



MONETARY AFFAIRS

Preview: BOE To Cut Rates In May, as Trump's Tariff Policies Cast A Shadow Over Global Growth

**by
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Executive Summary

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➤ **Expected Decision:** *In line with consensus, we expect the Bank of England (BoE) to cut its Bank Rate (BR) by 25 bps to 4.25% in May.* Regarding its *balance sheet policy*, in September 2024, the BoE announced the new pace of QT, which replicated that of the previous year. Regarding *forward guidance*, we expect the BoE to reiterate that decisions are taken meeting by meeting, still with a “gradual approach.”

➤ **Policy Discussion:** *The BoE is expected to cut interest rates by 25 bps as Trump's tariff policies raise concerns over global growth.* Governor Andrew Bailey, following the IMF's downgrade of UK and global forecasts, called U.S. trade tensions a serious risk. The IMF now projects UK growth at 1.1% in 2025—still above France, Germany, and Italy. UK private-sector activity dropped to its lowest since the 2022 Truss-era turmoil, while U.S. output declined for the first time in three years. Markets now price in three BoE cuts over the next four meetings—up from one per quarter—in line with Fed expectations. Rates are forecast to bottom around 3.4%, over 100 bps below current levels.

We expect a 7-2 split, with Swati Dhingra and Catherine Mann voting for a 50bps cut. The risk scenario of a 50bps cut exists with a non-zero probability, but we would give it only 25% chances at this time.

The BoE has taken a cautious approach, cutting rates three times since August 2024 due to persistent inflation and strong wage growth. But Trump's tariffs may warrant earlier and more frequent cuts. Inflation eased to 2.6% in March but is expected to rise above 3% in April amid higher energy costs, while wage growth remains near 6%, well above the BoE's 2% target.

Bailey said the Bank is monitoring trade-related risks but does not expect a UK recession. Although the direct impact of tariffs may be limited, a U.S. downturn could hit UK services trade.

➤ **Changes to Economic Forecasts:** *Welfare cuts and higher business taxes have heightened concerns over the UK's outlook.* The OBR recently halved its 2025 growth forecast from 2% to 1%, though stronger-than-expected Q1 data led the BoE to revise its own forecast upward. Still, the medium-term outlook remains subdued. New U.S. tariffs on UK exports—potentially returning this summer—add further strain, with the U.S. accounting for 17% of British trade. Meanwhile, households face sharp rises in utility bills and council tax, and businesses confront £25bn in tax hikes.

The economy has grown in only four of the last nine months, with limited signs of renewed momentum. While easing energy prices may lower inflation forecasts, services inflation remains persistently high at 4.7%. As a result, we expect a downward revision to the growth outlook and an upward revision to the inflation forecasts.

Key Picture: BoE Key Forecasts From the February MPR

	Latest Reading	2024f		2025f		2026f		2027f	
		Feb. Report	Nov. Report	Feb. Report	Nov. Report	Feb. Report	Nov. Report	Feb. Report	Nov. Report
GDP (real growth, y-o-y)	1.5	0.8	1.0	0.8	1.5	1.5	1.3	1.5	1.3
Unemployment rate (% , y-o-y)	4.4	4.5	4.3	4.5	4.3	4.8	4.3	4.8	4.5
CPI inflation (% , y-o-y)	2.6	2.5	2.3	3.5	2.8	2.5	2.3	2.0	1.8
Bank rate (%)	4.50	4.9	4.8	4.2	3.7	4.1	3.7	4.0	3.6

Source: Bank of England 'Monetary Policy Report' (MPR), November 2024 and February 2025. Note: 1. GDP reading for Q4 2024; 2. Unemployment reading for February 2024; 3. Inflation reading for March 2025; 4. Bank Rate as implied by forward market interest rates

Analysis

- ✦ **EXPECTED DECISION:** *On May 8, in line with consensus, we expect the Bank of England (BoE) to cut its Bank Rate by 25 bps to 4.25%.* In March, the BoE voted 8-1 in favour of holding rates, in consistent with the BoE's "gradual approach" to monetary easing.

