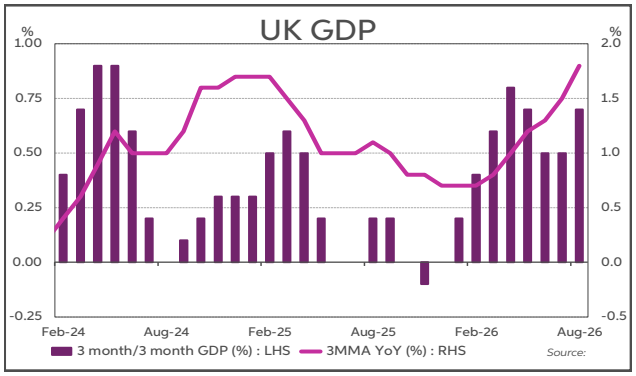
BoE Watch

AIB Treasury Economic Research Unit

5th November 2026

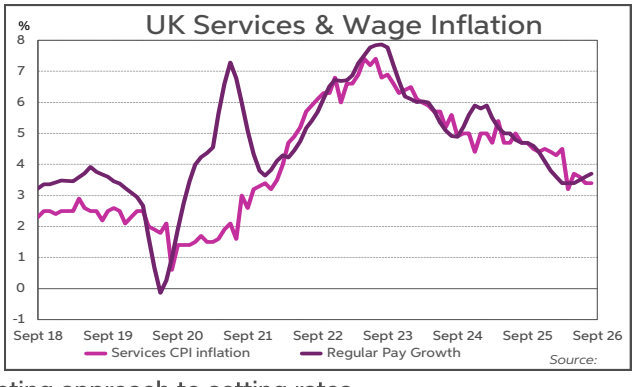
BoE hikes the Bank rate by 25bps to 4.00%, as expected

The November meeting of the Bank of England's Monetary Policy Committee (MPC) saw the central bank hike the Bank rate by 25bps to 4.00%, as expected. It marks the first rate increase in the UK since August 2023. In the six successive meetings prior to today, the central bank had left rates unchanged. **Once again, the decision by the BoE was not unanimous.** The MPC was split 8:1 in favour of the 25bps rate hike. However, external member Catherine Mann dissented, preferring instead to raise rates by 50bps. She noted that "from a risk management and credibility perspective, a 50bps hike" is "good policy".



Meanwhile, the minutes showed that six of the eight members who voted for the 25bps hike are of the view that further tightening could be warranted. Four members, including Governor Bailey noted that while indirect and second -round inflation effects have "not emerged yet", absent real progress towards ending the conflict in the Middle East, "further increases in rates" may be warranted. Two members (Greene, Pill) argued more strongly that further tightening will be needed. In contrast though, two other members (Dhingra and Taylor) described today's decision as an "insurance" hike, and indicated that there would need to be signs of "reinforcing wage and price pressures" (i.e. the emergence of second-round inflation effects) for the current level of Bank rate to be maintained for "an extended period of time", suggesting that the next policy change from the BoE could be a rate cut rather than a rate hike.

The updated Monetary Policy Report (MPR) released today contained three different macroeconomic scenarios. The central projection assumes that second-round inflation effects contribute circa 0.5 percentage points (p.p.) to inflation over the second have the forecast period, up from 0.3 p.p. in the July MPR. As a result, CPI inflation is now projected to average 3.8% this quarter, peak at 4.9% in Q2 2027, before falling back to 4.0%, 2.0% and 1.8% at the end of 2027, 2028 and 2029, respectively. In the "Weaker Demand" scenario, inflation is projected to rise to a similar level but fall more quickly, declining from 4.8% in Q2'27, to 3.6% in Q4'27, and to 1.3% and 1.2% by Q4'28 and Q4'29. However, in the "Adverse Inflation" scenario, in which energy prices rise sharply and stay elevated for longer, inflation is projected to peak at 6.2% in Q3'27 and remain above target throughout the forecast period. In terms of economic growth, the BoE has revised up its baseline forecast, to reflect the more resilient outturn in the first half of this year and recent strong levels of business investment. It now sees GDP rising by 1.6% this year (was 1.1%), 1.4% in 2027 (was 1.1%), and 1.2% in 2028 (was 1.7%). In the weaker growth scenario, the economy expands by just 0.9% in 2027 and 2028. Meantime, under the adverse inflation scenario, growth is seen to be 1.2% next year and 1.1% the year after.



Overall, assessing the meeting statement, minutes, the updated MPR, and the press conference, **it is clear that the near-term path for UK interest rates is highly dependent on the conflict in the Middle East and the potential emergence of second-round inflation effects.** This was summed-up best by Governor Bailey, who stated at the press conference that "unless progress towards solving the conflict is made, or there is other news which softens the risk to inflationary pressures, a further increase in bank rate may be warranted", but then went on to say that today's hike "shouldn't be seen as the first in an inevitably long sequence of hikes - that is not inevitable". At the same time, the MPC reiterated that it will take a meeting-by-meeting approach to setting rates.

