United Kingdom: Recovery Under Constraint

Cyclical recovery, structural weakness, and limited policy space

IMF OAP 27th Macroeconomist Training Program
Group 3

31 July 2026

CHHEM Solinda | Sanghu Lee | Kai Ogawa | Huaiyuan Zhou | Himene Tanaka

The UK is recovering cyclically, but medium-term constraints remain binding

Staff diagnosis

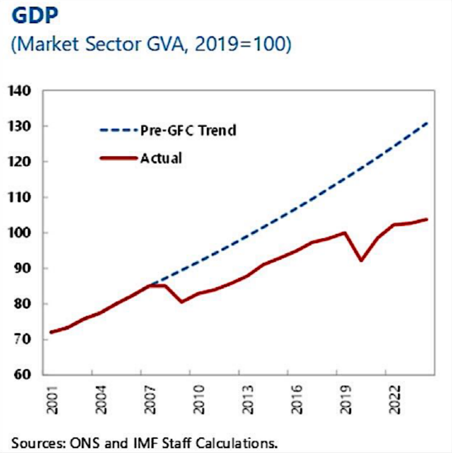
The UK economy is experiencing a cyclical recovery, but structural weakness and limited policy space constrain the medium-term outlook.

Real GDP growth	Output gap	CPI inflation
1.2%	**-0.4%**	**3.2%**
2025 projection	2025 projection	2025 average

Current account	Gross public debt	Unemployment
-3.4%	**103%**	**4.5%**
of GDP, 2025	of GDP, 2025	2025 projection

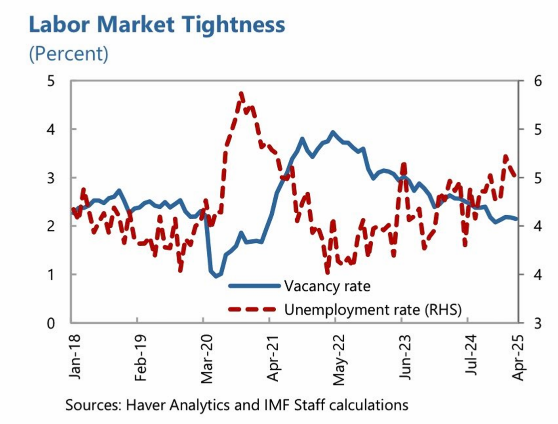
Bottom line: recovery has resumed, but inflation persistence and limited policy space keep the medium-term outlook constrained.

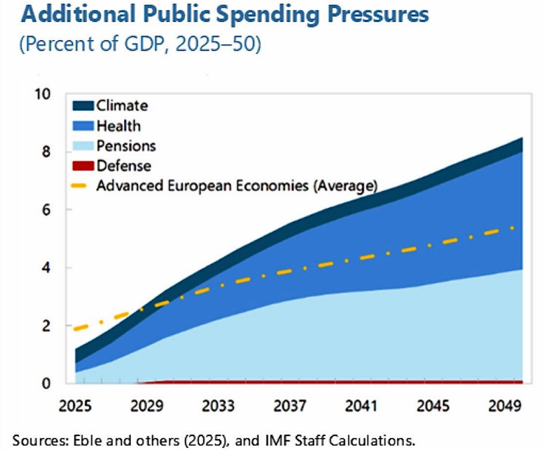
The recovery is stable, but growth remains close to weak potential



- Real GDP growth recovered to **1.1 percent in 2024** and is projected at **1.2 percent in 2025**.
- The output gap remains mildly negative, indicating some cyclical slack.
- Medium-term growth settles near **1.4–1.5 percent**, close to weak potential.
- The gap from the pre-GFC trend points to a long-standing productivity problem.

