

Welcome

Business Resilience and the Year Ahead

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The UK Economy in 2026: Challenges and Risks

Professor Eric Pentecost, FREcon

Good News?

Latest (January 2026) IMF forecasts say:

- UK GDP to expand by 1.3% this year (compared to 1.4% in 2025) to reach 1.7% in 2027
- This will make the UK the 3rd fastest growing economy in the G7 behind only the USA and Canada and will grow at the same rate as the 21 Eurozone countries.
- Inflation is expected to return to the 2% per annum target rate by the middle of the year from the current 3.4%.
- Unemployment at about 5% is around its long run norm (although nearly 1% higher over the year)

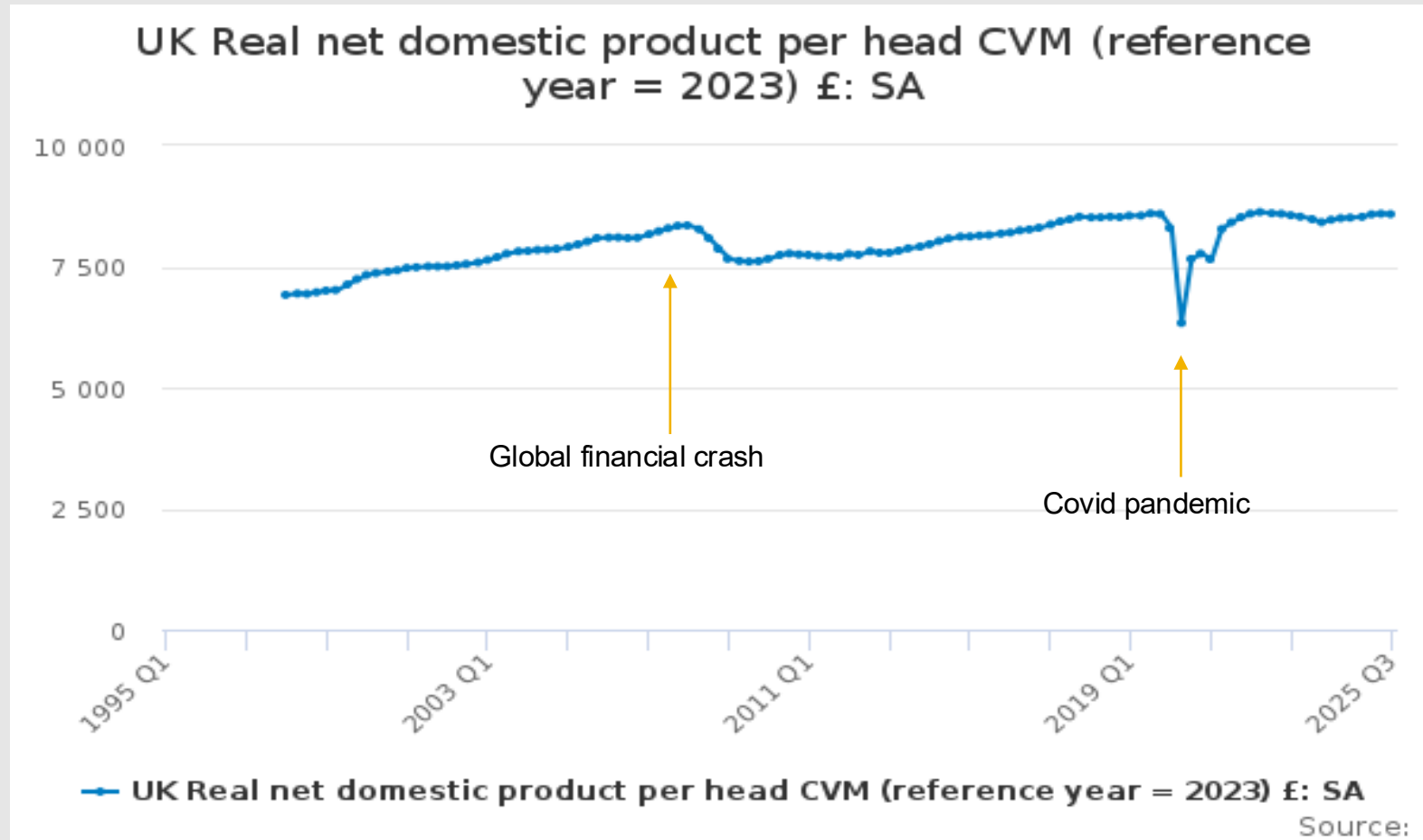
So Why all the Pessimism About the Economy?

