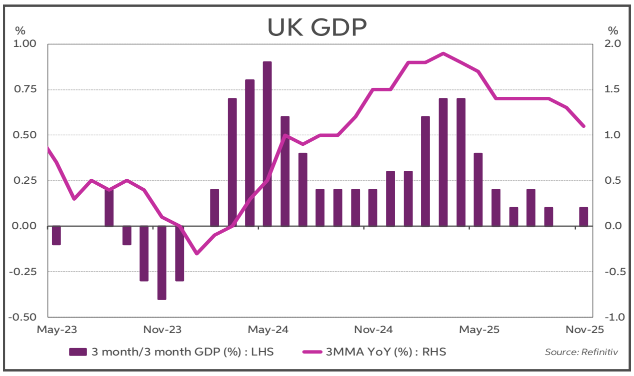
BoE Watch

AIB Treasury Economic Research Unit

5th February 2026

BoE holds at 3.75%, but another rate cut likely sooner rather than later

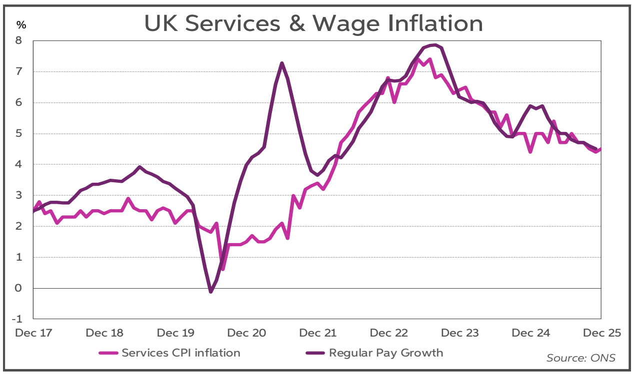


The first policy setting meeting of the year of the Bank of England's Monetary Policy Committee (MPC), saw the central bank leave the Bank Rate unchanged today, at 3.75%. This outcome was very much in line with market expectations. The most recent rate cut from the BoE occurred at its previous meeting in December, when it lowered the Bank Rate by 25bps. This represented the fourth 25bps rate cut from the BoE last year. So far in its current easing cycle, which began in August 2024, the BoE has lowered rates by 150bps in total.

Once again, there was no unanimity within the MPC on its policy announcement. The decision to leave rates on hold this month was a close call, with a 5:4 split in favour of no change. Even within the majority of five, there were differing views. For three of these five (Greene, Lombardelli and Pill) they were of the view that a "more prolonged period" of restrictive policy was "likely" to be required to "mitigate the remaining risks" that inflation could "settle above target". For the other two members (Bailey and Mann) within this group of five, they had "greater confidence" that the inflation target would be achieved but judged that there was not yet enough evidence "to warrant" an immediate rate cut. **Meanwhile, four members** (Breeden, Dhingra, Ramsden and Taylor) were of the view that inflation risks had "receded materially". They also placed a "greater weight to the risks to inflation from weaker demand" and **judged that policy was "still too restrictive" and therefore deemed that another immediate rate cut was warranted.**

Today also saw the publication of the BoE's detailed examination of the UK economic outlook, with the release of its quarterly Monetary Policy Report (MPR) for February. In terms of its growth outlook, the central bank revised lower its near term GDP projections. It is now forecasting GDP to rise by 0.9% this year (was 1.2%) and by 1.5% in 2027 (was 1.6%). For 2028, it is pencilling in GDP growth of 1.9% (was 1.8%). On the inflation front, the BoE anticipates it will return to "around" its 2% target during the second quarter of this year and "remain close to that level over the forecast period", between 2026-2028.

Assessing the text of the meeting statement, the minutes (including the voting split) and Governor Bailey's remarks during the press conference, another rate cut from the BoE is now more likely sooner rather than later. The meeting statement showed that the BoE retains an easing bias, explicitly stating that a further rate cut "is likely". As discussed above, the minutes showed that there are already four members voting for it, so it only takes one more vote to shift the balance in favour of a cut. In this context, for two of the five voting today for no change, the minutes indicated that they needed to see further indications that inflation was on target, to be willing to vote for a cut. In the press conference, Governor Bailey emphasised that he "needed some more evidence" to support a rate cut. Interestingly, he didn't specifically state that by the time of the next meeting on 19th of March, that he would have sufficient evidence in this regard.



Futures contracts have softened in the aftermath of today's BoE meeting. The market is now attaching around a 90% probability to a 25bps rate cut in April. Prior to today, futures contracts were not fully pricing in another rate cut until June at the earliest. Overall, the market is anticipating rates falling to 3.25% during the second half of this year.

