New Year Outlook 2026

Early and encouraging signs of a mild zombie apocalypse

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Ruth Curtice and Gregory Thwaites

What a difference a year doesn't make. This time last year the Government had just announced huge tax rises, having previously said they weren't coming; trade wonks were wondering what Donald Trump's next tariff policy would be; and Labour politicians awaited the May elections with trepidation.

Yet this sense of déjà vu is only part of the story. Beneath the surface, several things have changed in ways that will matter for the years ahead: the political system has fragmented; new technologies are starting to affect how work is done; and the UK is edging towards a demographic milestone not seen in modern times.

This New Year Outlook looks back at some of the less-remarked developments of 2025, and forward to what they mean for the economy in 2026 and beyond.

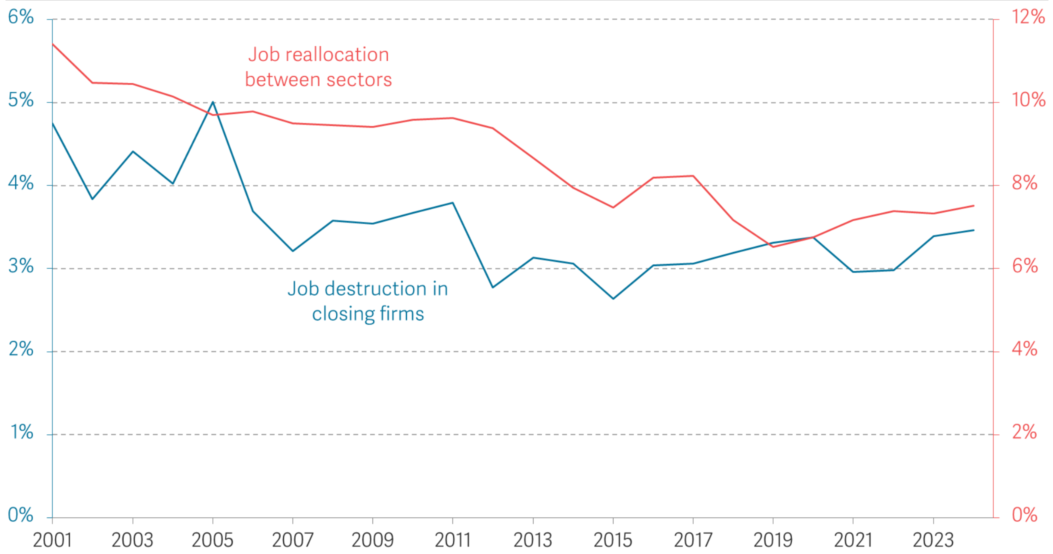
Early and encouraging signs of a mild zombie apocalypse

Weak productivity growth is the main reason that incomes have risen so slowly since the financial crisis. A key driver of productivity growth is 'creative destruction', whereby newer and better firms, products or processes replace older, less-efficient, ones. One way to measure how much this is happening is by how many jobs are created by new, growing firms, and how many are destroyed by old, shrinking ones. In fact, this sort of reallocation of labour has been slowing for much of the 21st century, in the UK and elsewhere, for reasons that are not fully understood.

But last year there were signs of a turnaround. In particular, the share of jobs destroyed by firms that are closing increased to the highest level since 2011, as did the number of firms becoming insolvent. The share of employment that moved between sectors has also started to increase. Our hunch is that the triple whammy of multi-year increases in interest rates, energy prices and the minimum wage is finally beginning to finish off some of the low-productivity 'zombie' firms that managed to stay afloat in the 2010s, and this is forcing a reallocation of employment across firms and sectors. It's also possible that we're seeing the early effects of AI.

Figure 1 **Early and encouraging signs of a mild zombie apocalypse**

Job reallocation between sectors and job destruction in closing firms: UK



Source: ONS and RF calculations

Of course, these closures and job losses are hugely difficult for many of those directly affected. And it is hard to call this unambiguously good news. But if – and we haven't seen it yet – they begin to make room for more and better jobs to be created in growing firms, then it bodes well for future productivity growth.

