Economic Research Unit

Economics Weekly

Bank of Ireland

Bank of England cuts rates to 4.5% as it halves GDP forecast

The Bank of England cut its policy interest rate to 4.5% as expected today. This was despite the Monetary Policy Committee (MPC) now expecting CPI inflation to pick-up to 3.75% during the summer of 2025, mainly due to higher energy prices. However, the most striking feature of the MPC's new forecast was the halving in expected GDP growth to just 0.75% in 2025. This means the UK will only just steer clear of recession during the winter, GDP expected to fall 0.1% in Q4 2024 and see a marginal 0.1% gain in Q1 2025. The entire downward revision to the MPC's GDP forecast was explained by the poor performance of the UK's export sector, but with consumer spending (1.5%) and business investment (3%) still expected to see robust gains in 2025.

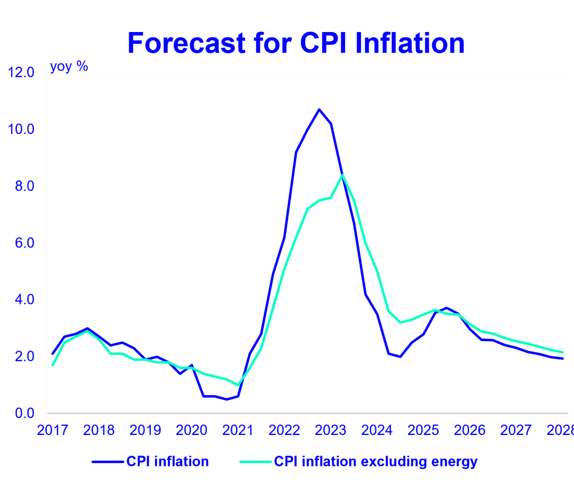
Bank of England cuts policy rate to 4.5% as expected: At it's policy meeting today, the Bank of England's Monetary Policy Committee (MPC) cut interest rates as expected by 25 basis points (bps) to 4.5%. However, the vote was split 7-2, with two members, Swati Dhingra and Catherine Mann preferring a 50bps cut. In his press conference, Governor Andrew Bailey said he expects the MPC will be able to cut interest rates further, but will do so gradually on a meeting-by-meeting basis.

CPI inflation still expected to fall back to 2%, but after 3.7% peak in 2025: The MPC is forecasting that CPI inflation will pick-up to 3.7% during the summer of 2025, but mainly driven by higher energy prices. The forecast still expects CPI inflation to fall back towards 2% in 2026 and 2027. Here, the MPC highlighted weaker services inflation and surveys pointing to softer pay growth as reassuring. Similarly, given weak demand, surveys also suggested firms were now less likely to pass-on higher costs.

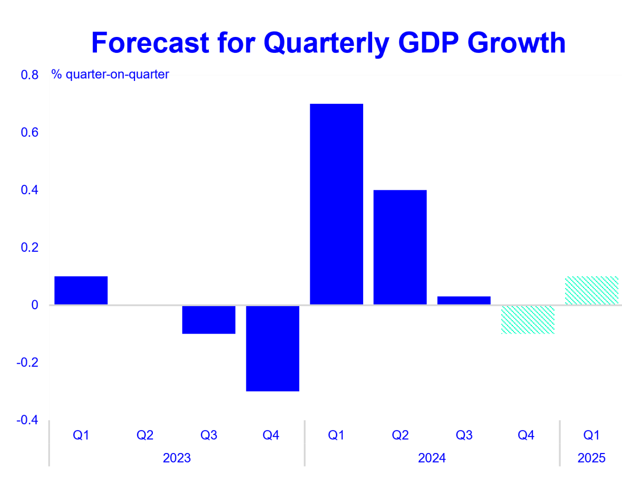
Bank of England halves GDP growth forecast to 0.75% in 2025: The MPC's new 0.75% GDP forecast is well below the 1.5% projection in November, the consensus average of 1.2% and Office for Budgetary Responsibility (2%). The MPC expects the UK to only just steer clear of recession during the winter, GDP expected to fall 0.1% in Q4 2024 and see a marginal 0.1% gain in Q1 2025. Furthermore, Governor Bailey highlighted the prospect of global tariffs as a downside risk to the GDP forecast.

Poor export performance drives weaker outlook: The Bank of England still forecast consumer spending will see a reasonably robust 1.5% gain in 2025, driven by employment (0.75%) and wages (3.75%) growth. Business investment is also expected to see a 3% gain in 2025. However, the MPC now expect UK exports to contract by 0.75% in 2025, vs the 2.25% gain forecast in November - accounting for the entire 0.75 percentage point revision to the GDP growth forecast for 2025.

Sterling loses ground after rate decision, further Bank of England rate cuts priced in: Sterling depreciated following the Bank of England's press conference, the exchange rate against the euro rising to 83.7p, from 83.2p earlier. Against the dollar, sterling fell to $1.238, well down from above $1.25 yesterday. Options on overnight index swaps are now fully pricing in two further 25bp cuts to Bank rate to 4% by August with an 80% likelihood of further cut to 3.75% by the end of 2025.



Source: Bank of England



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