excl. public and financial services).

CPI inflation accelerated over the first half of 2025, with a notable uptick from April onwards, reflecting long-standing sticky services inflation and base effects from energy price movements last year. Inflation rose to 3.5% in the year to April, the highest since February 2024, due to a number of one-off regulated price increases coming into effect. Alongside Ofgem's higher energy price cap, these included an unprecedented rise in water bills and in Vehicle Excise Duty. Price pressures may also have been compounded by the passthrough of higher labour costs, with the rise in employer NICs (and lowering of the threshold) and the National Living Wage coming into effect in April. Price pressures persisted into May, where annual CPI inflation remained at 3.4%.

CBI surveys point to continued price pressures over the second half of 2025. Private sector businesses reported that they anticipate selling prices to rise over the next three months, with forward-looking expectations having been elevated since the end of last year.

Our latest forecast expects inflation to stay above the Bank of England's 2% target through 2025, peaking at 3.8% in September, before easing to 2.5% (on average) in 2026. Housing & utilities prices are set to be the main driver of inflation, while price pressures also remain persistent in hospitality, food & drink, transport, and recreation & culture. Rising geopolitical tensions, especially in the Middle East, are adding uncertainty to the inflation outlook due to potential oil price increases.. While the direct impact of US tariffs on UK inflation looks likely to be limited, the full extent of the impact remains uncertain with pricing being dependent on external demand, exchange rates, trade flows and interest rates. It's worth noting that Even after the new UK-US trade deal, US tariffs on the UK remain higher than before Trump's 'Liberation Day' on April 2.

Labour market continues to cool



Sources: ONS, Macrobond, CBI surveys

CBI Hiring Intentions

CBI surveys suggest that headcount will be cut back at a modest pace in the three months to September

Expectations balance (next 3m)*

-18%

*Balance between % of respondents expecting headcount to be "up" and those expecting it to be "down". The long-run average is +5%. The index is a weighted average of the CBI's surveys for the manufacturing, distribution and services sectors (excl. public and financial services).

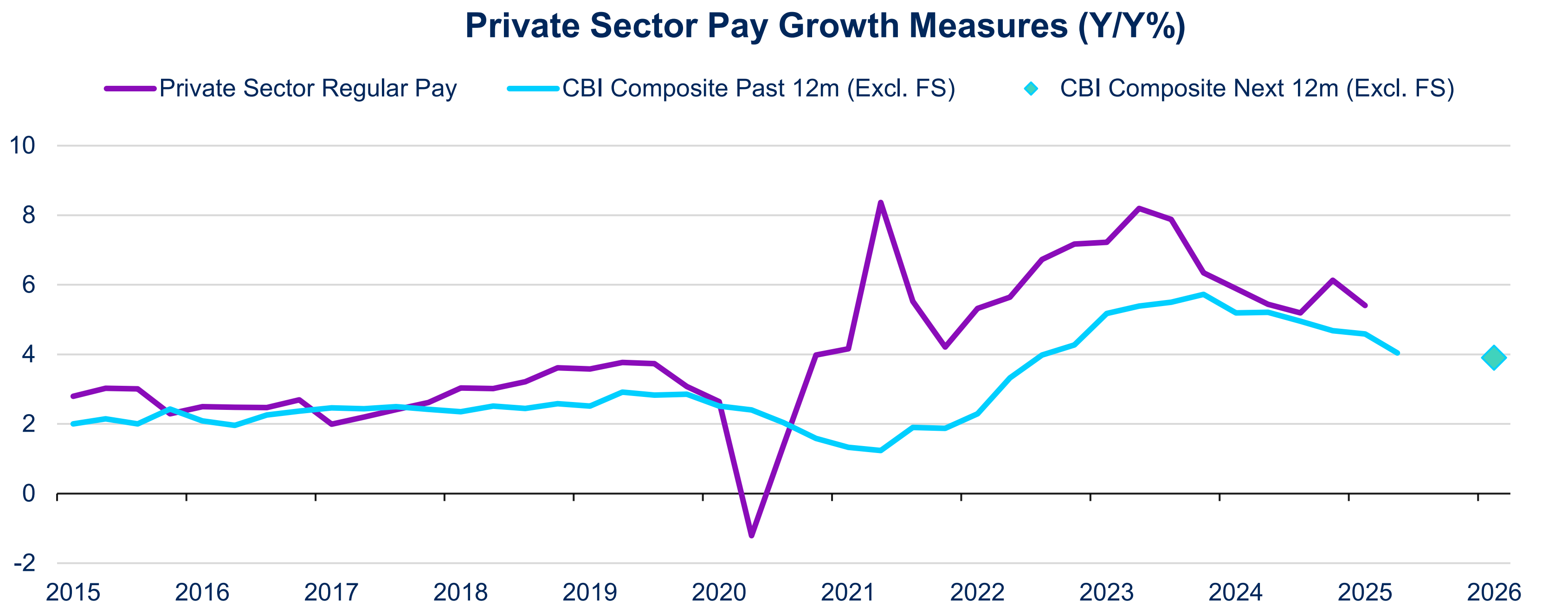
UK labour market conditions have continued cooling, reflecting a mix of higher labour costs and weak economic activity. The number of payrolled employees fell by 141k from November 2024 to April 2025, while vacancies dropped to 7% below their pre-pandemic levels in the three months to May 2025. These data chime with the substantial deterioration in hiring intentions following the Autumn Budget, according to CBI survey data.

