THEMATIC RESEARCH · UNITED KINGDOM

The United Kingdom: Inflation, Gilts and the Budget

a hike, then a Budget

September inflation rose to 3.5%, borrowing ran above forecast and net debt passed £3 trillion, all in the week before John Healey's first Budget and two weeks before a Bank of England meeting at which markets expect the first rate rise since 2023. This report examines the data, the gilt market and the choices ahead.

Global Markets Research · Rates and Macro Desk Prepared by ANDRA MARKETS

fuel +29.8%

Coverage summary. Consumer price inflation rose to 3.5% in September from 3.1%, above the 3.4% consensus and the highest in almost a year, driven by motor fuels as severe disruption in the Strait of Hormuz keeps Brent near $110. Core inflation rose to 2.8% and services to 3.7%. On the same morning, public sector borrowing came in at £24.5bn, £1.9bn above the OBR forecast, with debt interest of £10.9bn, the highest for any September on record. Markets now price a quarter-point rise in Bank Rate on 5 November, a week after the Budget on 28 October.

hike ~95% priced

CPI inflation, Sep	Bank Rate	10-year gilt, 21 Oct	Net debt
3.5%	**3.75%**	**5.40%**	**£3.0tn**
core 2.8%, services 3.7%	*hike to 4% priced for 5 Nov*	*5.48% on 7 Oct*	*94.0% of GDP*

Exhibit A. The week in numbers

Release	Latest	Previous	Comment
CPI inflation, Sep	3.5%	3.1%	consensus 3.4%
Core CPI, Sep	2.8%	2.6%	above expectations
Services CPI, Sep	3.7%	3.4%	BoE focus
Unemployment, Jun-Aug	4.7%	4.9% (May-Jul)	vacancies 691k
Regular pay growth	3.7%	3.7%	private sector 3.0%
Borrowing, Sep (PSNB ex)	£24.5bn	£22.8bn (Sep 25)	£1.9bn above OBR
Debt interest, Sep	£10.9bn	£9.4bn (Sep 25)	September record
Net debt / GDP	94.0%	94.7% (Sep 25)	above £3tn for the first time

all above forecast

index-linked: + £4.0bn

Source: Office for National Statistics (releases of 20 and 21 October 2026); consensus from Reuters polls.

1.0 Executive Summary

Key takeaways

Inflation is turning up again, mainly because of energy. Motor fuels are 29.8% more expensive than a year ago and transport alone added almost a percentage point to the headline rate. Food inflation, by contrast, fell to 1.3%. The Bank of England expects inflation of about 3.75% in the fourth quarter and slightly above 4% early in 2027, when the household energy price cap is due to rise again.

energy, not demand

first hike since 2023

The Bank is set to raise rates. Three of nine policymakers already voted for a hike in July and September, and core and services inflation both beat forecasts. Markets price about a 95% chance of a rise to 4.00% on 5 November, which would be the first increase since August 2023.

gilts: G7 highest

Gilt yields are the highest in the G7. The 30-year yield passed 6% in early October for the first time since 1998, and the ten-year approached 5.5%. The move is largely global, driven by oil and US Treasuries, but higher borrowing costs feed directly into the debt interest bill.

headroom: thin

The Budget has little room. The OBR left £23.6bn of headroom in March; UBS estimates higher yields alone have since cost about £10bn. A credible, uneventful Budget is the best outcome for gilts; a loosening would be judged harshly.