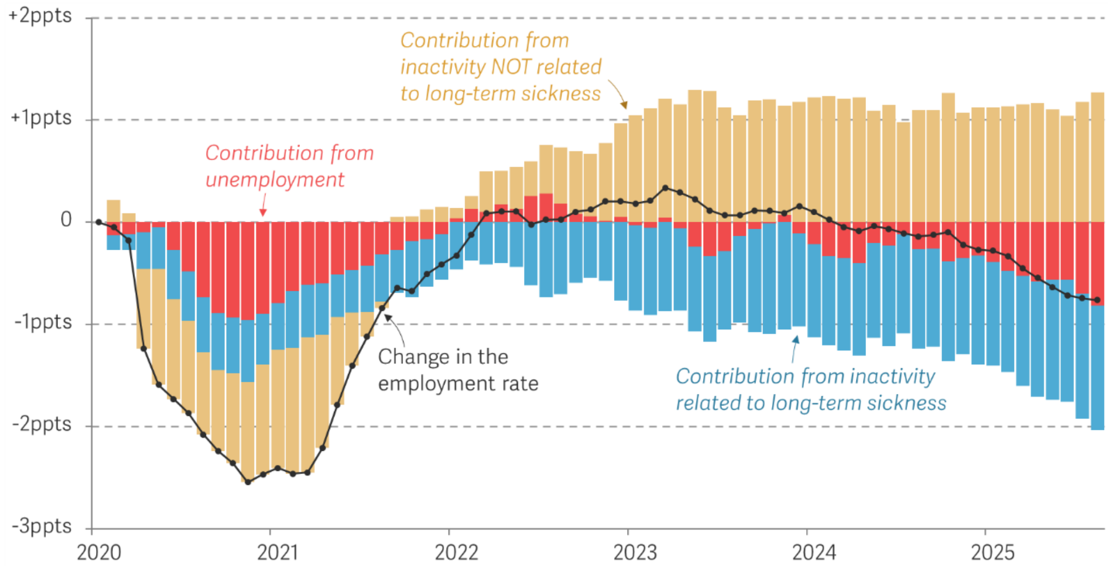
Indeed, our own in-house estimates of productivity do suggest a turnaround in growth over the past year or so. Not because output has been growing especially quickly, but because the number of people working to produce that output has been falling...

An economy that needs jobs as well as jobseekers

The employment rate – properly measured – has been falling for over two years. There has been plenty of political drama this year about the concerning, and real, rise in inactivity related to ill-health. But overall inactivity is at about the same level as it was pre-pandemic, as the rise in ill-health has been offset by continued falls in other reasons for inactivity. In fact, all of the fall in the employment rate since the pandemic is accounted for by rising unemployment, which now stands at 5 per cent. It's no good having the destruction of inferior jobs without the creation of better ones.

Figure 2 **An economy that needs jobs as well as jobseekers**

Change in the 16-64 employment rate compared to January 2020, and contributions from participation and unemployment: UK



Notes: Data is from the Labour Force Survey before 2020. After 2020, we use Resolution Foundation alternative employment estimates (with ONS population projections adjusted to reflect outturn net migration data) and the unemployment rate from the LFS, which in turn allows us to derive an inactivity rate. Chart stops in August 2025 as that is currently the latest available unemployment data from the LFS (relating to July-September 2025).

Source: RF analysis of ONS, Labour Force Survey; RF, Estimates of UK employment; ONS, Long-term international migration, provisional: year ending June 2025.

