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Preview: BoE To Cut Rates In August, While Keeping A “Careful and Gradual Approach”

by

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Executive Summary

- **Expected Decision**: *In line with consensus, we expect the Bank of England (BoE) to cut its Bank Rate (BR) by 25 bps to 4.00% in August*. 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 and careful approach."
- **Policy Discussion**: *The Bank of England is expected to cut interest rates by 0.25pp to 4% this week—its fifth cut since last August—to cushion the economy amid rising unemployment and Trump's tariffs.* Markets assign an 80% chance of a cut in August and expect another by year-end. However, divisions on the MPC and fiscal uncertainty limit forward guidance. Doves may push for deeper cuts citing job losses and cooling wage growth, while hawks remain concerned about persistent 3.6% inflation. A split vote is likely, with swing members staying cautious.

  Chancellor Reeves may introduce autumn tax hikes, adding uncertainty. While tax rises are typically disinflationary, stealth duties could spark fresh inflation. Reeves would welcome lower rates to ease mortgage and business borrowing costs, but the UK still faces sluggish growth and tight budgets. The BoE will clarify its approach to quantitative tightening in September, with analysts expecting a slowdown in bond sales or a shift to shorter maturities.
- **Changes To Economic Forecasts:** *The BoE is expected to downgrade its forecasts, fueling stagflation concerns amid stagnant growth and persistent inflation.* While wage growth is cooling and unemployment rising, a June spike in food prices may delay deeper rate cuts. The IMF sees just 0.1% UK growth in Q3 and Q4, with weak April–May GDP and rising joblessness underscoring a deteriorating labour market. Inflation, driven by essentials like meat and butter, remains above expectations, and policymakers remain split on the pace of disinflation.

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)*	4.7	**4.8**	**4.5**	**5.0**	**4.8**	**5.0**	**4.8**
CPI inflation *(%, y-o-y)*	3.6	**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 Q1 2025; 2. Unemployment reading for May 2025; 3. Inflation reading for June 2025; 4. Bank Rate as implied by forward market interest rates.

Analysis

- **EXPECTED DECISION**: *On August 7, in line with consensus, we expect the Bank of England (BoE) to cuts its Bank Rate by 25 bps to 4.00%.* In June, the Bank voted 6-3 to hold interest rates at 4.25%, following a more divided May meeting where two members backed a 50-basis point cut and two others favored holding rates. June meeting decision was considered slightly "dovish hold" making another 25-bps cut in August virtually a done deal.

  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 QT in September, this will be reduced potentially to GBP 80bn a year.

- **POLICY DISCUSSION:** *The Bank of England is widely expected to cut interest rates by 0.25 pp to 4% this week, aiming to cushion the economy amid rising unemployment and Trump's new import tariffs.* If confirmed, it would be the fifth cut since last August, returning rates to March 2023 levels. Markets see over an 80% chance of a cut in August and anticipate another by year-end.

  However, internal divisions and fiscal uncertainty will prevent the MPC from offering clear guidance on the future path of rates. While dovish members, including externals Alan Taylor and Swati Dhingra, may push for deeper cuts due to rising job losses and easing wage pressures, hawks, including chief economist Huw Pill, remain concerned about sticky inflation, now at 3.6%. A split vote is likely, with swing members expected to remain non-committal. A group of "swing" voters, including BoE Governor Andrew Bailey and three deputy governors, have not opposed market expectations of a rate cut this month, but they have also avoided offering clear signals on the future pace or eventual level of rate reductions.

  Fiscal policy has emerged as a fresh source of uncertainty, with expectations that Chancellor Rachel Reeves may announce new tax hikes in the autumn to meet fiscal targets. While the BoE can't factor in unannounced policies, economists say MPC members are unlikely to ignore the potential for fiscal tightening. Though tax hikes are typically disinflationary, "stealth" increases in duties could fuel another inflation bump, as seen last April.

  Chancellor Rachel Reeves is likely to welcome the anticipated rate cut, which would ease mortgage costs and reduce borrowing expenses for struggling businesses. However, the move also highlights the UK's challenging position, balancing sluggish growth with the need to rein in public spending ahead of the autumn budget.

  Amid these uncertainties, the BoE may offer clearer guidance in September on the pace of quantitative tightening (QT). Its bond sales, expected to reduce holdings by £100bn this year, are putting upward pressure on borrowing costs. Analysts suggest the Bank may slow the pace of QT or shift toward selling shorter-term bonds.

- **EXPECTED CHANGES TO ECONOMIC FORECASTS:** *The BoE's new forecasts may reinforce stagflation fears: slow growth combined with stubborn inflation.* The BoE is expected to downgrade its economic forecasts, reinforcing stagflation concerns as growth stagnates and inflation proves persistent. Slowing wage growth and rising unemployment point to a weakening labour market, but a recent spike in food prices could delay more aggressive rate cuts.

Policymakers remain split on how quickly underlying inflation is easing and whether sluggish growth and a weakening labour market could push inflation below target if rates aren't cut further. However, a spike in food inflation in June could lead to a split vote on the MPC. Inflation has exceeded the Bank's earlier forecasts, driven by sharp increases in essentials like meat and butter.

Regarding economic activity, the IMF projects UK growth to be just 0.1% in Q3 and Q4, with only a modest pickup next year. The economy contracted 0.3% in April and 0.1% in May, amid rising unemployment and uncertainty from Trump's tariffs and UK business tax hikes. While Trump's UK trade deal capped most tariffs at 10%, his broader tariff hikes of up to 50% threaten global trade and growth.

