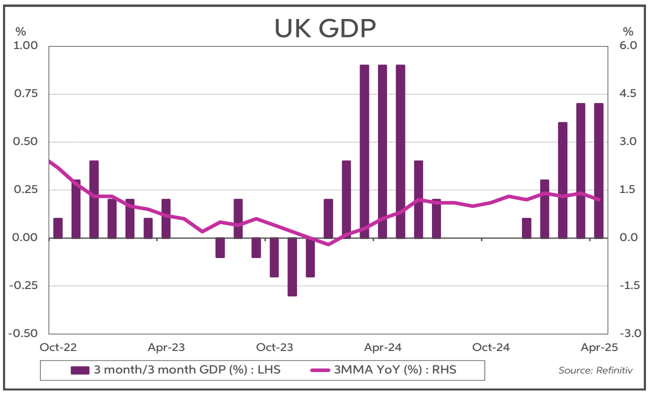
BoE Watch

AIB Treasury Economic Research Unit

19th June 2025

BoE on hold, but has dovish bias on rates outlook

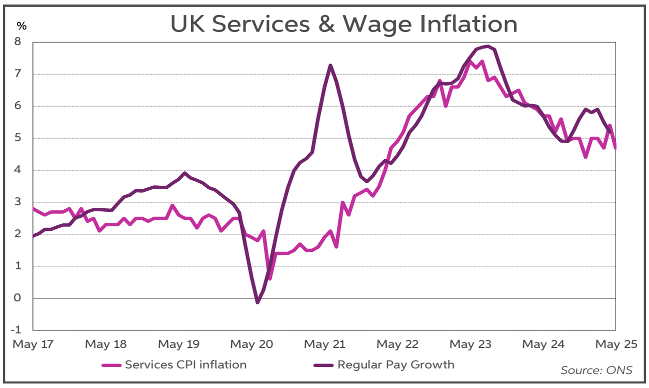
The June meeting of the Bank of England's Monetary Policy Committee (MPC) saw the central bank leave the Bank rate unchanged at 4.25%. This followed a 25bps reduction in May. Today's decision for unaltered rates was very much in line with market expectations. So far in its current easing cycle, which began in August last year, the BoE has cut by a total of 100bps.



Once again, there was no unanimity within the MPC on its policy decision. The voting breakdown showed a 6:3 split, with the minority in favour of a 25bps rate cut. For these three, they noted that the "cumulative evidence from a range of labour market data pointed to a material further loosening in labour market conditions" thereby justifying a further reduction in rates. However, for the majority, their view was that while the disinflationary trend has continued "there was not a strong case for a further easing of monetary policy at this meeting". They preferred to see further progress on this disinflationary process before contemplating another rate cut.

The meeting statement and minutes continued to acknowledged the high degree of unpredictability in relation to the economic outlook. The central bank commented that "global uncertainty remains elevated". Their assessment of the UK economy's recent performance was that underlying growth "appears to have remained weak" and the labour market "has continued to loosen".

The most recent detailed update from the BoE on its view of the UK economic outlook was contained in its quarterly Monetary Policy Report (MPR), which was published at its last meeting in May. In terms of its growth expectations, the May MPR forecasts showed only minimal changes compared to their February edition. There was a modest upward revision to its 2025 GDP growth forecast to 1.0% (from 0.75%). Meanwhile, for 2026, it marginally downgraded its GDP projection to 1.25% (from 1.50%). Further out, it maintained its projection for GDP growth to average 1.5% in 2027.



Meanwhile, in terms of its outlook for inflation, its forecasts saw relatively minor revisions (compared to the February MPR). The central bank remains confident that the recent uptick in price pressures will be temporary and in today's minutes it stated that it expects inflation to "broadly remain at current rates throughout the remainder of this year before falling back towards target next year". The May MPR forecasts show that it is projecting inflation to be at 3.25% by the end of this year. The end-26 and end-27 forecasts were for inflation rates of 2.25% and 1.75%, respectively.

As regards the outlook for UK official rates, today's minutes from the BoE, including its characterisation of the economy/labour market and voting breakdown, were somewhat more dovish in tone. The BoE continued to emphasis a "gradual and careful approach to any further rate cuts". It remained of the view that its current interest rate setting was "restrictive" in order "to continue to squeeze out persistent inflationary pressures". Further progress in this regard would likely see more MPC members join their three colleagues in favouring a rate cut and becoming the majority within the BoE over the coming months.

In terms of market expectations, UK futures contracts are not fully pricing-in another 25bps rate cut until September. **However, given that its next meeting on August 7th will include its updated MPR, it would not be a surprise to see the BoE cut rates then.** In this context, it is interesting to note that during its current easing cycle, each of the four 25bps rate cuts have coincided with is MPR publication meetings (Aug'24, Nov'24, Feb'25, May'25). Meanwhile, BoE Governor Bailey stated today in a video clip that he "expects that the path of interest rates will continue to be gradually downwards". **Our opinion since the start of the year has been for Bank Rate to reach 3.75% by end 2025.** We see no reason to change that view following today's update from the BoE.

