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Review: BOE Cuts Rates, With Uncertainty on The Outlook Leading to a Three-Way Split in the MPC

By

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Executive Summary

- **Decision Made**: *The Bank of England (BoE) cut its Bank Rate by 25 bps to 4.25% citing weak growth and uncertainty over Trump's tariffs.* The vote was split: five members supported the cut, two wanted a deeper 50bps cut, and two preferred to hold. In terms of *forward guidance*, future decisions will be data-dependent and made meeting-by-meeting, with a "gradual and careful approach" to easing policy restraint if no significant developments occur. No changes to the *balance sheet* policy.

- **Policy Discussion**: *The Bank maintained its guidance that future cuts would be "gradual and careful," avoiding any hint of a June move.* It stuck to its language on future cuts being "gradual and careful," avoiding any signal of a move in June. The split vote—five in favor, two for a deeper cut, and two for holding—prompted markets to pare back about 10bp of easing priced over the next year.

  At the press conference, Governor Bailey said inflation is gradually easing, helped by softer wage growth, but warned that progress remains fragile. On trade, Bailey noted that global price pressures, particularly in China, are weakening. He welcomed reports of a UK-U.S. trade agreement, calling it a positive step, but acknowledged the inflation effects of future trade talks remain uncertain and are not central to the BoE's outlook.

  The Bank reiterated that monetary policy is not on a pre-set path and must remain responsive to shifting risks. For some members, the latest global trade news tipped the balance toward a cut, while others saw progress in disinflation and weakening activity as sufficient justification. The dissenting members reflected opposing views: Dhingra and Taylor backed a larger cut amid weak demand and subdued investment, while Mann and Pill preferred to hold, citing persistent inflationary pressures and a still-resilient labour market.

- **Changes to Forecasts:** *In the baseline scenario, both growth and inflation have been revised downward.* In the baseline scenario, based on a lower interest rate path, growth forecasts were revised slightly up for 2025 (because of statistical revision), slightly down for 2026 and was unchanged for 2027. Instead, the inflation outlook was revised lower across the board, given the opening up of a margin of spare capacity. Risks are tilted to the downside. But the MPC also made a scenario analysis. In one scenario, inflation proves to be more persistent than in the baseline: in this scenario, inflation moves up rather than down, and the

Key Picture: BoE Key Forecasts From the May MPR

	Latest Reading	2025*f*		2026*f*		2027*f*	
		May Report	Feb. Report	May Report	Feb. Report	May Report	Feb. Report
GDP *(real growth, y-o-y)*	1.5	**1.0**	**0.8**	**1.3**	**1.5**	**1.5**	**1.5**
Unemployment rate *(%, y-o-y)*	4.4	**4.8**	**4.5**	**5.0**	**4.8**	**5.0**	**4.8**
CPI inflation *(%, y-o-y)*	2.6	**3.3**	**3.5**	**2.0**	**2.5**	**1.8**	**2.0**
Bank rate *(%)*	4.25	**3.7**	**4.2**	**3.6**	**4.1**	**3.6**	**4.0**

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

Analysis

- **DECISION MADE**: *On May 8, in line with consensus, the Bank of England (BoE) cuts its Bank Rate (BR) by 25 bps to 4.25% amid sluggish economic growth and ongoing uncertainty over Trump's trade tariffs.* The Committee was divided. Five members (Bailey, Breeden, Greene, Lombardelli, Ramsden) backed the proposal. Four opposed: Dhingra and Taylor favored a 0.5pp cut to 4%, while Mann and Pill preferred to hold at 4.5%.

  In terms of *forward guidance*, the Bank will remain evidence-based, and data dependent, with decisions made meeting-by-meeting. Given the level of high uncertainty, the MPC maintained a piece of rhetoric to its forward guidance, saying that the Bank will pursue a "gradual and careful" approach in its policy easing.

  Monetary policy has focused on eliminating lingering inflationary pressures to reach the 2% target promptly and sustainably. The Committee stressed that policy will remain restrictive as needed to ensure inflation returns sustainably to target, and future moves will be guided by evolving data. The Committee reiterated that the stance is not on a preset path. Future adjustments will depend on evolving risks to inflation, supply-demand dynamics, and global uncertainty. Monetary policy will need to stay restrictive for as long as necessary to further reduce the risks of inflation failing to sustainably return to the 2% target in the medium term.

  In terms of *balance sheet policy*, in September 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. As of May 7, the stock of UK government bonds held for monetary policy purposes was £620 billion. According to the head of Markets Dave Ramsden, the BoE will need to start thinking about its QE strategy on the back of this new uncertain scenario that puts upward pressure on longer-term yields.

- **POLICY DISCUSSION:** *The Bank stuck to its language, signaling that future cuts will be "gradual and careful," avoiding any hint of a likely June move.* The BoE cut its key rate from 4.5% to 4.25%, citing weak growth and growing uncertainty over President Trump's trade tariffs. The move was widely expected after inflation eased to 2.6% in March. The BoE noted heightened global trade tensions and weaker global growth prospects, though it expects limited impact on the UK economy. The Bank noted that the dis-inflationary process continues, even if a bump in the middle of the year is expected, before inflation returns towards target – according to the central scenario.

  The Bank's unchanged guidance, along with two votes to hold rates, led markets to pare back about 10bp of easing over the next year. The Bank made only minor tweaks to its growth and inflation forecasts, mainly reflecting lower oil prices. Rate cuts are expected to continue quarterly, with the next likely in August, though a faster move can't be ruled out—particularly with April's services inflation data looming large.

