

## BAILY GARNER ECONOMIC BRIEFING – NOVEMBER 2025

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**Guest speaker: Thomas Pugh, UK Economist, RSM UK – A frequent contributor to the BBC and Financial Times.**

*Thomas began his career at The Treasury during the financial crisis, helping design banking regulations to strengthen the financial system, before joining Capital Economics to analyse energy commodity trends and forecast prices. He now works as an Economist at RSM UK focused on the UK and Ireland.*

*Thomas has assessed the impacts of Brexit and the pandemic on UK sectors and regions. He examines consumer spending, investment, and public finances, and their influence on global factors such as inflation, trade, and monetary policy.*

### Key Figures:

- The UK grew by 0.7% in Q1, 0.3% in Q2 and 0.1% in Q3, and it's predicted we'll end 2025 with an annual growth rate between 1.3%–1.5%.
- The rate of inflation dropped from 3% at the start of 2025 to a low of 2.6% at the end of Q1, climbed to a high of 3.6% in Q2 and stayed consistent at 3.8% throughout Q3.
- The interest rate was cut from 4.75% at the start of 2025 to 4.5% in February, 4.25% in May and 4% in August, where it remains as of today (November 26).

All of the above fall broadly in line with Thomas' predictions made at our last economic briefing before the October 2024 budget, that there would be a 'sugar rush' of growth that would slow down to reach approximately 1.5% for the year, and that the Bank of England would cut rates slowly to around 4%.

With the new budget announcement coming tomorrow, Thomas shared his thoughts (summarised below) on how the economy has performed so far this year, and how the new budget might impact it over the short- and long-term.

### Key Insights:

#### **THE UK ECONOMY IS GROWING MORE THAN PEOPLE REALISE**

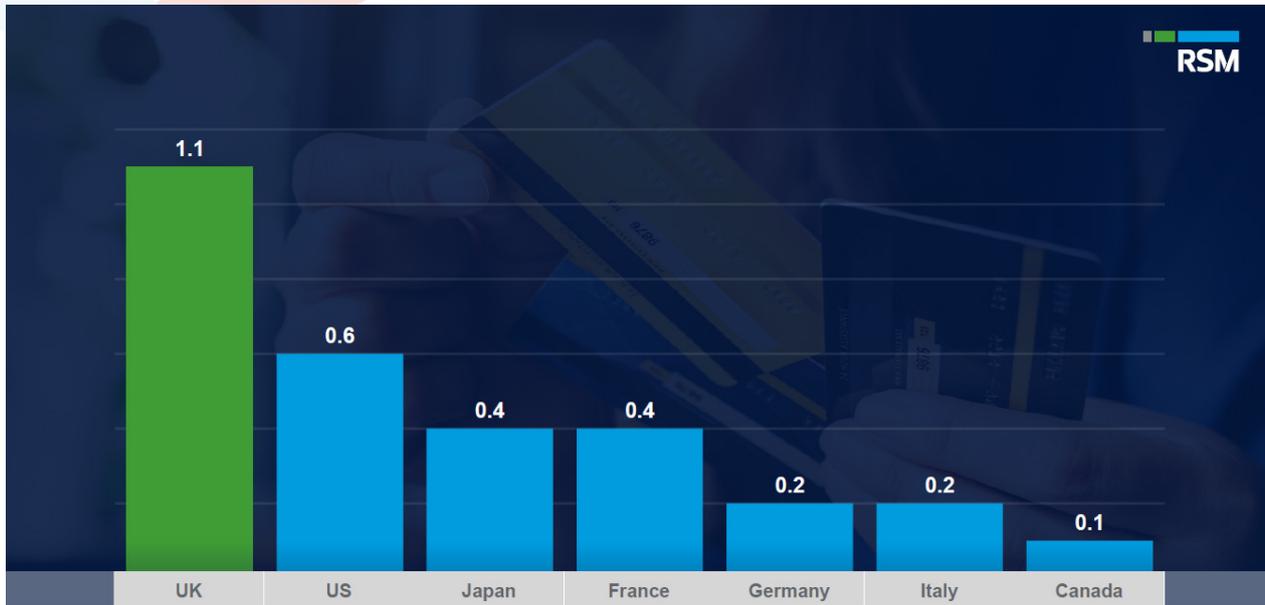
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You'd be forgiven for checking the newspapers or the TV and thinking the whole of the UK is in recession, but actually, growth of over 1% for the first half and 1.5% by the end of year is pretty good. It's better than the US, better than the Eurozone and it's twice as fast as we grew in the previous two years on average. It's not all government spending either. Consumer spending makes up of two thirds of the economy, and last year it was falling by 1%; it's now growing by 1%.

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Coming into this new budget, the UK is in a much stronger position than is widely acknowledged and the economy this year has performed much better than it has any time since the end of the pandemic.



