InflationWatch

September 2026

About this publication

Since the post-pandemic inflation surge and subsequent tightening cycle, UK inflation has moved closer to the Bank of England's (BoE) 2% target. However, that path hasn't been smooth. Domestic price pressures have eased over the past year, but inflation remains sensitive to developments in energy markets, supply chains and labour costs. Recent events in the Middle East have added a new source of uncertainty, pushing energy prices higher and raising concerns about potential spillovers into broader inflation.

InflationWatch aims to help you assess the outlook for UK inflation and interest rates. In a modern, open economy, inflation is driven by a dynamic set of factors, including aggregate demand, input costs, inflation expectations, labour market conditions and monetary policy. We focus on these key drivers over the next two to three years, alongside our assessment of the balance of risks to inflation.

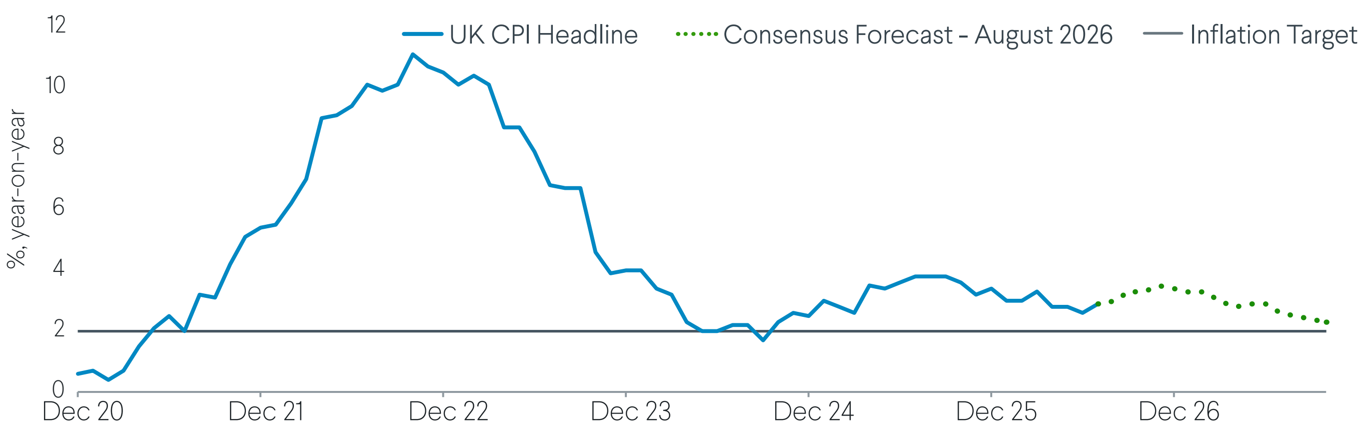
The story to date

UK inflation has continued to moderate in 2026, but progress has been uneven. Headline CPI fell from 3.4% at the end of 2025 to 2.6% in June, before rising to a four-month high of 2.9% in July. Much of this recent increase reflects higher household energy costs, following changes in Ofgem's energy cap and rises in global energy prices.

Outside of energy, inflation trends have generally been encouraging. Core CPI (which removes volatile energy and food items) has been relatively stable, at 2.6% in July and unchanged from the previous two months. And services inflation eased further from the elevated levels seen during 2024 and 2025.

Although the sharp price rises in food, goods and energy following the pandemic have unwound, the BoE is still focused on wage growth and services inflation. Encouragingly, a tougher market for jobseekers has helped reduce underlying inflation pressures. As a result, inflation has moved closer to target; however, recent energy market developments have interrupted what had been a broadly disinflationary trend.

Chart 1: Inflation is forecast to rise temporarily, owing to energy prices



Source: Hymans Robertson, Consensus Economics, https://www.consensuseconomics.com

Forecasts point to temporary inflation rises later this year, owing to energy prices. However, for the BoE, the most important question is whether those increases become embedded in wages and domestic prices. These so-called second-round effects, whereby higher energy costs feed into wage negotiations and firms' pricing decisions, can create more persistent inflation. While those risks have increased following developments in the Middle East, evidence of material second-round effects remains limited.

