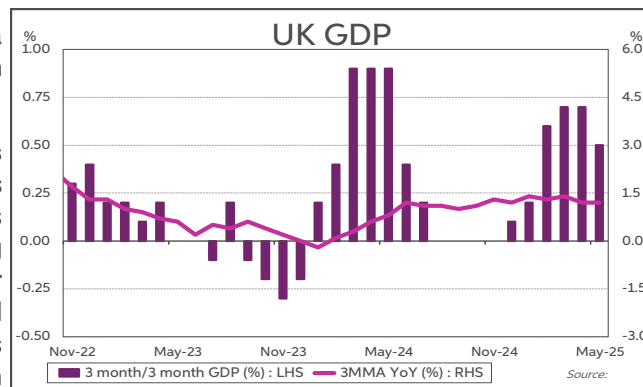


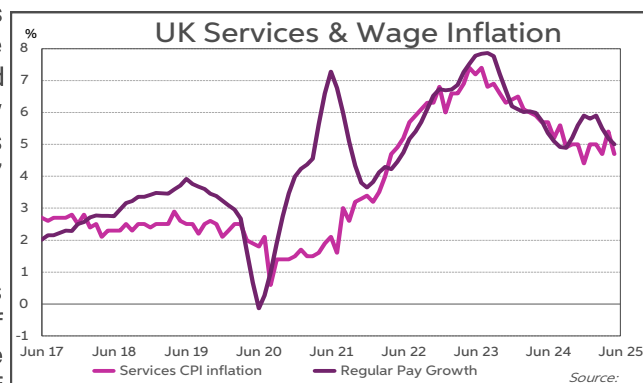
BoE cuts as expected, but slightly less dovish tone to guidance

The Bank of England's Monetary Policy Committee (MPC) meeting for August saw the central bank cut the Bank Rate by 25bps to 4.00%. This represented the third 25bps rate reduction from the BoE this year, having previously cut in February and May. It also maintained its practice of easing policy at meetings that coincide with the publication of its Monetary Policy Report (MPR). So far in its current easing cycle, which began in August last year, the BoE has cut by a total of 125bps. Today's decision was very much in line with market expectations.

Once again, there was no unanimity within the MPC on its policy decision. The voting breakdown showed five members in favour of cutting rates. Four of these five voted for a 25bps reduction. They had seen "sufficient progress in underlying disinflation" to warrant a rate cut. The other dovish voter (Taylor) was initially in favour of a 50bps rate reduction (voted in favour of 25bps in the second round of voting). His assessment of downside risks including in relation to inflation falling below forecast and an "increased risk of recession" justified a less restrictive policy setting (i.e. 50bps cut). Meanwhile, four members preferred to keep rates unchanged on their view that the "disinflationary process had slowed".



Today also saw the release of the BoE's detailed assessment of the UK economic outlook, with the publication of its quarterly Monetary Policy Report (MPR) for August. In terms of its growth outlook, the August MPR forecasts showed only minimal changes compared to their May version. There was a modest upward revision to its 2025 GDP growth forecast to 1.25% (from 1.00%). Meanwhile, for 2026, its GDP projection was unaltered at 1.25%. Further out, it also maintained its projection for GDP growth to average 1.5% in 2027. On the inflation front, its forecasts saw some upward revisions compared to the May MPR. This was in part due to the central bank factoring in "supply issues in certain foods and changes in administered prices". It is important to note too that the MPC now judges that the "upside risks around medium term inflationary pressures had moved slightly higher since May". The updated forecasts show that the BoE is now projecting inflation to be at 3.75% (was 3.25%) by the end of this year. The end-26 and end-27 inflation forecasts were also raised to 2.50% (from 2.00%) and 2.0% (was 1.75%), respectively.

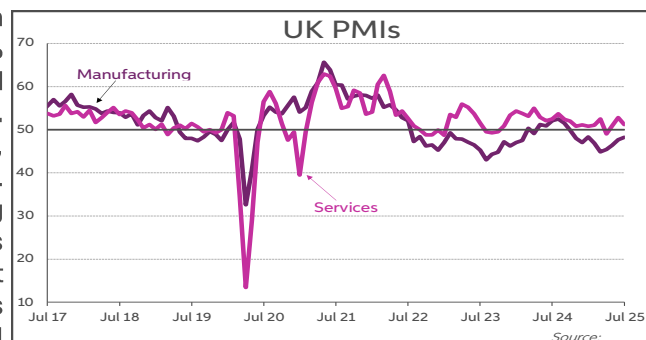


In terms of forward guidance, the BoE continued to emphasise a "gradual and careful approach" to any further easing of interest rates. However, there was a less dovish slant to the text. The minutes stated that the "timing and pace" of additional rate cuts would "depend on the extent to which underlying disinflationary pressures would continue to ease". The MPC also removed its reference to "policy being kept restrictive for sufficiently long" to instead noting that "restrictiveness of monetary policy had fallen as Bank Rate reduced". These changes imply that the MPC may be more cautious on the extent of further rate cuts. Governor's Baileys remarks during the press conference did not provide much additional insight on what was already outlined in the minutes.

