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## **MONETARY AFFAIRS:**

**Review: BoE Cuts Rates With a Highly Divided MPC,  
and Makes the Pace of Further Easing More Uncertain**

**by**

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**7 August 2025**

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**Executive Summary**

Page | 2

- ✧ **Decision Made:** *The Bank of England (BoE) hold its Bank Rate at 4.25% amid Middle East uncertainties.* For the first time ever, the MPC held a second vote after the initial round resulted in a 4–4–1 deadlock. The BoE ultimately cut its policy rate by 25 basis points in an exceptionally close decision. In terms of *forward guidance*, future decisions will remain data-dependent and made meeting-by-meeting, with a “gradual and careful approach” to easing policy restraint. While the direction of travel remains intact (lower rates ahead), the speed of travel (i.e. the pace of restrictiveness withdrawal) is now more uncertain. No changes to the *balance sheet* policy, which will be announced in September.
- ✧ **Policy Discussion:** *The BoE has narrowly approved a rate cut from 4.25% to 4%, its fifth since last August, after an unprecedented second vote, reflecting deep divisions among policymakers.* Governor Andrew Bailey reaffirmed the Bank’s commitment to the 2% inflation target but warned of “real risks” and continued weak growth. While he expects rates to continue falling, he acknowledged “genuine uncertainty” about the pace and timing of future cuts. He noted that both global and domestic factors made “small-ish” contributions to the decision, which was mostly domestically driven.

The initial vote ended in a rare 4–4–1 stalemate, requiring a second round as one member preferred a large cut. Five members ultimately supported a cut: four backed a 25 basis point reduction, citing continued disinflation—especially in wages—and weak economic activity. One member favored a deeper 50 basis point cut, arguing inflation was driven by one-off factors, wage growth had slowed to 3.5%, and downside risks to growth were rising. Four members voted to hold, concerned that disinflation had lost momentum and that inflation expectations remained elevated. They warned that rising food and energy prices could lead to persistent inflation through second-round effects.

The Bank reiterated that rates remain on a gradual downward path, but with upwardly revised inflation forecasts, markets now see a lower likelihood of another cut in September, with November or December seen as more likely.

- ✧ **Changes To Economic Forecasts:** *The BoE now expects inflation to peak at 4% in September, double its target and above May’s 3.8% forecast.* It remains alert to the risk that rising food prices could fuel wage pressures and persistent inflation. The MPC sees medium-term inflation risks as slightly higher than in May and now projects inflation to return to 2% by Q2 2027, three months later than previously expected.

GDP growth for Q2 is forecast to slow to just 0.1%, though the UK-US trade deal is expected to boost exports and support activity going forward. Wage growth is slowing faster than expected, projected to drop from 5% to 3.75% by year-end. Following its August meeting, the Bank also raised its estimate of QT’s impact on 10-year gilt yields to 0.15–0.25 percentage points, up from last year’s 0.1–0.2 estimate, reflecting the increased pace of tightening.

### Key Picture: BoE Key Forecasts From the May MPR

	Latest Reading	2025f		2026f		2027f	
		August Report	May Report	August Report	May Report	August Report	May Report
GDP ( <i>real growth, y-o-y</i> )	1.3	1.3	1.0	1.3	1.3	1.5	1.5
Unemployment rate (% <i>y-o-y</i> )	4.7	4.8	4.8	5.0	5.0	4.8	5.0
CPI inflation (% <i>y-o-y</i> )	3.6	3.8	3.3	2.5	2.0	2.0	1.8
Bank rate (%)	4.25	3.8	3.7	3.5	3.6	3.6	3.6

Source: Bank of England 'Monetary Policy Report' (MPR), [May](#) and [August](#) 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.

Page | 3

### Analysis

✦ **DECISION MADE:** *On August 7, in line with consensus, the Bank of England (BoE) cuts its Bank Rate by 25 bps to 4.00%.* The Committee was divided. Five members (Bailey, Breeden, Dhingra, Ramsden and Taylor) backed the proposal. One of these members (Taylor) initially preferred a 50-bps cut in Bank Rate, and eventually voted for a smaller 25 bps reduction rather than keeping the rate unchanged. Four opposed: Greene, Lombardelli, Katherine Mann and Huw Pill, favored to maintain BR at 4.25%

In terms of *forward guidance*, the Bank will remain evidence-based, and data dependent, with decisions made meeting-by-meeting. Policy decisions are not on a pre-set course, and the Committee will adjust its approach in response to incoming data.

