Annual report to the Treasury Select Committee

Clare Lombardelli, Deputy Governor for Monetary Policy, Bank of England

8 August 2025

Overview

I joined the Bank of England and the Monetary Policy Committee a little over a year ago, on 1 July 2024. Throughout that time monetary policy has been restrictive, putting downward pressure on the underlying drivers of inflation. We have been able to reduce the amount of policy restriction by lowering Bank Rate from 5.25% when I joined the committee to its current rate of 4.0%. This is because of progress on underlying disinflation.

Over the past year I voted to cut Bank Rate by 25 basis points 4 times. At the latest meeting, in August 2025, I voted in the minority to hold Bank Rate at 4.25%. I judged it appropriate to pause the reduction of monetary restriction, due to my concerns about the current and expected above-target rates of underlying inflation and my judgements about the balance of supply and demand in the economy. I preferred to maintain the level of monetary restriction for longer rather than continue to reduce it at the previous pace.

As the Deputy Governor for Monetary Policy, I am also responsible for the Bank's response to Dr Bernanke's review of forecasting for monetary policymaking and communication. We have put in place a large work programme in response to this review to upgrade our policymaking process and communication. I want to take this opportunity to update the committee on this work.

Voting record

In **August 2024**, CPI inflation had fallen significantly from its peak of over 11% in late 2022 to around target. Most of this decline had been driven by easing global price pressures, especially from energy and goods.

Within this headline improvement, underlying domestic inflation was materially above rates consistent with our 2% target on a sustainable basis. Both wage growth and services inflation remained concerning at well over 5%. These domestic dynamics revealed second-round effects on wages and consumer inflation from the large inflationary shocks of 2021-22, and I said publicly that the "last mile" of disinflation would be the hardest.

Against that backdrop, however, we saw evidence that underlying inflation was falling gradually. For example, at the time of the August 2024 vote, annual growth in private sector regular pay had come down from its peak of 8.1% the previous summer to 5.6%; and intelligence from the Bank's Agents, who speak to businesses around the country, was supportive of further wage and price disinflation to come. There was also evidence that the labour market was continuing to ease gradually, albeit after having been very tight in previous years. Our monetary policy stance was significantly restrictive at the time. So in August 2024 I voted to reduce slightly the degree of policy restrictiveness by lowering Bank Rate from 5.25% to 5%.

The process of underlying disinflation across this period was gradual. Given this and a preference to provide stability and predictability on policy rates, I supported a gradual approach to the removal of policy restriction, and so in **September 2024** I voted to maintain Bank Rate at 5%, in the absence of material economic developments.

At the time of the **November 2024** vote, headline inflation was slightly below target. I took a limited signal from that as it had been pushed down by temporary factors like falls in energy prices after the large increases in previous years. More importantly, the more persistent components of inflation were continuing to come down gradually, broadly in line with our expectations. In November the MPC discussed three cases for how the UK economy could evolve, depending on different interpretations of the impact of the past inflationary shocks. It was a useful framing of the risks to the disinflationary process. I viewed the probabilities of downside and upside risks to inflation as broadly balanced, although I was more worried about the possible consequences if the upside materialised, as it could require a more costly monetary policy response. Taking into account all the evidence, I voted to lower Bank Rate from 5% to 4.75%. This gradual approach to cutting Bank Rate would allow us to monitor the flow of data over the following months and calibrate our policy path as needed at a time of increasing uncertainty, including in relation to the impact of the measures announced in the Autumn Budget.

In **December 2024** I voted to maintain Bank Rate at 4.75%, in the absence of significant news, consistent with the gradual approach to removing policy restriction.

Ahead of the **February 2025** vote it became clear that headline consumer inflation was expected to rise back to rates of between 3½% and 4% in Q3 2025, with the increase mainly driven by higher energy bills, higher food prices and increases in regulated prices such as broadband and phone contracts. This is painful, coming on top of a large increase in the cost of living and challenging for businesses dealing with increasing costs. Higher inflation for food and energy is particularly challenging for households with low and fixed incomes. These higher rates of inflation also present a greater risk of persistence as they impact wages and price setting behaviour. Research shows that food and energy prices in particular are most salient to people – having a greater impact on perceptions and expectations of inflation than rises in the prices of other goods and services.

