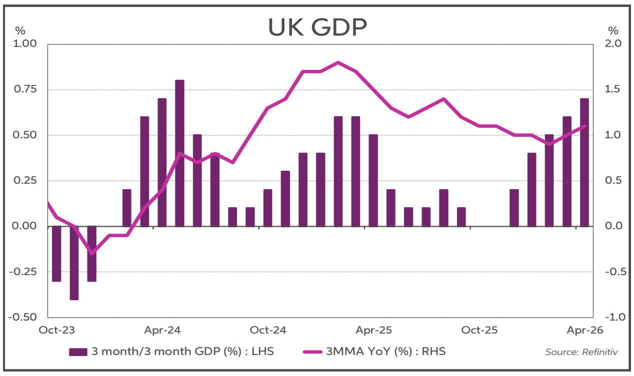
BoE Watch

AIB Treasury Economic Research Unit

18th June 2026

BoE remains on hold, at 3.75%



The June policy setting meeting of the Bank of England's Monetary Policy Committee (MPC), saw the central bank leave the Bank Rate unchanged today, at 3.75%. This represents the fourth successive meeting where the official rate has been left unaltered. This outcome was very much in line with market expectations. The most recent rate cut from the BoE occurred at its December meeting, when it lowered the Bank Rate by 25bps. This represented the fourth 25bps rate cut from the BoE last year. The BoE has lowered rates by 150bps in total since August 2024.

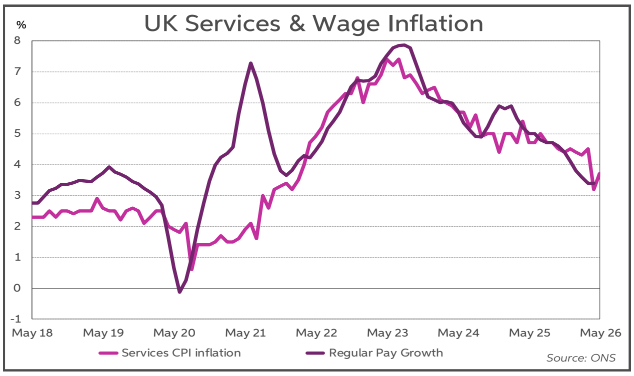
Today's decision to leave rates on hold was not unanimous once again, following an 8:1 split in April. Today's vote was split 7:2, with two member (Huw Pill, Megan Green) voting for a 25bps rate hike. They referenced the risk of "larger second-round effects" on inflation from higher energy prices. **Within the majority of seven, there was a slight divergence of views amongst the members.** For six members , "upside risks to energy prices had receded", while a single member, Catherine Mann, noted continued "upside risks" to inflation.

Today's BoE meeting did not coincide with the publication of the Bank's assessment of the UK economic outlook. However, the statement noted that the data out-turns since the last forecast in April were generally better than expected in terms of inflation. That April forecast had outlined three different scenarios for the economic outlook. Scenario A is the most benign, with no second-round inflation effects. Scenario B assumes a more prolonged conflict and incorporates "modest additional second-round effects". Meanwhile, Scenario C assumes a much more disruptive conflict including "stronger and more persistent second round effects" over the full horizon of its 3-year forecasting period.

In terms of the growth outlook, Scenario A and B are very similar. GDP is forecast to rise, in both, by 0.8% and 1.0% in 2026 and 2027, respectively. Scenario A envisages 1.8% GDP growth in 2028, while Scenario B is at 1.7%. This compares to its February MPR central projection GDP growth profile of 0.9% (2026), 1.5% (2027) and 1.9% (2028). Meanwhile, Scenario C has growth at 0.7% (2026), 0.8% (2027) and 1.7% (2028).

On the inflation front, while member's views diverged, the majority still view the risks of second-round inflation as relatively muted compared to the last price shock in 2022. The statement emphasised two key factors: 1) the labour market continues to loosen "gradually", with wage growth slightly weaker than expected; and 2) already "material tightening" in financial conditions, with significant pass through of market rate rises to household and business lending pricing. The BoE now expects inflation to peak at 3.25% in Q4 '26, below the path expected in the April Monetary Policy Report.

In summary, today's communications from the BoE indicate a slightly dovish shift in the central bank's mindset regarding the interest rate outlook, with the announcement of a US-Iran ceasefire deal likely giving the BoE some comfort in positioning of monetary policy. The statement also noted some "partial mitigants to the impact of the disruption to global energy supply on energy prices", such as the drawdown of global strategic oil reserves.