### **GROWTH IN H1 2025 (%)**

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#### **GROWTH STAGNATED IN THE SECOND HALF OF THE YEAR**

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For the second year now, growth was really strong in the first half and then completely stagnated. In 2024, that's because we had an election in the UK and US as well as a budget with the highest fiscal spending we'd seen in decades. We're seeing a repeat of this stagnation, and it's due to constant speculation about which taxes are going up for businesses and households. The surprising thing was actually how resilient the economy had been. And then, come last week, we got what we were expecting: Retail sales slumped, consumer confidence was down and business confidence had fallen really sharply.

#### **THE BUDGET HAS TO ADDRESS A £30BN FISCAL 'BLACK HOLE'**

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A combination of increased benefit spending and the removal of VAT on household energy bills wiped out the £10bn of headroom the government had against its own fiscal rule to have a budget surplus in 2029-30. A downgrade in the productivity forecast from the Office for Budget Responsibility (OBR) created a further deficit of £20bn. In total, this means the government needs to raise £30bn to restore its original headroom. A budget that goes beyond that would be more painful in the short term but would also look more credible and allow confidence to rebuild.

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## CHANCELLOR'S FISCAL HEADROOM (£BN)

### HOW THE MONEY IS RAISED MAKES A BIG DIFFERENCE TO THE ECONOMY

What you don't want to do is increase inflationary pressure by raising things like VAT and duties. You also don't want to do anything that distorts the economy by altering normal price signals or resource allocation. You definitely don't want to do both at once, and that's exactly what the government did by raising employer's NICs, which pushed up inflation and raised the unemployment rate.

You want to raise taxes that are deflationary or disinflationary and also make it clear how much you'll gain. Income tax is the best example of this; it's predictable, sucks demand out of the economy, brings inflation down and allows the Bank of England to offset some of that pain by cutting interest rates. That doesn't look likely though, and we're expecting to get hundreds of smaller tax rises.



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## RISKS, BENEFITS AND OPTIMISTIC UPSIDES

The budget could turn out to be backloaded quite heavily because of fiscal drag adding between £8bn and £10bn. If half of it doesn't actually kick in until 2030, there's no incentive for the Bank of England to cut interest rates before then. The complexity of the smorgasbord tax approach also means the government doesn't have a clear sense of how much they'll raise. This is especially true because a lot of the measures have behavioural changes associated with them, and those behaviours aren't linear so there will be a tipping point where people change them. The key risk here is that a lot less tax is raised than expected, but there's also a knock-on effect because big behavioural changes distort the economy and can act as a drag on growth.

Despite these risks, we will still see inflation drop quite sharply from 3.6% to between 2% and 2.5% by the end of 2026, partly because measures like cutting VAT on energy bills will mechanically just reduce it. The current oversupply of oil could further decrease inflation and make interest rate cuts more likely, which could offset the impact of some of the tax raises.

## A SAVING GRACE?

Households have been saving a really high proportion of their income — averaging 10.7% in Q2 2025. That's as high as it was during the financial crisis. At the same time, household incomes have grown by between 5% and 6%, while consumer spending has only increased by 1%. The reasons for this are twofold: High interest rates make saving more attractive; and consumer confidence has dropped. The good news is that means there is scope here for households to absorb some of the impact of higher taxes.



## CONSUMER SPENDING AND REAL HOUSEHOLD INCOME (Q4 2019=100)

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If the budget is backloaded, so we get £15bn in tax rises and spending cuts in 2030, but that's offset by £10bn of increased benefit spending, the economic hit might be pretty small. For those that are hit most heavily, they're likely to be on the wealthier end and have this big savings pile. So actually, we could see a scenario where the economic hit from this budget isn't that big.

The other thing to be hopeful about is that we're going to see further falls in interest rates. The bar to not cutting in December is pretty high now if we look at the labour market data, activity data and inflation data – even if we weren't having this budget, a December rate cut would be nailed on. It would have to look quite inflationary to get them not to cut. With the expected budget, we might get one more rate cut after that to get to 3.5%. The data has been poor enough though that even with the budget, we could even get cuts in February and April and potentially more until we're at 3% by the middle of next year. It's not the base case, but it's also not unrealistic.

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**Thomas' prediction:** *Consumer confidence will fall further over the next couple of months. Then, if we fast forward into the second half of next year, we've got that inflation rate really coming down quite sharply, we should be over the worst of the labour market pain and interest rates may have come down another half a percent. Everything should start picking up and that will be a big driver of consumer confidence, especially if we can get out of this constant cycle of worrying about tax rises. That does set the stage for 2027 to look a lot better than next year.*



### Q&A:

**Q:** Rachel Reeves has been saying in the lead up to the budget that she will do what's best for country, not the party. Has this budget turned that on its head?