2.0 Inflation

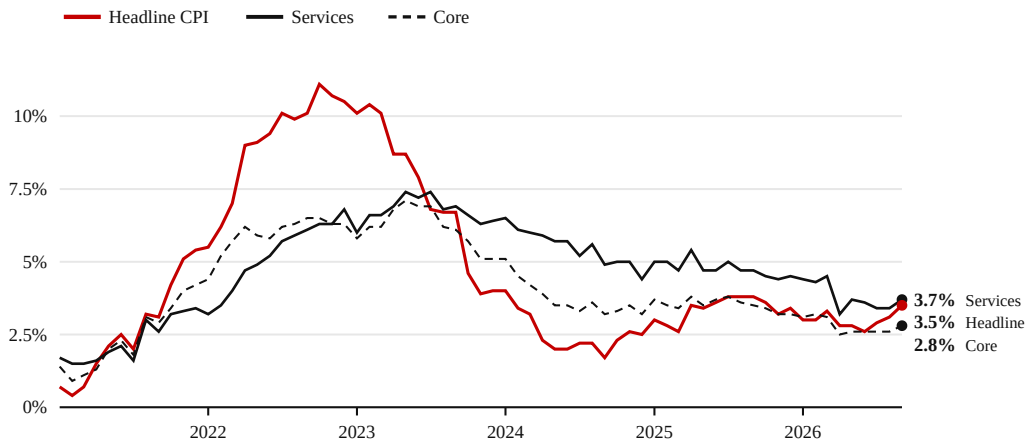
September CPI in detail

3 months of increases

Headline inflation has risen for three consecutive months, from 2.6% in June to 3.5% in September. Monthly prices rose 0.4%. Petrol averaged 169.5p a litre and diesel 192.5p, the highest since July 2022, and goods inflation jumped to 3.2% from 2.7%. The worry for the Bank is that core and services prices also accelerated: core rose to 2.8% and services to 3.7%, both above expectations, while factory-gate prices rose 4.6%, the most since April 2023.

goods 3.2%

Exhibit 1. UK consumer price inflation: headline, core and services (% year on year)



2022 peak 11.1%

turning up again

Source: Office for National Statistics (series D7G7, D7NN, DKO8), monthly to September 2026. The darker 2% gridline marks the target.

Exhibit B. Inflation compared, September 2026 (% year on year)

Economy	Headline	Core	Energy
United Kingdom (CPI)	3.5	2.8	fuels +29.8
United States (CPI)	3.7	2.6	+20.4
Euro area (HICP)	3.8	2.5	+18.9

Sources: ONS; US Bureau of Labor Statistics (14 October); Eurostat (16 October).

UK core highest

Unlike in 2022 and 2023, the United Kingdom is not the outlier on headline inflation: the energy shock has lifted prices everywhere, and headline rates in the United States and the euro area are slightly higher. The difference is in core inflation, which at 2.8% is above both, a sign of more persistent domestic price pressure.

UK not an outlier

3.0 Labour Market and Growth

Slack is building slowly

jobs: cooling

The labour market is cooling but not breaking. Unemployment was 4.7% in the three months to August, vacancies fell to 691,000 and payrolled employment is 66,000 lower than a year ago. Regular pay growth held at 3.7%, and was 3.0% in the private sector, the measure the Bank

watches most closely. Growth has held up better than expected: GDP rose 0.5% in the second quarter and 0.7% in the three months to August. This is not an economy that needs rate cuts, which is why an energy shock tilts the balance towards tightening.

