

The background features a complex financial chart with multiple overlapping lines and candlestick patterns in shades of blue and cyan. Some data points are labeled with numbers: 21,678, 30,001, 44,611, 54,812, and 17,890. The overall aesthetic is professional and data-driven.

UK Economic and Consumer Outlook in Light of the Iran Conflict

Economic Insights

May 2026

Executive Summary

The Iran conflict is unlikely to tip the UK into immediate crisis, but it does create a more inflationary, fiscally constrained environment, with tighter, more selective pressures on households, businesses and lenders.



Gee Lefevre
Global Head of
Consumer and
Economics
Gee.Lefevre@teneo.com
+44 20 3206 8860



Kabir Sehra
Senior Director
Consumer and
Economics
Kabir.Sehra@teneo.com
+44 7584 10 3640




Professor Jonathan Portes
Senior Advisor &
Former Chief Economist
to the Cabinet Office

The UK enters this shock in better shape than it did during the 2022–23 energy crisis, but not from a position of full strength. The immediate risk is not direct trade exposure to Iran, but a renewed external shock transmitted through higher energy and freight costs, supply-chain disruption, market volatility, weaker confidence and tighter fiscal constraints. In **our central case, this develops into a prolonged tension scenario**: inflation remains higher for longer, Bank of England easing is delayed, real incomes soften and the next Budget becomes more difficult, but the UK avoids an immediate slide into a severe downturn. The more important macro effect is therefore not a sudden collapse in activity, but a worsening of the trade-offs already facing the economy, with growth remaining modest, inflation proving more persistent and policy choices becoming harder. For UK firms, the risk is not only higher input costs but also delays, shortages and greater uncertainty around the delivery of key materials and components, **adding further strain to an economy already operating with more trade friction than many continental European peers**.

Inflation is likely to be the clearest and earliest transmission channel. A sustained period of elevated oil, gas, shipping and insurance costs would slow the UK's disinflation path, lifting petrol and transport costs first and feeding more gradually into food and broader imported goods prices if disruption persists. That matters because the UK was already on a gradual path back to target, rather than a rapid one. As a result, the conflict is **less likely to create a wholly new inflation regime than to interrupt the improvement that had already begun**. For monetary policy, this points more convincingly to a longer hold than to a renewed hiking cycle: the Bank of England is unlikely to want to tighten aggressively into weak underlying demand, but it will also find it harder to cut quickly while inflation is being pushed higher by another external shock.

For the consumer, the key question is not whether confidence weakens, but when higher prices begin to change behaviour. **Households are more insulated than they were a year ago**, supported by stronger real wages and rebuilt savings buffers, but that resilience is unevenly distributed. Lower-income households remain materially more exposed to higher fuel, food and utility costs, while higher-income groups retain much greater capacity to absorb another external shock. That means the consumer response is likely to be selective rather than broad-based at first. **Spending pressure is most likely to emerge earliest in travel and other exposed discretionary categories**, while domestic leisure and everyday spending should prove more resilient initially. Only if higher essential-cost pressures persist, and real wage support weakens more noticeably later in the year, does the risk of a broader consumer slowdown become more pronounced.

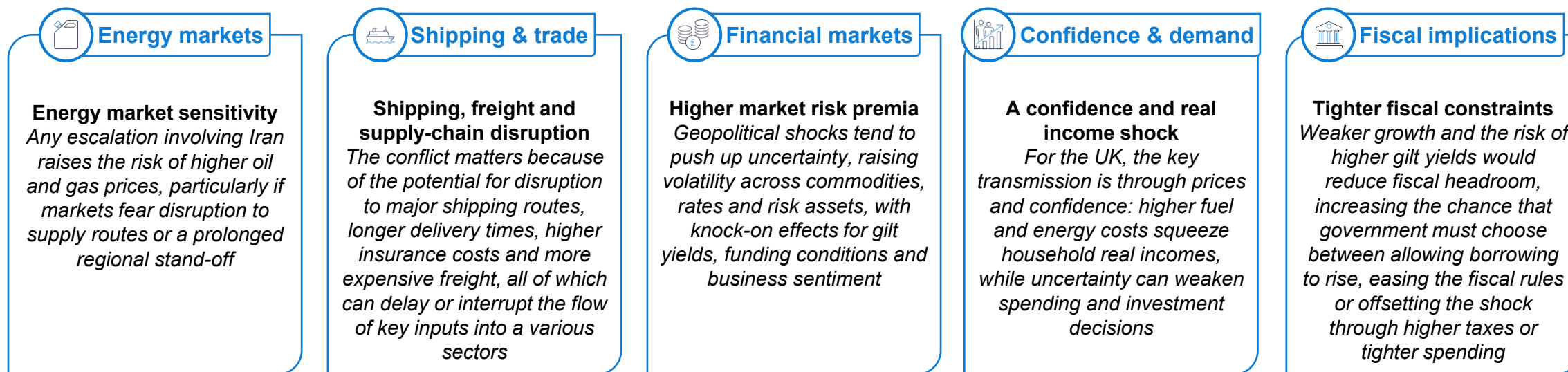
For government, the conflict sharpens an already difficult fiscal backdrop. **Weaker growth, the risk of higher gilt yields and greater pressure for targeted support would all tighten fiscal headroom** ahead of the next Budget. That does not necessarily imply a dramatic fiscal event in the base case, but it does mean the Chancellor has less room to absorb a renewed cost-of-living squeeze without harder choices. If the shock remains contained, the most likely response is cautious, targeted adjustment rather than broad based intervention. If it were to intensify materially and push the economy into contraction, the pressure on the fiscal framework would become significantly harder to manage. The significance of this conflict for the UK, then, lies not in direct exposure, but in the way it interacts with an economy still repairing, with incomplete disinflation, limited fiscal room and a consumer that is stronger than before, but far from uniformly secure.

An aerial photograph of London, England, taken at dusk or dawn. The River Thames flows through the center of the city, with the Tower Bridge visible in the lower-left quadrant. The city skyline is filled with numerous buildings, some illuminated by lights. The overall atmosphere is hazy and dimly lit, with a blue and grey color palette.

For the UK, the significance of the Iran conflict lies not in direct exposure, but in how it intensifies the cost, supply and policy trade-offs already shaping the economy and the consumer

Why the Iran Conflict Matters for the UK Economy

The immediate risk is not direct trade exposure, but in a prolonged tension scenario, a renewed external shock through energy, supply chains, markets, confidence and the UK's already limited fiscal room.

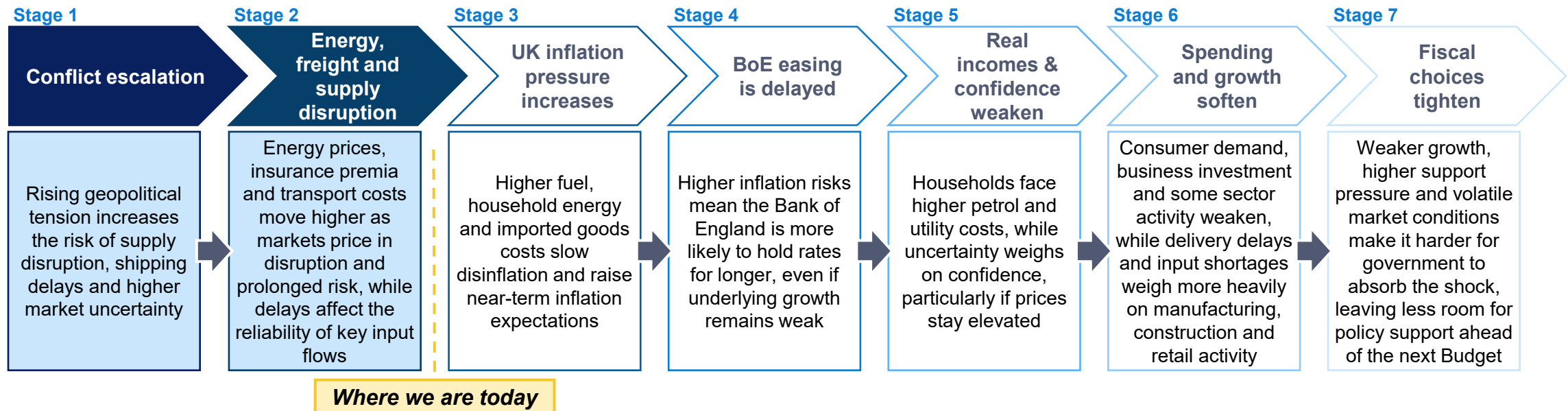


For the UK, this is primarily an imported inflation, confidence and policy shock, with the scale of the impact determined by how long disruption lasts and whether energy markets normalise.

