

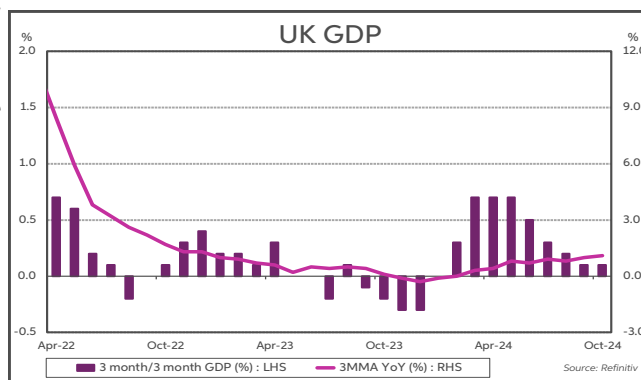
BoE leaves Bank rate unchanged as expected

The December meeting of the Bank of England's Monetary Policy Committee (MPC) saw the central bank leave the Bank rate at 4.75%. This follows 25bps cuts implemented at the August and November meetings, following its rate tightening cycle, which had been in place since the end of 2021.

Today's 'hold' on rates from the BoE was very much in line with expectations, given there was no guidance from the BoE in the lead up to today's meeting on the potential for a rate cut this month. Once again, there was a split within the BoE on their rates decision. The vote was 6:3 in favour of no change. For the majority, recent developments on inflation "added to the argument for a gradual approach to the withdrawal of policy restrictiveness". They noted that "CPI inflation, wage growth and some indicators of inflation expectations had risen, adding to the risk of inflation persistence".

For the three dissenters, they preferred a 25bps cut. Their view was that the Bank rate needed to be lowered to combat "sluggish demand and a weakening labour market", and that "given the evolving balance of risks, a less restrictive policy rate was warranted". The breakdown of the vote today may be significant for future meetings.

The meeting statement noted that "most indicators of UK near-term activity have declined" since its last meeting in November, and the labour market was now "in balance". In terms of its growth outlook, the BoE had revised down its near term growth expectation in November. It forecasted GDP growth of 1% for this year, down from 1.25% in its previous forecast in August. Meanwhile, for 2025, it revised up its GDP projection to 1.5% from 1%, some of this reflecting the positive impact of higher Government spending in the Budget. However, in today's statement the BoE noted that growth out-turns have been weaker than that forecast.

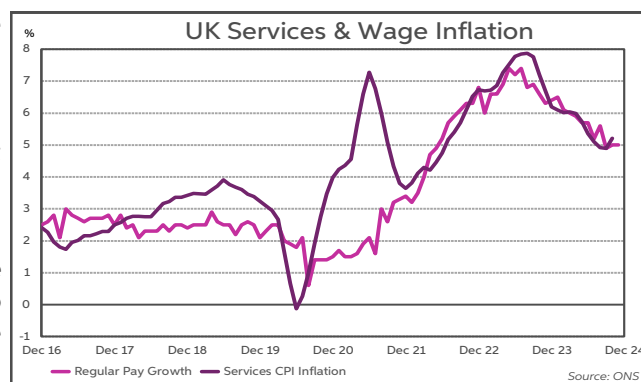


On the inflation front, the November projections already look a little benign. They showed that the BoE expected the CPI rate will end this year at 2.4%, which represents a downward revision to its August MPR forecast for 2.7%. Further out, it expects that inflation will rise to 2.7% by the end of 2025, higher than its August forecast at 2.2%. The end-2026 forecast was also revised higher to 2.2% from 1.6%. However, today's statement stated that inflation has been "slightly higher than previous expectations".

With no rate change from the BoE today, the focus was on what guidance, if any, would be forthcoming for Bank rate over the coming months. The meeting minutes highlight the split on the MPC between those still concerned about inflationary pressures, and those placing more store in a softer labour market. The minutes also highlight concerns around the impact of policy changes by President Trump on external trade. Indeed, the expansion of the 'doves' camp to three members from the single dissenter at the last 'hold' meeting in September, suggests the BoE may move faster than current market pricing suggests in 2025.

Futures contracts were slightly softer in the aftermath of the statement. Current pricing is for just over 50bps of cuts in 2025, with a first rate cut now nearly fully priced in for the March meeting. This likely reflects the growth concerns apparent in the statement and the vote split on the MPC. 50bps of rate cuts next year would see Bank rate end 2025 at 4.25%, which is still a restrictive policy rate.