Despite the slightly dovish tilt in the BoE statement, futures contracts continue to price in around 35bps of rate hikes by the end of this year, with the first 25bps hike fully priced in by October.

Overall then, the BoE rate outlook remains very much dependent on how the post-conflict situation in the Middle East evolves in terms of energy and commodity prices, but there is now a greater chance of the BoE not tightening policy further in the coming months, if oil prices continue to evolve favourably.

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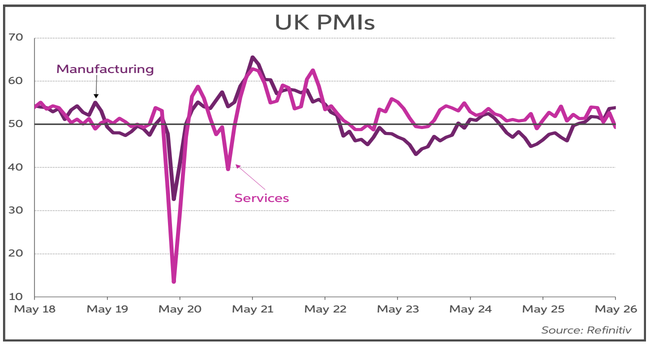
UK economy still faces the risk of stagflation

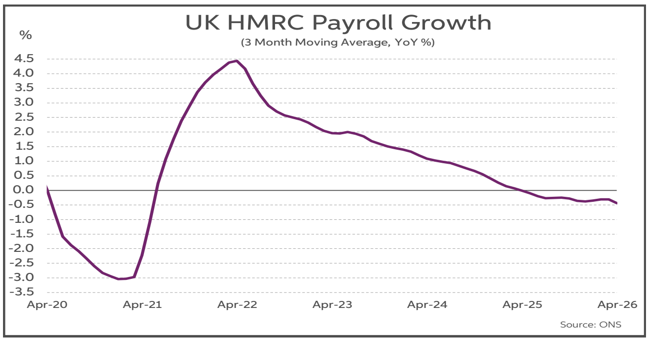


Solid UK growth, particularly in the first half of 2025, meant that the UK economy expanded by 1.3% last year. Crucially, GDP per capita increased by 1.0% in 2025, having flatlined in 2024 and contracted by 1.0% in 2023. However, it should be noted that the economy shed significant momentum in the second half of the year, with GDP rising by just 0.1% per quarter in H2. The economy looks to have regathered some steam in Q1 2026 though, with GDP rising by 0.6% in the quarter. A solid rise in government expenditure and consumption contributed 0.4 percentage points (p.p.) to growth. However, a fall in investment and a contraction in external trade, clipped 0.3 p.p. from the total, albeit this was offset by changes in inventories.

Meanwhile, the available hard data for Q2 have been relatively soft. The monthly reading GDP contracted by 0.1% in April. At the same time, industrial production stagnated in the month, following a slight contraction in March. Retail sales were also quite weak, falling by 1.3% in April, albeit this was partly driven by lower fuel consumption due to the increase costs at the pump due to the war in the Middle East.

However, the key survey data have been mixed in the second quarter. The services PMI moved back into contraction territory in May, for the first time since April 2025. In contrast, the manufacturing PMI has continued to trend higher, rising to 53.9 at the midpoint of Q2, a four-year high. Consumer confidence has deteriorated sharply though. It fell to −25.0 in may, its lowest level since October 2023, before rebounding modestly to −23.0 in May.

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, albeit it has printed at 4.9-5.0% in the past three months. However, this appears to have been partly driven by people leaving the labour force rater than a significant drop in the number unemployed. Worryingly, payrolls have contracted in eight of the past twelve months to April. Against this backdrop, wage inflation has cooled over the last year. Average earnings growth fell to +3.9% y/y in the three months to February. It should be noted that it rose to +4.4% y/y in March and April though. Meanwhile, the BoE Agent's Summary Survey for Q2 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.



Overall, 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. Similarly, core inflation fell sharply to 2.5% in April from 3.1% in March. In May, it edged slightly higher to 2.6%. 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 peak at 3.25% 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 any rate cuts this year.** The economic fallout of the war pose a stagflationary shock to the UK economy, meaning it will simultaneously increase inflation and weigh on growth. Furthermore, the UK government continues to lack a coherent growth strategy, with little in the Autumn Budget or recent Spring Statement that is likely to alleviate the UK's ongoing problem of weak productivity. Thus, the IMF has recently revised down its UK GDP forecasts to 0.8% (was 1.3%) this year and 1.3% (from 1.5%) next year.

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