Bank of England

Monetary Policy Report

Monetary Policy Committee
May 2025

Monetary policy at the Bank of England

The objectives of monetary policy

The Bank's Monetary Policy Committee (MPC) sets monetary policy to keep inflation low and stable, which supports growth and jobs. Subject to maintaining price stability, the MPC is also required to support the Government's economic policy.

The Government has set the MPC a target for the 12-month increase in the Consumer Prices Index of 2%.

The 2% inflation target is symmetric and applies at all times.

The MPC's **remit** recognises, however, that the actual inflation rate will depart from its target as a result of shocks and disturbances, and that attempts to keep inflation at target in these circumstances may cause undesirable volatility in output. In exceptional circumstances, the appropriate horizon for returning inflation to target can vary. The MPC will communicate how and when it intends to return inflation to the target.

The instruments of monetary policy

The MPC currently uses two main monetary policy tools. First, we set the interest rate that banks and building societies earn on deposits, or 'reserves', placed with the Bank of England – this is Bank Rate. Second, we can buy government and corporate bonds, financed by the issuance of central bank reserves – this is asset purchases or quantitative easing.

The Monetary Policy Report

The MPC is committed to clear, transparent communication. The Monetary Policy Report (MPR) is a key part of that. It allows the MPC to share its thinking and explain the reasons for its decisions.

The Report is produced quarterly by Bank staff under the guidance of the members of the MPC.

This Report has been prepared and published by the Bank of England in accordance with section 18 of the Bank of England Act 1998.

The Monetary Policy Committee

- Andrew Bailey, Chair
- Sarah Breeden
- Swati Dhingra
- Megan Greene
- Clare Lombardelli
- Catherine L Mann
- Huw Pill
- Dave Ramsden
- Alan Taylor

PowerPoint™ versions of the Monetary Policy Report charts and Excel spreadsheets of the data underlying most of them are available at **http://www.bankofengland.co.uk/monetary-policy-report/2025/may-2025**.

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Contents

Monetary Policy Summary

The Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. The MPC adopts a medium-term and forward-looking approach to determine the monetary stance required to achieve the inflation target sustainably.

At its meeting ending on 7 May 2025, the MPC voted by a majority of 5–4 to reduce Bank Rate by 0.25 percentage points, to 4.25%. Two members preferred to reduce Bank Rate by 0.5 percentage points, to 4%. Two members preferred to maintain Bank Rate at 4.5%.

There has been substantial progress on disinflation over the past two years, as previous external shocks have receded, and as the restrictive stance of monetary policy has curbed second-round effects and stabilised longer-term inflation expectations. That progress has allowed the MPC to withdraw gradually some degree of policy restraint, while maintaining Bank Rate in restrictive territory so as to continue to squeeze out persistent inflationary pressures.

Underlying UK GDP growth is judged to have slowed since the middle of 2024, and the labour market has continued to loosen.

Progress on disinflation in domestic price and wage pressures is generally continuing. Twelve-month CPI inflation fell to 2.6% in March from 2.8% in February, close to expectations in the February Report. Although indicators of pay growth remain elevated, a significant slowing is still expected over the rest of the year. Wholesale energy prices have fallen back since the February Report. Previous increases in energy prices are still likely to drive up CPI inflation from April onwards, to 3.5% for 2025 Q3. Inflation is expected to fall back thereafter. Measures of household inflation expectations have risen recently.

Uncertainty surrounding global trade policies has intensified since the imposition of tariffs by the United States and the measures taken in response by some of its trading partners. There has subsequently been volatility in financial markets, and market-implied policy rates have moved lower. Prospects for global growth have weakened as a result of this uncertainty and new tariff announcements, although the negative impacts on UK growth and inflation are likely to be smaller.

The Committee remains focused on returning CPI inflation sustainably to target in the medium term. In deciding the appropriate degree and pace of monetary policy adjustments required to achieve this, the Committee has considered a range of possibilities for how domestic inflationary pressures could evolve, as well as the broader circumstances that could necessitate varying the course of policy.

The May Report sets out two illustrative scenarios. In one scenario, there could be weaker supply and more persistence in domestic wages and prices, including from second-round effects related to the near-term increase in CPI inflation. In another scenario, inflationary pressures could ease more quickly owing to greater or longer-lasting weakness in demand relative to supply, in part reflecting uncertainties globally and domestically.

Monetary policy is not on a pre-set path. The Committee will remain sensitive to heightened unpredictability in the economic environment and will continue to update its assessment of risks.

At this meeting, the Committee voted to reduce Bank Rate to 4.25%, reflecting continued progress in disinflation though with risks to inflation remaining in both directions.

Based on the Committee's evolving view of the medium-term outlook for inflation, a gradual and careful approach to the further withdrawal of monetary policy restraint remains appropriate. The Committee will continue to monitor closely the risks of inflation persistence and what the evidence may reveal about the balance between aggregate supply and demand in the economy. Monetary policy will need to continue to remain restrictive for sufficiently long until the risks to inflation returning sustainably to the 2% target in the medium term have dissipated further. The Committee will decide the appropriate degree of monetary policy restrictiveness at each meeting.

1: The economic outlook

Progress on disinflation in domestic price and wage pressures is generally continuing (Key judgement 1). CPI inflation averaged 2.8% in 2025 Q1, above target but close to expectations at the time of the February Report. CPI inflation excluding energy has remained around 3½% over recent quarters, compared with its peak of nearly 8½% in mid-2023 (Chart 1.1). Headline CPI inflation is still expected to rise temporarily in the near term, to 3.5% in 2025 Q3, in large part reflecting developments in household energy bills and, to a lesser degree, regulated prices.

A small margin of excess supply has opened up in the UK economy. This is expected to widen over the next couple of years, to just under 1% of potential GDP (Key judgement 2). That in large part reflects a tightening in the stance of fiscal policy and the continuing restrictive stance of monetary policy. Relative to the February Report projection, there is expected to be a slightly greater margin of excess supply throughout most of the forecast period, in part reflecting global trade developments.

Conditioned on the market path of interest rates, the building margin of excess supply in the economy acts against some continuing second-round effects in domestic prices and wages in order for CPI inflation to fall back to around the 2% target in the medium term (Key judgement 3). The May CPI projection is broadly similar to the profile in February, albeit slightly lower. In the medium term, that reflects the downward pressure on inflation from a slightly wider margin of slack and a weaker contribution from import price pass-through, in turn owing to the impact of global trade developments and the appreciation of the sterling exchange rate.

The imposition of tariffs and the heightened uncertainty about trade policies has introduced a new source of risk for the global economy. What matters for UK monetary policy is the overall impact of these developments on the outlook for CPI inflation in the medium term. In the baseline forecast, based on current policies, new tariffs and the elevated level of trade policy uncertainty weigh on global activity. World export prices are expected to be materially weaker, particularly in China (Key judgement 4). The current overall impact of trade developments on the UK is therefore more likely to be disinflationary than inflationary. Consistent with this, the effects incorporated into the baseline are negative, though not large particularly in the medium term.

There is elevated uncertainty around the speed with which excess domestic inflationary pressures dissipate, in part related to global trade developments since the February Report. In assessing the medium-term outlook for CPI inflation, the MPC is

currently considering a wide range of risks alongside its baseline forecast.

As set out in Box A, Bank staff have constructed two alternative scenarios for how the economy may evolve. These demonstrate the mechanisms through which: first, there could be greater or longer-lasting weakness in demand relative to supply, in part reflecting uncertainties globally and domestically, which would lead second-round effects to fade more quickly; or second, there could be more persistence in domestic wage and prices, both from additional second-round effects related to the near-term increase in CPI inflation and from weaker supply.

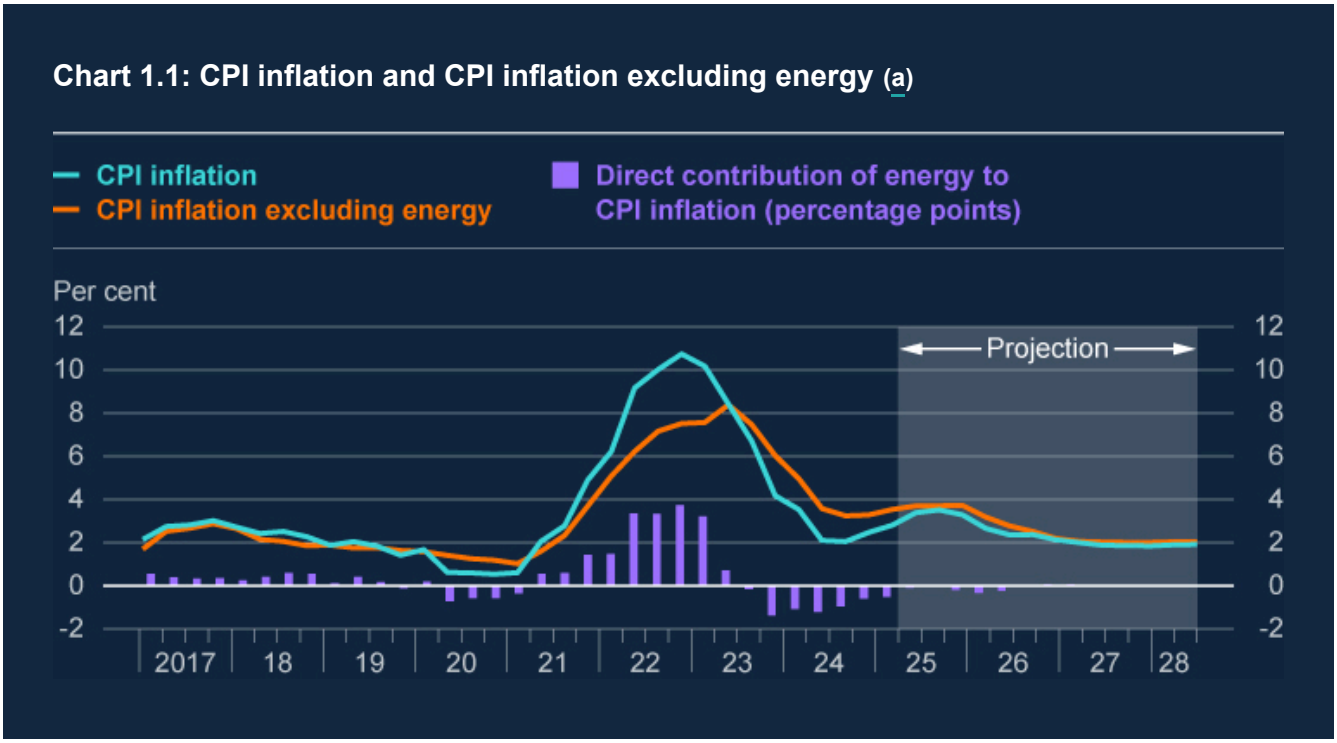
The scenarios described in Box A are merely two examples from a wide range of different paths that the UK economy could take. Overall, the Committee judges that the risks around GDP growth in this forecast are somewhat to the downside, while the risks around the CPI projection are two-sided.

Table 1.A: Baseline forecast summary (a) (b)

	2025 Q2	2026 Q2	2027 Q2	2028 Q2
GDP (c)	0.8 (0.3)	1.3 (1.5)	1.5 (1.4)	1.9
CPI inflation (d)	3.4 (3.5)	2.4 (2.6)	1.9 (2.2)	1.9
Unemployment rate (e)	4.6 (4.5)	4.8 (4.6)	5 (4.8)	4.9
Excess supply/Excess demand (f)	-½ (-¼)	-¾ (-½)	-¾ (-¾)	-¼
Bank Rate (g)	4.3 (4.4)	3.5 (4.1)	3.6 (4.1)	3.7

(a) Figures in parentheses show the corresponding projections in the February 2025 Monetary Policy Report.
(b) The numbers shown in this table are conditioned on the assumptions described in Section 1.1.
(c) Four-quarter growth in real GDP.
(d) Four-quarter inflation rate.
(e) International Labour Organization (ILO) definition of unemployment. Although LFS unemployment data have been reinstated by the ONS, they are badged as official statistics in development and the LFS continues to suffer from very low response rates, which can introduce volatility and potentially non-response bias (Box D of the **May 2024 Monetary Policy Report**).
(f) Per cent of potential GDP. A negative figure implies output is below potential and a positive that it is above.
(g) Per cent. The path for Bank Rate implied by forward market interest rates. The curves are based on overnight index swap rates.

Chart 1.1: CPI inflation and CPI inflation excluding energy (a)



Sources: Bloomberg Finance L.P., ONS and Bank calculations.

(a) Energy prices include fuels and lubricants, electricity, gas and other fuels.

1.1: The conditioning assumptions underlying the MPC's baseline projections

As set out in Table 1.B, the MPC's May baseline projections are conditioned on:

- The paths for policy rates in advanced economies implied by financial markets, as captured in the 15 working day averages of forward interest rates to 29 April (Chart 2.3). The market-implied path for Bank Rate underpinning the May projections declines to just over 3½% by the middle of the forecast period, around ½ percentage point lower on average than in the February Report.
- A path for the sterling effective exchange rate index that is around 2% higher compared with the February Report. The exchange rate depreciates slightly over the forecast period, reflecting the role of expected interest rate differentials in the Committee's conditioning assumption.
- Wholesale energy prices that follow their respective futures curves over the forecast period. Since February, oil and gas prices have fallen (Chart 2.4). Significant uncertainty remains around the outlook for wholesale energy prices.
- UK household energy prices that move in line with Bank staff estimates of the Ofgem price cap implied by the paths of wholesale gas and electricity prices (Section 2.5).

- UK fiscal policy that evolves in line with government policies to date, as announced in Spring Statement 2025 (Section 2.3).
- Global and UK trade policies as of 29 April including a continuation throughout the forecast period of the current very high US-China bilateral tariffs and of the current 90-day pause on higher-band US tariffs excluding China (Box C).

Table 1.B: Conditioning assumptions (a) (b)

	Average 1998–2007	Average 2010–19	2023	2024	2025	2026	2027
Bank Rate (c)	5.0	0.5	5.3 (5.3)	4.9 (4.9)	3.7 (4.2)	3.6 (4.1)	3.6 (4)
Sterling effective exchange rate (d)	100	82	81 (81)	85 (85)	84 (82)	84 (82)	83 (81)
Oil prices (e)	39	77	84 (84)	75 (75)	64 (74)	64 (71)	65 (70)
Gas prices (f)	29	52	101 (101)	107 (107)	94 (115)	86 (97)	78 (82)
Nominal government expenditure (g)	7¼	2¼	7¾ (7¾)	6½ (5¾)	8¼ (7)	3 (3½)	3¼ (3¼)

Sources: Bank of England, Bloomberg Finance L.P., LSEG Workspace, Office for Budget Responsibility (OBR), ONS and Bank calculations.

(a) The table shows the projections for financial market prices, wholesale energy prices and government spending projections that are used as conditioning assumptions for the MPC's projections for CPI inflation, GDP growth and the unemployment rate. Figures in parentheses show the corresponding projections in the February 2025 Monetary Policy Report.
(b) Financial market data are based on averages in the 15 working days to 29 April 2025. Figures show the average level in Q4 of each year, unless otherwise stated.
(c) Per cent. The path for Bank Rate implied by forward market interest rates. The curves are based on overnight index swap rates.
(d) Index: January 2005 = 100. The convention is that the sterling exchange rate follows a path that is halfway between the starting level of the sterling ERI and a path implied by interest rate differentials.
(e) Dollars per barrel. Projection based on monthly Brent futures prices.
(f) Pence per therm. Projection based on monthly natural gas futures prices.
(g) Annual average growth rate. Nominal general government consumption and investment. Projections are based on the OBR's March 2025 Economic and Fiscal Outlook. Historical data based on NMRP+D7QK.

1.2: Key judgements and risks

1.2: Key judgement 1

Progress on disinflation in domestic price and wage pressures is generally continuing. While headline inflation is expected to rise in the near term to 3.5%, the MPC judges that this will not lead to additional second-round effects on underlying domestic inflationary pressures.

Twelve-month CPI inflation peaked at around 11% at the end of 2022, following the succession of very large external cost shocks that occurred in 2021–22. Inflation fell back in 2023 and progress on disinflation has continued since then. This has allowed the MPC to reduce gradually the degree of monetary policy restrictiveness.

CPI inflation was 2.6% in March and averaged 2.8% in 2025 Q1, above the MPC's 2% target but close to expectations at the time of the February Report (Section 2.5). CPI inflation excluding energy has remained around 3½% over recent quarters, compared with its peak of nearly 8½% in mid-2023 (Chart 1.1).

The latest evidence suggests progress on disinflation in domestic price and wage pressures is generally continuing, supported by the restrictive stance of monetary policy.

Services consumer price inflation has risen over recent months, to 4.7% in March from 4.4% in December, but to a slightly lesser degree than expected at the time of the February Report. This increase in services inflation and a further rise expected in April relate partly to volatility in airfares, while there is also upward pressure from increases in regulated and administered prices. Measures of underlying services price inflation have continued to ease gradually since their peaks in 2023 but remain elevated (Chart 2.24).

After having risen in 2024 H2, annual private sector regular average weekly earnings (AWE) growth declined to 5.9% in the three months to February, weaker than expected in the February Report. Most other measures of pay growth have also fallen back somewhat over recent months (Chart 2.16). Private sector regular pay growth is expected to slow significantly further by the end of 2025, to around 3¾%, consistent with the latest indications from Agency intelligence and the DMP Survey.

The MPC monitors a range of indicators from households, businesses and financial markets to make a joint assessment of whether inflation expectations remain consistent with meeting the 2% inflation target sustainably in the medium term. Having fallen significantly from the end of 2022, survey measures of household inflation expectations have risen since mid-2024 (Chart 2.26). These increases have been towards the top of the band of, or a little above, what would be implied by the rise in CPI inflation over the past year, suggesting that households' inflation expectations may have become more responsive to inflationary pressures since the period of very high inflation in 2022. Businesses' medium-term CPI

inflation expectations have increased slightly recently, although indicators of medium-term inflation expectations derived from financial markets have generally continued to trend downwards. Monetary policy will act to ensure that longer-term inflation expectations are anchored at the 2% target.

In the May Report projection, CPI inflation is expected to rise in coming months, to 3.4% in 2025 Q2 and to a peak of 3.5% on average in Q3, in large part reflecting developments in household energy bills and, to a lesser degree, regulated prices (Chart 2.20). Although wholesale energy prices have fallen back since the February Report, the direct energy price contribution to 12-month CPI inflation is projected to increase from -0.5 percentage points in 2025 Q1 to around zero in Q2 and Q3 (Chart 1.1). That pickup in large part reflects the announced increase in the Ofgem energy price cap in April, and that the large fall in the price cap last April will drop out of the annual comparison.

The projected increase in CPI inflation over coming months is still expected to be temporary. This in part reflects the Committee's judgement that the near-term increase will not lead to additional second-round effects on underlying domestic inflationary pressures, beyond those that would typically be expected to occur and in contrast to the more persistent dynamics in the inflation generating process that occurred following the very large shocks in 2021–22. This reflects that there is going to be a much smaller increase in headline inflation than at that time and comes against the backdrop of a looser labour market.

In this forecast, the Committee has also maintained its judgement on the speed with which overall excess domestic inflationary pressures are expected to dissipate in the medium term (Key judgement 3). There is elevated uncertainty around this judgement, in part related to global trade developments since the February Report. In assessing the medium-term outlook for CPI inflation, the MPC is considering a wide range of risks alongside its baseline forecast.

As set out in Box A, Bank staff have constructed two alternative scenarios for how the economy may evolve. These demonstrate the mechanisms through which: first, there could be greater or longer-lasting weakness in demand relative to supply, in part reflecting uncertainties globally and domestically, which would lead second-round effects to fade more quickly; or second, there could be more persistence in domestic wage and prices, both from additional second-round effects related to the near-term increase in CPI inflation and from weaker supply. These scenarios are designed to represent plausible rather than tail outcomes. So, for example, they would generally sit within the central bands of the fan charts published in this Report, even though they are not technically drawn from the distributions of the fan charts. Such a comparison does not imply anything about the precise likelihood of the scenarios occurring.