Source(s): Teneo research and analysis

How the Shock Reaches the UK Economy

The conflict affects the UK through a chain that starts with energy and shipping, then feeds into inflation, rates, household incomes, spending and fiscal choices.

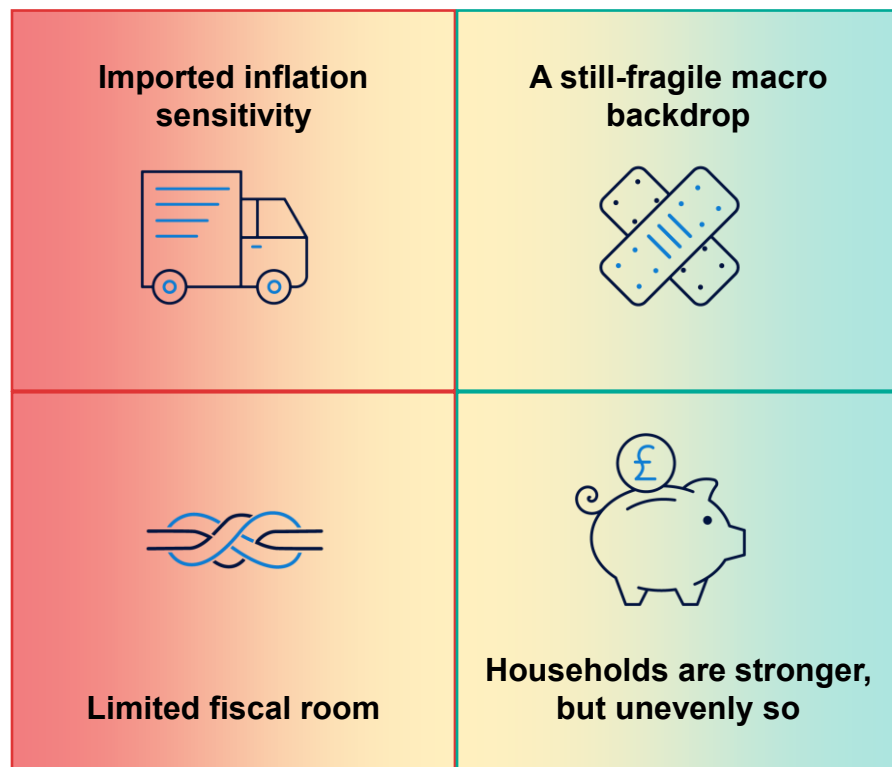


The main risk to the UK is not direct exposure to Iran, but a higher-for-longer inflation and supply shock that weakens real incomes, delays policy easing and tightens fiscal choices.

Source(s): Teneo research and analysis

Why the UK is Exposed to This Shock

The UK enters this period with limited fiscal room, incomplete disinflation and consumers who are more resilient than in 2022–23 but still sensitive to higher prices and rates.



Source(s): Teneo research and analysis

Higher exposure to risks



Imported inflation sensitivity: The UK remains exposed to energy and trade shocks. Any sustained rise in oil, gas, freight or insurance costs would slow the path back to target inflation and pressure household budgets



Limited fiscal room: Government has less policy flexibility than it would want. Elevated borrowing and debt interest costs mean that any need for household support or weaker growth makes the fiscal position more difficult to manage

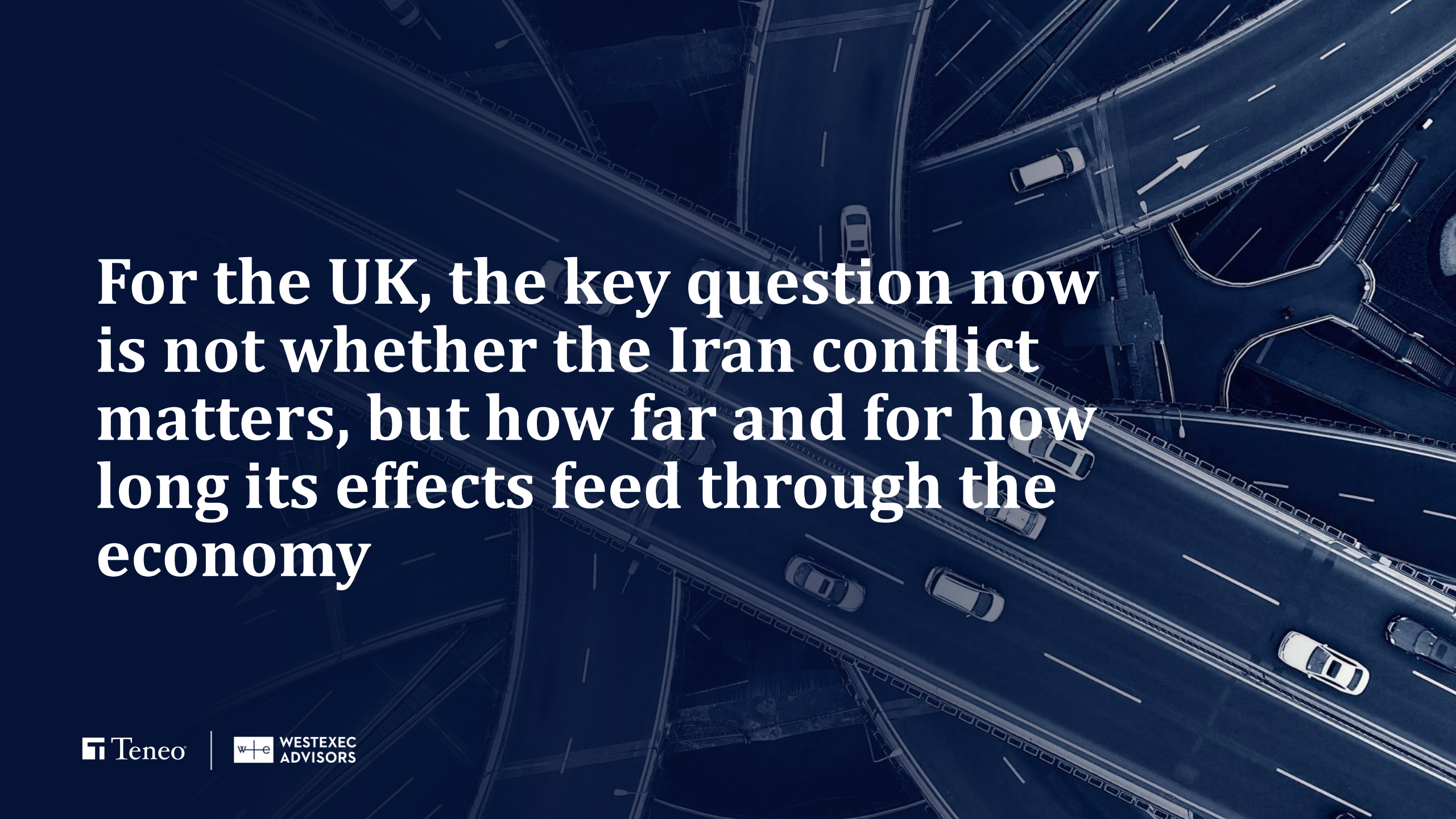
Lower exposure to risks



A still-fragile macro backdrop: The UK economy has stabilised, but it is still in a repair phase rather than a full expansion. Growth has been modest, confidence remains uneven and the economy is less well placed to absorb another external shock than it would be in a stronger cycle



Households are stronger, but unevenly so: Consumers are better prepared for a shock than in 2022–23 because real wages and savings buffers have improved. But resilience is uneven: lower-income households remain much more exposed to higher fuel, food and utility costs than affluent households



For the UK, the key question now is not whether the Iran conflict matters, but how far and for how long its effects feed through the economy

Potential Scenarios for the UK Economy From Here

The range of outcomes depends on whether the shock fades, persists or escalates into a more sustained disruption to energy, trade and confidence.

