

BoE maintains the Bank Rate at 4%

The September meeting of the Bank of England's Monetary Policy Committee (MPC) saw the central bank maintain the Bank Rate at 4.00%. This was very much in line with market expectations. The most recent rate cut from the BoE occurred at its previous meeting in August when it cut by 25bps. This represented the third 25bps rate reduction in 2025, following earlier cuts in February and May. So far in its current easing cycle, which began in August last year, the BoE has lowered rates by a total of 125bps.

Once again, there was no unanimity within the MPC on its policy decision to hold rates steady. The voting breakdown showed a 7:2 split among the MPC. External members, Dhingra and Taylor maintained their position as the two most dovish committee members, by dissenting in favour of a 25bps rate cut. For them, a cut was warranted "to insure against an increased risk of recession, below-target inflation and a further deterioration in supply capacity". In contrast, the majority noted that "the main risks and required strategy to achieve the 2% target sustainably in the medium term had not changed materially", i.e. they were happy to proceed with the current pace of easing, which has been to cut at every second meeting so far this year.

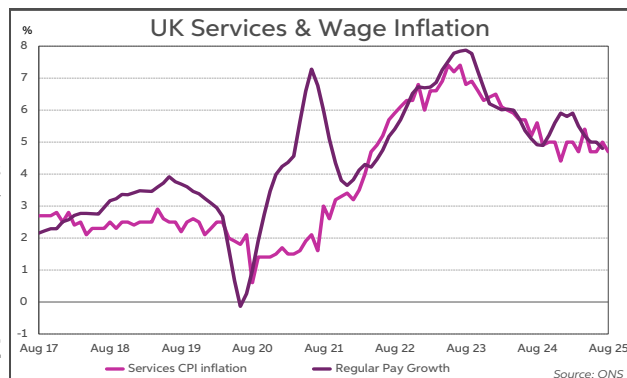
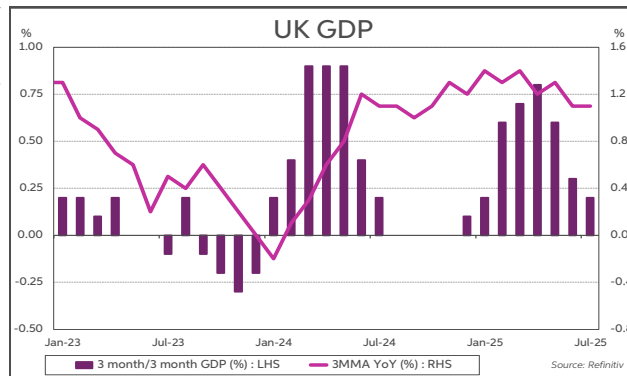
The MPC also voted 7-2 in favour of reducing the stock of UK government bonds held by the central bank by £70bn over the next 12 months. This marks a slowdown in the pace of the BoE's quantitative tightening programme from its current pace of £100bn over the prior year. The BoE also noted that it will change the composition of its QT programme, by aiming to sell fewer long maturity gilts. External member Mann voted against the decision, preferring instead to slow QT down to £62bn, while Chief Economist Pill was in favour of maintain the pace at £100bn.

The overarching message in the meeting statement issued today was little changed from August. Indeed, the MPC continues to guide that, "a gradual and careful approach to the further withdrawal of monetary policy restraint remains appropriate", and that the timing and pace of further rate cuts will depend on "the extent to which underlying disinflationary pressures continue to ease". Thus, it is clear that incoming data and how it impacts the BoE's economic outlook will remain the key determinant of future policy decisions.

The most recent detailed macro outlook update from the BoE was provided in its quarterly Monetary Policy Report (MPR) released at its last meeting in August. In terms of its growth outlook, the August MPR forecasts showed only minimal changes compared to the May edition. There was a modest upward revision to its 2025 GDP growth forecast to 1.25%. 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, the BoE is projecting inflation to be at 3.75% by the end of this year. The end-26 and end-27 inflation forecasts were raised to 2.50% and 2.0%, respectively.