The scenarios described in Box A are merely two examples from a wide range of different paths that the UK economy could take. Broader global risks are discussed in Key judgement 4, including those related to the unpredictability of future trade policies. Key judgement 2 discusses other risks to the balance of demand and supply, and hence to underlying inflationary pressures.

1.2: Key judgement 2

A small margin of excess supply has opened up in the UK economy. This is expected to widen over the next couple of years, to just under 1% of potential GDP, before narrowing by the end of the forecast period.

Underlying UK GDP growth is judged to have slowed since the middle of 2024 and has been much less volatile than growth in headline GDP (Section 2.3). Underlying GDP growth is expected to have been around zero in 2025 Q1, well below Bank staff's projection for headline growth of 0.6%. The S&P Global UK composite output PMI fell sharply in April, suggesting downside risks around the near-term outlook. Household spending growth has remained subdued over recent quarters, although real incomes have risen quite strongly such that the saving ratio increased to 11.6% in 2024 Q4, its highest level since the pandemic.

Underlying employment growth has also softened recently and the labour market has continued to loosen (Section 2.4). The ratio of vacancies to unemployment has fallen further and is now judged to be below its equilibrium level. The impact of higher NICs on employment appears to have been fairly small to date.

As outlined in Box E of the February Report, much of the recent weakness in productivity growth is judged to reflect weaker growth in potential productivity. Potential productivity remains notably weaker than can be explained by previously identified factors such as the impacts of past shocks from Brexit and the pandemic.

Overall, a small margin of excess supply is judged to have opened up around the turn of last year. This is consistent with labour market developments, survey indicators of capacity utilisation and top-down statistical estimates of the output gap. The MPC continues to recognise the significant uncertainty around estimates of slack in the economy.

The outlook for UK activity will be determined by both domestic and global factors.

As set out in Box C, current global trade policy developments are likely to reduce UK GDP growth. Weaker UK-weighted world GDP growth is expected to weigh on demand for UK exports, which in turn drags on UK growth. And some degree of expenditure switching by US consumers away from imports, including those from the UK, and towards domestically produced products, further weighs on UK growth. Trade-related developments in financial

markets have generally pushed down on growth, including the appreciation of the sterling exchange rate, although these effects are partly offset by the fall in short-term interest rates since February.

The MPC judges that the current stance of monetary policy remains restrictive. Under the latest market-implied path for interest rates, including its expected impact on broader financial conditions, monetary policy is expected to have a broadly neutral impact on GDP growth over much of the forecast period, even as its previous negative impact on the level of GDP remains. There remain uncertainties around the impact of monetary policy on demand and hence on the margin of slack in the economy.

The measures announced in Spring Statement 2025 are expected to have little impact on the UK's fiscal stance, and hence on projected GDP growth, over the three-year forecast period. The overall stance of fiscal policy is still expected to tighten. This pulls down somewhat on the GDP growth projection over most of the forecast period beyond the next few quarters.

In the May forecast, four-quarter GDP growth is projected to remain close to its current level, of just over 1%, before picking up towards the end of the forecast period (Chart 1.2). Quarterly growth rates are expected to be slightly weaker than in the February Report at the start of the forecast beyond 2025 Q1 and slightly stronger further out.

Household spending growth is projected to pick up throughout most of the forecast period (Table 1.D), supported by a declining saving ratio that in turn reflects the impact of the downward-sloping assumed path of interest rates. Annual housing investment growth is expected to strengthen to 5% in 2026 and to 6% in 2027, in part reflecting a positive impact from planning reforms over time. Business investment growth is weak throughout much of the forecast period. Export growth has been revised down, particularly in 2026, compared with the February Report, owing to global trade developments. Trade data have been volatile recently, which may make it harder to assess underlying developments going forward.

Four-quarter potential supply growth is projected to remain at around 1½% in the medium term. Within that, potential labour supply growth is around ¾% per annum in the medium term. Potential productivity is assumed to recover some of its recent weakness and settles at annual growth rates of around ¾%.

Reflecting these paths of GDP and potential supply, the margin of excess supply is expected to widen further over the next couple of years in the May forecast, from ¼% in 2025 Q1 to just under 1% of potential GDP by the end of 2026. That in large part reflects the tightening in the stance of fiscal policy and the continuing restrictive stance of monetary policy. The margin of slack is then projected to narrow by the end of the forecast period. Relative to the February Report projection, there is expected to be a slightly greater margin of excess supply throughout most of the forecast period, in part reflecting global trade developments.

The unemployment rate is projected to rise gradually to around 5% by the end of 2026 (Chart 1.3), above its assumed medium-term equilibrium rate of just over 4½%. Unemployment is somewhat higher than in the February Report, in part reflecting a slightly higher starting point suggested by the current LFS data.

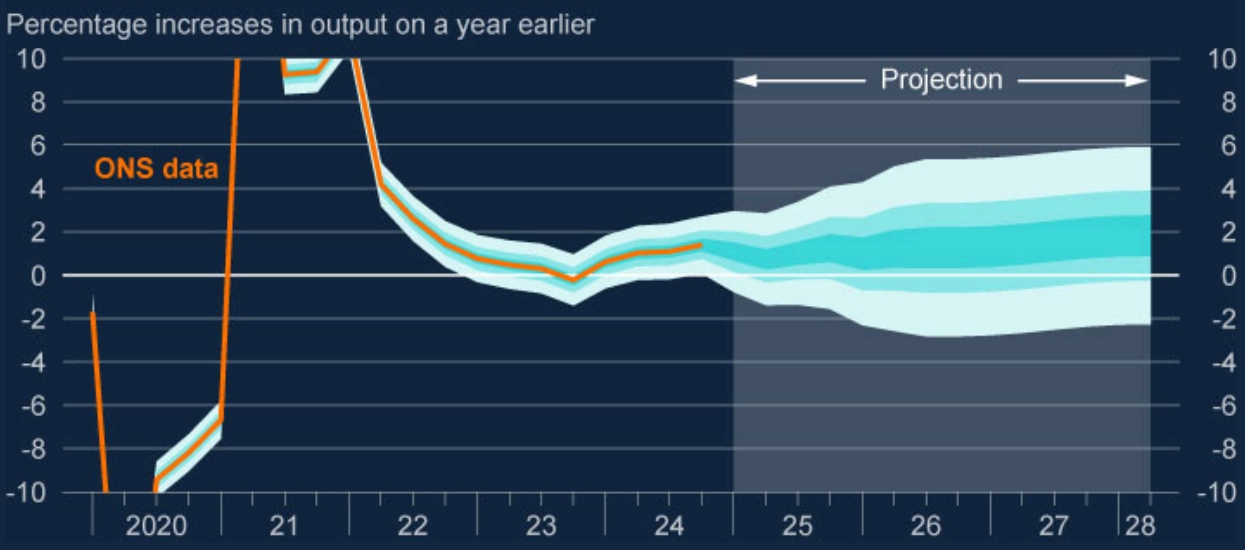
There are considerable risks around the future path of excess supply in the economy, and hence inflationary pressures in the medium term, reflecting both global (Key judgement 4) and domestic factors.

As set out in Box A, Bank staff have prepared an alternative scenario in which aggregate demand is substantially weaker than in the baseline projection, as an additional UK-specific increase in uncertainty drags on consumption and investment to a greater extent. There may also be other downside risks to demand from recent consumption and saving behaviour. The Committee has for some time expected the household saving ratio to decline and support consumption over the forecast period, but saving has so far continued to increase and to a greater degree recently than can be explained by the stance of monetary policy.

Supply growth could be weaker than in the baseline forecast if potential productivity were to recover less from its recent unexplained weakness. In this case, the implications for GDP growth and slack in the economy would depend on the speed with which weaker supply fed through into weaker demand. Box A sets out an alternative scenario in which potential productivity growth is materially weaker than in the baseline, and that weakness in productivity is not reflected in lower wages, which adds to domestic inflationary pressures.

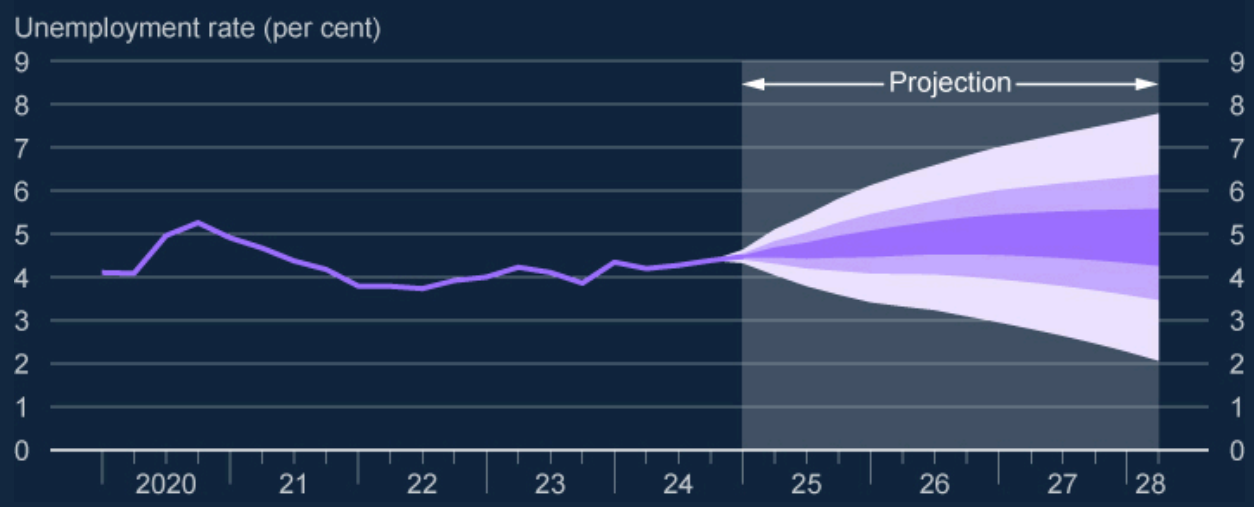
Overall, the Committee judges that the risks around GDP growth in this forecast are somewhat to the downside. On balance, this is also judged to lead to a risk of a greater margin of excess supply over the forecast period than in the baseline.

Chart 1.2: GDP growth projection based on market interest rate expectations, other policy measures as announced



The fan chart depicts the probability of various outcomes for GDP growth. It has been conditioned on Bank Rate following a path implied by market yields, but allows the Committee's judgement on the risks around the other conditioning assumptions set out in Section 1.1, including wholesale energy prices, to affect the calibration of the fan chart skew. To the left of the shaded area, the distribution reflects uncertainty around revisions to the data over the past. To the right of the shaded area, the distribution reflects uncertainty over the evolution of GDP growth in the future. If economic circumstances identical to today's were to prevail on 100 occasions, the MPC's judgement is that the mature estimate of GDP growth would lie within the darkest central band on only 30 of those occasions. The fan chart is constructed so that outturns are also expected to lie within each pair of the lighter aqua areas on 30 occasions. In any particular quarter of the forecast period, GDP growth is therefore expected to lie somewhere within the fan on 90 out of 100 occasions. And on the remaining 10 out of 100 occasions GDP growth can fall anywhere outside the aqua area of the fan chart. Over the forecast period, this has been depicted by the grey background. The Box on page 39 of the **November 2007 Inflation Report** provides a fuller description of the fan chart and what it represents. The y-axis of the chart has been truncated to illustrate more clearly the current uncertainty around the path of GDP growth, as otherwise this would be obscured by the volatility of GDP growth during the pandemic.

Chart 1.3: Unemployment rate projection based on market interest rate expectations, other policy measures as announced



The fan chart depicts the probability of various future outcomes for the ILO definition of unemployment and begins in 2025 Q1. Although LFS unemployment data have recently been reinstated by the ONS, they are badged as official statistics in development and the LFS continues to suffer from very low response rates, which can introduce volatility and potentially non-response bias (Box D of the **May 2024 Monetary Policy Report**). The fan chart has been conditioned on Bank Rate following a path implied by market yields, but allows the Committee's judgement on the risks around the other conditioning assumptions set out in Section 1.1, including wholesale energy prices, to affect the calibration of the fan chart skew. The coloured bands have the same interpretation as in Chart 1.2 and portray 90% of the probability distribution. A significant proportion of this distribution lies below Bank staff's current estimate of the long-term equilibrium unemployment rate. There is therefore uncertainty about the precise calibration of this fan chart.

1.2: Key judgement 3

Conditioned on the market path of interest rates, the building margin of excess supply in the economy acts against some continuing second-round effects in domestic prices and wages in order for CPI inflation to fall back to around the 2% target in the medium term.

As for the growth outlook, medium-term inflationary pressures are being affected by both domestic and global factors.

As set out in Box C, and conditional on current global trade policies and asset prices, the evidence to date suggests that the overall impact of trade developments on the UK is more likely to be disinflationary than inflationary. Consistent with this, the effects incorporated into the baseline forecast are negative, though not large particularly in the medium term.

UK non-energy import prices are projected to be 2¼% lower than expected at the time of the February Report over the forecast period. That in part reflects the assumed effects of reduced US import demand in response to higher tariffs (Key judgement 4). The recent appreciation in

sterling also weighs on UK import prices over the forecast period, which drags further on inflation. The degree and timing of pass-through from import prices to CPI inflation will be affected by the domestic costs of transport and retailing.

Overall, there is significant uncertainty around the size, and possibly the sign, of any net effect on UK inflation of trade developments. The risks to global inflation set out in Key judgement 4 apply to the UK. For example, there is uncertainty around the extent of the shift in global trade patterns and developments in major economies' exchange rates, and how these may come to affect the UK in particular. The UK pricing decisions of multinational corporations could be affected indirectly by their exposure to higher costs in other jurisdictions.

Domestically, the May forecast for CPI inflation continues to incorporate a period of economic slack, which is required in order for pay and price-setting dynamics to normalise fully. The Committee has not changed its judgement on the speed with which excess domestic inflationary pressures are expected to dissipate. The continuing second-round effects in this forecast relate in large part to the unwind of the succession of very large external cost shocks in 2021–22, rather than additional second-round effects from the near-term pickup in headline inflation (Key judgement 1).

In the projection conditioned on the market-implied path of interest rates in the 15 working days to 29 April, CPI inflation falls back gradually from 3.5% in 2025 Q3 to around the 2% target in the medium term (Chart 1.4 and Table 1.C). This reflects the continuing restrictive stance of monetary policy and the building margin of slack in the economy.

The May CPI projection is broadly similar to the profile in February throughout the forecast period, albeit slightly lower. In the medium term, that reflects the downward pressure on inflation from a slightly wider margin of slack throughout most of the forecast period and the weaker contribution from import price pass-through, in turn owing to the impact of global trade developments and the appreciation of the sterling exchange rate.

Private sector regular AWE growth is expected to fall from around 3¾% at the end of this year to just under 3% in the medium term, similar to the February Report (Table 1.D).

There remains uncertainty around the calibration of the Committee's judgement on the path of second-round effects in domestic prices and wages. The staff scenarios in Box A describe two alternative paths for the persistence of inflationary pressures.

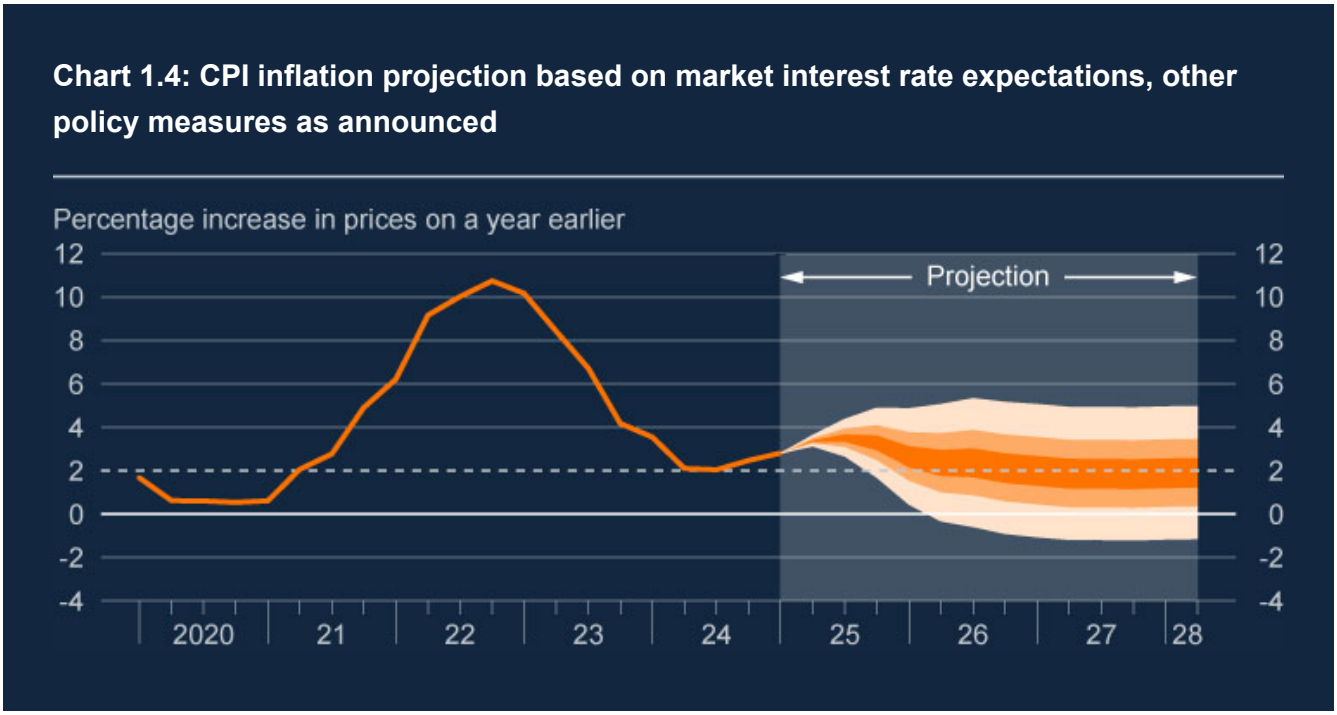
In the first scenario, economic slack builds and inflation persistence fades more quickly than in the baseline projection, including via a temporary steepening in the slope of the Phillips curve.

The second scenario explores the possibility that inflation persistence is greater than assumed in the baseline, including that the upcoming rise in headline inflation results in additional second-round effects in domestic wage and price-setting alongside weaker supply.

These scenarios do not encompass all the risks around inflationary pressures in the medium term. For example, there remains a risk that the economy has been subject to lasting changes in wage and price-setting behaviour following the major supply shocks experienced over previous years. The path for the medium-term equilibrium rate of unemployment could be higher than has been assumed in the forecast, which would be consistent with greater persistence in wage growth.

Overall, the Committee judges that the risks around the CPI projection are two-sided. Downside risks to growth, which carry through to inflation, are offset broadly by upside risks from the persistence of domestic inflationary pressures.

Chart 1.4: CPI inflation projection based on market interest rate expectations, other policy measures as announced



The fan chart depicts the probability of various future outcomes for CPI inflation and begins in 2025 Q2. It has been conditioned on Bank Rate following a path implied by market yields, but allows the Committee's judgement on the risks around the other conditioning assumptions set out in Section 1.1, including wholesale energy prices, to affect the calibration of the fan chart skew. If economic circumstances identical to today's were to prevail on 100 occasions, the MPC's judgement is that inflation in any particular quarter would lie within the darkest central band on only 30 of those occasions. The fan chart is constructed so that outturns of inflation are also expected to lie within each pair of the lighter orange areas on 30 occasions. In any particular quarter of the forecast period, inflation is therefore expected to lie somewhere within the fans on 90 out of 100 occasions. And on the remaining 10 out of 100 occasions inflation can fall anywhere outside the orange area of the fan chart. Over the forecast period, this has been depicted by the grey background. The Box on pages 48–49 of the **May 2002 Inflation Report** provides a fuller description of the fan chart and what it represents.