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 become less restrictive following the recent reduction in the Bank Rate. The *timing* and *pace* of any further easing will depend on how underlying disinflationary pressures evolve.

MPC acknowledges that domestic price and wage pressures have continued to ease, though unevenly. The Committee remains alert to how easing wage pressures may affect overall inflation. Overall, medium-term inflation risks have risen slightly since May.

In terms of *balance sheet policy*, in September 2025 the BoE will announced the new pace of QT. Last year, 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 came from maturing gilts, with proceeds not being reinvested. As of August 6, the stock of UK government bonds held for monetary policy purposes was £586 billion. We expect the pace of QT to be reduced to around GBP 80bn a year in September, but we'll finalise this prediction ahead of that meeting.

✦ **POLICY DISCUSSION:** *The Bank of England has narrowly approved an interest rate cut following an unusual second vote, highlighting deep divisions among policymakers.* Bank Rate was lowered from 4.25% to 4%, marking the fifth reduction since last August. Governor Andrew Bailey reaffirmed the Bank's commitment to the 2% inflation target but warned of "real risks" and continued weak economic growth. However, the need for a second vote underscores how finely balanced future rate decisions may be, as concerns persist that rising employment costs could drive up food prices and reignite inflation. While Governor Bailey expects rates to decline further, he noted "genuine uncertainty" about the path ahead. He noted that while the direction remains downward, the path is

now less certain, and the key question is how and over what timeframe further cuts will be made. During the press conference, Bailey noted that both global and domestic factors made "small-ish" contributions to the decision.

Five MPC members supported cutting the Bank Rate, with four favoring a 25 bps reduction, citing continued disinflation, especially in wages and the labour market, despite persistent domestic price pressures. They noted weak activity and diverging risks: higher food prices could fuel inflation expectations, while subdued demand might accelerate labour market slack, justifying gradual policy easing.

One member (Taylor) supported a larger 50 bps point cut, arguing that disinflation was well underway, wage growth had slowed to 3.5%, and inflation was largely driven by one-off factors unrelated to demand. Given weak sentiment, flat energy prices, and trade diversion effects, this member saw increased downside risks to inflation and growth, warranting a more aggressive cut for insurance.

In contrast, four members voted to hold the rate at 4.25%, concerned that disinflation had slowed and inflation expectations remained elevated. With inflation expected to peak at 4%, they warned of second-round effects from food and energy prices and structural shifts in goods and labour markets. These members favored a more cautious approach to avoid undermining progress toward the inflation target.

The second vote grabbed the headlines, but in reality from the beginning there was a 5-4 majority for a cut. The second vote just clarified the size of the cut. So the real story is not about the second vote, but rather the wafer thin majority in favour of a cut, which casts doubts about the possibility of further cuts down the road.

The Bank reiterated today that it sees rates on a "gradual" downward path. However, with inflation forecasts revised upward, there's growing uncertainty about the timing of the next cut. Markets no longer expect a rate reduction in September but see higher chances for one in November or December.

✦ **CHANGES TO ECONOMIC ASSESSMENT:** *Inflation forecasts revised upward.* Inflation is now projected to peak at 4% in September, according to the Bank's MPR, double its target rate and higher than the 3.8% forecast made in May. The Bank warned it remains vigilant to the risk that rising prices, particularly for food, could drive higher wage settlements and sustained inflationary pressures. The MPC now sees medium-term inflation risks as slightly higher than in May, according to the meeting summary. The Bank of England also revised its forecast, expecting inflation to reach the 2% target by Q2 2027, three months later than previously projected.

The Bank now expects GDP growth for the Q2 quarter, set to be released next week, to slow sharply to just 0.1%. Looking ahead, the government's trade agreement with the US is projected to support a recovery in exports and overall economic activity.