In terms of market expectations, there was a modest firming of around 5bps in pricing in the immediate aftermath of today's BoE meeting. This suggests the tone of the meeting outputs (minutes/press conference/macro forecasts/voting breakdown) were marginally less dovish than the market had been anticipating. There were a number of examples of this: (1) the upward revisions to its inflation forecasts, (2) assessment that upside risks to price pressures had risen, (3) the 5:4 split in favour of a rate cut was much closer than the consensus expectation of a 7:2 result and (4) changes to its forward guidance. UK futures contracts are now not fully pricing-in another 25bps rate cut until February next year. Prior to the meeting, the market was anticipating another rate cut before the end of this year. Our assessment since the start of the year has been for the Bank Rate to reach 3.75% by end 2025 and we remain satisfied with this outlook given the weak growth trajectory for the UK economy.

UK economy slows after strong start to 2025

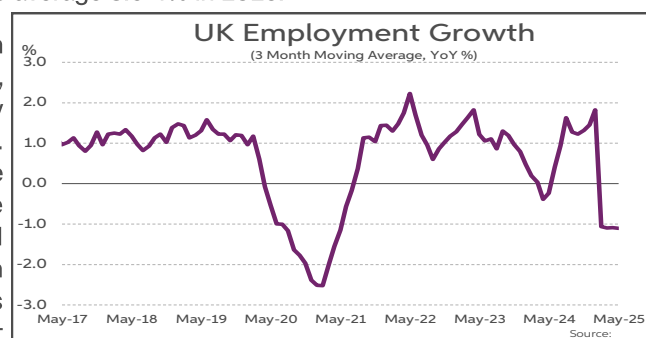
The UK economy performed better than anticipated in 2024, with GDP expanding by 0.9% overall last year. Encouragingly, growth accelerated in the first quarter of 2025, with GDP rising by 0.7%. Personal consumption rose by 0.2% in the quarter, contributing 0.1 percentage points (p.p.) to growth. Meantime, 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.



However, the available hard data for Q2 indicate that the economy may have lost some momentum. GDP contracted by 0.3% in April, the fastest pace of monthly decline since October 2023. Furthermore, it fell again by 0.1% m/m in May. Meantime, industrial production has been very weak, contracting for three straight months, including by -0.7% in April and by -0.9% in May. Elsewhere, retail sales have been quite volatile. They jumped by 1.3% in April, before plunging 2.8% in May. They staged a modest rebound in June, rising by 0.9%. A poor seasonal adjustment over the easter-period and some good weather throughout June may have exacerbated the volatility in the data. Overall, though, retail sales have risen by an average of 0.2% m/m in H1, and they were 1.7% higher in year-on-year terms at the end of June. **Survey data also suggest that economy slowed in Q2.** The manufacturing PMI remained firmly in contraction mode, and averaged just 46.5 in the quarter, down from 46.7 in Q1. Similarly, the services PMI was lower in Q2, averaging 50.9, compared to 51.4 in the opening three months of the year. Meanwhile, having dropped precipitously to -23.0 in April, consumer confidence trended slightly higher in May and June. However, it edged marginally lower in July. At the same time, the manufacturing and services PMI were little changed at the start of Q3.

In terms of the labour market, conditions have softened recently. However, the data remains plagued by low survey response rates, which means caution is needed when trying to interpret them. The unemployment rate increased steadily, reaching 4.7% in May, compared to 4.4% at the start of the year. The May reading was the highest level since June 2021. Worryingly, payrolls have contracted in nine of the past eleven months to June, and at an accelerating rate throughout 2025. Against this backdrop, wage inflation has cooled, albeit it remains elevated. Average earnings growth fell to +5.0% y/y in the three months to May, its slowest rate since last September. Other measures of wage inflation point to lower earnings growth. The BoE Agent's Summary Survey for Q2 noted that pay settlements are likely to average 3.5-4% in 2025.

Inflation has moved in the wrong direction in recent months. Having declined throughout Q1, both headline and core inflation jumped markedly higher in April, owing to a number of one-off factors. They inched marginally lower in May, before unexpectedly rising in June, meaning that the headline and core rates were elevated at 3.6% and 3.7% at the end of Q2. The BoE still expects inflation to fall back to its 2% target in the medium-term. Its latest forecasts are for the headline rate to be at 3.75% by year end and to decline to 2.5% by the end of 2026, before slowing to 2.0% by end-2027



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, there are some potential tailwinds for the UK economic outlook. If inflation eases once more, there should be scope for additional BoE rate cuts, providing support to the economy. Increased government spending and investment could also boost GDP in the near-term. The UK was also quick to agree a new trade deal with the US, and less uncertainty in this regard is a positive for UK exporters. The IMF sees UK GDP rising by 1.2% in 2025, and by 1.4% in 2026.

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