Set against this news, there were signs of weakening activity and labour market, and underlying inflationary pressures continued to reduce gradually. The Agents' pay survey suggested further moderation in pay growth to come, with pay settlements expected to grow by 3.7% in 2025, down from over 5% in 2024. So in February I voted to lower Bank Rate by 25 basis points to 4.50%, as I judged that the disinflation process was still broadly on track.

In **March 2025** I voted to hold Bank Rate at 4.50%, in line with my gradual and careful approach to removing policy restriction, at a time of continued domestic uncertainty and growing international uncertainty.

Coming into the **May 2025** policy round I was finely balanced between holding and cutting Bank Rate, as the amount of policy restriction had been reducing, indicators of underlying inflation were still high in absolute terms and household inflation expectations were rising. But there was evidence of continued underlying disinflation, as pay settlements from the first few months of the year were in line with the Agents' prediction of slowing wage growth over 2025. The picture for services inflation, a proxy for the persistent component of inflation, was broadly similar to that of wages. The absolute rate of services inflation was still too high, with the annual measure at 4.7% in March, but it had come down from 6% one year before. However, higher-frequency measures of services inflation that exclude volatile items had been flatter in previous months. So the picture was not entirely reassuring, although a bumpy disinflation was to be expected.

The other source of news in May was the global uncertainty caused by US trade policy, which created a risk that global demand and UK investment may prove weaker than previously thought. I saw this as a risk rather than the most likely outcome, but taken with the evidence of underlying wage pressures continuing to reduce, I voted for a further reduction in Bank rate from 4.50% to 4.25% to provide the right balance between acting on inflation and providing support to the economy.

In **June 2025** I voted to hold Bank Rate at 4.25%. There was notable downside news in the labour market, with a large fall in employment recorded in HMRC data in the preliminary data release for the month of May. But this data source is prone to large revisions and I preferred to wait for further evidence, consistent with my gradual and careful approach to policy.

My August 2025 vote

In August I voted in the minority to hold Bank Rate at 4.25%.

At the time of the August decision headline inflation was 3.6% and it is expected to remain roughly between 3.5 and 4.0% for the remainder of this year. This is driven in part by inflation in food and energy - the most salient prices - and comes after a long period of relatively high inflation. This increases the risk of an inflation persistence scenario such as the one we considered in May.

Coupled with this, it is less clear if the disinflation process is continuing in services prices. Annual services inflation was 4.7% in June, slightly above the May MPR projection. Higher-frequency measures that exclude volatile items have been hovering at annual rates around 4½% in recent months, still much too high to be consistent with inflation at target sustainably. And we hear from our Agency Network that businesses are worried about costs going forward and this may affect their pricing decisions.

Activity growth is weak, and the labour market continues to loosen gradually. That labour market loosening has been from a very tight starting point, so could still be reflecting normalisation rather than the emergence of slack. We may also be observing the consequence of structural changes in the labour market – including the total size of the workforce due to changes in population, retirement and health. The August MPR baseline forecast estimates that there is currently a margin of slack and that this will increase, exerting downward pressure on inflation. But there is a large degree of uncertainty about this. In June I was more concerned about the risk that the labour market may be deteriorating rapidly. The latest data continues to show some loosening, but not a rapid deterioration – the most recent HMRC payroll numbers revised away the large decline in employment numbers reported in the previous release.

More broadly, it is extremely hard to judge the relative levels of aggregate demand and supply in the economy. Supply growth appears weak, and estimates suggest structural productivity hasn't grown over the past three years. Output gap estimates are inevitably highly uncertain, and given the persistence of nominal indicators, I am not confident that there is currently a margin of slack in the economy.