Increased labour costs and subdued activity are expected to weigh on private sector employment in our latest economic forecast. Higher employer NICs, lowering of the secondary threshold, and the rise in the National Living Wage are anticipated to disproportionately impact lower-paid roles in labour-intensive sectors.

Pay growth has been slowing recently but, nonetheless, remains relatively strong. Annual wage growth (excl. bonuses) across the private sector was 5.1% in the three months to April, down from 5.5% in the three months to January. This is the slowest wage growth in over three years, but is still elevated by pre-COVID standards.

Looking ahead, CBI surveys suggest that private sector wage growth will ease to below 4% over the next twelve months. Our economic forecast expects that lower inflation next year, a growing measure of labour market slack, and weak potential productivity will drag on pay growth going forward. Some businesses may also reduce pay awards as they grapple with higher labour costs following the Autumn Budget.

Wage pressures soften



Sources: ONS, Macrobond, CBI surveys

Business view

- Many businesses report that pay pressures remain elevated, but new wage settlements are coming in closer to inflation. Some firms remained concerned that wage expectations will remain high, partly reflecting the knock-on effects of the National Living Wage increase.
- Many firms have scaled back or frozen hiring plans due to the increased cost of employment following the Autumn Budget. Pressures are greatest in lower-paying sectors, such as retail and hospitality. Some firms are investing in AI and automation in order to manage higher labour costs and a lack of skilled workers.

Unemployment rate

(Feb '25 – Apr '25)

4.6%

The unemployment rate rose to its highest in nearly four years in the three months to April.

CBI: Labour shortages

(Q2 '25)

17%

The share of manufacturing & services firms expecting labour shortages to limit future capex rose from Q1

Private sector pay growth

(Feb '25 – Apr '25, on a year ago)

5.1%

Private sector annual wage growth remains elevated.

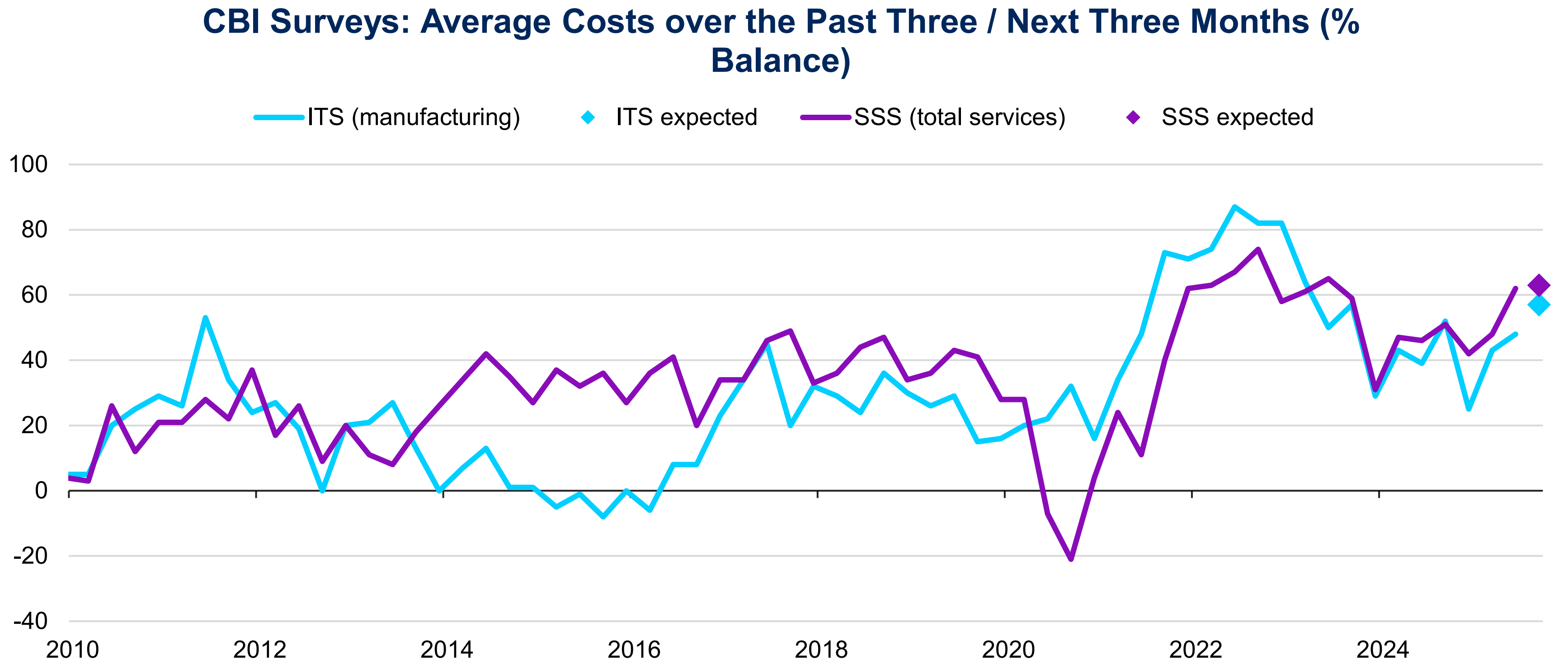
CBI: Wage expectations

(Apr '25, next 12 months)

3.9%

CBI surveys expect wage growth to slow in the next 12 months.

