

UK Watch

BoE preview: Careful (not cautious) hold

Hold with a 7-2 vote

We expect the Bank of England (BoE) to keep the Bank Rate on hold at 4.25% at its June meeting, with a 7-2 vote (2 votes for 25bps cut). Risks of a more dovish pattern.

Gradual guidance, inflation strength, better trade news

BoE's gradual guidance, April inflation strength and slightly better trade news support a hold. Even though we judge April inflation strength to be noisy and reverse in May (out a day before June meeting), the upside surprise will nonetheless make an uncomfortable print. The US/ UK trade deal and US de-escalation with China also cap severe downside risks to UK growth from tariffs, though growth is likely to be lower vs. pre-liberation day.

Gradual and careful guidance in the midst of uncertainty

We expect the BoE to retain the careful, gradual and meeting by meeting bias as well as need for policy to remain restrictive, in the midst of uncertainty. We think the BoE will likely hold on to its careful/ gradual guidance as it judges how much of the April inflation strength persists, the impact of the inflation hump on inflation expectations and pay awards as well as wait for more evidence on growth/ inflation hit from tariffs. The MPC is also likely to keep optionality by noting that "Monetary policy is not on a pre-set path.

Minutes to imply skip to quarterly cuts is less likely

Barring big upside surprises in May inflation, we expect the minutes to imply that a summer skip to quarterly cuts (an idea that gained traction after Pill's cautious speech and April inflation) is less likely. This could be by emphasizing that progress in underlying inflation is continuing amid looser labour market, lower pay awards and weaker growth. We expect cuts in August, September and November to 3.5%, with a dovish pivot in H2 once the near-term inflation hump is out of the way and disinflationary /growth hit from tariffs is more evident. Though we acknowledge that elevated domestic inflation puts our call for September cut at risk, we think the bar to cut less than quarterly is high.

Rates: Keeping the faith

The Bank has said that it will need to see sufficient progress in inflation, with the outlook for Bank Rate cuts importantly relying on continued slowing of wage gains. This week's data provided some encouraging evidence. The rates market is not expecting the Bank of England (BoE) to cut Bank Rate next week, and nor do we. But our projection of three sequential 25bp Bank Rate cuts starting in August implies a faster rate cutting pace than assumed by the market, with the divergence particularly notable in November.

GBP: Can BoE ease the squeeze?

Seasonal GBP underperformance and renewed macro data softness have provided the catalysts for recent price action. But our GBP dashboard does not suggest that markets are taking an increasingly bearish stance towards GBP. Positioning though is a concern as is the broader risk backdrop against the July 9th tariff deadline. The recalibration in BoE market pricing brings it closer to our base case though we note that rates/carry have not been a good guide for GBP price action. The global risk dynamic will likely dominate. A dovish MPC is perhaps the base case which creates some GBP asymmetry.

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BoE preview: Careful (not cautious) hold

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Hold

We expect the Bank of England (BoE) to keep the Bank Rate on hold at 4.25% at its meeting next week. We expect a vote of 7-2, with Dhingra and Taylor voting for a 25bps cut. There are risks of a more dovish pattern with Mann voting for a cut due to tighter financial conditions/looser labour market or one of the members voting for a 50bps cut.

Gradual guidance, April inflation strength, better trade news support a June hold

BoE's gradual guidance, April inflation strength and slightly better trade news support a hold in June. The voting pattern in May was hawkish as some members mainly voted for a cut due to emerging tariff risks. The BoE retained its gradual guidance, a disappointment to markets expecting a dovish twist. The gradual guidance and hawkish voting pattern imply that chances of a back-to-back June cut reduced significantly.

The May meeting implied to us that BoE will need to see sufficient progress in inflation to switch from its gradual stance and vote for consecutive meeting cuts. The upside surprise in April inflation (headline at 3.5%, 10bps above the BoE's forecast and services at 5.4%, 40bps above the BoE's forecast) is unlikely to give them that confidence.

