International Commentary — August 7, 2025

# Bank of England Continues Gradual and Careful Rate Cuts

Economist(s)

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## Summary

- The Bank of England (BoE) cut rates by 25 bps to 4.00% at today's announcement, although its accompanying commentary was noticeably hawkish in tone.
- BoE policymakers voted by just a slim 5-4 margin to lower interest rates at today's meeting, with the four dissenters preferring to hold rates steady. The central bank's GDP growth forecasts were little changed, although the BoE offered a less favorable outlook on inflation. The BoE now expects a higher near-term inflation peak of 4.0%, and sees inflation decelerating more gradually over time toward, but not below, the 2% inflation target.
- Against this backdrop, the BoE offered cautious guidance regarding further rate cuts, signaling that a "gradual and careful approach to the further withdrawal of monetary policy restraint remains appropriate. The restrictiveness of monetary policy has fallen as Bank Rate has been reduced."
- Acknowledging that today's announcement was hawkish in tone and cautious regarding policy guidance, for now we do not expect a deviation from BoE's quarterly cadence of policy interest rate cuts. **Our base case remains for two more rate cuts during the current easing cycle, with 25 bps rate cuts in November and February bringing the policy rate to a low of 3.50% by early next year.** Our view stems from our relatively underwhelming view of the U.K.'s economic prospects. Amid sluggish demand we think that there is potential for favorable inflation surprises in the months ahead which should be enough, we think, to keep the central bank at a quarterly rate cut pace.

## Bank of England Cuts Rates, Signals Cautious Approach to Further Easing

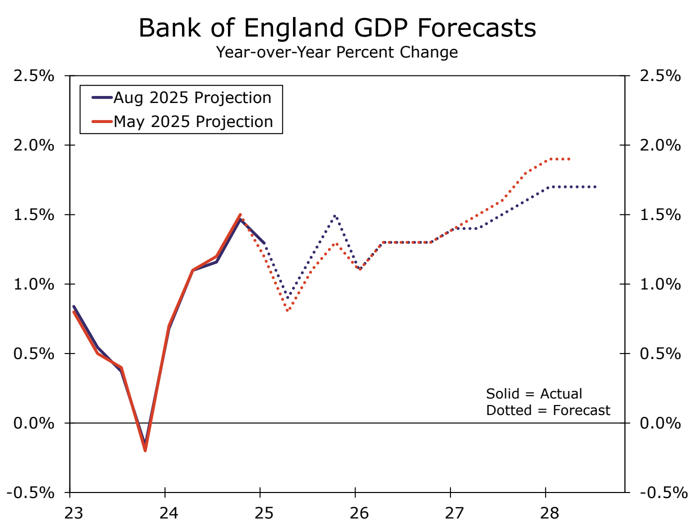
The Bank of England (BoE) cut its policy rate by 25 bps to 4.00% at today's monetary policy announcement, a widely expected decision, and the fifth rate reduction in the current easing cycle. The rate cut was, however, one of the few aspects of today's decision that was "as expected". The vote to lower interest rates was finely balanced, while the other elements of the announcement were generally viewed as more hawkish than expected.

Regarding the decision to lower interest rates, BoE policymakers voted by a slim 5-4 margin to lower interest rates at today's meeting, with the four dissenters preferring to hold rates steady. Moreover, today's policy decision went to a second round of voting, with the first "ballot" showing four policymakers preferring to hold rates steady, four voting to cut rates by 25 bps, and one policymaker initially opting for a larger 50 bps rate reduction. The close vote split, in our view, almost guarantees that the central bank will hold rates steady at its next announcement in September, while we also think it argues against any acceleration in BoE monetary easing.

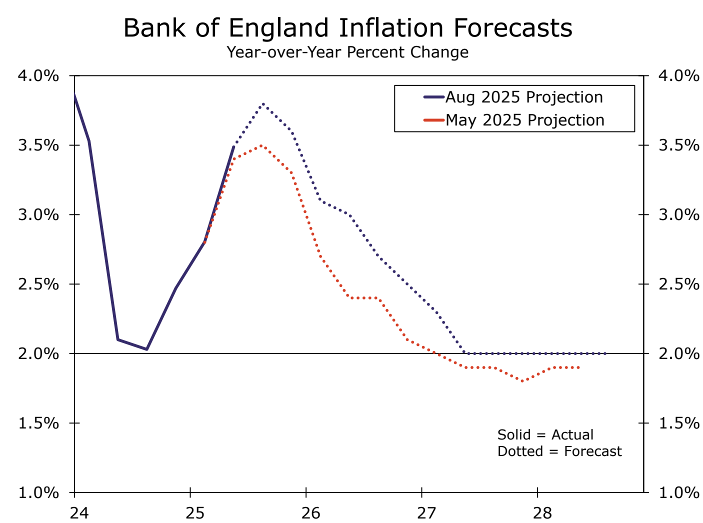
Regarding the comments accompanying the decision, the BoE's assessment of the U.K. economy was mixed, while its policy guidance was generally cautious. The central bank said underlying GDP growth has remained generally subdued, consistent with a gradual loosening in the labor market. It also said downside domestic and geopolitical risks around economic activity remain, although trade policy uncertainty has diminished somewhat. The central bank's comments on inflation were less clear-cut. First, the BoE now sees a higher peak in inflation than previously, at 4.0% in September, and added that upside risks around medium-term inflationary pressures have moved slightly higher since May. It also noted that disinflation in wages and prices has continued, but to differing degrees. Pay growth, while elevated, has declined further recently, and is expected to slow significantly over the rest of the year, in contrast to still persistent price pressures.