Table 1.C: The quarterly baseline projection for CPI inflation based on market rate expectations (a)

	2025 Q2	2025 Q3	2025 Q4	2026 Q1	
CPI inflation	3.4	3.5	3.3	2.7	
	2026 Q2	**2026 Q3**	**2026 Q4**	**2027 Q1**	
CPI inflation	2.4	2.4	2.1	2.0	
	2027 Q2	**2027 Q3**	**2027 Q4**	**2028 Q1**	**2028 Q2**
CPI inflation	1.9	1.9	1.8	1.9	1.9

(a) Four-quarter inflation rate.

1.2: Key judgement 4

New tariff announcements and the elevated level of trade policy uncertainty weigh on global activity. World export prices are expected to be materially weaker, particularly in China.

The world economy has been subject to several new shocks over recent months, including the imposition of significant changes in tariffs by the United States and some of its trading partners, the associated and intensifying trade policy uncertainty, and the prospective loosening in euro-area fiscal policy. What matters for UK monetary policy is the overall impact of these developments on the outlook for CPI inflation in the medium term (Key judgement 3), and how the risks around the constellation and impact of global trade policies would affect UK inflationary pressures if they were to transpire.

There has been significant volatility and movements in financial markets since the February Report, with partly offsetting effects on financial conditions (Section 2.1). Global equity prices have fallen, market-implied policy rates are lower, and the US dollar has depreciated, as market participants have reassessed the impact of, and uncertainty around, tariffs and broader economic policies on the global outlook.

Global trade policy uncertainty rose sharply after the US presidential election and has risen further since the February Report, to its highest recorded level (Chart B in Box C). This is likely to weigh on world growth by causing households and businesses to delay spending decisions. The Committee has allowed for these global effects to pull down on its UK growth forecast, but has not incorporated an additional UK-specific increase in uncertainty in its baseline projection beyond the effects already apparent in business surveys. The May

forecast assumes that global trade policy uncertainty remains at a very elevated level in the near term before falling back, though at a slower pace than in previous episodes of heightened economic uncertainty.

In the baseline forecast, and conditioned on current trade policies, tariffs directly increase the price of imported goods in the US and reduce demand for tradeable goods in the rest of the world. Tariffs are expected to weaken potential supply in the countries that initiate them as production shifts to less efficient inputs, firms and sectors. The global economy adjusts through a mix of reduced prices and quantities, including via reduced US demand and shifts in global trade patterns.

German fiscal policy is assumed to be loosened significantly following policy changes including the exemption of defence spending above 1% of GDP from the debt brake, and the creation of a €500 billion deficit-financed infrastructure fund. Some other euro-area countries are also assumed to increase defence spending to a smaller degree.

Overall, the level of global GDP is now expected to be around ¾% weaker over the forecast period than in the February Report, as new tariff announcements and the elevated level of trade policy uncertainty weigh by more than the prospective boost from looser euro-area fiscal policy. Four-quarter UK-weighted world GDP growth falls back to around 1½% this year and next, before rising to just over 2% in 2027.

Conditioned on current trade policies and the profile of trade policy uncertainty, growth is projected to weaken most significantly in the United States and in China, with a peak negative impact on the level of GDP of around 1¾% and 2% respectively compared with the February Report. The majority of this weakness is matched by lower potential output owing to the assumed impacts of tariffs. Fiscal policy is assumed to provide a partial offset to the trade impacts in China.

Euro-area GDP is also weaker overall throughout much of the forecast period due to the impact of tariffs and trade policy uncertainty. This is despite the assumed loosening in German and, to a lesser degree, other countries' fiscal policy, which boosts euro-area GDP over time by just over ½% by the end of the forecast period relative to the February Report.

An important part of the adjustment to higher tariffs comes through lower world export prices rather than lower export volumes. In this forecast, four-quarter UK-weighted world export prices, excluding the direct effect of oil prices, are expected to be around 2% lower than in the February Report, reflecting lower energy prices as well as the estimated effects of changes in global trade patterns. In particular, Chinese export prices are projected to be over 10% lower than in February by the end of the forecast period, owing to reduced US demand. Headline consumer price inflation across advanced economies is expected to diverge, primarily due to tariff impacts, with US inflation rising but euro-area inflation falling over coming quarters.

The global outlook is highly uncertain and the balance of risks around that outlook is very difficult to judge. The future constellation of trade policies is impossible to predict at this juncture, and the impact of a given set of trade policies on world growth and inflation is hard to estimate with precision. There is also uncertainty about the response of global financial markets to future trade developments, including exchange rates. These uncertainties also apply to the outlook for UK growth and inflation (Key judgements 2 and 3).

In terms of its impact on the baseline forecast, any future news on trade policy can be judged relative to the conditioning assumption of a continuation of the current very high US-China bilateral tariffs and of the current 90-day pause on higher-band US tariffs excluding China. Negotiated solutions may weaken the assumed tariff shock, while broader global trade fragmentation could result in a stronger shock.

There is particular uncertainty about the scale of export price adjustment in China given the very large and persistent shock to trading patterns that has been assumed in the forecast. The degree of price response could be stronger or weaker than expected.

This forecast assumes that current trade developments do not lead to significant global supply chain disruption, such as through geoeconomic fragmentation or the rewiring of shipping routes. Supply chains could be disrupted more materially and quite quickly if fragmentation or the need to exclude certain supply sources result as economies impose new tariffs and non-trade barriers, pushing up on world export prices and weighing on global activity. As global resources are reallocated away from the most efficient allocation based on comparative advantage, tariffs could also lead to weaker global productivity growth, beyond the US and China.

As set out in the **April 2025 FPC Record**, several risks associated with the fragmentation of global trade in goods, and financial markets, have intensified. A major shift in the nature and predictability of global trading arrangements could harm financial stability by depressing growth. A further risk is a reduction in global co-operation, which could reduce resilience. The FPC will continue to monitor the situation closely and will provide an update on these risks at the time of its July Financial Stability Report.

There are also uncertainties around the paths of fiscal policy in Germany and elsewhere. For example, more extensive European defence spending than assumed in the forecast would present an upside risk to global activity and world export prices.

Table 1.D: Indicative projections consistent with the MPC's baseline forecast (a) (b)

	Average 1998–2007	Average 2010–19	2023	2024	2025	2026	2027
World GDP (UK-weighted) (c)	3	2½	2 (1¾)	2 (2)	1½ (1¾)	1½ (2)	2¼ (2)
World GDP (PPP-weighted) (d)	4	3¾	3¼ (3¼)	3¼ (3¼)	2½ (3)	2¾ (3)	3¼ (3)
Euro-area GDP (e)	2½	1½	½ (½)	¾ (¾)	¾ (¾)	1 (1½)	1¾ (1½)
US GDP (f)	3	2½	3 (3)	2¾ (2¾)	1¼ (2¼)	1¼ (1¾)	1¾ (1¾)
Emerging market GDP (PPP-weighted) (g)	5½	5	4½ (4¼)	4¼ (4¼)	3½ (3¾)	3¾ (4)	4¼ (4)
of which, China GDP (h)	10	7¾	5½ (5½)	5 (5)	4 (4¾)	4 (4¼)	4¼ (4)
UK GDP (i)	2¾	2	½ (½)	1 (¾)	1 (¾)	1¼ (1½)	1½ (1½)
Household consumption (j)	3¼	2	½ (½)	¾ (1)	1¼ (1½)	1¾ (1¾)	1¾ (1½)
Business investment (k)	3	4¼	4½ (4½)	2 (3)	1½ (3)	1 (1¾)	1¼ (1½)
Housing investment (l)	3¼	4	-7 (-7¼)	¾ (0)	0 (½)	5 (2¾)	6 (2¾)
Exports (m)	4½	3½	-½ (-3¼)	-1¼ (-2½)	½ (-¾)	0 (2½)	2 (2½)
Imports (n)	6	4	-1¼ (-4½)	2¾ (1¾)	1½ (3½)	2 (3)	2¾ (2¾)
Contribution of net trade to GDP (o)	-¼	-¼	¼ (½)	-1¼ (-1½)	-½ (-1½)	-¾ (-¼)	-½ (-¼)
Real post-tax labour income (p)	3¼	1½	1 (1)	4¼ (4½)	1½ (1¼)	½ (¼)	½ (¼)
Household saving ratio (q)	7¼	7¾	7¼ (7¼)	10 (10)	10½ (9¼)	9¾ (8½)	9 (7¾)

Credit spreads (r)	¾	2½	1 (1)	1 (1)	1½ (1¼)	1½ (1½)	1½ (1½)
Excess supply/Excess demand (s)	0	-1¾	¾ (¾)	0 (0)	-½ (-¼)	-¾ (-½)	-¾ (-½)
Labour productivity (output per worker) (t)	1¾	¾	-¾ (-¾)	¼ (0)	-¼ (-½)	¾ (¾)	¾ (¾)
Employment (u)	1	1¼	¾ (¾)	1½ (1¼)	¾ (¾)	½ (¾)	¾ (¾)
Working-age (16+) population (v)	¾	¾	1¼ (1¼)	1¼ (1¼)	1 (1¼)	1 (1)	1 (1)
Unemployment rate (w)	5¼	6	3¾ (3¾)	4½ (4½)	4¾ (4½)	5 (4¾)	5 (4¾)
Participation rate (x)	63	63½	62¾ (62¾)	63¼ (63¼)	63¼ (63)	63 (63)	63 (63)
CPI inflation (y)	1½	2¼	4¼ (4¼)	2½ (2½)	3¼ (3½)	2 (2½)	1¾ (2)
UK import prices (z)	-¼	1¼	1 (1)	-1¼ (-1)	-¼ (1½)	¼ (¾)	½ (½)
Energy prices – direct contribution to CPI inflation (aa)	¼	¼	-1¼ (-1¼)	-½ (-½)	-¼ (¼)	0 (0)	0 (0)
Private sector regular average weekly earnings (ab)	4	2¼	6¼ (6¼)	6¼ (6¼)	3¾ (3¾)	2¾ (3)	2¾ (3)
Private sector regular pay-based unit wage costs (ac)	2	1¾	7¼ (7¼)	6½ (7)	2¾ (3¾)	1¾ (2¼)	1¾ (1¾)

Sources: Bank of England, Bloomberg Finance L.P., Department for Energy Security and Net Zero, Eurostat, IMF World Economic Outlook, National Bureau of Statistics of China, ONS, US Bureau of Economic Analysis and Bank calculations.

(a) The profiles in this table should be viewed as broadly consistent with the MPC's baseline projections for GDP growth, CPI inflation and unemployment (as presented in the fan charts).
(b) Figures show annual average growth rates unless otherwise stated. Figures in parentheses show the corresponding projections in the February 2025 Monetary Policy Report. Calculations for back data based on ONS data are shown using ONS series identifiers.
(c) Chained-volume measure. Constructed using real GDP growth rates of 188 countries weighted according to their shares in UK exports.
(d) Chained-volume measure. Constructed using real GDP growth rates of 189 countries weighted according to their shares in world GDP using the IMF's purchasing power parity (PPP) weights.

(e) Chained-volume measure. The forecast was finalised before the release of the preliminary flash estimate of euro-area GDP for Q1, so that has not been incorporated.
(f) Chained-volume measure. The forecast was finalised before the release of the advance estimate of US GDP for Q1, so that has not been incorporated.
(g) Chained-volume measure. Constructed using real GDP growth rates of 155 emerging market economies, weighted according to their relative shares in world GDP using the IMF's PPP weights.
(h) Chained-volume measure.
(i) Chained-volume measure.
(j) Chained-volume measure. Includes non-profit institutions serving households. Based on ABJR+HAYO.
(k) Chained-volume measure. Based on GAN8.
(l) Chained-volume measure. Whole-economy measure. Includes new dwellings, improvements and spending on services associated with the sale and purchase of property. Based on DFEG+L635+L637.
(m) Chained-volume measure. The historical data exclude the impact of missing trader intra-community (MTIC) fraud. Since 1998 based on IKBK-OFNN/(BOKH/BQKO). Prior to 1998 based on IKBK.
(n) Chained-volume measure. The historical data exclude the impact of MTIC fraud. Since 1998 based on IKBL-OFNN/(BOKH/BQKO). Prior to 1998 based on IKBL.
(o) Chained-volume measure. Exports less imports.
(p) Wages and salaries plus mixed income and general government benefits less income taxes and employees' National Insurance contributions, deflated by the consumer expenditure deflator. Based on [ROYJ+ROYH-(RPHS+AIIV-CUCT)+GZVX]/[(ABJQ+HAYE)/(ABJR+HAYO)]. The backdata for this series are available at **Monetary Policy Report – Download chart slides and data – May 2025**.
(q) Annual average. Percentage of total available household resources. Based on NRJS.
(r) Level in Q4. Percentage point spread over reference rates. Based on a weighted average of household and corporate loan and deposit spreads over appropriate risk-free rates. Indexed to equal zero in 2007 Q3.
(s) Annual average. Per cent of potential GDP. A negative figure implies output is below potential and a positive figure that it is above.
(t) Real GDP (ABMI) divided by total 16+ employment (MGRZ). Although LFS employment data have been reinstated by the ONS, they are badged as official statistics in development and the LFS continues to suffer from very low response rates, which can introduce volatility and potentially non-response bias (Box D of the **May 2024 Monetary Policy Report**).
(u) Four-quarter growth in the ILO definition of employment in Q4 (MGRZ). Although LFS employment data have been reinstated by the ONS, they are badged as official statistics in development and the LFS continues to suffer from very low response rates, which can introduce volatility and potentially non-response bias (Box D of the May 2024 Monetary Policy Report).
(v) Four-quarter growth in Q4. LFS household population, all aged 16 and over (MGSL). Growth rates are interpolated between the LFS and ONS National population projections: 2022-based interim within the forecast period.
(w) ILO definition of unemployment rate in Q4 (MGSX). Although LFS unemployment data have been reinstated by the ONS, they are badged as official statistics in development and the LFS continues to suffer from very low response rates, which can introduce volatility and potentially non-response bias (Box D of the May 2024 Monetary Policy Report).
(x) ILO definition of labour force participation in Q4 as a percentage of the 16+ population (MGWG). Although LFS participation data have been reinstated by the ONS, they are badged as official statistics in development and the LFS continues to suffer from very low response rates, which can introduce volatility and potentially non-response bias (Box D of the May 2024 Monetary Policy Report).
(y) Four-quarter inflation rate in Q4.
(z) Four-quarter inflation rate in Q4 excluding fuel and the impact of MTIC fraud.
(aa) Contribution of fuels and lubricants and gas and electricity prices to four-quarter CPI inflation in Q4.
(ab) Four-quarter growth in Q4. Private sector AWE excluding bonuses and arrears of pay (KAJ2).
(ac) Four-quarter growth in private sector regular pay-based unit wage costs in Q4. Private sector wage costs divided by private sector output at constant prices. Private sector wage costs are AWE (excluding bonuses) multiplied by private sector employment.

Box A: Alternative scenarios prepared by Bank staff for the evolution of the economy

In the May baseline forecast, conditioned on the market path for interest rates, CPI inflation is expected to rise to 3.5% in 2025 Q3 before falling back to around the 2% target in the medium term. There are significant risks around how the economy will evolve, however, including around the pace at which domestic inflationary pressures will unwind.

To understand better some of the risks around the baseline projections, this box explores two alternative scenarios for the economy. These scenarios have been prepared by Bank staff and were presented to the MPC as part of its monetary policy deliberations. They were designed to provide an illustrative quantification of how alternative economic mechanisms could result in plausible different paths for the UK economy over the forecast period, building on the approach set out in Box A of the **November 2024 Monetary Policy Report**.

The first scenario explores a channel through which demand could be substantially weaker than in the baseline projection. Elevated uncertainty, related in part to developments in global trade policy, is assumed to weigh on demand to a greater extent than in the baseline. Economic slack builds and inflation persistence fades more quickly.

The second scenario explores one way in which inflationary pressures might be more persistent than assumed in the baseline. The upcoming rise in headline inflation results in additional second-round effects in domestic wage and price-setting, while recent weakness in potential productivity growth persists.

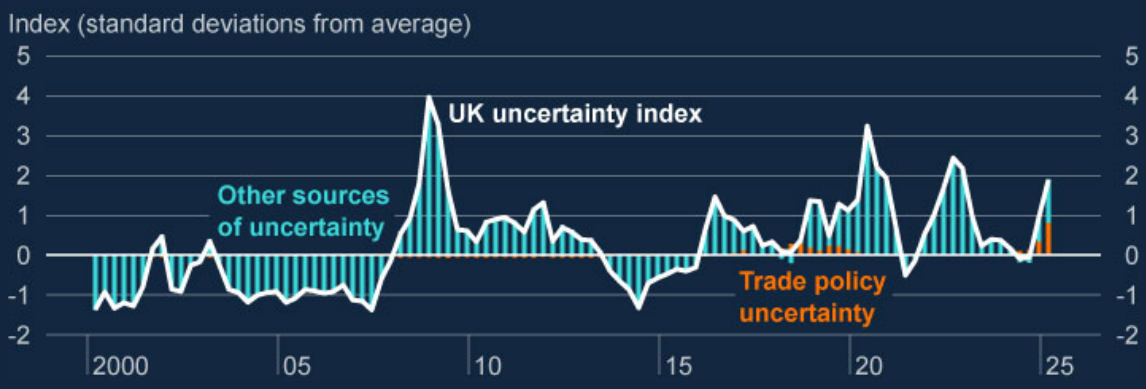
The scenarios described in this box are merely two examples of a wide range of different paths the economy could take. They do not incorporate the wider set of risks posed by future developments in trade policy (Section 1.2). The scenarios are also not mutually exclusive. For example, weaker demand could coincide with renewed second round effects in wage and price-setting, creating a starker trade-off between stabilising inflation and stabilising output.

> **In the first scenario, UK demand is weaker and domestic inflationary pressures fade more quickly than in the baseline projections, driven by elevated uncertainty.**

Indicators of uncertainty in the UK have picked up sharply in recent months, partly in response to developments in global trade policy (Chart A). Uncertainty can weigh on economic growth by causing households and businesses to delay consumption and investment decisions until the economic outlook becomes clearer (**Haddow et al (2013)**).

Chart A: UK households and businesses face material uncertainty, partly driven by higher trade policy uncertainty

Contributions to UK uncertainty index (a)



Sources: **Baker et al (2016)**, Bloomberg Finance L.P., **Caldara et al (2019)**, CBI, Consensus Economics, GfK, ICE Data Services, LSEG, S&P Global, and Bank calculations.

(a) The UK uncertainty index is calculated as the first principal component of nine proxies of economic uncertainty, based on data starting in 1985. These proxies are three-month option-implied FTSE volatility, three-month option-implied sterling exchange rate volatility, dispersion of consensus GDP forecasts, GfK expectations of the general economic and financial situation over the next 12 months, PMI services expectations one year ahead, CBI demand uncertainty limiting investment, standard deviation of analysts' forecasts of 12 month ahead company earnings growth for the FTSE All-Share index, the UK economic policy uncertainty index, and a trade policy uncertainty index.

In the baseline projection, this depressing effect is incorporated insofar as it is reflected in recent business surveys, asset prices and through its estimated impact on global economic growth (Section 1). Survey evidence suggests that, while uncertainty has increased, the impact on near-term UK output is likely to be relatively muted (Section 2.3). There is a risk, however, that heightened uncertainty has a larger-than-expected impact on UK activity growth.

In the lower demand scenario, elevated uncertainty drags on UK consumption and investment by more than in the baseline projection. The household saving ratio falls by less than in the baseline (Section 1), and overall GDP growth and inflation are lower.