While previous policy restrictiveness continues to weigh on the economy, I am less confident that the current policy stance as embodied in the market curve continues to be meaningfully restrictive. At the time of the August MPC vote, we had reduced rates by 100 basis points and I judged that there might not be that much further to go before the current policy stance is effectively neutral. Looking at history, it's plausible that neutral may be closer to the upper end of the 2-4% range from Bank analysis. If so, this would mean we don't have many more rate cuts to go as we potentially approach the end of the cutting cycle. I am not predicting that we are already at neutral, but nor am I confident that if we reduce restrictiveness much further we will still be sufficiently restrictive to return inflation to target sustainably.

Over coming months, we may learn more about how the economy responds to the continued feeding through of previous policy restriction, a further period of inflation above target and cost-push factors. I judge that we should retain the space to cut further in future if needed. If we cut too far or too fast, we may then have to change policy direction. That would come with a higher cost in terms of providing a stable basis for economic decision-making across the economy.

Progress in responding to the Bernanke review

As the Deputy Governor for Monetary Policy, I am responsible for implementing the Bank's response to Dr Bernanke's review of forecasting for monetary policymaking and communication. Dr Bernanke's review was fundamental and its implications wide-ranging. We have put in place a large work programme in response.

Dr Bernanke conducted his review at the Bank in November 2023, published his findings on 12 April 2024 and gave evidence at the Treasury Select Committee on 15 May 2024. Dr Bernanke covered a wide range of issues in his review and made 12 recommendations in three main areas: (i) building and maintaining a high-quality infrastructure for forecasting and analysis; (ii) providing an analytical process that better supports the MPC's decision-making; and (iii) communicating the MPC's outlook and policy rationale to the public.

The work under way to respond to the Bernanke review can be divided into:

Infrastructure. We are building a new data platform that will significantly change how our staff work with data and models, providing easier access to data and advanced analytical tools, allow us to work more nimbly with models, forecasts and scenarios and support the automation of tasks including the evaluation of forecast performance.

The platform is set to go live in mid-2026, with the migration of core analytical processes supporting the MPC, including the production of the forecast and scenarios, expected to be completed by mid-2027. Our early work has demonstrated the potential for automation to enhance efficiency and operational resilience, freeing up staff time for higher-value analysis to deepen our understanding of the economy and improve our policy making. As we make these changes, we are building flexibility into our data and analytical infrastructure to ensure it can meet evolving needs and opportunities and as wider data technology, including the application of AI, develops.

Analytical capability. We are developing and increasingly using a wider range of inputs to our policy making process. This allows us to better explore and support the diversity of thinking across the committee. The MPC has been spending more time reviewing and discussing data-driven economic assessment. This has been supported by an expansion of our well-established 'nowcasting' (short-term forecasting) toolkit to include a suite of measures that look through volatility and erratic movements in headline economic measures of activity, slack, labour quantities and prices, and combine the signal from a wider range of indicators and surveys. These tools give the MPC steers on the underlying evolution of the economy and developments of relevance for monetary policy. We have invested in new tools that provide a better view of the range of possible outcomes and risks through new density nowcasting models and new models of how economic slack is evolving in real time.

We are retaining an important role for a baseline forecast in providing our view of the outlook but are seeking to supplement this with a wider picture including scenarios and risk analysis. We have been experimenting with scenarios, as we showed in the November MPR when we set out different cases for inflation persistence. In the May MPR we published scenarios where the economy differed from the central forecast in various ways. We quantified possible alternatives around inflation expectations, productivity, the impact of uncertainty and the relationship between labour market tightness and inflation. We drew on these scenarios for our decisions in May and August. We continue to test and experiment with different ways to communicate about scenarios to help explain our policy thinking.

Modelling. The Bank has long used a suite of models to understand the economy and forecast activity and inflation. We are now widening the range of models that we use to better test different hypotheses about how the economy may behave, and to better challenge how it may differ from a central viewpoint. Macroeconomic forecasting is inherently uncertain and different models also enable us to more rigorously cross-check our central forecast and explore areas where the relationships in the economy are most uncertain.

