8 April 2025

UK in Focus

Economics
United Kingdom

Tariffs adding to an uncertain outlook

- UK hit with a 10% tariff from the US, but the impact will depend on how various governments react
- Economic activity has been weak, while labour markets have been resilient, at least for now
- Although fiscal headroom was restored, vulnerabilities remain

Less 'Liberation' more 'Amerexit'

The first quarter of 2025 has been tumultuous as financial markets and policymakers have sought to decipher between the noise and signals. That volatility looks set to continue with US tariff announcements on 2 April giving further impetus to an already uncertain outlook.

For the UK, its small goods trade deficit with the US meant it faces the baseline 10% tariff. A relatively better outturn compared to those applied to peers – the EU faces a 20% tariff – but a significant jump from the current 0.5% weighted average tariff. Moreover, the steel, aluminium, and automotive sectors are hit with 25%, while other industries, such as pharma, are yet to be the subject of focus. From here, the UK economic impact will depend on the outcome of any retaliatory measures, deal negotiations, their timing, and any support from the government.

If the UK opts for retaliation, that would deepen the economic impact and add to inflationary pressures. However, remarks from UK Business Secretary, Jonathan Reynolds, suggest the focus is on deal negotiation rather than retaliation. On that basis, we judge the risks are weighted towards weaker growth and disinflation. Indeed, financial markets have increased their expectations of Bank of England rate cuts this year and are now more in line with our view of a 3.75% base rate by end-2025 (Chart 1).

Risks to the downside

All that said, the outcome is highly uncertain and the risk to that view is to the downside given that other countries have vowed to retaliate. An escalating trade war could see the UK caught in the economic crosshairs. Such an environment only adds to the picture of economic unease painted by surveys in recent months.

Now, official data has confirmed the weak start to the year, with the UK economy contracting 0.1% m-o-m in January. Of the three broad sectors, services was the only positive contributor, while output in both the construction and manufacturing sectors reported sharp declines. That divergence may continue, the PMI survey points to some signs of life in the services sector, but further weakness across production sectors will be a drag on overall growth. Global economic uncertainty, particularly pertaining to tariffs, has weighed on manufacturers. And while European peers appeared to have front loaded activity ahead of tariff announcements, manufacturers in the UK reported a sharp decline across output and new orders in March.

KEY UK DATA

▲ **0.2%**
GDP growth in 3m to January

▼ **2.8%**
Consumer Price Inflation, February y-o-y

► **4.4%**
Unemployment rate, January

► **4.50%**
Bank of England Base Rate

Source: HSBC

HSBC

There was slightly better news on the inflation front. Headline CPI moderated to 2.8% from 3.0% in the month prior, largely driven by an unusually sharp fall in clothing prices. Retailers have noted softer demand – retail sales volumes rose 0.3% in the three months to February – and the need to offer discounts. Indeed, household consumption rose just 0.1% in 4Q24, while the savings rate rose to 12.0%, its highest on record, excluding the pandemic. It's possible that a shift in the price level for various non-discretionary items in April will further drag on activity and limit the ability of firms to pass higher unit labour costs on. In our view, the headline inflation rate will resume its acceleration and peak in September. However, wage growth should moderate sharply in the second half of the year, placing a lid on persistent price pressures and enable a gradual – one 0.25ppt cut per quarter – decline in interest rates.

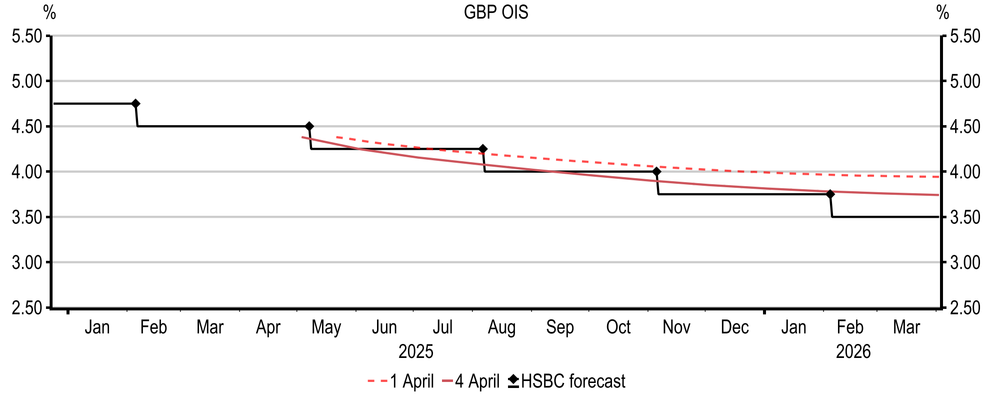
Labour market data remains an uncertainty. While the unemployment rate, for now, has remained stable, supported by still decent employment growth, survey measures point to a further weakening in the demand for workers. In our view, the flurry of headwinds facing employers that hit from April will see a continued loosening in the labour market and a rise in the rate of unemployment (Chart 2); although the UK may just avoid outright falls in overall employment. Nonetheless, concerns over job losses alongside still elevated interest rates and another jump in the cost of living will weigh on consumption and consequently GDP growth in 2025.

