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Preview: BoE To Keep Rates On Hold,

Amid Strong Growth and Above-Target Inflation

by

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Executive Summary

- **Expected Decision**: *In line with consensus, we expect the Bank of England (BoE) to hold its Bank Rate (BR) at 4.25% in June*. 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 likely to hold rates as markets watch for guidance.* The BoE is expected to keep interest rates steady at 4.25% next week, continuing its cautious approach after May's cut. Since August 2024, the BoE has eased only once per quarter, citing persistent inflation and strong wage growth.

  A Reuters poll of 60 economists confirms expectations for no change in June, with most predicting the next 25bp cut in August and another by year-end. May's vote showed divisions: five members backed the cut, two preferred a 50bp move, and two wanted to hold. Some cited Trump's new tariffs as a reason to act.

  Recent data point to softening conditions. Wage growth slowed in April, payrolls saw their biggest drop in five years, and unemployment hit a post-2021 high. However, inflation jumped to 3.5%, driven by temporary factors. The BoE expects inflation to peak in Q3 and growth to reach just 1% in 2025. Markets will focus on the BoE's forward guidance. A neutral or hawkish tone could support the pound and push gilt yields higher. A dovish tilt might boost equities. Upcoming CPI data—due a day before the decision—will be crucial in shaping the Bank's stance.

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)*	1.3	1.0	0.8	1.3	1.5	1.5	1.5
Unemployment rate *(%, y-o-y)*	4.6	4.8	4.5	5.0	4.8	5.0	4.8
CPI inflation *(%, y-o-y)*	3.5	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 Q1 2025; 2. Unemployment reading for April 2025; 3. Inflation reading for April 2025; 4. Bank Rate as implied by forward market interest rates.

Analysis

- **EXPECTED DECISION**: *On June 19, in line with consensus, we expect the Bank of England (BoE) to hold its Bank Rate at 4.25%.* In May, the vote was split: five members supported the cut, two wanted a deeper 50bps cut, and two preferred to hold. This month more likely there will be *at most* a two-way split, with some members (potentially Swati Dhingra and Alan Taylor) voting for a 25bps cut, and the others voting for no change.

  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. There are reasons to believe that, when the BoE will review its pace of QE, this will be reduced in September 2025, potentially to GBP 80bn a year.

- **POLICY DISCUSSION:** *The BoE is expected to hold interest rates steady this week, maintaining its cautious approach to easing after a rate cut in May.* The BoE has so far followed a "gradual and careful" approach to rate cuts, easing only once per quarter since August 2024 due to persistent inflation and strong wage growth. However, investors will be watching closely for any signals that a weakening economy and softer wage growth might prompt the Bank to accelerate the pace of cuts.

  According to a Reuters poll of 60 economists, all anticipate the Bank will keep rates at 4.25% this month. Nearly all respondents predict the next 25-basis-point cut will come in August, with a strong majority also expecting another reduction to 3.75% by the end of the year. Though the odds dipped slightly after Israel's military strike on Iran sent oil prices higher.

  May's rate decision revealed growing divisions among policymakers, initially dampening hopes of a faster pace of easing—until recent weak domestic data revived expectations of continued quarterly cuts. At the May meeting, the MPC voted 5–4 to lower rates by 25 basis points to 4.25%, in its first decision following President Trump's sweeping tariff announcements. The vote was split three ways: two members, Swati Dhingra and Alan Taylor, pushed for a larger 50bp cut, while Huw Pill and Catherine Mann unexpectedly voted to keep rates at 4.5%. Some who backed the cut said they were swayed by the potential economic impact of Trump's April 2 tariffs.

  Fresh labour market data this week reinforced expectations of further easing. Although wage growth remains above 5%, it cooled in April, and payroll numbers saw their sharpest monthly fall in five years. Unemployment also rose to its highest level since 2021. Meanwhile, consumer price inflation jumped to 3.5% in April, driven by one-off factors. The BoE has forecast inflation to peak at 3.5% in Q3, with economic growth expected to reach just 1% in 2025. New CPI data will be released a day before the Bank's upcoming decision.

  The May CPI report, set for release a day before the MPC meeting, will heavily influence the Bank's tone. Forecasts place inflation between 3.5% and 3.7%, in line with BoE projections of a Q3 peak. A higher reading could delay cuts, while a softer one may open the door to earlier easing.

  With markets widely anticipating the BoE to hold rates steady at its upcoming meeting, attention will shift to the tone of its forward guidance. The tone policymakers adopt—whether neutral, hawkish, or dovish—will be the key driver of market reactions. A neutral or slightly hawkish message, in which the MPC reaffirms its data-dependent stance while flagging ongoing inflation risks, could offer support to the pound, particularly against the euro and dollar. It might also lead to a modest rise in short-term gilt yields, as investors adjust their expectations around the timing of future rate cuts. For UK equities, especially in rate-sensitive areas of the FTSE 100, confirmation that borrowing costs may ease in the near future would likely be a positive signal.

- **MACROECONOMIC ANALYSIS:** *The UK economy delivered a surprisingly strong performance in the Q1 2025, growing at its fastest pace in a year and defying earlier warnings of a slowdown.* GDP rose by 0.7% between January and March, beating economists' expectations of a 0.6% increase and building on modest growth of 0.1% at the end of 2024. This momentum was largely driven by the services sector, with strong showings in retail, wholesale, computer programming, car leasing, and advertising. Production output, which includes manufacturing, mining, and energy, also performed well, rising by 1.1%. Construction activity, however, remained flat. Much of the growth was attributed to a surge in business investment and exports, as companies scrambled to act before the introduction of sweeping tariffs announced by Donald Trump as part of his "liberation day" trade strategy.

