24TH FEBRUARY 2026

Political risk and the UK Economic and Market Outlook

Paul Dales, Chief UK Economist
Ruth Gregory, Deputy Chief UK Economist
Jonas Goltermann, Deputy Chief Markets Economist

CAPITAL ECONOMICS

Agenda

- Presentation (10 mins):
  - Setting the scene – our key economic and markets forecasts.
  - How will the Fiscal Statement on 3rd March influence the politics and the economy?
  - What would happen to policy and the economy if Starmer/Reeves are replaced?
  - How would the response of gilts and the pound differ to after other political events?
- Discussion (40 mins).
- Demonstration of how the CE Platform can help you (5 mins).

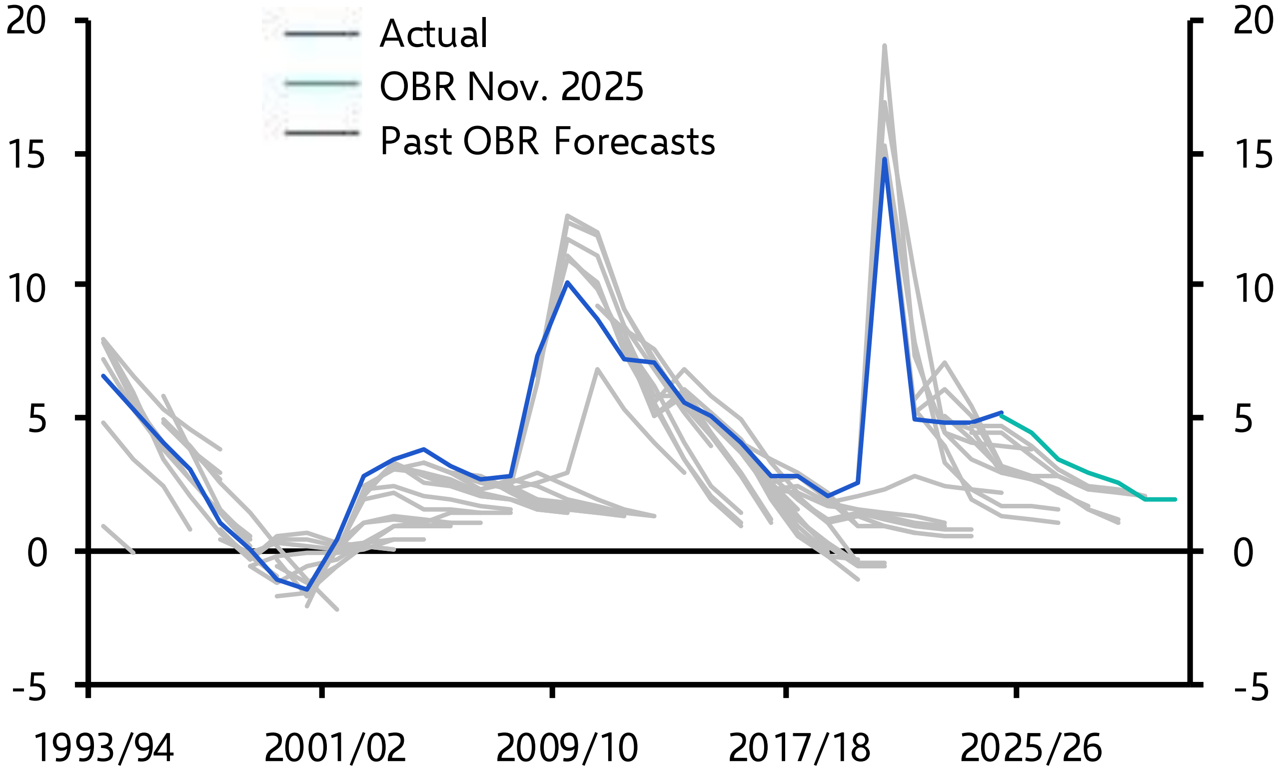
Key Economic & Market Forecasts

Access and download our key macro and markets forecasts from our interactive UK Data Dashboards.

	Latest	Forecasts	
	(23rd Feb)	2026f (End of Year)	2027f (End of Year)
GDP (%y/y)	1.3 (2025)	1.0 (Yr Av.)	1.2 (Yr Av.)
Unemployment Rate (%)	5.2% (Dec.)	5.0 (Q4)	4.6 (Q4)
CPI Inflation (%)	3.0 (Jan.)	1.8 (Q4)	1.9 (Q4)
Bank Rate (%)	3.75	3.00	3.00
10-Year Gilt Yield (%)	4.35	4.25	4.25
$/£	1.35	1.25	1.25
Euro/£	1.15	1.14	1.14

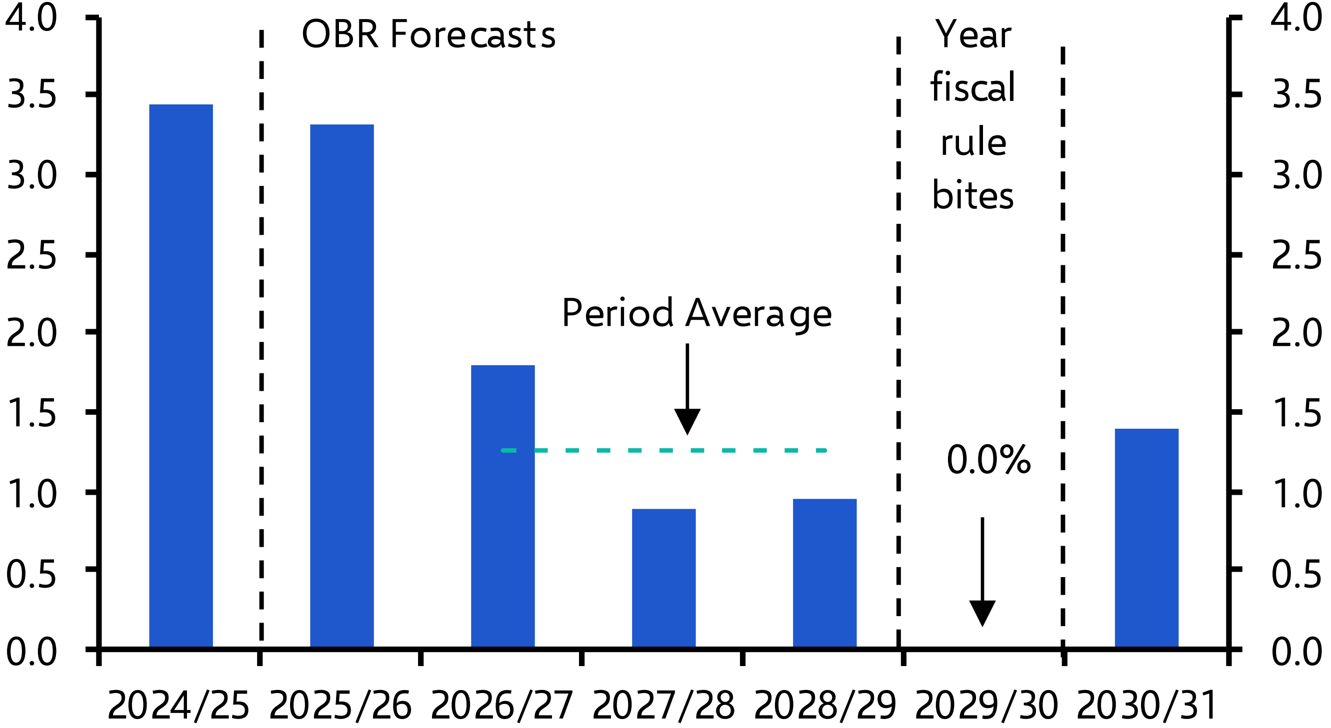
Source: LSEG Data and Analytics, Capital Economics

Public Sector Net Borrowing (As a % of GDP)



Sources: LSEG Data and Analytics, OBR, Capital Economics

Real Government Department Spending (%y/y)



Sources: OBR, Capital Economics

The Chancellor’s Fiscal Statement

- Could add to/ease pressure on Starmer/Reeves.

- Much will depend on the Chancellor’s headroom.

Three possibilities:

1. **Less than £20bn**: Concern about more tax hikes adds to pressure on Starmer/Reeves.

