MONETARY POLICY PRESS CONFERENCE

Thursday 6 February 2025

Opening remarks by Andrew Bailey, Governor

Today, we have cut Bank Rate by 0.25 percentage points, to 4.5%.

With the progress we have made to reduce inflationary pressures in the UK economy, we have been able to take another step to make monetary policy less restrictive.

This will be welcome news to many.

We expect to be able to cut Bank Rate further as the disinflation process continues.

But we will have to judge meeting by meeting how far and how fast.

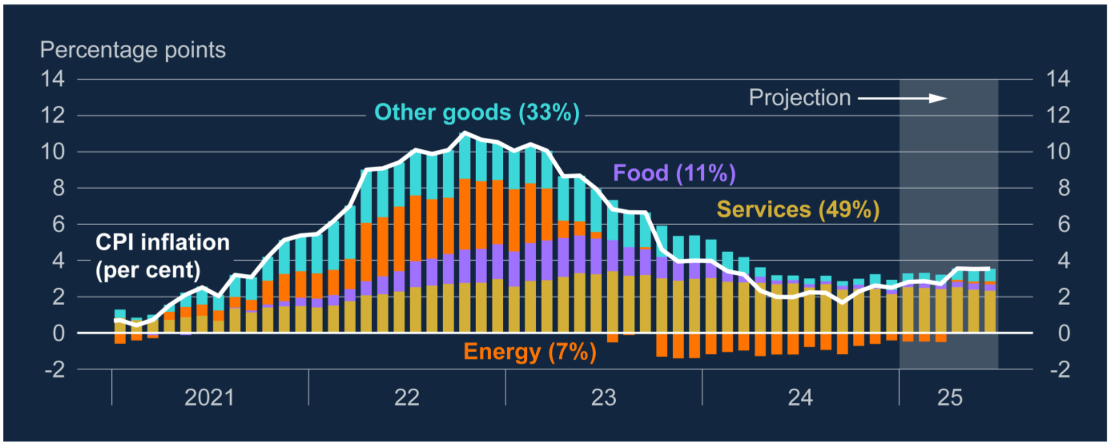
We live in an uncertain world, and the road ahead will have bumps. We expect inflation to increase this year, to a peak of about 3.7%, before returning to the 2% target. We will set Bank Rate to ensure that it does so sustainably.

Low and stable inflation is the foundation of a healthy economy, and we will do our job to continue to ensure that.

I will now describe the outlook for inflation in more detail, and the uncertainties we face, before concluding on today's monetary policy decision.

Chart 1: Inflation has fallen but is expected to rise over the first half of 2025

Contributions to consumer price inflation



Sources: Bloomberg Finance L.P., Department for Energy Security and Net Zero, ONS and Bank calculations

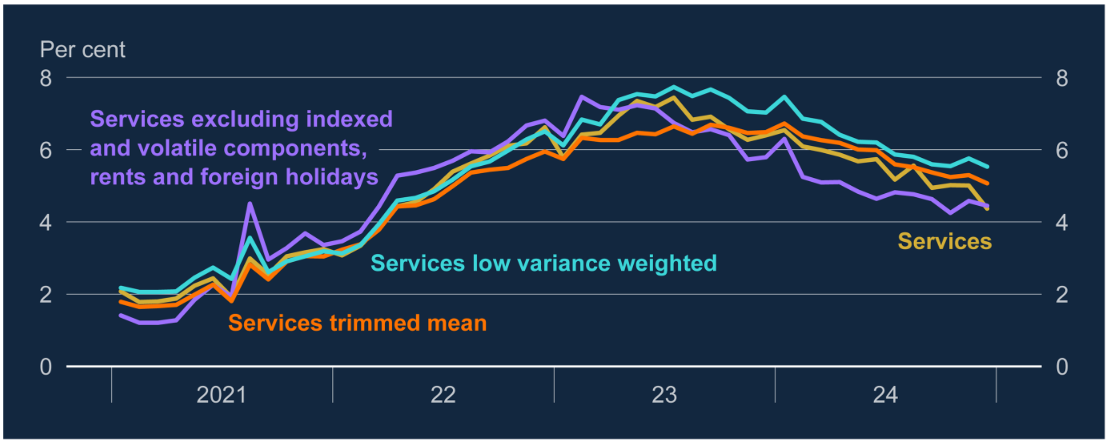
Chart 1 shows the development of twelve-month consumer price inflation since 2021 (white line). It shows how headline inflation fell sharply through 2023 and into 2024, before reaching the 2% target towards the middle of last year. In the shaded area, you can see how we now expect inflation to increase to about 3.7% towards the middle of this year as negative contributions from energy prices (orange bars) first fade and then turn slightly positive – with some further upward pressure from food and goods prices (purple and blue bars). This is a full percentage point higher than the peak we expected in November.