We have updated the core dynamic stochastic general equilibrium ('DSGE') model that underpins our baseline forecast. This has included incorporating an energy sector directly into our core model. This allows us to better understand the implications of large changes in energy prices, a significant source of price volatility in recent years which is likely to remain relevant given the increasingly shock-prone nature of the global economy. We are developing a large 'semi-structural' model for the UK economy, based on a similar model used by the European Central Bank. We have developed, and continue to develop, more statistical models to support the forecasting process such as structural vector autoregression ('SVAR') models. We are also expanding our capability by including innovative approaches. For example, we have developed a machine-learning model of price and wage formation incorporating non-linearities.

We have created a Monetary Policy Innovation Lab which uses new modelling approaches to test alternative hypotheses about current dynamics in the inflation process. For example, to consider alternative paths for inflation expectations or different labour market dynamics. The Lab has helped us incorporate multiple inputs into our approach to live policy questions, using for example: vector autoregression models allowing for threshold effects and regime changes in nominal variables; and small, off-the-shelf satellite DSGE models better suited to exploring the implications of persistent shocks to the supply side of the economy.

This programme of work will also improve our understanding of the UK economy, in particular the supply side of the economy which is important given the impact of supply shocks on UK households and businesses in recent years. It will also further our understanding of structural changes we are seeing because of trends such as changing labour markets, technology, demographics and the changing international environment.

Outreach and consultation. We hosted a three-day conference in June focused on policymaking and communication under uncertainty which brought together experts across academia, central banks, market practitioners and commentators to enable us to draw on a wider range of views and perspectives on the issues we are considering in our response to the Bernanke review and help us test and explore developing thinking. This included experts from other disciplines from which we could draw lessons. Colleagues from other central banks usefully shared their experience around key issues such as using policy paths, scenarios and communicating uncertainty.

In June we launched a new "Macro Technical Paper" (MTP) series. The papers published in the series document the models, analysis and conceptual frameworks that underpin our monetary policy analysis. The first three published papers summarise central models in our forecasting process, with more planned for the second half of this year. We are publishing this work to encourage an active and informed debate about our models and analytical frameworks. We held a “Macro Modelling for Monetary Policy Forum” at the National Institute for Economic and Social Research (NIESR) on 18 July, where Bank staff presented MTPs and received feedback from experts from academia and other central banks. The event offered a valuable opportunity to engage with external experts. Participants noted that the series boosted the Bank’s transparency and flagged that they were keen to work with Bank staff on future modelling efforts.

Resourcing. We have increased and reprioritised staff resources. Since the review was published in April 2024, we are temporarily increasing our total resource devoted to monetary policy. We have brought in around 30 additional staff and reallocated 30 people from other parts of the Bank. We anticipate the changes to infrastructure and processes will deliver higher-quality analysis more efficiently beyond this programme.

We have a considerable way to go in delivering the largest change programme across monetary policy since the MPC was established in 1997. But we are making progress across infrastructure, analysis, communication and culture and we will demonstrate more progress on this over the coming year.

External Engagement

I have given 3 on-the-record speeches in my first year as Deputy Governor:

Managing the present, shaping the future, given at the Bank of England Watchers Conference, 25 November 2024.

What if things are different?, given at the Bank of England Watchers Conference, London, 12 May 2025.

Central bank communications and uncertainty, given at the Second Thomas Laubach Research Conference, Federal Reserve Board, Washington DC, USA, 16 May 2025.

I have made 9 **regional visits**:

2024

- North West – 30 September-1 October 2024
- Yorkshire – 2 October 2024
- Greater London – 28 November 2024
- Northern Ireland – 5 December 2024

2025 to date

- South East & East Anglia – 17 January 2025
- North East – 19-20 February 2025
- West Midlands – 2 April 2025
- Scotland – 30 June-1 July 2025
- Yorkshire – 10 July 2025

Other initiatives

I am passionate about widening access to economics so that the profession both better represents the people of the UK and draws on more diverse thinking, including pushing to improve socio-economic, gender, and ethnic representation and better joining up economics with other disciplines – such as science, technology, history, psychology. Alongside participating in events to promote these agendas I launched the Bank's initiative to increase the teaching of economics, 'Widening access to economics for the next generation' at Manchester Business School on 30 April. The first cohort of additional economics teachers will begin their training on this scheme in September.