Scenario 1: Contained shock	Scenario 2: Prolonged tension	Scenario 3: Severe disruption
<ul style="list-style-type: none"> • Energy prices retrace part of their rise • The inflation impact is limited and temporary • Rate cuts are modestly delayed • Consumer and growth effects remain manageable 	<p><i>Covered in detail on following page</i></p> <ul style="list-style-type: none"> • The conflict does not meaningfully resolve • Risk premia stay elevated • Oil, gas and freight costs remain higher for longer • Delivery times lengthen and supply reliability weakens 	<ul style="list-style-type: none"> • The conflict broadens materially • Shipping or supply routes face major disruption • Energy prices rise sharply again
<p>Implication for the UK</p> <ul style="list-style-type: none"> • Inflation rises modestly in the near term • Rate cuts are delayed rather than cancelled • The hit to consumers and growth remains manageable 	<p>Implication for the UK</p> <ul style="list-style-type: none"> • Inflation remains higher for longer • The Bank of England holds interest rates for longer • Real incomes weaken and growth softens • Fiscal choices at the next Budget become harder 	<p>Implication for the UK</p> <ul style="list-style-type: none"> • Inflation reaccelerates meaningfully • Growth could stall or turn negative • Fiscal flexibility is tested • Downside consumer and credit risks increase materially
<p><i>Possible, but lower likelihood than base case</i></p>	<p><i>Likeliest scenario</i></p>	<p><i>Lower probability, but higher impact</i></p>

The most likely path today is not de-escalation or crisis, but a more persistent drag through prices, confidence and policy

Source(s): Teneo research and analysis

Our Base Case is Prolonged Tension, not a Severe Disruption Shock

We expect the most likely path today to be a persistent external price and confidence drag that keeps UK inflation higher for longer, delays easing and softens demand without creating an immediate deep downturn.

In this scenario, there is a period of continued tension that keeps energy, freight and market risk premia elevated, but this falls short of a full supply shock. For the UK, that means slower disinflation, delayed rate cuts and a moderate squeeze on real incomes and demand

Why this is the likeliest outcome

- Markets price tension faster than supply is physically disrupted
- Energy import costs are higher but there isn't an immediate shortage
- Inflation remains sticky, delaying Bank of England easing
- Demand softens slowly through higher prices rather than physical shortages

What this means for the UK

- Inflation stays higher for longer
- Manufacturing, construction and import-dependent retail face growing pressure from delays and input uncertainty
- The Bank of England is likely to hold interest rates for longer
- Consumer pressure builds gradually
- Fiscal trade-offs become harder to make

What would change our view

- Energy markets normalise quickly
- Supply disruption intensifies sharply
- UK economic activity weakens faster than expected
- Inflation persistence broadens

Source(s): Teneo research and analysis

An aerial view of London at dusk, featuring the Tower Bridge in the foreground and The Shard in the background. The sky is a mix of orange, yellow, and blue, and the city lights are beginning to glow.

What matters for the UK economy is whether this geopolitical shock becomes a broader shock to inflation, growth and fiscal choices in 2026 and beyond

What has Changed in the UK Macro Outlook

The conflict has raised inflation and policy risks, but it has not yet turned a modest UK growth story into a clear downturn.

← What hasn't changed

The UK economy is still healing, not yet moving into a true expansion

- IMF and OECD forecasts suggest the 2026 outlook has softened, reinforcing the view that growth is likely to remain modest

Consumer demand is under pressure, but not collapsing domestically

- Current spending patterns suggest households are becoming more selective, with weakness focused in exposed categories rather than spreading across consumption as a whole

Labour remains soft, but there is no evidence of a break in the jobs market

- The labour backdrop looks weaker than a year ago, but not yet in a way that points to a more abrupt downturn

↻ What has changed

Upside inflation risks have strengthened

- The balance of risks has shifted, with cost pressures, supply disruption and external shocks increasing the chance that disinflation stalls

The path to policy easing is becoming more complicated

- Policymakers may need to weigh weaker growth against stickier inflation, making the easing cycle less predictable

Budget constraints leave the downside more exposed

- Tighter fiscal headroom reduces the capacity to absorb further shocks, bringing downside economic scenarios further into focus

Covered in more detail on the following slides

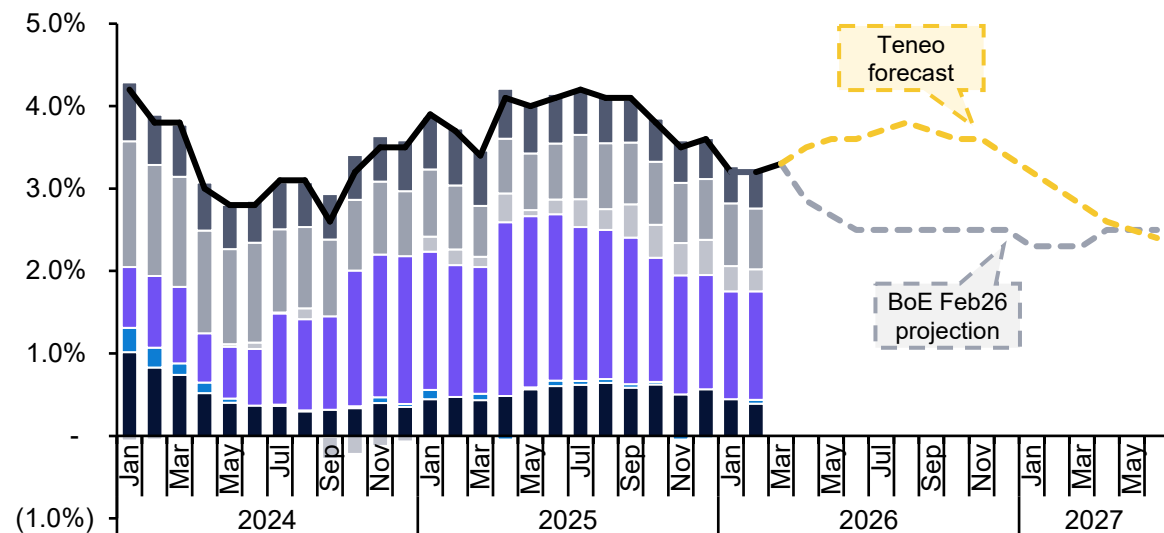
Source(s): IMF; OECD; Teneo research and analysis

Inflation is the Main Macro Transmission Channel

For the UK, the clearest effect of the Iran conflict is likely to be slower disinflation, led initially by fuel and energy and later, if disruption persists, by food, other imported costs and supply bottlenecks.

CPIH was expected to lower to around 2.5% by end-of-year, however, it is now likely to be remain above 3% until the first quarter of 2027

UK CPIH by category, Jan-24 to Jun-27F



Near-term pass-through channels:

- Petrol and transport costs
- Household energy expectations
- Shipping, freight and insurance costs
- Near-term inflation expectations

Secondary inflationary pressures if disruption persists:

- Food prices
- Broader imported goods costs
- Greater pressure on household budgets
- Higher risk that inflation stays above target for longer

Inflation in 2026 is expected to remain well below the double-digit levels seen early in the Ukraine war in 2022, reflecting more moderate commodity price increases and weaker consumer demand, which limits retailers' ability to pass on higher costs.