2. **Greater than £25bn**: Adds to pressure if Reeves doesn't use the extra headroom.

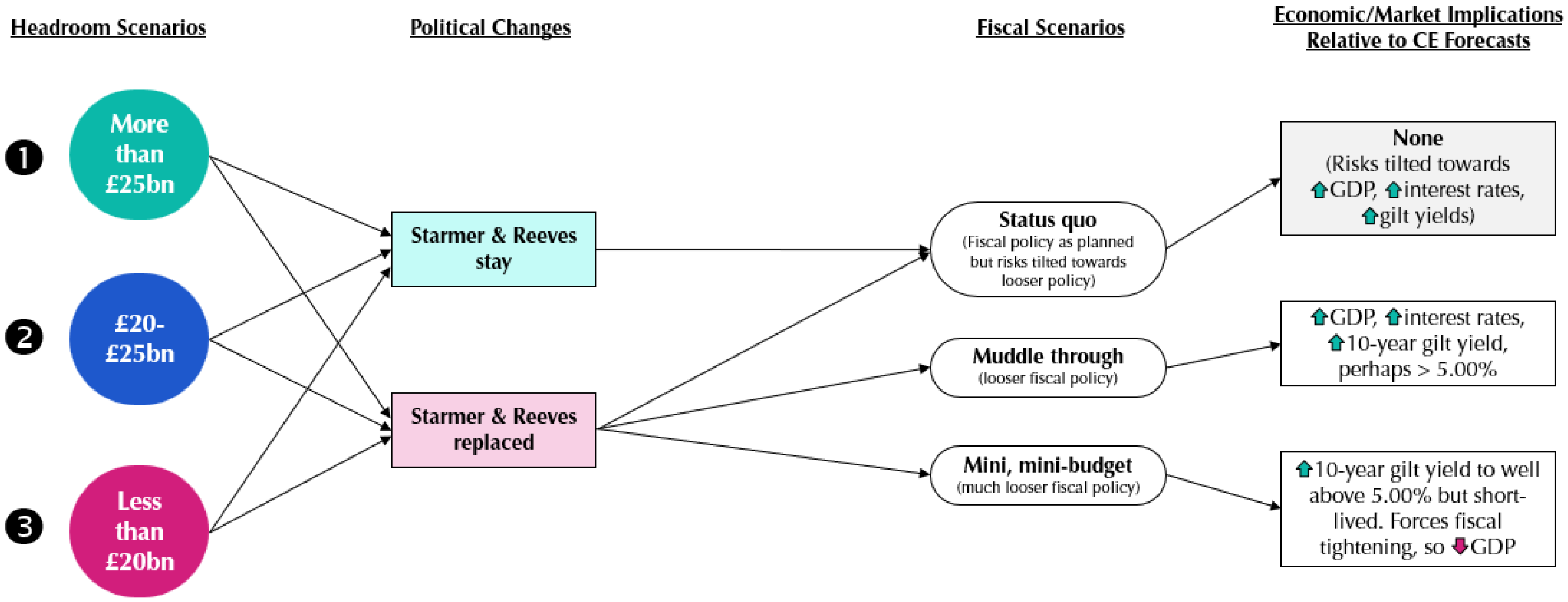
3. **Between £20-25bn**: Pressure on Starmer/Reeves might ease (for now).

We forecast a rise in fiscal ‘headroom’ from £21.7bn to £24bn

Headroom Against Main Fiscal Rule (£bn)	
	£bn, 2029/30
Nov. 2025	**21.7**
Lower gilt yields*	+1.4
Higher equity prices	+1.7
Lower CPI/RPI inflation	-0.9
Other	-0.3
Mar. 2026	**24**

Sources: OBR, Capital Economics. *Based on OBR window of the 10 working days to 30th January.

Possible Political/Fiscal Changes & Economic/Market Implications

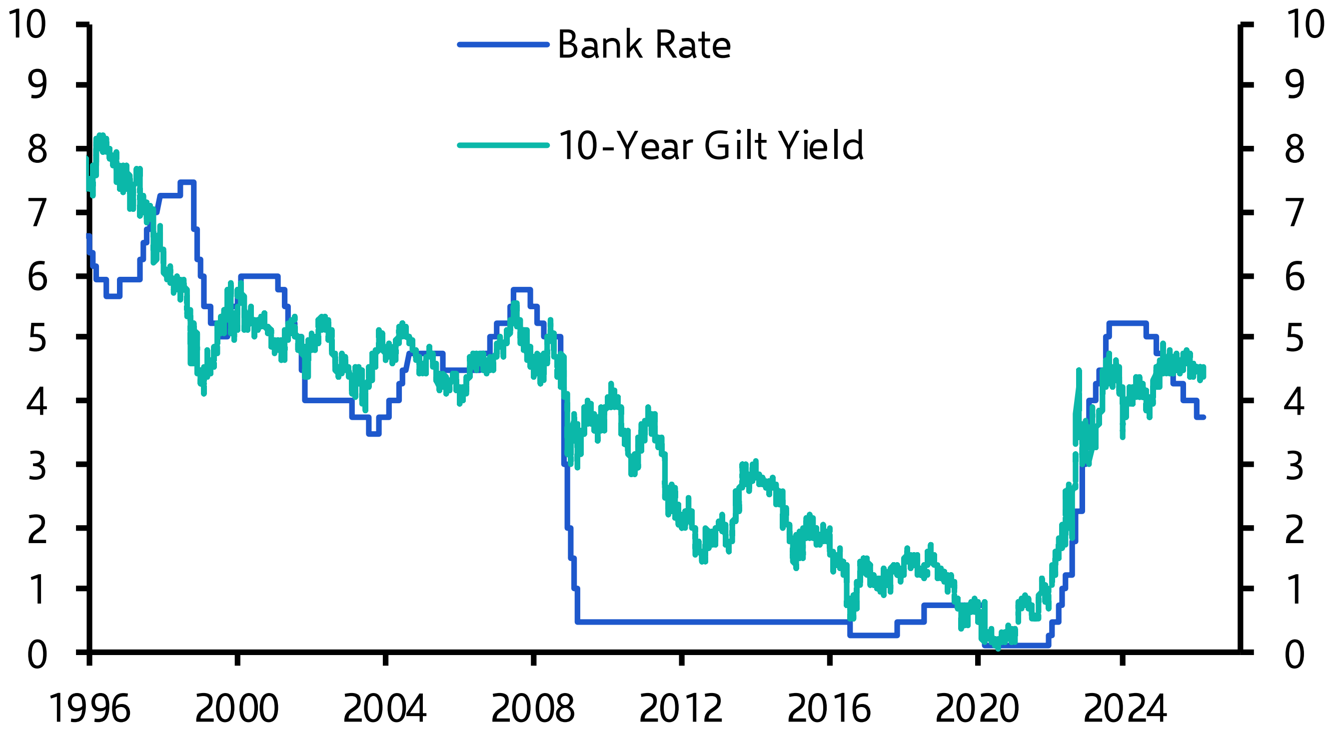


Source: Capital Economics

Financial Markets Scenarios

- **1. Status quo**: more BoE easing -> lower Gilt yields (end-26 forecast for 10yr Gilt Yield: 4.25%) & weaker sterling (end-26 forecast for GBP/USD: 1.25).
- **2. Muddle through**: less BoE easing, somewhat higher political risk premium → higher 10yr Gilt yield (rising toward 5% again) & weaker sterling (GBP/USD: 1.25).
- **3. "Mini, mini-Budget":** Much higher political risk premium → 10yr Gilt yield spikes well above 5% & sterling falls sharply – GBP/USD hits 1.20 or lower.

