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**Preview: BoE To Remain on Hold In March,
As the Iran War Poses Upward Risks to Inflation**

by

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13 March 2025

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Executive Summary

- ✦ **Expected Decision:** *In line with consensus, we expect the Bank of England (BoE) to hold Bank Rate by 25 bps (BR) at 3.75% in March.* Regarding its *balance sheet policy*, in September 2025, the BoE cut gilt holdings by £70bn over the next year (down from £100bn), reducing the stock to £488bn. The plan includes £21bn of active sales, up from £13bn, with fewer maturities expected; only 20% will be long-dated gilts, versus a third previously. Regarding *forward guidance*, we expect the BoE to reiterate that decisions are taken meeting by meeting.
- ✦ **Policy Discussion:** *The Iran war has cast doubt on the timing of the next Bank of England rate cut.* Earlier signs of softer labour data and easing inflation had strengthened expectations for further easing, but the Middle East conflict has dampened those hopes. Markets now price two rate cuts this year, taking the policy rate to around 3.25%, while expectations for a March cut have dropped to about 20% from roughly 80% before the geopolitical escalation. UK two-year yields have risen to around 4.13%, and higher borrowing costs are already pushing mortgage rates upward.

The UK is seen as particularly vulnerable to an energy shock given its reliance on imported oil and gas and already stretched public finances. If energy prices remain elevated into the second quarter, inflation could approach 3.5% later this year. However, a weakening labour market—with lower vacancies and rising unemployment—should limit wage pressures. As a result, while the Bank of England may pause in March, further rate cuts later in the year remain more likely than not. Some analysts now expect the first cut in April rather than March, with the policy rate potentially reaching about 3.25% by the end of 2026.

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Key Picture: BoE Key Forecasts From the February MPR

	Latest Reading	2025f		2026f		2027f		2028	
		February Report	November Report	February Report	Nov. Report	February Report	Nov. Report	February Report	Nov. Report
GDP (<i>real growth, y-o-y</i>)	1.0	1.4	1.5	0.9	1.2	1.5	1.6	1.9	1.8
Unemployment rate (<i>%, y-o-y</i>)	5.2	4.8	4.8	5.3	5.0	5.2	5.0	5.1	4.8
CPI inflation (<i>%, y-o-y</i>)	3.0	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 Q4 2025; 2. Unemployment reading for December 2025; 3. Inflation reading for January 2025; 4. Bank Rate as implied by forward market interest rates.

Analysis

- ✦ **EXPECTED DECISION:** *On March 19th, in line with consensus, we expect the Bank of England (BoE) to hold its Bank Rate at 3.75%.* As oil and gas prices have jumped about 50% and 90% since late February, raising inflation risks that could force central banks, including the BoE, to alter their easing path.

Markets are now pricing a 98% probability that the Bank of England will hold rates this month, according to LSEG data.

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 terms of *balance sheet policy*, 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. Only 20% of sales will be long-dated gilts, down from a third previously.

- ✦ **POLICY DISCUSSION:** *The Iran war has delayed the Bank of England's next rate cut.* Earlier, before the conflict in the Middle East, softer labor data and easing inflation had strengthened expectations that the Bank of England would cut interest rates again, as slower wage growth suggested that inflationary pressures in the labor market were moderating. Markets now fully price two rate cuts this year, taking the policy rate to 3.25%, while the pound weakened following the release of the data. However, markets have sharply reduced expectations for a March rate cut by the BoE, with the probability falling to around 20%, down from about 80% before recent geopolitical tensions. Bond markets have reacted sharply, with UK two-year yields rising to about 4.13%, while higher borrowing costs are already pushing mortgage rates upward.

Investors see Britain as particularly vulnerable to an energy shock, with already stretched public finances likely to face further strain if the government moves to cushion energy costs. The UK, as a major importer of oil and gas, is particularly exposed to rising energy costs. Rising energy prices could push UK inflation toward 3.5% later this year if oil and gas prices remain elevated into the second quarter. However, economists note that the weakening labor market should limit the pass-through into wages and services inflation, as lower vacancies and higher unemployment reduce workers' bargaining power. As a result, while the BoE may pause in March due to inflation risks, further rate cuts later in the year remain more likely than not.

While some analysts now expect the next cut in April, a March move remains possible (although unlikely) if energy market pressures ease quickly. One British brokerage has pushed its expected March rate cut to the second quarter and reduced the pace of subsequent easing, now seeing the terminal rate at 3.25% by the end of 2026. Morgan Stanley has also revised its outlook, dropping its call for a March cut and now expecting the first move in April, followed by cuts in November and February 2027 instead of July and November. Meanwhile, Standard Chartered warns that prolonged energy price spikes could add up to 1.5 percentage points to eurozone inflation.