One surprise in the MPC's report is that wage growth is slowing faster than expected, projected to drop from 5% to 3.75% by year-end. This reflects a softer labour market, lower inflation, and firms adjusting to higher employer national insurance costs. However, wage growth remains elevated—around 7%—in retail and hospitality, driven by April's minimum wage hike affecting many low-paid workers.

In a report released following its August MPC meeting, the Bank of England raised its estimate of the cumulative impact of quantitative tightening on 10-year gilt yields to 0.15–0.25 percentage points, up from 0.1–0.2 percentage points a year earlier. The revision reflects the additional QT carried out over the past year: this likely justifies a reduction in the pace of QT from September 2025.

✦ **ECONOMIC ASSESSMENT:** *UK GDP growth remains weak, and the labour market continues to loosen, indicating a growing margin of slack.* The BoE estimates GDP grew by 0.1% in the second quarter, with

a pickup to 0.3% expected in the third. It noted that stronger growth earlier in the year was partly driven by front-loaded activity due to international tariffs and domestic tax changes.

Underlying domestic price and wage pressures have continued to ease, though unevenly. CPI inflation rose to 3.5% in Q2 2025, mainly due to higher energy, food, and administered prices. CPI inflation rose from 2.6% in March to 3.4% in May, mainly due to regulated and earlier energy price increases, and is expected to stay near current levels through year-end before declining toward target in 2026. Pay growth remains high but is slowing and expected to decline further. Services inflation has been stable. The Committee remains watchful of how easing wage pressures may affect overall inflation.

CPI inflation is forecast to peak at 4.0% in September before falling back toward the 2% target. However, the Committee remains cautious that this temporary rise could fuel renewed wage and price pressures. Since May, medium-term inflation risks have edged slightly higher.

Food prices are rising again, driving overall inflation, which now stands at 4.5% for groceries, pushing up the cost of staples like bread, milk, eggs, and meat. This is due to higher energy costs, increased minimum wages, and higher employer National Insurance contributions, which are likely being passed on to consumers.

The Bank of England expects inflation to peak at 4% in September—twice its 2% target—contributing to today's narrow 5–4 vote to cut rates. With wage growth expected to slow and household bills like water, council tax, and broadband rising, cost-of-living pressures remain high.

The labour market has continued to loosen gradually, with weak employment growth in recent quarters driven by soft demand and rising business costs. The unemployment rate rose as expected in the three months to May, while vacancies remained below equilibrium, indicating growing spare capacity. Evidence from various sources and Bank analysis shows that disinflation in price and wage pressures has generally persisted. Private sector regular pay growth fell to just under 5%, below May expectations but in line with other indicators. Although still above model estimates, pay growth is expected to slow further, reaching around 3.75% by year-end.

Global uncertainty remains high, with energy prices rising due to Middle East tensions. The Committee will continue to monitor economic and geopolitical risks closely.

✦ **OUR TAKE:** *Further cuts ahead, but with caution.* The division within the MPC will make it harder to implement further cuts ahead. If the governor were to switch side, the easing cycle would likely come to a halt. Given all this, the BoE is likely to continue its quarterly pace of easing, with the next move expected in November. If inflation hasn't show signs of decisive easing, this may be postponed to December. Eventually, over the next 6 month, we expect Bank Rate to reach 3.5%, and this is likely the point in which the BoE may take a pause before further action.

✦ **MARKET REACTION AND IMPLICATIONS:** *Gilt yields climb as narrow BoE vote casts doubt on further rate cuts this year.* Yields on UK government bonds climbed, with the 2-year yield, sensitive to rate changes, up 5 basis points to 3.88%. The 10-year benchmark briefly rose over 6 basis points to 4.597%, before easing to 4.55%. *In the currency space, the pound rose on the BoE's hawkishness.* The pound is trading just above \$1.34, up 0.5% against the dollar. A slower pace of Bank of England rate cuts could further support the pound, prompting some investors and analysts to rethink their stance on the currency. *In the equity space, stocks fell as traders digested the BoE's widely expected cut.* the FTSE 100 fell slightly after the initial announcement, but has remained broadly flat.



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