Costs growth expected to remain elevated



Source: CBI surveys

CBI Costs Expectations

Costs growth in the manufacturing and non-financial services sectors are expected to continue rising at an elevated pace in Q3.

Expectations balance (next 3m)*

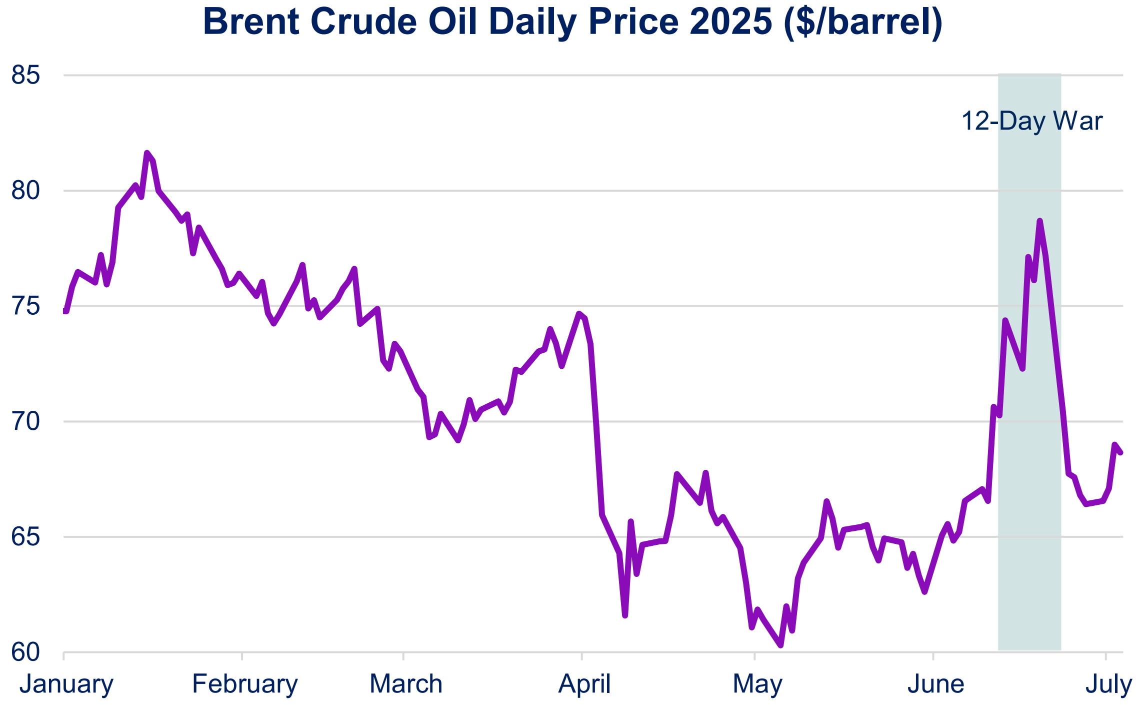
+61%

*Balance between % of respondents reporting costs were "up" and those saying they were "down". The long-run average is +29%. The index is a weighted average of the CBI's surveys for the manufacturing and services sectors (excl. distribution, public and financial services).

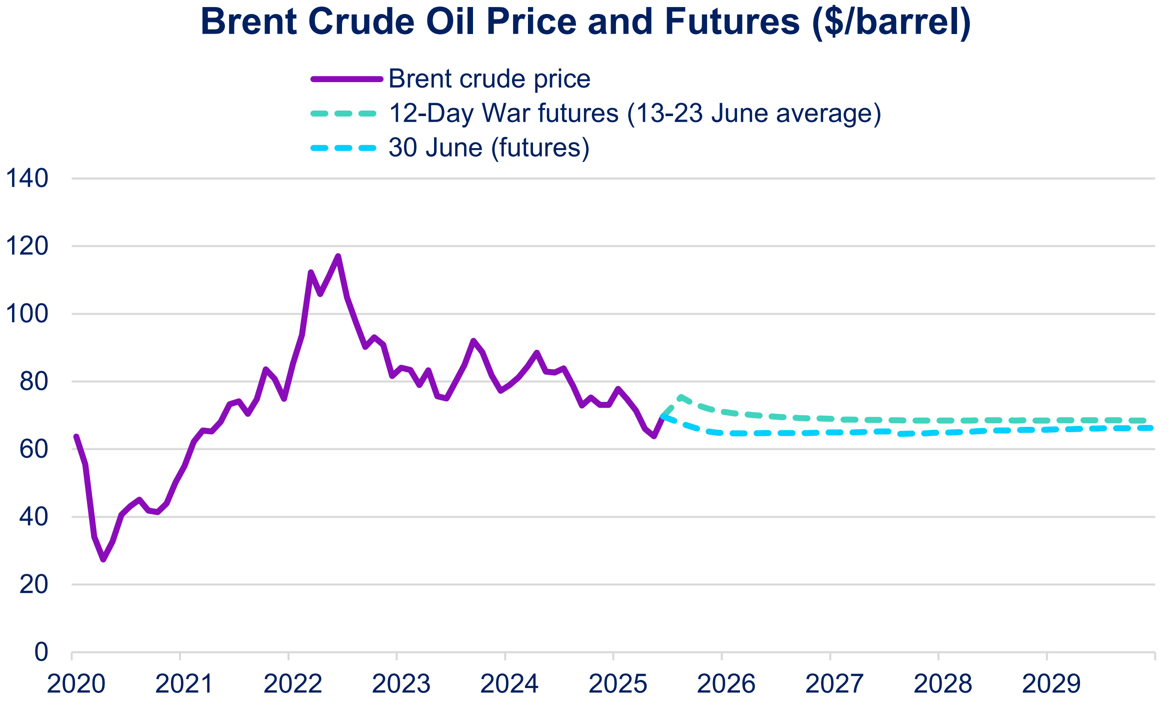
CBI surveys point to an increase in business costs since the end of 2024, with this trend set to continue into the autumn. The balance of firms expecting costs to increase over the quarter to September was above average in both the non-financial services and manufacturing sectors. ONS surveys suggest labour costs are a key source of pressure on businesses. Measures included in the 2024 Budget, notably the increase in employer National Insurance Contributions and the rise in the National Living Wage from April, have pushed up labour costs. Anecdotal evidence suggests that firms have responded by reducing margins, increasing prices, reducing pay growth and pulling back on hiring/investment plans.