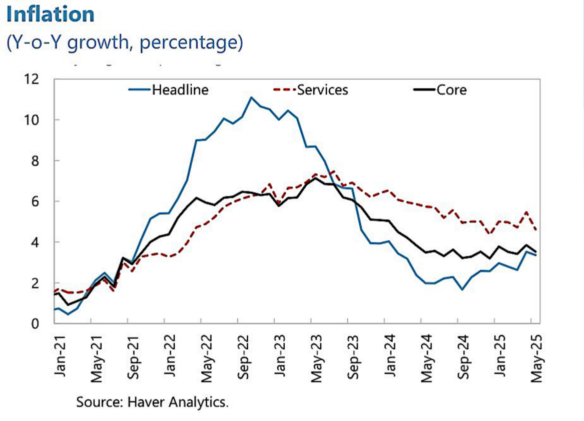
Backup: labor-market cooling and long-term spending pressures remain visible





Source: IMF staff data pack, labor-market tightness panel and additional public spending pressures panel.

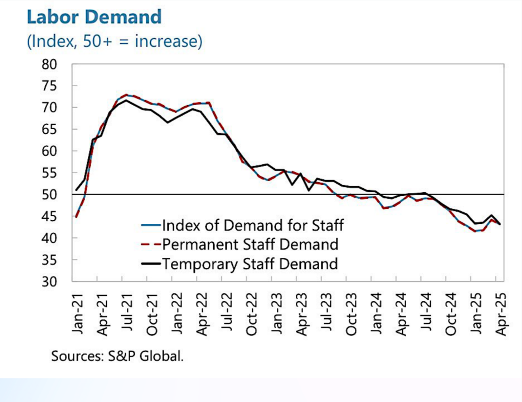
Disinflation is incomplete because domestic price pressures remain sticky

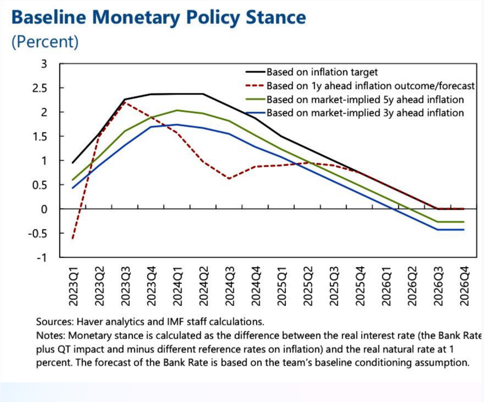


- Headline and core inflation have moderated from their peaks.
- **Services inflation remains elevated**, showing persistent domestic price pressure.
- Wage growth has eased, but not enough to justify rapid easing.

Implication: convergence to target is plausible, but not yet secure.

A cooling labor market supports gradual, data-dependent easing



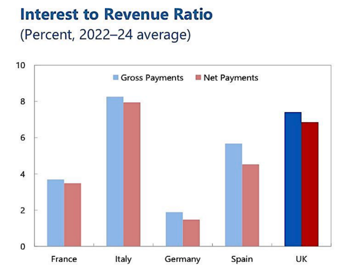


Trade-off

Easing too early could prolong services inflation; staying restrictive for too long could deepen labor-market weakness.