Source(s): ONS; OBR; Bank of England; Food & Drink Federation; Teneo research and analysis

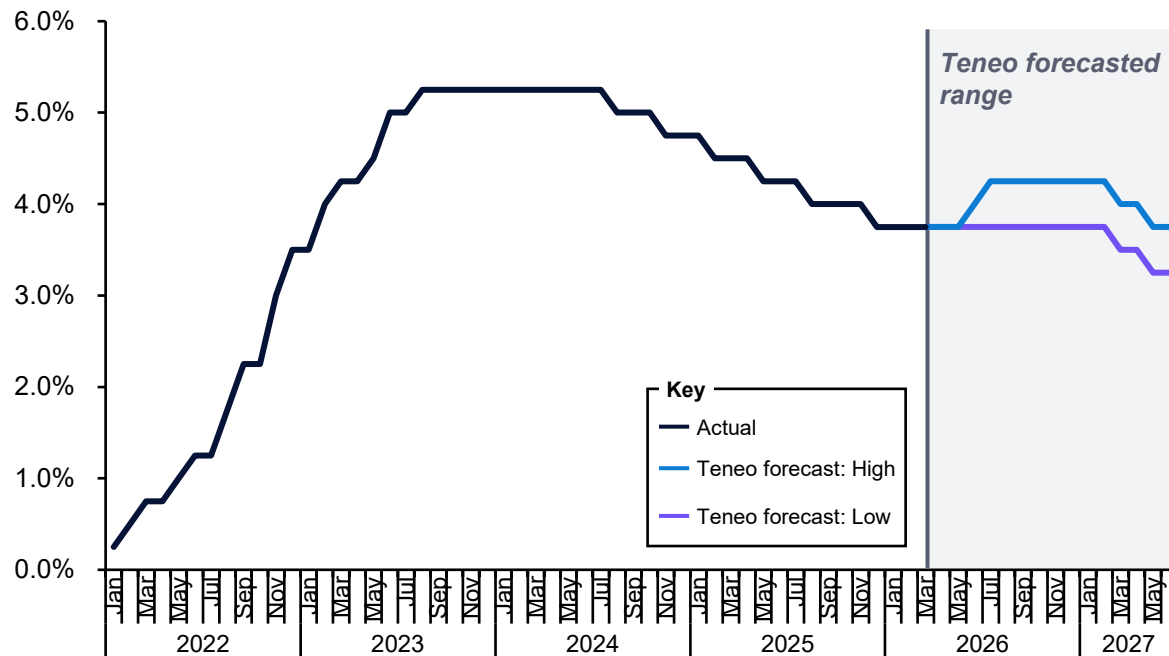
Note(s): 1. Food & non-alcoholic beverages, alcohol & tobacco; 2. Clothing & footwear, furniture & household goods; 3. Housing & household services (incl. utilities & council tax); 4. Recreation & culture, restaurants & hotels

Rates are More Likely to Stay Higher for Longer Than Move Sharply Higher

A renewed external inflation shock would make it harder for the Bank of England to cut quickly, but weak underlying demand still argues against an aggressive tightening response.

We expect BoE rates to be between 3.75-4.25% from now until the middle of Q1 2027, with a series of cuts thereafter

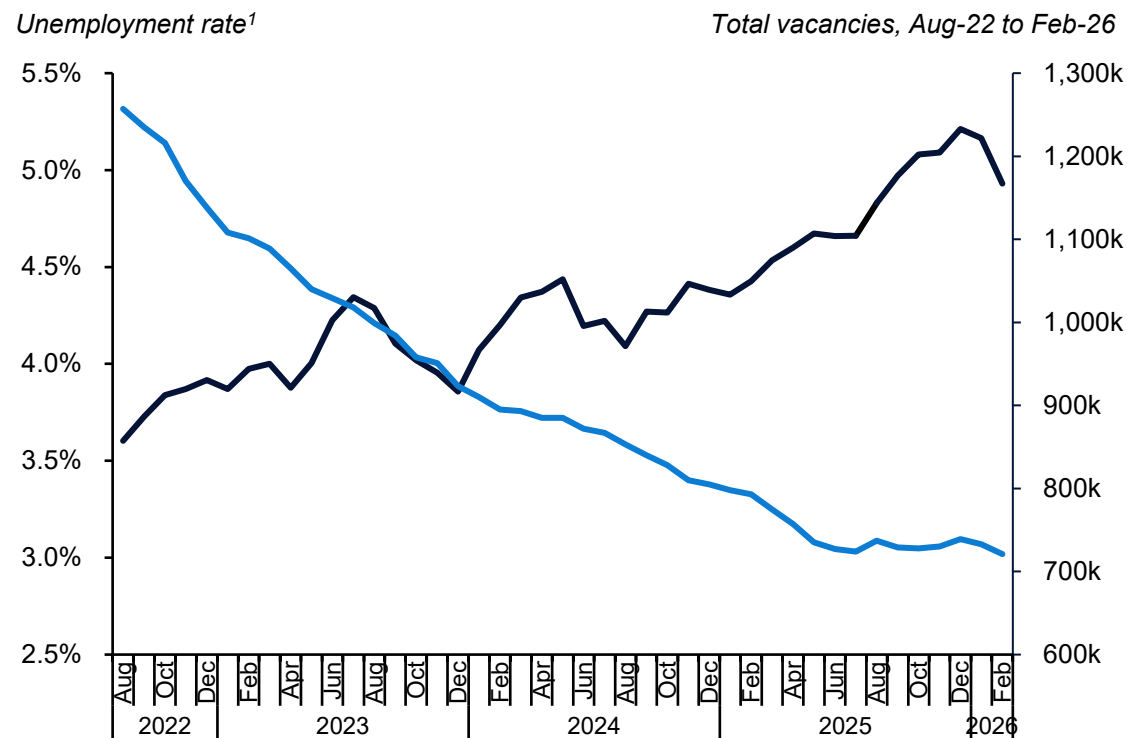
Interest rate, BoE actual 2022 to Mar-25, Teneo forecast Apr-26 to Jun-27



Softness in the Labour Market Remains

Headline unemployment has eased, but weak hiring, lower participation and rising structural frictions suggest the labour market is no longer tight enough to support materially higher rates unless inflation becomes far more persistent.

Domestic and global headwinds continue to weigh on hiring



Source(s): ONS; BBC; Teneo research and analysis
 Note(s): 1. Seasonally adjusted

Unemployment alone understates the softness

Although the headline unemployment rate has moved lower, from a December high of 5.2% to 4.9% in February, that does not mean the labour market is strong. The broader picture is one of softer labour demand, fewer vacancies, weaker hiring and lingering participation issues



Hiring is weak, even without a broad shakeout

Firms are hiring cautiously rather than shedding labour aggressively, with youth hiring especially weak: the unemployment rate for young people was 15.8% in February, up from 14.6% a year earlier. Payroll and activity data also suggest sideways employment



This is not a labour market that invites aggressive tightening

Wage pressure is no longer consistent with an overheating labour market, and weak hiring makes the economy less able to absorb higher rates. Annual regular pay growth slowed to 3.6% for the December 2025 to February 2026 period