4.0 The Bank of England

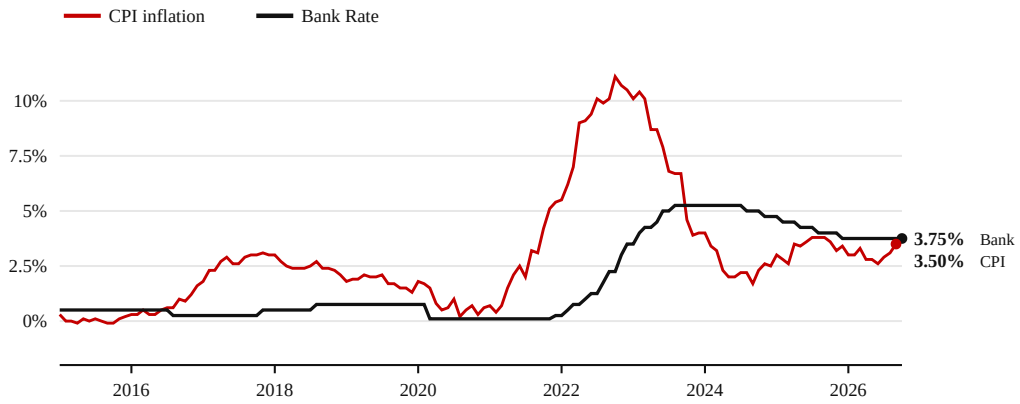
From cuts to a hike

Bank Rate has been 3.75% since December 2025, after 1.5 points of cuts from August 2024. This year the vote has swung from easing to tightening: in February four members voted for a cut, but Catherine Mann, Huw Pill and Megan Greene voted for a rise to 4% in July and again in September. Governor Andrew Bailey said in September that policy "may have to tighten" if the Middle East conflict persists, and Greene argued on 13 October that waiting for second-round effects would be too late.

3 votes for a hike

Exhibit 2. Bank Rate and CPI inflation (%)

real rate: ~+0.25%



Sources: Bank of England (IUDBEDR); ONS (D7G7), monthly to September and October 2026.

Exhibit C. Monetary Policy Committee votes in 2026

Meeting	Decision	Vote	Dissent
5 Feb	hold 3.75%	5-4	4 members (cut to 3.50%)
19 Mar	hold	9-0	none
30 Apr	hold	8-1	Pill (hike)
18 Jun	hold	7-2	Greene, Pill (hike)
30 Jul	hold	6-3	Greene, Mann, Pill (hike)
17 Sep	hold	6-3	Greene, Mann, Pill (hike)
5 Nov	**hike to 4.00% priced**		**~95% (OIS)**

drift to tightening

Sources: Bank of England minutes; Macquarie and LSEG via Reuters for market pricing.

QT: long end protected

The Bank has also changed its balance-sheet policy. In September it voted 9-0 to stop selling long-dated gilts until April while it consults on selling directly to the Debt Management Office, and to hold £120bn of the longest bonds permanently. That removes a source of supply at the long end, which Aberdeen described as gilt-positive.

5.0 Gilts

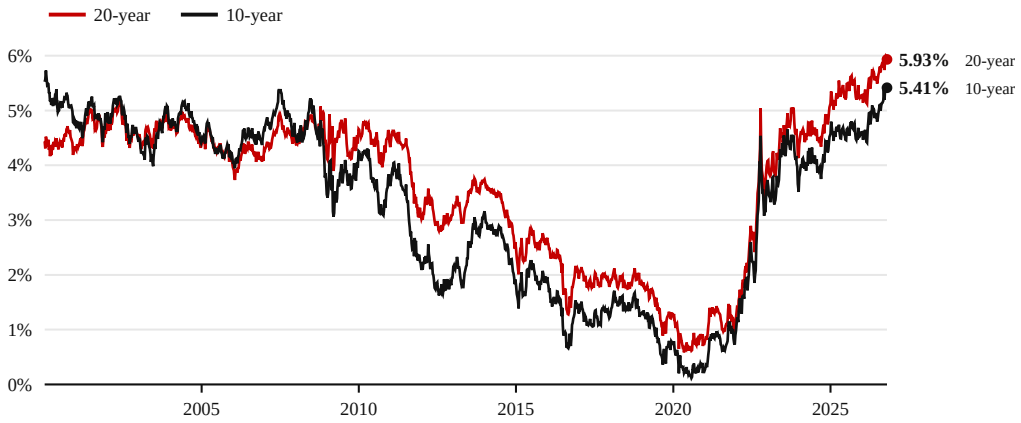
Yields at multi-decade highs

Long gilt yields reached their highest in almost three decades this month. On 7 October the 30-year yield touched 6.04% and the ten-year 5.48% in a global sell-off led by oil and US Treasuries. On the Bank of England's own curve, the 20-year zero-coupon yield peaked at 6.04% on 8 October, the highest since January 1998. The ten-year was about 5.40% on 21 October, above both US Treasuries (5.10%) and German Bunds (3.41%). UK borrowing costs are the highest in the G7.

