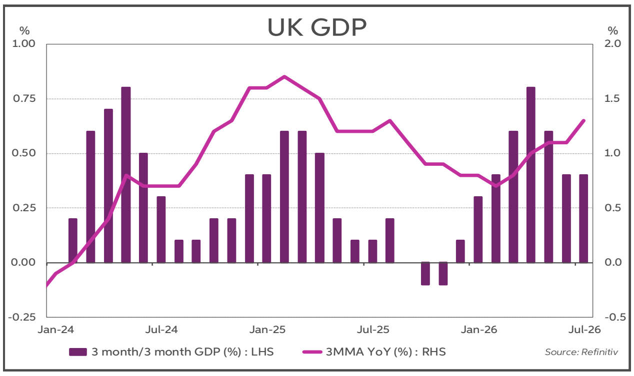
BoE Watch

AIB Treasury Economic Research Unit

17th September 2026

No-change again but rate hike appears on the cards

The September meeting of the Bank of England's Monetary Policy Committee (MPC) saw the central bank continue to leave the Bank Rate unchanged, at 3.75%. This was in line with market expectations. It marks the sixth successive meeting where the central bank has been on hold.



Once again, the decision to leave the Bank Rate unaltered was not unanimous. Similar to July, the decision was split 6:3, with three members (Pill, Green and Mann) in favour of a 25bps rate hike. **In terms of its balance sheet/quantitative tightening policy, the MPC announced today that it will reduce its holding of UK government bonds by £368bn over eight years.**

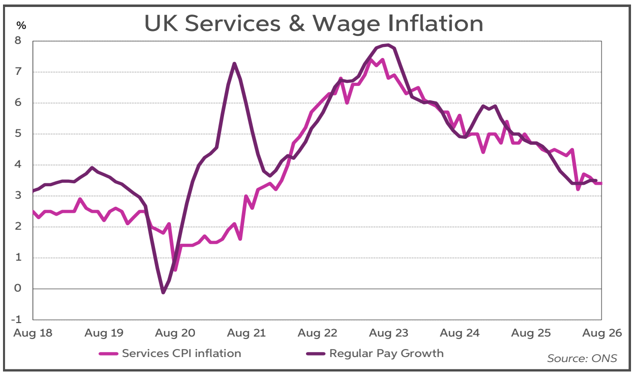
Overall, assessing both the meeting statement and minutes, it is quite clear that the BoE has turned more hawkish compared to its previous meeting in July. In terms of the statement, it noted that the risks of material second round effects on prices and wages, and in turn the need for tighter policy is "greater the longer higher energy prices persist and are more volatile". The statement also referenced the view within the MPC that the "risks to inflation are tilted to the upside" and to a greater extent than at the time of its July meeting.

Meanwhile, the minutes showed that while six MPC members were in favour of no rate change in September, it appears that four of the six could soon decide to vote in favour of policy tightening unless energy prices started to ease. Governor Bailey was one of these four. He noted the "material increase in energy prices since July" and that the geopolitical backdrop "makes the upside risk more prominent" and "risks to energy and food prices more to the upside" thereby meaning "second-round effects could materialise more strongly". His conclusion was that if the Middle East conflict becomes prolonged "as appears to be the case" and there are increased risk of second-round effects then "it is likely that policy may have to tighten". This is in contrast to his comments at the July press conference when he said that the BoE was not edging towards a rate hike". Instead, it now very much seems that the BoE is getting ready to increase interest rates.

UK rate expectations had already firmed considerably over recent weeks amid the resumption of military strikes in the Middle East and the resulting sharp move higher in energy prices. In the aftermath of today's BoE meeting, futures contracts actually softened marginally, which suggest that markets had been positioned for an even more hawkish tone/guidance from Threadneedle street. The market is now attaching around a 60% probability to a hike at its next meeting on November 5th. Earlier in the week, this probability was nearer to 80%. Further out, the market still envisages rates getting up towards 4.75% over the course of next year.

In light of today's hawkish BoE communications, we now expect the central bank to hike rates by 25bps in November. This is assuming there is no meaningful resolution to the Middle East conflict by then and as a result energy prices remain high, meeting the 'conditional' guidance outlined by the BoE today to warrant a rate increase. The November MPC meeting/policy deliberations will also be informed by updated macro forecasts contained in its quarterly Monetary Policy Report. Meanwhile, today's minutes referenced the fact that given lags to signs of second round effects, "it was not appropriate to wait too long for evidence" of these effects "before responding with policy".