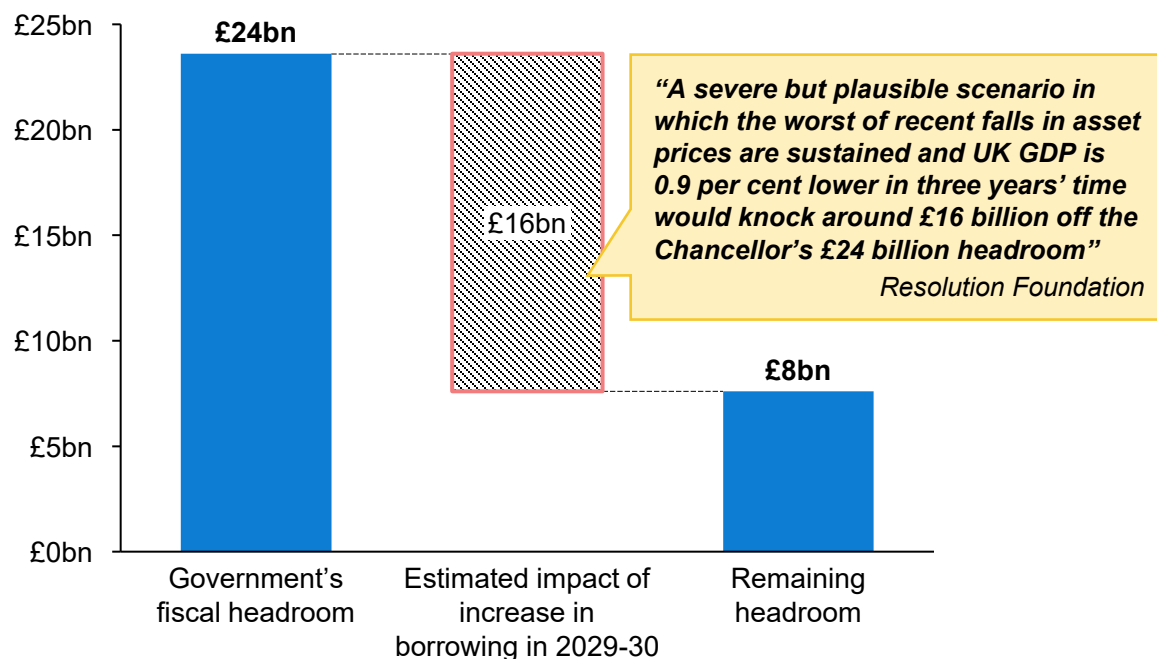


The Autumn Budget Could Become More Difficult

A renewed external shock would tighten fiscal choices by slowing growth, increasing policy pressure and reducing the government's room to absorb higher living costs.

The fallout from the Iran conflict, on top of any government response to rising energy prices, is likely to eat into the Chancellor's fiscal headroom

Headroom against the stability rule, HM Treasury Spring Forecast 2026



The next Budget is likely to be difficult

A prolonged external shock would make the fiscal position harder to manage through weaker activity, greater pressure on real incomes and the possibility of higher debt-servicing costs if market conditions remain volatile



The likeliest response: targeted adjustment, not broad stimulus

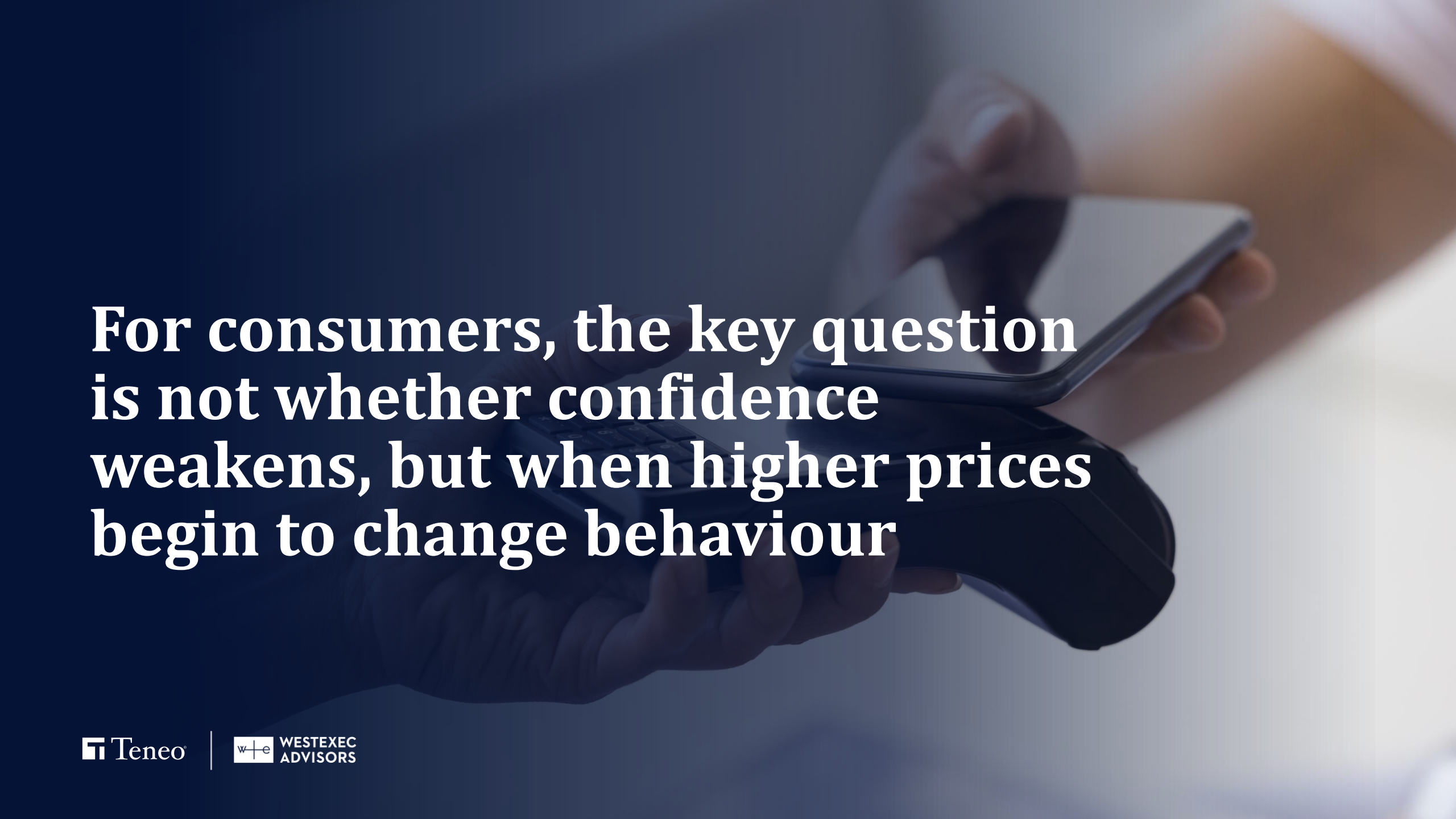
In the base case, government is more likely to bring in targeted support for vulnerable households and take a cautious fiscal stance than to deliver a large-scale intervention



A larger shock could force a bigger response

A materially larger shock, particularly one strong enough to push growth into contraction, would make adherence to existing fiscal plans much harder and could require government to invoke greater flexibility around fiscal rules, rather than tighten policy into a weakening economy

Source(s): HM Treasury; Resolution Foundation; Teneo research and analysis

A hand holding a smartphone over a payment terminal. The background is a blurred image of a person's arm and hand holding a smartphone, with a payment terminal in the foreground. The text is overlaid on the image.

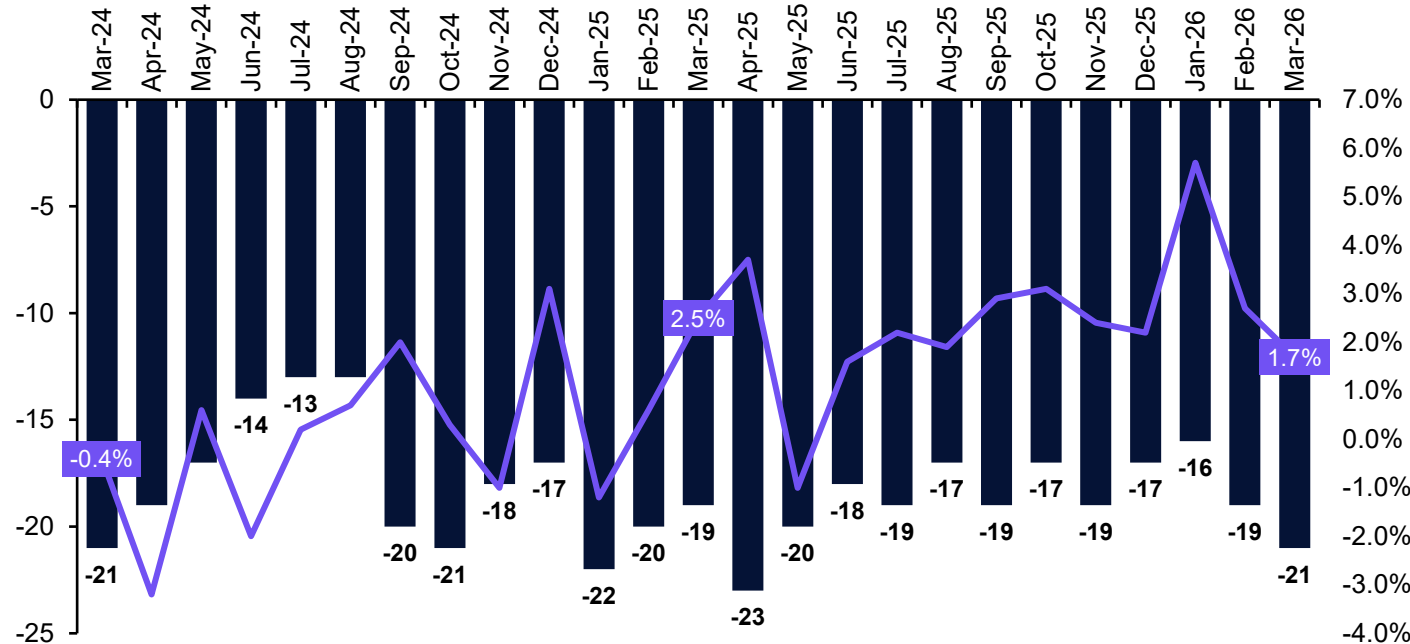
For consumers, the key question is not whether confidence weakens, but when higher prices begin to change behaviour