Businesses also report cost pressures stemming from prices for raw materials and energy, alongside a rising burden from regulation (with the looming Employment Rights Bill a particular concern). Indirect pressures are also mounting. Companies are devoting more time and resource to explore the impact of changing global tariff schedules on supply chain options, moving to shorter planning cycles, while some manufacturers are considering changes to production locations in response to higher US tariffs. While weaker global demand may exert some downward pressure on goods and commodity prices in the year ahead, rising geopolitical tensions – especially in the Middle East – pose upward risks.

Middle East conflicts pose risk to oil prices



Source: Macrobond, ICE

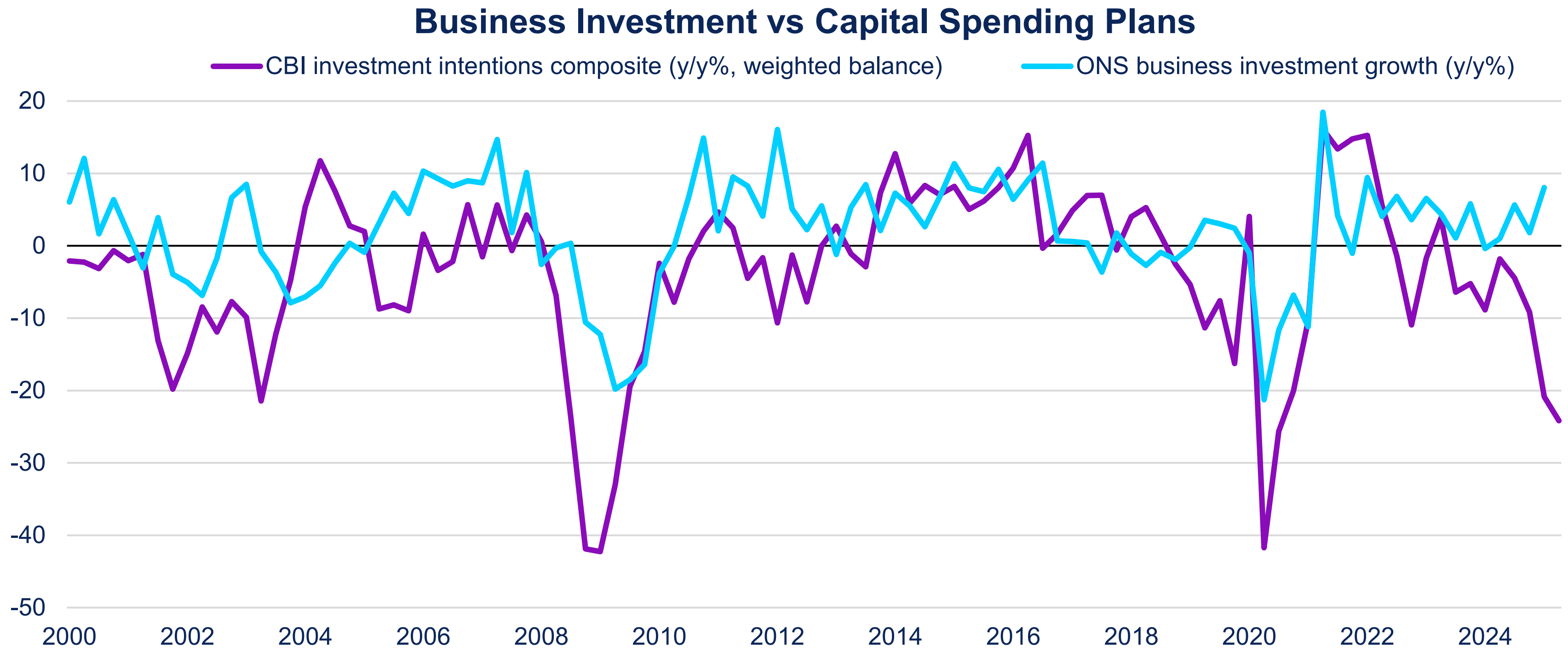


Source: Macrobond, ICE

The recent conflict between Iran and Israel has driven volatility in global oil prices. Oil prices jumped from $65 per barrel at the beginning of June, surging to an intra-day high of over $80 on June 22nd, immediately after US strikes on Iranian nuclear facilities. Despite oil prices falling back following the announcement of a ceasefire, the possibility of a resumption in hostilities could trigger more market volatility.

