

BoE remains on hold, but edging nearer to cutting rates

The Bank of England kept its key interest rate unchanged at 5.25% at the conclusion of its June Monetary Policy Committee (MPC) meeting. In the immediate aftermath of the last MPC meeting in May, there was increased speculation of the potential for a rate cut in June following dovish comments from Governor Bailey. However, subsequent to this, there was an above consensus CPI inflation print, which meant the consensus view heading into this week's BoE meeting was for no change to rates. The June MPC marks the seventh consecutive meeting where the BoE has remained on hold.

The voting breakdown today showed that the MPC remains split on the rate decision. The vote split was once again 7:2 in favour of no change. The same two MPC members (Dhingra and Ramsden) voted for a rate cut again. For these two, they judged that now was the appropriate time for the BoE's interest rate

setting to become less restrictive to "enable a smooth and gradual transition in the policy stance". For the majority of MPC members, they judged that maintaining the Bank rate at 5.25% was warranted in light of the fact that while inflation continued to moderate, it remained elevated. Similar to May, there was a wide range of views among the 'seven' about how much more data was needed for them to be comfortable with cutting rates.

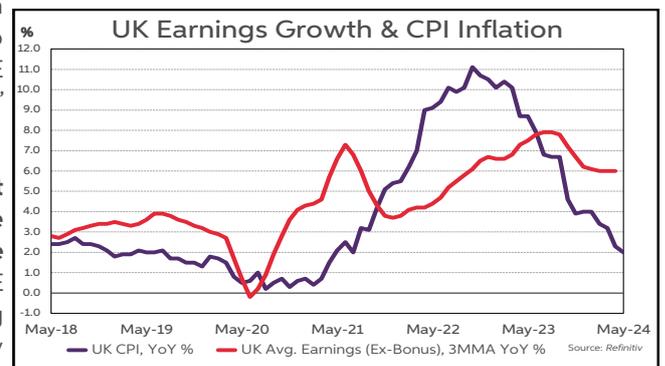
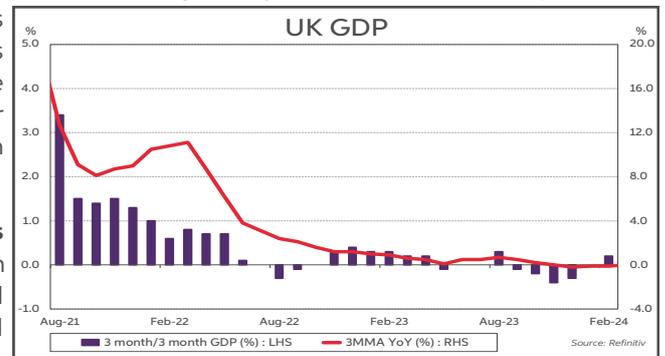
However, the meeting minutes suggested that a number of these 'seven' may be leaning towards voting for a rate cut soon. For "some members" within this grouping while recognising the return of headline inflation to its 2% target, they required "more evidence of diminishing inflation persistence" was needed before cutting rates. For "other members" though the decision on interest rates at the June meeting "was finely balanced".

The BoE's most recent set of detailed macro forecasts were contained in the publication of its Monetary Policy Report (MPR) which was released at its previous meeting in May. In terms of its growth outlook, the BoE continues to project a prolonged period of very weak activity in the UK economy. Although it did revise slightly higher its GDP projections in May. GDP growth is now forecast at 0.5% this year (was 0.25%), then picking up modestly to 1.0% in 2025 (was 0.75%) and rising to 1.25% in 2026 (from 1.0%). In today's meeting statement, the BoE commented that UK GDP seems to have "grown more strongly" than expected in the first half of this year.

On the inflation front, the May MPR projections showed that the BoE anticipate the CPI rate will fall temporarily to 2% in the near term (which has subsequently happened), but to rise slightly in the second half of this year, to around 2.5%. The BoE attributes the modest acceleration in inflation to the unwinding of energy related base effects. Further out, it revised slightly lower its inflation projections. It is now forecasting that inflation will decline to 2.25% by the end of next year. Meantime, it is pencilling in an inflation rate of 1.5% by end-2026. The MPC noted today that short term inflation expectations have "continued to moderate".

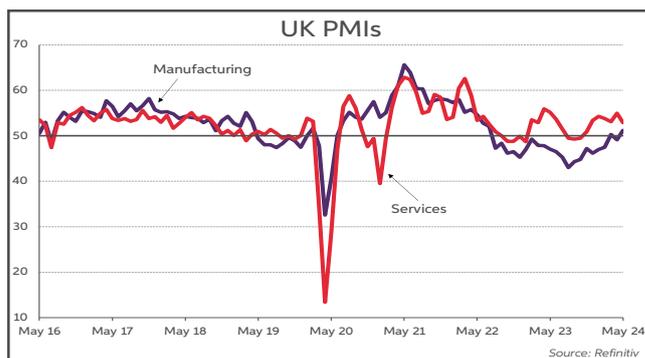
Overall, assessing the text of the June meeting minutes and specifically the reference to the June 'no rate change' decision being "finely balanced" for a number of MPC members, it does appear that the centre ground within the MPC is shifting towards being in favour of a rate cut, sooner rather than later. With two MPC members already voting for a rate cut, all it requires is three more votes to sway the decision.