Bank Rate & 10-Year Gilt Yield (%)



Source: LSEG Data and Analytics, Capital Economics

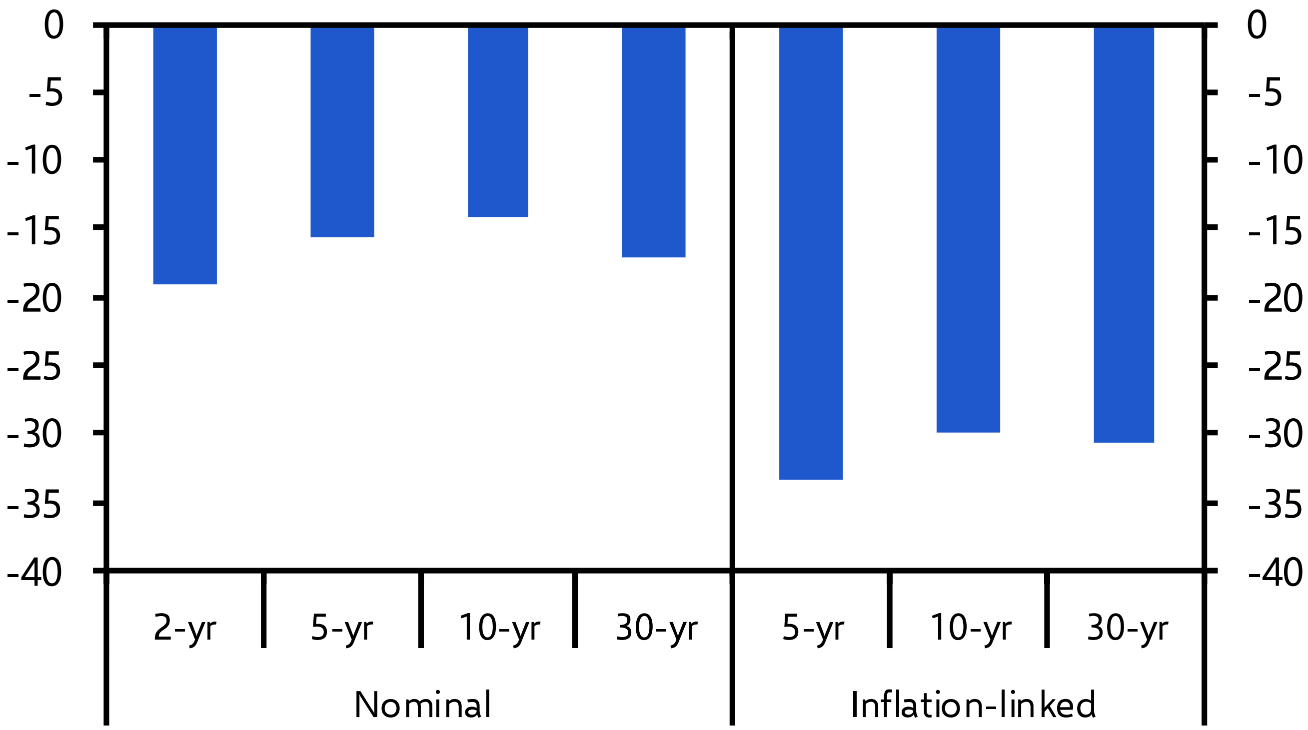
Financial Markets Scenarios

- **1. Status quo**: more BoE easing -> lower Gilt yields (end-26 forecast for 10yr Gilt Yield: 4.25%) & weaker sterling (end-26 forecast for GBP/USD: 1.25).

- **2. Muddle through**: less BoE easing, somewhat higher political risk premium → higher 10yr Gilt yield (rising toward 5% again) & weaker sterling (GBP/USD: 1.25).

- **3. "Mini, mini-Budget":** Much higher political risk premium → 10y Gilt yield spikes well above 5% & sterling falls sharply – GBP/USD hits 1.20 or lower.

Changes in Gilt Yields Since 2025 Budget (bp)

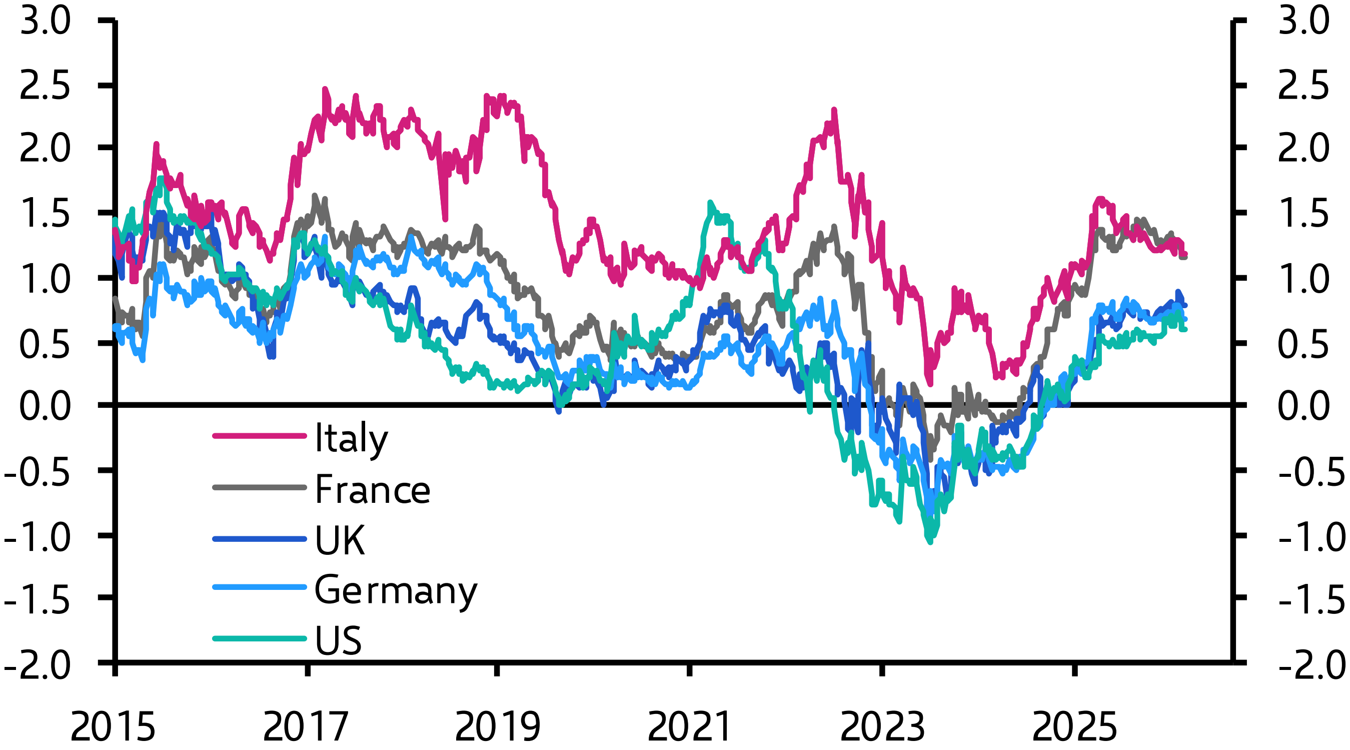


Source: LSEG Data and Analytics, [Capital Economics]

Financial Markets Scenarios

- **1. Status quo**: more BoE easing -> lower Gilt yields (end-26 forecast for 10yr Gilt Yield: 4.25%) & weaker sterling (end-26 forecast for GBP/USD: 1.25).
- **2. Muddle through**: less BoE easing, somewhat higher political risk premium → higher 10yr Gilt yield (rising toward 5% again) & weaker sterling (GBP/USD: 1.25).
- **3. "Mini, mini-Budget":** Much higher political risk premium → 10y Gilt yield spikes well above 5% & sterling falls sharply – GBP/USD hits 1.20 or lower.

10-yr less 2-yr Government Bond Yield Spreads (%-pts)



Source: LSEG Data and Analytics, Capital Economics

Conclusions

- Risks tilted towards looser fiscal policy, especially if Starmer/Reeves are replaced.

- Fiscal Statement may mean Starmer/Reeves live to fight another day, but there are plenty of other flashpoints.

- Our economic forecasts point to lower gilt yields and a weaker pound. But the politics create upside risks to yields and extra downsides for the pound.

EUROPE – LONDON

Capital Economics Ltd
5th Floor, 100 Victoria Street
Cardinal Place
London
SW1E 5JL

Telephone: +44 (0)20 7823 5000

Capital Economics Ltd. is registered in England, Registration No. 2484735. VAT No. GB 198 2919 50.