- Because the IMF forecasts, like all such forecasts do not deal with the longer-term issues or comparisons!
- I will outline the main risks to the UK economy in 2026 under three main headings: long-term supply problems, shorter-term demand issues and external factors

Long Term Perspective: Structural Weakness

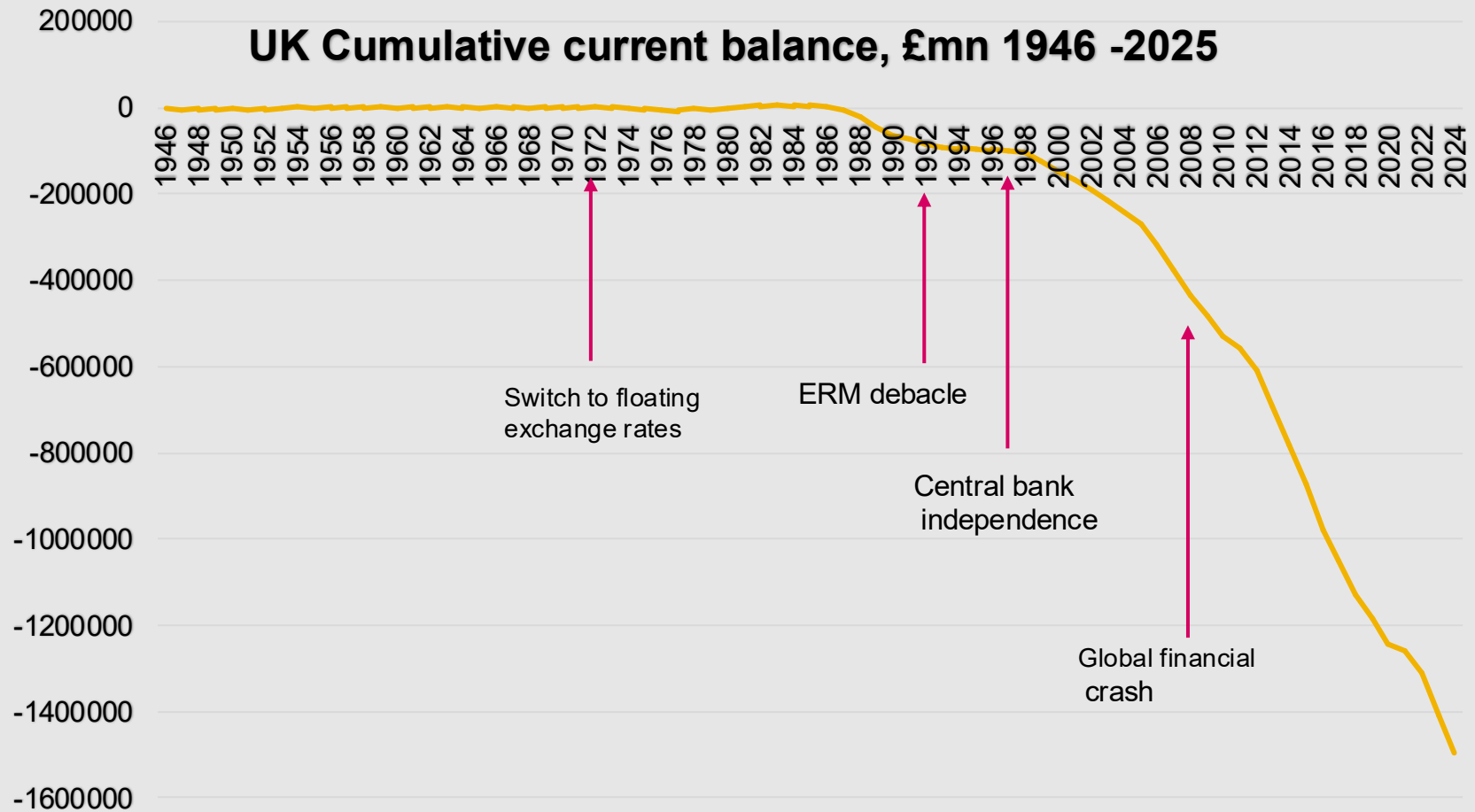
- It is not GDP, or real GDP growth that really matters but *real per capita GDP*– and this has been flat for a long time. GDP per head is 30% lower than the extrapolated trend from 1999 -2007 [Chart1]
- Growth of productivity has been the lowest in the G7 for 15 years. The “productivity gap” has been widening since 2008
- Investment in fixed capital is the lowest of all G7 countries

Chart 1



- Weak growth in supply – combined with increases consumption leads to a current account deficit
- Persistent current account deficits – implies we have been living beyond our means every year since the mid-1980s. [Chart 2]
- This means we are increasingly dependent on foreign residents lending us money – i.e. our indebtedness to foreigners is increasing. This is unsustainable in the long run.
- This is partly a consequence of the supply-problem and governments' casual attitude to trade imbalances

Chart 2



Policies to Address Structural Weaknesses?

- The government have identified the problem but have not so far pursued policies to help. In mixed/market economies governments are generally unable to stimulate economic growth, other than by creating an investment (business) friendly environment.
- The *Autumn budget* might have given priority to:
 - basing business rates on site values - a land tax rather than on property values
 - abolish stamp duty (to help labour mobility)
 - remove distortions on incentives to invest (e.g. investment allowance against capital gains tax, end full relief of CGT on death; only capital gains made in this country are taxed in this country).
 - reform corporation tax by giving up front tax relief on all business expenditures, end bias towards debt finance and remove limits on loss deductions
- None of these simple, cheap options were part of the government's tax policy despite wanting to stimulate growth!