- ✦ **MACROECONOMIC ANALYSIS:** *Budget uncertainty weighed on UK growth in Q4.* Britain's economy barely expanded in Q4 2025, with GDP growing just 0.1%, matching the previous quarter and falling short of the 0.2% expected by the BoE. The period was marked by uncertainty ahead of Finance Minister Rachel Reeves' November budget, amid speculation over potential tax increases. Official data also revised earlier estimates, showing the economy contracted by 0.1% in the three months to November rather than growing. Business investment fell sharply during the quarter, while manufacturing supported growth and services activity remained largely flat. Some surveys suggest sentiment improved after the budget, though recent political uncertainty could weigh on confidence again.

UK unemployment rose to 5.2% in the Q4, the highest level since the pandemic and above economists' forecasts of 5.1%, as the labor market continued to weaken. Wage pressures also eased, with regular

private-sector pay growth slowing to 3.4%, the lowest level in more than five years. Payroll data showed employment declining, with 11,000 fewer employees in January, bringing the annual drop to 134,000.

Inflation slowed to 3.0% in January, down from 3.4% in December and matching economists' forecasts, marking the lowest level since March last year. The decline was driven by slower increases in transport, food, and non-alcoholic drink prices, with food inflation falling to its weakest pace since April 2025. Core inflation eased to 3.1%, the lowest since 2021, although services inflation remained relatively high at 4.4%. Page | 4

Britain's construction sector remained in contraction in February, marking its 14th consecutive month of decline and the longest downturn since the global financial crisis. The S&P Global UK Construction PMI fell to 44.5 from 46.4 in January, staying well below the 50 threshold that separates growth from contraction and below economists' expectations of 47.0.

✦ **MARKET IMPLICATIONS:** *Gilts and GBP remain vulnerable to shocks and BoE announcements.* British government bond prices fell on Friday, pushing the 10-year gilt yield to its highest level since September. UK government bond yields have surged since the start of the Iran war as markets scaled back expectations for interest rate cuts. put things into context, *in the fixed-income space*, as of March 13 and since the last meeting on February 5: *i) the 2y Gilt yield* rose by 42 bps to around 3.73% (+34 bps y-t-d); and *ii) the 10y Gilt yield* edged up by 19 bps to around 4.76% (+22 bps y-t-d). *In the currency space*, the pound was set for a fourth straight daily loss against the dollar on Friday after weak UK economic data, while concerns about the economic fallout from the Middle East conflict pushed investors toward the greenback. As of March 13, *GBP/USD* fell by 1.9% from the last meeting in February to 1.33 (-1.4% y-t-d). *GBP/EUR* increased by 0.7% since the February meeting to around 1.16 (+0.7% y-t-d). *In the equity space*, the FTSE 100 edged higher by noon Friday while European markets slipped, capping a volatile week as investors watched oil prices after the US temporarily allowed purchases of sanctioned Russian oil already loaded at sea. Since the last meeting in February, the FTSE 100 increased by 0.3% to around 10,340.99 at (+3.9% y-t-d).

✦ **APPENDIX (MACRO ASSESSMENT): UK economy barely grows in third quarter.** In Q4, the economy advanced marginally by 0.1% q-o-q (c: 0.2%; p: 0.1%) lower than the market expectations. Household expenditure and government consumption rose by 0.2% (p: 0.4% in Q3) and by 0.4% (p: 0.3% in Q3) respectively. Gross fixed capital formation shrank by 0.1% (p: 1.1% in Q3). Business investment also contracted by 2.7% q-o-q (p: 1.6%). There was a decrease in net trade, with imports increasing by 0.8% (p: 0.5%) and exports shrinking 0.6% (p: 0.2%). The British economy expanded 1.0% y-o-y (c: 1.2%; p: 1.2%) in Q4. The British economy advanced by 0.1% m-o-m in December (c: 0.1%; p: 0.2%).

Leading business indicators signaled a solid expansion. Retail sales volumes rose 4.5% y-o-y (c: 2.8%; p: 1.9%) in December. When looking at business confidence, in January, the S&P Global/CIPS Flash UK Composite PMI stood at 53.7 (c: 53.9). Services PMI declined marginally to 53.9 (p: 54.0). Manufacturing PMI was up to 51.7 (c: 52.0; p: 51.8).

UK jobless rate hits 5-year high. In December, unemployment rate rose to 5.2% (c: 5.1%; p: 5.1%). Total average weekly earnings, including bonuses, increased by 4.2% y-o-y (c: 4.6%; p: 4.6%) in the three months leading up to December. Average wages rose in real terms, with an annual change of 4.2% excluding bonuses. The number of job vacancies declined to 726K in December.

UK inflation falls to the lowest rate since March 2025. In January, CPI inflation eased to 3.0% y-o-y (c: 3.0%; p: 3.4%). Core inflation edged down to 3.1% y-o-y (c: 3.1%; p: 3.2%). Transport and food prices drove the decrease, with prices rising by 2.7% down from 4.0% in December and food prices increasing by 3.6% down from 4.5% in the previous month. Services inflation, a key gauge of domestic price pressures for the BOE, edged down slightly to 4.4% from 4.5%.



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