ASIA – SINGAPORE

Capital Economics (Asia) Pte. Ltd
05-01/02, CapitaGreen
138 Market Street
Singapore, 048946

Telephone: +65 6595 5190

The Asian office, Capital Economics (Asia) Pte. Ltd, is a wholly-owned subsidiary of Capital Economics Ltd. Registered in Singapore, Registration No. 200909395K.

NORTH AMERICA – TORONTO

Capital Economics (N.A.) Ltd
Suite 600, 77 Bloor Street West
Toronto, ON
M5S 1M2

Telephone: +1 416 413 0428

The North American office is a branch of Capital Economics (N.A.) Ltd, a wholly-owned subsidiary of Capital Economics Ltd. Registered in England, Registration No. 6190831. Registered in Canada, Registration No. BN 851886358.

Subscription enquiries: sales@capitaleconomics.com

Consultancy: commissioned.projects@capitaleconomics.com

Recruitment enquiries: business@capitaleconomics.com

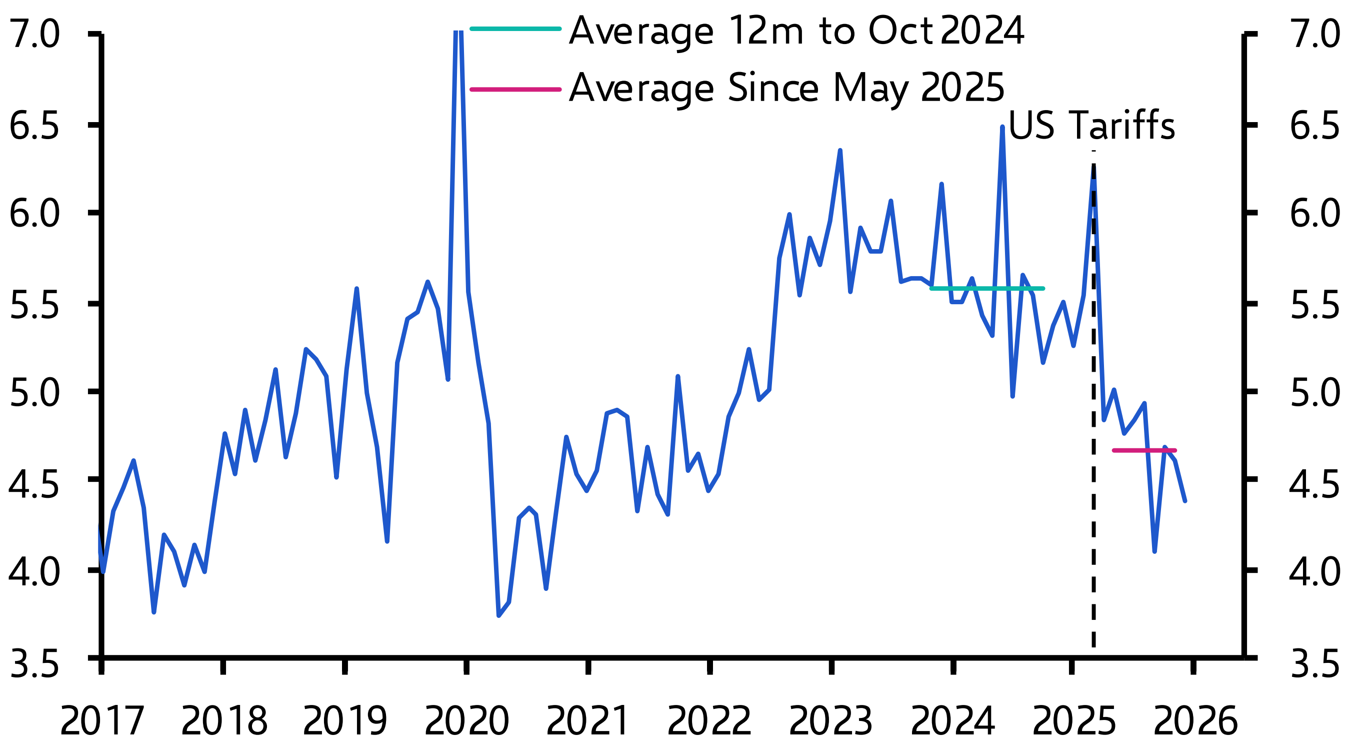
General enquiries: support@capitaleconomics.com

Possible Tariffs on UK Goods Exports to the US

Scenario	Previously	From 24th Feb.
Baseline	10%	15%
Steel & Aluminium	25%	25%?
Cars (1st 100,000 a yr)	25%(10%)	25%(10%)?
Aerospace	0%	0%?
Pharmaceutical	0%	0%?

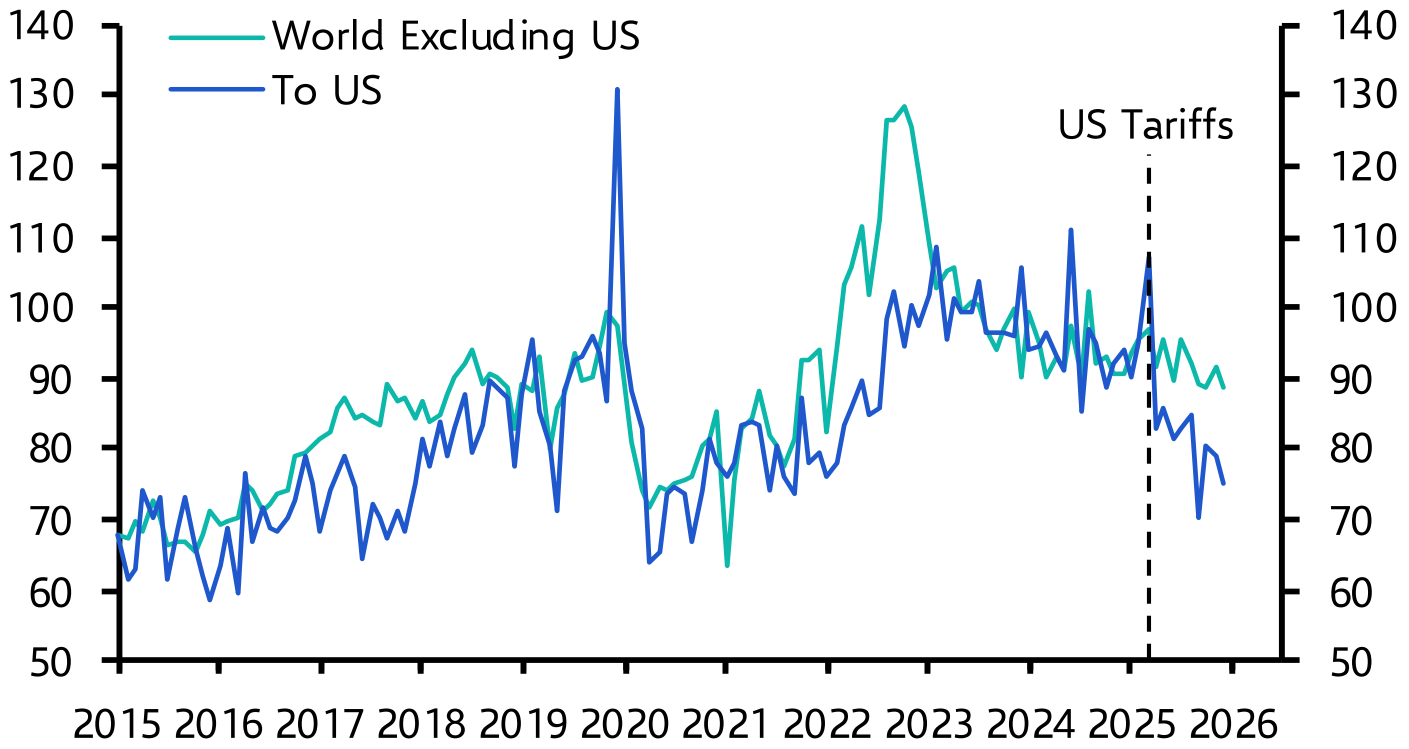
Source: Capital Economics

US Goods Exports to the US (£bn)



