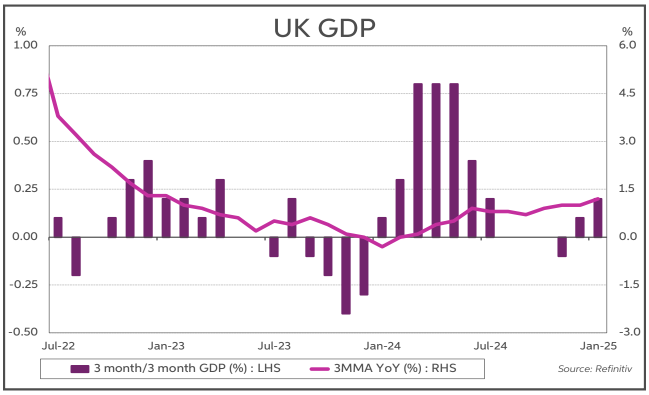
BoE Watch

AIB Treasury Economic Research Unit

20th March 2025

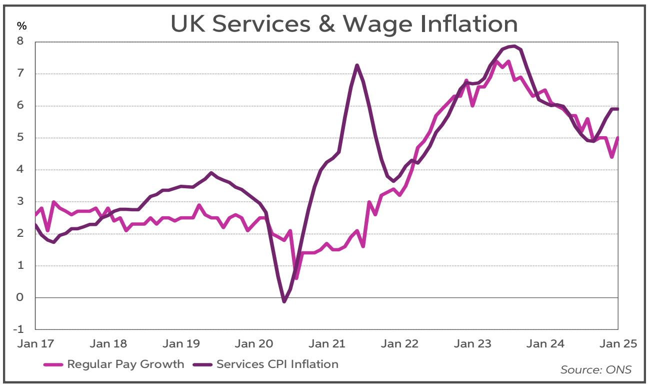
BoE leaves policy unchanged, keeping its options open

The March policy setting meeting of the Bank of England's Monetary Policy Committee (MPC) saw the central bank leave the Bank rate unchanged at 4.50%. Today's decision was very much in-line with market expectations. The most recent policy change came at the previous meeting in February, when the MPC cut official rates by 25bps. So far, in its current easing cycle, which began in August last year, the BoE has cut by a total of 75bps. **Once again, there was no unanimity within the MPC on its policy decision today.** The voting breakdown showed an 8:1 split, which was more hawkish than consensus forecasts for a 7:2 vote. Eight MPC members voted in favour of keeping rates on hold. Meanwhile, the one dissenter (Dhingra) was in favour of a 25bps rate cut.



Today's meeting statement noted that "global trade policy uncertainty had intensified". It also stated that "business survey indicators generally continue to suggest weakness in growth and particularly in employment intentions". **The most recent detailed update from the BoE on its assessment of the UK economic outlook was outlined in it quarterly Monetary Policy Report (MPR) which was released at the February MPC meeting.** In terms of its growth outlook, the updated forecasts show that the BoE is more pessimistic on the UK economy's near term growth prospects compared to its previous forecasting round in November. It revised down its 2025 GDP forecasts on the back of growth in 2024 being weaker than anticipated, and to take into account the declines in business and consumer confidence indicators during the first quarter of this year. The BoE is now forecasting GDP growth of just 0.75% for this year, down from its previous (Nov'24) forecast for 1.5%. Meanwhile, for 2026, it marginally upgraded its GDP projection to 1.50% from 1.25%. Further out, it also revised slightly higher its growth outlook for 2027, with GDP growth of 1.5% (from 1.25%) now being pencilled in.

On the inflation front, the February edition of the MPR incorporated the BoE's expectation that inflation will rise "quite sharply" over the coming months to 3.7% due to "global energy costs and regulated prices". However, the central bank is reasonably confident that this pick-up in inflation will "be temporary" and "will not lead to additional second round effects on underlying domestic inflationary pressures" and remains of the view that it will return to "around the 2% target" over the medium term. It now expects inflation to be at 3.5% by the end of this year (was 2.75%). The end-26 and end-27 forecasts were revised up modestly to 2.5% (from 2.25%) and 2% (from 1.75%), respectively.



In terms of policy guidance, the BoE retains a bias to ease policy further. However, the extent of further rate cuts remains unclear. The Bank emphasised once again today that a gradual and careful approach to the further withdrawal of monetary policy restraint is "appropriate". Increased uncertainty in relation to trade adds an additional complicating factor to the central bank's policy deliberations. However, the MPC is confident that the disinflationary process will resume, and therefore, it has flexibility and can await for further data before deciding when it needs to cut rates again.

Futures contracts indicate that the market seems to share the BoE's view for a gradual pace of rate cuts over the remainder of its current easing cycle. The next 25bps rate cut is not fully priced in until the June 18th MPC meeting. Subsequent to this, the market is anticipating just one more 25bps cut by end year. This would see the Bank rate at 4.00% heading into 2026. Our view for some time is that the market has been underestimating the extent of rate cuts from the BoE over the course of this year given the subdued growth outlook and easing in underlying inflationary pressures. A Bank rate of 3.75% by year end is consistent with both the macro backdrop and the BoE's preference for a "gradual" and "careful" approach to rate cuts. The BoE's next MPC meeting is scheduled for May 8th. This meeting also includes the publication of its next set of macro forecasts. These forecasts, as well as the accompanying press conference will provide Governor Bailey and the broader MPC with an opportunity to provide more explicit communication on the potential timing of the next rate cut from the BoE.