Confidence May Weaken Before Spending Does

For UK consumers, the first response to the Iran shock is likely to be greater caution, but broader spending effects are more likely to emerge as higher fuel, food and energy costs feed through.

Consumer confidence is worse than a year ago, while consumption is up year-on-year

Consumer confidence vs. retail sales volume YoY change, Mar-24 to Mar-26



Source(s): GfK Group; ONS; Teneo research and analysis



Caution comes first

Geopolitical shocks often affect how consumers feel before they materially affect how they spend, so while weaker confidence may reveal itself quickly, that **does not necessarily imply an immediate collapse in domestic demand**

Households do not usually retrench sharply on headlines alone: **existing income and savings buffers can initially absorb some of the shock**



Prices matter more than headlines

A more meaningful **consumer response is likely to come as higher fuel, transport and, later, food costs feed through** into everyday budgets. That is where the shock becomes more tangible for households

Petrol will be the clearest first-round pressure point, with food following later if disruption persists

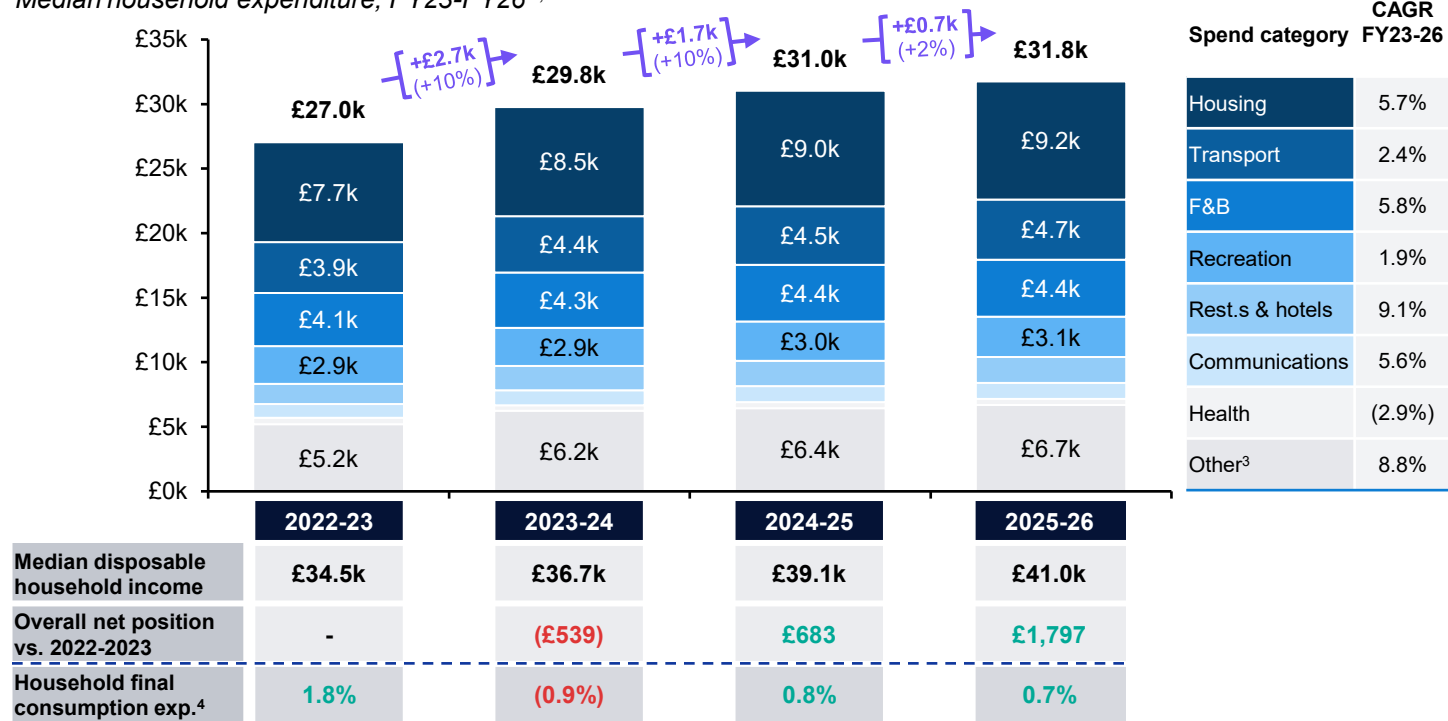
This squeeze will be **felt most acutely by lower-income households**

Consumers are Better Prepared for This Shock Than in 2022–23, but Resilience is Uneven

Real wages and savings buffers have improved, giving many households more protection than during the last energy shock, although lower-income groups remain much more exposed to higher essential costs.

Household's net cash position has improved due to growth in real wages, returning to pre-crisis levels

Median household expenditure, FY23-FY26^{1,2}



While this hasn't translated into spending, **consumers are in a more insulated position** now than if this shock had occurred a year ago, but the **improvement in household finances is not evenly shared**



Higher-income households hold significantly larger savings buffers and are better able to absorb higher fuel, food and utility costs



Lower-income households remain far more exposed to another essential-cost shock

Source(s): ONS; Bank of England; OBR; Deloitte; Teneo research and analysis

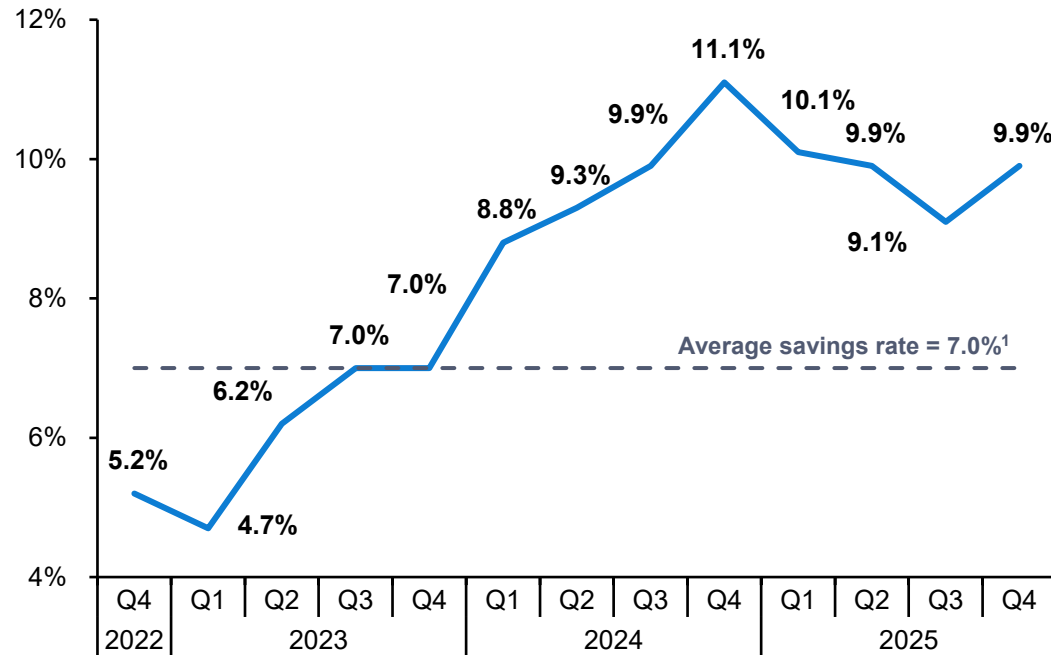
Note(s): 1. Household expenditure in nominal terms; 2. FY is April to March, FY25/26 expenditure and disposable income figures refer to April to October 2025; 3. Education, consumer debt, and clothing are included in "Other"; 4. Measured from Q1 to Q1, except '25-'26 which measures Q3 '24 to Q3 '25; 5. High-income households refers to the top four income deciles. Low-income households refers to the bottom two income deciles