Middle East tensions will pose an upward risk to price pressures going forward. A sustained increase in the price of oil would push up fuel costs for households and businesses, while also raising transport and shipping costs. This would likely feed through into higher prices for goods, including food, and add to near-term inflationary pressures in the UK and global economy. In an extreme scenario, where Iran disrupts oil flows through the Strait of Hormuz, oil prices could potentially jump to over $100 per barrel, according to Goldman Sachs analysis. Such a spike would amplify the inflationary impact of higher energy and transport costs.

Headwinds weigh on investment plans



Sources: ONS, Macrobond, CBI surveys

CBI Investment Intentions

Firms expect to reduce capital expenditure over the next 12 months, compared with the previous 12 months, to the greatest extent since Q3 2020.

Expectations balance (next 12m)*

-24%

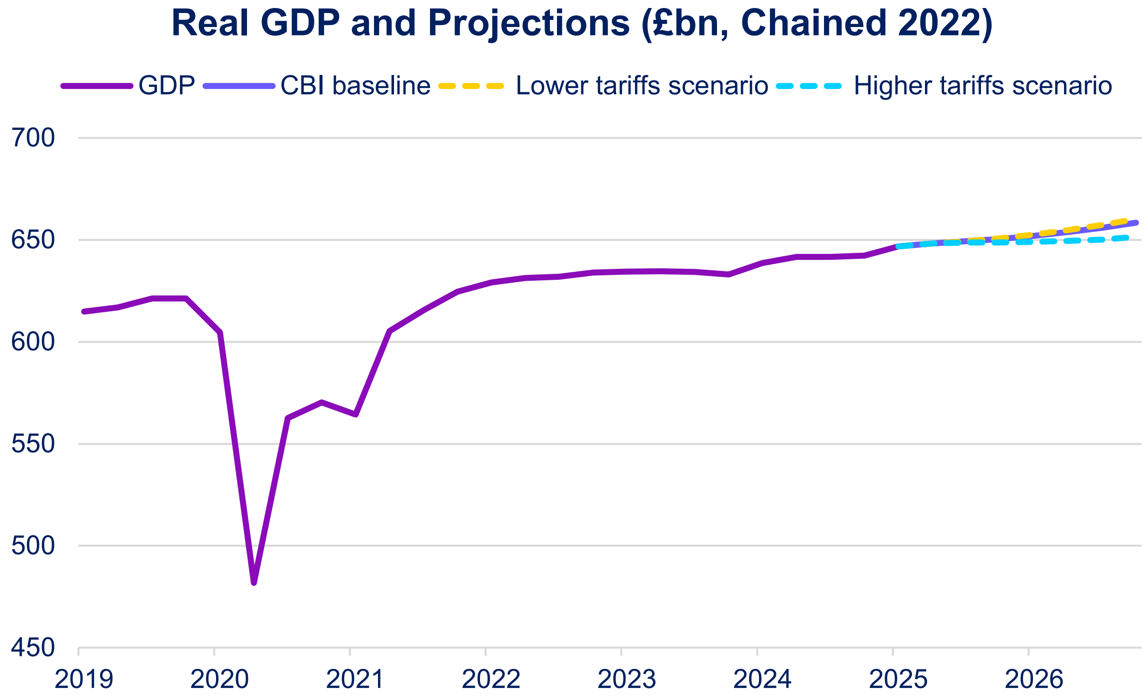
*Balance between % of respondents expecting capex to be "up" and those expecting it to be "down". The long-run average is -3%. The index is a weighted average of the CBI's surveys for the manufacturing, distribution and services sectors (excl. public and financial services).

Private sector investment intentions have continued to deteriorate significantly in recent CBI surveys. Firms reported that they expect to cut back on capital spending over the next 12 months (compared with the previous 12) to the greatest extent since Q3 2020. CBI surveys point to weaker investment momentum compared with official, backward-looking figures, which showed that business investment grew in Q1 2025 at the fastest pace in two years (by 6.1% year-on-year), which was partly due to a (likely temporary) increase in aircraft purchases.

