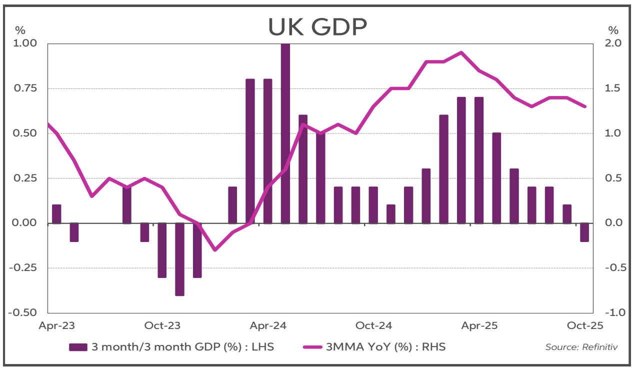
BoE Watch

AIB Treasury Economic Research Unit

18th December 2025

BoE cuts Bank rate to 3.75% in a very tight vote

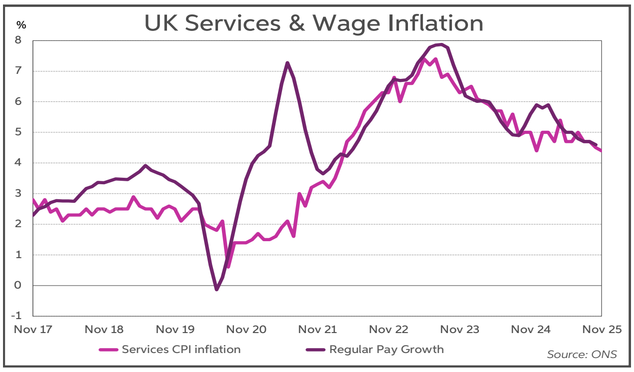
The December meeting of the Bank of England's Monetary Policy Committee (MPC) saw the central bank lower the Bank Rate to 3.75%. The decision was very much in line with market expectations, which had softened recently amid a slew of data released this week, indicating that labour market conditions had deteriorated and inflation had slowed further in Q4. Today's decision marks the fourth 25bps rate cut in 2025, but it was the first since August. Previously, the BoE had opted to leave rates on hold at both its September and November gatherings. So far in its easing cycle, which began in August 2024, the BoE has lowered rates by 150bps in total.



Once again, there was no unanimity within the MPC on its policy decision, and if anything, the committee appears to be even more split then it was before. The voting breakdown showed a narrow 5-4 majority in favour of the 25bps rate cut, with Governor Bailey being the only member to change his vote from the last meeting in November. For the four dissenters, "the current and forward-looking evidence on services inflation, wage growth and inflation expectations remained above target-consistent levels". For them, "a more prolonged restriction was warranted" to reduce the upside risks to inflation. However, for the majority, the disinflation process "was on track". Yet, even amongst this group of five members, there was a clear differing of views. Three members in this group (Bailey, Breeden & Ramsden) voted for the cut, as they judged that the upside risks to inflation had "receded". However, the other two officials in the majority (Dhingra & Taylor) supported the decision, to protect against the "downside risks to activity and inflation".

The meeting statement was very short. It noted that while inflation is above the 2% target, "it is now expected to fall back towards target more quickly in the near term". Furthermore, the MPC also stated that the risk of persistent inflation had become "less pronounced since the previous meeting". Regarding the policy outlook, the BoE continued to guide that "Bank rate is likely to continue on a gradual downward path", indicating that the committee retains a bias to ease policy further. In an important change though, the MPC warned that "judgements around further policy easing will become a closer call". This strongly suggests that the BoE is drawing near to the end of its cutting cycle.

The BoE's detailed assessment of the UK economic outlook is contained in the Monetary Policy Report, released at the previous meeting in November. In terms of its growth outlook, the MPR forecast GDP would expand by 1.5% this year, 1.3% next year and by 1.6% in 2027. On the inflation front, the BoE was forecasting that inflation would be 3.5% by the end of this year. However, the December meeting minutes, released today, acknowledged that CPI was now likely to end the year below this rate, following the recent decline in CPI to 3.2% in November. Furthermore, BoE staff noted that inflation is likely to be "closer to 2%" by Q2 next year, largely owing to a raft of energy price measures announced in the recent Autumn Budget.



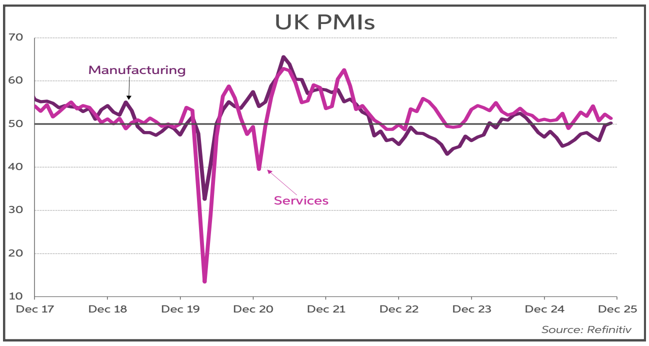
Examining the meeting statement, the minutes, and the voting split, it seems that the bar for further easing has risen. Of the group of three within the majority, Bailey indicated that he sees "more limited space" for cuts, Breeden guided that she needs further evidence of disinflation to support easing further, and Ramsden noted that the BoE may need to slow the "cadence of easing". All three also stated that measures of forward-looking wage inflation are still too high. The four dissenters also highlighted that they are concerned by the potential for second-round effects from sticky wage inflation. Thus, the BoE is unlikely to reduce the Bank rate further, unless its confidence that wage inflation is easing increases. **Futures contracts firmed by circa 5bps in the initial aftermath of today's policy announcement.** Current pricing indicates that the next rate cut is not fully priced-in until June, out from April previously. Overall, around 35bps of further easing is expected next year, which would bring Bank rate down to around 3.5%. **Our view remains that the Bank rate will trough at 3.50% in 2026, albeit the probability of the rate cut taking place in Q2 instead of Q1 next year, appears to have increased.**