Short-Term Problems

- Domestic

- Inflation persistence
- shrinking labour market in which 1 in 5 working age people are inactive
- unsustainable public finances [Chart 3]
- policy uncertainty?

- External

- financial stability risks
- geo-political shocks

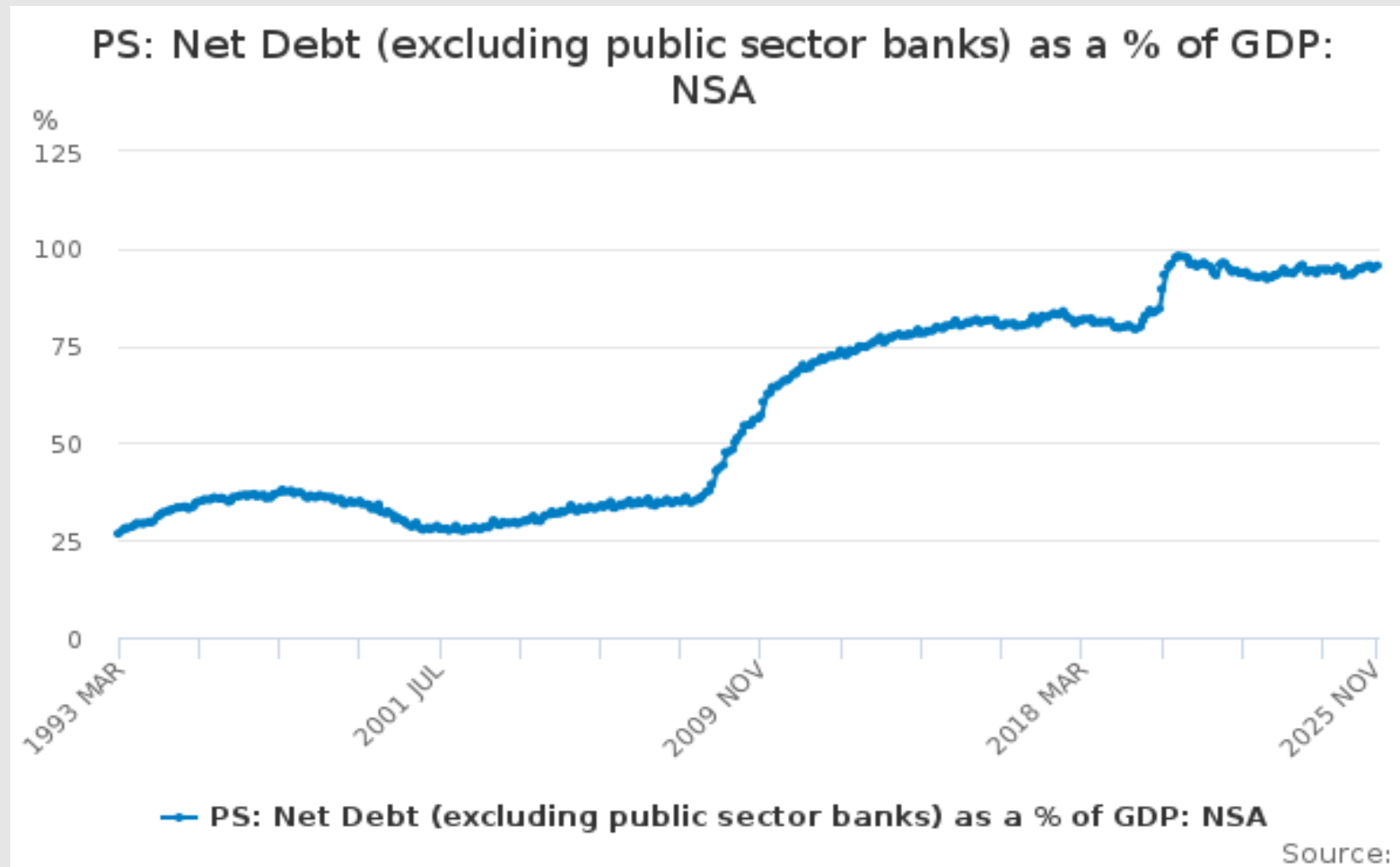
Domestic Pressures

- Inflation has been slow to fall – BOE admits that it has underpredicted inflation in recent years (!) – partly due to the very high energy and food prices (prices are 12% than 3 years ago – 100% higher than expected!). Although slowing, at 3.4% - it will be Easter before the 2%% target is again achieved. [BOE may not now cut interest rates in February as expected]
- The rise in unemployment for 4% to 5% over the past years is in part due to a policy 'mistake' – raising employee NI contribution in 2024 budget. This tax on jobs – has led to employers not hiring young workers – as they are more expensive (and unskilled). Simultaneously, the budget has allocated more funds for social protection – rewarding non-work!
- Policy U-turns(uncertainty) have generated a great deal of uncertainty amongst consumers , who have responded by increasing the savings ratio over the past 18 months – and by delaying spending have not helped the economy grow

Domestic Pressures (cont'd)

- Unsustainable public finances – basically the need to meet the fiscal rules –to maintain confidence in the policies. Needed to raise tax revenue to be sure to have sufficient headroom to hit fiscal targets in 2029-30. This was the main focus of the budget – hence it was a tax raising budget.
- There is historically no reason why a debt stock of over 100% of GDP should be a problem. In the past it has been paid off by a combination of economic growth (average about 2.5% per annum) and inflation (3%-4% per annum)
- Today the problem is more difficult – not only a lack of growth and with inflation targeted at historically low levels; but also about 22% of the bond stock is indexed linked – so fixed in real terms and not eroded by inflation!
- With relatively high interest rates the cost of servicing this debt is very expensive £135bn – 7% of government spending in 2026-7 is scheduled for the payment of interest. (More than the defence budget!)

