



## United Kingdom: Staff Concluding Statement of the 2026 Article IV Mission

May 18, 2026

- While the UK economy has remained resilient in recent years, the war in the Middle East is dampening near-term prospects. Growth is projected to slow to 1.0 percent this year, then gradually recover as the shock dissipates. Higher energy prices are expected to push inflation up temporarily and delay the return to the central bank's target by about one year.
- Monetary policy should remain sufficiently restrictive to ensure that second-round effects from higher energy prices to inflation are contained. Under the current energy price outlook, holding rates for the remainder of the year should be sufficient to bring inflation back to target by end-2027. But given heightened uncertainty, decisions should remain data dependent and taken meeting by meeting, with clear communication on the Bank of England's reaction function.
- The authorities' medium-term fiscal strategy continues to strike a good balance between deficit reduction and growth-friendly spending, and recent changes to the fiscal framework strengthen policy stability and credibility. Staying the course on deficit reduction will be important given market pressures and elevated implementation risks. In response to the energy crisis, support to households should remain targeted, temporary, and financed through offsetting measures. Over the longer term, rising pressures from ageing, defense, and the climate transition will require difficult choices to contain spending growth.
- The government's structural reform agenda encompasses the right areas—planning, skills, innovation, trade diversification, and energy security. Given inevitable lags, the authorities should sustain implementation, supported by greater prioritization, systematic monitoring, and transparent progress reporting. These reforms are also essential to realize the productivity potential of AI.

London – May 18, 2026:

### *Economic Outlook*

While the UK economy has remained resilient in recent years, the Middle East war is dampening near-term prospects. The economy grew at its potential rate of 1.4 percent in 2025 despite headwinds—trade tensions and tight and volatile global financial conditions. Conditional on commodity futures prices as of mid-May, growth is projected to slow to 1.0

percent in 2026[1] (as higher energy prices dampen consumer spending and increase production costs, while tighter financial conditions and elevated uncertainty weigh on consumption and investment. Once the energy price shock dissipates, growth should recover in the second half of 2027 and stabilize around potential in the medium term. Headline inflation is projected to rise temporarily, peaking just below 4 percent at the end of 2026, easing in the second half of 2027 and returning to target by the end of the year.

Risks to growth are tilted to the downside. The main risk is a prolonged war in the Middle East, resulting in higher energy and food prices for an extended period, and sustained global market volatility, which would weigh on confidence and hurt economic activity. If there are large second-round effects of the energy price shock on core inflation, monetary policy would need to be more restrictive, leading to tighter credit conditions and slower economic growth. Domestic uncertainty could also add to the already volatile global environment, holding back consumption and investment decisions.

### *Monetary Policy and Operations*

Monetary policy should remain restrictive to ensure that higher energy prices do not spill over to core inflation and wage growth. The rise in energy prices will lift headline inflation this year while also weighing on output, complicating policy calibration. Staff assesses that holding the policy rate unchanged for the remainder of the year would maintain a sufficiently restrictive monetary stance to limit second-round effects and keep long-term inflation expectations anchored. However, given exceptional uncertainty, the BoE should retain the flexibility to adjust the monetary stance in either direction, and be prepared to respond forcefully if second-round effects prove stronger than anticipated.

The shift toward a repo-led, demand-driven liquidity framework is progressing well, but the transition is still ongoing and experience with the new framework remains limited. As the Bank of England (BoE) continues to normalize its balance sheet, its asset purchase portfolio is expected to shrink to a point where an increasing share of liquidity is provided through regular repo operations. This shift, which has been smooth so far, entails transitional risks as market participants adapt to the new framework, and the system's robustness remains untested especially under severe stress conditions. Close monitoring of liquidity and collateral in the financial system, complemented with market intelligence can help identify emerging stresses in real time. The BoE should stand ready to adjust the modalities of operations if needed.

The BoE has continued to strengthen its forecasting and communication capacity in response to the Bernanke review. Recent changes— particularly the individual MPC member statements, enhancements to the Monetary Policy Report, and the illustrative paths for the Bank Rate under monetary policy rules—are welcome steps. Looking ahead, the BoE could further refine this approach by presenting, alongside the central forecast, a more streamlined and selective set of policy paths under alternative scenarios. For example, the BoE could consider basing the rate paths on a single rule that may change depending on economic circumstances.