In terms of *forward guidance*, the Bank will remain evidence-based, and data dependent, with decisions made meeting-by-meeting. The MPC will continue to monitor closely the risks of inflation persistence and will decide the appropriate degree of monetary policy restrictiveness at each meeting. In September last year, the BoE updated its forward guidance stating that: "*in the absence of material developments, a gradual approach to removing policy restraint remains appropriate*".

In terms of *balance sheet policy*, in September 2024, the BoE announced the new pace of QT: the Committee unanimously agreed to decrease the stock of UK government bond purchases, held for monetary policy purposes and financed through central bank reserves, by £100 billion over the next 12 months, bringing the total to £558 billion. The active gilt sales are being significantly reduced to £13 billion, compared to £80 billion last year. The remaining £87 billion will come from maturing gilts, with proceeds not being reinvested.

- ✦ **POLICY DISCUSSION:** *The BoE is expected to cut interest rates by 25 bps, as Trump's tariff policies cast a shadow over global growth.* BoE Governor Andrew Bailey, speaking after the IMF downgraded UK and global growth forecasts, acknowledged the risks posed by U.S. tariffs, calling them a serious concern. The IMF recently cut its UK growth forecast for 2025 to 1.1%, though this remains stronger than projections for France, Germany, and Italy. UK private-sector activity fell sharply in April, hitting its lowest level since the market turmoil following Liz Truss's 2022 budget, while U.S. output declined for the first time in three years. Markets expect the BoE to accelerate rate cuts this summer, with investors pricing in three cuts over the next four meetings—up from one per quarter. This aligns with expectations for the Fed. Rates are projected to bottom out around 3.4%, over 100bps below current levels.

Until now, the BoE has taken a cautious approach, cutting rates only three times since August 2024 due to persistent inflation and strong wage growth. However, while gradual cuts may have been justified before, Trump's tariffs could weigh on growth and inflation, warranting earlier and more frequent rate reductions. However, not all MPC members may support a faster pace. Despite inflation easing to 2.6% in March, it's expected to rise above 3% in April due to higher energy tariffs. Wage growth remains strong at nearly 6%—double the level consistent with the BoE's 2% target—while inflation expectations among businesses and the public remain elevated.

Bailey said on Thursday that the BoE is closely monitoring the likely hit to growth from U.S. tariffs and global trade tensions but does not expect the UK to enter a recession. While recent tariffs are expected to have limited direct impact—given the UK's modest reliance on U.S. goods demand—a U.S. recession could weigh on UK services trade.

We expect a 7-2 split, with Swati Dhingra and Catherine Mann voting for a 50bps cut. The risk scenario of a 50bps cut exists with a non-zero probability, but we would give it only 25% chances at this time.

- ✦ **CHANGES TO ECONOMIC FORECASTS:** *Deep welfare cuts and higher business taxes have raised concerns about the UK's economic prospects.* Last month, the Office for Budget Responsibility cut its 2025 growth forecast in half—from 2% to 1%. However better-than-expected figures come as the country faces potential economic strain from new 10% U.S. tariffs on British exports. The U.S.—Britain's largest trading partner—accounts for 17% of its trade, and suspended tariffs could return this summer. So far, the BoE is expected raised its 2025 GDP growth projection following stronger-than-expected Q1 data, while leaving the medium-term outlook weakened.

As said, the economic rebound may be short-lived. This month, households face steep increases in utility bills and council tax, while businesses grapple with £25 billion in tax hikes. The UK economy has expanded in just four of the last nine months, with little sign of strong momentum ahead.

On inflation, energy prices have eased, which may slightly lower the BoE's forecast, with headline inflation expected to peak around 3.5% this year. However, services inflation remains sticky at 4.7%, still far too high despite being marginally below earlier projections.

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As a result, we expect a downward revision to the growth outlook and an upward revision to the inflation forecasts.

- ✦ **MACROECONOMIC ANALYSIS:** *The UK economy expanded by a stronger-than-expected 0.5% in February*, providing a boost for Chancellor Rachel Reeves ahead of a likely slowdown triggered by Donald Trump's tariff war. The UK economy grew 0.1% in Q4, after flat Q3 growth and mixed monthly data. The economy grew 0.5% m-o-m in February, beating forecasts of 0.1%, driven by a rebound in services and production. Services output rose 0.3%, up from 0.1% in January, while production jumped 1.5% after a 0.5% decline. Construction also recovered, rising 0.4% after a 0.3% drop.

