The UK's Double Shock: An Outsized Hit from the Iran War

The OECD's March 2026 interim update delivers a stark verdict: no major economy faces a sharper growth downgrade or bigger inflation revision than the UK. Gas-linked electricity pricing, pre-existing fiscal drag, and a Bank of England caught in a stagflation trap make Britain the conflict's most exposed G7 economy.

The OECD has cut its 2026 UK growth forecast by 0.5 percentage points to 0.7% – the sharpest downgrade of any major economy. UK inflation is now projected at 4.0% for 2026, a 1.5pp upward revision – the largest of any large advanced economy. No other G7 nation received a comparable double downgrade on both growth and inflation.

The transmission mechanism is energy. The Strait of Hormuz – through which ~20% of global oil and all Qatari LNG flows – has driven a surge in wholesale gas prices. The UK's electricity market is marginal-price based and gas-linked: gas sets the clearing price for the whole grid. Unlike France (nuclear-heavy) or Germany (long-term supply contracts), the UK has no structural insulation from spot gas shocks. Price spikes transmit immediately and in full to household bills and business costs.

The shock compounds a pre-existing fragility. The OECD had already flagged fiscal tightening and weak productivity as structural drags before the conflict. UK GDP expanded just 0.1% in Q4 2025, and the OBR's March 2026 baseline – finalised days before the strikes – projected 1.1% growth this year. That ceiling has now been cut nearly in half. The April 2025 employer NI increase has already raised the cost of labour in precisely the sectors most sensitive to demand weakness, and the saving ratio remains well above pre-pandemic levels, leaving consumer spending with little capacity to absorb a fresh cost shock. The UK entered this crisis with its buffers depleted.

The Bank of England's position has become acutely uncomfortable. The OECD expects the MPC to hold Bank Rate at 3.75% through 2026 and begin cutting only in Q1 2027 – a sharp reversal of market expectations. The committee faces a textbook stagflation dilemma: inflation at 4% and well above target, while growth collapses toward stall speed. Cutting too early risks embedding an inflationary spiral – a weaker pound amplifies import costs at precisely the moment global energy prices are already elevated. Holding too long risks tipping a weakly-growing economy into contraction. The Bank had been expected to deliver quarterly cuts through 2026; that cadence is now in serious doubt.

The contrast with the United States could not be starker. The OECD upgraded US growth to 2.0% in 2026 – up from December's 1.7% – because the US is a net energy exporter that benefits directly from elevated oil and gas prices. Beyond that, the US is attracting massive AI and technology investment that is providing a powerful demand offset. The UK has no comparable tailwind: business investment remains subdued, and the NI cost shock has further dampened hiring and capital allocation. The Iran conflict is, in effect, a terms-of-trade transfer from energy-importing economies to producers – and the UK sits at the most exposed end of the G7 spectrum, with nothing to cushion the blow.

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The 0.7% print may itself prove optimistic – it rests on the assumption that energy disruption moderates from mid-2026, which markets are not pricing with confidence at Brent near $106. Our base case holds with the OECD: BoE on hold until Q1 2027. But the risk is asymmetric – sustained Hormuz closure through summer would force a 5%+ inflation print and make any 2026 cut politically impossible. The NI shock and the energy shock are landing simultaneously, squeezing UK labour demand with no obvious monetary offset available.

0.7%

UK GDP Growth 2026

OECD March 2026 – down from 1.2% in Dec. Worst downgrade of any OECD member.

KEY RELEASE

OECD Full Economic Outlook

May 2026

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