### *Fiscal Policy*

Staff welcomes the prudent approach to fiscal measures taken by the authorities in response to the energy crisis. Following a consolidation of close to 1 percent of GDP last year, the continued reduction in the fiscal deficit in FY2026/27 will help reinforce credibility and commitment to the fiscal rules, while the slower pace of adjustment (around half a

percent of GDP) will limit procyclical fiscal policy that could otherwise amplify the downturn. So far, the authorities have announced cash transfers to low-income families using oil for heating. Given limited fiscal space and elevated borrowing costs, broad-based measures should be avoided, and any additional support to households (if the war is more prolonged) should remain well targeted, budget neutral, and time bound.

The authorities' medium-term fiscal strategy continues to strike a good balance between deficit reduction and growth-friendly spending. The frontloaded increase in public investment, alongside the protection of core public services, appropriately acknowledges the UK's persistent infrastructure shortfalls and demands for quality service delivery. The steady fiscal adjustment of around half a percent of GDP per year over the next four years, which relies primarily on taxation, is appropriate and is expected to stabilize debt over the medium term. The June 2025 spending review has further enhanced the credibility of the consolidation path by setting clear departmental expenditure limits.

Recent changes to the fiscal framework strengthen the stability and credibility of fiscal policy. The Budget is now the sole fiscal event: the spring statement did not include new measures, and the OBR now assesses compliance with rules only at the time of the Budget. Furthermore, the doubling of headroom against the current balance rule at the time of the November budget should help insulate fiscal policy from shocks. Taken together, these reforms are expected to improve policy predictability, reduce market pressures, and reinforce the credibility of the consolidation strategy.

Given elevated implementation risks, sticking to the planned deficit reduction and proactively developing contingency measures would help protect fiscal credibility. Risks to the multi-year adjustment exist on both the expenditure and revenue sides. The projected path for spending relies on ambitious efficiency savings targets and continued expenditure restraint beyond the Spending Review period, while the increase in receipts depends in part on the evolution of respective tax bases and sizeable but uncertain yields from tax administration measures. In case the consolidation is pushed off course, contingency measures on both sides should be formulated in advance. Candidate revenue measures include further broadening the VAT base and reforming property taxation. On the spending side, the focus should continue to be on controlling the rising welfare bill, as well as delivering further efficiency measures in public services, while protecting the most vulnerable.

Over the coming two decades, rising pressures from ageing, defense, and the climate transition will require difficult choices to contain spending growth in a context of constrained revenue-raising capacity. These pressures could raise public spending by about 6 percent of GDP by 2050. Beyond the planned tax ratio increase until 2030, staff analysis suggests that the long-term scope for further revenue increases is becoming limited unless more fundamental tax reforms are envisaged. Thus, the scale of rising spending pressures and limited tax space imply that a growing share of the adjustment will likely need to come from expenditure restraint in the longer term. Deeper expenditure reforms could, for example, entail replacing the triple lock with a policy of indexing the state pension to the cost of living, improving the targeting of social benefits, as well as focusing more on preventative care, and expanding charges in the health system while protecting the vulnerable. A transparent public debate would facilitate a better understanding of the trade-offs, clarify policy priorities, and support durable reforms.

### *Financial Sector Policies*

The UK financial system appears resilient, despite some increase in financial stability risks since the 2025 Article IV consultation. The banking sector is well capitalized, non-performing loans are at low levels, and the BoE's 2025 stress test shows that banks could continue to support the economy even under severe stress. Household and corporate balance sheets have strengthened in recent years. However, the global risk environment has deteriorated, with elevated global uncertainty, stretched asset valuations, and pressures in sovereign debt markets. Taking into account both sectoral resilience and global risks, staff supports the FPC decision to maintain the countercyclical capital buffer (CCyB) at its two percent neutral level.

The authorities have been at the forefront of international efforts to address risks in the non-bank financial sector. Building on the innovative System-Wide Exploratory Scenario (SWES) framework, a second iteration will examine risks stemming from private markets, with completion expected in 2027. The contingent non-bank repo facility (CNRF) can help mitigate gilt market dysfunction arising from non-bank demand for liquidity under stress. In parallel, ongoing work on stablecoins, tokenized assets, and AI reflect a measured and welcome stance towards emerging risks.