Worth noting though that there is a lot of noise in the April data, and we expect the strength to reverse in May. The rise in services inflation was due to administered prices, volatile components, and timing of Easter. Moreover, given the error identified by ONS on Vehicle Excise Duty, April inflation was lower than printed by 12bps (corrected headline is at 3.4%, in line with BoE's forecast and services inflation would likely have been lower too). So, we think the BoE is unlikely to derive a strong signal from the April print. Nonetheless it makes for an uncomfortable print for the BoE worried about inflation persistence. The BoE would be looking for April's strength to reverse in May (published on 18 June, a day before the MPC's June meeting), which would be key.

At the same time, the US/ UK trade deal and US de-escalation with China cap severe downside risks to UK growth from tariffs. However, growth is likely to be lower relative to pre-liberation day as 10% tariffs remain in place (we downgraded growth by 30bps in 2025 due to tariffs). In that regard GDP contracted more than expected by 0.3% in April, driven by tariffs and tax rises (stamp duty and NICs), with goods exports to the US experiencing the largest monthly drop on record.

We expect gradual and careful guidance in the midst of uncertainty

We expect the BoE to retain the careful, gradual and meeting by meeting bias as well as need for policy to remain restrictive, in the midst of uncertainty. We think the BoE will likely hold on to its careful/ gradual guidance as it judges how much of the April inflation strength persists, the impact of the inflation hump on inflation expectations and pay awards as well as wait for more evidence on growth/ inflation hit from tariffs.

Guidance to remain unchanged from May- "Based on the Committee's evolving view of medium-term outlook for inflation, a **gradual and careful** approach to the further withdrawal of monetary policy restraint is appropriate. Monetary policy will need to **continue to remain restrictive for sufficiently long** until the risks to inflation returning sustainably to the 2% target in the medium term had dissipated further. The Committee will decide the appropriate degree of monetary policy restrictiveness **at each meeting.**"



In the midst of uncertainty, the MPC is also likely to keep optionality by noting that "Monetary policy is not on a pre-set path. The Committee will remain sensitive to heightened unpredictability in the economic environment and will continue to update its assessment of risks."

But minutes to imply that summer skip to quarterly cuts is less likely

The idea that the BoE could skip quarterly cuts in the summer gained traction after the April inflation print and Pill's speech. Pill, in his speech explaining his vote for a May hold, revealed that his preference for a cautious path implies a pace which is slower than quarterly 25bps cuts, opening the door for him to vote for skips to the quarterly path. But worth noting that Pill is not the median voter and has dissented in the past. In comments since May, the median of the committee has stuck to the careful and gradual guidance (which we interpret as more dovish relative to cautious).

We think the bar for the BoE to cut less than quarterly path is high. For that to happen, we would need to see stalling in the underlying path of disinflation and strong second round effects to emerge. In that regard it was reassuring that in the Treasury Select Committee, Bailey and Breeden continued to think that the path of disinflation is intact amongst looser labour market and lower pay awards, and path of rates is downwards.

The latest labour market data showed weaker than expected wage growth (see [UK Labour market: Wage growth cools faster than expected](#)) and GDP contracted more than expected in April (see [UK GDP: Tariffs and taxes weigh on growth](#)). At 5.1% in three months to April, private wage growth is likely to undershoot BoE's expectation of 5.2% for Q2. At the same time, unemployment rose, and payrolls fell for the eighth consecutive month. While we need to be cautious in overinterpreting the weakness in payrolls data which gets frequently revised, the labour market nonetheless is loosening, and wage growth is moderating faster than expected. BoE has emphasized that rates outlook hinges on continued slowing of wage gains and the faster than expected progress on that front is encouraging. Business inflation and wage expectations from the Decision Maker Panel also continue to grind lower, PMI indicators point to easing price pressures in May and BoE Agents 2025 pay settlements are expected at 3.7%.

