UK Watch

BoE review: Hold with small dovish undertones

19 June 2025

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Hold with a dovish vote pattern

The Bank of England (BoE) kept the Bank Rate unchanged at 4.25% as expected. The voting pattern of 6-3 was more dovish than expected.

Gradual guidance but small dovish undertones

The BoE retained its careful and gradual guidance. There were some small dovish undertones. The MPC seems more convinced that the labour market is loosening and at the margin more sensitive to growth and labour market weakness. However, for now they don't expect a sharp slowdown. The MPC also has more confidence in significant slowing in pay growth. There were also some less dovish elements, including the need to keep monitoring rising energy prices and the impact of NICs and rising food prices on inflation expectations. The MPC continues to see two sided risks to inflation.

We continue to expect the next cut in August

The overall message from today's meeting implies that a summer skip to quarterly cuts is less likely. We continue to expect the next cut in August. There isn't a strong signal yet in the minutes that they are ready to accelerate, but greater sensitivity to labour market and growth as well as higher confidence in disinflation mean data can get them there. We see scope for inflation to be lower than the BoE's estimates and expect cuts in August, September and November with a dovish pivot in H2. Having said that, we acknowledge that elevated inflation, gradual guidance and rising energy/ food prices put our call for September cut at risk, but we think the bar to cut less than quarterly is high.

Rates: benign messaging sets up August for a cut

A more dovish than expected June MPC did not sway the market much. 1y1y Sonia is now below the post-May MPC level, with today's meeting augmenting support from this week's May CPI data, which the market took to be benign. Our confidence in an at least quarterly cutting path has firmed this week on both the inflation release on Wednesday and Thursday's June BoE MPC outcome. Risk-reward in receiving late 2025 MPC-dated Sonia continues to look attractive. Relative to our economists' global outlook, our Fed call versus market pricing stands out as the sharpest contrast to what we expect in the UK. Further out, our conviction remains unchanged, with us seeing UK rates as attractive, tactically, over the summer (and hopefully beyond).

FX: Markets were prepared

Our priors that argued that risks were skewed to a more dovish outcome were realised and subsequent GBP price action suggests that this was the prevailing market view. The initial dip was quickly recouped but for the time being against the backdrop of seasonality (June being the worst month for GBP) and geo-politics suggest GBP will remain on the defensive. We are encouraged by the fact that markets are not positioning themselves for a period of GBP weakness using risk reversals as a proxy.

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BoE review: Hold with small dovish undertones

Hold with a dovish vote pattern

The Bank of England (BoE) kept the Bank Rate unchanged at 4.25% as expected. The voting pattern of 6-3 was more dovish than expected, with Ramsden voting for a 25bps cut along with Dhingra and Taylor. The members who voted for a cut said that evidence points to material further loosening in labour market conditions.

Gradual guidance but small dovish undertones

As expected, the BoE retained its careful, gradual and meeting by meeting guidance as well as need for policy to remain restrictive, in the midst of uncertainty. The MPC also keeps optionality by noting that "Monetary policy is not on a pre-set path."

But there were some small dovish undertones in the minutes:

1) The vote was more dovish than expected.

2) The MPC seems more convinced that the labour market is loosening and at the margin more sensitive to growth and labour market weakness. The minutes state that evidence is pointing to clearer signs that slack has opened up. While the MPC is treating the recent fall in payrolls with caution, it says survey measures are also corroborating the pattern of ongoing loosening. However, for now they don't expect a non-linear and sharp slowdown.

> From the minutes "Underlying UK GDP growth appears to have remained weak. The labour market has continued to loosen, leading to clearer signs that a margin of slack has opened up over time. A measure of underlying employment growth developed by Bank staff continued to suggest a subdued rate of near-zero employment growth. Taken together, the analysis conducted by Bank staff implied that slack was continuing to emerge in the labour market but there were no strong signs, as yet, that a more abrupt loosening was underway."

3) MPC has more confidence in significant slowing in pay growth over the rest of the year, with evidence from a more representative sample of pay settlements in April continuing to point to 3.5-4% range. The minutes also noted that "The growing margin of slack in the labour market pointed to limited pay drift going forward". Focus would now be on how much this easing pay growth feeds to domestic inflation.

4) The minutes say that inflation can fall back towards target next year.

Having said that there were also some less dovish elements, including the need to keep monitoring the impact of NICs and rising food prices on inflation expectations as well as rising energy prices due to geopolitical tensions. The members who voted for a hold noted that persistence could be generated by second round effects of higher food prices. The committee continues to see two sided risks to inflation. The members who voted for a hold said that geopolitics didn't play a role in their decision.

We continue to expect the next cut in August

Overall, the message is that there has been good progress in underlying inflation, greater conviction that the labour market is loosening and higher sensitivity to growth and labour market weakness. This implies that summer skip to quarterly cuts is less likely. We continue to expect the next cut in August.

At the same time, risks to inflation remain two sided. There isn't a strong signal yet that they are ready to accelerate, but greater sensitivity to the labour market and growth as well as higher confidence in disinflation mean data can get them there.

We see scope for inflation to be lower than the BoE's estimates, amid continued progress in domestic inflation/pay growth, further loosening of the labour market, weaker growth, easing inflation expectations and potential disinflationary impact from tariffs. We expect cuts in August, September and November to a terminal of 3.5%, with a dovish pivot in H2. Having said that, we acknowledge that elevated inflation, gradual guidance and rising energy/ food prices put our call for September cut at risk, but we think the bar to cut less than quarterly is high.