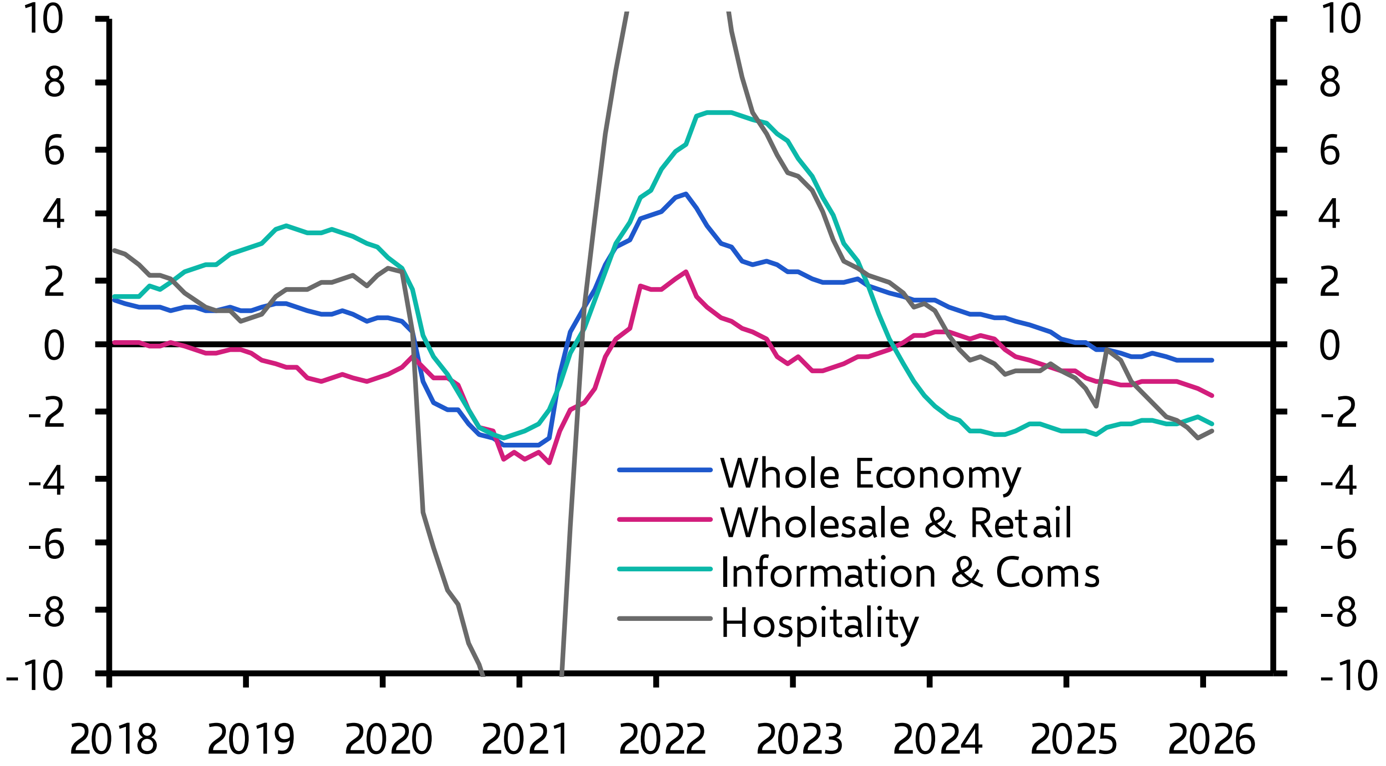
Source: LSEG Data & Analytics, Capital Economics

US Goods Exports by Destination (2023 = 100)



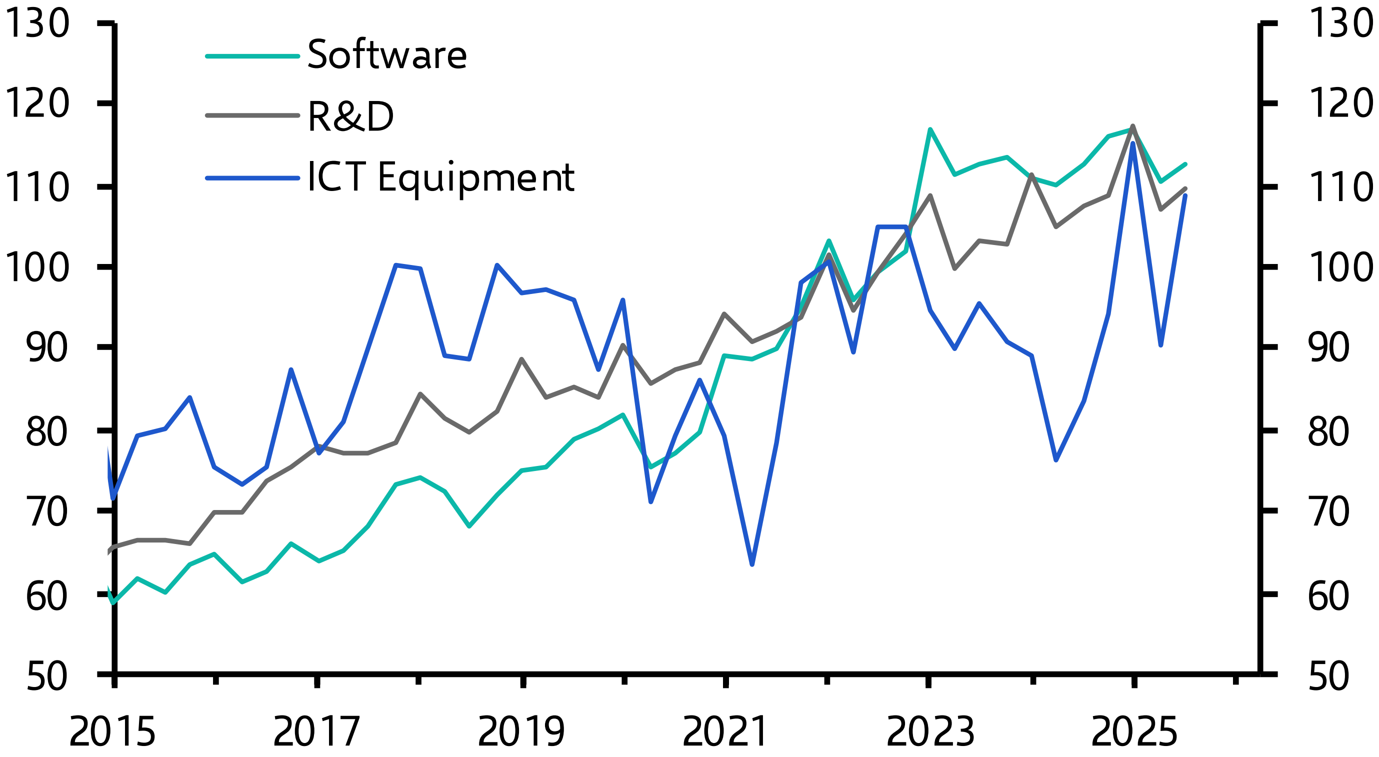
Source: LSEG Data & Analytics, ONS, Capital Economics

PAYE Payroll Employment (%y/y)