Chart 3

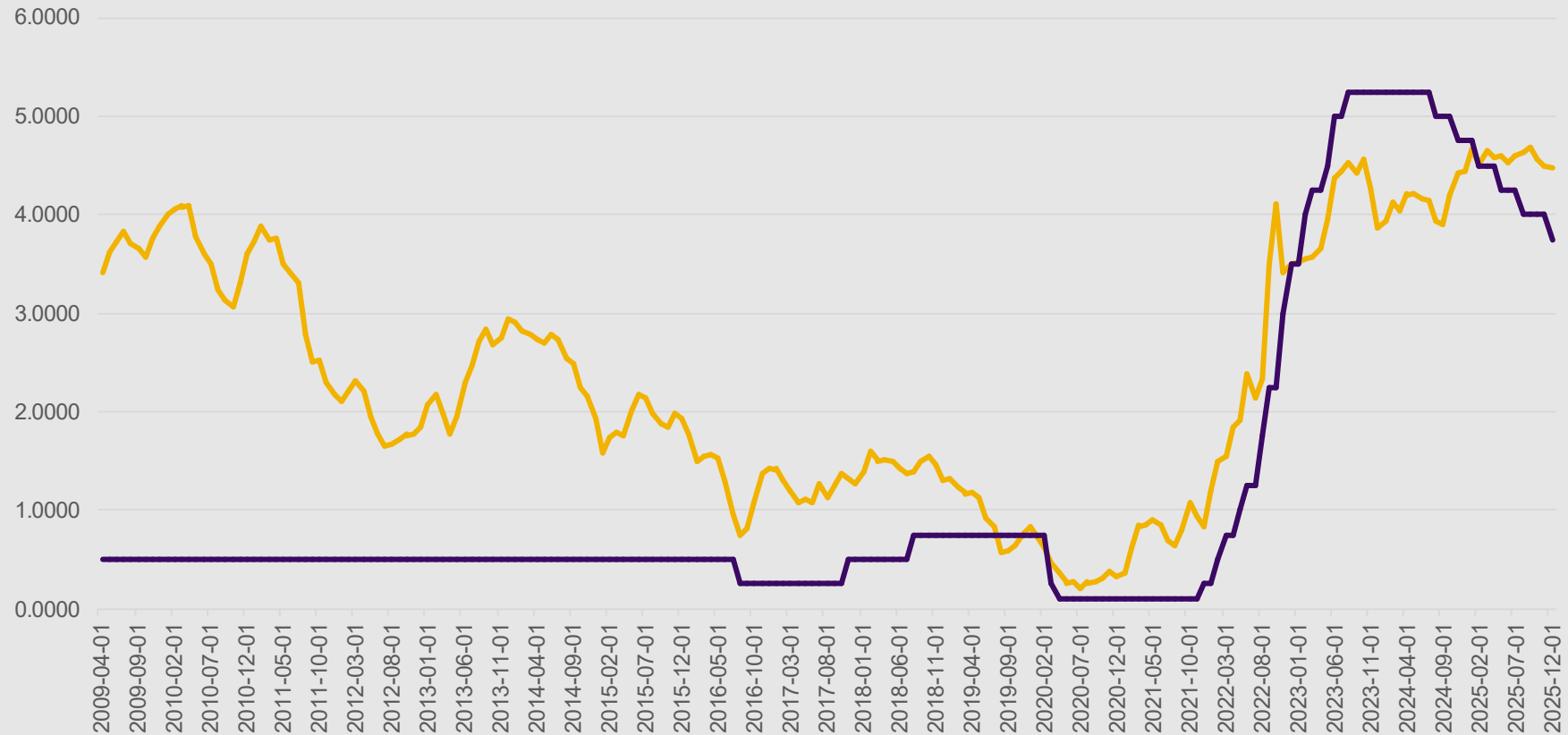


External Pressures

- About 1/3 of UK bond debt is held overseas – so any potential sell off would put upward pressure on interest rates
- In the GFC it was the banks that failed. Regulation changes regarding the amount of capital banks have to hold – means that the banks are thought to be fairly safe.
- Many of the gilts are held in the shadow banking system – by US hedge funds (about 1/3 of the market compared to just 15% a year ago) which is not so closely regulated .
- Borrow £100bn to invest in gilts (risk free assets) which they then use as collateral for to further invest in gilts. If these hedge funds decide to sell up – the market will be flooded by gilts, prices will plummet and interest rates rise - BoE may have to intervene to avoid another 2008-9 type crash
- **Chart 4** shows that there might be a disconnect between the short rates and 10-year bond yields – as the former have been falling the latter have been rising - this has in the past been a requisite for a financial crash!