Fiscal buffer restored, but at a cost (cutting)

Lack of clarity in official data has worsened and in addition to labour market data issues, the Office for National Statistics has raised concerns about trade, producer prices, retail sales, and possible revision to average wage growth. That carries significant implications for the Bank of England in determining the risk of persistent inflationary pressures and for the government. In that, their low margin for error leaves the Chancellor exposed to small changes in the Office for Budget Responsibility's economic forecasts (Chart 3).

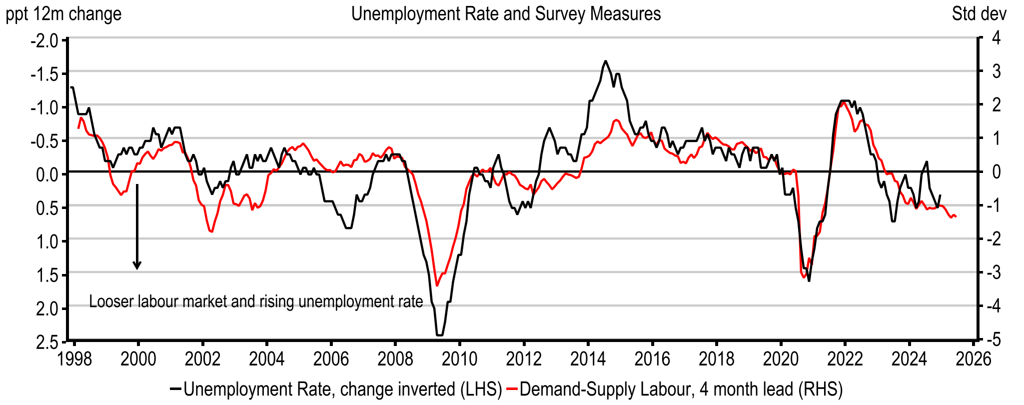
In fact, economic developments since the Autumn Budget did not go the Chancellor's way. And in the end, the public finances faced a GBP4.1bn shortfall against the fiscal target, Chancellor Reeves went a step further and opted to restore the fiscal margin to exactly where it was in October; a miracle, in our view. Despite its restoration, fiscal policy is in the same, if not a worse, position than a few months ago. Downside risks to growth and considerable uncertainty ahead mean the public finances are not on such a firm footing, and the Chancellor may find herself in the same position in a few months' time. But with less public spending fat to cut.

1. Downside risks to growth and inflation pulls market interest rate expectations lower



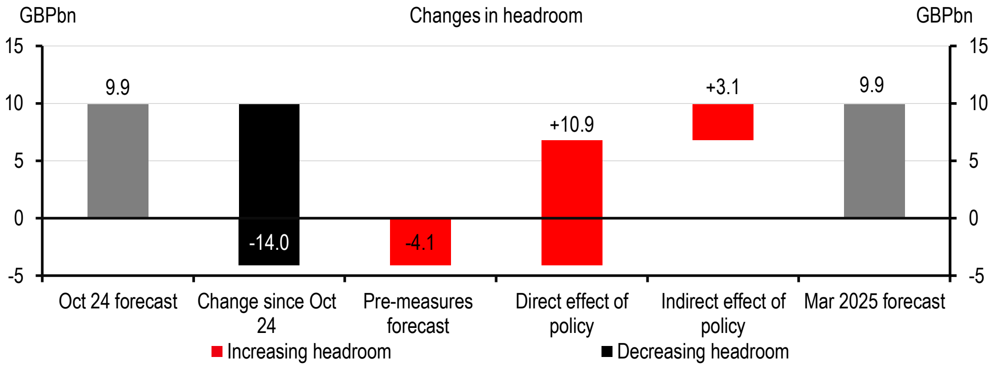
Source: Macrobond, HSBC forecasts

2. Surveys point to further loosening in official labour market data



Source: Macrobond, ONS, KPMG/REC

3. Fiscal headroom restored but the UK government remains vulnerable to shocks



Source: OBR

Disclosure appendix

Important disclosures

1 This report is dated as at 08 April 2025.

2 All market data included in this report are dated as at close 07 April 2025, unless a different date and/or a specific time of day is indicated in the report.

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