However, we think the market is excessive in anticipating rates increasing towards 4.75% in 2027. Whilst the BoE may hike again in early 2027, to 4.25%, we expect that this may be the extent of policy tightening from the central bank. Notwithstanding the fact that the UK economy has shown resilience and tended to surprise to the upside of expectations over the last 1-2 years, the pace of growth remains subdued. Signs of slack are already evident in the labour market, including weak payroll data. The combination of subdued underlying growth and labour market slack may limit the extent and/or need for an extensive tightening cycle from the BoE.



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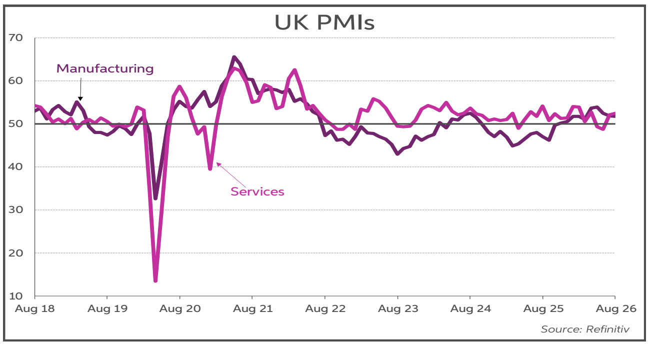
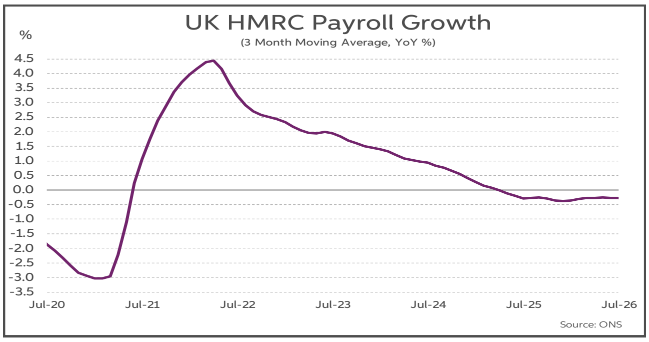
Resilient UK economy expected to grow modestly



Having shed significant momentum in the second half of last year, the UK economy looks to have regathered some steam in 2026. UK GDP expanded by 1.3% last year, but it grew by just 0.1% per quarter in the second half of 2025. However, the economy expanded by 0.6% in Q1 and by 0.4% 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 1.2%, largely due to a sharp 1.7% rise in business investment, also adding 0.2 p.p. to the total. In terms of external trade, exports and imports both rose by 0.5%, resulting in a negligible impact on growth. Similarly, a modest contraction in government expenditure and a marginal rundown in inventories had only a trivial effect on GDP.

Meanwhile, the limited available hard data for Q3 have been mixed. The monthly reading of GDP expanded by 0.4% m/m in July, up slightly from the 0.3% rise in June. Industrial production increased by 0.2% in the month, partly offsetting the 0.2% fall in June. In contrast though, retail sales fell by 0.5% m/m, following two months of solid gains. **The key survey data for the third quarter have also been varied.** The services PMI returned to expansion territory in July, and improved further in August. Overall, it has averaged 52.3 so far in Q3, up from 50.3 in Q2. However, the manufacturing PMI has been trending lower recently, albeit it remains firmly in expansion mode. It has averaged 51.8 in the first two months of Q3 compared to 53.4 in Q2. At the same time, consumer confidence has maintained its recent upward momentum, rising to –14.0 in August, its highest level in two years.

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 six 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 ten of the past twelve months to August, and in all bar one month this year. Against this backdrop, wage inflation has cooled. Average earnings growth fell to +3.9% y/y in the three months to July, compared to +4.9% 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 3.1% in August. **However, core inflation has been contained.** It fell to 2.5% in April, its lowest level since July'21, and it has printed at 2.6% in each of the four months since. 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 has removed any chance of the BoE easing policy this year, as had previously been expected. Indeed, the war 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 policy options available to new PM Burnham to try and stimulate the economy are limited. Overall, the IMF is pencilling in modest UK growth of 1.0% and 1.3% this year and next.

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