Behind this uptick in headline inflation, however, stands a continued, gradual easing of underlying inflationary pressures in the UK economy. This is the backdrop to our withdrawal of monetary policy restrictiveness, and to our policy decision today.

As **Chart 2** shows, inflation in the prices of services has been coming down since the middle of last year. In the latest data for December, services inflation fell more than expected to 4.4%. Some of that downside surprise was driven by smaller than expected increases in airfares, which can be volatile. But other measures of underlying services price inflation have been gradually easing too.

Chart 2: Underlying services inflation measures have continued to moderate

Measures of annual underlying services price inflation



Sources: ONS and Bank calculations

And higher frequency measures of underlying services price inflation, which can be indicative of near-term inflation momentum, have remained lower than their annual rates. This points to a prospect of further moderation in underlying services price inflation.

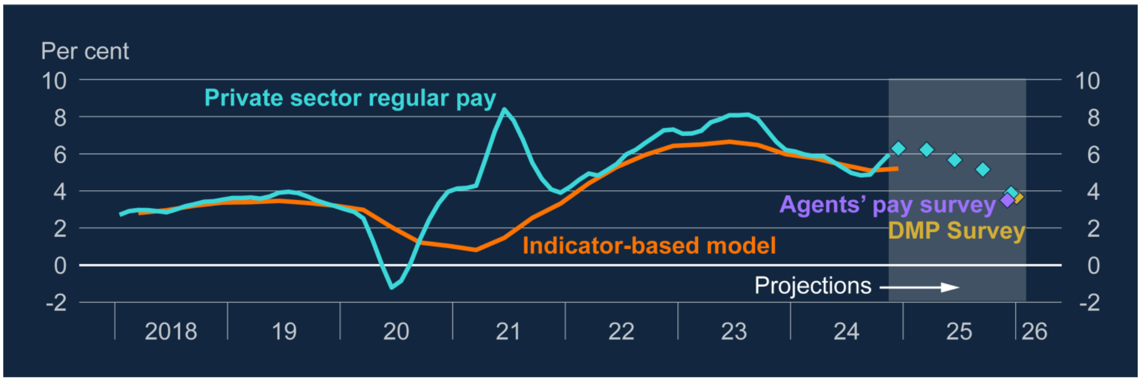
Wage growth remains an important factor behind the remaining persistence in services price inflation. Annual growth in private-sector regular average weekly earnings (AWE) increased to 6.0% in the three months to November. This may suggest that the disinflationary process has slowed in recent months.

The news from other measures of private-sector regular pay growth has been mixed. The Bank staff's indicator model of underlying pay growth has plateaued recently, as **Chart 3** shows, but it still points to a lower rate of wage growth (orange line) than the

AWE (in blue). Both the Bank's Decision Maker Panel and our Agent's annual pay survey point to a softening in wage growth over this year, to just below 4% and 3.7%, (yellow and purple dots) respectively.

Chart 3: AWE growth has picked up but is expected to moderate

Measures of annual private sector wage growth

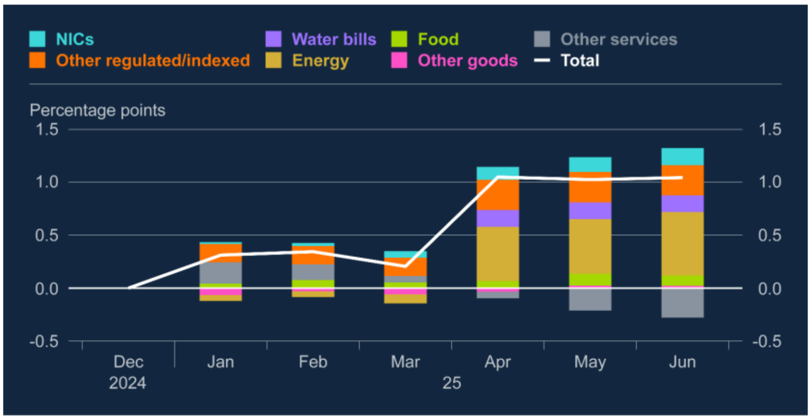


Sources: Agents, DMP Survey, HMRC, Indeed, KPMG/REC UK Report on Jobs, Lloyds Business Barometer, ONS and Bank calculations

So while we expect inflation to rise again over the coming months, it is almost entirely due to factors that are not directly linked to underlying cost and price pressures in the UK economy – factors that we expect to be temporary.

