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MONETARY AFFAIRS:

Review: BoE Keeps Rates on Hold,

While the MPC Remains Split in Half

by

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Executive Summary

- **Decision Made**: *The Bank of England (BoE) kept its Bank Rate unchanged at 3.75%.* The Committee was split: five members (Bailey, Greene, Lombardelli, L Mann and Pill) backed the proposal. Four members (Breeden, Dhingra, Ramsden Alan Taylor) preferred cutting rates by 25 bps to at 3.50%.

  Forward guidance points to gradual easing, though future decisions are increasingly finely balanced. Inflation is expected to return to around the 2% target from April, partly reflecting energy price measures in Budget 2025. As weaker growth and a loosening labour market ease wage and services inflation, risks of persistence have receded, while downside risks from weaker demand have grown. Further rate cuts will depend on how inflation, wages and expectations evolve.

- **Policy Discussion**: *While broadly in line with forecasts, the narrow vote signalled growing support for easing if the expected fall in inflation proves durable.* Governor Andrew Bailey said there would be scope for cuts later this year if inflation returns sustainably to the 2% target, stressing the need to avoid moving too quickly or too slowly. The close split may lead markets to bring forward expectations of the next cut, though Bailey noted that market pricing does not pre-judge the timing or scale of future moves.

  Views differ on the pace of easing. Some expect two cuts this year, with scope for more if growth weakens, while others anticipate a cautious start and possible pause amid firmer demand and stickier inflation. Overall, markets expect easing to begin in spring, with the Bank proceeding carefully as inflation cools and demand remains uncertain. Bailey added that staff analysis points to no structural shift in wage-setting, and that falling inflation should gradually feed through into expectations.

  Within the MPC, members voting to hold rates highlighted continued disinflation but warned of lingering risks to wage and price pressures, arguing for a longer period of restriction. Those favouring an immediate cut judged that weaker demand, rising slack and easing wage growth had materially reduced persistence risks, and that keeping policy too tight could unnecessarily weigh on activity and employment.

- **Changes to Economic Forecasts:** *The Bank downgraded its growth outlook and forecast higher unemployment but judged it premature to cut rates at this meeting.* The overall projections are based on interest rates bottoming out at 3.25% by the end of this year then climbing back to around 3.75% in 2029. Disinflation is advancing faster than expected, with CPI inflation set to return close to the 2% target from April, boosting confidence that inflation is on track. While policy has already been eased through six rate cuts, some members argued for maintaining restriction to guard against persistence. Markets expect easing to begin in spring, though views differ on the pace, with the Bank proceeding cautiously amid still-uncertain demand.

Key Picture: BoE Key Forecasts From the February MPR

	Latest Reading	2025*f*		2026*f*		2027*f*		2028	
		February Report	November Report	February Report	Nov. Report	February Report	Nov. Report	February Report	Nov. Report
GDP *(real growth, y-o-y)*	1.3	**1.4**	**1.5**	**0.9**	**1.2**	**1.5**	**1.6**	**1.9**	**1.8**
Unemployment rate *(%, y-o-y)*	5.1	**4.8**	**4.8**	**5.3**	**5.0**	**5.2**	**5.0**	**5.1**	**4.8**
CPI inflation *(%, y-o-y)*	3.4	**3.4**	**3.5**	**2.0**	**2.5**	**1.8**	**2.0**	**2.0**	**2.1**
Bank rate *(%)*	3.75	**4.0**	**3.9**	**3.3**	**3.5**	**3.5**	**3.5**	**3.7**	**3.6**

Source: Bank of England *'Monetary Policy Report'* (MPR), November 2025 and February 2026. *Note:* 1. GDP reading for Q3 2025; 2. Unemployment reading for October 2025; 3. Inflation reading for December 2025; 4. Bank Rate as implied by forward market interest rates.

Analysis

- **DECISION MADE**: *On February 5, in line with consensus, the Bank of England (BoE) held its Bank Rate at 3.75%.* The Committee was divided. Five members (Andrew Bailey, Megan Greene, Clare Lombardelli, Catherine L Mann and Huw Pill) backed the proposal. Four members (Sarah Breeden, Swati Dhingra, Dave Ramsden and Alan Taylor) voted against this proposition, preferring to reduce Bank Rate by 25 bps to 3.50%. Policy restrictiveness has eased, with Bank Rate cut by 150 basis points since August 2024.

  In terms of *forward guidance*, the Bank Rate is expected to keep edging lower, but decisions on further easing will become increasingly finely balanced. Any further easing of monetary policy will be guided by developments in the inflation outlook. Although CPI inflation remains above the 2% target, it is expected to return to around target from April, driven in part by energy price developments linked to Budget 2025. With monetary policy restraining activity, weaker growth and a loosening labour market have eased pay growth and services inflation. Risks of persistent inflation have diminished, while downside risks from weaker demand have increased. Future rate cuts would depend on how wages, prices and expectations evolve.

  In terms of *balance sheet policy*, in September, the BoE agreed to cut its government bond holdings by £70 billion (from £100 billion) over the next year, bringing the total to £488 billion. The plan includes £21bn of active bond sales, up from £13bn last year, with fewer maturities expected. On 4 February, the stock of UK government bonds held for monetary policy purposes was £531 billion.

