Global Matters Weekly

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Bank of England cuts rates: how low can they go?

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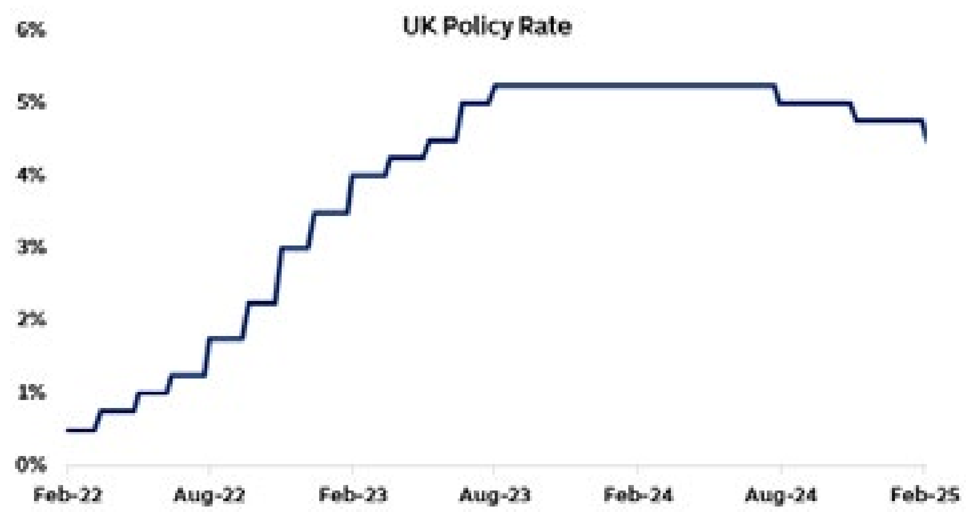
Chart of the Week



Source: Bloomberg Finance L.P., as at 6 February 2025.

What this chart shows

The chart above shows the latest 25bps rate cut by the Bank of England (BoE) to 4.5%. This is the lowest the policy rate has been in 19 months with two of the nine policymakers in the Monetary Policy Committee (MPC) supporting a 50bps rate cut on February 6, 2025. The bank signalled a 'gradual and careful approach' to future rate cuts, forecasting two more quarter point reductions by the end of this year, in an effort to reign inflation back to the BoE's 2% target. This is now the third reduction in policy rate since August 2024, with the BoE halving growth expectations and raising its inflation forecast.

Whilst the US Federal Reserve has moderated its monetary policy easing in the face of sticky inflation and uncertainty surrounding President Trump's trade tariffs, the UK (and Europe) are on different paths due to lacklustre economic growth. Both the UK and European central banks are now expected to cut rates more than previously forecast in an effort to support growth.

In the UK, the Bank of England views Chancellor Rachel Reeves' decision to raise employer national insurance contributions as having a greater-than-expected impact on jobs and prices. As a result, it has revised its economic growth forecast for this year to just 0.75%—half of its November projection. Meanwhile, inflation is expected to rise further and peak at 3.7% by the third quarter of 2025.

Why this is important

UK government bonds have had a volatile start to the year, with the market's views on the BoE's interest rate path seesawing since November due to uncertainty around the potential for tariffs on the UK and the impact of chancellor Reeves' October Budget. Markets had until today been reticent to price in a more aggressive rate cutting path, fixated on a terminal rate of 4%, mainly on the back of expectations that increased government spending would be inflationary. However, markets seem to be coming round to the idea that there is another component in the fiscal equation and that is the likelihood of increased taxes, which on a net basis should keep fiscal policy tight.

There is little reason to doubt that the UK will maintain its fiscal discipline, particularly in light of the turmoil in bond markets caused by Liz Truss' budget and the lasting damage to the country's fiscal credibility. With ongoing uncertainty in global trade, the prospect of a tight fiscal policy, and a significant downward revision in growth forecasts, the likelihood of additional rate cuts appears higher than what is currently priced in.

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