Chart 4: Energy and regulated prices will drive up CPI inflation temporarily

Projected contributions to cumulative changes in CPI inflation from December 2024



Sources: Bloomberg Finance L.P., Department for Energy Security and Net Zero, ONS and Bank calculations

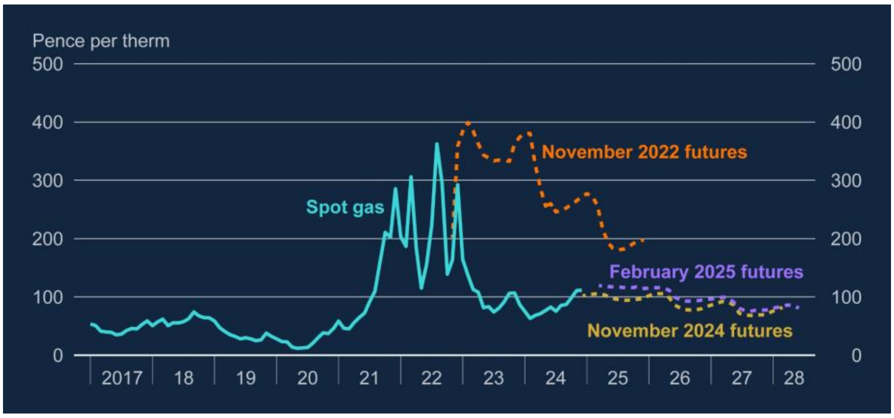
Chart 4 shows a decomposition. The combined effects of regulated price changes and fiscal measures may add around half a percentage point to inflation towards the middle of this year (orange, blue and purple bars). Core goods and food price inflation measures have also ticked up (pink and green bars). But the single largest driver is household energy bills (gold bars). With current expectations for wholesale prices, energy prices may contribute as much as three quarters of a percentage point to the increase in headline inflation expected towards the middle of the year.

The winter has been colder than expected in Europe and that has led to an increase in demand for natural gas while supply has remained tight.

As **Chart 5** shows, wholesale natural gas futures prices have risen by around 20% since our November Report. The increase in European gas prices has led to an increase in the Ofgem price cap for UK household energy bills for the current quarter, and it will affect the cap for the second quarter of this year too when it is announced by Ofgem later this month. But gas futures prices remain significantly lower than in 2022, and they are little changed further out. While energy prices are volatile and notoriously hard to predict, these are developments that should help to limit further increases in energy prices.

Chart 5: Gas futures prices have risen but remain well below 2022 levels

Wholesale UK natural gas spot price and selected futures curves



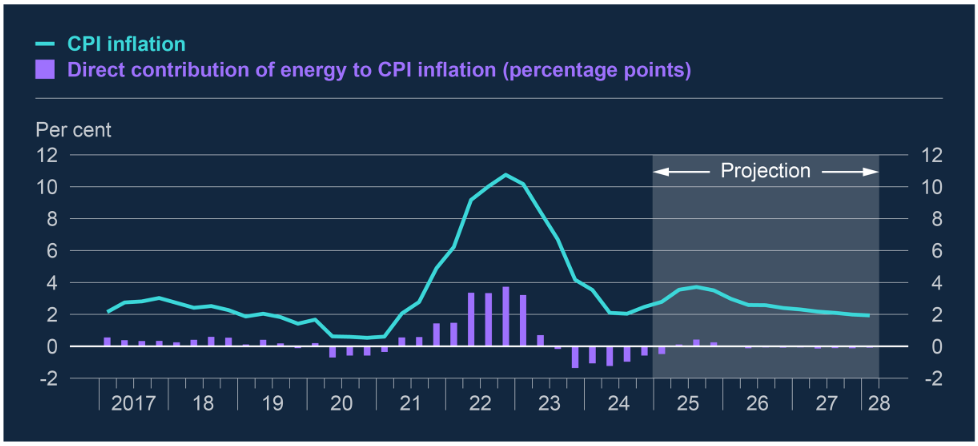
Sources: Bloomberg Finance L.P. and Bank calculations

Monetary policy cannot prevent such short-term influences on headline inflation, nor should monetary policy respond to factors that will fade by the time monetary policy takes it effect. But we should recognise that this short-term pick-up in inflation introduces some further uncertainty into the near-term outlook for inflation. Utility and food prices are salient to the consumer, and we have to make sure that temporary increases in them do not feed through to lasting second-round effects on wages and other prices. With the underlying disinflationary process well underway, and a continued restrictive stance of monetary policy in place, we can, however, be reasonably confident that the pick-up in inflation we see ahead of us will be temporary – and much smaller and less prolonged than the one we have just put behind us.

Today, the labour market is cooling. The context is one of a weaking in economic activity. Intelligence from the Bank's Agents suggests that firms are increasingly either reluctant or unable to pass through costs to consumer prices given subdued demand. These are signs that the restrictive stance of monetary policy continues to work to reduce inflationary pressure in the UK economy.