  The upbeat figures offered a boost to Chancellor Rachel Reeves, who had faced criticism from some business leaders earlier in the year over her tax policies, which they claimed would harm employment and economic expansion. While the first-quarter growth appeared to disprove those concerns for now, many economists warned that the outlook for the rest of the year was more fragile, given the uncertainty created by Trump's unpredictable trade actions.

  Indeed, by April the economic tide had turned. The UK economy shrank by 0.3% that month, the sharpest monthly fall since October 2023, and worse than the 0.1% contraction forecast by analysts. The reversal came as several tax hikes took effect, including changes to stamp duty in England and Northern Ireland, which triggered a sharp decline in house sales. This in turn weighed on the broader property industry, pulling down services output by 0.4%.

  A further blow came from a dramatic £2 billion fall in exports – the largest monthly drop since records began in 1997 – as Trump's tariffs took effect and disrupted trade flows. Liz McKeown, director of economic statistics at the ONS, highlighted the export shock as a major contributor to the April downturn.

  UK inflation has surged to its highest level in over a year, rising to 3.5% in the 12 months to April. The increase is mainly due to higher household bills, including rising gas and electricity prices following the Ofgem price cap adjustment, as well as increased water, sewerage, and vehicle excise charges. Additional upward pressure came from higher employer National Insurance contributions and the recent rise in the National Living Wage. These pressures are expected to keep inflation above 3% in the coming months.

  Chancellor Rachel Reeves called the figures "disappointing" but promised to "go further and faster" to ease the financial burden on households. The Conservative Party, however, blamed Reeves's policies, arguing that families are "paying the price" for her economic decisions. The Liberal Democrats echoed public frustration, urging "bold action" to support millions of struggling households. The BoE has projected that inflation could peak at 3.7% between July and September 2025, before gradually returning to its 2% target.
- **MARKET IMPLICATIONS**: *Little market reaction is expected as the BoE is unlikely to shift its current stance., So market reaction will depend on the vote split and whether the MPC will signal further cuts in the future*. Meanwhile, the outlook for the pound remains bearish amid ongoing uncertainty and its sensitivity to dollar weakness. Slowing UK growth further weighs on the currency. To put things into context, *in the fixed-income space,* as of June 16 and since the last meeting on May 8: *i)* the *2y Gilt yield* edged down by 3 bps to 3,90% (-50 bps y-t-d); and *ii)* the *10y Gilt yield* edged down by 1 bps to 4,54% (65 bps y-t-d). *In the currency space,* currency traders dumped the dollar in favor of the yen and euro, both up about 1%, pushing the dollar nearly 10% lower year-to-date. The pound also gained but stalled near $1.36 amid worries over UK economic weakness and expectations of early BoE rate cuts dampening sterling demand. As of June 17, *GBP/USD* rose by 2.5% from the last meeting in May and trades around 1.36 (+8.4% y-t-d). *GBP/EUR* fell by 0.5% since the May meeting to around 1.17 (-2.7% y-t-d). *In the equity space,* the London's FTSE 100 climbed

on Monday, nearing its all-time high, as global risk appetite improved following reports that Iran was pursuing a truce with Israel. As of June 16, and since May 8 the *FTSE 100* edged up by 4.0% and closed at 8,875.22 (+7.5% y-t-d).

- **APPENDIX (MACRO ASSESSMENT):** *The UK economy expanded in Q1, marking the strongest growth rate in 3 quarters.* In Q1, according to the preliminary estimate, the economy advanced by 0.7% q-o-q-q (*c*: 0.6%; *p:* 0.1%). *Household expenditure* and *gross fixed capital formation* rose by 0.2% (*p:* 0.1% in Q4) and by 2.9% (*p:* -0.6% in Q4) respectively. *Government consumption* contracted by 0.5% (*p:* 0.5% in Q4). There was a increase in net trade, with exports rising by 3.5% (*p:* -1.8%) and imports rising by 2.1% (*p:* 2.9%). The British economy expanded 1.5% y-o-y (*c:* 1.4%; *p:* 1.2%) in Q4. The British economy shrank by 0.3% m-o-m in April (*c*: -0.1%; *p*: 0.2%).

  The data indicated that the UK manufacturing sector remained under significant pressure in May. Retail sales volumes increased by 5.0% y-o-y *(c:* 4.5%; *p:* 1.9%) in April. When looking at business confidence, in May, the *S&P Global/CIPS Flash UK Composite PMI* fell to 50.3 (*c*: 49.4; *p*: 48.5). Services PMI edged up to 50.9 (*c:* 50.2; *p:* 49.0). Manufacturing PMI was revised up to 46.4 (*c:* 45.1; *p:* 45.4).

  UK jobless rate marked the highest level since August 2021. In April, unemployment rate edged up to 4.6% (*p*: 4.5%) as expected. Regular pay, excluding bonuses, increased by 5.2% y-o-y (*c*: 5.4%; *p*: 5.5%) in the three months leading up to April. Average wages rose in real terms, with an annual change of 0.8% excluding bonuses. The number of job vacancies fell to 736K in April, to the lowest level in nearly four years.

  UK inflation rises to 3.5% in April as increased household bills take effect. In April, CPI inflation jumped to 3.5% y-o-y (*c:* 3.3%; *p:* 2.6%). Prices rose for housing and utilities (7.8% vs 1.8%), Primarily driven by electricity (up 4.6% vs -8.8%) and gas (up 12.2% vs -12%), this reflects the increase in the Ofgem energy price cap implemented in April 2025. Meanwhile, prices slowed for clothing and footwear (-0.4% vs 1.1%) and transport (1.2% vs 1.8%). Core inflation cooled to 3.8% y-o-y (*c:* 3.6%; *p:* 3.4%).