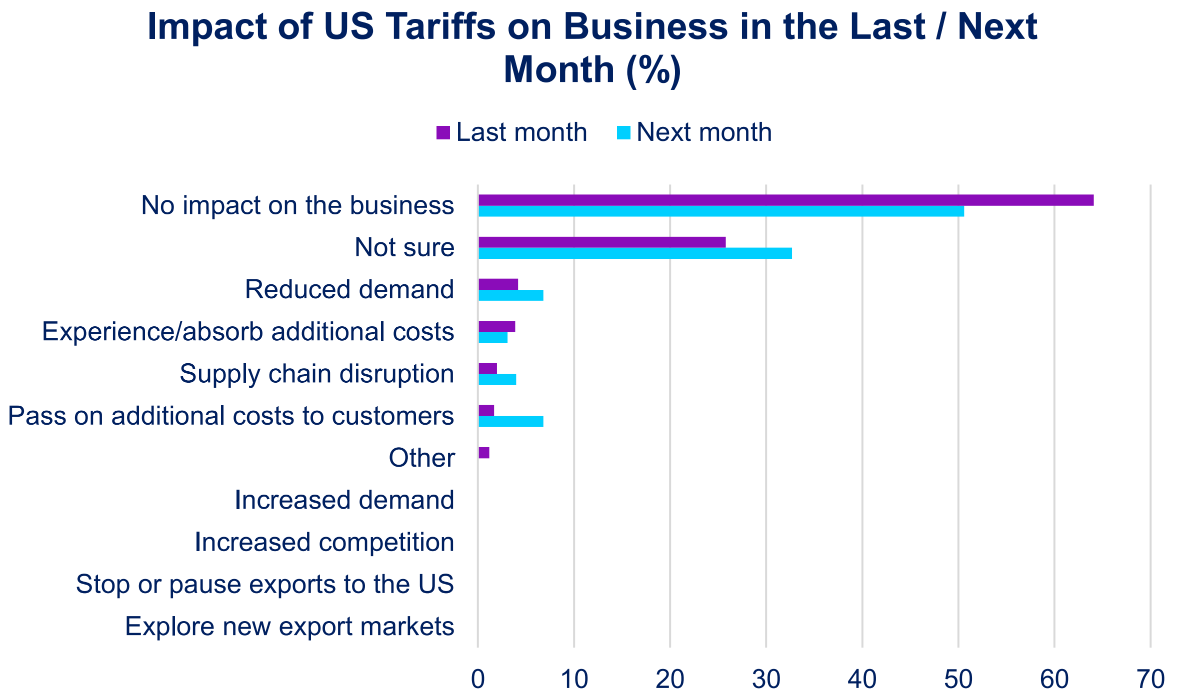
The weakness in investment intentions reflects a wide variety of factors. According to CBI surveys, demand uncertainty is the primary factor weighing on capex plans (being cited 58% of manufacturers and 65% of non-financial services firms). The elevated cost of finance, access to external finance, and labour shortages remain commonly cited constraints to future investment plans. Economic and trade uncertainty also spiked following US tariff announcements, which may dampen business investment for an extended period. Our recent forecast expects underlying growth in business investment to remain muted.

Many businesses will continue their "wait and see" approach as weak demand, the impacts of the Autumn Budget, and global uncertainty persist. However, motivations for businesses to invest in net zero, automation and digital transformation remain strong. Moreover, interest rates are expected to continue falling gradually, which will reduce the cost of borrowing for businesses and support firms' investment plans.

US tariffs will pose a limited headwind to UK activity



Sources: ONS, Macrobond, CBI forecast, Oxford Economics Global Model, CBI analysis



Sources: ONS BICS (Data represents responses of firms with 10 or more employees. 22 April to 2 May 2025

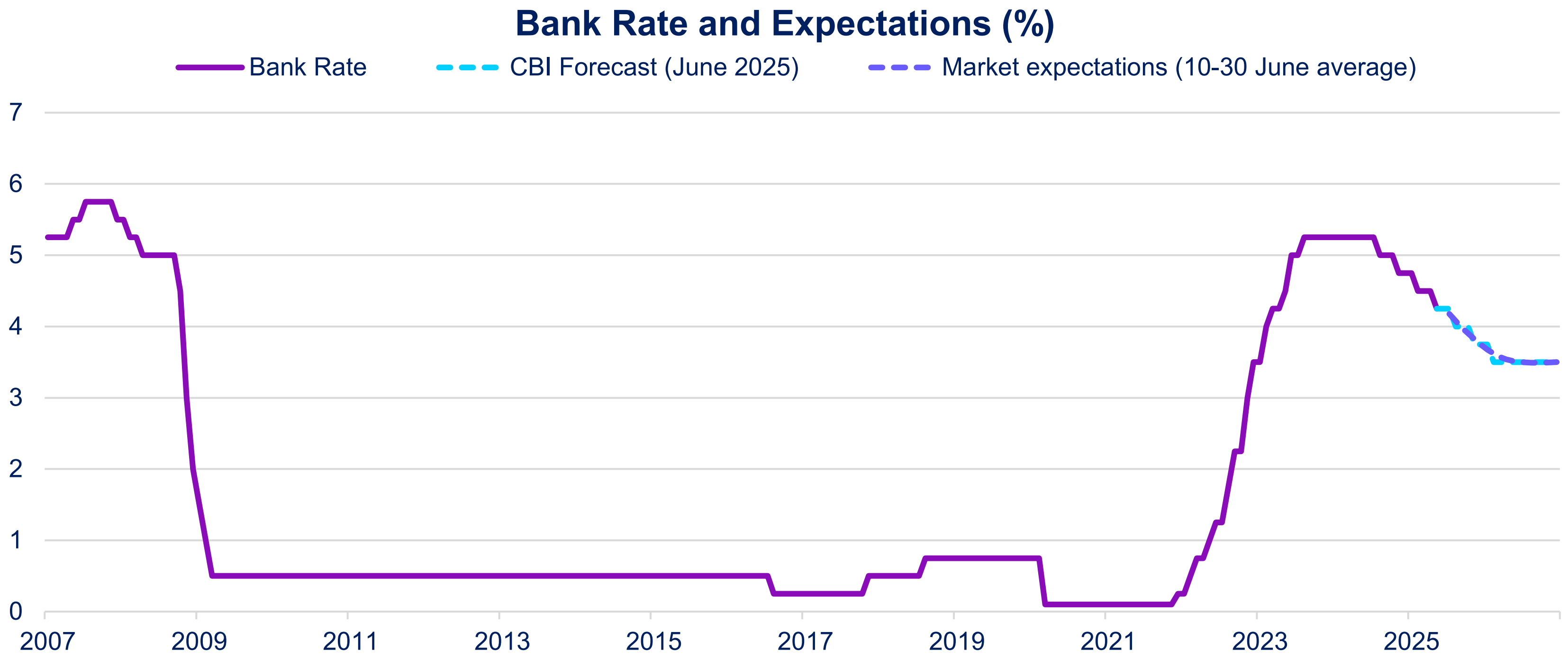
US tariffs are expected to weigh on activity and trade internationally. Despite the recent de-escalation of the trade war between the US and China, the real effective US tariff rate remains at levels not seen since the 1940s.