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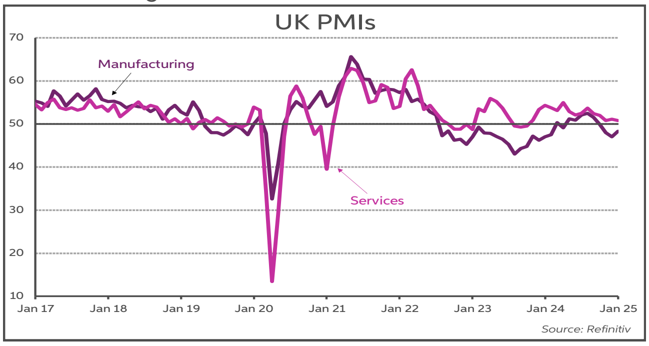
UK growth has slowed and price pressures remain high

The UK economy performed better than anticipated in 2024, particularly in the first half of the year. GDP rose by 0.9% in Q1 and by 0.5% in Q2, with consumer spending, government expenditure and fixed investment all performing well during this period. However, GDP stagnated in Q3, albeit this was largely attributable to a substantial change in inventories and acquisitions less disposable assets, before rising by a meagre 0.1% in Q4. Overall then, the UK economy expanded by 0.9% in 2024, but growth lost considerable momentum in the second half of the year.

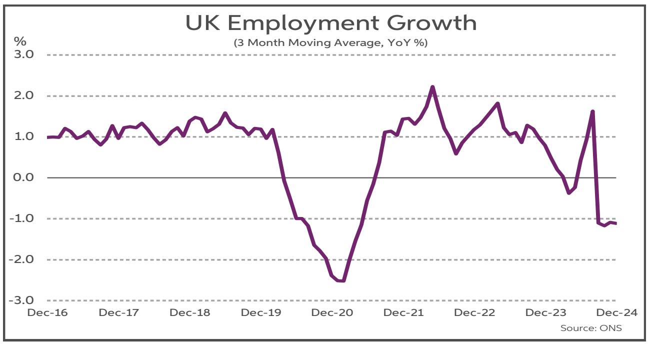


Worryingly though, the limited available hard data for January have been weak. The monthly reading of GDP for January shows the economy contracted by 0.1% in the month. Elsewhere, industrial production fell by 0.9% in January, meaning output was 1.5% lower in year-on-year terms. The one bright spark so far has been retail sales, which unexpectedly jumped by 1.7% in January. However, the increase was driven by a sharp rebound in food store sales following four months of contraction, and a rise in online sales. The five other main sub-categories all fell at the start of the year.

Likewise, survey data indicate the economy may have slowed somewhat in the opening months of the year. The manufacturing PMI remained firmly in contraction territory in January and February, having moved below the key 50 mark at the start of Q4. The February reading of 46.9, was the lowest reading since December 2023. The services PMI has remained in expansion mode, but it fell to 50.8 in January, matching its low from November, which was the weakest reading since October 2023. It inched slightly higher to 51.0 in February, but overall, the data are consistent with a slower pace of growth in the sector at the start of 2025. At the same time, consumer confidence plunged to –22.0 in January, before recovering slightly to –20.0 in February.

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 from a low of 4.1% in August to 4.4% in November, and has stayed at that level throughout the winter. Regarding wage inflation, average earnings growth had cooled throughout the first three quarters of 2024, falling to a low of +3.9% y/y in the three months to August. More recently though, it has re-accelerated sharply, climbing to +5.8% y/y in January. 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 3.5-4% in 2025.

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 rose throughout the winter and stood at 3.0% in January. Meanwhile, core-CPI jumped to 3.7% in January, its highest level since April. This was largely owing to a rebound in services inflation (a key area of concern for the BoE), to 5.0% in January, from 4.4% in December. Looking ahead, the BoE expects headline inflation to rise to 3.75% in Q3, before falling slowly back towards the 2% target in 2026 and 2027.



Overall, the UK economy beat expectations in 2024 with good growth recorded in H1. At the same time, inflation fell, averaging just 2.5% last year, compared to 7.4% in 2023, paving the way for a return to real income growth and allowing the BoE to cut rates by 75bps in recent months. If inflation eases further there should be scope for the BoE to lower rates this year, providing additional support to the economy. Increased government spending and investment, could also boost GDP in the near-term. However, the most recent data suggest growth has slowed and price pressures remain high. Thus, the BoE will have to proceed cautiously when setting monetary policy this year. At the same time, the outlook has become less clear, owing to uncertainty around US trade policy, and the potential for spillovers from a trade war to slower global growth. Against this backdrop, the OECD is forecasting that UK GDP will rise by 1.4% in 2025, and by 1.2% next year.

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