Chart 6: Inflation is projected to return to the 2% target in the medium term

CPI inflation projection conditional on market-path for interest rates



Sources: ONS and Bank calculations

So looking further ahead as in **Chart 6**, our February projection – which is conditional on the market-implied path for interest rates – suggests that consumer price inflation will peak this year at around 3.7% and then fall steadily back to the 2% target over the rest of the forecast period.

In our projection, the return of inflation to target is supported by an emerging degree of economic slack in the UK economy.

Activity in the UK economy has been weaker than expected last year. And we now expect GDP growth to be notably weaker in the near term too before picking up from the middle of the year. We expect similar growth rates for 2026 and 2027 as we did in November.

There is considerable uncertainty over the extent to which this weakness in UK GDP should be ascribed to demand or to supply, and so what that weakness means for inflation. Metrics of business and consumer confidence have deteriorated over recent months, and contacts of the Bank's Agents report that consumers are more price conscious and holding back on spending. This is consistent with a slowdown in demand. Equally, the disinflationary process has been slow too, and both services price inflation and pay growth remain at elevated levels. Price balances in business surveys have increased, while activity balances have fallen. This suggests that demand has been slowing against the backdrop of continued weakness in the potential supply capacity of the UK economy.

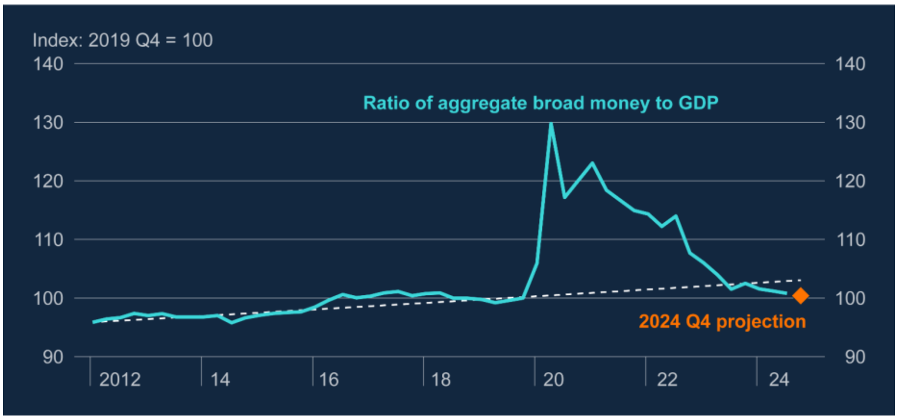
Our February projection ascribes much of the weakness in economic activity to supply. This means that the more recent slowdown in demand has so far led to only a small margin of slack opening up. The output gap then widens over the next couple of years of the projection to around three quarters of a per cent of potential GDP, before narrowing towards the end of the forecast period.

This is consistent with current measures of slack in the economy. Both the level of vacancies and the ratio of vacancies to unemployment have returned close to pre-pandemic levels, suggesting that the labour market is broadly in balance.

I would also note that the ratio of broad money to GDP, shown in **Chart 7**, has returned close to its pre-pandemic trend, though it is clear that the slope of the current direction of travel is down.

Chart 7: Money growth has been normalising

Ratio of aggregate broad money to nominal GDP



Sources: Bank of England, ONS and Bank calculations

While we would expect the underlying disinflationary process to continue, the balance between aggregate demand and supply is one of the main determinants of inflationary pressures in the medium term.

This will influence the path for Bank Rate. On the one hand, greater or longer-lasting weakness in demand relative to supply would push down on inflationary pressures, consistent with a less restrictive path for Bank Rate. On the other hand, if supply is more constrained relative to demand, domestic wage and price pressures could be sustained, consistent with a slower pace of future reductions in Bank Rate.

There are risks from the global economy too. It remains unclear what form global trade policies might ultimately take, and the MPC's February projection is not conditioned on any change in global tariffs. A Box in the Monetary Policy Report sets out a framework for how tariffs could affect UK output and inflation.

Let me conclude.

Our restrictive stance of monetary policy has reduced inflationary pressures in the UK economy. With the progress we have made, we have been able to take another step in making monetary policy a little less restrictive today.

The judgement we will have to make at our future meetings is whether underlying inflationary pressures in the UK economy are easing enough to allow further cuts in Bank Rate.

Some domestic inflationary pressures remain and may have eased a little more slowly than we expected last year, reaffirming the importance of taking a gradual approach to the withdrawal of monetary policy restrictiveness. Bank Rate is not on a pre-set path. With increased uncertainty and risks to inflation on both sides – from the near-term outlook to UK activity and inflation, and from developments in the global economy – we must also proceed carefully, judging the evidence afresh at each meeting.

Based on the Committee's evolving views of the outlook for medium-term inflation, a gradual and careful approach to the further withdrawal of monetary policy restraint is appropriate.

And with that, Clare, Dave and I will be happy to take your questions.