Chart 4

UK Interest Rates, 2009-2025



US Position

- The US has a \$38tr (12 0's!) debt stock outstanding. \$9tr matures in early 2026 – so will need to be rolled over. This could push up US interest rates – as the Fed tries to sell more bonds.
- Rising rates on US Treasuries may well lead to a depreciation of sterling (already at \$1.34 compared to \$1.22 last year at this time), which may work to push up inflation. (This is another reason interest rates will not be cut further in February.)
- Bond selling in Japan may also push up rates there and is another potential downside risk for the UK bond markets: unlikely there will be another cut in interest rates early this year
- Trump tariffs – hopefully largely irrelevant for the UK!

Hopefully it will not turn out as bad as many believe, but remember

An Economist is :

Someone who does precision guesswork based on unreliable data provided by those of questionable knowledge

Thank you

Appendix 1: Budget 2025

Tax receipts 2026-7 (Change on 2025-6)

Total raised: £1,304bn (+6%)

o/w:

Income tax:	£359bn	(+9%)
VAT:	£220bn	(+3%)
NI:	£214bn	(+8%)
Corporation tax:	£104bn	(-1%)
Excise duties	£44bn	(-4%)
Council tax	£54bn	(+8%)
Business rates	£37bn	(+9.0)
Other taxes	£272bn	(+8%)
Borrowing	£112bn	(+15%)

Expenditures, 2026- 7 (Change on 2025-6)

Total £1,416bn (+6.15%)

o/w:

Social protection	£400bn (+6%)
Health	£294bn (+6%)
Education	£145bn (-0.7%)
Defence	£90bn (+8%)
Public order & Safety	£62bn (+13%)
Debt interest	£135bn (+7%)
Transport	£69bn (+5%)
Personal Social Serv	£54bn (+6%)
Housing & environmt	£51bn (+16%)
Ind, agri & employ	£56bn (10%)
Other	£60bn (+7%)

Appendix 2: Historical national debt

Is the size of the stock of debt important?

It changes considerably over time
rises sharply largely due to wars –
but then falls back to much lower
levels

Global financial crash raises national
debt from around 45% of GDP to
75% of GDP

In 2026 it is about 95% of GDP

The Relationship of Changes in the National Debt to
Changes in GDP, 1816 to 2010

Year	Debt:GDP %	Gross Debt £'000m	GDP £'000m	Unemployment %
1816	260	0.78	0.30	..
1914	24	0.62	2.55	3
1919	127	7.41	5.83	3
1923	176	7.73	4.39	12
1929	158	7.49	4.73	10
1933	179	7.63	4.26	20
1939	137	8.15	5.96	11
1945	225	21.4	9.5	1
1970	67	33.1	49.4	3
1980	43	95.3	222	7
1990	35	193	551	7
2000	45	426	943	5
2010	75 [53]*	1,071 [760]	1,437	8

* Debt net of assets (including bank shares acquired in rescue operations) as used in government and OBR statements.

Appendix 3: Macroeconomic Performance indicators for the UK since 1950

- There are 5 charts that follow that summarise the UK performance. The prominence each target variable has varied over time, according to the changing importance of the problem