Moreover, Bailey emphasized that it is unclear how much of the April inflation rise was due to seasonal effects and they would have another month's data to consider before its June decision. He noted that the less volatile part of inflation is gradually grinding down, referring to services inflation excluding indexed and volatile components (BoE's measure of services inflation) falling from 4.4% to 4.2% in April, after stalling for past two prints.

But May inflation data needs to confirm the assessment that April inflation strength was a one-off (we expect headline inflation to fall from 3.5% to 3.3% and services to fall from 5.4% to 4.8% in May). Another key data point before June MPC is BoE's Ipsos Inflation Expectations (13 June), where we think there is scope for household inflation expectations for Q2 to fall, after rising since Q4 2024 which has worried MPC members.

Barring big upside surprises in these two data points, we expect the minutes to imply that a summer skip to quarterly cuts is less likely. This could be by emphasizing that progress in underlying inflation is continuing amid looser labour market and lower pay awards, one-off price rises are not expected to lead to second round effects and tariffs are negative for growth and mildly disinflationary.

We continue to expect cuts in August, September and November to 3.5%, with a dovish pivot and small acceleration in H2, once the near-term hump in inflation is out of the way and the disinflationary /growth hit from tariffs is more evident. We see scope for inflation to be lower than the BoE's estimates, amid continued progress in domestic inflation/pay growth, looser labour market, weaker growth, easing inflation expectations and potential disinflationary impact from tariffs. Even though we do acknowledge that elevated domestic inflation puts our call for September cut at risk, we think the bar for the BoE to cut less than the quarterly path is high.

Rates

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Keeping the faith

Data builds in favour of cuts after setback from MPC messaging

The Bank has said that it will need to see sufficient progress in inflation, with the outlook for Bank Rate cuts importantly relying on continued slowing of wage gains. This week's data provided encouraging evidence of labour market and wage moderation (while acknowledging that the monthly wage numbers are volatile).

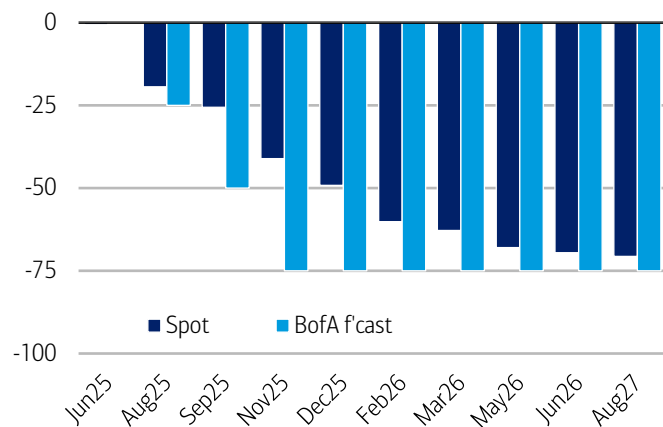
This, alongside other evidence of a moderating inflation picture – the Decision Maker Panel (DMP) noting lower price and wage expectations in May, the Office for National Statistics (ONS) reporting that there has been an upside error in the April CPI numbers worth 12bps – and weaker monthly GDP on Thursday, all prop up our confidence in at least quarterly Bank Rate cuts being delivered for the rest of 2025.

The rates market is not expecting the Bank of England (BoE) to cut Bank Rate next week, and nor do we. But our projection of three sequential 25bp Bank Rate cuts starting in August implies a faster rate cutting pace than assumed by the market, with the divergence particularly notable in November (Exhibit 1).

1y1y Sonia is almost back to post-May Monetary Policy Committee (MPC) yield levels, with another 13bp rally needed to erase the underperformance after the hawkish surprise at the May MPC (Exhibit 7). This week's labour market data provided the latest bout of support (Exhibit 2).

