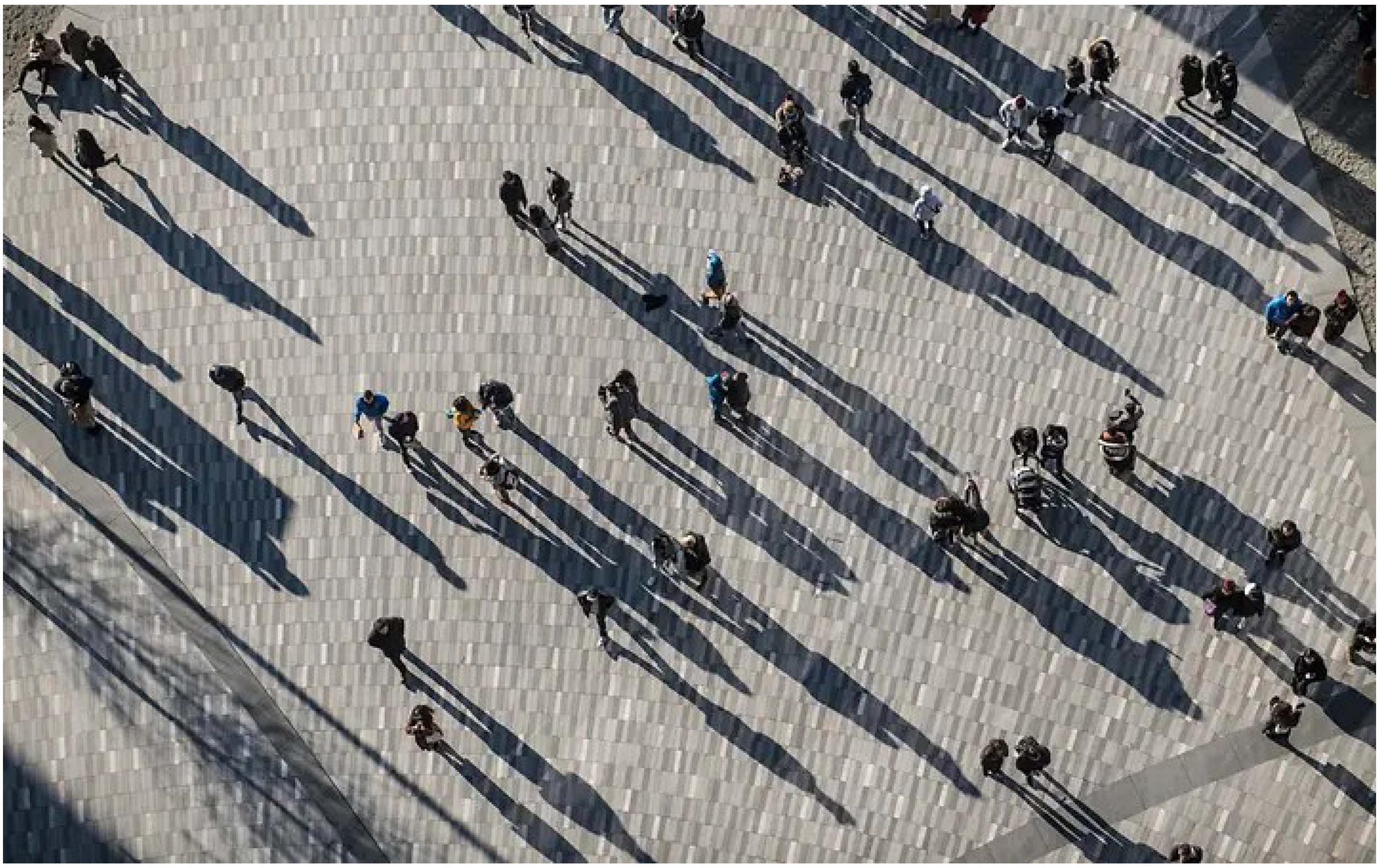
Home > Insights > Market views

Market View
Britain's dichotomy: equities hit highs despite challenging domestic outlook

from Jeremy Sterngold Deputy Chief Investment Officer

Date 18 July 2025

Reading time 5 minutes



At a glance

Strong first half equity market performance skewed by large multi-nationals

Inflation surprises to upside as higher National Insurance impact kicks in

GDP contracts after strong Q1 while labour data remains soft

Looking solely at equity market performance, it's easy to see how one could argue the British economy is primed for solid growth—the FTSE 100 reached a new record earlier this week, breaching 9,000 points intraday for the first time in its 41-year history, and is up 12% so far this year.[1] However, this index is skewed to large international corporations and therefore is not necessarily representative of the broader UK economy. This week, we dig into the domestic economy to see what lies beneath the surface and why the outlook is more challenging.