Instead of Spending, Households will Continue to Save More

Households have been choosing to rebuild their buffers in anticipation of future economic headwinds. In Q4 2024, savings rates reached their highest levels since 2015 and although they have been decreasing since then, this conflict is likely to drive them back up.

The average UK household is saving well above historic norms, but the absolute gap between income groups has widened

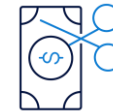
Households' savings ratio (%), seasonally adjusted, Q4 2022-Q4 2025



In Q4 2025, the household savings ratio stood at 9.9%, reflecting still-strong **precautionary saving amid uncertainty**, suggesting many remain reluctant to deploy liquidity for consumption or investment



High-income households have far greater buffers compared to low-income families: **this savings gap has widened since the pandemic and the cost-of-living crisis**, highlighting stark inequality in financial resilience



Consumer caution is expected to sustain through 2026, with individuals saving more and being more careful with their money over the coming 12 months to **mitigate rising costs**

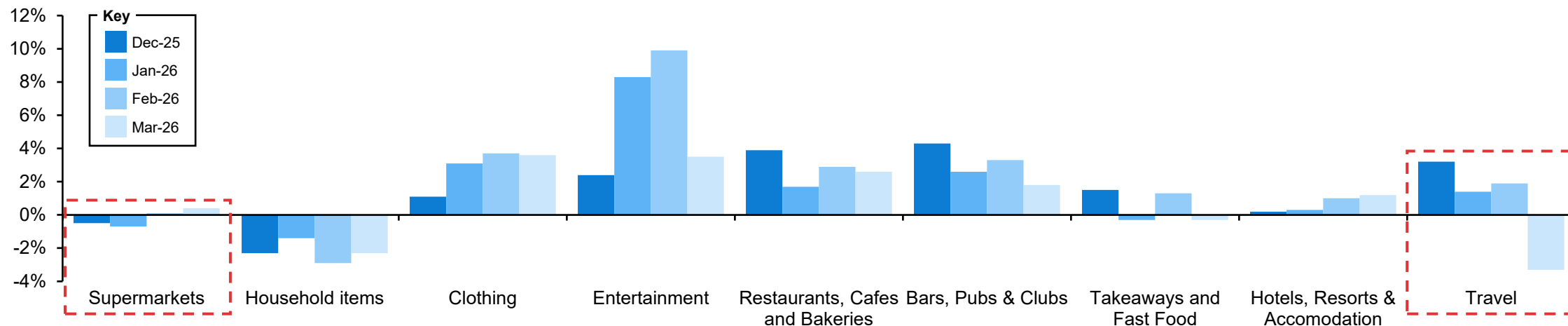
Source(s): ONS; Financial Times; VYPR; Teneo research and analysis
 Note(s): 1. 2015-2025 average (excluding COVID-19, Q2-20 to Q4-21)

Spending has Softened Selectively, not Collapsed Broadly

The early evidence suggests a targeted pullback in more exposed discretionary categories, while much of domestic spending remains more resilient for now.

Spending has fallen in select categories, but overall essential spending is returning to growth while discretionary spend growth is slowing

Change in spend by category, cash, Dec-25 to Mar-26



Essential spend returned to growth (+0.5%) for the first time since July 2025, led by an **increase in fuel spending**



By contrast, **discretionary spend growth slowed to 1.1%**, with **travel in decline** for the first time since 2021. **Spend on hotels, resorts and accommodation increased 1.2%**, potentially due to a preference for UK-based 'staycations'. Otherwise, spend **momentum held up** in categories including **digital content and subscriptions (10.9%)**, **health and beauty (6.3%)** and **clothing (3.6%)**

Source(s): Barclays Bank; Teneo research and analysis

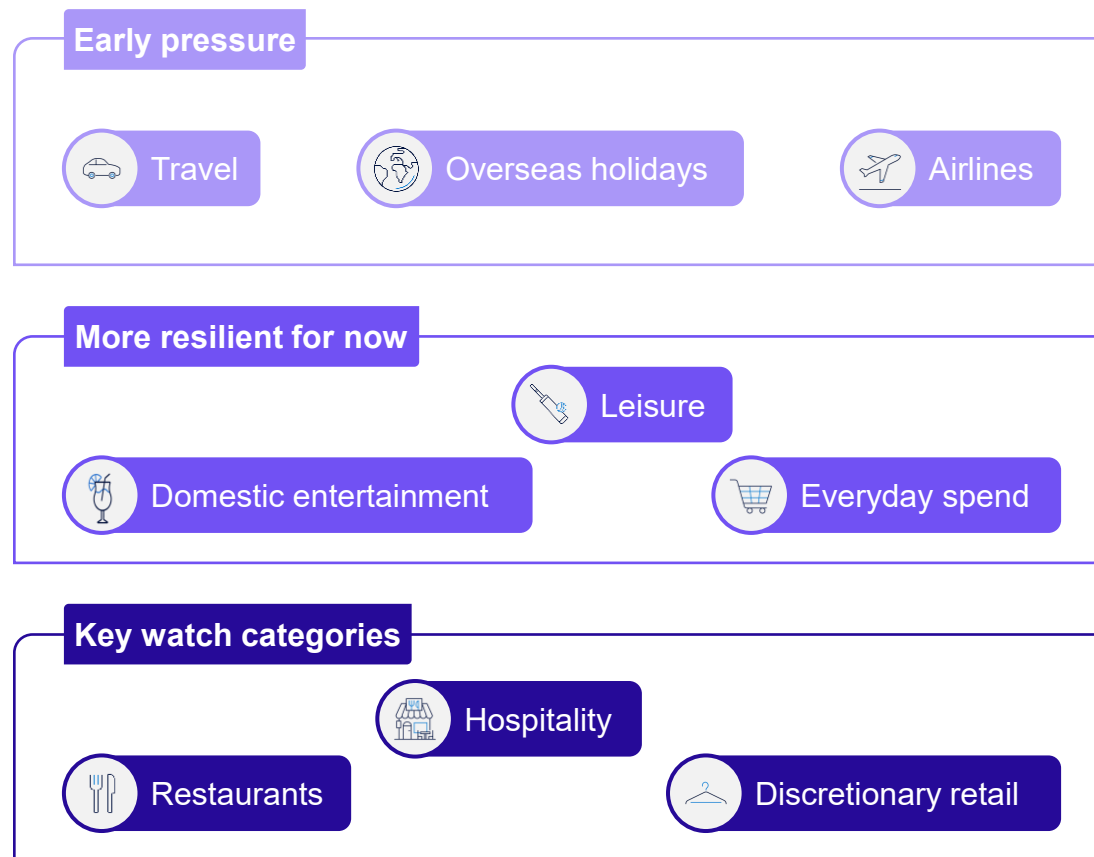
Consumers are Becoming More Selective, Rather Than Pulling Back Across the Board