In conclusion, today's various communications from the BoE in relation to the outlook/guidance for UK interest rates had a more dovish slant compared to December. A rate cut at the 30th of April MPC meeting seems a reasonable expectation, given that Governor Bailey did not specifically call out the next meeting in March. The MPC will also have its next set of macro forecasts to inform its policy decision in April. Governor Bailey commented today in response to a question on market expectations/pricing that there is a "reasonable market curve at the moment". **This suggest that the Bank rate levelling off at 3.25% over the course of this year seems a plausible scenario.**

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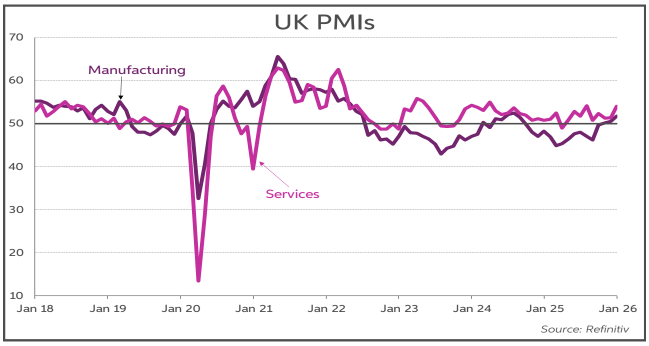
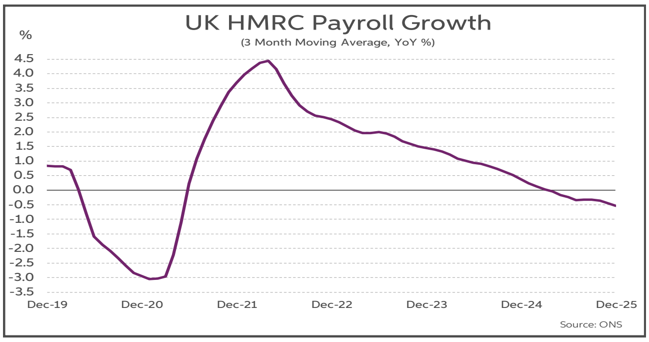
UK economy to remain on a modest growth path

Following a solid start to the year, UK GDP growth slowed markedly in Q3 2025, to just 0.1% q/q. The underlying breakdown for Q3 though, shows that the slowdown was not as severe as the headline growth figure suggested. Household consumption and government expenditure both rose by 0.4% in the quarter. Together, they contributed 0.3 percentage points (p.p.) to growth. Meantime, fixed investment expanded by 1.3% in Q3, adding 0.2 p.p. to the total. At the same time, external trade had a negligible impact on GDP. However, a rundown of inventories and some volatility in the "valuables" segment (non-financial assets such as precious metals) knocked circa 0.4 p.p. from output.



Meanwhile, the available hard data for the final quarter of the year were mixed. The monthly reading of GDP contracted by 0.1% m/m in October, amid weaker activity levels in the services sector, but rebounded by 0.3% m/m in November. Meantime, industrial production increased by 1.3% in October and by 1.1% in November, as car manufacturing recovered somewhat, following a cyber attack which halted production in the sector in September. In contrast, retail sales declined by an average of 0.3% m/m throughout Q4. **Similarly, survey data for Q4 were also disparate.** The manufacturing PMI averaged 50.2 in Q4, up from 47.1 in Q3, suggesting conditions in the sector stabilised at the end of 2025. The services sector continued to outperform though, with the PMI averaging 51.7 in Q4, consistent with expanding activity levels in the sector, albeit, it was down slightly compared to the Q3 reading of 52.3. **Both the manufacturing and services PMIs improved in January, with the former reaching its highest level since August 2024, at 51.8.** Consumer confidence registered its highest level since August 2024 as well, rising to –16.0 at the start of the year.

In terms of the labour market, conditions have softened throughout 2025. The unemployment rate increased steadily, from 4.4% at the start of the year to 5.1% in October/November. It should be noted that this is the highest jobless rate since January 2021. Worryingly, payrolls have contracted in ten of the past thirteen months to December, and at a sharper rate recently. Against this backdrop, wage inflation has cooled, but it remains elevated. Average earnings growth fell to +4.7% y/y in the three months to November. Other measures of wage inflation point to lower earnings growth also. Indeed, the BoE Agent's Summary Survey for Q1 suggests that pay settlements averaged 4.0% in 2025, and that there are early indications that they may be lower again in 2026, at around 3.4%.



Meanwhile, inflation looks to have peaked. Both headline and core inflation jumped higher in April, owing to a number of one-off factors, and rose further during Q2 and the early part of Q3. However, having reached 3.8% in July and stayed at that level throughout Q3, the headline rate dropped sharply to 3.2% in November, before rising to 3.4% in December. Meantime, the core rate also fell to 3.2% in November and stayed at that level in December, down from a peak of 3.8% earlier in the year. Services inflation has also decelerated, although it remains at a high level, printing at 4.5% in December. Looking ahead, the BoE expects inflation to ease to 2.0% in Q4 2026, and to 1.8% in Q4 2027.

In summary, the UK economy enjoyed a solid start to 2025 but growth moderated in the second half of the year. At the same time, conditions in the labour market deteriorated, resulting in the unemployment rate moving back up above 5%. Meanwhile, inflation remains elevated but it seems to have peaked. This has opened the door to the potential for further rate cuts from the BoE in 2026. **However, the UK continues to lack a coherent economic policy.** There was little in the recent Autumn Budget that is likely to help alleviate the UK's ongoing problem of weak productivity. Worse still, although the Budget was initially well received by markets, it increases borrowing (which will run at 4.5% of GDP this year) over the next four years compared to previous plans. Thus, the IMF is forecasting that UK GDP expanded by a modest 1.4% last year, and that growth will remain tepid, at 1.3% and 1.5% this year and next.

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