The scenario is calibrated using a UK uncertainty index constructed by Bank staff (Chart A), which aggregates nine different proxies of economic uncertainty. Bank staff have estimated the impact of this observed rise in uncertainty on demand using a structural vector autoregressive (SVAR) model and incorporated this estimate into the Bank's **central forecasting model**. Since some degree of uncertainty is already captured within the baseline, Bank staff have adjusted the central estimate of the SVAR model by incorporating a somewhat smaller additional drag on demand.

The demand weakness in this scenario adds to existing pressures on firms to reduce costs, resulting in a more rapid loosening of labour market conditions and opening up of economic slack. The unemployment rate rises, and pay growth declines, more quickly than in the baseline projection. Lower household incomes due to higher unemployment and lower pay growth further weigh on demand, resulting in additional disinflationary pressures. Compared with the baseline projection, these mechanisms reduce inflation by 0.3 percentage points in the first year and by 0.2 percentage points by the end of the forecast period.

The disinflationary effects in this scenario could be amplified if the faster build-up of excess supply triggers a quicker unwind of inflation. To explore this, the scenario includes a small steepening of the Phillips curve within the Bank's central forecasting model, accounting for the fact that greater economic slack may prompt the second-round effects incorporated in the baseline projection to fade more quickly. This judgement was based on simulations of a UK version of the semi-structural **Bernanke and Blanchard (2023)** model estimated by **Haskel et al (2023)**. This channel reduces inflation by an additional 0.1 percentage point at the end of the forecast period, with limited effects on demand and output.

Overall, the lower demand scenario implies a materially greater margin of economic slack and weaker inflation than in the baseline projection. Inflation is 0.3 percentage points lower at the three-year forecast horizon (Table 1).

Table 1: Evolution of key variables in Bank staff's weaker demand scenario conditioned on the market path of interest rates, relative to the baseline projections (a)

	2026 Q2	2027 Q2	2028 Q2
CPI inflation	-0.3	-0.3	-0.3
Excess supply/Excess demand	-0.8	-0.6	-0.4

(a) The table shows percentage point deviations from the baseline projection.

Several indicators could provide a signal that uncertainty is weighing on demand more strongly than in the baseline projections.

Bank staff monitor a wide range of data that could help assess whether the economy is evolving in a similar way to the lower demand scenario. Further rises in indicators of uncertainty, or a further deterioration in consumer and business confidence surveys, could suggest that demand may be weaker than in the baseline projections. Specific indicators from the Bank of England/NMG survey that measure households' assessment of their own financial situation and the risk of unemployment can be used to monitor risks of greater precautionary savings and weaker household consumption. Intelligence from the Bank's Agents and the DMP Survey about the impact of global trade policy uncertainty on UK business investment will also provide important information. That said, any individual data point should be treated with caution in the context of elevated volatility in financial markets (Section 2.1), and any further changes in global trade policy.

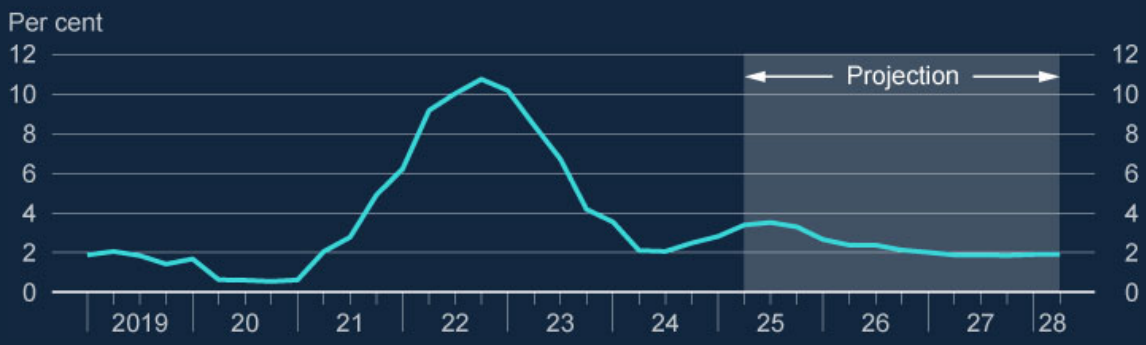
Evidence of a more rapid fading in inflation persistence for a given amount of weakness in demand, and hence the possibility of a steepening Phillips curve, will be difficult to judge in real time. But a reduction in inflation and wage expectations, or a more rapid weakening in forward-looking wage and price indicators, could point to a faster-than-expected fading of inflation persistence.

In the second scenario, the upcoming rise in headline inflation leads to additional second round effects in domestic price and wage-setting that are amplified by weak potential productivity growth.

In the baseline projection, CPI inflation rises to 3.5% in 2025 Q3, reflecting higher energy bills and indexed and regulated prices (Chart B and Section 2.5). The MPC judges that this pickup in headline inflation will not lead to additional second-round effects on domestic inflationary pressures, beyond those that would typically be expected to occur (Section 1).

Chart B: CPI inflation is expected to increase in the near term

UK CPI inflation and projection (a)



Sources: ONS and Bank calculations.

(a) Four-quarter inflation rate.

There is a risk that such additional second-round effects do emerge following the near-term rise in CPI inflation, however. Households and businesses appear to have become more sensitive to realised inflation during the recent period of high inflation (Section 2.5). Based on evidence from the DMP Survey, firms' year ahead own-price growth expectations have been more responsive to changes in CPI inflation since 2022 (**Yotzov et al (2025)**), and their price setting has in turn become more dependent on their own-price growth expectations. Firms' inflation expectations also appear to respond more strongly when there is significant media coverage of inflation releases, which is likely to be the case when headline inflation rises again in the middle part of this year. Similarly, households' near-term inflation expectations appear to have become more sensitive to headline CPI inflation and media coverage since 2022 (Section 2.5). Separate staff analysis also suggests that second-round effects via inflation expectations can become stronger when inflation exceeds certain thresholds, which could be approached by the upcoming rise in headline inflation.

In the higher inflation persistence scenario, increased responsiveness of inflation expectations to CPI outturns generates additional second-round effects in domestic price and wage-setting. The upcoming rise in headline inflation is assumed to result in a further increase in inflation expectations, beyond the pickup that has occurred since mid-2024 (Section 2.5), which in turn results in workers pushing for higher wage settlements and firms setting higher prices. The calibration of this scenario can broadly

be thought of as assuming that the responsiveness of inflation expectations to realised inflation, as well as the dependence of price and wage-setting on inflation expectations, stall at recent elevated levels.

Greater second-round effects would lead to domestically generated inflationary pressures being higher for longer than in the baseline projection. However, these estimated effects, which add around 0.4 percentage points to CPI inflation in the first year and 0.2 percentage points by the end of the forecast period, are modest compared with the second-round effects that followed the headline inflation peak of 11.1% in 2022. That reflects the much smaller near-term increase in CPI compared with the rise in 2022.

The inflationary pressures from additional second-round effects could be amplified if there were to be weaker supply growth than in the baseline projection. As outlined in Box E of the **February 2025 Monetary Policy Report**, productivity growth has been particularly weak over the past couple of years, much of which is judged to reflect weak growth in potential productivity. This recent weakness cannot be fully explained by previously identified factors such as the impacts of past shocks from Brexit and the pandemic, and so is assumed not to intensify. Productivity growth therefore rises over the forecast period, although it remains low by historical standards (Section 1). It is possible, however, that the unusual weakness in productivity growth persists.

In the scenario, potential productivity growth is materially weaker than in the baseline projection. This lower potential productivity growth is not reflected in lower wages, meaning that wage growth continues to outpace productivity gains, adding to domestic inflationary pressures. This lower potential productivity growth channel adds around 0.2 percentage points to CPI inflation by the end of the forecast period relative to the baseline projection.

Overall, the higher inflation persistence scenario has only a small impact on the output gap relative to the baseline projection, while inflation is 0.4 percentage points higher throughout the forecast period (Table 2). The higher profile for inflation mainly reflects stronger second-round effects in the first half of the forecast period, while lower potential productivity growth becomes an increasingly important driver in the second half.

Table 2: Evolution of key variables in Bank staff's inflation persistence scenario conditioned on the market path of interest rates, relative to the baseline projections (a)

	2026 Q2	2027 Q2	2028 Q2
CPI inflation	+0.4	+0.4	+0.4
Excess supply/Excess demand	+0.1	+0.1	+0.1

(a) The table shows percentage point deviations from the baseline projection.

Several indicators may provide early evidence that the economy could evolve in a similar way to the inflation persistence scenario.

Bank staff have been monitoring a wide range of data that could detect shifts in wage and price-setting behaviour. A further pickup in inflation expectations or their responsiveness to realised inflation would provide evidence of possible additional second-round effects. A stalling of the disinflationary progress in forward-looking wage and price indicators from Agents' intelligence and the DMP Survey could similarly provide an early signal of greater second-round effects emerging. Machine learning models suggest that inflation persistence has eased (Section 2.5), but a pause in the normalisation of measures of price-setting behaviour could suggest that mechanisms similar to those incorporated in the higher inflation persistence scenario could be operating.

Data on productivity growth only become available with a lag, which will make it difficult to judge in real time whether productivity growth could be evolving in line with the weaker path for potential productivity in this scenario.

Monetary policy would be required to respond if either scenario were to materialise, to ensure that inflation returns to the 2% target in the medium term.

In the construction of these scenarios, Bank staff have assumed that Bank Rate mechanically follows the same market-implied path as in the baseline projection. Because monetary policy is unresponsive in this analysis, inflation remains materially lower than in the baseline projection in the lower demand scenario at the end of the forecast period, and materially above the baseline projection in the inflation persistence scenario. Were the MPC to judge that effects similar to those underpinning either scenario were emerging, then monetary policy would be required to respond. All

else equal, the path for Bank Rate would need to be lower in the weaker demand scenario, relative to the Bank Rate path required under the baseline projection, and higher in the stronger inflation persistence scenario.

While the magnitude of the impact of both scenarios on inflation is similar, the size of the required policy response is likely to be greater under the lower demand scenario than under the higher inflation persistence scenario. That is because the higher inflation persistence scenario implies a larger trade-off for monetary policy between reducing output gap fluctuations and stabilising inflation around the 2% target. In the lower demand scenario, inflation weakens and the output gap widens materially. A lower path for Bank Rate would improve on both of these outcomes. In the greater persistence scenario, an equally forceful monetary policy response could weigh more heavily on activity than may be desirable.

Box B: Monetary policy since the February 2025 Report

At its meeting ending on 19 March 2025, the MPC voted by a majority of 8–1 to maintain Bank Rate at 4.5%. One member preferred to reduce Bank Rate by 0.25 percentage points, to 4.25%.

The Committee noted that there had been substantial progress on disinflation over the past two years, as previous external shocks had receded, and as the restrictive stance of monetary policy had curbed second-round effects and stabilised longer-term inflation expectations. That progress had allowed the MPC to withdraw gradually some degree of policy restraint, while maintaining Bank Rate in restrictive territory so as to continue to squeeze out persistent inflationary pressures.

Since the MPC's February 2025 meeting, global trade policy uncertainty had intensified, and the United States had made a range of tariff announcements, to which some governments had responded. Other geopolitical uncertainties had also increased, and indicators of financial market volatility had risen globally. The German Government had announced plans for significant reform to its fiscal rules.

While UK GDP growth estimates had been slightly stronger than expected at the time of the **February 2025 Monetary Policy Report**, business survey indicators had generally continued to suggest weakness in growth and particularly in employment intentions. In recent quarters, subdued activity had been judged to reflect both demand and supply factors.

Twelve-month CPI inflation had increased to 3.0% in January from 2.5% in December, slightly higher than had been expected in the February Report. Domestic price and wage pressures were moderating but remained somewhat elevated. Although global energy prices had fallen back, they remained higher than the previous year and CPI inflation was still projected to rise to around 3¾% in 2025 Q3. While inflation was expected to fall back thereafter, the Committee would pay close attention to any consequent signs of more lasting inflationary pressures.

2: Current economic conditions

CPI inflation was 2.6% in March, above the MPC's 2% target but slightly below the February Report projection. Headline CPI inflation is projected to pick up from April, owing to higher contributions from household energy prices as well as increases in indexed and regulated prices, and reach 3.5% in 2025 Q3. Indicators of households' inflation expectations have risen further. Firms' inflation expectations have also increased slightly, while indicators of inflation expectations derived from financial markets have continued to trend downwards.

Annual private sector regular average weekly earnings (AWE) growth was 5.9% in the three months to February, lower than expected in the February Report. Underlying pay growth is judged to be somewhat weaker than this at around 5¼%. Pay growth is projected to slow to 3¾% by the end of the year, consistent with the signal from a range of forward-looking indicators.

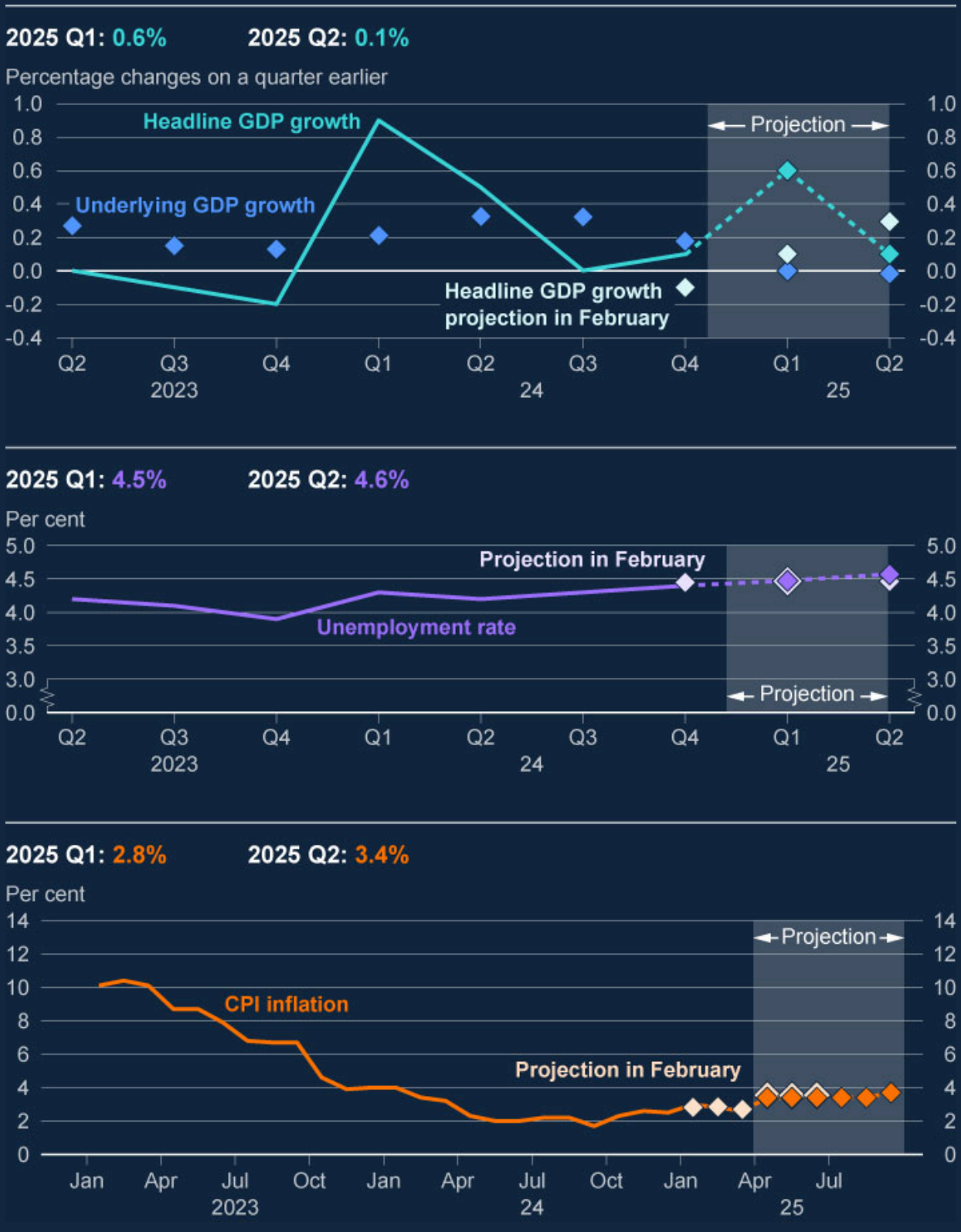
Underlying UK GDP growth is judged to have slowed since mid-2024 and has been less volatile than growth in headline GDP. Heightened uncertainty, weak productivity growth and the continued restrictive stance of monetary policy have all been weighing on GDP growth recently. Early indications from surveys and Agency intelligence point to uncertainty about demand prospects having risen, albeit by materially less than the rise in global trade policy uncertainty.

Employment growth has softened since the turn of the year and the labour market has loosened further. In the MPC's baseline forecast, the recent slowdown in GDP growth is judged to have resulted in a small margin of spare capacity opening up. There are significant uncertainties around the current and prospective balance of aggregate demand and supply in the economy.

The imposition of tariffs and the heightened uncertainty about trade policies has introduced a new source of risk for the global economy. In the 15 UK working days to 29 April, global equity prices had fallen, market-implied policy rates in advanced economies were lower, and the US dollar had depreciated relative to levels in the February Report, as market participants had reassessed the impact of trade tariffs and broader economic policies on the global outlook. Key commodity prices had also fallen, mainly in response to trade policy developments. Bank staff project global activity growth to be weaker over 2025 than was expected three months ago.

Chart 2.1: In the MPC's latest projections, headline GDP growth rises in 2025 Q1 while underlying GDP growth remains weak, the unemployment rate edges higher, and CPI inflation picks up from 2025 Q2

Near-term projections (a)



Sources: BCC, CBI, Lloyds Business Barometer, ONS, S&P Global and Bank calculations.

(a) The lighter diamonds show Bank staff's projections at the time of the February Report. The darker diamonds show Bank staff's current projections. The azure diamonds in the top panel are Bank staff's estimates of underlying quarterly GDP growth. Underlying GDP data from 2023 Q2 to 2024 Q4 show in-sample fitted values of a survey indicator model estimated by Bank staff, and data for 2025 Q1 and 2025 Q2 show out of sample projections (see Chart 2.8). The projections for headline GDP growth and the unemployment rate are quarterly and show 2025 Q1 and 2025 Q2 (February projections show 2024 Q4 to 2025 Q2). The projections for CPI inflation are monthly and show April to September 2025 (February projections show January 2025 to June 2025). The GDP growth and unemployment rate projections for 2025 Q1 are based on official data to February 2025, while the CPI inflation figures over the same quarter are outturns. Although LFS unemployment data have been reinstated by the ONS, they are badged as official statistics in development and the LFS continues to suffer from very low response rates, which can introduce volatility and potentially non-response bias (Box D of the **May 2024 Monetary Policy Report**).

2.1: Global economy and financial markets

There have been significant geopolitical developments since the February Report.

Since the February Report, new tariffs have been implemented by the US, some countries have retaliated, and trade policy uncertainty has risen further (Box C). The German Parliament has passed significant fiscal reforms, including the exemption of defence spending above 1% of GDP from the debt brake, and the creation of a €500 billion deficit-financed infrastructure fund. Meanwhile, there have been negotiations around a ceasefire in the war in Ukraine.

Financial markets have been volatile in response to this geopolitical news.

Since the February Report, financial market participants have reassessed the expected impact of trade and broader US economic policies on the global growth outlook. Implied volatility has risen for many asset prices, with the Chicago Board Options Exchange's VIX measure of equity market implied volatility peaking at its highest level since 2020 in April, partly reflecting the continued rise in trade policy uncertainty.