Inflation dashboard

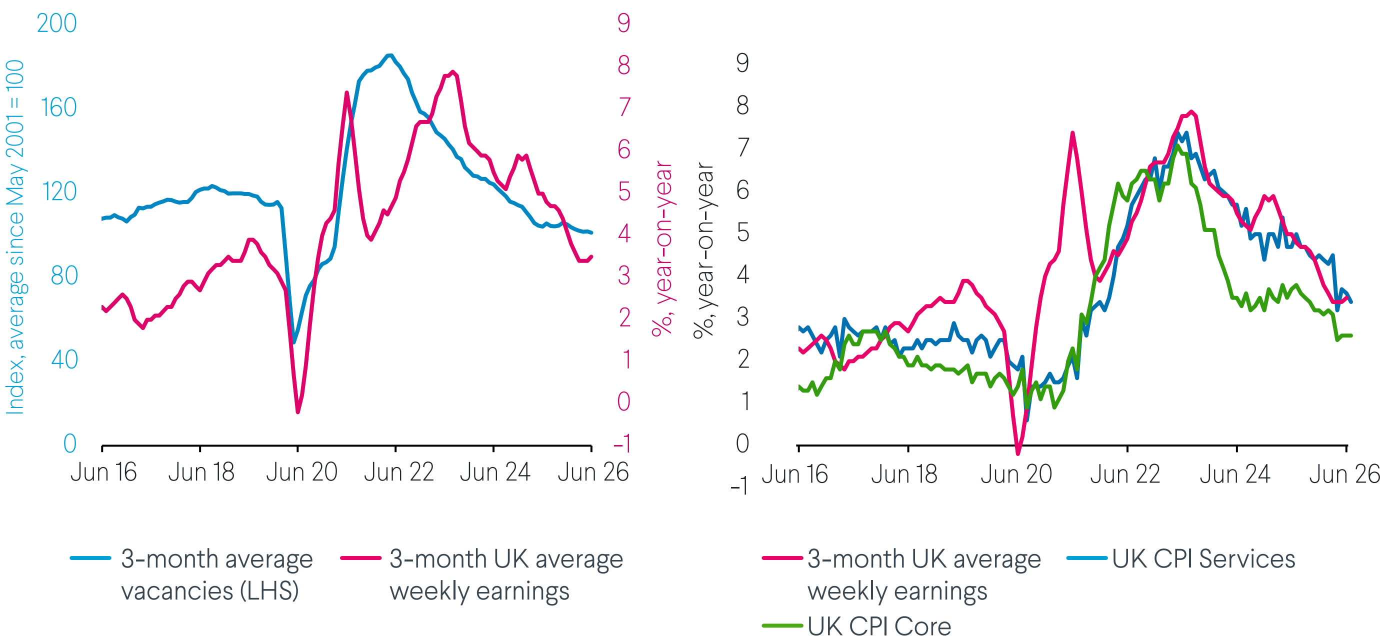
Source: Hymans Robertson/Bank of England/ONS/Bloomberg. Interactive version.

In our heatmap above, you'll find recent indicators compared to their long-term levels. The tone of the colour represents the strength of the signal: a darker tone indicates either a stronger inflationary or disinflationary signal, depending on whether red or blue, respectively.

Easing inflationary pressures

Several indicators suggest domestic inflationary pressures are easing. The UK labour market is experiencing a noticeable cooling phase, characterised by slower hiring and moderating wage growth. There are fewer job vacancies, as businesses have scaled back recruitment in the face of increased operational costs and broader economic uncertainty. Nominal wage growth has slowed significantly as labour demand has weakened. In real terms, wage growth is modestly positive.

Charts 2 & 3: Domestic price pressures continue to ease, limiting the risk of second-round effects



Source: Bloomberg

At the same time, services inflation has trended lower and recent PMI surveys indicate that growth is modest. Together, these developments are consistent with inflation gradually returning to target over the medium term.

Policymakers are likely to stay hawkish but refrain from hiking rates until the growth and inflation outlooks become clearer. Recent PMI surveys report rising fuel and transport costs, while higher energy prices continue to work through the economy. If elevated energy prices were to persist, the risk of renewed wage-price dynamics would increase. As a result, the BoE is likely to stay keenly focused on labour market indicators and inflation expectations over the coming quarters.

Our view

Recent inflation increases appear largely due to energy-related factors rather than a broad-based resurgence in domestic inflation.

Nevertheless, the outlook is uncertain. The US-Iran conflict has reinforced the sensitivity of inflation to geopolitical developments and commodity prices. Higher energy prices are likely to keep headline inflation elevated for the rest of the year. However, unless these shocks trigger more persistent wage and price-setting behaviours, their effects should eventually fade.

Today's conditions are softer than in 2022. Growth and inflation were stronger then, as post-pandemic demand collided with acute supply constraints and exceptionally tight labour markets. As a result, we anticipate that the BoE will stay hawkish and tread cautiously, keeping borrowing costs at current levels rather than raising them.

Looking ahead, we expect inflation to be more volatile, driven by fragile supply chains, with diminishing returns from globalisation, disruptions due to climate change and geopolitics. Demand-side factors include a shift towards more active fiscal policies in advanced economies like the UK, making a return to the loose monetary and tight fiscal policy that followed the global financial crisis (GFC) unlikely.

We expect central-bank mandates to remain intact and inflation, on average, to stay near targets, but with increased volatility. Inflation and rates should fall and may dip below targets, but a return to post-GFC ultra-low rates is unlikely. Nominal rates are likely to align more closely with real growth and inflation, with continued higher volatility in the coming decade.

If you'd like to discuss anything covered in this publication, please get in touch with your usual Hymans Robertson consultant or our authors, below.

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