- **POLICY DISCUSSION:** *While broadly in line with forecasts, the narrower split signalled growing support for easing if the anticipated fall in inflation proves durable.* Governor Andrew Bailey said there would be scope for further rate reductions later this year if inflation returns sustainably to the 2% target from April, stressing that the fall must not be temporary. The close vote may prompt markets to bring forward expectations of the next cut, having previously priced only a limited chance of easing before April. Bailey emphasised the trade-off facing policymakers: easing too quickly could reignite inflation pressures, while waiting too long could risk a sharper downturn and require larger cuts later. He described current market pricing as broadly reasonable but stressed it does not pre-judge the timing or scale of future moves.

  Views differ on the pace. Some expect two cuts this year, with scope for more if growth weakens, while others anticipate a cautious start followed by a pause, reflecting signs of firmer demand and stickier inflation early in the year. Overall, markets expect easing to begin in the spring, with the Bank proceeding carefully as it balances cooling inflation against still-uncertain demand conditions.

On inflation, Bailey said new staff analysis suggested no structural changes in wage-setting that would sustain inflation, and he expected falling inflation to feed through into expectations over time. He downplayed political developments in the UK as a market risk, noting orderly conditions, and said early signs of weaker hiring in some sectors may partly reflect the growing impact of AI.

Members voting to hold rates acknowledged continued progress in disinflation and welcomed the lower near-term inflation outlook, but differed in their assessment of remaining risks. Megan Greene, Clare Lombardelli and Huw Pill placed greater weight on the risk that inflation could prove persistent, emphasising uncertainty over whether wage growth and underlying price pressures would return sustainably to target-consistent rates. They argued that a longer period of policy restriction may still be warranted to guard against inflation settling above target.

Andrew Bailey and Catherine L Mann also recognised the improvement in the inflation outlook but placed relatively greater emphasis on risks from weak activity and a loosening labour market. However, both judged that the weight of evidence was not yet sufficient to justify a rate cut at this meeting, noting continued uncertainty over the transmission of lower inflation into wage and price-setting.

Members voting for a reduction argued that the balance of risks had shifted decisively. Sarah Breeden and Dave Ramsden judged that evidence of weaker demand, rising slack and easing wage growth pointed to materially reduced risks of inflation persistence. Swati Dhingra and Alan Taylor placed particular emphasis on the likelihood that inflation expectations would normalise as headline inflation returns to target, and argued that maintaining the current stance risked unnecessarily constraining activity and employment. Collectively, these members judged that monetary policy remained overly restrictive and that a modest reduction in Bank Rate was warranted at this meeting.

- **CHANGES TO ECONOMIC ASSESSMENT:** *The Bank revised down its growth outlook and forecast higher unemployment, yet judged it premature to cut rates at this meeting.* The overall projections are based on interest rates bottoming out at 3.25% by the end of this year then climbing back to around 3.75% in 2029. Disinflation is progressing faster than previously expected. CPI inflation fell from 3.8% in September to 3.4% in December, below earlier projections, and is expected to decline further to around 3% in the first quarter before returning close to the 2% target from April—almost a year earlier than anticipated in November. With inflation easing, monetary policy has become less restrictive, with Bank Rate cut six times, including in December.

  Recent developments increase confidence that inflation is on track to return to target, but policy must ensure it does so sustainably. However, several members favouring no change argued that policy should remain restrictive for longer to guard against persistent inflation pressures, even as disinflation continues. Views differ on the pace of easing. Some expect two cuts this year, with scope for more if growth weakens, while others foresee a cautious start and possible pause amid firmer demand and stickier inflation. Overall, markets expect cuts to begin in spring, with the Bank moving carefully as inflation cools and demand remains uncertain.

- **ECONOMIC ASSESSMENT**: *Growth remained below potential, demand subdued, and the labour market continued to loosen, with unemployment rising above 5%, implying a wider output gap.* Most members saw downside risks from weak demand and higher unemployment that could lead to an inflation undershoot without looser policy, while others pointed to signs that labour market loosening may be slowing and to firmer credit and money growth, suggesting policy was not overly restrictive.

  The Committee focused on the near-term inflation outlook, underlying wage and price pressures, the role of economic slack, and the appropriate monetary policy response. CPI inflation fell to 3.4% in December and was expected to return to around the 2% target from April, largely reflecting energy price developments linked to Budget 2025. Wage growth and services inflation continued to ease but remained above target-consistent levels. Import prices were also contributing modestly to disinflation, amid ongoing global uncertainty.

Risks nevertheless remain. Elevated inflation may have altered wage- and price-setting behaviour, increasing the risk of persistence, while weaker labour demand and subdued household spending could push inflation lower. Monetary policy continues to balance these opposing risks.

- **OUR TAKE:** *Further Cuts to come during the year*. Considering how split the MPC was in this occasions, and Bailey's words during the press conference, further cuts need to be the baseline, assuming inflation will continue falling towards target. For now, we assume two cuts to take place, possibly in May and November.
- **MARKET REACTION AND IMPLICATIONS***: Markets moved to price in nearly 50bp of rate cuts by year-end, up from around 35bp beforehand.* The shift was reinforced by a softer policy signal, with the BoE dropping references to a gradual easing path and cutting its inflation forecast to 1.7%, below target, with inflation now expected to reach 2% by April. The 2Y gilt yields fell 9bp to a three-week low of 3.63%, marking their biggest one-day drop since April, as bonds rallied after the BoE decision. 10-Y gilt yields fell 2bp to 4.53%. *In the currency space,* the pound fell 0.7% to below $1.36, its weakest level since January 22. *In the equity space,* UK equities fell in volatile trading on. The FTSE 100 pared earlier losses following a narrow vote, but was down 0.4% after closing at a record high the previous session. The more domestically focused FTSE 250 declined 0.7%.