Economic Research Unit

Economics Weekly

Bank of Ireland

Bank of England holds, March Budget statement up next

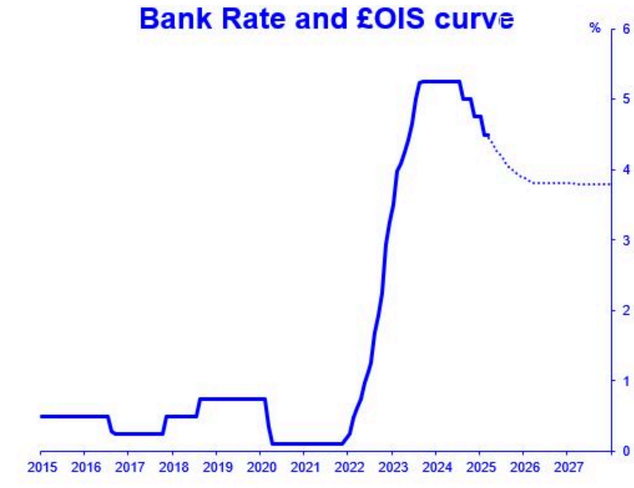
This morning's Bank of England decision to hold rates at 4.5% was in line with market expectations. Sterling rose slightly to 83.6p against the euro following the decision, but with markets still pricing in the Bank Rate to fall to 4% by end-2025. This response was helped by the dovish tone of the MPC meeting minutes, maintaining guidance of a 'gradual and careful' approach to further rate cuts and downplaying recent resilient GDP and employment data and the 6% pace of private sector earnings growth. The MPC maintains a broad set of indicators still point to easing pay growth, for example, recent wage settlements of 3-4%.

Looking forward sterling could be hurt by the March 26th Budget statement, if Chancellor of the Exchequer Rachel Reeves sets out aggressive spending cuts, or on the other hand fails to convince investors sufficient action is being taken to rein in borrowing. That said, sterling could benefit should the UK be seen as a haven from Donald Trump's threat of 'reciprocal tariffs' on the EU and other countries, apparently due to be unveiled on April 2nd.

Bank of England holds rates as expected: This morning's decision by the MPC to hold rates at 4.5% was in line with market expectations. However, the vote was split 8-1 (from 7-2 in February), with Catherine Mann changing her vote for rates to be cut to 4.25%. Sterling rose slightly to 83.6p against the euro following the decision. Options still indicate rates will be most likely cut to 4.25% at the May 8th policy meeting and then to 4% by end-2025. We still believe the market is underpricing the likelihood of rate cuts below 4%, given the weak economic outlook and uncertainty created by Donald Trump's tariff threats.

Minutes show MPC take dovish view on growth and inflation: The MPC's minutes conceded GDP had held up better than expected, a 0.25% gain now forecast for Q1 2025, but highlighted business surveys point to subdued conditions going forward. This morning's labour market data showed pay-rolled employee numbers up 21,000 in February. However, the MPC still expects a modest rise in the unemployment rate in the coming months, highlighting recent surveys indicating firms are cutting back on employment. The minutes also painted a sanguine view of the 6% pace of pay growth, highlighting a broad set of indicators point to a slowdown. For example, settlements data show pay awards in the range 3-4% in the three months to February.

March 26th Budget statement next on the agenda: The rise in 10-year UK gilt yields to 4.6% has almost certainly eliminated the £10bn headroom vs the fiscal rules estimated in November's budget. Hence, Chancellor of the Exchequer Rachel Reeves will face a difficult balancing act next week between implementing politically contentious welfare and spending cuts, whilst convincing investors sufficient action has been taken to help rein in borrowing. Indeed, the Institute for Fiscal Studies (IFS) has described the official projections, for restrained public expenditure from 2026 onwards, as unrealistic. The government has also committed to raise defense spending to 2.5% of GDP from 2027. This leaves a lot of work to be done in the next spending review to reduce borrowing from 4% of GDP.



Source: Bloomberg

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