30y >6%: first since 1998

G7 highest

Exhibit 3. Gilt yields, 10-year and 20-year, Bank of England zero-coupon curve (%)



back to late 1990s

2022: Truss episode

Source: Bank of England (IUDLNZC, IUDMNZC), daily sampled weekly, to 19 October 2026.

This is not a repeat of the September 2022 crisis, when the 30-year yield rose 1.5 points in four days and forced pension funds to sell. The current rise has been gradual and shared with other markets, and there are no reports of stress in liability-driven funds. But the level matters more than the speed: about a quarter of gilts are index-linked, so higher inflation raises the interest bill directly, and every new bond is issued at yields well above the average on existing debt.

not a Truss moment

6.0 Public Finances

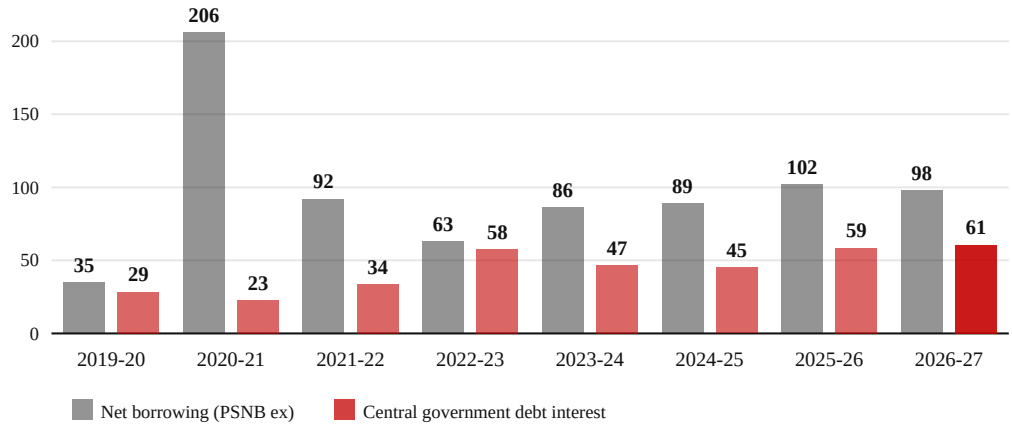
Borrowing and the interest bill

£6bn above OBR

Borrowing in the first half of the fiscal year was £97.8bn, £4.4bn less than a year earlier but £6.0bn above the OBR's March forecast. Receipts are rising faster than spending, 6.0% against 4.9%, yet interest is eating the improvement: central government debt interest reached £60.8bn in six months, on our calculations from ONS data the highest for the first half of any fiscal year since 1997, in cash terms. Of September's £10.9bn, £4.0bn reflected the inflation uplift on index-linked gilts.

Exhibit 4. Borrowing and debt interest, April to September of each fiscal year (£bn)

Covid: £206bn



interest > 60% of borrowing

Source: ONS (series J5II, NMFX), first six months of each fiscal year; Andra Markets calculations.

debt 94% of GDP

Net debt passed £3tn for the first time in September, at 94.0% of GDP, slightly lower as a share of output than a year ago because nominal GDP is growing quickly. That is the paradox of the moment: inflation flatters the debt ratio while raising the cost of servicing it. S&P has flagged 100% of GDP as a sensitivity for its AA rating.

7.0 The Budget

28 October

The Budget on 28 October will be the first for John Healey, appointed Chancellor when Andy Burnham became Prime Minister on 20 July. Markets have not forgotten Burnham's talk of fiscal "flexibility" on his first day, when the ten-year yield rose 8 basis points. The fiscal rules leave little room. UBS estimates that of the £23.6bn of headroom in March, higher yields have cost about £10bn and inflation £3bn, partly offset by stronger receipts; lower migration costs a further £4bn on IFS estimates cited by UBS, with £7bn of unfunded policy pressures.