Inflation comes in higher than expected

Inflation data released earlier this week dampened expectations of more aggressive interest rate cuts. Prices rose by more than expected in the year to June, with the Core Consumer Price Index (CPI), which excludes food and energy, rising by 3.7% in the 12 months to June 2025, up from 3.5% in May.[2] Higher National Insurance (NI) contributions may have contributed to food, restaurant and hotel inflation, as these businesses tend to have large wage bills. Raising prices and then passing those costs onto customers is one way for these businesses to offset higher taxes. The latest reading was above the Bank of England (BoE)'s most recent inflation forecasts, but in line with messages delivered in February when they projected that inflation would peak around the third quarter.

Soft labour data and shrinking GDP

Unemployment data from the Office for National Statistics (ONS) showed the unemployment rate for people aged 16 and over was estimated at 4.7% in the three months to May,[3] the highest since the second quarter 2021 when the UK was emerging from Covid lockdowns.[4] These latest ONS employment figures— which coincide with the period of higher employer NI contributions, which many companies warned could lead to job cuts or postponed recruitment —are the latest sign the UK jobs market is weakening, increasing the likelihood that the BoE will cut rates in August. (It is worth noting that the data collection has faced issues over several quarters, but other data points confirm that labour trends have been weakening.)

Despite the weakness, recorded wage growth remains around 5%, which means wage pressures are still elevated, making the central bank's job of bringing inflation down to 2% more challenging. This may prompt the BoE to maintain its slow and steady approach towards rate cuts.

While the US and German governments recently announced fiscal support in their stimulus policies, the fiscal situation in the UK remains precarious. Earlier in July, speculation mounted about Chancellor Rachel Reeves's future, leading to a sharp sell-off in bonds and the pound until Prime Minister Keir Starmer later insisted that Reeves "will be chancellor for a very long time to come".[5] This underscored how jittery markets remain after Liz Truss's government triggered a bond market sell-off following unfunded tax cut announcements.

Meanwhile Britain's economy contracted in May for a second month in a row, with GDP shrinking by 0.1% in May following a 0.3% drop in April.[6] This sluggish performance contrasts sharply with the robust first quarter, which was likely driven by frontloading orders ahead of US tariffs.

Securing a trade deal framework with the United States provided relief to sectors like automotive and aerospace, but the blanket 10% tariffs on most UK exports remain and will weigh on growth this year.

Watered-down benefits bill

Earlier in July, Labour MPs approved the government's benefits bill, although the bill was significantly watered down following a rebellion by Labour backbenchers.[7] Proposals to tighten eligibility for the personal independence payment were scrapped for existing claimants and deferred for future claimants. The inability of the government to cut costs while facing elevated borrowing costs amid gilt market volatility has raised speculation that Reeves will have no choice but to announce further tax increases in the autumn budget, a move that would likely be politically damaging to the Labour government.

In a speech at a Mansion House dinner in the City of London mid-July, Reeves claimed that rules and red tape are acting as a "boot in the neck" of businesses and risk "choking off" innovation across the UK without bold reforms.[8] She put further pressure on regulators to loosen the strings to boost economic growth.

Conclusion

While the FTSE 100 has been pushing to all-time highs, the disconnect between market performance and the underlying economy remains stark. With political uncertainty and economic challenges mounting, the government will need to demonstrate stronger leadership to reassure markets and rebuild confidence in Britain's economic future.

[1] Bloomberg

[2] ONS: https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/latest

[3] ONS: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/uklabourmarket/july2025

[4] Standard: https://www.standard.co.uk/business/jobless-unemployment-vacancies-awful-april-wages-budget-b1238607.html

[5] BBC: https://www.bbc.com/news/articles/ce375w2z6yyo

[6] ONS: https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpmonthlyestimateuk/may2025

[7] BBC: https://www.bbc.com/news/articles/cm2zyvypmeeo

[8] Guardian: https://www.theguardian.com/politics/2025/jul/15/rachel-reeves-rules-red-tape-boot-on-neck-innovation-mansion-house