Global equity prices fell sharply following news that tariffs in excess of 10% would be placed on most of the United States' biggest trading partners, before recovering somewhat following a 90-day pause to these measures for all countries except China (Box C). In the 15 UK working days to 29 April 2025, the S&P 500 index was on average 7% below its pre-US election level (Chart 2.2, left panel). US equity prices have risen since then and were 2% lower than their pre-US election level on 2 May. US equity market valuations remain elevated in an absolute sense (**April 2025 FPC Record**). In the 15 UK working days to 29 April 2025, European equity prices had also fallen slightly relative to their level in the February Report, despite the strong performance of European defence stocks following the announcement of recent German fiscal reforms. But since the 15-day average window, the Euro Stoxx index has risen to above its level in the February Report.

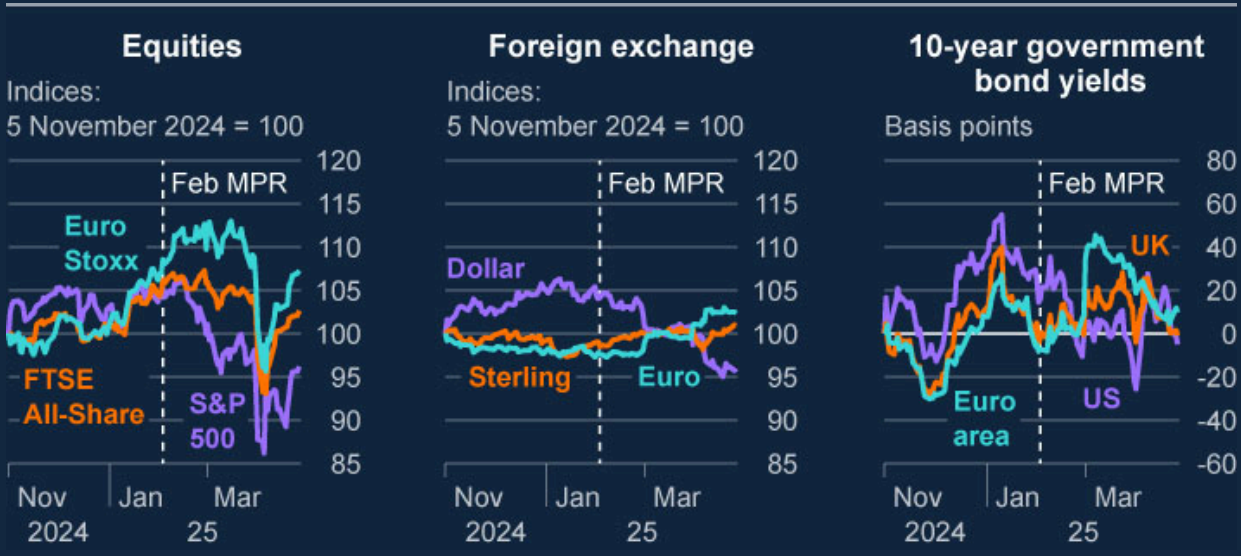
Investment-grade corporate bond spreads have widened across advanced economies but remain tight relative to their peaks in March 2020. In the 15 UK working days to 29 April, the US dollar effective exchange rate had fallen to 3% below its level ahead of the US election (Chart 2.2, middle panel). Exchange rates have been volatile in response to the trade policy announcements from the US and other countries.

UK risky asset prices have also responded to global news. In the 15 UK working days to 29 April, the FTSE All-Share index had fallen by 3% relative to its level in the February Report, having been as much as 10% lower in the days following the US tariff announcements on 2 April. UK equity prices have risen since then, and the FTSE All-share index was around 2% above its level in the February Report on 2 May. Sterling investment-grade corporate bond spreads had widened by around 30 basis points since the February Report, broadly in line with moves in equivalent spreads in the US. The sterling effective exchange rate had appreciated by around 2%, primarily reflecting US dollar weakness, although sterling had depreciated by around 2% against the euro.

There have been some quite sharp movements in government bond markets in the past three months. In the 15 UK working days to 29 April, 10-year UK gilt and US treasury yields were 10 basis points and 30 basis points lower, respectively, than in the February Report (Chart 2.2, right panel). Those moves reflect lower interest rate expectations, which have been partly offset by rises in term premia, the additional compensation investors require to hold a longer-term bond relative to a series of shorter-term bonds. Thirty-year UK gilt yields have been more volatile and have broadly tracked moves in long-dated US treasury yields. Market intelligence suggests that lower liquidity in long-dated bonds has exacerbated these moves. Longer-term euro-area government bond yields are little changed overall, as anticipation of higher deficit-financed defence spending has provided a counterbalance to the impact of trade policy news.

Chart 2.2: Global equity prices fell sharply in response to US tariff announcements, the US dollar has depreciated to below its pre-US election level and 10-year government bond yields are little changed overall since the February Report

Changes in equity indices, effective exchange rates and 10-year government bond yields since 5 November 2024 (a)



Sources: Bloomberg Finance L.P., Tradeweb FTSE Gilt Closing Data and Bank calculations.

(a) Equities and effective exchange rates are indexed to the date of the 2024 US presidential election, while 10-year yields show cumulative changes in yields over the same period. The final data points are for 29 April 2025.

The market-implied paths for advanced economy policy rates have fallen since the February Report, particularly in the US.

The European Central Bank (ECB) Governing Council cut its deposit facility rate to 2.25% at its April meeting. Meanwhile, the Federal Reserve's Federal Open Market Committee maintained the target range for the federal funds rate at 4.25%–4.5% at its March meeting, while announcing a slower pace for its quantitative tightening programme.

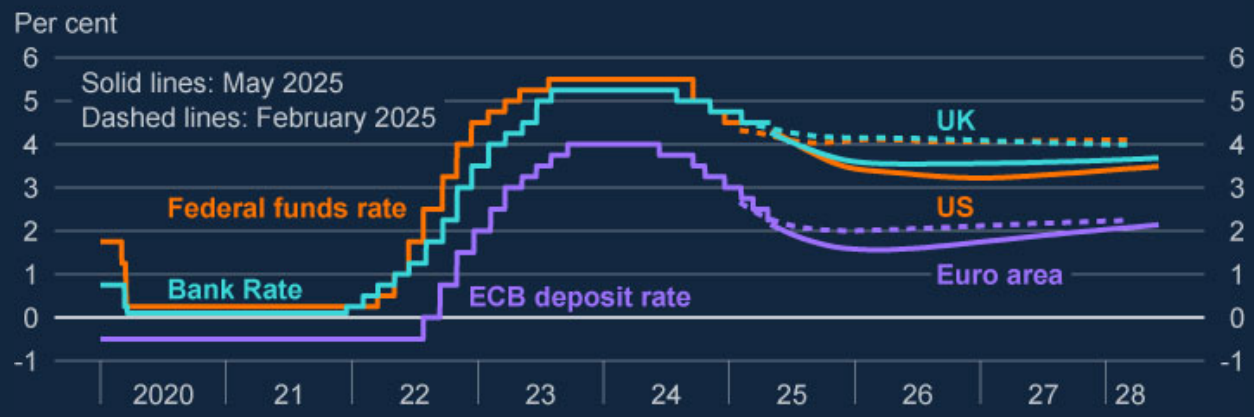
The market-implied path for US policy rates has fallen significantly since the February Report, as markets have reassessed the implications of trade and other economic policies on the outlook for US economic growth and inflation (Chart 2.3). The market-implied path for the ECB's deposit facility rate is also lower than in the February Report, particularly in the near term. Some market contacts expect that the negative effect of trade tariffs on economic growth will more than offset the near-term boost to activity from higher defence and infrastructural spending in Germany and other European countries.

Based on the 15-day averages to 29 April 2025, 85 basis points and 65 basis points of cuts were priced into the US and euro-area curves, respectively, over the remainder of this year. For the euro area, this implied a total reduction of 140 basis points over 2025. The effective federal funds rate was expected to stand at 3.5% in three years' time, around 60 basis points lower than in the February Report. The market-implied path for euro-area rates sloped gently upwards from 2026, to 2.1% in three years' time, around 15 basis points lower than in the February Report.

The market-implied path for the UK policy rate has fallen since the February Report but as of the 15-day average to 29 April 2025, movements had been smaller than those for the US. Based on this 15-day average, Bank Rate was expected to stand at 3.6% by the end of 2025, before rising slightly to 3.7% by the end of the forecast period. That was around 30 basis points lower than in the February Report. Since 29 April, the market-implied path for Bank Rate has fallen further. On 2 May, Bank Rate was expected to stand at 3.6% in three years' time.

Chart 2.3: The market-implied path for US policy rates has shifted notably lower since the February Report, while the UK and euro-area paths have also fallen

Policy rates and instantaneous forward curves for the UK, US and euro area (a)



Sources: Bloomberg Finance L.P. and Bank calculations.

(a) All data are as of 29 April 2025. The February 2025 curves are estimated based on the 15 UK working days to 28 January 2025. The May 2025 curves are estimated using the 15 UK working days to 29 April 2025. The federal funds rate is the upper bound of the announced target range. The market-implied path for US policy rates is the expected effective federal funds rate. The ECB deposit rate is based on the date from which changes in policy rates are effective. The final data points are forward rates for June 2028.

The large moves in asset prices since the February Report have had opposing effects on financial conditions.

Despite large moves in some UK and global asset prices, financial conditions, taken together, were estimated to be broadly unchanged between the February Report and the 15 UK working days to 29 April. Lower equity prices and an appreciation in the sterling effective exchange rate had caused a tightening in financial conditions relative to the time of the February Report. But reductions in medium-term market-implied interest rates had acted in the opposite direction.

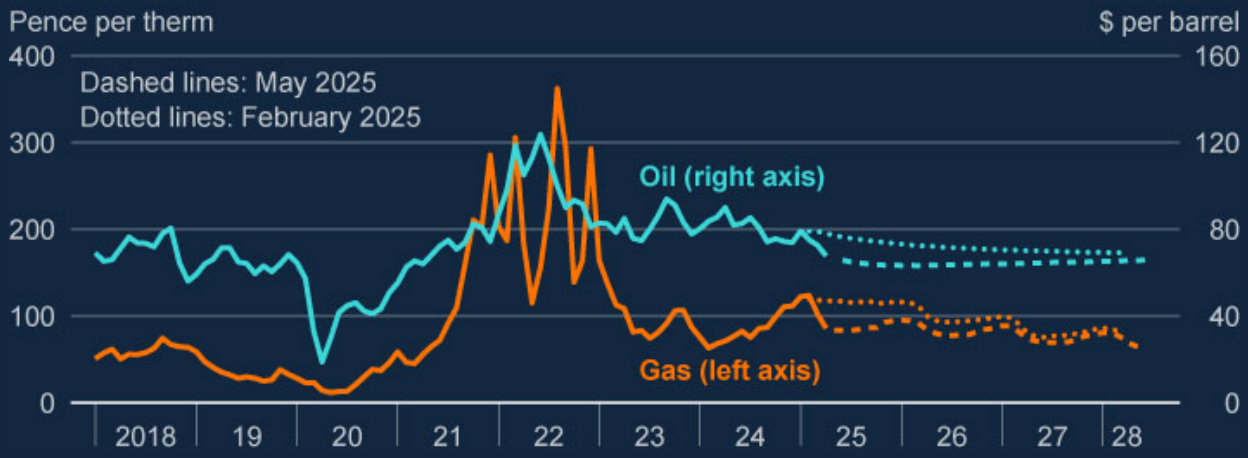
Key commodity prices have fallen since the February Report and the effects of increased trade tariffs are expected to lead to weaker world export price inflation.

Since the February Report, spot Brent crude oil prices have fallen and oil futures prices have also shifted lower (Chart 2.4). In the 15 UK working days to 29 April, spot prices had fallen by around 15% to $67 per barrel. And by 2 May, prices had fallen to $62 per barrel. Concerns that a weaker global economic growth outlook will result in lower oil demand have been the primary driver of these moves, while increased production by OPEC+ countries since April has also weighed on prices. Natural gas prices have fallen since the February Report in response to trade policy developments, and the futures curve is now a little below its November 2024 level. Market intelligence suggests that ceasefire negotiations between Russia and Ukraine and increased European imports of liquified natural gas have contributed towards the fall in gas prices. All else equal, recent reductions in wholesale energy prices are expected to weigh on UK CPI inflation this year, relative to expectations at the time of the February Report (Section 2.5).

Increases in global trade barriers are expected to weigh on global export price inflation over coming quarters, in part due to lower US demand for imports (Box C, and Box C of the **February 2025 Monetary Policy Report)**. Some agricultural commodity prices have moved a little lower since the February Report, following the imposition of tariffs on imports of some agricultural goods. And other non-oil goods export prices are expected to fall over coming quarters, as rises in tariffs reduce US demand for imports (Section 1.2). Overall, global non-oil export prices are expected to fall by 0.7% over 2025 H2, compared with a 0.2% rise at the time of the February Report. Changes in global export price inflation tend to feed through to changes in UK consumer price inflation with a lag (Box D of the **November 2024 Monetary Policy Report**).

Chart 2.4: Natural gas and crude oil futures prices have fallen since the February Report

UK wholesale natural gas and oil spot and futures prices (a)



Sources: Bloomberg Finance L.P. and Bank calculations.

(a) Spot prices are monthly averages of Brent crude oil and Bloomberg UK NBP Natural Gas Forward Day prices respectively. Natural gas prices are in sterling while oil prices are in US dollars. The dashed lines refer to respective futures curves using one-month forward prices based on the 15-day averages to 29 April 2025, while dotted lines are based on the 15-day averages to 28 January 2025. The final data points shown are forward prices for June 2028.

World trade growth has remained robust since the US presidential election, although some of this strength may reflect front-loading of imports.

Data on world trade are only available for the period prior to the 2 April tariff announcements. They suggest that since the US presidential election, measures of global goods trade growth have been robust. The **World Trade Organization's Goods Trade Barometer** indicates that global goods trade growth increased in January 2025, and had been particularly strong in components such as container shipping and automotive products. But qualitative responses to recent S&P Global PMI surveys suggest that some of this strength may have been driven by temporary front-loading of imports by businesses, given growing trade policy uncertainty and the anticipation of additional tariff measures.

Global trade policy developments are expected to weigh significantly on near-term world activity.

Quarterly UK-weighted world GDP growth is projected to have slowed to 0.4% in 2025 Q1 (Chart 2.5), in line with the projection in the February Report. Global activity growth is projected to slow further to 0.3% in 2025 Q2, slightly weaker than expected in February, and

then to 0.2% in 2025 Q3, as the impact of higher trade barriers and trade policy uncertainty weigh on world growth.

According to the advance estimate, US GDP contracted by 0.1% in 2025 Q1, much weaker than the growth of 0.5% projected at the time of the February Report. That slowdown partly reflected a large increase in imports, ahead of the implementation of higher tariffs. Other US activity indicators have generally softened over recent months, while forward-looking consumer and business confidence survey measures have deteriorated. Much of the weakness in these measures appears to have been driven by the impact of implemented and announced trade policies, and broader US economic and trade policy uncertainty. Bank staff project that US activity growth will remain weak in the near term, with quarterly GDP growth expected to average 0.1% over the remainder of 2025. Near-term risks to US activity growth are judged to be skewed to the downside, partly owing to the potential for severe supply chain disruptions from existing tariff measures (Box C).

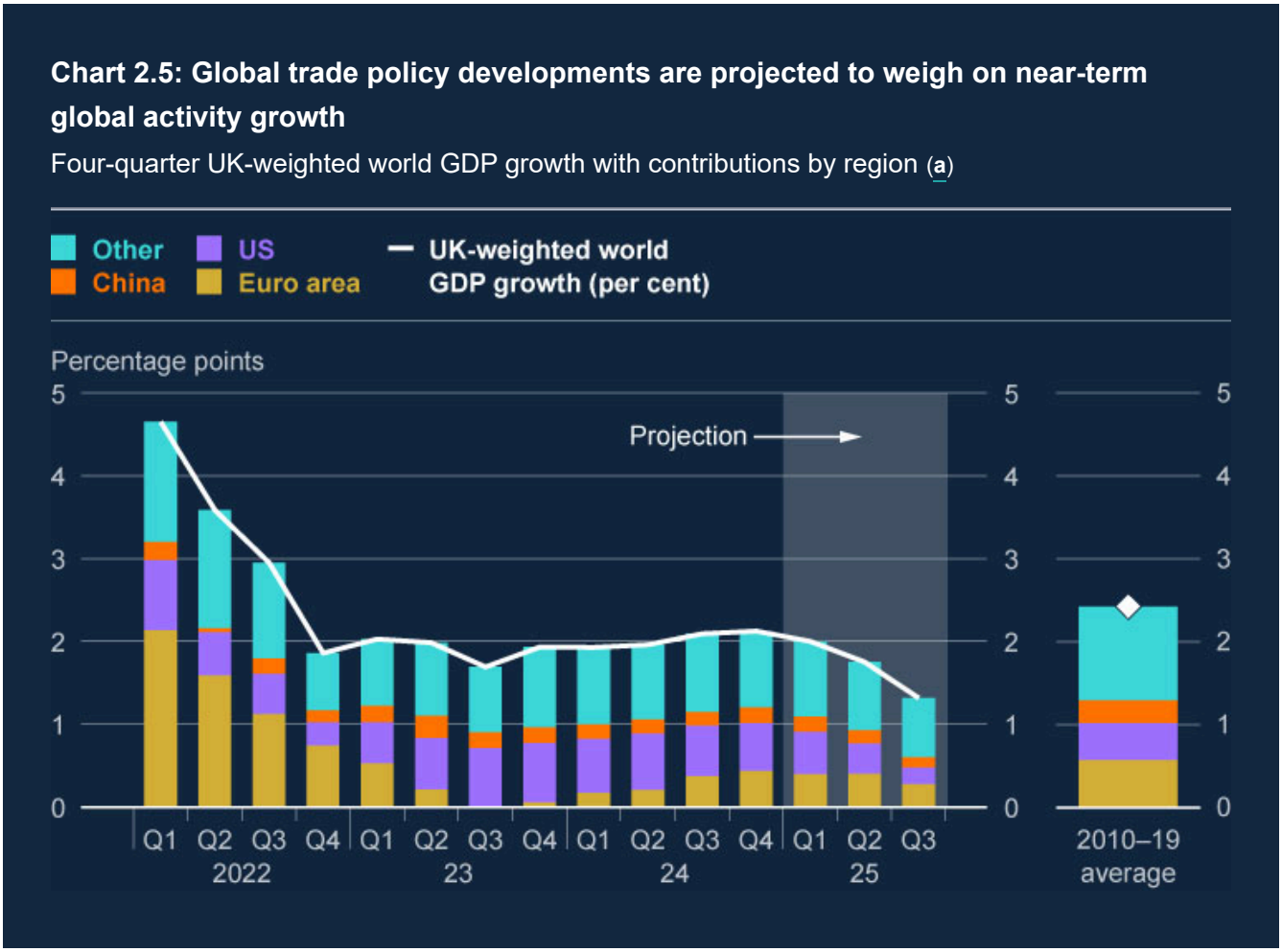
According to the preliminary flash release, euro-area activity growth picked up to 0.4% in 2025 Q1, higher than expected in the February Report, following growth of 0.2% in 2024 Q4. Bank staff project that euro-area GDP growth will slow to 0.2% in 2025 Q2, as the effects of higher US tariffs and trade policy uncertainty start to drag on activity.

Following the fiscal reforms passed by the German Parliament, Bank staff expect a significant increase in German defence and infrastructure spending starting from 2025 H2, along with a smaller increase in defence spending by other euro-area countries. This increase in government spending is projected to provide a boost to euro-area GDP, which is expected to partially offset the negative activity impacts from trade policy developments by the end of the forecast period (Section 1.2).