Fiscal tightening is pro-cyclical, but broadly appropriate

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31
							Projections					
Net lending/borrowing (overall balance)	-2.6	-15.1	-5.3	-5.0	-4.8	-4.7	-4.1	-3.5	-2.8	-2.6	-2.3	-1.9
Primary balance	-1.3	-14.1	-3.2	-1.2	-1.7	-1.9	-1.1	-0.6	0.2	0.5	0.8	1.1
Cyclically adjusted overall balance 2/	-2.7	-13.1	-5.6	-6.2	-4.9	-4.6	-3.8	-3.2	-2.6	-2.4	-2.3	-1.9
Cyclically adjusted primary balance (CAPB) 2/	-1.4	-12.0	-3.5	-2.4	-1.9	-1.8	-0.8	-0.3	0.4	0.6	0.9	1.1
General government gross debt 3/	84.7	107.5	101.2	98.2	99.4	101.0	103.0	104.6	105.2	105.6	105.5	105.4
Public sector net financial liabilities /4	74.8	83.1	80.4	80.5	80.9	81.5	82.9	84.0	84.1	84.1	83.9	83.4
Memorandum items:												
Output gap (percent of potential)	-0.8	-3.8	2.1	1.6	-0.4	-0.2	-0.5	-0.4	-0.2	-0.2	0.0	0.0
Deflator growth (Percent)	2.4	5.2	-0.4	7.0	5.9	4.1	2.7	2.2	2.2	2.2	2.3	2.2
Real GDP growth (percent)	0.9	-11.6	13.6	2.3	0.4	1.2	1.2	1.4	1.6	1.4	1.5	1.5
Nominal GDP growth (percent)	3.2	-6.9	13.0	9.5	6.3	5.4	4.0	3.5	3.8	3.6	3.8	3.8
Nominal GDP (in billions of pounds)	2,241	2,086	2,358	2,582	2,743	2,891	3,007	3,114	3,233	3,351	3,477	3,599
Potential GDP growth (percent)	1.4	-8.8	7.0	2.8	2.5	1.0	1.6	1.2	1.4	1.3	1.4	1.4

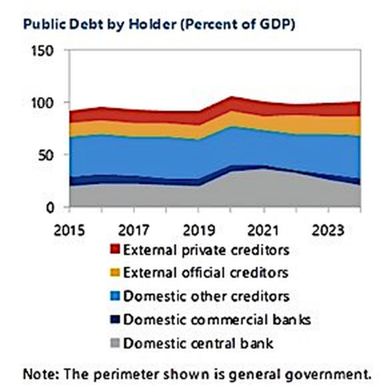


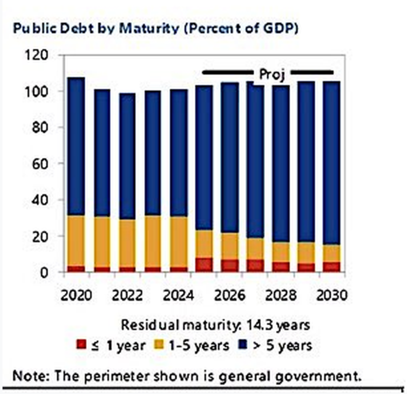
Source: IMF staff calculations.

- The cyclically adjusted primary balance improves while the output gap remains negative, making the adjustment **somewhat pro-cyclical**.
- High borrowing and a comparatively heavy interest burden nevertheless make consolidation broadly appropriate.
- The composition matters: protect productive investment while restraining recurrent spending.

Source: IMF staff data pack, pp. 5 and 42.

Backup: public debt structure supports near-term resilience

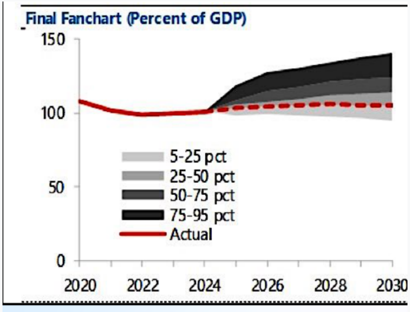


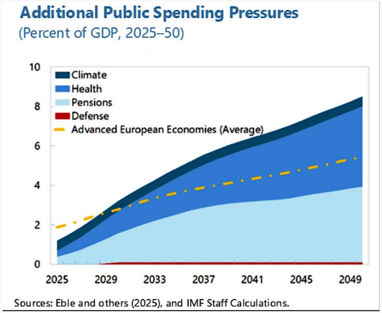


Debt is mostly domestically held and long-term, reducing immediate rollover and currency risks.

Source: IMF staff data pack, p. 44. Charts cropped directly from the original source page.