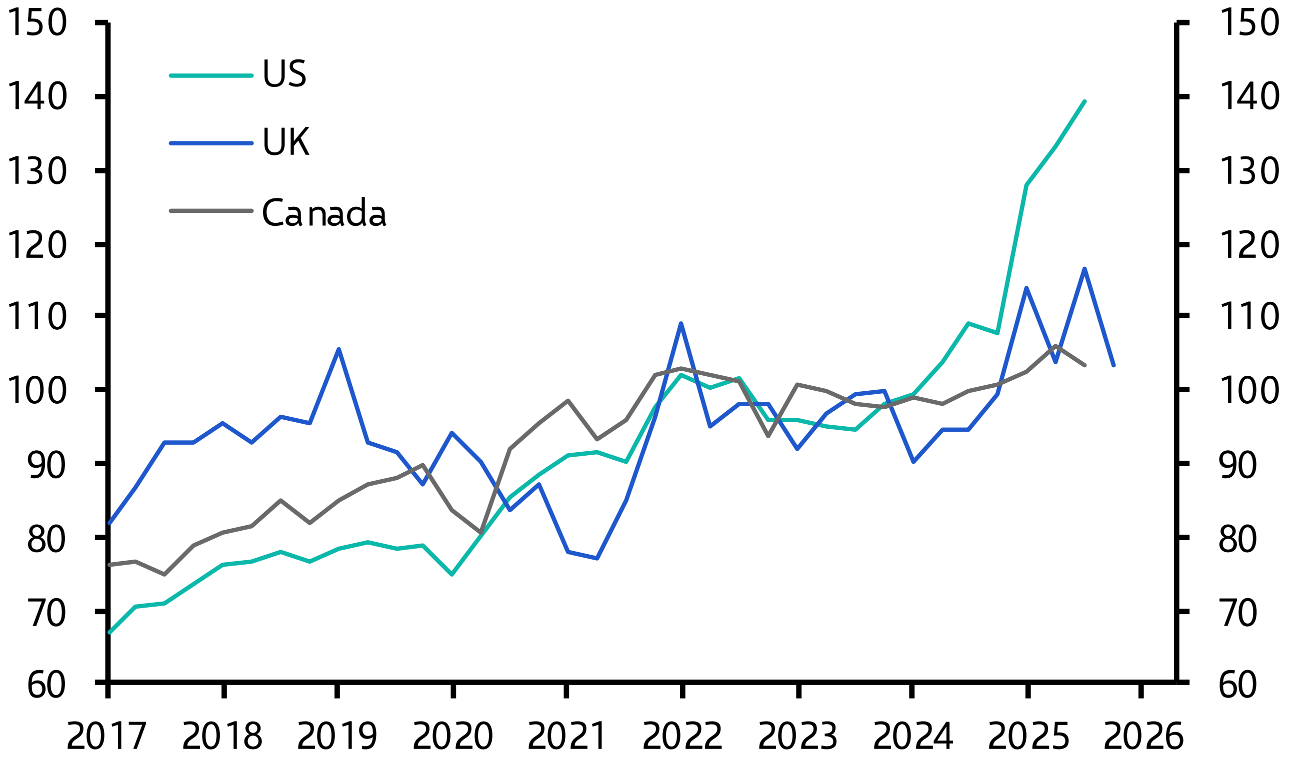
Sources: ONS, Capital Economics

Nominal Investment (Non-seasonally Adjusted, 2022=100)



Sources: ONS, Capital Economics

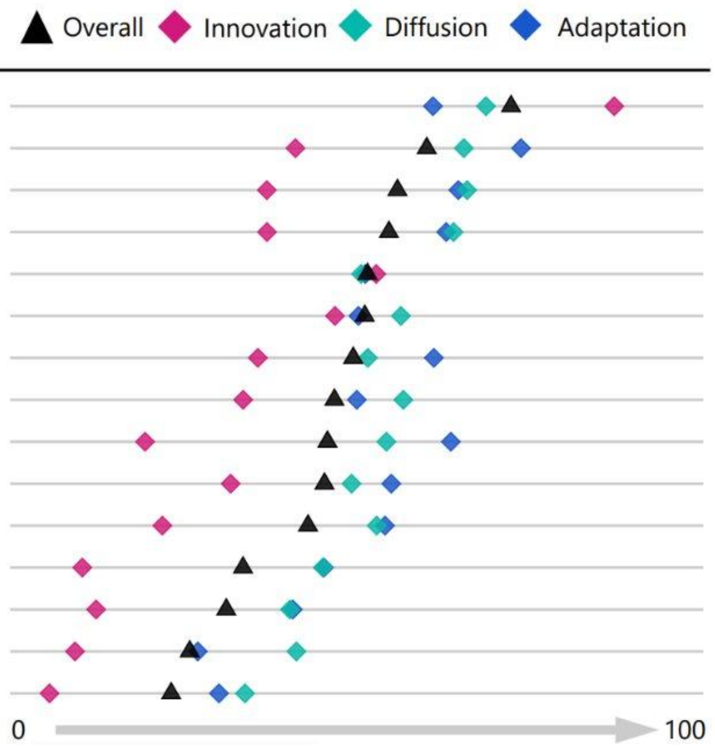
Real Investment in ICT Equipment (2022=100)



Sources: LSEG Data & Analytics, Capital Economics

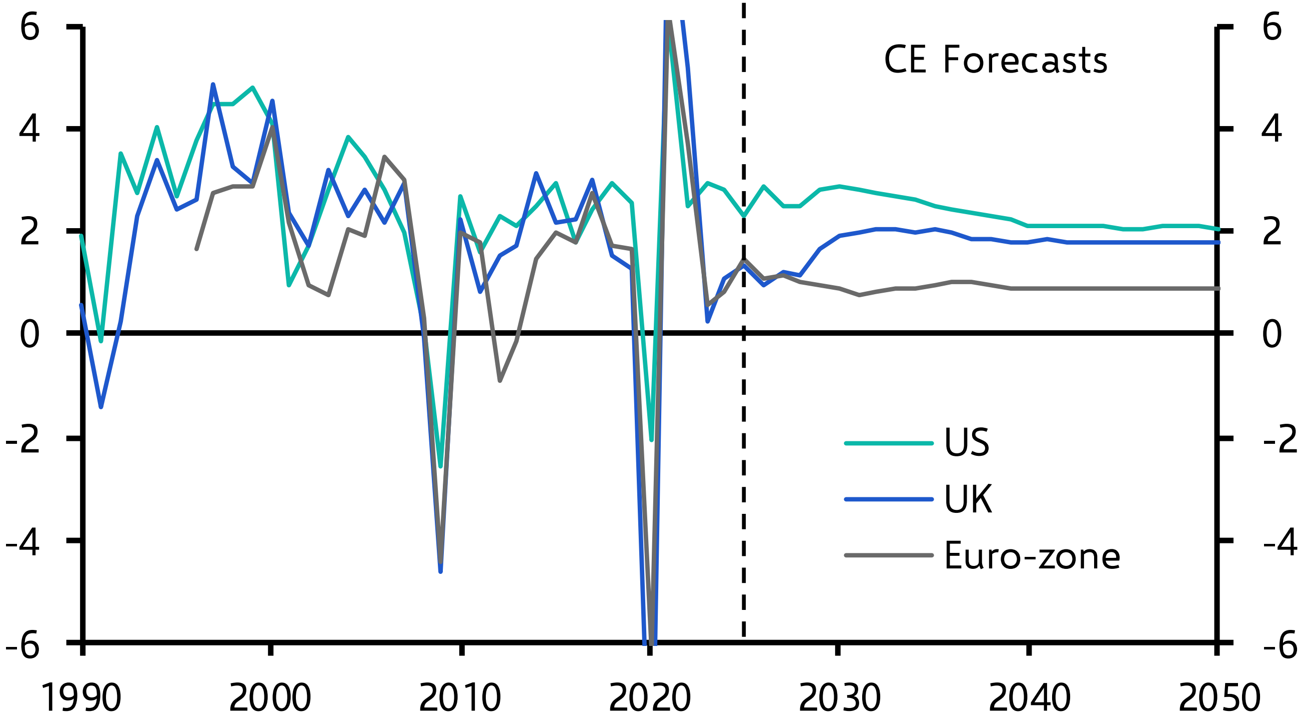
CE AI Economic Impact Index – Ranking of Major Economies

Overall Rank /47	Country	Overall Score / 100
1	US	72
2	Singapore	59
3	UK	55
4	South Korea	54
6	Israel	51
7	China	50
9	Canada	48
13	Germany	46
15	Australia	45
16	Japan	44
22	France	42
29	Italy	32
32	India	30
40	Brazil	24
42	Russia	22