Although higher tariffs are anticipated to only pose a limited headwind to UK activity, given goods exports to the US account for around 7% of total exports. Overall, the main channels through which US tariffs are expected to hit UK activity are weaker exports, financial market volatility, and economic uncertainty, which is expected to impact business investment.

Some sectors of the economy will be disproportionately hit, particularly goods-producing sectors directly exposed to US markets. But the UK-US trade agreement has gone some way to mitigating the impact of tariffs for the UK steel, aluminium, and automotive sectors. But the agreement covers less than 1% of total UK exports, meaning that products accounting for 5% of total UK exports will face the new 10% baseline tariff rate, while a further 1% will be left at risk to potential future tariffs (e.g. pharmaceuticals). As a result, we expect that the agreement will have a minimal impact for the UK at a macroeconomic level.

The end-point of US trade policy remains uncertain. In a scenario where US "reciprocal" tariffs are reimposed and exemptions for certain goods are removed, our recent forecast expects the level of UK GDP to be 1.1% lower than baseline by the end of 2026.

Interest rates to be cut at a “gradual and careful” pace



Source: Macrobond, CBI forecast, Bank of England

What does this mean for businesses?

- Our June forecast expects Bank Rate to be cut at a gradual pace of 25 basis points until it reaches 3.50% in Q1 2026.
- Lower interest rates should provide some support to household spending and business investment going forward. However, rates will likely remain noticeably higher than they were pre-pandemic.
- The “two-sided” risks to the outlook mean that businesses should consider alternative scenarios for their forward planning, where interest rates may fall at a slower or quicker pace than currently expected.

The Bank of England’s MPC has cut Bank Rate by a cumulative 100bps over the past year to 4.25%, reflecting an easing in inflationary pressures. The Bank of England’s MPC recently kept interest rates unchanged in June in a 6-3 vote. In the meeting minutes, the MPC maintained its forward guidance of a “gradual and careful approach” to loosening policy to bring inflation sustainably to the 2% target.

Looking ahead, the CBI June forecast expects that the MPC will reduce Bank Rate by 25 basis points each quarter until reaching a terminal rate of 3.50% in Q1 2026. It’s worth noting that the MPC has warned of “two-sided” risks to the monetary policy outlook, which could alter the pace of interest rate cuts. On the one hand, if domestic wage and price growth remain elevated, then interest rates could remain higher for longer to squeeze out inflationary pressures. On the other, if growth is weaker than expected, then rates could be reduced faster to support economic activity.

Global growth is set to slow due to trade frictions

The OECD's Economic Outlook (released in June) projects that global GDP growth will slow from 3.3% in 2024 to 2.9% in both 2025 and 2026. These forecasts have been revised down from March, reflecting the impact of higher tariffs and economic uncertainty on consumer spending, business investment, and trade . Inflation is set to continue easing across OECD countries, to 3.6% in 2025 and 3.2% in 2026.

GDP growth in the US is expected to slow markedly due to higher tariff rates and policy uncertainty. Nevertheless, the US is projected to remain the fastest-growing economy in the G7 . The Eurozone is expected to see only subdued growth, with the drag from trade frictions set to be offset by looser monetary and fiscal policy. Activity in the UK is set to be modest, but it will still see the second-fastest growth in the G7. The Chinese economy is expected to grow at a slower pace due to increased bilateral tariffs with the US, while India is projected to see a strong increase in GDP.