  During the press conference, BoE Governor Andrew Bailey said domestic inflation is gradually easing, supported by weaker wage pressures, though the path to price stability will be slow and remains uncertain amid shifting economic conditions. Bailey emphasized that the current inflation rise is temporary, driven by one-off factors, and will fade over time. He noted that services inflation—a key BoE focus—is still expected to slow gradually. Addressing financial stability, Governor Bailey acknowledged recent market volatility but said the system remained resilient. He dismissed the idea of a trade-off between stability and growth, calling it a lesson learned "the hard way."

  Turning to the broader global trade outlook, Bailey warned that trade prices—especially in China—are expected to weaken significantly. The U.S. administration's recent flurry of tariff policy announcements has sparked responses from trading partners and triggered volatility in financial markets. This turbulence is likely to weigh on global growth, dampen demand for UK exports, and slow domestic economic activity. Bailey emphasized China's central role, noting that U.S.-China tariffs are more substantial and will shape broader outcomes. He added that while trade imbalances are inevitable, China's weak domestic demand has clear implications for global trade.

Bailey commented on reports of a UK-U.S. trade agreement, expressing strong support, calling it a welcome development and praising those involved for their efforts. He also cautioned that the inflationary effects of future trade negotiations are uncertain, but these are not central to the Bank's policy outlook. Market reactions to UK-U.S. trade developments, he added, will be closely watched and could influence future decisions.

All members emphasized that monetary policy is not on a pre-set path and that decisions will remain responsive to heightened uncertainty and evolving risks. At this meeting, five members voted to cut Bank Rate to 4.25%. While some had previously seen the case as finely balanced, recent global trade developments—though limited in immediate impact—tipped the balance in favor of a cut. They judged that the new rate would still maintain a restrictive stance to contain inflation. For others in this group, progress in domestic disinflation and softening activity already justified a reduction, even without the latest global news.

Two members – Dhingra and Taylor – favored a deeper 0.5pp cut, citing weak demand, subdued investment, and easing wage pressures. They warned that overly tight policy risked inflation falling below target and a widening output gap. Two members – Mann and Pill – preferred to hold at 4.5%, pointing to resilient labour market data, sticky inflation expectations, and ongoing supply-side pressures. For them, maintaining a restrictive stance was essential to counter persistent inflation risks. For them, the approach should be "cautious" rather than "careful." While the latter reflects the presence of two-way risks, the former suggests that there may be structural changes in the economy underway justifying a slower easing pace. While Pill has always been in the cautious side, Mann has shifted back in the more hawkish camp after having briefly staying in the more dovish camp with a "50bps cut" in February.

- **CHANGES TO ECONOMIC FORECASTS:** *Growth is expected to be higher, while inflation lower in 2025.* The growth to stay "subdued" in the near term but sees a pickup later this year, driven by recovering household spending and business investment as rates decline. Amid heightened uncertainty, the Committee assessed a broad range of domestic and global risks to the baseline forecast, outlined in two scenarios in the May Report. *In the first scenario*, weaker demand relative to supply—driven by global uncertainty—could further ease inflation, with rising precautionary saving and subdued consumption. *In the second scenario*, persistent domestic wage and price pressures, coupled with weaker supply, could prolong inflation. Near-term inflation expectations have become more reactive, and potential productivity growth remains soft. More broadly, evolving global trade policies could lead to either disinflationary or mildly inflationary outcomes, but their full impact remains uncertain.

If tariffs impact not just demand, but also value chains, and therefore supply, the net effect on spare capacity is ambiguous and for this reason the Bank is considering various scenarios. In the baseline assumption, the impact on growth in 2026 is quite limited (0.3%), and this is because there are countervailing effects from tariffs, trade policy uncertainty and market pricing responding to policy actions. In the short term, GDP growth was revised higher given the expected impact of higher real wages, higher saving ratios and lower rates that improve financial conditions.

In effect, February GDP growth surprised to the upside at 0.5%, pushing Bank staff's Q1 estimate to 0.6%. However, this was largely driven by temporary, erratic factors—particularly in manufacturing—with underlying growth seen as flat. Looking ahead, GDP is projected to slow sharply to 0.1% in Q2, with downside risks indicated by high-frequency data.

CPI inflation fell to 2.6% in March, and underlying disinflation continues. However, inflation is expected to temporarily rise to 3.5% or even 3.7% in Q3 due to energy and regulated price effects, which could pose risks if inflation expectations shift sharply. The Bank expects services inflation to rise to 5.0% in April, up from 4.7%, but we see downside risks and believe it will trend closer to 4% later this quarter.

The MPC judged that a mix of weak demand and supply constraints is opening up economic slack, helping ease inflation. Policy is expected to remain tight, with fiscal consolidation weighing more in the medium term.

- **OUR TAKE:** *MPC to continue cutting rates on a quarterly basis.* Given the high level of uncertainty, the MPC is more likely than not to continue with its "gradual and careful" approach of quarterly cuts, with the next one likely to take place in August. Clearly between now and then plenty of events may occur, which could alter the situation: the "careful" component of forward guidance suggests that the MPC is ready to react to two-ways risks.
- **MARKET REACTION AND IMPLICATIONS:** *UK gilt yields climb amid vote split*. As a result: *i)* after the decision, the *2y Gilt yield* rose to 3.91% and since then trades around 3.89%; and ii) the *10y Gilt yield* edged up by 8 bps to as high as 4.56% and now trades around 4.53%. *In the currency space, the Pound gains as the BoE stuck to its gradual easing stance.* It gained 0.24% against the dollar, 0.9% against the yen at 192.80, and extended its lead over the euro, which fell 0.3% to 84.78 pence. *In the equity space, UK stocks rose.* FTSE 100 rose 0.4% by midday after Downing Street confirmed the prime minister would issue a statement on UK-US trade talks later today. Now FTSE100 now trades lower around 8,550.