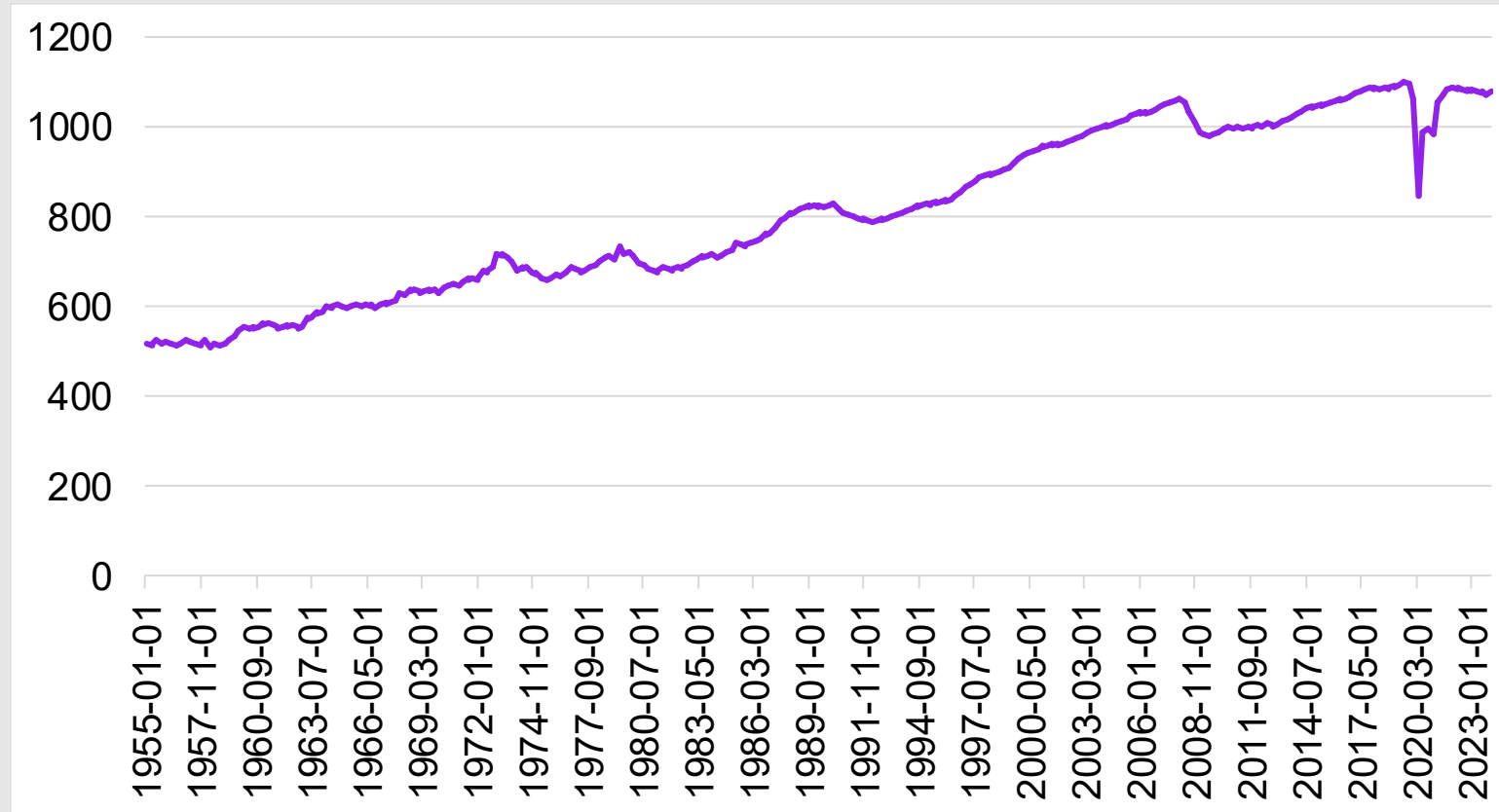
Output and Economic growth

Unemployment

Inflation

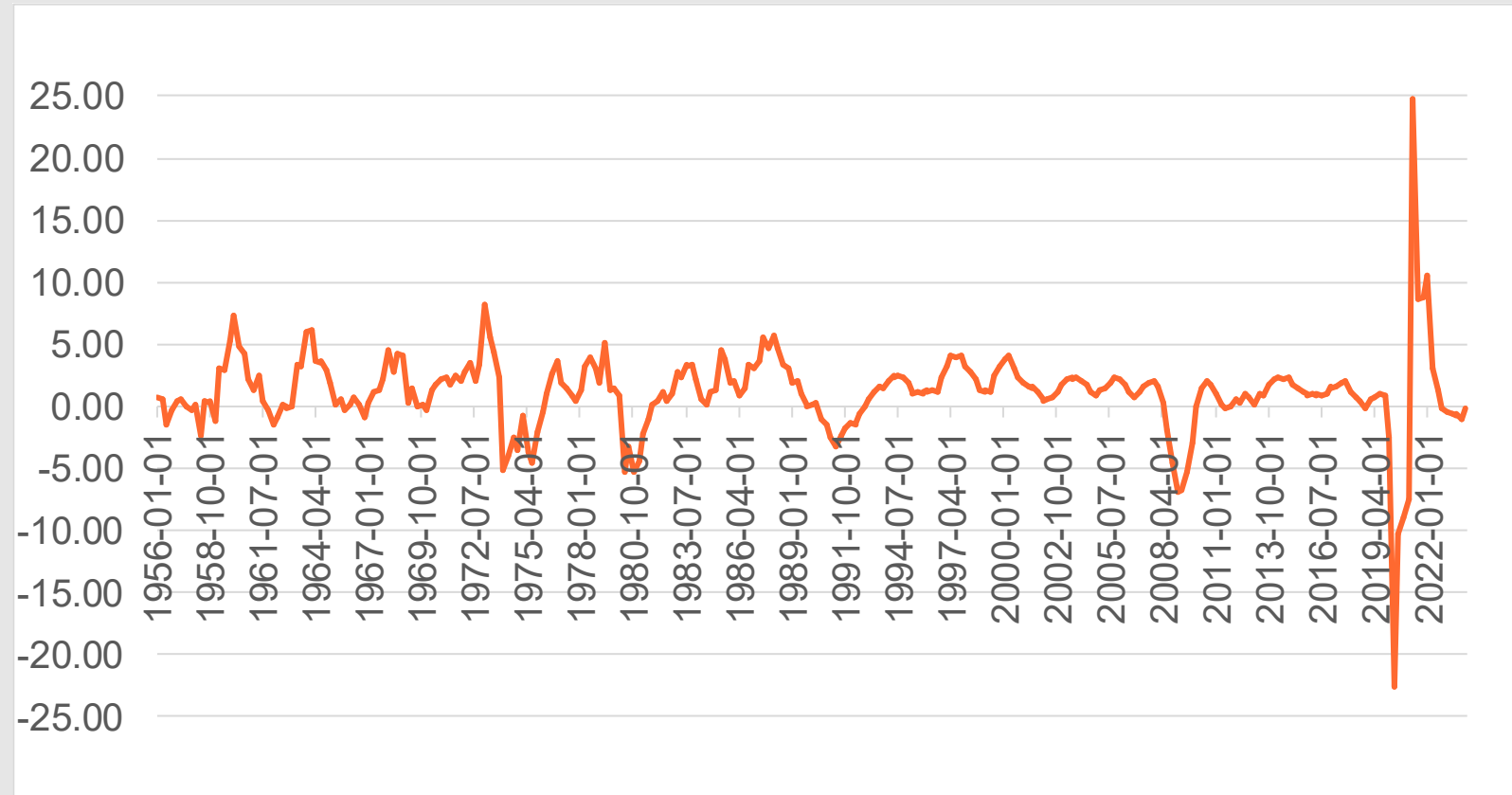
UK GDP (£mn) in Constant Prices, 1955-2024