Debt risks are contained near term, but long-term pressures remain

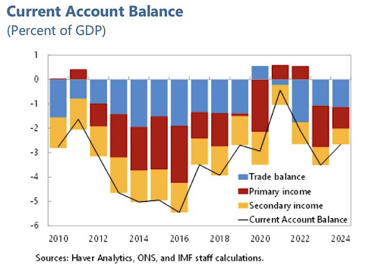


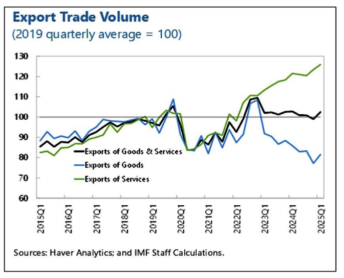


Debt structure is strong, but overall risk remains: domestic-currency debt and long maturity reduce immediate rollover risk, while the debt fanchart still signals moderate uncertainty. Health and pension pressures should be addressed now, even as near-term fiscal policy avoids unnecessary damage to the recovery.

Source: IMF staff data pack, pp. 39, 44, and 46.

External deficits are persistent, but composition is uneven

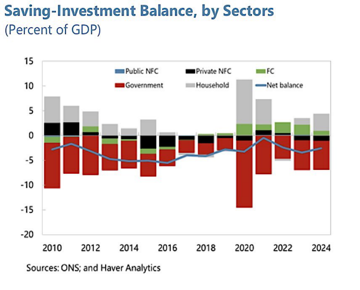


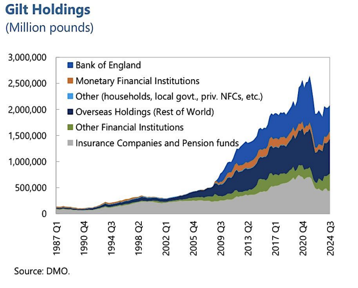


- The current account deficit stays near **3 percent of GDP**: -**2.7 percent** in 2024, -**3.4 percent** in 2025, and -**2.8 percent** by 2030.
- A large goods deficit is offset by a strong services surplus; services export volumes are well above 2019, while goods exports remain weak.
- The 2024 improvement was supported by primary income and terms-of-trade gains, not clear evidence of stronger structural competitiveness.

Source: IMF staff data pack, pp. 6, 30, 32, and 34.

External financing is manageable, but confidence-sensitive

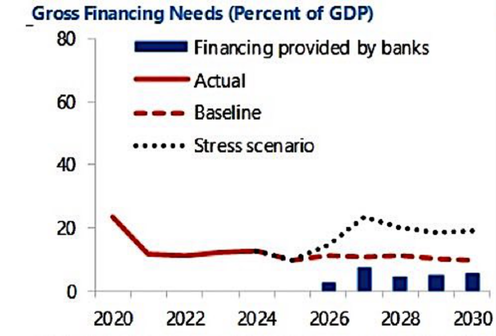




- The saving-investment gap mirrors the current-account deficit: saving is projected at **13.1 percent** of GDP against investment of **16.4 percent** in 2025.
- Persistent public-sector borrowing keeps the economy reliant on external financing, even as households and firms remain net savers.
- Long maturity and domestic-currency debt reduce rollover risk, but foreign and non-bank gilt demand makes credibility and market sentiment important.

Source: IMF staff data pack, pp. 4–6, 23, 31, and 44.