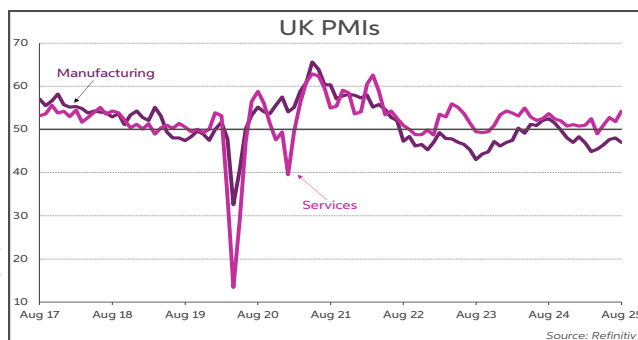
Although the meeting statement offered little in the way of new forward guidance and continued to emphasise a "gradual and careful approach" to further easing, the meeting minutes suggest the BoE has become less willing to cut rates in the near-term. In particular, the minutes noted that there may be "less of an immediate risk" of slack emerging in the labour market. At the same time, the minutes also continued to note that the upside risks around medium term inflation "remained prominent in the committee's assessment". This would suggest the BoE is now less concerned about the labour market but it remains focused on the risks of a further bout of high inflation, which may necessitate a break from its current pace of easing once every second meeting.

In terms of market expectations, futures contracts are attaching around a 10% probability to a rate cut at the next BoE meeting in November. Furthermore, markets see just a 40% chance the BoE will lower rates again this year, and the next cut is not fully priced-in until April 2026. However, given the weak momentum in the UK economy, a 25bps rate cut before the end of this year cannot be completely ruled out.



UK economy slows after strong start to 2025

The UK economy had a better than anticipated start to 2025, with GDP expanding by 0.7% q/q in Q1 and by 0.3% q/q in Q2. The underlying breakdown for Q2 showed that household consumption inched 0.1% higher in the quarter, while government expenditure rose by 1.2%. Together, they contributed 0.3 percentage points (p.p.) to growth. Meantime, fixed investment contracted by 1.1% in Q2, knocking 0.2 p.p. from the total. In terms of external trade, exports continued to rise more quickly than imports, albeit the overall impact on GDP was negligible. At the same time, a rebuilding of inventories added 0.2 p.p. to output.

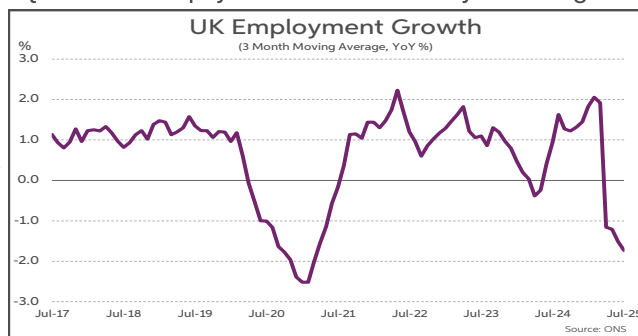


However, the available hard data for Q3 have been mixed. The monthly reading of GDP stagnated in July, as sharp falls in manufacturing and mining acted as headwinds to growth. Meanwhile, industrial production remained volatile, contracting sharply by 0.9% m/m in July, erasing a 0.7% m/m increase in June. Elsewhere, retail sales increased by 0.6% m/m in July, leaving them 1.1% higher in year-on-year terms.

Similarly, survey data also paint a contrasting view of the UK economy in Q3. The manufacturing PMI remains firmly in contraction mode, and has averaged 46.5 between July and August, matching the average reading registered in Q2. In contrast, the services PMI has averaged 53.0 so far in Q3, up from 50.9 during Q2, consistent with an increase in activity levels in the sector. Meanwhile, having dropped precipitously to -23.0 in April, consumer confidence has trended higher, improving in three of the last four months and printing at -17.0 in August, its highest level since the end of 2024.

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, from 4.4% at the start of the year to 4.7% in May, before staying at that level in June and July. It should be noted that the recent 4.7% jobless rate is the highest level since June 2021. Worryingly, payrolls have contracted in eleven of the past thirteen months to August, albeit the rate of retraction has eased recently. Against this backdrop, wage inflation has cooled, albeit it remains elevated. Average earnings growth fell to +4.7% y/y in the three months to August. Other measures of wage inflation point to lower earnings growth. Indeed, the BoE Agent's Summary Survey for Q2 noted that pay settlements are likely to average 3.5-4% in 2025.

Meanwhile 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 rising again between June-August, meaning that the headline and core rates were elevated at 3.8% and 3.6% at the midpoint of Q3. Importantly, services inflation also remains at a very high level, printing at 4.7% in August. The BoE still expects inflation to fall back to its 2% target in the medium-term. Its latest forecasts from the August Monetary Policy Report 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 deteriorated in Q2. At the same time, inflation and labour market data have moved in the wrong direction. Continuous concerns surrounding the cost of borrowing and attempts to narrow the Budget deficit to satisfy the Chancellor's fiscal rules, ahead of the Budget at the end of November, continue to fester also. However, recent data suggest activity levels may now be increasing gradually once more, and sentiment appears to be on the mend. Meanwhile 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. 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. Overall, the IMF sees UK GDP rising by 1.2% in 2025, and by 1.4% in 2026.

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