21



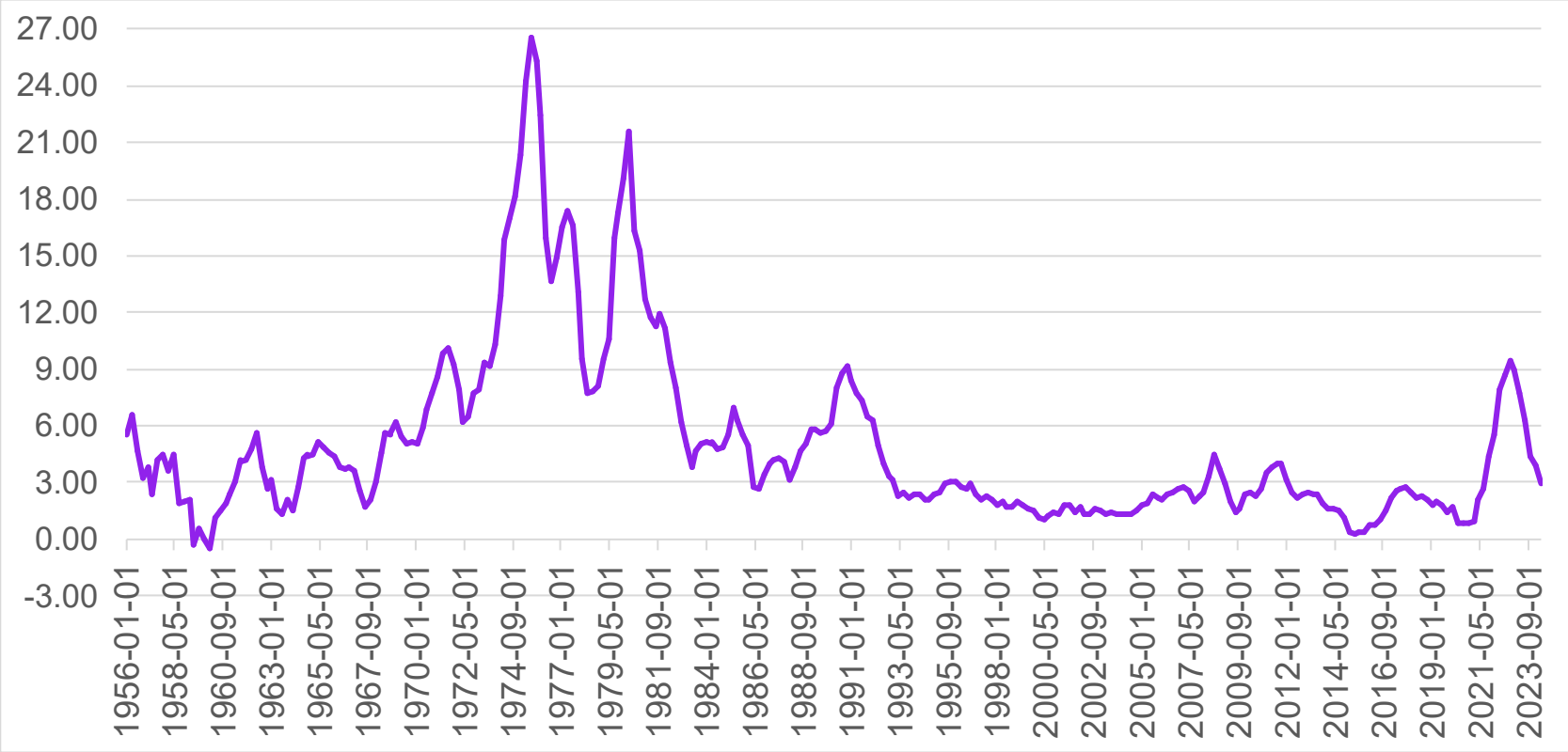
UK GDP Growth Rate (%) per annum, 1956-2024