Given the BoE's next meeting in February corresponds with the publication of their updated macro forecasts, it is reasonable to anticipate this as the first "live meeting" in 2025, but a cut here would depend on further progress in disinflation, which has slowed somewhat recently. We expect Bank rate to be cut more quickly than the current market pricing given GDP growth remains relatively weak at present.



UK economy performs well but momentum is slipping

The UK economy has performed better than anticipated this year, amid stronger than expected growth in H1, with GDP rising by 0.7% in Q1 and by 0.5% in Q2. The underlying data show that consumer spending, government expenditure and fixed investment all performed well in the opening half of the year, while net trade was a significant drag on growth.

However, the UK economy appears to have lost some momentum in Q3. Growth slowed sharply, with GDP rising by a meagre 0.1% in the quarter. It

should be noted though, that all the major components of GDP made a positive contribution to growth, including net trade, but this was offset by a substantial change in inventories and acquisitions less disposable assets. The underlying breakdown for Q3 indicates, consumption (+0.3 percentage points), government spending (+0.1 p.p.), fixed investment (+0.2 p.p.) and net trade (+0.4 p.p.) boosted growth by a cumulative 1.0 p.p., while the aforementioned move in inventories knocked 0.9 p.p. from the total.

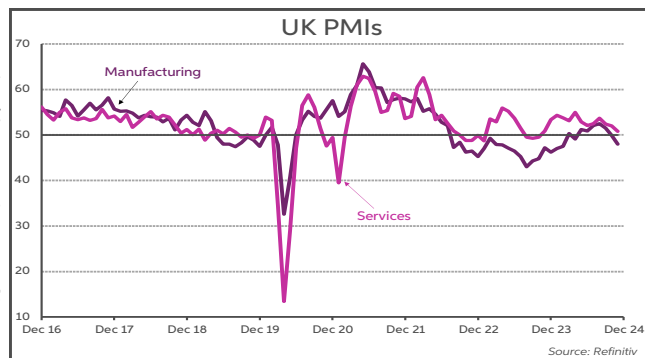
Worryingly though, the available hard data for Q4 suggest the economy has lost further steam. The monthly reading of GDP contracted by 0.1% in October for a second consecutive month. Meanwhile, industrial production remains volatile and continues to struggle, falling by 0.6% in October leaving it down by 0.7% in year-on-year terms. Retail sales also declined sharply in October, by 0.7% in the month, albeit, they were 2.4% higher on an annual basis owing to base effects and sharp rises earlier in the year.

Likewise, survey data indicate the economy slowed somewhat in the final quarter of the year. The manufacturing PMI has printed in contraction territory throughout Q4, averaging just 48.4 compared to 52.0 in Q3. The services PMI also remained in expansion mood but averaged 51.4 in Q4, down from 52.9 in Q3, consistent with a slower pace of growth. However, consumer confidence dropped sharply, to -20.0 in September from -13 in August. Elsewhere, consumer confidence deteriorated at the start of Q4, falling to -21.0 in October, its lowest level since March, before rebounding slightly to -18.0 and -17.0 in November and December, respectively.

In terms of the labour market, despite clear signs of softening in the first five months of the year, conditions appear to have tightened slightly once again. The unemployment rate increased steadily from 3.8% in December to 4.4% in April and May, before declining again to 4.1% in August. However, it rose to 4.3% in September and stayed at that level in October also. At the same time, average earnings growth has cooled, but it remains elevated at +5.2% y/y in the three months to October. However, other measures of wage inflation continue to point to lower and more stable earnings growth. The BoE Agent's Summary Survey for Q4 noted that pay settlements are likely to average 3-4% in 2025, down from 5.5% this year.

On the inflation front, there have been signs of stickiness in the recent data. Headline CPI fell to a low of 1.7% in September, but it has since risen to 2.3% in October and to 2.6% in November. Core-CPI has increased in the past two months to 3.5% in November, having printed at 3.2% at the end of Q3. A key reason for this is the fact that services inflation remains very high, at 5.0% in November and it is still a key area of concern for the BoE.

Overall, the UK economy has beat expectations this year as inflation has eased, paving the way for real income growth. The BoE's decision to cut rates by 50bps this year have also provided a supportive backdrop. If inflation continues to fall, there should be scope for the BoE to lower rates further in 2025. Increased government spending and investment, as announced in the Autumn Budget, could boost also GDP in the near-term. However, the most recent data suggest growth has slowed and price pressures remain high, and the outlook for UK growth remains subdued. Thus, the BoE will have to proceed cautiously when setting monetary policy in 2025. The IMF is forecasting that UK GDP will rise by 1.1% this year, and by 1.5% in 2025.



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