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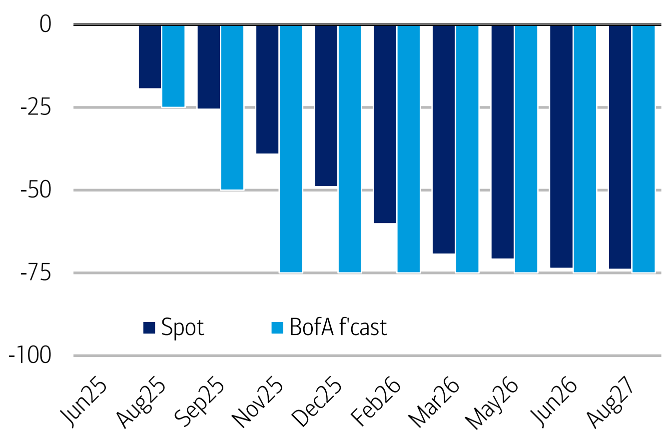
Rates: benign messaging sets up August for a cut

A more dovish-than-expected June MPC did not sway the market much, with money markets adding to BoE rate-cut expectations at margin and pricing in 19bp of cuts in August and 49bp by year-end at the time of writing (Exhibit 1). 10y Gilts rallied 1bp after the Bank Rate decision, having rallied 4bp in the morning. 1y1y Sonia is now below the post-May MPC level (Exhibit 2), with today's meeting augmenting support from this week's May CPI data, which the market took to be benign.

Our confidence in an at least quarterly cutting path has firmed this week on both the inflation release on Wednesday (Inflation Review: Progress in underlying inflation continues, 18 June) and Thursday's June BoE MPC outcome. Risk-reward in receiving late 2025 MPC-dated Sonia continues to look attractive, with the market pricing only two 25bp rate cuts while our base case remains three sequential 25bp Bank Rate cuts starting in August (albeit with risks of no cut in September). Relative to our economists' global outlook, our Fed call versus market pricing stands out as the sharpest contrast to what we expect in the UK. Our US economists continue to expect no FOMC rate cuts this year (June FOMC meeting: Maximal optionality, 18 June).

Further out, our conviction remains unchanged, with us seeing UK rates as attractive, tactically, over the summer (and hopefully beyond). Next Monday's speech by the Fed's Vice Chair for Supervision Michelle Bowman ("Assessing the effectiveness of monetary policy during and after the COVID-19 pandemic) will be in focus for any hints on US SLR developments and their potential spillover effects to the UK.

Exhibit 1: MPC-dated Sonia rate cut pricing, bp
Market pricing in around one 25bp cut less than our base case by end-2025



Source: Bloomberg, BofA Global Research

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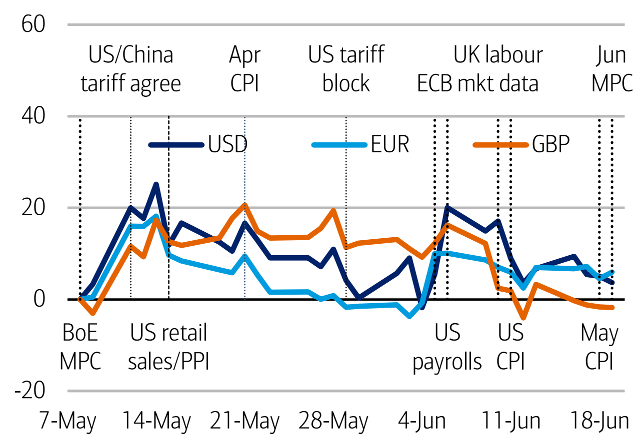
Exhibit 2: 1y1y OIS changes since May MPC, bp
1y1y Sonia now below the yield levels of the May MPC aftermath



Source: Bloomberg, BofA Global Research

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FX: Markets were prepared

Our priors that argued that the risks were skewed to a more dovish outcome were realised and the subsequent GBP price action suggests that this was the prevailing market view. The initial dip was quickly recouped but for the time being against the backdrop of seasonality (June being the worst month for GBP) and geo-politics suggest GBP will remain on the defensive. Much has been made of the weak June performance of GBP but we are encouraged by the fact that markets are not positioning themselves for a period of GBP weakness using risk reversals as a proxy.

In some ways, the tone of the statement is a mark to market exercise by the MPC in light of recent data on employment and inflation. We do not believe that the BoE is picking up signs of slowing momentum that have not already been flagged. As a result, with the UK perhaps at the forefront of feeling the impact of the tariff tumult, we think other countries will inevitably follow. Fiscal stimulus remains a key factor in our view that the UK will escape the worst excesses of trade uncertainty and softer inflation reduces consumer headwinds as well as rate cuts. With trade protection on the rise, the UK, ironically, has pivoted towards more liberalisation with the announcements of the UK-US trade deals and Brexit reset talks.

Additionally, with UK Plc still attractive from valuation and positioning terms, we think GBP could be the beneficiary of USD derisking with some talk that reserve managers are actively considering GBP as a reserve currency once more. Furthermore, whilst much print has been devoted to PM Starmer, in a world dominated by policy volatility, a stable UK government in comparison to previous years does hold its appeal. GBP/USD towards 1.40 and above remains our core view whilst we think EUR/GBP levels are becoming increasingly attractive to establish medium-term shorts and towards our 0.75-0.80 trading range over the next 18 months.

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