In terms of market expectations, in the aftermath of today's BoE statement/minutes, futures contracts are now attaching around a 50% chance of a rate cut at its next policy decision on August 1st. Prior to their publication, the probability being attached to this timing was closer to 30%. Meanwhile, market expectations have moved nearer to envisaging 50bps of rate cuts (around 40bps this morning) in total by year end. Given that the next meeting in early August also corresponds to the release of its updated macro forecasts, we think that a 25bps rate cut is on the cards for August and a Bank rate of 4.75% by end year is a rational base case.



Economy gains momentum but outlook still challenging

The UK economy performed better than anticipated in 2023, as it avoided the deep recession that had been widely predicted. However, growth was muted, with the economy expanding by just 0.1% overall last year. Encouragingly, growth has accelerated in the first quarter of 2024, with GDP rising by 0.6%. The underlying breakdown shows consumption increased by 0.2%, contributing 0.1 percentage points (p.p.) to the total. Likewise, Government expenditure added 0.1 p.p. to growth. Fixed investment rose by 1.4%, resulting in a 0.3 p.p. increase in activity. Elsewhere, exports (-1.0%) fell by less than imports (-2.3%), meaning net trade boosted GDP by 0.4 p.p., although this was offset by a rundown in inventories, which knocked 0.5 p.p. from output.

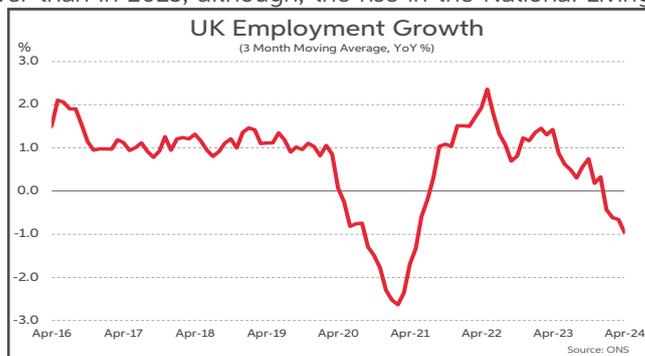


However, the limited hard data available for Q2 suggest the economy lost some momentum at the start of the quarter. The April reading of GDP showed output stagnated in the month, as poor weather dampened activity in the consumer facing services and construction sectors. Meanwhile, industrial production contracted by 0.9% in the month, amid a sharp 1.4% drop in manufacturing output. Retail sales, which have been quite volatile in recent months declined by 2.3% in April, meaning they were 2.7% lower in year-on-year terms.

In contrast, survey data indicate the economy continued to expand at a solid pace in Q2. The services PMI remained in expansion mode, jumping to 55.0 in April, its highest level in a year, and printing at 52.9 in May. Meantime, the manufacturing PMI edged back into contraction territory, at 49.1 in April, before rising to 51.2 in May, its highest level since July 2022. Elsewhere, consumer confidence improved to -17.0 in May, its highest level since December 2021.

In terms of the labour market, conditions remain tight but there have been some signs of softening in recent months. The unemployment rate has increased steadily to 4.4% in April from 3.8% in December. Furthermore, the number of people in employment has fallen by 207k so far in 2024. At the same time, average earnings growth remains elevated at +5.9% y/y in the three months to April. However, the MPC has noted that other measures of wage inflation continue to point to lower and more stable earnings growth. Indeed, an increase in the minimum wage boosted the wage inflation figures in April. The BoE Agent's Summary Survey for Q2, noted that pay settlements this year have been lower than in 2023, although, the rise in the National Living Wage is masking the downward pressure on wages.

Meantime, inflation is in decline. Headline CPI inflation fell to 2% in May, reaching the target for the first time since July 2021. Core-CPI inflation, which had been proving to be quite sticky, dropped to 3.5% in May, from 3.9% in April. However, services inflation remains very high, running at 5.7% in May, well above the BoE's forecast of 5.3%. Looking ahead, the BoE sees headline inflation at 2.5% in Q4 2024, easing to 2.25% by Q4 2024.



Overall, having performed poorly in 2023, the UK economy appears to have registered some improvement this year. Furthermore, inflation is in decline, with headline CPI back to 2% in May. Easing inflation should pave the way for real income growth and interest rate cuts in the second half of 2024, helping to underpin a rebound in consumption. However, the outlook for UK growth remains subdued. The IMF is forecasting the UK will record the second slowest growth rate in the G7 this year, with GDP rising by just 0.5%. Growth is expected to accelerate to around 1.5% in 2025. Meanwhile, the Monetary Policy Report from May shows the BoE sees the economy growing by a 0.5% in 2024 and by 1.0% in 2025. Thus, whoever wins the election on July 4th, the UK economic outlook remains challenging. The polls suggest a Labour victory is the most likely outcome. If Labour win, they are promising a more stable political environment, to increase workers right, and to stimulate investment, in an attempt to boost growth. The party has also indicated that it wants an improved trading relationship with the EU, although it has ruled out re-joining the Customs Union or Single Market.

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