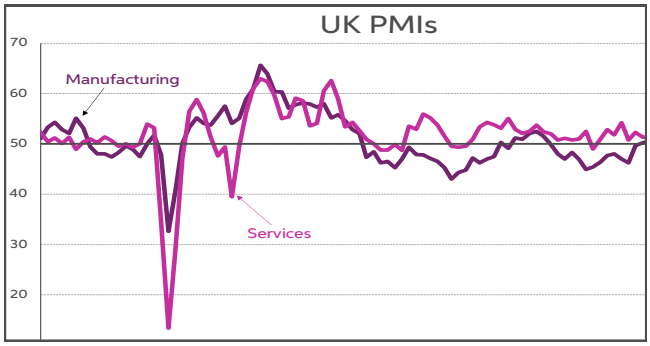
Against this backdrop, the market had a slightly hawkish reaction to today's BoE meeting. However, it should be noted that rate expectations firmed to varying degrees in the US and Eurozone today as well. The market is now attaching around a 50% probability to a hike at the next BoE meeting on December 17th. In any case, a rate hike is fully priced-in for the following meeting in February, and a total of 75bps of further tightening is priced-in by the end of next year. **However, we remain of the view that current market pricing is excessive, and continue to pencil in just one more rate hike from the BoE, in early 2027.** This would see the Bank rate peak at 4.25% compared to market expectations of 4.75%.

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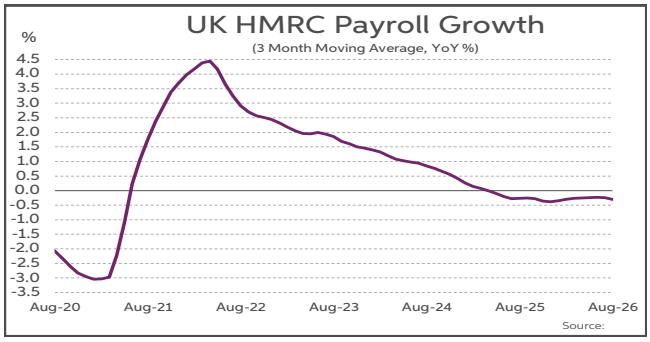
Resilient UK economy expected to grow modestly



UK GDP rose by 1.2% last year, despite growth slowing markedly in the second half of 2025. GDP stagnated in Q3 before rising by just 0.1% q/q in Q4. **However, the economy looks to have regathered some momentum this year.** GDP expanded by 0.6% in Q1 and by 0.5% in Q2 2026, supported by a boost in personal consumption and investment. In Q2, consumer spending rose by 0.3%, contributing 0.2 percentage points (p.p.) to output. Investment jumped by 0.9%, largely due to a sharp 1.8% rise in business investment, also adding 0.2 p.p. to the total. In terms of external trade, revised data now show that exports expanded strongly by 2.6% while imports were broadly flat, meaning net trade boosting growth by 0.8 p.p.. However, this was partially offset by a rundown in inventories, which clipped 0.6 p.p. from the total. At the same time, a modest contraction in government expenditure had a trivial effect on GDP.

The data were more mixed in Q3 though. The monthly reading of GDP shows that economic output rose by 0.4% m/m in July but slowed to just 0.1% m/m in August. Meanwhile, retail sales remain volatile, contracting sharply at the beginning and end of the quarter. Overall though, retail sales were broadly flat compared to Q2. Similarly, industrial production has been volatile recently, albeit the available data show it has expanded modestly in the first two months of the quarter. In terms of the survey data, both the manufacturing and the services PMIs printed in expansion mode throughout Q3. However, the former declined slightly, averaging 51.8 compared to 53.4 in Q2, while the latter improved, averaging 52.2 up from 50.3. Consumer confidence also trended higher during Q3. However, it plunged markedly from –13.0 in September to –24.0 in October. Elsewhere, both sector PMIs printed at 52.8 at the start of Q4.

In terms of the labour market, conditions have softened over the past year. The unemployment rate has remained relatively steady, falling from 5.2% in January to 4.9% in February, and remaining in a tight 4.9-5.0% range since then. However, this has partly been driven by people leaving the labour market. Payrolls have contracted in five months so far in 2026, although they rose modestly in August and September. Against this backdrop, wage inflation has cooled. Average earnings growth fell to +3.7% y/y in the three months to August, compared to +5.0% over the same period last year. Meanwhile, the BoE Agent's Summary Survey for September shows that pay settlements may average 3.6% in 2026, and that wage agreements will be broadly in line with this again in 2027.



Regarding inflation, the headline rate has remained elevated this year, but underlying price pressures have yet to appear. In the first half of the year, headline inflation edged lower, due to a reduction in the retail energy price cap which was announced before the closure of the Strait of Hormuz. It fell from 3.3% in March to 2.8% in April, before troughing at 2.6% in June. However, Ofgem increased the price cap by 13% in July, amid higher wholesale gas prices - which coupled with higher fuel prices - has seen the headline rate reaccelerate to 3.5% in September. **Core inflation has been contained though.** It fell to 2.5% in April, its lowest level since July'21, printed at 2.6% in each of the four months thereafter, before rising slightly to 2.8% in September. At the same time, services inflation has remained in a narrow 3.2-3.7% range since April, down from 4.5-5.4% in the twelve-months prior.

In summary, the UK economy has shown resilience in H1'26. At the same, inflationary pressures have been relatively contained to date, although the war in the Middle East still poses a stagflationary risk to the UK, meaning an escalation in the conflict could simultaneously raise inflation and dampen growth. Meanwhile, the UK fiscal position remains challenging, with the recent surge in global bond yields proving particularly acute in the UK. As a result, the options available to new PM Burnham to try and stimulate the economy are limited, as evidenced by the minimal policy changes announced in the recent Budget. Overall, the IMF is pencilling in UK growth of 1.2% and 1.3% this year and next.

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