22



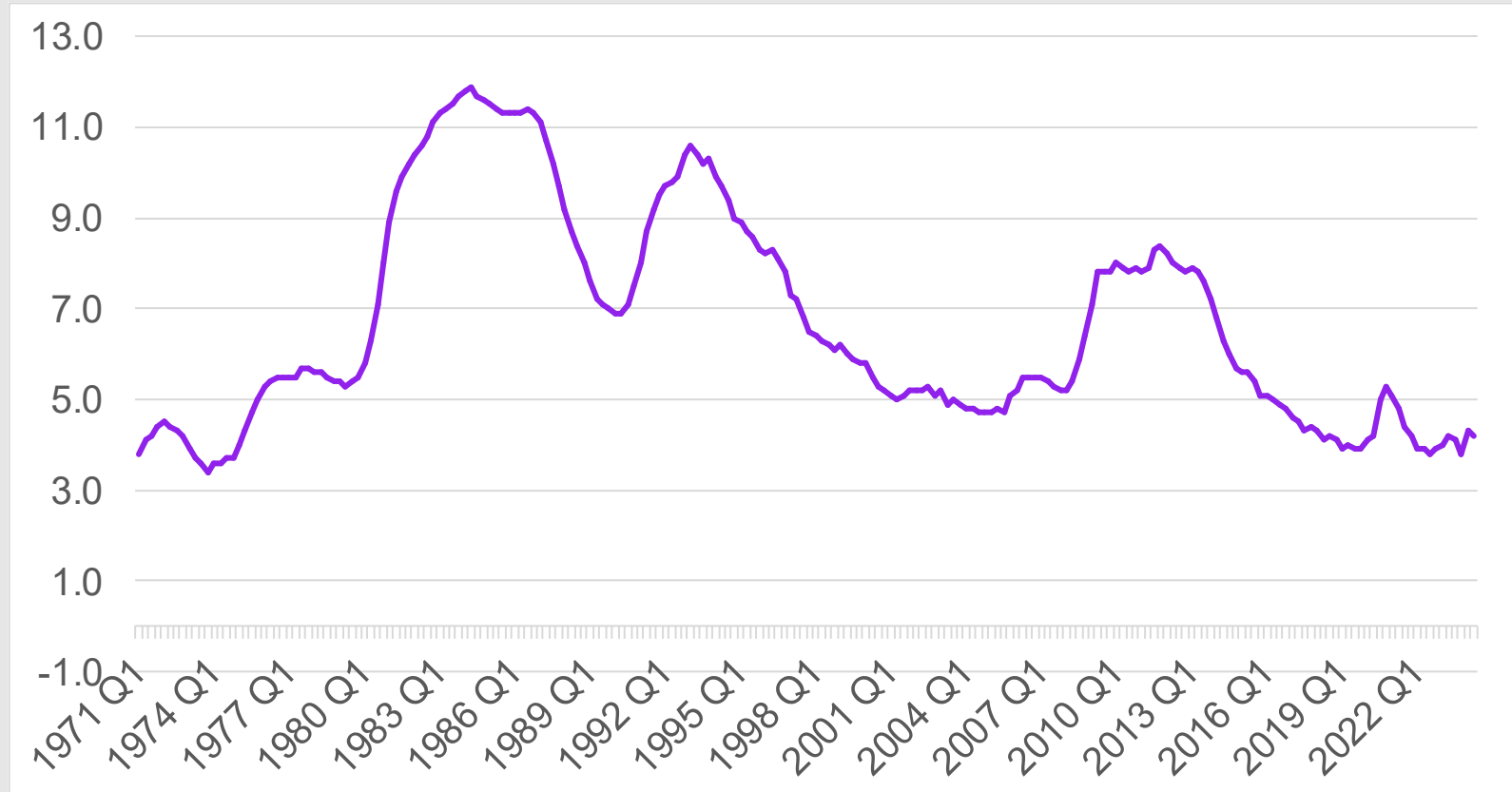
UK Inflation (% per annum), 1956-2024

23



UK Unemployment, % per annum, 1971-2024

24



Q&As

Mukesh Bulsara - Partner at Coadax LLP

**Eric Pentecost – Professor of Economics at
Loughborough University**

**Stephen Grubb, Director Commercial Banking,
Leicestershire at NatWest**

Thank You

A BIG THANK YOU TO:

- ❑ **Our amazing guest speakers and panellists – Professor Eric Pentecost from Loughborough University and and Stephen Grubb from NatWest**
- ❑ **Burleigh Court Hotel & Conference Centre for hosting**
- ❑ **Loughborough University Science and Enterprise Park for their support**
- ❑ **You, for all your continued support of LBV**

Next event

**‘Sporting Stories’ from 6-8pm, Thursday 26 February 2026 at
Leicestershire County Cricket Club.**

**An after-work social event for members and guests, where
we’ll be hearing about the successes and challenges of the
business of sport.**

Visit www.lbv.co.uk/events

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Thank you.

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