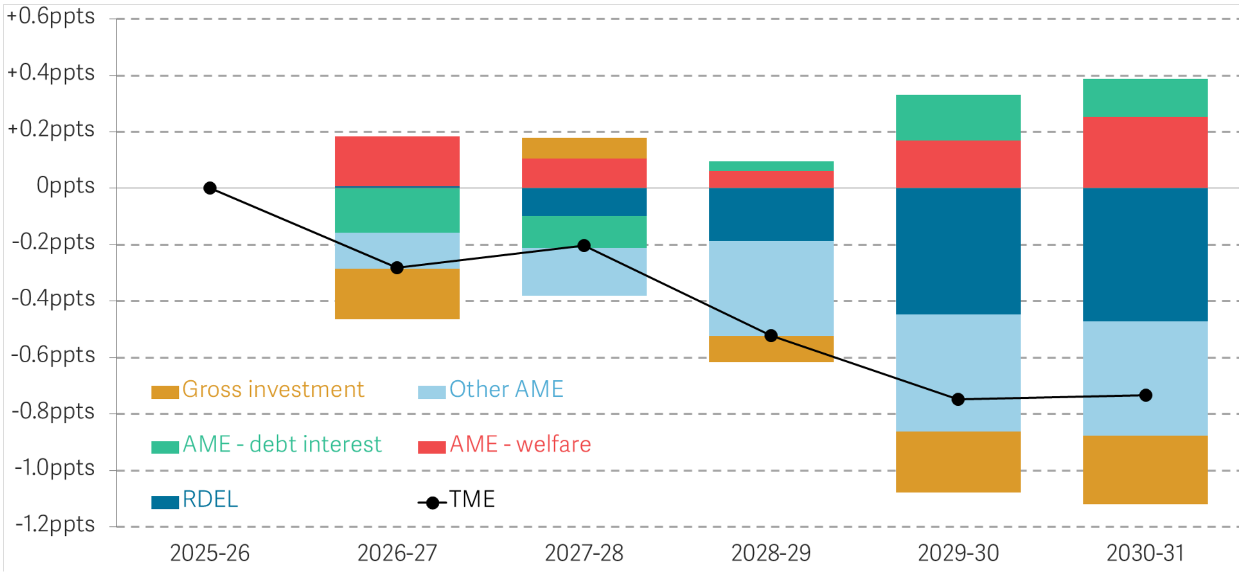
Public spending as a share of the economy will stop growing in 2026 – won't it?

The pandemic brought a notable increase in the size of the state. The current Government then boosted spending totals for its first two years, but always planned for the state to start shrinking from then on. 2026 is the year when the brakes need to come on.

Just as some of the rise in total spending was out of the government's control – with debt interest gobbling up an [additional 2 per cent of GDP]() compared to pre-pandemic – so too will be some of the fall. In particular, if expected lower inflation and interest rates come to pass, then this will ease some pressures on the state, as will some quirks of the capital spending profile. Beyond that, we are due to see small reductions in day-to-day departmental spending (“RDEL”), meaning that productivity improvements are the only route for services to improve in the run-up to the UK general election. It would be wise for Ministers to start thinking about how to achieve those, rather than hoping the growth fairy will come to the rescue.

Figure 3 **Public spending as a share of the economy will stop growing in 2026 – won't it?**

Contributions to the change in the ratio of total managed expenditure to GDP relative to 2025-26: UK



Source: OBR and RF calculations

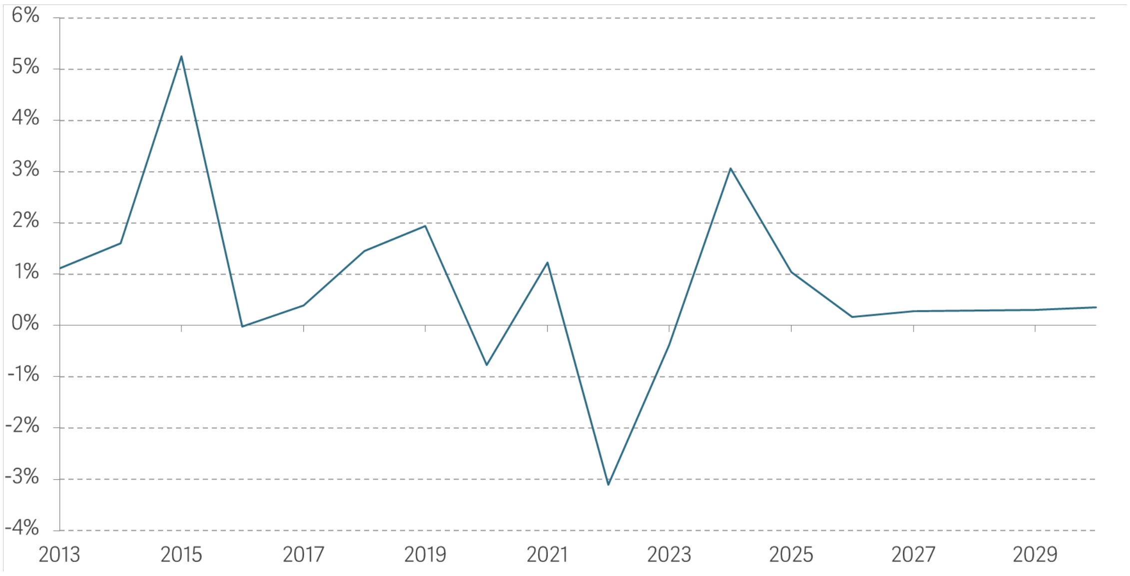
Taxes haven't yet caught up with spending, but that is set to happen over the next few years, as the Government attempts to shrink the budget deficit. Financial markets are clear that the UK can't continue to borrow at current levels, so there is no alternative. But voters may well feel that they are "paying more for less". And it's not like we can expect growth in living standards to come to the rescue…