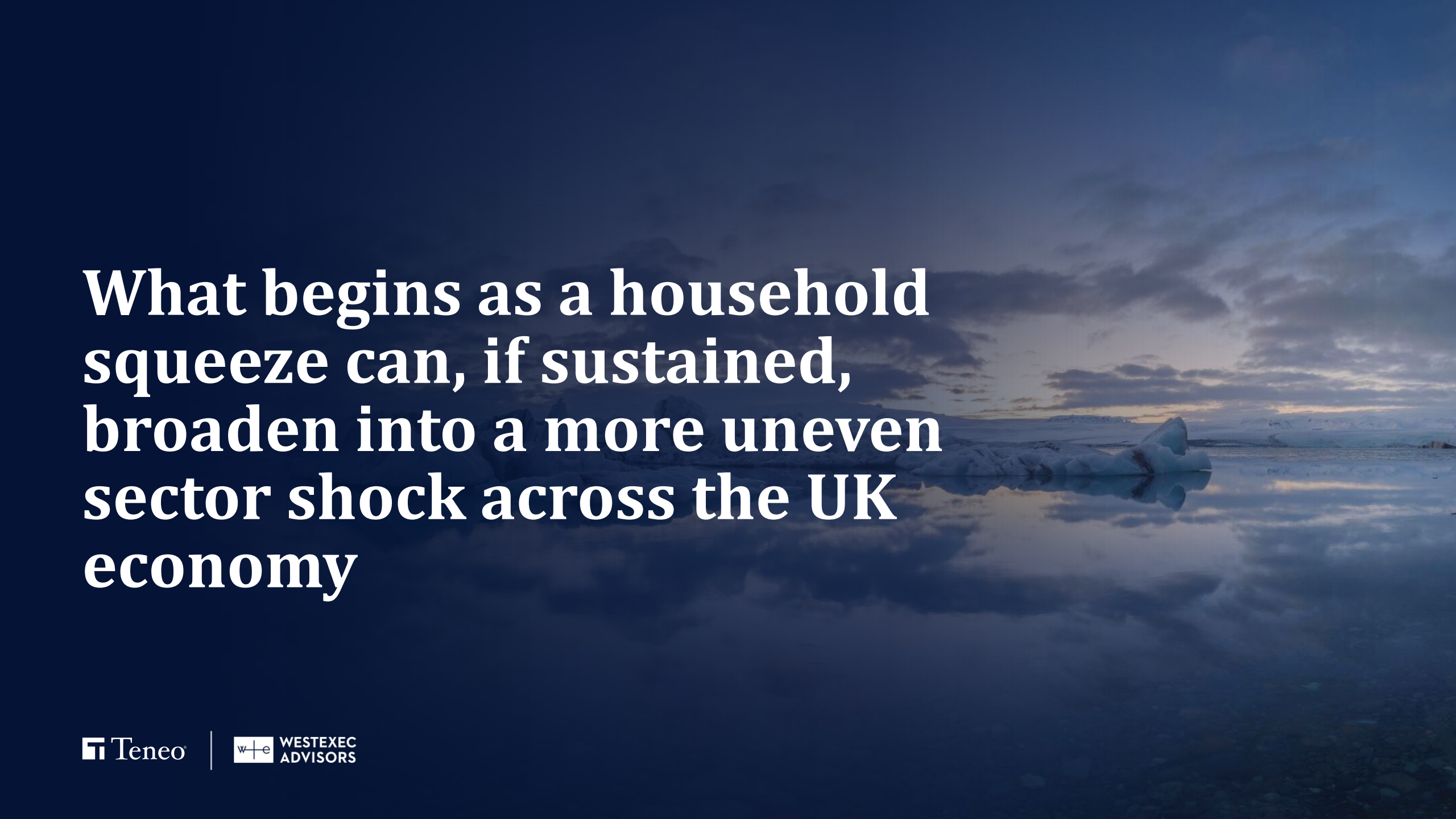
Spending trends point to pressure in travel and other exposed discretionary categories, while domestic leisure and everyday spend remain more resilient.

What the data is showing

- The **early consumer response appears targeted** rather than broad-based
 - Categories most exposed to higher fuel costs, travel disruption and forward-booked discretionary spend are showing the clearest signs of weakness, while domestic activity has remained firmer
 - By contrast, day-to-day domestic spending remains firmer, suggesting a selective adjustment rather than a broad retrenchment
 - This is consistent with a gradual behavioural adjustment rather than a sharp consumer retrenchment
- **Households appear to be becoming more selective rather than stepping away** from spending altogether
 - Consumers appear to be reprioritising spend towards everyday and domestic categories
 - That suggests early weakness is being driven more by selectivity than by a collapse in confidence
- A **broader slowdown will be likelier if essential-cost pressures persist**
 - Weakness across hospitality, leisure and retail would be a clear sign that pressures are becoming more economy-wide

Source(s): Teneo research and analysis





What begins as a household squeeze can, if sustained, broaden into a more uneven sector shock across the UK economy

Sector Pressure Would Build Unevenly Across the UK Economy

The earliest pressure points are in energy-sensitive, fuel-sensitive and margin-constrained sectors, with broader exposure emerging only if the shock persists or intensifies.

Already exposed	More exposed if the shock persists	Only exposed in severe downside
<p><i>Sectors where pressure either shows up first or is most immediate</i></p> <ul style="list-style-type: none"> Airlines, travel & transport Fuel costs feed through; travel demand is highly sensitive to pricing and uncertainty Logistics & freight-intensive businesses Higher shipping, freight and insurance costs hit quickly, while delays disrupt inventory flow and delivery schedules Energy-intensive industries Manufacturing segments with high energy usage are exposed early, especially where production depends on timely imported inputs Import-dependent retail and wholesale Sectors reliant on imported goods face margin pressure sooner, and are more vulnerable to delayed deliveries and stock disruption 	<p><i>These sectors come under broader pressure in the base case scenario</i></p> <ul style="list-style-type: none"> Hospitality and leisure Households become more selective; operators continue to face cost pressure General discretionary retail More exposed if households reallocate budgets toward essentials Consumer-facing SMEs Smaller firms with weaker margins become more vulnerable as costs stay high Manufacturing Broader margin pressure emerges through energy, freight disruption and softer external demand Commercial real estate-linked sectors Higher-for-longer rates and weak confidence weigh on activity 	<p><i>These sectors become much more concerning only if the shock broadens materially</i></p> <ul style="list-style-type: none"> Construction and housing-related activity Persistently tighter rates and weaker confidence would hit activity harder Business services and professional services Slower growth could turn into a pullback in hiring and investment Broad labour-intensive domestic services A broader slowdown feeds through into demand and employment Bank asset quality / lower-grade credit exposures Relevant if the shock broadens; becomes less sector-specific
<p><i>Driven by fuel, freight, input-cost and delivery disruption</i></p>	<p><i>Driven by a margin squeeze, weaker real incomes, slower demand and less reliable supply</i></p>	<p><i>Driven by tighter financing conditions, weaker confidence and a broader macro slowdown</i></p>

Source(s): Teneo research and analysis

What This Means for Banks and Lenders

The base case is a longer period of pressure rather than panic, with risks concentrated in affordability, exposed sectors and delayed policy easing.



What to worry about

- **Affordability pressure for lower-income households** as fuel, food and utility costs rise
- Higher **stress in travel, transport, hospitality** and other margin-constrained sectors
- More **pressure on consumer-facing SMEs** with limited pricing power
- **Restrictive financing and refinancing conditions** lasting longer than previously expected



What not to overstate

- An immediate **system-wide consumer stress event**
- A **broad collapse in domestic spending**
- A full, renewed **Bank of England hiking cycle** as the central case
- A **near-term economy-wide credit deterioration** in the absence of a more severe shock



What to watch now

- **Petrol prices** and household energy expectations
- Spend data, especially **travel and discretionary** categories
- BoE communication and rate-cut pricing
- Gilt yields and broader funding conditions
- Signs that stress is **broadening from prices into delivery disruption** and from specific sectors into wider activity

Source(s): Teneo research and analysis

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