Chinese GDP grew by 1.2% in 2025 Q1, following growth of 1.6% in 2024 Q4. This was slightly stronger than expected in the February Report and is judged to have reflected some temporary front-loading of exports ahead of higher US tariffs on Chinese goods. But the impacts of much higher tariffs and elevated trade policy uncertainty are expected to weigh on Chinese activity, and Bank staff project significantly weaker GDP growth of 0.3% in 2025 Q2. Near-term risks to Chinese GDP growth are two-sided. While an agreement between the US and China to lower tariffs, or additional Chinese fiscal stimulus, would present material upside risks to activity, there are downside risks related to a broadening of global trade barriers. Moreover, existing tariffs and elevated trade policy uncertainty could also lead to larger negative impacts on Chinese GDP growth, including through supply chain disruptions.

Chart 2.5: Global trade policy developments are projected to weigh on near-term global activity growth

Four-quarter UK-weighted world GDP growth with contributions by region (a)



Sources: LSEG Workspace and Bank calculations.

(a) See footnote (c) of Table 1.D for definition. The figures for 2025 Q1 to 2025 Q3 are Bank staff projections. These projections do not include the advance estimate of US GDP in 2025 Q1 or the preliminary flash estimate of euro-area GDP for the same quarter, as the data were published after the cut-off for incorporation into the forecast.

Inflation in the US is expected to pick up in the near term as a result of tariff policies, while euro-area inflation continues to slow.

Inflation in advanced economies has eased in recent years, following the peaks in headline consumer inflation rates in 2022. But at 2.3% and 2.2% in the US and euro area, respectively, headline inflation rates remain slightly above the respective central bank targets, largely due to elevated services inflation. Bank staff expect US PCE inflation to rise in coming quarters as increases in tariffs push up US import prices. Consistent with that, short and medium-term US household inflation expectations measures have risen recently.

Bank staff expect the disinflation process to continue in the euro area over coming quarters. In contrast with the near-term rise expected in UK CPI inflation (Section 2.5), HICP inflation in the euro area is not expected to pick up in the coming months. That is mainly because previous large falls in domestic energy bills in the UK, which did not occur to the same extent

in the euro area, will fall out of the annual comparison from 2025 Q2, causing UK CPI inflation to rise. In addition, while the euro area and UK share common energy markets, the way in which energy is priced in the UK through the Ofgem price cap differs from that of other jurisdictions and can lead to more variation in the pass-through of higher wholesale energy prices to household energy bills. Part of the expected rise in near-term UK CPI inflation also reflects increases in indexed and regulated prices (Section 2.5), which are not expected to occur in the euro area.

2.2: Domestic credit conditions

Spreads on wholesale bank funding have risen a little in response to recent geopolitical news but remain close to their average levels over recent years.

In addition to taking deposits from households and firms, banks also fund themselves through issuance of debt in wholesale financial markets. Major UK banks tend to issue a lot of their wholesale debt in US dollars and euros, given debt markets are most liquid in these currencies. Spreads on UK banks' wholesale funding have widened since the February Report, by around 40 basis points for senior unsecured debt issued in US dollars, in response to growing fears around the impact of higher tariffs on global economic activity. But this widening in spreads has been quite small relative to that observed in the Covid pandemic, markets have remained orderly, and wholesale bank funding costs remain close to their average levels over recent years.

Changes in reference rates continue to feed through to most household and corporate interest rates as expected.

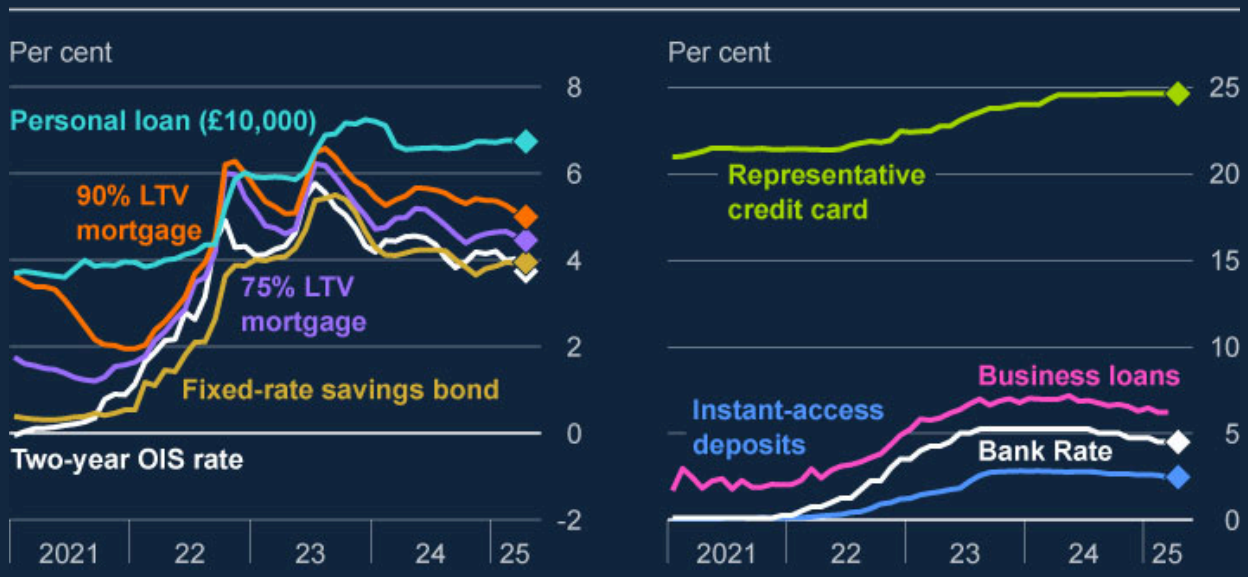
Since the MPC began reducing Bank Rate in August 2024, interest rates on new corporate lending, for which Bank Rate is the main reference rate, have fallen by 70 basis points, in line with historical experience (Chart 2.6). Quoted instant-access deposit rates for households have only fallen by around 30 basis points over the same period. That low degree of pass-through is partly a consequence of low pass-through during the most recent Bank Rate tightening cycle, along with increasingly strong competition for deposits between banks. Meanwhile, quoted interest rates on representative credit card lending to households tend to respond to changes in Bank Rate very slowly and have remained around the same level since the start of the current cutting cycle.

Term OIS rates are materially lower than their peaks in 2023 Q3, despite a tick-up in these rates towards the end of last year. Quoted rates on two-year fixed-rate mortgages with loan to value (LTV) ratios of 75% and 90% have responded as expected to changes in OIS rates, falling by around 20 basis points and 35 basis points, respectively, since January 2025. Quoted rates on time deposits and personal loans have also continued to evolve as expected over this period.

Evidence from the 2025 Q1 **Credit Conditions Survey** suggests that households' demand for secured borrowing and unsecured credit card borrowing continued to grow over the start of this year. But demand for secured lending was expected to stall in 2025 Q2, potentially reflecting a normalisation in activity following changes to Stamp Duty Land Tax in April (Section 2.3). Banks indicated that the availability of credit to households had grown in 2025 Q1 and that this was expected to continue into 2025 Q2. Credit availability for businesses had also grown in 2025 Q1 but was expected to remain broadly unchanged over the current quarter. The survey window did not capture the recent period of market volatility.

Chart 2.6: Pass-through of changes in reference rates has been broadly as expected over recent months

Household and corporate interest rates and their corresponding reference rates (a)



Sources: Bank of England, Bloomberg Finance L.P. and Bank calculations.

(a) Household loan and deposit rates are based on average quoted rates and business loan rates are based on average effective rates on new lending. The Bank's quoted rates series are weighted monthly average rates advertised by all UK banks and building societies with products meeting the specific criteria. **Introduction of new Quoted Rates data** provides more information. The 75% and 90% LTV mortgage rates are for two-year fixed-rate products. The reference rate for these, and for personal loans and fixed-rate savings bonds, is the two-year OIS rate. The two-year OIS rate shows monthly averages, while Bank Rate shows month-end numbers. The provisional April 2025 data are shown in diamonds. For quoted rate series and the two-year OIS rate, these are based on average values to 29 April 2025. The provisional data for Bank Rate is based on the rate as of 29 April 2025. The final business loan rate data is shown for March 2025.

> **Despite falling quoted rates on mortgages, many households continue to face higher rates when they come to refinance.**

Changes in the interest rates paid on existing UK mortgages are important in determining the strength of the cash-flow channel of monetary policy. All else equal, increases in effective mortgage rates, relative to rates paid on household deposits, will weigh on household consumption (Box C of the **August 2024 Monetary Policy Report**).

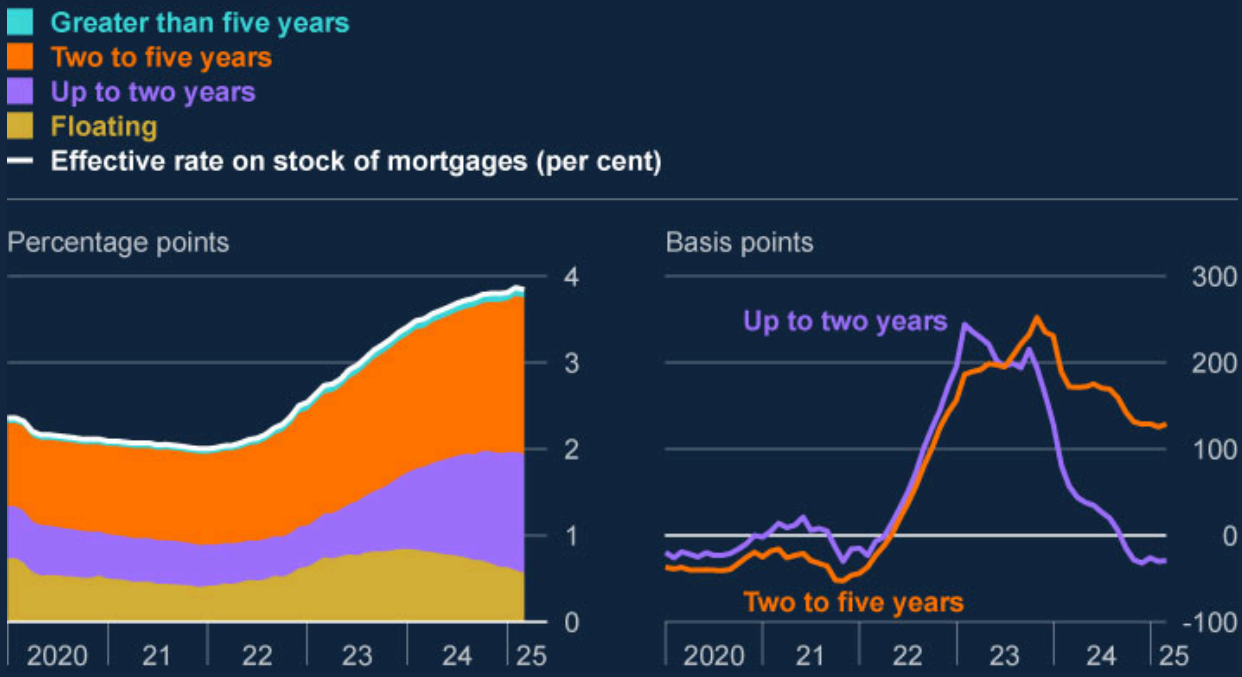
Effective interest rates paid on the stock of UK mortgages are continuing to increase (Chart 2.7, left panel), which, together with recent reductions in household deposit rates, means that monetary policy is judged to still be weighing on household consumption growth through the cash-flow channel. Effective rates on new mortgages with a fixed-rate period of between two and five years, which represent around 60% of the mortgage stock, remain around 130 basis points higher than the corresponding rates on outstanding mortgages (Chart 2.7, right panel). This means that households are facing higher interest rates when they come to refinance, which in turn is pushing up the effective interest rate on the average of all outstanding UK mortgages.

While monetary policy is judged still to be weighing on household consumption growth through the cash-flow channel, that effect is likely to be waning as rises in effective mortgage rates have slowed. The spread between the effective rates paid on new and outstanding mortgages has narrowed since 2023 and has turned negative for mortgages with a fixed period of up to two years. This means that fixed mortgage rates have been decreasing for some households. Together with reductions in floating mortgage rates, this has slowed the rise in the overall effective rate on the stock of UK mortgages (Chart 2.7, left panel).

Some of the impact of increases in effective interest rates on households' monthly mortgage payments over recent years has been mitigated by mortgagors choosing to increase the overall term of their mortgages. Over half of new mortgage lending now takes place at a term of 30 years or more, compared with around 30% in 2015 (**Waddell and Shrestha (2024)**). Borrowers on longer-term mortgages pay less interest each month, but more interest over the life of their loans.

Chart 2.7: The effective interest rate on the stock of UK mortgages is still rising, but at a slower pace than in recent years

Contributions to the effective rate on the stock of mortgages and spreads between the effective rate on new and outstanding mortgage lending (a)



Sources: Bank of England and Bank calculations.

(a) Mortgage tenors refer to the initial fixation period. The 'up to two years' category includes mortgages with an initial fixation period of two years. The final data points are for March 2025.

2.3: Domestic activity

Underlying GDP growth is judged to have slowed and is expected to remain subdued in the near term.

Bank staff judge that underlying GDP growth, as measured by the collective steer from several business survey indicators, slowed over the second half of 2024 (Chart 2.8). The slowing in underlying GDP growth was less than implied by the headline data, which have been volatile recently. Headline GDP growth slowed more sharply in 2024 H2, largely due to a slowing in market sector output growth.

Underlying GDP growth is expected to have been around zero in 2025 Q1, as expected in the February Report, and well below Bank staff's projection for headline GDP. The S&P Global UK composite output PMI and the BCC composite output index were below their historical averages in 2025 Q1. Survey respondents attributed that weakness to concerns about UK

economic prospects. Following strong monthly GDP growth of 0.5% in February, partly driven by volatility in manufacturing sector output, headline GDP is projected to have risen by 0.6% in 2025 Q1, significantly above the estimated pace of underlying growth.

Official activity data are released with a lag and will not yet capture the impact of higher US tariffs announced in April. Survey data released following those tariff announcements have suggested some weakening in activity growth. The April S&P Global composite output PMI, which covered the period between 9 and 28 April, fell to its lowest level since September 2023. Much of the weakness in these responses appeared to reflect an expected negative impact of tariffs on activity. The April CBI composite output index rose somewhat in April, however. Overall, Bank staff expect underlying GDP to remain broadly flat in 2025 Q2, while headline GDP is expected to grow by 0.1%.

Chart 2.8: Underlying GDP growth has slowed and has been less volatile than growth in headline GDP

Three-month on three-month growth in GDP and quarterly GDP growth implied by business surveys (a)

Sources: BCC, CBI, Lloyds Business Barometer, ONS, S&P Global and Bank calculations.

(a) The final data point for three-month on three-month GDP growth is for the three months to February 2025. The aqua diamonds show Bank staff projections for headline GDP. The orange diamonds to 2024 Q4 show in-sample fitted values of the survey indicator model and diamonds for 2025 Q1 and Q2 show out of sample projections.

Business confidence has weakened further in recent months.

Measures of business confidence in 2025 Q1, including the S&P Global UK PMI future output index and the Deloitte CFO survey, had already fallen by around one standard deviation on average relative to 2024 Q3. Survey respondents over this period highlighted increases in employer National Insurance contributions (NICs) and uncertainty about its impact on the

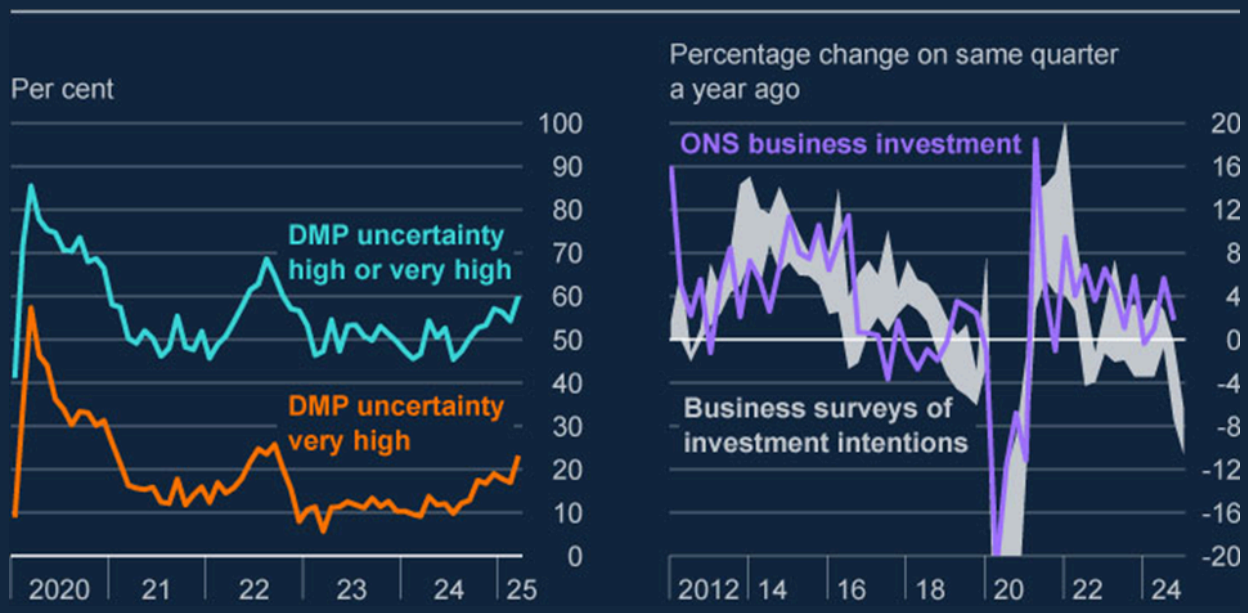
economy among their primary concerns. While heightened domestic uncertainty appeared to be the main driver of deteriorating business confidence, concerns about the global economy were also increasing.

Uncertainty has increased further since the rises in US tariffs in April. In the April S&P Global UK PMI survey, the first covering the period since the US tariff announcements, respondents attributed weakness in new export orders to heightened global uncertainty, particularly around trade policy and higher tariffs. And in the April DMP Survey, which was in the field from 4–18 April, the share of respondents reporting that uncertainty was high or very high was at its highest level since November 2022 (Chart 2.9, left panel), and global trade tariffs were reported to be a key source of uncertainty (Box C). The share of firms that cited US tariffs as one of their top three sources of uncertainty rose further following the announcement of the 90-day pause in higher tariff rates on 9 April. Nevertheless, the rise in uncertainty has been much smaller than the pickup in global trade policy uncertainty (Box C).

Heightened uncertainty, as well as a weak demand outlook, appears to be weighing on investment intentions according to Agency intelligence. Investment intentions for the year ahead have fallen recently and suggest slowing investment growth (Chart 2.9, right panel). Business investment is expected to grow at a subdued pace in the near term.

Chart 2.9: Business investment intentions have weakened, consistent with heightened uncertainty

Percentage of respondents to the DMP survey reporting high or very high uncertainty; four-quarter business investment growth and survey indicators of investment intentions (a) (b)



Sources: Bank of England Agents, BCC, CBI, DMP Survey, ONS and Bank calculations.

(a) DMP uncertainty measure is based on responses to the question 'How would you rate the overall uncertainty facing your business at the moment?'. Latest data are for April 2025.
(b) Survey measures are scaled to match the mean and variance of four-quarter business investment growth since 2000. Measures for the Bank's Agents (split by manufacturing and services), the BCC (non-services and services) and the CBI (manufacturing, distribution, financial services and business/consumer/professional services) are weighted together using shares in real business investment. The Agents' measure shows companies' intended changes in investment over the next 12 months; last available observation for each quarter. The BCC measure is the net percentage balance of respondents reporting that they have increased planned investment in plant and machinery; data are not seasonally adjusted. The CBI measure is the net percentage balance of respondents reporting that they have increased planned investment in plant and machinery for the next 12 months.

Household spending growth has remained subdued, although real incomes have risen.

Real household disposable income has risen by 9.5% since 2022 Q2, and by 6.3% per head, as wage growth has been strong and past shocks to global energy and other goods prices have waned. Despite this increase in real incomes, household consumption has risen by just 1.3% over the same period. As a result, the aggregate household saving ratio rose to 11.6% in 2024 Q4, its highest level since the pandemic (Chart 2.10).