Job vacancies have dropped below pre-pandemic levels and unemployment has climbed to 4.7%, the highest since mid-2021. Rising vacancies and higher unemployment point to a weakening labour market, while wage growth has slowed faster than the BoE projected in May.

- **MACROECONOMIC ANALYSIS:** *The UK economy showed signs of stagnation in early Q3 2025.* Weak PMI data reinforces concerns about the UK economy with a sharp slowdown in hiring as firms cut headcount in response to higher taxes and wage costs. July's composite PMI fell to 51.0 from 52.0 in June, below expectations. The decline was led by the services sector, while manufacturing rebounded to the neutral 50.0 mark.

  Despite the sharp drop in headline inflation in 2023, core CPI and services inflation, key measures of underlying domestic pressures, have remained elevated, driven in part by rising labour costs. Food and drink inflation, highly visible to consumers and particularly burdensome for low-income households, is also climbing again. Inflation climbed to 3.6% in June, the highest level since January 2024, with some economists predicting it could soon reach 4%. Inflation pressures in services rose modestly, suggesting services CPI could drop below 4% by year-end. Despite recent strong inflation and jobs data, the report supports expectations that the BoE may cut rates from 4.25% to 4.00% in August, with further gradual cuts likely.

  Employment continued to weaken, with payrolls falling at an estimated 0.2% pace over three months. Private-sector wage growth has slowed from its 2022 peak but remains nearly 2 percentage points above pre-pandemic levels. While the BoE and employers expect it to ease toward 3% over the next 18 months, the decline has been uneven, and weakening labour market conditions don't guarantee a faster slowdown.

  While the UK economy expanded in Q1, marking its strongest growth rate in a year, prospects dimmed in Q2, with GDP contracting by 0.1% in May following a 0.3% decline in April. Some rebound is expected in H2 following stagnation in Q2, but risks remain high: inflation erodes real incomes, borrowing costs stay elevated, and the labor market is weakening. Looming Labour tax hikes may further dampen investment. For the BoE, this fragile outlook complicates rate decisions.
- **MARKET IMPLICATIONS**: *The FTSE 100 climbs, led by BP and Smith & Nephew after strong earnings and share buyback announcements. Meanwhile, the pound slips below $1.33 amid dollar strength, and gilt yields remain stable.* To put things into context, *in the fixed-income space,* as of August 5 and since the last meeting on June 19: *i)* the *2y Gilt yield* is virtually unchanged at 3.82% (-58 bps y-t-d); and *ii)* the *10y Gilt yield* edged down by 2 bps to 4,51% (-8 bps y-t-d). *In the currency space,* the pound sterling fell amid a selloff in British government bonds. However, an improving risk appetite helps the Pound Sterling maintain its footing. As of August 5, *GBP/USD* fell by 1.4% from the last meeting in June and trades around 1.33 (+6.1% y-t-d). *GBP/EUR* fell by 1.8% since the June meeting to around 1.15 (-4.6% y-t-d). *In the equity space,* the FTSE 100 rises, supported by earnings reports from oil giant BP (BP.L) and beverage leader Diageo (DGE.L), as sentiment improves following Friday's weaker-than-expected U.S. jobs report. As of August 5, and since June 19, the *FTSE 100* edged up by 4.3% and trades around 9,170 (+11.0% y-t-d).

- **APPENDIX (MACRO ASSESSMENT):** *The UK economy expanded in Q1, marking the strongest growth rate in a year.* In Q1, according to the second estimate, the economy advanced by 0.7% q-o-q-q (*p:* 0.1%) matching the preliminary estimate. *Household expenditure* and *gross fixed capital formation* rose by 0.4% (*p:* 0.1% in Q4) and by 2.0% (*p:* -0.6% in Q4) respectively. *Government consumption* contracted by 0.4% (*p:* 0.5% in Q4). There was an increase in net trade, with exports rising by 3.3% (*p:* -1.8%) and imports rising by 2.0% (*p:* 2.9%). The British economy expanded 1.3% y-o-y (*c:* 1.3%; *p:* 1.5%) in Q4. The British economy shrank by 0.1% m-o-m in May (*c*: 0.1%; *p*: -0.3%).

  UK PMIs show signs of stagnation. *Retail sales volumes* increased by 1.7% y-o-y *(c:* 1.8%; *p:* -1.1%) in June. When looking at business confidence, in May, the *S&P Global/CIPS Flash UK Composite PMI* fell to 51.0 (*c*: 51.8; *p*: 52.0). Services PMI edged down to 51.2 (*c:* 53.0; *p:* 52.8). Manufacturing PMI was up to 48 (*c:* 48.2; *p:* 47.7).

  UK jobless rate marked the highest level in four years. In April, unemployment rate edged up to 4.7% (*c*: 4.6%; *p*: 4.6%). Regular pay, excluding bonuses, increased by 5.2% y-o-y (*c*: 5.0%; *p*: 5.4%) in the three months leading up to May. Average wages rose in real terms, with an annual change of 0.9% excluding bonuses. The number of job vacancies fell to 727K in May, to the lowest level in nearly four years.

  UK inflation rose to a hotter-than-expected rate. In April, CPI inflation jumped to 3.6% y-o-y (*c:* 3.4%; *p:* 3.4%). The main upward pressure came from transport prices, which increased by (1.7% vs 0.7%), driven largely by motor fuel costs. Prices for clothing and footwear prices (0.5% vs -0.3%) as well as food inflation (4.5%) rose, the highest since February 2024, mainly due to cakes and cheddar cheese. Prices eased for housing and utilities (7.5% vs 7.7%). Core inflation increased to 3.7% y-o-y (*c:* 3.5%; *p:* 3.5%).