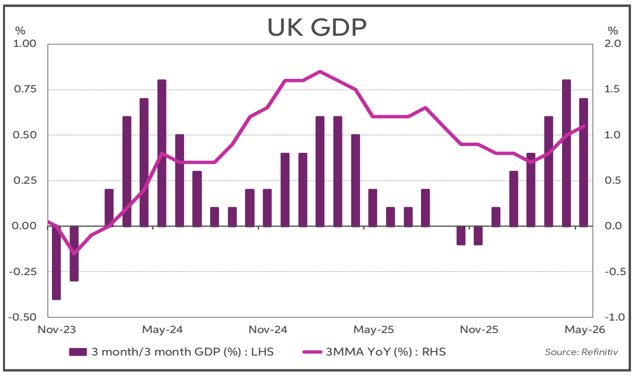
BoE Watch

AIB Treasury Economic Research Unit

30th July 2026

BoE remains on hold at 3.75% and near term rate change unlikely



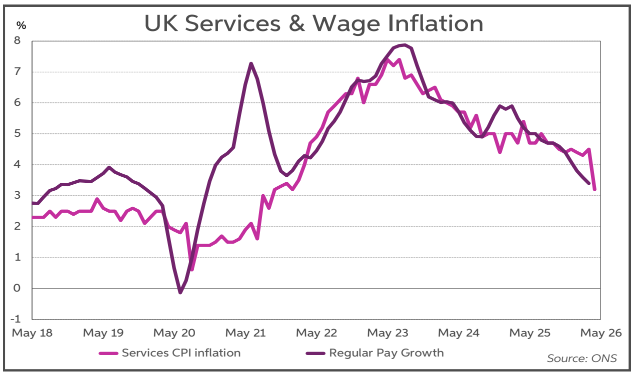
The Bank of England's Monetary Policy Committee (MPC) meeting for July saw the central bank leave the Bank Rate unchanged today, at 3.75%, as expected. This represents the fifth successive meeting where the central bank has been on hold.

Today's decision to leave rate unaltered was once again, not unanimous. There was a further hawkish shift in the voting breakdown, with the decision split at 6:3, with three members (Pill, Green and Mann) in favour of a 25bps rate hike (there were two votes for this at the June MPC). For the majority, they were of the view that the combined effect of keeping official interest rates steady and the tightening in financial conditions since the Middle East conflict began was "providing sufficient insurance against the upside risks to inflation" arising the energy price shock. For the three dissenters, they were "less assured" on the underlying disinflationary process and were worried that "second-round effects could be material" and were of the view that a "proactive increase" in rates was warranted.

We also got a more detailed insight on the BoE's assessment of the economic outlook, with the publication of its latest Monetary Policy Report for July (MPR). In terms of its central scenario which assumes only "moderate second-round inflation effects, it has upgraded its growth outlook compared to its April forecasts. GDP is now expected to rise by 1.1% both this year (was 0.8%) and next year (was 1.0%). GDP growth is seen averaging 1.7% in 2028. On the inflation front, the BoE is now anticipating inflation to end this year at 3.2% easing to 2.1% by Q4 of 2027 and falling below its 2% target to 1.9% by the end of 2028. **Similar to its April edition, the MPC outlined two alternative scenarios for the economic outlook to factor in the elevated level of uncertainty due to the Middle East conflict.** The "Milder" scenario entails no additional second-round effects from the recent energy price shock, while the "Adverse" scenario encompasses "stronger and more persistent additional second-round effects". In short, relative to the central projection, inflation is higher in the adverse scenario and lower in the milder scenario.

While the voting breakdown was more hawkish versus June, the meeting statement for July had a less hawkish tone to it. The BoE noted today that "there is little evidence so far" in relation to second-round effects, whilst at the same time "there have continued to be clear signs of underlying disinflation in recent data". **Meanwhile, in the press conference Governor's Bailey's comments were also less hawkish in tone**. He noted that inflation metrics were below its previous expectations as well as stating there was "little evidence of second-round effects so far" while also referencing increasing spare capacity in the labour market.

Overall, assessing the various updates (statement, minutes, MPR, press conference) from the BoE today, there is little to suggest that the BoE is contemplating any near term rate hikes. Indeed, in the press conference Governor Bailey was very keen to clarify a misconception from a journalist that the BoE was considering tightening policy by saying "do not leave this room thinking that the Bank of England is edging towards a hike". **Our view remains unchanged. We believe that the BoE will not hike interest rates this year.** Instead, we project that the Bank Rate will remain at its current 3.75% level into year end. Looking further ahead, we anticipate that the next policy move from the BoE will be a rate cut, to resume its easing cycle, which has been paused since December 2025. However, we do not expect this to happen until the first quarter of 2027 at the earliest. Of course, the evolution of the Middle East conflict and energy prices will very much determine the near term policy outlook for the BoE.



The movement in futures contracts in the aftermath of today's BoE meeting indicate that investors interpreted the MPC as being less hawkish in its mindset. The market is now attaching around a 30% probability to a September hike (was nearer to 45% prior to today). However, it is continuing to price -in a 25bps rate hike by the end of the year and another increase by the end of H1'27.