These mixed comments translated into cautious guidance from the BoE, which signaled that a "gradual and careful approach to the further withdrawal of monetary policy restraint remains appropriate. The restrictiveness of monetary policy has fallen as Bank Rate has been reduced. The timing and pace of future reductions in the restrictiveness of policy will depend on the extent to which underlying disinflationary pressures continue to ease. Monetary policy is not on a pre-set path, and the Committee will remain responsive to the accumulation of evidence."

We view both the "gradual and careful approach" to easing, and reference to monetary policy becoming less restrictive, as arguments against any acceleration in the pace of monetary easing. Finally, in separate comments, BoE Governor Bailey also offered some cautious guidance. He said the central bank shouldn't cut rates too quickly or by too much, and that inflation risks have shifted to the upside while growth risks have shifted to the downside. He also said that interest rates are on a downward path, but that there is genuine uncertainty about the path of interest rates.




Source: Bank of England, Bloomberg Finance L.P. and Wells Fargo Economics

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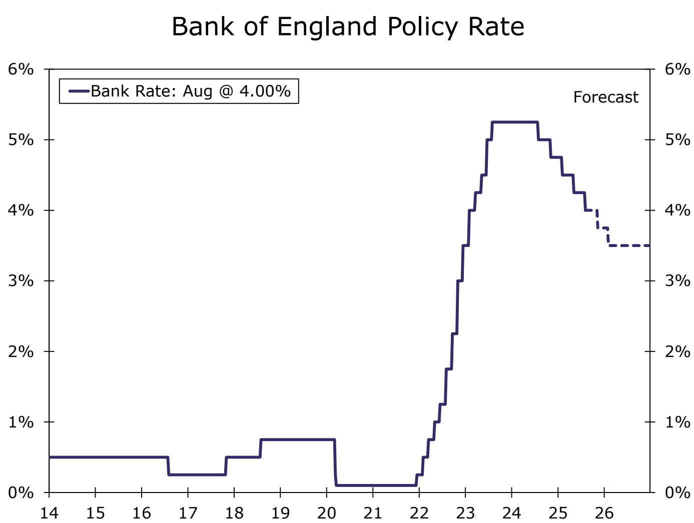
The Bank of England's updated economic projections were also consistent with a gradual approach to monetary easing. The BoE's forecasts, which were predicated on the policy rate falling to around 3.5% by Q2-2026, saw little change to its GDP forecasts, with annual average GDP growth seen at 1.2% in 2025 and 2026, before firming slightly to 1.5% in 2027. Regarding headline inflation, after the higher near-term peak, inflation is seen decelerating more slowly over time to 3.6% by Q4-2025, 2.5% by Q4-2026 and eventually 2.0% by Q2-2027. Moreover, whereas the central bank forecast inflation slightly below target over the medium-term in its May projections, in its updated forecasts it now no longer sees an undershoot of that 2% inflation target.

Acknowledging that today's announcement was hawkish in tone, and cautious regarding policy guidance, for now we do not expect a deviation from BoE's quarterly cadence of policy interest rate cuts. **Our base case remains for two more rate cuts during the current easing cycle, with 25 bps rate cuts in November and February bringing the policy rate to a low of 3.50% by early next year.** Our monetary policy outlook envisages a faster pace, but similar magnitude, of rate cuts than reflected in market implied pricing, which see the policy rate reaching 3.50% by around the middle of 2026. Our less hawkish BoE policy rate view stems from our relatively underwhelming view of the U.K.'s economic prospects. Sentiment surveys such as the PMI indices remain at subdued levels, and there is potential for further fiscal tightening at the government's budget update in the fall. Given these headwinds and an environment of sluggish demand, we believe inflation has potential to surprise to the downside. That is, as pricing power diminishes, we think inflation could peak at a lower level than the BoE forecasts, and/or decelerate faster than the BoE projects. That is especially the case given that wages are already on a more clearly slowing path, which amid subdued economic demand and potentially narrowing corporate margins, could also be reflected in slower price inflation over time. If upcoming CPI readings and other price indicators are consistent with our more favorable inflation view, we expect the quarterly pace of rate cuts to continue. That said, we are data-dependent and will be critically watching inflation figures, in particular. Should those inflation pressures unexpectedly intensify or fail to dissipate, we remain prepared to adjust our outlook.

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