Exhibit 1: MPC-dated Sonia rate cut pricing, bp

Market pricing in around one 25bp cut less than our base case by end-2025

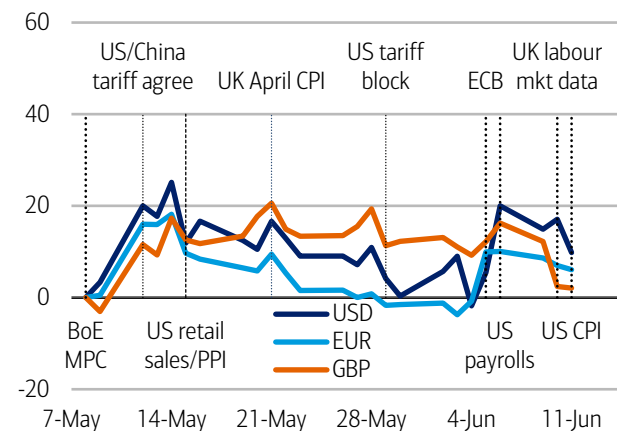


Source: Bloomberg, BofA Global Research

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Exhibit 2: 1y1y OIS changes since May MPC, bp

1y1y Sonia almost back to the levels of the May MPC aftermath



Source: Bloomberg, BofA Global Research

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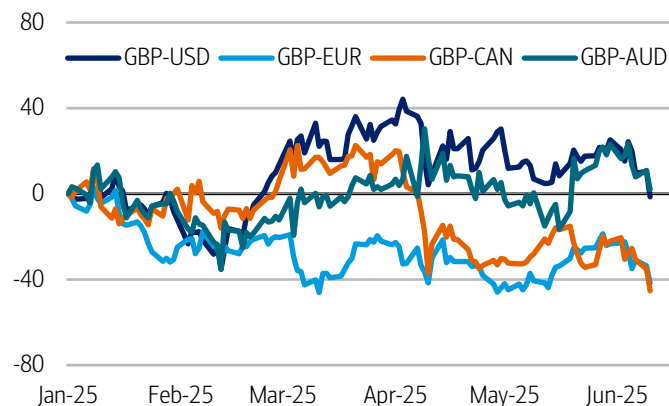
Year-to-date, 1y1y Sonia is some 40bp richer relative to EUR and CAD OIS and broadly flat versus 1y1y USD and AUD (Exhibit 3). On a relative basis, 1y1y Sonia looks rich relative to 1y1y SOFR over the past 12 months (Exhibit 4).

Still, relative to our economists' global outlook, our Fed call vs. market pricing stands out as the sharpest contrast to what we expect in the UK (Exhibit 5 **Error! Reference source not found.**). Low positive directionality as of late between Sonia and SOFR would be helpful, if persisting, allowing Sonia to perform relative to SOFR further (Exhibit 6).



Exhibit 3: 1y1y OIS changes year-to-date, bp

Back to flat relative to 1y1y USD and AUD, 40bp rich vs. CAD and EUR



Source: Bloomberg, BofA Global Research

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Exhibit 5: Central bank rate change expectations, market and BofA

Our Fed call vs. market stands as the most opposite to the case in the UK

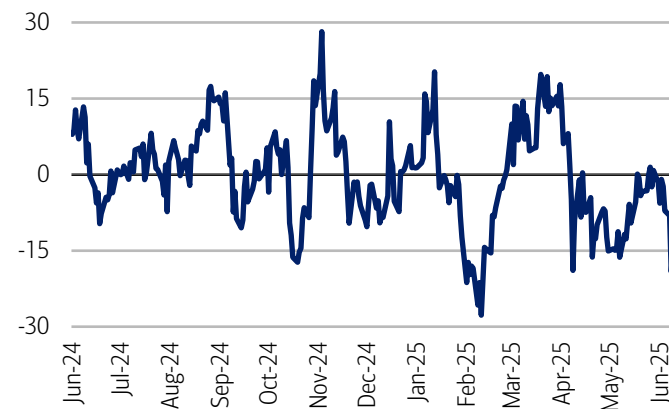
	Current (%)	Next change (bp)		Change by end-2025 (bp)		
		BofA	Market	BofA	Market	Diff
Fed	4.375	Jul'26 (-25)	Oct'25 (-32)	0	-48	48
ECB (depo)	2.00	Sep'25 (-25)	Dec'25 (-26)	-50	-26	-24
BoE	4.25	Aug'25 (-25)	Sep'25 (-26)	-75	-50	-25
BoC	2.75	Sep'25 (-25)	Oct'25 (-27)	-75	-23	-52
RBA	3.85	Nov'25 (-25)	Aug'25 (-41)	-50	-78	28