Chart 2.10: The household saving ratio has risen further

Household saving ratio (a)

Sources: ONS and Bank calculations.

(a) Saving as a percentage of total available household resources. The series is NRJS from the ONS. The final data point is 2024 Q4.

Much of the rise in the saving ratio since 2022 reflects the restrictive stance of monetary policy, as well as households choosing to smooth through rises in their real incomes following previous increases in the cost of living (Box E of the **November 2024 Monetary Policy Report**). Consistent with that, 27% of respondents to the March 2025 Bank of England/NMG survey reported that higher savings interest was a reason why they had saved more than usual over the past year (Chart 2.11). Just over one-third of respondents reported having saved more in order to rebuild their savings in case of emergencies. That might suggest a precautionary savings motive, although less than 10% of respondents said that they were saving more due to concerns about job loss. Evidence from individual-level data from the NMG survey suggests that household deposits are at or above pre-pandemic levels in real terms across the distribution of households, although aggregate data suggest that the ratio of household money to household incomes is below its pre-pandemic trend (Box D).

Chart 2.11: Survey evidence suggests higher savings have partly reflected households trying to rebuild savings in case of emergencies

Households' stated reasons for saving more than usual over the past year, NMG survey (a)

Sources: Bank/NMG survey and Bank calculations.

(a) Results are based on responses to the question: 'You said that you have saved more than usual over the last 12 months. What would you say are the main reasons for this increase?'. Respondents were able to select up to three reasons. 'Don't know', 'prefer not to say' and 'other' responses have been excluded.

Indicators of household spending growth have been mixed in recent months. Retail sales have risen by 2.5% since the start of the year. But the headline GfK consumer confidence index has been subdued recently and fell in April to one standard deviation below its historical average, possibly reflecting higher household bills (Section 2.5), as well as heightened global uncertainty following the rise in US tariffs. Alongside this, in the March 2025 NMG survey, households' expectations for the general macroeconomic situation in the year ahead declined relative to the September 2024 survey.

Bank staff expect consumption to have risen by 0.4% in Q1, and for growth to be modest at 0.2% in 2025 Q2. Further out, consumption growth is expected to pick up gradually, supported by a reduced drag from past rises in interest rates. This is consistent with a gradual decline in the saving ratio (Section 1).

Housing market activity has continued to strengthen, although housing investment growth remains weak.

Restrictive monetary policy has weighed on housing market activity and house price inflation, but these have picked up since their troughs in 2023. Monthly mortgage approvals for house purchases are currently just above their 2012–19 average. And having been broadly flat over

2023 and early 2024, house prices have since risen. The official ONS UK house price index increased by 1.5% in the three months to February, although timelier data from Nationwide and Halifax suggest some slowing in the pace of growth in the months ahead. The strengthening in housing market activity may partly reflect a fading drag from past rises in interest rates, as well as continued growth in household incomes. In addition, contacts of the Bank's Agents noted that anticipation of increases in Stamp Duty Land Tax, which took effect from April, had accounted for part of the recent pickup in approvals. This was reflected in an increase in secured lending to households (Box D). Leading indicators of future housing market activity have softened somewhat, and the RICS new instructions to sell balance, which measures activity at the start of the housing chain, fell to its lowest level since July 2024 in March.

Despite strengthening housing market activity, housing investment growth has been weak and housing investment remained 2.5% below its pre-Covid level in 2024 Q4. The revised **National Planning Policy Framework** contained several measures designed to boost house building. Based on the OBR estimates of additional house building resulting from this policy change, Bank staff judge that these reforms will boost the level of housing investment by a little over 7%, and the level of GDP by around ¼%, by the third year of the forecast period, broadly similar to the OBR's assessment.

Fiscal measures announced in the 2025 Spring Statement are expected to have little impact on GDP over the forecast period.

Measures announced in the Government's Spring Statement 2025 are expected to have very little impact on the fiscal stance, and hence on projected GDP growth, over the three-year forecast period. Government spending plans have become more front-loaded, resulting in increased spending of £1.8 billion in 2026–27, before £3.6 billion of cuts in day-to-day spending are scheduled to occur in 2029–30, beyond the MPC's forecast horizon. Defence spending has been increased from 2.3% to 2.5% of GDP by 2027–28, funded by a reduction in overseas aid. The boost to output from increased spending in 2026–27 is partially offset by policies to reduce tax avoidance and other minor tax revenue raising measures such as increased passport and visa fees. The Government has also announced a series of welfare reforms which largely occur beyond the forecast horizon.

2.4: The labour market and supply

Underlying employment growth has softened.

The ONS LFS estimate of employment increased by 0.6% in the three months to February. Despite a small tick-up in response rates, LFS data remain volatile and highly uncertain (Box D of the **May 2024 Monetary Policy Report**). In an **update published in April**, the ONS noted that it intends to transition to the transformed Labour Force Survey in November 2026 at the earliest. This survey is intended as the long-term replacement for the LFS.

Underlying employment growth is judged to be somewhat weaker currently than implied by the LFS estimate. Bank staff have estimated a new statistical model that extracts a common signal from a broad array of survey measures of employment growth. This model is timelier and includes a broader set of indicators than the quarterly indicator model shown in Section 2.4 of the **February 2025 Monetary Policy Report**. The new model suggests that underlying three-month on three-month employment growth softened to around 0% at the start of 2025 (Chart 2.12). This is below estimated population growth, of around ¼% in 2025 Q1, and hence is consistent with a rising rate of unemployment or inactivity.

Chart 2.12: Underlying employment growth is judged to have softened

Measures of employment growth (a)

Sources: Bank of England Agents, DMP Survey, HMRC, KPMG/REC/S&P Global UK Report on Jobs, Lloyds Business Barometer, ONS, S&P Global and Bank calculations.

(a) Bank staff's indicator-based measure of underlying employment growth is constructed using a dynamic factor model following the approach of **Doz et al (2011)**. The model extracts a common component from monthly survey indicators, capturing comovements across series. The common component is scaled to align with LFS employment growth between 2000–19. Shaded area represents the 95% confidence interval. Latest data are for the three months to February 2025 for the LFS and April 2025 for the other survey data.

In addition to concerns around the broader economic outlook, firms have cited April's increase in employer NICs as a reason for weakness in employment growth. Survey evidence suggests that firms are utilising several margins of adjustment in response to the rise in employer NICs, including lower growth in employment (Box D of the **February 2025 Monetary Policy Report** and Section 2.5). The impact of higher NICs on employment appears to have been fairly small to date, however. That is consistent with the fact that, while the REC and PMI employment indicators fell sharply around the turn of the year ahead of the rise in employer NICs, they have since recovered somewhat.

The labour market has continued to loosen and there are tentative signs of slack emerging.

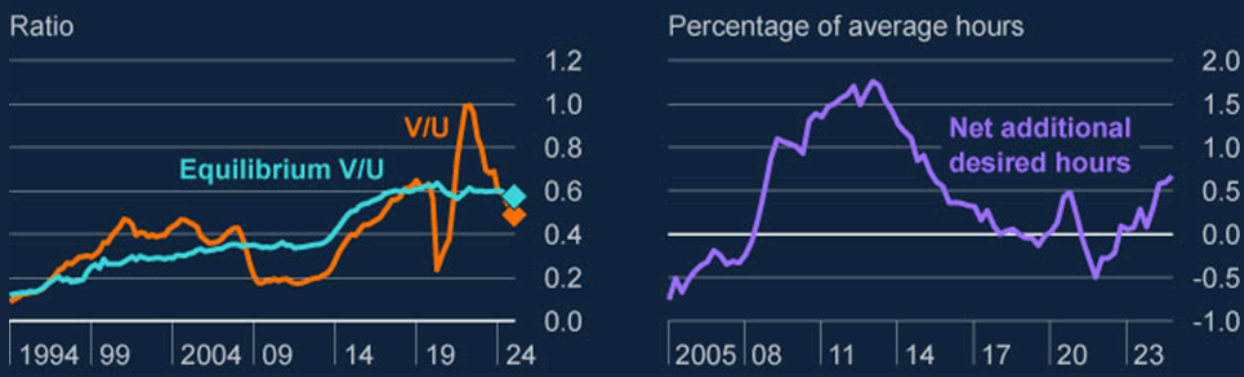
The LFS unemployment rate has been little changed recently and was 4.4% in the three months to February. Indicators of underlying unemployment, such as the claimant count, and measures of recruitment difficulties, have also been stable, while indicators of redundancy intentions have remained at low levels. The unemployment rate is projected to edge up slightly to 4.6% in 2025 Q2, before rising a little further over the forecast period (Section 1.2).

Job vacancies have been falling since mid-2022, although the pace of decline has slowed somewhat since the turn of the year. Alongside a modest pickup in unemployment, this has meant that the ratio of vacancies to unemployment has continued to fall. The vacancies to unemployment ratio is now judged to be a little below its equilibrium level (Chart 2.13, left panel), based on analysis by Bank staff (**Stelmach et al (2025**)) in which the real cost of posting a vacancy and hourly labour productivity determine the long-run level of vacancies.

Consistent with labour market slack having opened up, several measures suggest that underemployment has increased. The net additional hours desired by workers, as a percentage of average hours worked, rose to its highest level since June 2015 in 2024 Q4. (Chart 2.13, right panel). And the marginal attachment ratio, which measures the proportion of the working-age population who are not currently in work or seeking employment but report that they would like a job, has been rising steadily since February 2024. These data are taken from the LFS and so should be treated with caution.

Chart 2.13: The vacancies to unemployment ratio is estimated to be below its equilibrium, while net additional desired hours have increased

Vacancies to unemployment ratio and its estimated equilibrium value and net additional desired hours as a percentage of average weekly hours (a) (b)



Sources: AA/WARC Expenditure Report, ONS and Bank calculations.

(a) The equilibrium V/U ratio is estimated using an error-correction model over the period 1982–2023. The real cost of vacancy posting and hourly labour productivity are included as long-run determinants for the level of vacancies. The model also includes controls for short-term movements in these variables (**Stelmach et al (2025)**). The final data points for both series in the chart are 2024 Q4, while diamonds represent projections for 2025 Q1.
(b) Number of net additional hours that the currently employed report they would like to work, on average, per week, expressed as a share of average weekly hours. Latest data are to 2024 Q4.

Weak growth in labour productivity has weighed on GDP growth.

Growth in underlying output per worker has been weak in recent quarters, at 0.4% in the four quarters to 2024 Q4 (Chart 2.14). Output per worker based on the headline ONS measures for GDP and employment was flat over the same period. Output per hour, based on headline GDP and LFS total hours worked, fell by 0.5%.

As outlined in Box E of the **February 2025 Monetary Policy Report**, much of the recent weakness in productivity growth is judged to have reflected weaker growth in potential productivity. As discussed in that box, however, a reassessment of the economic factors likely to affect productivity, including Brexit and supply-side effects from the pandemic, cannot fully account for this weakness. Part of the unexplained weakness in productivity is therefore assumed to dissipate over the forecast period (Section 1.2). Box A explores a scenario where productivity growth is weaker than assumed in the baseline projection.

Chart 2.14: Labour productivity growth has been weak

Measures of four-quarter labour productivity growth (a)

Sources: ONS and Bank calculations.

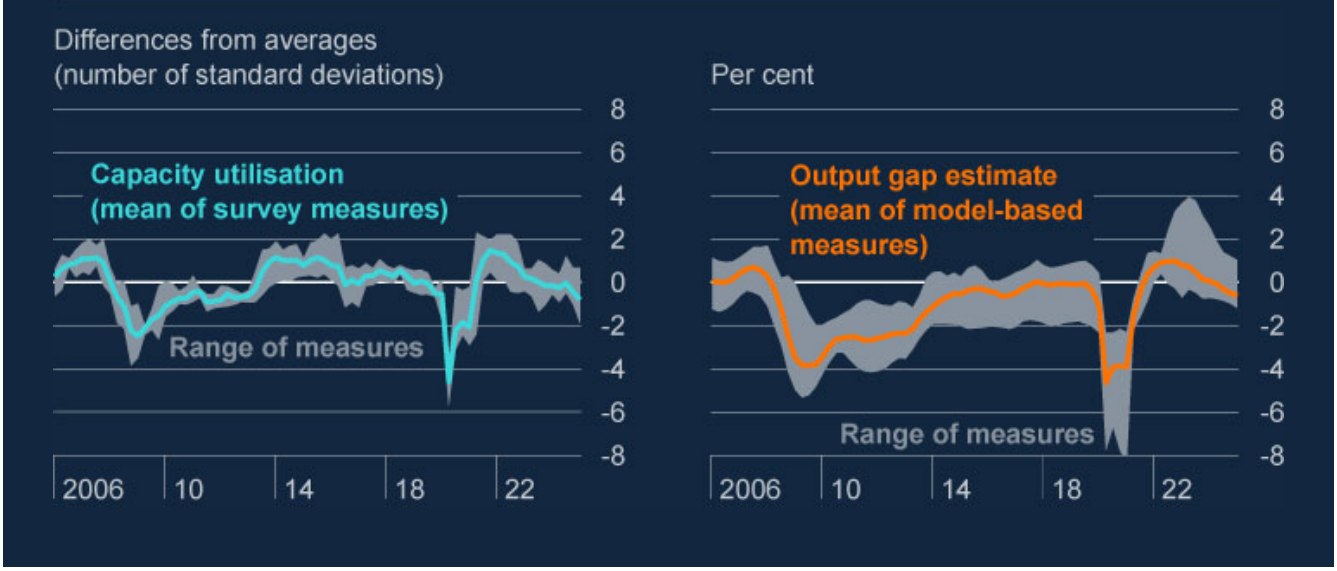
(a) Underlying output per worker is based on Bank staff's underlying measures of GDP and employment based on indicator-based models from Charts 2.8 and 2.12 for GDP and employment respectively. The final data points are for 2024 Q4.

A small margin of economic slack is judged to have opened up.

The recent weakening in GDP growth is judged to have resulted in a small widening in slack. That is consistent with recent signs of labour market slack having begun to emerge, as well as with survey measures of capacity utilisation that suggest an increase in spare capacity within firms (Chart 2.15, left panel). In addition, top-down estimates of the output gap based on statistical techniques imply a recent widening (Chart 2.15, right panel). Since spare capacity cannot be observed, there are large uncertainties around this judgement. The MPC projects a further widening in the margin of excess supply over the forecast period. Box A in Section 1 explores a scenario in which slack widens by more than in the baseline projection.

Chart 2.15: Measures of capacity utilisation are slightly below historical averages and output gap models signal a modest widening in economic slack

Survey indicators of capacity utilisation; model-based estimates of the output gap (a) (b)



Sources: Bank of England Agents, BCC, CBI, ONS, S&P Global and Bank calculations.

(a) Left-hand side chart measures are standard deviations from averages between 2000–19. The measures included in the swathe are from the Bank's Agents, the BCC (non-services and services), the CBI (manufacturing (capacity); financial services, business/consumer/professional services and distributive trade (business relative to normal)) and S&P Global PMI (manufacturing (backlogs); services (outstanding business)). Sectors are weighted using shares in gross value added. The BCC data are not seasonally adjusted. The data are shown to 2025 Q1.
(b) The model-based estimates of the output gap are based on a variety of multivariate filters whose mean values are standardised to the MPC's estimate of the output gap. Relative to previous Reports, this chart now contains a greater number of filter models, resulting in a wider swathe. The final data point in the chart is 2025 Q1.

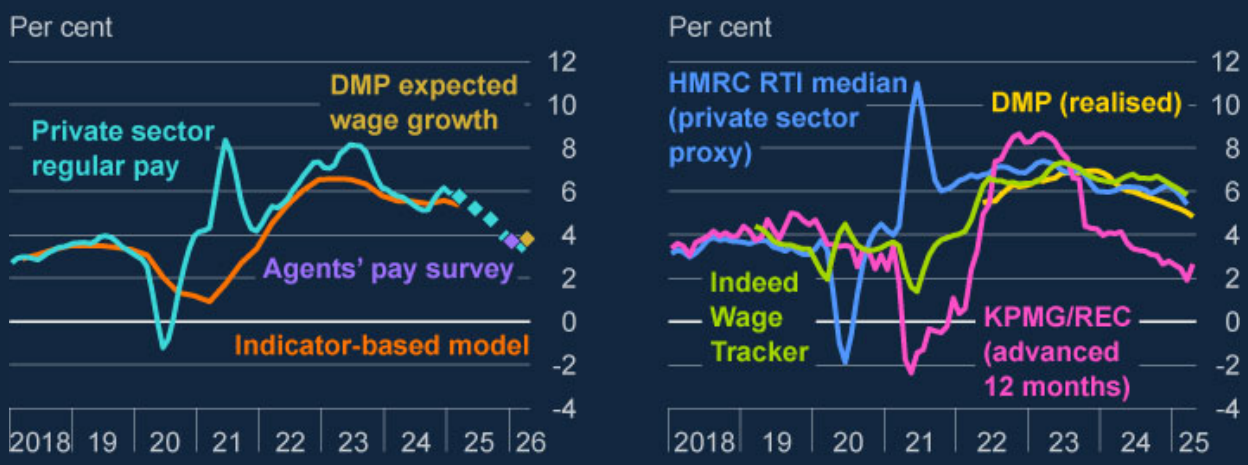
2.5: Wages and inflation

Headline private sector regular pay growth picked up at the end of 2024 and is slightly higher than underlying wage growth.

Annual private sector regular AWE growth was 5.9% in the three months to February, having risen in 2024 Q4 (Chart 2.16, left panel). While AWE growth was 0.4 percentage points below expectations at the time of the February Report, it is a little above Bank staff's estimate of underlying wage growth of around 5¼% in 2025 Q1. Analysis by Bank staff suggests that most of the recent difference between the rates of AWE and underlying wage growth can be accounted for by compositional effects, due to changes in the sectoral and full-time mix of employees, and by base effects from unusually weak wage growth at the end of 2023. Small revisions mean that the pickup in AWE growth over 2024 H2 is slightly smaller than previously estimated (**ONS (2025)**), but the strength of AWE growth in the most recent data has been largely unaffected.

Chart 2.16: Official AWE growth picked up at the end of 2024, but underlying measures have been more stable and point to a slightly lower rate of pay growth

Measures of private sector wage growth (a) (b)



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

(a) Private sector regular pay growth in the aqua line shows the ONS measure of private sector regular average weekly earnings growth (three-month average on same three-month average a year ago). Bank staff's indicator-based model of near-term private sector regular pay growth is quarterly and uses mixed-data sampling (or MIDAS) techniques. A range of indicators inform the model, including series from the Bank of England Agents, the Lloyds Business Barometer, Indeed, ONS/HMRC PAYE payrolls and the KPMG/REC UK Report on Jobs. Indicators are weighted together according to their relative forecast performance in the recent past. Latest data points are for the three months to February 2025 for private sector regular pay and 2025 Q1 for the indicator-based model estimates. The Agents' pay survey diamond shows respondents' expected average pay settlements in 2025, weighted by employment and sector. The DMP diamond shows average expected pay growth one year ahead for respondents to the April 2025 DMP Survey. Pay growth projections are for 2025 Q1 to 2026 Q1.
(b) DMP shows three-month average realised pay growth from the DMP Survey (three-month average on same three-month average a year ago). KPMG/REC shows average starting salaries for permanent staff compared to the previous month. The KPMG/REC index is mean-variance adjusted to ONS private sector regular pay growth over 2002–19 and is advanced by 12 months, which better reflects the leading relationship between the KPMG/REC index and the ONS measure of pay growth. HMRC Real-Time Information (RTI) shows median of private sector employee pay growth. Indeed shows annual average job title matched pay growth for UK job vacancies. Latest data points are April 2024 for the KPMG/REC index, March 2025 for Indeed and HMRC RTI, and April 2025 for the DMP Survey.