UK job vacancies dropped to 781,000—the lowest in nearly four years—signaling weakening demand amid rising employment costs. Payrolls also declined, and while average pay rose 5.9%, higher National Insurance and minimum wage hikes are expected to put pressure on wages.

Regarding the prices, UK annual inflation eased to 2.6% in March, below the 2.7% forecast. This marks a decline from 2.8% in February and 3% in January. Core inflation dipped to 3.4% from 3.5%, with falling prices in recreation, culture, and motor fuels offset by a rise in clothing costs.

- ✦ **MARKET IMPLICATIONS:** *The market expects this cut, so market reaction will depend on the vote split and whether the MPC will signal further cuts in the future, possibly at an accelerated pace.* In case of larger cut, or of a larger minority for a 50bps rate cut, or if the MPC were to signal a faster pace of easing, we should expect a dovish market reaction, with lower yields, weaker GBP and higher equity prices. Meanwhile, British government bond yields fall ahead of expected BoE rate cuts. To put things into context, *in the fixed-income space*, as of April 2 and since the last meeting on March 20: *i)* the 2y Gilt yield edged down by 35 bps to 4.89% (-51 bps y-t-d); and *ii)* the 10y Gilt yield edged down by 11 bps to 4.55% (-5 bps y-t-d). *In the currency space*, the Sterling strengthened against a softer dollar on Monday, ahead of the Bank of England's policy decision later this week. As of April 5, GBP/USD rose by 2.6% from the last meeting in March to around 1.33 (+6.3% y-t-d). GBP/EUR fell by 1.8% since the March meeting to 1.17 (-2.7% y-t-d). *In the equity space*, the UK's FTSE 100 edged slightly higher, extending its winning streak to match its best performance since 2017. As of April 2, and since March 20 the FTSE 100 edged down by 1.2% and closed at 8,596.35 (+4.1% y-t-d).

✦ **APPENDIX (MACRO ASSESSMENT):** *The UK economy far exceeds forecasts in February.* In Q4 2024, according to the preliminary estimate, the economy advanced marginally by 0.1% q-o-q-q (p: 0.0%) matching the market expectations. *Household expenditure* and *government consumption* rose by 0.1% (p: 0.5% in Q3) and by 0.5% (p: 0.3%) respectively. *Gross fixed capital formation* (a: -0.6%; p: 1.0%) contracted. There was a decrease in net trade, with exports declining by 1.8% (p: -0.1%) and imports rising by 2.9% (p: -2.8%). The British economy expanded 1.5% y-o-y (c: 1.4%; p: 1.2%) in Q4. The British economy expanded by 0.5% m-o-m in February, reversing the no growth recorded in January.

Composite PMI declined, signaling the first contraction in UK economic activity since October 2023. Retail sales volumes increased by 2.6% y-o-y (c: 1.8%; p: 1.8%) in March. When looking at business confidence, in April, the S&P Global/CIPS Flash UK Composite PMI fell to 48.2 (c: 50.4; p: 51.5). Services PMI edged down to 48.9 (c: 51.3; p: 52.5). Manufacturing PMI was revised up to 45.4 (c: 44.0; p: 44.9).

UK labour market softens amid rising employment costs. In February, unemployment rate held steady at 4.4% as expected. Regular pay, excluding bonuses, increased by 5.9% y-o-y (c: 5.9%; p: 5.6%) in the three months leading up to February. Average wages rose in real terms, with an annual change of 2.0% excluding bonuses. The number of job vacancies fell to 781K in February, to the lowest level in nearly four years.

CPI inflation accelerated. In March, CPI inflation eased off to 2.6% y-o-y (c: 2.7%; p: 2.8%) below the BoE's forecasts of 2.7%. Prices slowed for recreation and culture (2.4% vs 3.4%) and transport (1.2% vs 1.8%). Meanwhile, prices rose for clothing and footwear (1.1% vs -0.6%). Core inflation cooled to 3.4% y-o-y (c: 3.4%; p: 3.5%).

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