Source: Bloomberg, BofA Global Research

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Exhibit 4: 1y1y Sonia vs. SOFR regression residual, bp

1y1y Sonia appears on the rich side over the past 12 months

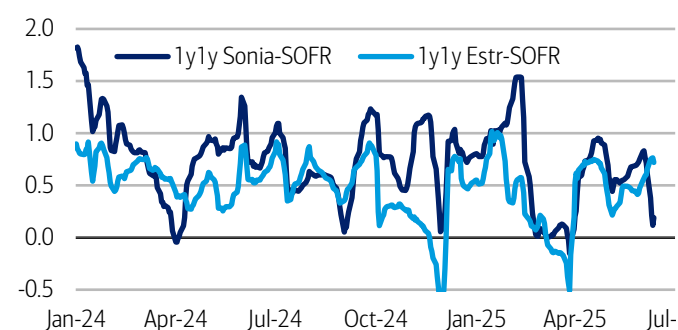


Source: Bloomberg, BofA Global Research

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Exhibit 6: 1y1y Sonia and Estr directionality to SOFR

Low directionality between Sonia and SOFR lately

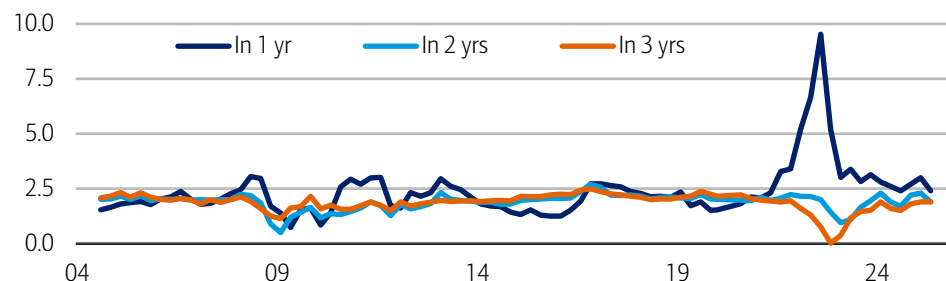


Source: Bloomberg, BofA Global Research

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Exhibit 7: Hawkish May MPC undeniable, but they did still cut 1- and 2-year ahead inflation forecasts

1- and 2-year ahead MPC inflation forecasts fall, with the all-important 2-year ahead figure falling below 2%.



Source: Bank of England Monetary Policy Report, BofA Global Research

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Tracking global trends.

Weak seasonals, positioning and technical charts have been the key drivers for GBP underperformance of the past month and given added impetus renewed macro softness. GBP TWI (trade weighted index) is currently trading close to its highs since 2016 and given the broader macro/markets set-up, we think the constraints to near-term gains have been limited. We maintain a medium-term constructive view towards GBP but may need to see out the rest of the month for that view to play out – the start of H2 2025 is usually a strong seasonal period for GBP.

Whilst recent data has shown some attrition to recent domestic policy changes, we believe that UK data is starting to show some early signs of tariff impacts, most notably in the UK trade data. The UK will not be alone in facing such headwinds but due to relative openness may be amongst the first to feel the impacts. Fiscal stimulus should help to cushion some of these headwinds but the UK is unlikely to be the outlier amongst the major economies.

With these dynamics in play, the obvious direction of travel into the BoE is for the MPC to take a dovish slant but critically, how dovish will be gauged by how much the market moves in to price more easing into the curve. We think there is some asymmetry given the move in GBP over the past month and a reflection that “the world is changing” narrative will not be uncommon across G10 central banks. The UK cannot be singled out and for now, options skew is not suggesting this is the case.



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