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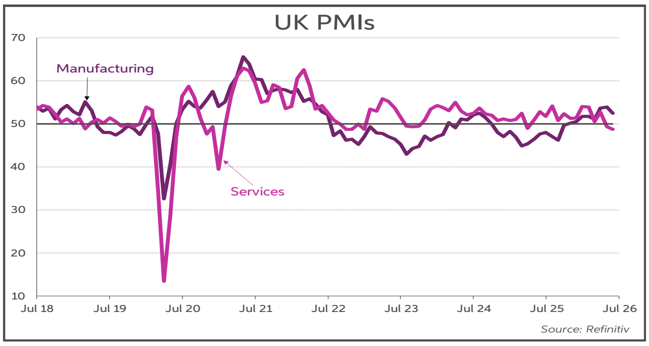
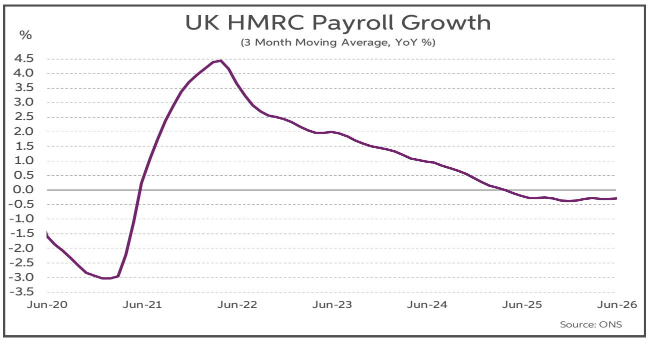
UK economy expected to grow at a moderate pace



Solid UK growth, particularly in the first half of 2025, meant that the UK economy expanded by 1.3% last year. Crucially, GDP per capita increased by 1.0% in 2025, having flatlined in 2024 and contracted by 1.0% in 2023. However, it should be noted that the economy shed significant momentum in the second half of the year, with GDP rising by just 0.1% per quarter in H2. The economy regathered some steam in Q1 2026 though, with GDP rising by 0.6% in the quarter. A rise in consumption and government expenditure, as well as a modest uplift in investment, contributed 0.7 percentage points (p.p.) to growth. However, a contraction in external trade knocked 0.4 p.p. from the total, albeit this was offset by changes in inventories.

Meanwhile, the available hard data for Q2 have been mixed. GDP contracted by 0.1% m/m in April, before rebounding by 0.1% in May. At the same time, industrial production has been weak, rising by 0.2% in April, but contracting by 0.5% in May. Meanwhile, retail sales fell by 0.7% in April, amid lower fuel consumption due to the increase costs at the pump, because of the war in the Middle East. However, it rebounded sharply in May and June, increasing by 1.3% and 1.0%, respectively. **The key survey data for the second quarter have also been varied.** The services PMI moved back into contraction territory in May, for the first time since April 2025, and deteriorated further in June. Overall, it averaged 50.3 in Q2 compared to 52.8 in Q1. In contrast, the manufacturing PMI has continued to trend higher. It averaged 53.4 in Q2 up from 51.5 in Q1. Consumer confidence deteriorated sharply though. It fell to −25.0 in April, its lowest level since October 2023, before rebounding modestly to −23.0 in May and June.

In terms of the labour market, conditions have softened over the past year. The unemployment rate increased steadily, from 4.4% at the start of 2025 to 5.2% in December, its highest level since January 2021. It remained at 5.2% in January and has printed in a 4.9-5.0% range in the past four months. However, this appears to have been partly driven by people leaving the labour force rather than a significant drop in the number unemployed. Worryingly, payrolls have contracted in seven of the past twelve months to June, and in all bar two months this year. Against this backdrop, wage inflation has cooled. Average earnings growth fell to +4.3% y/y in the three months to May, compared to +4.9% over the same period last year. Meanwhile, the BoE Agent's Summary Survey for July suggests that pay settlements may average around 3.5% in 2026 but that concerns around 2027 pay settlements are growing, amid the impact of higher inflation expectations this year.



Meanwhile, inflation has fallen in the UK this year, but it is likely to re-accelerate over the summer months. As the retail energy price cap reset lower in April, the headline CPI rate declined to 2.8% from 3.3%. It surprisingly remained at 2.8% in May also, amid a fall in food prices, and eased to 2.6% in June. Similarly, core inflation fell sharply to 2.5% in April from 3.1% in March. In May, it edged slightly higher to 2.6% and remained at that level in June. However, services inflation remains elevated and it rose sharply to 3.7% in May, up from 3.2% in April. The BoE noted today, that it now expects inflation to remain at 3.2% in Q4'26.

In summary, the UK economy enjoyed a solid start to the year following a weak end to 2025. At the same, inflationary pressures were continuing to cool at the start of 2026, which had opened the door to further rate cuts this year. However, the emergence of the war in the Middle East has narrowed the chances of policy easing. The economic fallout of the war poses a stagflationary shock to the UK economy, meaning it will simultaneously increase inflation and weigh on growth. At the same time, the UK fiscal position remains challenging, limiting the policy options available to new PM Burnham. Overall, the BoE is pencilling growth of 1.1% for both this year and next year.

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