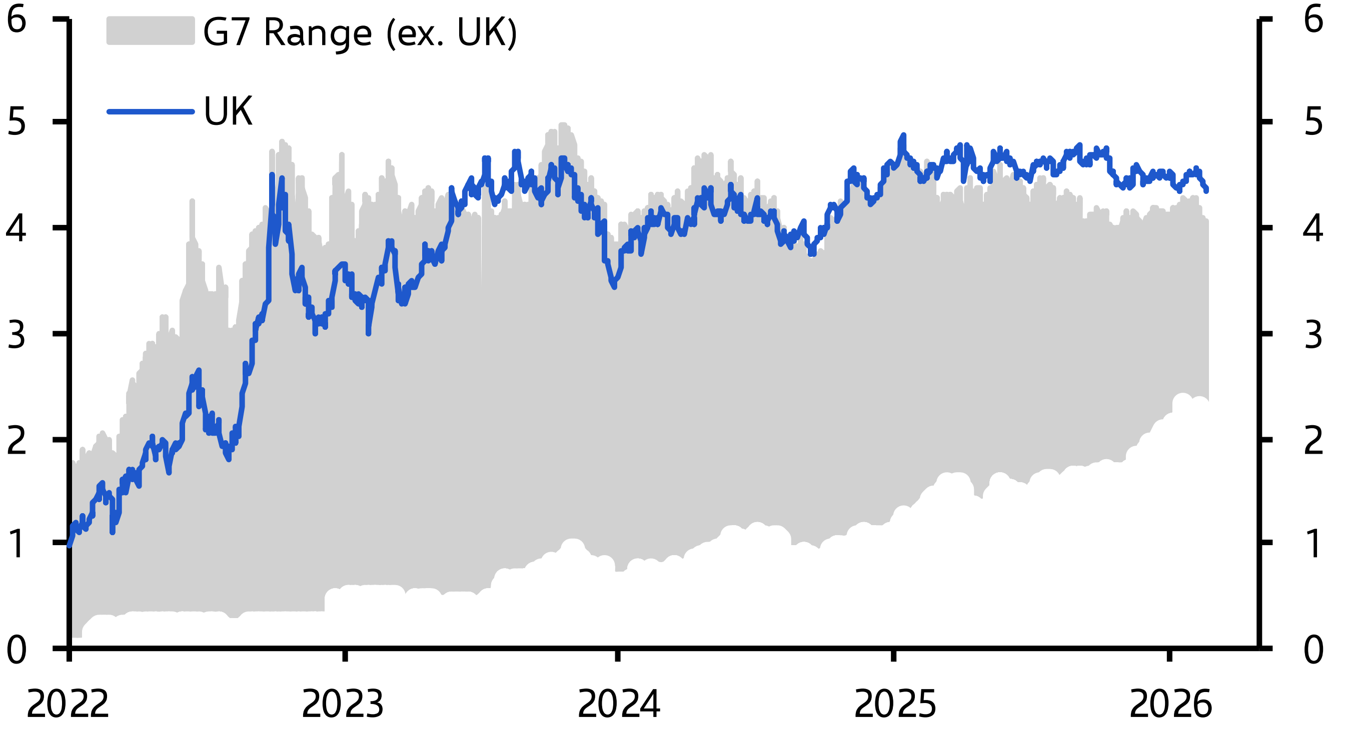
Sources: Capital Economics

Real GDP (%y/y)



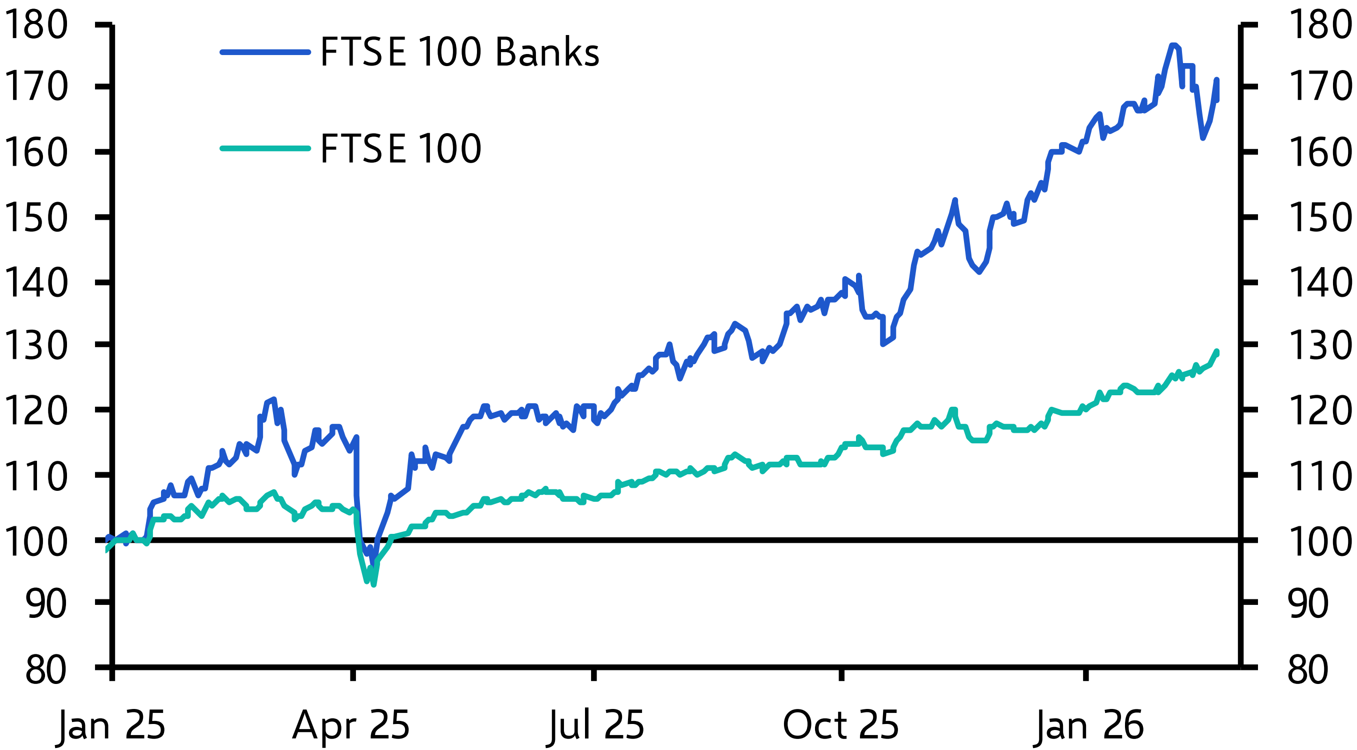
Sources: LSEG Data and Analytics, Capital Economics

10-Year Government Bond Yields (%)



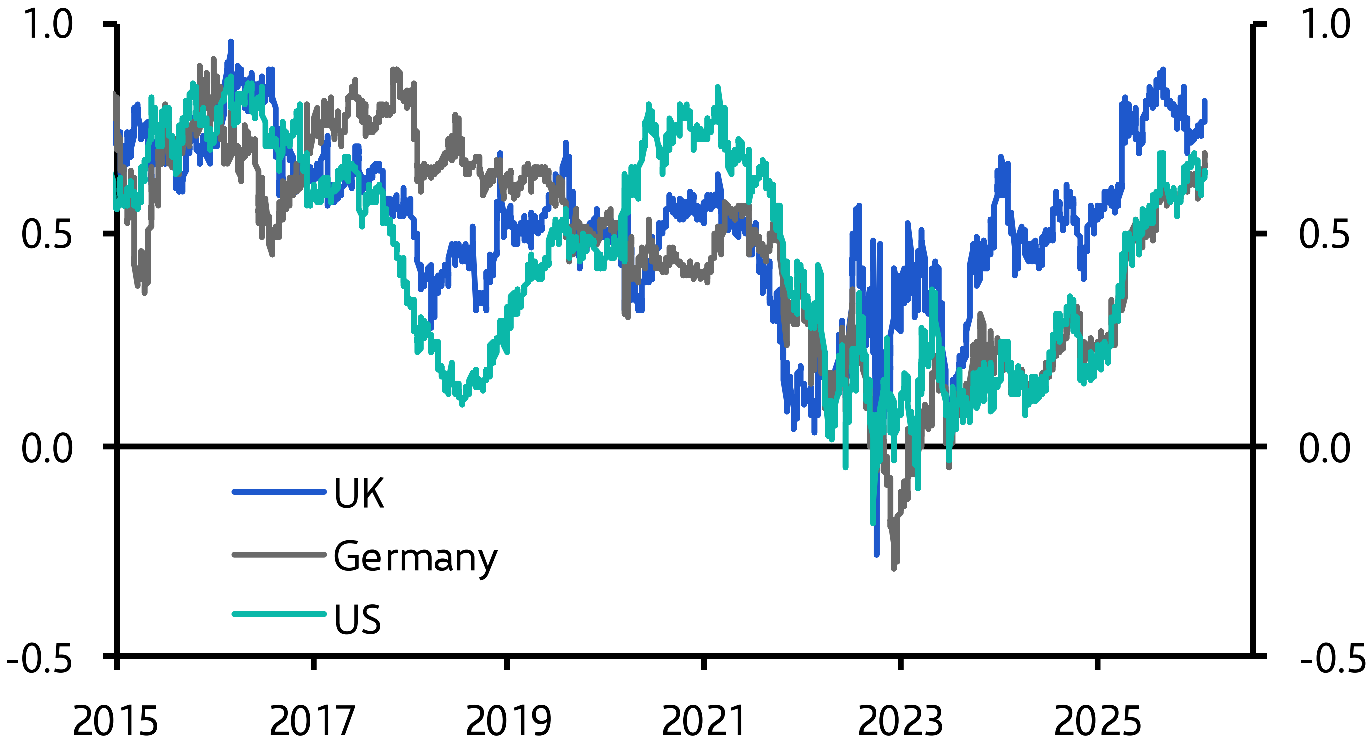
Sources: LSEG, Capital Economics

FTSE 100 Banks & FTSE 100 (1st January 2025 = 100)