The growth of incomes is set to slow to a crawl

2024 and 2025 have been relative bright spots in the desert of living standards growth over the last two decades. But much more lacklustre real wage growth, and rising tax bills, will push the growth of average incomes (as measured by real household disposable income per capita) down to 0.2 per cent in 2026, according to the OBR's latest forecast. And growth in 2026 may be even worse if the sharp fall in Q3 2025 turns out not to be a blip. In recent times, incomes have grown as slowly as this only in years of big external or self-inflicted shocks: the pandemic in 2020, the energy crisis in 2022-23 and the Brexit referendum in 2016. And this low growth rate is set to continue – a nowhere-near-good-enough outlook for living standards in a forecast that presumes no shocks.

Figure 4 **The growth of incomes is set to slow to a crawl**

Outturns and OBR forecast of annual growth in real household disposable income per head: UK

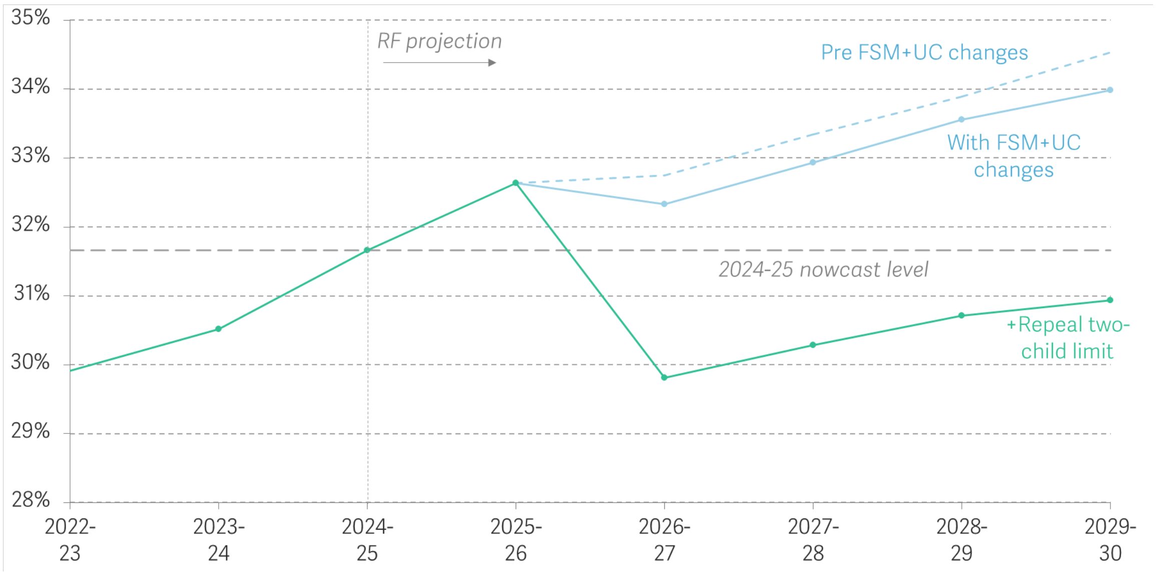


Notes: Chart shows the OBR's November 2025 forecast and outturn data available at the time.
Source: OBR and RF calculations

Child poverty will fall in 2026: a huge triumph, but a temporary one

Amid the gloomy picture for overall incomes, we should step back and celebrate a triumph. Child poverty is set to fall sharply in 2026, thanks to the abolition of the two-child limit that applies to those receiving Universal Credit. The Government should be congratulated on finding the fiscal space to address a growing problem and a deep unfairness in the system. But it cannot rest easy. The poverty rate is set to start rising from this new lower base in 2027.

Figure 5 **Child poverty will fall in 2026: a huge triumph, but a temporary one**
Proportion of children living in relative poverty after housing costs, under different policy scenarios: UK



Notes: All values beyond 2023-24 are projections.
Source: RF analysis of DWP, Households Below Average Income; RF projections including use of the IPPR Tax Benefit Model; DWP, Family Resources Survey; ONS, various; Bank of England, Monetary Policy Report - November 2025; and OBR, Economic and Fiscal Outlook - November 2025.