David McNamara
Chief Economist
david.g.mcnamara@aib.ie

John Fahey
Senior Economist
john.j.fahey@aib.ie

Daniel Noonan
Economist
daniel.x.noonan@aib.ie

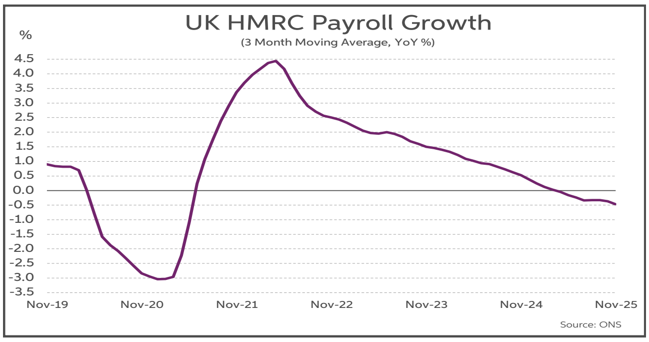
The UK economy has slowed recently



The UK economy had a better than anticipated start to 2025, with GDP expanding by 0.7% q/q in Q1 and by 0.3% q/q in Q2. However, growth slowed markedly in Q3 to just 0.1% q/q. The underlying breakdown for Q3 though, shows that the slowdown may not be as severe as the headline growth figure suggests. Household consumption inched 0.2% higher in the quarter, while government expenditure rose by 0.3%. Together, they contributed 0.2 percentage points (p.p.) to growth. Meantime, gross capital formation expanded by 1.8% in Q3, despite a 0.3% q/q contraction in business investment (dwellings, other machinery & equipment, and intellectual property products investment, increased sharply). Overall, it added 0.3 p.p. to the total. In terms of external trade, both exports and imports fell, but these components still boosted GDP by 0.1p.p.. At the same time, a rundown of inventories and some volatility in the "valuables" segment (non-financial assets such as precious metals) knocked circa 0.4 p.p. from output.

Meanwhile, the available data for the final quarter of the year have been mixed. The monthly reading of GDP contracted by 0.1% for a second consecutive month in October, amid weaker activity levels in the services sector. Retail sales declined by 1.0% in the month. Meantime, industrial production increased by 1.1% in October, as car manufacturing recovered somewhat following a cyberattack which halted production in the sector in September. **The survey data for Q4 suggest the rebound in the manufacturing sector has continued throughout the quarter.** The manufacturing PMI rose to 51.2 in December, its highest level since September 2024. Overall, it has averaged 50.4 in Q4, up from 47.1 in Q3. In contrast, the services PMI has averaged 51.9 in Q4, down slightly compared to the Q3 reading of 52.3.

In terms of the labour market, conditions have softened this year. The unemployment rate has increased steadily, from 4.4% at the start of the year to 5.1% in October. It should be noted that this is the highest jobless rate since January 2021. Worryingly, payrolls have contracted in nine of the past eleven months to November, and at a sharper rate recently. Against this backdrop, wage inflation has cooled, but it remains elevated. Average earnings growth fell to +4.7% y/y in the three months to October. Other measures of wage inflation point to lower earnings growth also. Indeed, the BoE Agent's Summary Survey for Q4 suggests that pay settlements are likely to average 3.9% this year, and that there are early indications that they may be lower again next year, at around 3.5%.



Meanwhile, inflation looks to have peaked and has fallen faster than the BoE anticipated in November. Both headline and core inflation jumped higher in April, owing to a number of one-off factors, and rose further during Q2 and the early part of Q3. However, having reached 3.8% in July and stayed at that level throughout Q3, the headline rate has dropped sharply to 3.2% in November, which is below the BoE's estimate of 3.4%. Meantime, the core rate also fell to 3.2% in November, down from 3.4% in October, and a peak of 3.8% earlier in the year. Services inflation has also decelerated, although it remains at a high level, printing at 4.4% in November.

In summary, the UK economy enjoyed a solid start to the year but more recently growth has moderated. At the same time, conditions in the labour market have deteriorated, resulting in the unemployment rate moving back up above 5% in recent months. Meanwhile, inflation remains elevated but it seems to have peaked, and is now falling at a faster rate than most expected. This has opened the door to the potential for a sharper pace of rate cuts from the BoE next year, which may provide a well needed boost to the economy. **However, the UK continues to lack a coherent economic policy.** The current government campaigned on increasing growth but there was little in the recent Autumn Budget that is likely to help alleviate the UK's ongoing problem of weak productivity. Worse still, although the Budget was initially well received by markets, it increases borrowing (which will run at 4.5% of GDP this year) over the next four years compared to previous plans. Thus, the IMF is forecasting that UK GDP will expand by a modest 1.3% in 2025 and 2026.