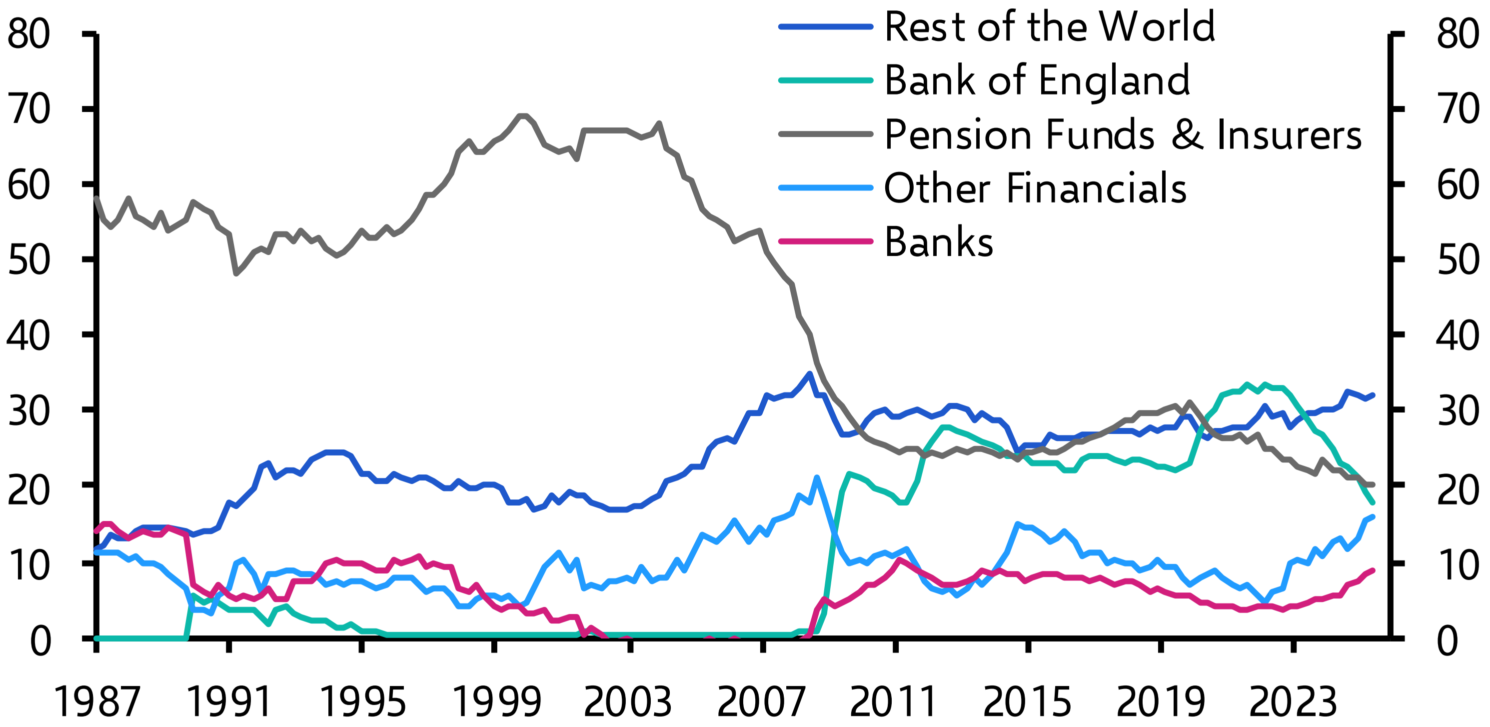
Sources: LSEG, Capital Economics

30-Year/10-Year Government Bond Yield Spreads (pp)



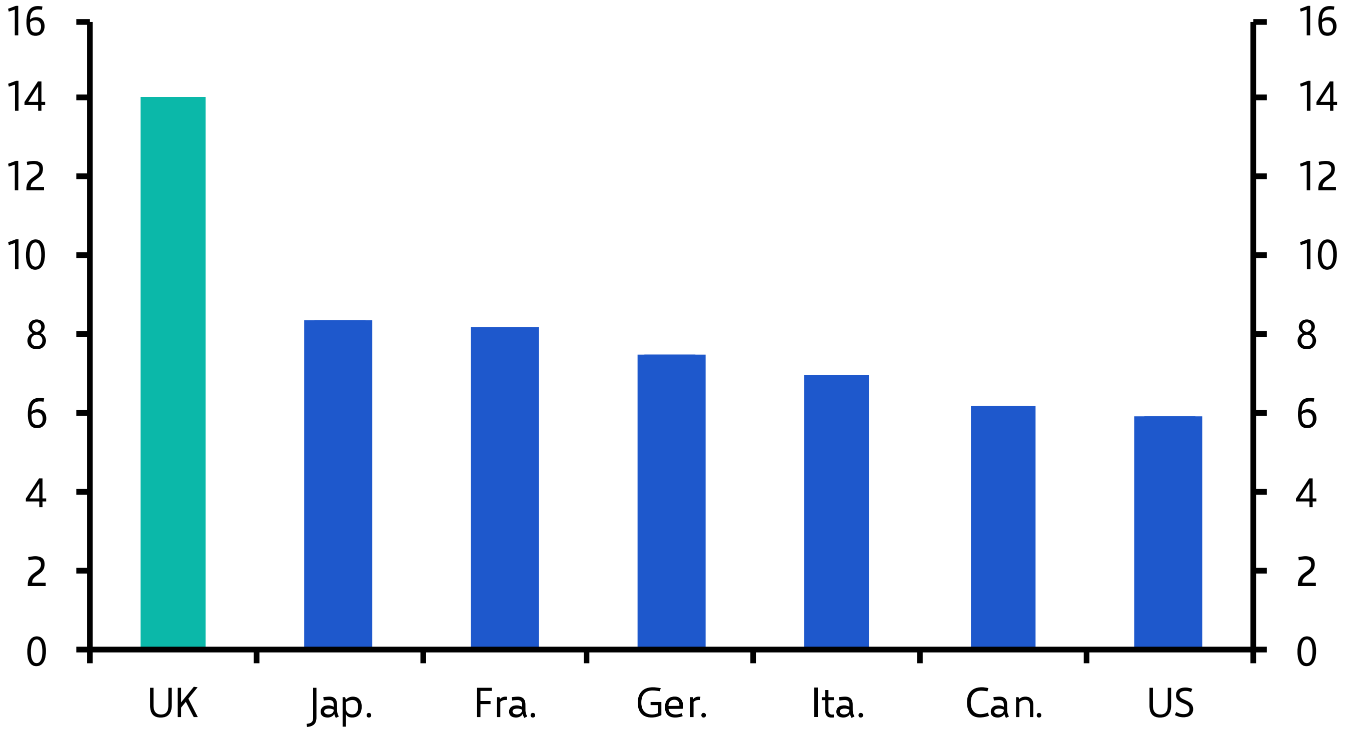
Sources: LSEG, Capital Economics

Gilt Ownership (% of Total)



Sources: LSEG, Capital Economics

Weighted Average Maturity of G7 Debt Stock (Years, End-2024)



Sources: UK DMO, Capital Economics