**A:** Yes. This is a budget for the back benches, not financial markets or the economy. If you were doing a budget for financial markets, it would look much

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more like raising income tax by 2p. If you were doing a budget for the broader economy, it would look much more weighted on the spending side and you would have much more growth reforming stuff in there. I'd say it's a budget for the back benches, because they're going round the houses and bending over backwards not to break their manifesto promise not to raise income tax. At the same time, they're also quite significantly increasing spending on welfare, which is a back bench priority. In my opinion, quite clearly that is putting politics and party ahead of the economy.

**Q:** Those backbenchers I appreciate are protecting their voter cohort, and welfare is a priority, but surely they see that at some point growth has to be prioritised?

**A:** I completely agree. With a lot of this stuff they're treating the symptom rather than the cause. If they don't get a handle on welfare commitments then they'll be back here in a few years having to raise taxes again. But fundamentally, it comes down to this question: Do we want to be a big state funded by taxes like one of the Nordic countries, or do we want to be more like the US where the state is a lot more limited and taxes are lower? If it's the former, we're going to have to broaden the tax base, because we're reaching a point where our tax system is so top heavy we won't be able to raise any more from the wealthy. Right now, we have the worst of both worlds, and if we carry on with this path we'll be back here every two years at least having the same conversation.



**Q:** How do different tax regimes affect productivity, GDP and growth?

**A:** Our tax system is anti-productivity for a few reasons: One is that if you earn more than £100,000 your personal allowance goes down by £1 for every £2 that your adjusted net income is above that figure. That's a massive disincentive on the most productive people. Stamp duty is another example because it disincentivises people to move home, and one of the key ways you improve productivity is to move people from less productive areas to more productive areas. It's not all on the tax system though; for a while after the financial crisis, we had 0% interest rates, which prevented bankruptcy because there was no benefit

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to pulling company's loans - and then we effectively outlawed bankruptcy. One of the biggest drivers of productivity in an economy is unproductive firms going bankrupt and being replaced by more productive firms. The US for example has a much higher productivity rating because there's massive churn of firms going bankrupt and those that remain becoming bigger and more productive.

**Q:** What impact would a peace deal between Ukraine and Russia have on our economy?

**A:** I'm not sure there'd be a huge difference, because we've ceased a lot of trade with Russia. The only way I see a difference is if Europe started to import large quantities of cheap Russian energy again. In that case, you can see energy prices coming down sharply or at the very least the removal of whatever risk premium is currently active in energy markets. I'm not convinced that all of Europe goes back to buying Russian natural gas and oil though, and I would hope they wouldn't because that just sets us up for the next time this happens.

**Q:** If the budget includes aggressive tax cuts or wealth taxes, how do you think markets would react to those contrasting positions compared to the smorgasbord approach?

**A:** Markets would much prefer aggressive tax cuts, but they're not ideological in that they care if it's a big state or a small state; what they care about is economic competence inasmuch as it provides a predictable path for inflation and interest rates. The problem with Liz Truss is that she went down the tax cutting route without cutting spending. Whether you go down the small state route of cutting taxes and spending or the big state route of increasing both, you still provide that predictability. The problem is that a tax on the wealthy doesn't work because it's massively distortionary. If the pillar of the budget were a 2% tax on billionaires, that



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wouldn't go down very well at all; if it was a 2p increase to income tax, markets wouldn't care.

**Q:** There is virtue to spending on public infrastructure that creates jobs and encourages growth, so how do you strike a balance with how much you spend?

**A:** Rachel Reeves gets criticised quite legitimately a lot of the time, but one of the things she hasn't been given credit for is changing the fiscal rules to separate what we call current, day-to-day spending and investment spending. The cardinal sin of the Cameron and Osborne government was slashing investment spending to balance the books, and Reeves has made a point of saying she's not going to do that, which she deserves credit for because we're crying out for higher investment. When it comes to infrastructure the cash has never really been a problem in the UK, it's more about regulations and resources that make the cost of investment prohibitive. The government has made a lot of noise in this area, but they haven't really done anything effective.

**Q:** If the government does adopt a smorgasbord approach, how much risk do you think behavioural change poses to creating more headroom against its fiscal rule?

**A:** If we take employer's NICs as an example, it was meant to raise £25bn by 2030; because businesses have cut wages, reduced hiring, and raised prices, that figure is expected to be closer to £15bn now. The problem with the smorgasbord approach is that if we've not had big changes in these small taxes before, there's nothing to base forecasts on, so if they're expected to raise £15bn for instance, you can probably chop five off that. This is the point though, the real figure is completely unknown.



**Thomas Pugh**  
**UK and Ireland Economist**  
**RSM**