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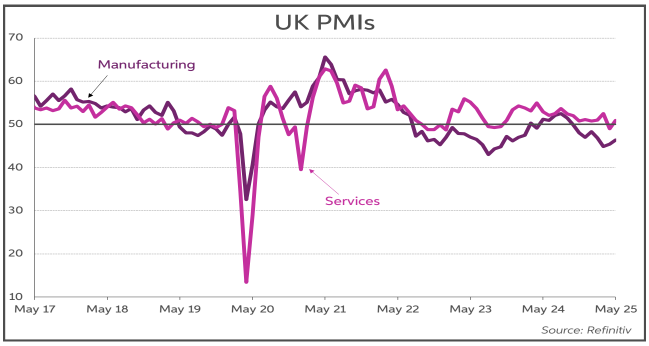
UK growth expected to accelerate 2025

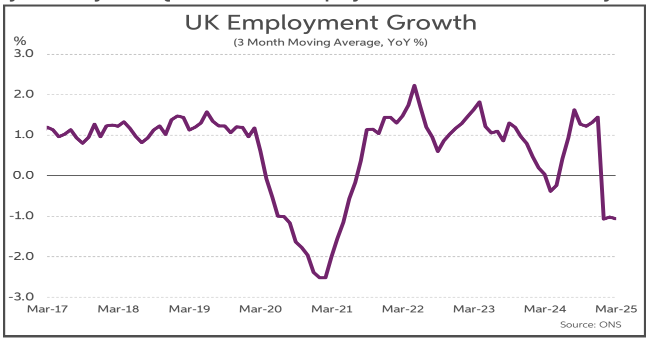
The UK economy performed better than anticipated in 2024, despite growth slowing in H2, with GDP expanding by 0.9% overall last year. Encouragingly, growth accelerated in the first quarter of 2025, with GDP rising by 0.7%**.** Personal consumption rose by 0.2% in the quarter, contributing 0.1 percentage points (p.p.) to growth. Meantime, fixed investment jumped by 2.9% adding 0.5 p.p to GDP. A sharper increase in exports (+3.5%) compared to imports (+2.1%) meant that net trade boosted output by 0.4 p.p.. However, this was offset by changes in inventories and acquisitions less disposable assets, and a slight contraction in government expenditure, which clipped 0.2 p.p. and 0.1 p.p. from the total.



Meanwhile, the limited hard data available for Q2 have been somewhat mixed at the start of the quarter. GDP contracted by 0.3% in April, the fastest pace of monthly contraction since October 2023. At the same time, industrial production fell by 0.6% at the start of Q2, on the back of a 0.7% decrease in March. In contrast though, retail sales have trended higher so far this year, rising by 2.2% cumulatively in Q1, and maintaining strong momentum in April, jumping by 1.2% in the month.

However, survey data remain soft, and continue to indicate that activity levels have declined and sentiment has deteriorated. The manufacturing PMI has edged slightly higher in April and May, but it remains firmly in contraction territory at 46.4 in May. The services PMI fell to 49.0 in April, consistent with a first fall in activity levels in the sector since October 2023, before rebounding to 50.9 in May. Elsewhere, consumer confidence has trended downwards in the first five months of 2025. This culminated with the index falling to –23.0 in April, its lowest reading since November 2023, before recovering to –20.0 in May.

In terms of the labour market, conditions appear to have softened in recent months. However the data remain volatile and are judged to be somewhat less reliable currently owing to low survey response rates. Nevertheless, the unemployment rate increased steadily to 4.6% in April, from 4.5% in March and 4.4% in each of the four months prior. The May reading was the highest level since July 2021. Worryingly, payrolls have contracted in each of the seven months to May, and at an ever increasing rate throughout 2025. Against this backdrop, wage inflation has cooled recently, albeit it remains elevated. Average earnings growth fell to +5.2% y/y in the three months to April, its slowest rate since last September. Other measures of wage inflation point to lower earnings growth. The BoE Agent's Summary Survey for Q1 noted that pay settlements are likely to average 3.5-4% in 2025.



Similarly, the inflation data have been somewhat volatile in recent months. Overall, inflation rose throughout the winter before declining in Q1. However, both headline and core inflation jumped markedly higher in April, owing to a number of one-off factors, but inched marginally lower in May. It means that the headline and core rates are elevated at 3.4% and 3.5%, respectively at the midpoint of Q2. Looking ahead, the BoE still expects inflation to fall back to the 2% target in the medium-term. Its latest forecasts from May are for the headline rate to decline to 3.25% by year end and to 2.25% by the end of 2026.

In summary, the UK economy's performance has been chequered so far in 2025. Measures of output improved in Q1, but recent data suggest activity levels have dropped and sentiment has deteriorated. At the same time, inflation and labour market data have moved in the wrong direction. However, the UK economic outlook is not all doom-and-gloom. If inflation eases further there should be scope for the BoE to lower rates again this year, providing support to the economy. Increased government spending and investment could also boost GDP in the near-term. The UK has also been quick to agree a new trade deal with the US, although uncertainty around US trade policy, and potential spillovers from slower global growth still cloud the outlook. Against this backdrop, the OECD sees UK GDP rising by 1.3% in 2025, and by 1.0% in 2026.

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