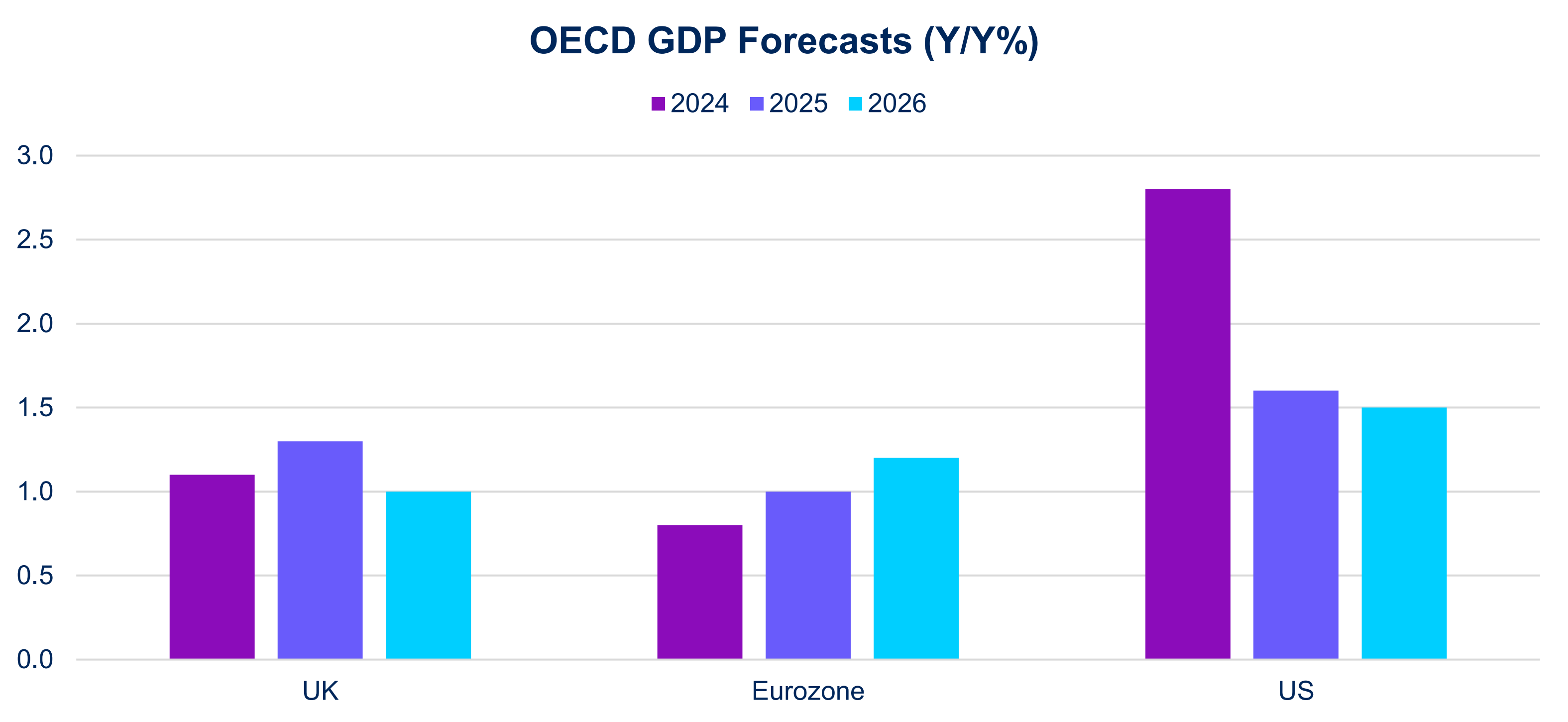
The OECD emphasised the risk that additional trade barriers could result in a deeper slowdown in global activity and disruption to international supply chains. Additionally, they warned that high public debt burdens could leave developed and developing countries vulnerable to future economic shocks.

2.9%

Projected global growth in 2025

2.9%

Projected global growth in 2026



Source: OECD Economic Outlook

The business view

How are businesses reacting to changes in the UK economy?

Demand conditions

Member insights suggest demand conditions remain mixed across the economy, given increased headwinds to the economic outlook.

- In manufacturing, secular trends are underpinning demand in businesses linked to the net zero transition, while long-standing solid performance in the aerospace & defence industries continues.
- Manufacturers exposed to real estate and construction reported mixed conditions. Uncertainty around the Planning and Infrastructure Bill and delays ahead of the Spending Review has led to some near-term weakness, but construction and civil engineering firms remain optimistic over medium-term prospects, given increased funding for government-backed projects.
- Professional services reported subdued conditions so far this year. Delays to public sector procurement and slow corporate markets have contributed to a softening in activity. Some firms have cited early signs of a drop off in demand from US clients, with activity holding up in other markets. Consultancies and law firms reported strong demand stemming from the energy transition, automation, and cyber security.

Labour market

Businesses in a wide variety of sectors are seeking to manage costs through headcount reductions, though primarily through natural attrition and more selective recruitment, rather than redundancies.

- Firms in a wide range of sectors reported scaling back or freezing recruitment as a response to rising employment costs (NICs and the NLW), subdued demand and global economic uncertainty.
- Manufacturers reported accelerating automation investment to mitigate rising wage costs and labour supply issues.
- Technical skills shortages are a consistently cited constraint across sectors such as engineering and construction. Professional and business services also desire more highly skilled staff, particularly in cybersecurity.
- New pay settlements were reported to be coming in a closer to inflation, but some services firms reported that wage pressures are still strong. Pay growth in manufacturing has cooled, especially in sectors that saw sharp increases during the pandemic.

US tariffs

The impact of the US trade war means that some firms are reassessing the risks to supply chains. The effects of higher uncertainty are being felt across the private sector.

- Direct exporters to the US were concerned about the impact of higher tariffs on the competitiveness of their products and reported pressure to absorb these new costs, e.g. in aerospace & defence, chemicals, automotive and other sub-sectors of manufacturing.
- Tariff increases have prompted businesses with complex international supply chains to reassess the cost of sourcing or producing goods in different locations, especially in manufacturing and distribution.
- The impact of uncertainty over global economic conditions and financial market volatility was also being felt. Financial and professional services firms noted that the tariff war has led clients to delay investments, with knock on impacts on demand for their own services.

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