Exhibit D. Erosion of fiscal headroom since March (£bn, estimates)

Item	Estimate	Source
Headroom, March 2026 forecast	23.6	OBR
Higher gilt yields	−10	UBS
Inflation effects (net of receipts)	−3	UBS
Lower net migration	−4	IFS, cited by UBS
Unfunded policy pressures	−7	UBS
Implied headroom before action	**~0**	**Andra Markets arithmetic**
Expected tax rises	5 to 6	ING

Sources: OBR (March 2026); UBS and ING via Investing.com and FXStreet. Estimates are not additive with certainty.

ING expects £5bn to £6bn of tax rises, for example on bank profits or on landlords' income, and sees the gross financing requirement approaching £325bn in 2027-28. Investors are divided. Fund managers including M&G and Ninety One have been buying gilts ahead of the Budget, and HSBC favours the long end; Franklin Templeton warns the government is "kicking the can down the road". Barclays' view sums up the consensus: a boring Budget is the best outcome.

8.0 Energy and Sterling

The external shock

The common thread is energy. Brent has risen about 79% this year to around $109, and the household energy price cap of £1,723 is expected to rise by 16% or more in January according to Cornwall Insight, which would push inflation above 4% early in 2027. Sterling has been stable, at $1.34 on 21 October, down about 0.5% this year, and the FTSE 100, heavy in energy and mining, is up about 8%. The currency is not signalling a loss of confidence, an important difference from 2022.

Exhibit 5. Brent crude oil ($ per barrel)



Source: Yahoo Finance (front-month futures), to 21 October 2026.

9.0 Scenarios and Calendar

What we are watching

judgemental

Exhibit E. Scenarios for the 10-year gilt to year-end

Scenario	Probability	10-year	Trigger
Credible Budget, one hike	45%	5.0% to 5.3%	tax rises; headroom rebuilt; oil stable
Sticky inflation, more hikes	35%	5.3% to 5.7%	energy cap rise; services inflation above 4%
Fiscal disappointment	20%	above 5.8%	loosening or optimistic assumptions in the Budget

Andra Markets scenarios; probabilities and ranges are judgemental.

Exhibit F. Calendar

Date	Event	Why it matters
27 Oct	£4.5bn 2032 gilt auction	demand before the Budget
28 Oct	Budget and OBR forecast	headroom, tax rises, issuance
5 Nov	BoE decision and Monetary Policy Report	first hike since 2023 priced
17 Nov	Labour market data	pay growth
~18 Nov	October CPI	energy pass-through
by 25 Nov	Ofgem cap for January	+16% forecast (Cornwall Insight)

Andra Markets selection; dates from HM Treasury, the Bank of England, ONS, DMO and Ofgem.

eight days that matter

verdict: an energy shock meets a thin budget. the bank will hike; gilts need a dull 28 october

Methodology and Source Notes

Method. This report uses official data from the Office for National Statistics (consumer prices, labour market, public sector finances) and the Bank of England (Bank Rate and zero-coupon gilt yields), market data from Yahoo Finance and press reporting for forecasts and views. Charts are drawn from the original series; benchmark gilt yields quoted in the text may differ slightly from the zero-coupon curve. Scenario probabilities are judgemental. Handwritten notes and highlights are informal commentary by the desk. This note is analysis, not investment advice.

Principal sources. ONS; Bank of England (minutes, Monetary Policy Summary, statistical database); OBR; HM Treasury; Debt Management Office; Ofgem; Cornwall Insight; US BLS; Eurostat; Fitch; S&P; UBS; ING; Reuters; Bloomberg; Investing.com; FXStreet; MoneyWeek; Yahoo Finance; Trading Economics.

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