Given the breadth and pace of the regulatory reform agenda, the authorities should ensure that the cumulative impact of incremental changes across the prudential framework does not weaken resilience. Staff supports the authorities' ambition to make the UK's financial sector a stronger engine of investment and productivity—helping to channel savings into productive uses, deepen capital markets, and improve access to finance for firms. This focus is well placed: private investment remains low relative to peers and financing conditions are uneven in the economy, with persistent constraints for SMEs and high-growth-firms—particularly in accessing scale-up and risk capital. Achieving these objectives will require a careful balance, especially in the review of financial regulations. There is certainly scope to modernize some regulations to reduce unnecessary complexity, improve market functioning, and enhance risk-based supervision, while remaining consistent with international prudential standards. At the same time, the breadth and pace of reforms imply that adjustments are occurring across multiple parts of the financial system simultaneously, underscoring the importance of assessing cumulative effects on resilience. In this context, staff takes note of the adjustment to the system-wide bank capital benchmark, which, according to the FPC, reflects a fall in average risk weights, a reduction in the systemic importance of some banks and the anticipated effects of Basel 3.1 standards. The drivers of the decline in risk weights warrant further assessment, and staff welcomes forthcoming results from the BoE's analysis. Given elevated global financial risks, the ongoing review of the capital framework, including the leverage ratio, should pay close attention to the overall resilience of the banking system.

### *Structural Policies*

The government's "Growth Mission" broadly aligns with past IMF recommendations, and the priority now is to sustain implementation despite near-term headwinds. The UK has faced a major productivity growth slowdown since the Global Financial Crisis. The authorities' agenda—structured around investment, reforms, and stability—encompasses the right areas. However, the economic and fiscal payoff from the structural reforms will materialize only gradually, and credibility will ultimately hinge on sustained implementation, staying the course through inevitable lags and trade-offs, and relying on systematic monitoring and evaluation to course-correct where needed. In this regard, staff recommends publishing annual reports on the advancement of the reform agenda.

Three areas are particularly important to boost productivity:

- *Improving labor mobility.* The UK's productivity problem reflects pronounced spatial disparities, with workers unable to easily move to high-productivity locations, in part due to housing costs. The Planning and Infrastructure Act, changes to the National Planning Policy Framework, the release of grey-belt land, and mandatory housing targets are all steps in the right direction. However, construction activity remains weak, underscoring the need to track implementation closely and assess whether weak outcomes reflect policy lags, design gaps, or other frictions.
- *Addressing skills gaps.* The UK workforce suffers from significant and long-standing skills gaps. While the authorities' skills agenda has the right institutional architecture with Skills England, the Growth and Skills Levy, and the Temporary Shortage List—it is operating against a backdrop of a deteriorating tertiary education funding model, decades of underinvestment, and migration restrictions that are further tightening availability of skilled labor. This calls for a significant enhancement of the pace and ambition of domestic upskilling, with a focus on younger people.
- *Deepening financing for innovation.* A central weakness in the UK innovation ecosystem is that many high-growth, innovation-intensive firms struggle to secure sufficient long-term risk capital. This reflects a lack of scale-up financing, institutional portfolios that are insufficiently oriented toward productive investment, and constrained financing for investment in intangibles. The authorities' measures—including pension fund consolidation, listing and market changes, and the expanded role of public finance institutions to catalyze private investment—target the right frictions, and could be complemented by consolidating these institutions without material disruption to their investment activity to reduce fragmentation and eventually increase the scale of their financing operations.

AI presents a transformative opportunity to boost productivity, but realizing its potential depends on progress with the broader reform agenda. The UK is well positioned to benefit from AI, given the strong research base, and large exposure and complementarity of its workforce. Horizontal reforms that ease economy-wide bottlenecks—policy stability, financing for innovation, infrastructure, and energy capacity—are essential for AI to translate into durable productivity gains. At the same time, complementary, more targeted, interventions can be justified where there is evidence of market failures that slow AI development and diffusion. The authorities could, in particular, focus on addressing near-term shortages in AI-relevant talent and providing a predictable regulatory framework that creates legal clarity for firms using AI.

Finally, to durably lift productivity, the reform agenda also needs to make the economy more resilient to shocks—so that firms can invest, innovate, and scale in a predictable environment. On trade, the government has moved to reduce trade-policy uncertainty and strengthen ties with major partners, notably through the UK–EU reset and the UK–US Economic Prosperity Deal. However, progress in translating the EU reset into operational reductions in border frictions has been gradual, and persistent geoeconomic fragmentation risks strengthen the case for a faster, more decisive approach to enhance supply-chain resilience through continued diversification. On energy security, in addition to measures already taken by the authorities, priorities include incentivizing investments in electricity storage, accelerating permitting of new renewables, and speeding up grid connections and transmission build-out—actions that will reduce vulnerability to external shocks and support more predictable energy costs over time.

*The mission thanks the authorities and other counterparts for open discussions, productive collaboration, and constructive policy dialogue.*

[1] The growth forecast for 2026 has been revised up compared to the *April World Economic Outlook* from 0.8 to 1.0 percent to reflect the strong pre-war momentum, as a result of data revisions and a robust Q1 outturn.