Backup: external financing remains confidence-sensitive

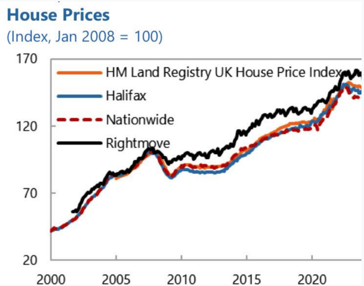


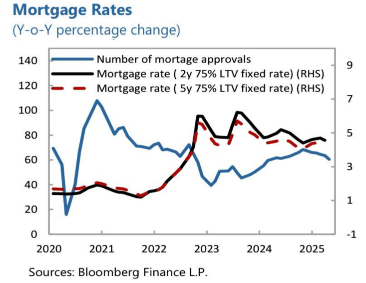
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Capital and financial account	-3.4	-3.3	-0.4	-2.4	-3.2	-2.0	-3.4	-3.3	-3.1	-3.1	-2.9	-2.8
Capital account	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1
Financial account	-3.5	-3.5	-0.5	-2.5	-3.4	-2.2	-3.5	-3.5	-3.3	-3.2	-3.0	-2.9
Direct investment	-1.5	-5.2	5.0	2.6	0.4	1.8	0.2	0.2	0.2	0.2	0.2	0.2
Abroad	-0.7	0.6	5.1	4.0	0.9	1.9	3.0	3.0	3.0	3.0	3.0	3.0
Domestic	0.8	5.8	0.1	1.4	0.4	0.1	2.8	2.8	2.8	2.8	2.8	2.8
Portfolio investment	1.2	1.4	-8.3	-1.4	6.4	-1.1	-5.4	-5.4	-5.4	-5.4	-5.4	-5.4
Abroad	3.5	4.1	-2.3	-2.7	9.3	3.0	1.8	1.8	1.8	1.8	1.8	1.8
Domestic	2.3	2.7	6.1	-1.3	2.8	4.2	7.2	7.2	7.2	7.2	7.2	7.2
Financial derivatives	0.1	1.2	-1.2	-1.9	0.0	-0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other investment	-3.2	-0.7	3.3	-1.7	-10.2	-2.5	1.5	1.6	1.8	1.8	2.0	2.1
Abroad	-12.1	17.9	13.0	4.1	-0.8	12.2	1.0	1.0	1.0	1.0	1.0	1.0
Domestic	-8.8	18.7	9.7	5.8	9.4	14.7	-0.5	-0.6	-0.8	-0.8	-1.0	-1.1
Net transactions in reserve assets	0.0	-0.1	0.8	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0

Portfolio inflows and gross financing needs are manageable, but market confidence matters when financing conditions tighten.

Source: IMF staff data pack, pp. 6 and 47. Red band marks foreign purchases of UK portfolio assets.

Banks remain resilient, but mortgage refinancing is weighing on households





- House prices remain high, but weak approvals and a deeply negative credit-to-GDP gap do not indicate a renewed credit boom.
- Higher refinancing costs are weighing on disposable income and household consumption; the saving ratio reached about **11.6 percent** in late 2024.
- Strong bank buffers and low NPLs limit immediate stress, but rising unemployment could turn household pressure into a credit-quality shock.

Source: IMF staff data pack, pp. 8, 53, and 55–59.

Risks are tilted to the downside and could reinforce one another

High likelihood / high impact: Trade and energy shock

Higher barriers, supply disruption, or renewed energy-price volatility would weaken exports, investment, and real incomes.

High likelihood / high impact: Fiscal slippage

Frequent policy changes or weaker consolidation could raise yields and undermine medium-term credibility.

Medium likelihood / high impact: Sticky services inflation

Persistent domestic inflation could delay monetary easing and deepen the growth slowdown.

Medium likelihood / high impact: Housing–labor shock

Higher mortgage costs combined with unemployment could hit consumption, defaults, and house prices.

Amplification mechanism: Weak productivity and limited fiscal space reduce shock absorption, while high mortgage costs transmit shocks rapidly to households.

Policy should support recovery without weakening medium-term credibility

1. Ease monetary policy gradually

Cut rates only as services inflation, wages, and labor demand confirm durable disinflation.

2. Consolidate credibly

Stabilize debt, control recurrent spending, preserve productive public investment, and allow automatic stabilizers to operate.

3. Raise investment and productivity

Improve planning, infrastructure, energy costs, policy certainty, and innovation diffusion.

4. Preserve financial resilience

Maintain strong buffers and monitor mortgage refinancing, household stress, and NBFI liquidity risks.

Bottom line

Gradual and data-dependent monetary easing, credible medium-term fiscal consolidation, and structural reforms to raise investment and productivity.