The rising rates from 2027 onwards are because other cuts to working-age benefits continue to bite. The benefits cap remains in place as a limit (frozen in nominal terms) on the total benefits families can receive if they are out of work. And the amount of benefits paid to cover rents also remains frozen, while rents continue to go up. Thanks to the Government's action in the Budget, the rate of child poverty will be 3.5 percentage points lower than it would have been had the two-child limit remained in place, but we are battling a rising tide. So it only ends the Parliament less than 1 percentage point lower than it was in 2024-25.

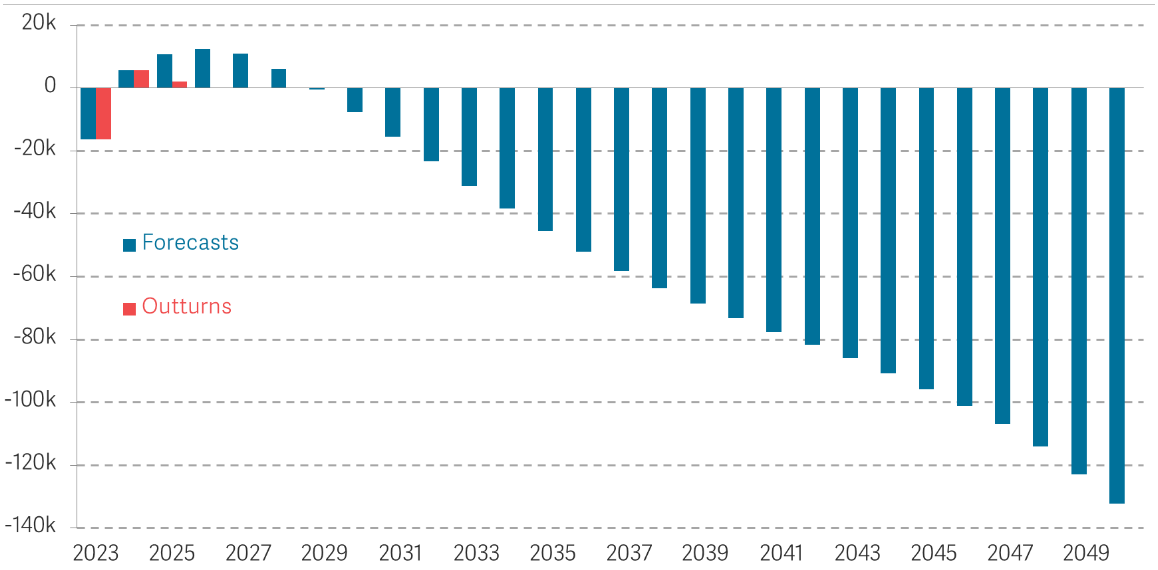
The poverty trends for children also look a bit different depending on whether you focus on the numbers or the rate. The number of children in poverty falls from 4.6 million in 2024-25 to 4.3 million in 2029-30, with that 300,000 fall much more than you would expect from the fall in the rate. Why? Because the overall number of children is falling. Demographic trends are flattering the Government's record.

2026 may be the start of a new era when deaths outnumber births in the UK

Since the beginning of the 20th Century (and probably before then too) births in Britain have exceeded deaths [almost every year](). But things have changed since the start of the current decade. Deaths exceeded births in 2020, due to Covid-19, and again in 2023. Births then edged just above deaths in 2024 and, we think, by an even narrower margin in 2025. These outturns suggest that 2026 may be the first year in a new era when deaths exceed births by an ever-widening margin, forever closing a chapter in the demographics of this country that opened over a century ago. From then on, any population growth we do get is set to come from international net migration, which the latest data suggest is also plummeting, down by three-quarters from its recent peak to around 200,000 a year.

Figure 6 **2026 may be the start of a new era when deaths outnumber births in the UK**

Outturns and forecasts of births minus deaths: UK



Notes: Forecasts are taken from the ONS's 2022-based national population projections.
Source: ONS and RF calculations

Taken together, these trends point to a country in the middle of a slow but consequential transition: fewer people of working age; a more fragile politics; higher taxes; and an economy that urgently needs new firms and new jobs to replace the old. The story of 2026 is not one of crisis, but of drift finally giving way to change. Whether that change is managed or merely endured is the question that will define the years ahead.