In contrast to the pickup in headline AWE growth in 2024 Q4, Bank staff's indicator-based model of underlying pay growth has been relatively stable in recent quarters (Chart 2.16, left panel). Most indicators are consistent with pay growth of around, or a little above, 5%. Annual growth in median private sector pay derived from HMRC payrolls data, for example, was 5.4% in the three months to March, having fallen from around 6% over 2024 (Chart 2.16, right panel).

Underlying wage growth remains materially higher than would be expected based on some of its key determinants. One model estimated on pre-Covid data, which decomposes movements in underlying wage growth into contributions from inflation expectations, productivity and economic slack, suggests that underlying wage growth is higher than can be explained based on these components (Chart 2.17).

Chart 2.17: Underlying wage growth is higher than expected based on its key determinants

Contributions to estimated underlying annual private sector regular pay growth (a)

Sources: Barclays, Citigroup, HMRC, Indeed, KPMG/REC UK Report on Jobs, Lloyds Business Barometer, ONS, YouGov and Bank calculations.

(a) Wage equation based on **Yellen (2017)**. Pay growth is Bank staff's estimate of underlying wage growth also shown in Chart 2.16. Short-term inflation expectations are based on the Barclays Basix Index and the YouGov/Citigroup one year ahead measure of household inflation expectations and projected forward based on a Bayesian VAR estimation. Slack is based on the MPC's estimates, informed by the vacancies to unemployment ratio. Productivity growth is based on long-run market sector productivity growth per head. Values may not sum due to rounding. The final data point is 2025 Q1 and based on staff projections.

Wage growth is expected to moderate over the course of 2025.

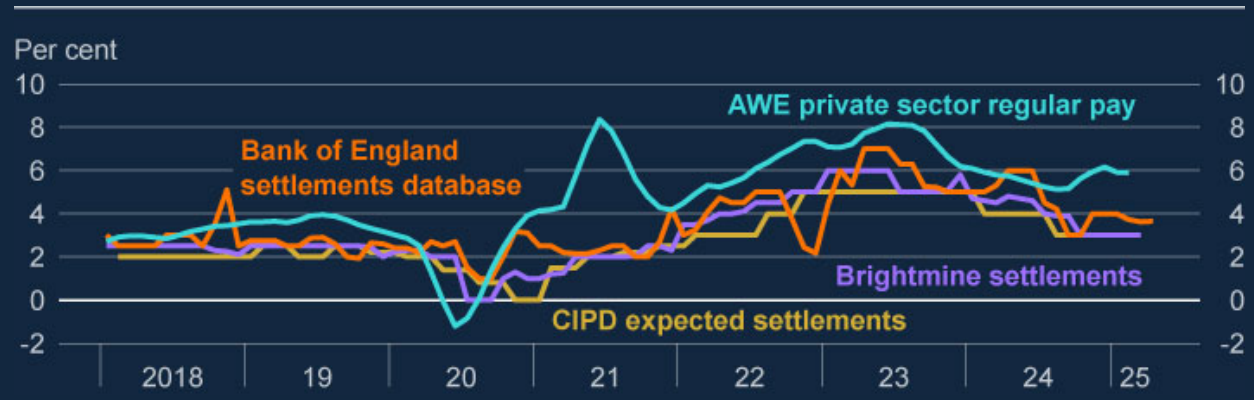
Indicators of wage growth and pay settlements suggest that annual pay growth will ease significantly over 2025. In the monthly DMP Survey data for April, reported annual wage growth among firms who typically reset wages in Q2 was 4.8%, around 1 percentage point lower than the average for these firms in the three-months to March, consistent with downward momentum in wage growth. And recent pay settlements data, from Brightmine, CIPD and the Bank's own settlements databases, suggest that pay awards have been around 3% to 4% since the start of the year (Chart 2.18).

The rise in the National Living Wage (NLW) in April, of 6.7%, is expected to push up annual pay growth by around 0.2 percentage points from 2025 Q2. And contacts of the Bank's Agents continue to cite the NLW as the largest factor exerting upward pressure on pay in 2025, although the impact varies by sector. Partly offsetting that, however, the increase in the rate of employer NICs is expected to weigh on wage growth as firms try to contain the rise in overall employment costs (Box D of the **February 2025 Monetary Policy Report**). The near-term impact of the rise in employer NICs on wages is expected to be relatively small on average across firms, although some contacts of the Bank's Agents report that they are reducing the pay rates they offer by around 1 to 2 percentage points in response to the rise.

Annual private sector wage growth is projected to slow to 3.8% by the end of 2025, as the easing in the labour market and past falls in inflation expectations feed through to lower wage growth (Chart 2.16, left panel). Consistent with that, the latest intelligence from the Bank's Agents points to average pay rises for 2025 of between 3.5% and 4%, in line with the average of 3.7% reported in the Agents' annual pay survey conducted ahead of the February Report. And respondents to the DMP Survey in the three months to April expected pay growth for the year ahead to be 3.8%, down from 4.8% currently.

Chart 2.18: Indicators of pay settlements have moved lower in recent quarters

Growth in AWE private sector regular pay and measures of annual pay settlements (a)



Sources: Bank of England Agents, Brightmine, CIPD, Incomes Data Research, Incomes Data Services, Industrial Relations Services, Labour Research Department, ONS and Bank calculations.

(a) Private sector regular pay growth in the aqua line shows the ONS measure of private sector regular average weekly earnings growth (three-month average on same three-month average a year ago). Final data points are the three months to February for AWE private sector regular pay growth, April for Bank of England settlements database, March for Brightmine settlements and 2025 Q1 for CIPD expected settlements.

While the rise in employer NICs is expected to weigh on wage growth somewhat, the majority of firms' adjustment is expected to come through lower profit margins in the near term.

In response to higher labour costs resulting from the increase in employer NICs, employers may adjust their profit margins, pass the additional costs on to consumers through higher prices, or mitigate these costs by reducing nominal wages or employment. Firms are expected to use these margins of adjustment to varying degrees (Box D of the **February 2025 Monetary Policy Report**), but most of the adjustment is assumed to come through lower profit margins in the near term.

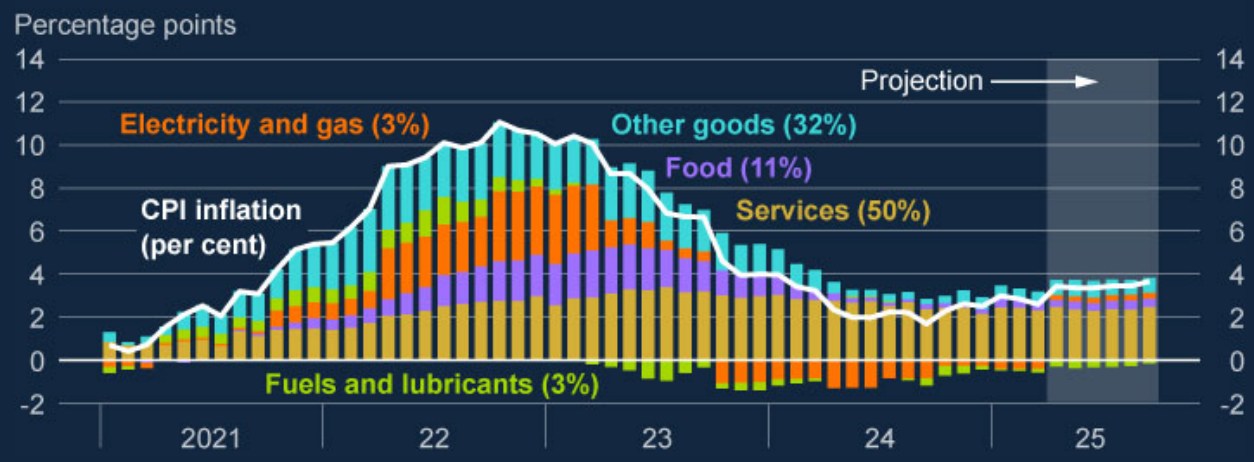
Survey evidence since the February Report has been mixed but is broadly consistent with this judgement. Respondents to the March ONS BICS expected to absorb the cost of employer NICs through both lower margins and higher prices, although reducing headcount and limiting wage increases were also common responses. Contacts of the Bank's Agents have suggested that, while margins are already somewhat compressed, they will decline further this year, due to higher employer NICs as well as costs stemming from the NLW and the Extended Producer Responsibility legislation. Likewise, respondents to the Deloitte CFO survey expected operating margins to decline over the year ahead, again partly as a result of the rise in employer NICs.

Headline CPI inflation was 2.6% in March.

Twelve-month CPI inflation was 2.6% in March (Chart 2.19), up slightly from 2.5% in December and a little below the February Report projection. Higher services inflation, reflecting volatility in airfares and increases in administered prices, as well as higher food price inflation, accounted for most of the rise in CPI inflation since December. Core CPI inflation, which excludes energy, food, beverages and tobacco, also rose from 3.2% in December to 3.4% in March.

Chart 2.19: CPI inflation was 2.6% in March and is expected to have risen in April

Contributions to CPI inflation (a)



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

(a) Figures in parentheses are CPI basket weights in 2025. Data are shown to March 2025. Component-level Bank staff projections are shown from April to September 2025. The food component is defined as food and non-alcoholic beverages. Fuels and lubricants estimates use Department for Energy Security and Net Zero petrol price data for April 2025 and are then projected based on the sterling oil futures curve.

CPI inflation is estimated to have risen in April due to higher energy bills, indexed and regulated prices and the impact of employer NICs.

Headline CPI inflation is expected to have risen to 3.4% in April and is projected to rise further to 3.7% by September. The single largest driver of the projected rise in inflation is household energy bills (Chart 2.20). The Ofgem energy price cap for the typical household rose from £1,738 in January 2025 to £1,849 in April 2025. The fall in the Ofgem price cap in April of last year will also drop out of the annual comparison, pushing up the annual inflation rate and raising the contribution of energy bills to headline inflation.

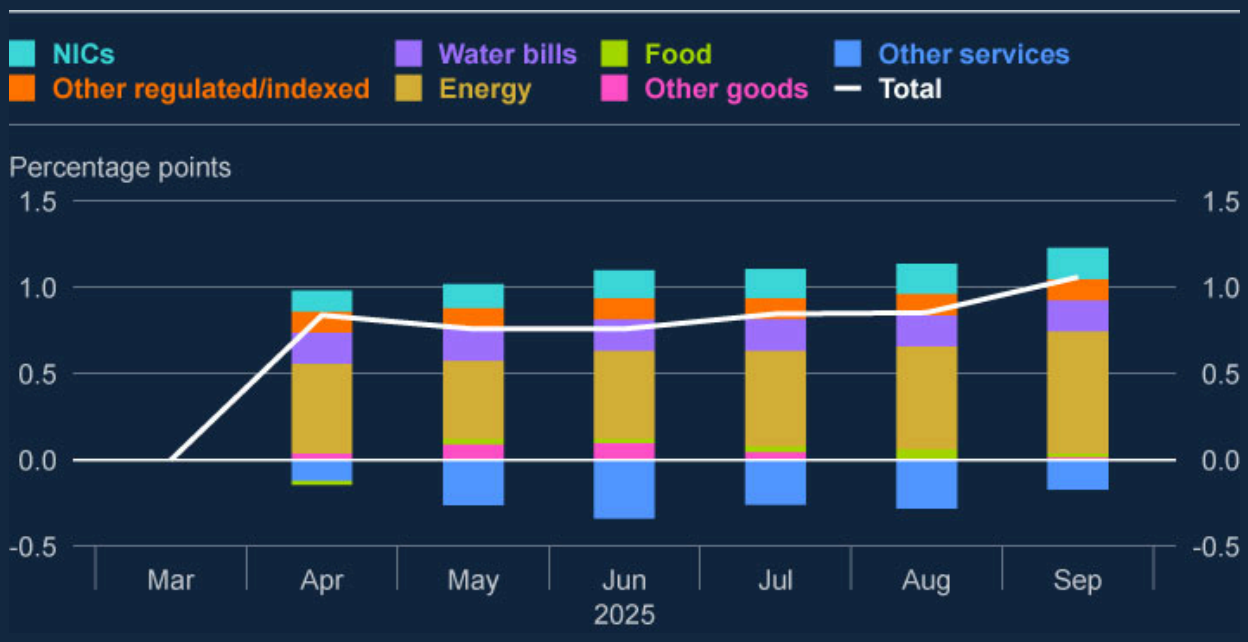
Besides the higher contribution from energy bills, increases in water bills, indexation of bills such as broadband and phone charges, and an expected impact from the higher rate of employer NICs also push up projected headline CPI inflation from April (Chart 2.20).

The near-term projection for CPI inflation is a little lower than in the February Report. This primarily reflects movements in sterling oil and gas prices, which have fallen since then (Section 2.1). This reduces the expected contribution of road fuel prices to projected headline inflation in Q2 and Q3 by around ¼ percentage points. The contribution of gas and electricity

prices is also a little lower in 2025 Q3. The imposition of higher global trade tariffs is expected to weigh on UK CPI inflation, but there are large risks around this judgement (Box C and Section 1).

Chart 2.20: CPI inflation is expected to rise from 2025 Q2 onwards

Projected contributions to the change in CPI inflation from March 2025 (a)



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

(a) Component-level Bank staff projections from April to September 2025. The energy component includes fuels and lubricants and electricity and gas. The NICs bars show Bank staff estimates of the pass-through of the increases in employer NICs announced in Autumn Budget 2024 to headline CPI inflation. The other regulated/indexed component includes education, other transport services, other services for personal transport equipment and communication services. The water bills component includes water supply and sewerage collection. The food component is defined as food and non-alcoholic beverages excluding the estimated impact of the changes to employer NICs. The other goods component is defined as goods excluding energy, food and non-alcoholic beverages, water supply and the estimated impact of the changes to employer NICs on goods inflation. The other services component is defined as services excluding education, other transport services, other services for personal transport equipment, communication services, sewerage collection and the estimated impact of the changes to employer NICs on services inflation.

Core goods and food price inflation have been rising and are above their pre-Covid averages.

Core goods and food price inflation fell materially over 2023 and early 2024 following declines in the prices of key inputs such as energy and other raw materials but have increased in recent months (Chart 2.21). Annual core goods and food price inflation were 1.1% and 3.0% respectively in March, above pre-Covid average rates.

Data quality issues have emerged since the February Report that mean that some indicators of input price pressures should be treated with caution. In late-March, the ONS paused the publication of its producer price inflation data following the identification of a problem in its production (**ONS (2025)**). While the impact of this problem on other economic statistics is not yet clear, the ONS has stated that the CPI is unaffected, headline PPI is likely to be revised upwards and headline services PPI to be revised downwards. The main impacts on annual producer price inflation rates are expected to be in 2022 and 2023. These revisions will also affect the calculation of headline GDP, although the ONS has said that early indications do not point to a notable change in the recent economic trends seen in these data.

Chart 2.21: Core goods and food price inflation are projected to remain above their pre-Covid averages and services inflation is expected to stay elevated in coming months

Annual inflation rates for components of CPI (a)

Sources: ONS and Bank calculations.

(a) The core goods component is defined as goods excluding food and non-alcoholic beverages (FNAB), alcohol, tobacco and energy. Data are to March 2025. Bank staff projections from April to September 2025. Dashed lines represent the 2010–19 averages, which are 3.0%, 1.6% and 0.8% for services, FNAB and core goods respectively.

Indicators of imported and non-labour cost pressures have picked up slightly from subdued levels, but remain muted. The overall manufacturing PMI input price balance (aqua line in Chart 2.22) and input prices for the food and drink sector specifically (orange line in Chart 2.22) have both picked up since late 2023 but remain around their long-run averages. Over that time there have also been pockets of strength in certain commodity prices, including

cocoa and coffee, and contacts of the Bank's Agents report that raw material cost inflation is becoming modestly positive. Looking ahead, contacts noted that price competition among supermarkets is expected to increase in coming quarters, which may exert some downward pressure on food prices. Meanwhile, contacts of the Bank's Agents have reported concerns that developments in global trade policies could potentially cause future volatility in exchange rates and imported product costs (Box E). Contacts have reported little impact from tariffs on domestic consumer prices so far, but have noted the potential for some discounting to occur in cases where UK producers have excess stock that was produced for export to the US.

Chart 2.22: Measures of goods input price growth have risen but remain around their historical averages

PMI input price balances (a)

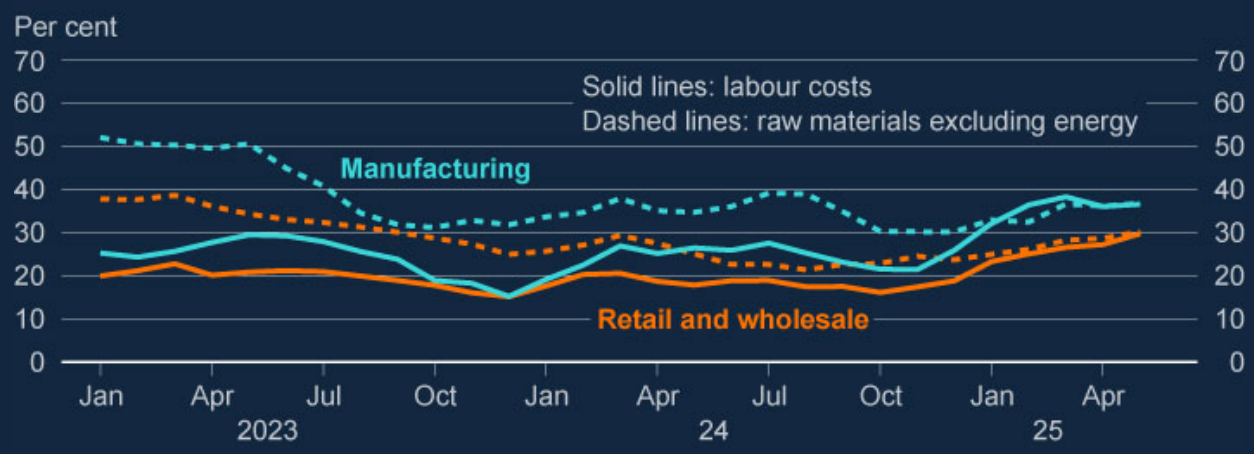
Sources: S&P Global and Bank calculations.

(a) The underlying measures are input price net balances which ask firms whether the price of their inputs are higher, lower, or the same as the previous month. Values are shown as standard deviations from averages between 1992–2019. The final data points are for April 2025.

Higher labour costs are judged to be making an increasing contribution to core goods and food inflation. The share of respondents to the ONS BICS who report that labour costs are a reason for price rises has been rising in recent months for both the manufacturing and wholesale and retail sectors (Chart 2.23). Intelligence from the Bank's Agents also points to labour costs playing an increasing role in core goods and food price inflation, with contacts relating this to elevated wage growth and the recent increases in the NLW and employer NICs.

Chart 2.23: Pay growth is increasingly cited as a driver of price increases among manufacturing and retail firms

Factors causing price increases, percentage share of firms (a)



Sources: ONS and Bank calculations.

(a) The question posed in the survey is 'Which of the following factors, if any, are causing your business to consider raising prices in [the next month]?'. The series shown in the chart are three-month averages of the share of firms choosing each respective answer. Data are not seasonally adjusted. The final data point is taken from the April survey, Wave 130, which refers to the month of May.

Core goods and food price inflation are expected to remain elevated at above their pre-Covid average rates in coming months (Chart 2.21). In addition to the upward pressure on prices from input costs, both sectors face exposure to the Extended Producer Responsibility regulations, which come into effect from October of this year. Contacts of the Bank's Agents report that they have already passed through some of the cost of these regulations but noted that further pass-through is possible in the second half of 2025. The food and hospitality sectors are expected to be particularly affected, due to their higher use of packaging.

Measures of underlying services inflation have continued to slow but remain elevated.

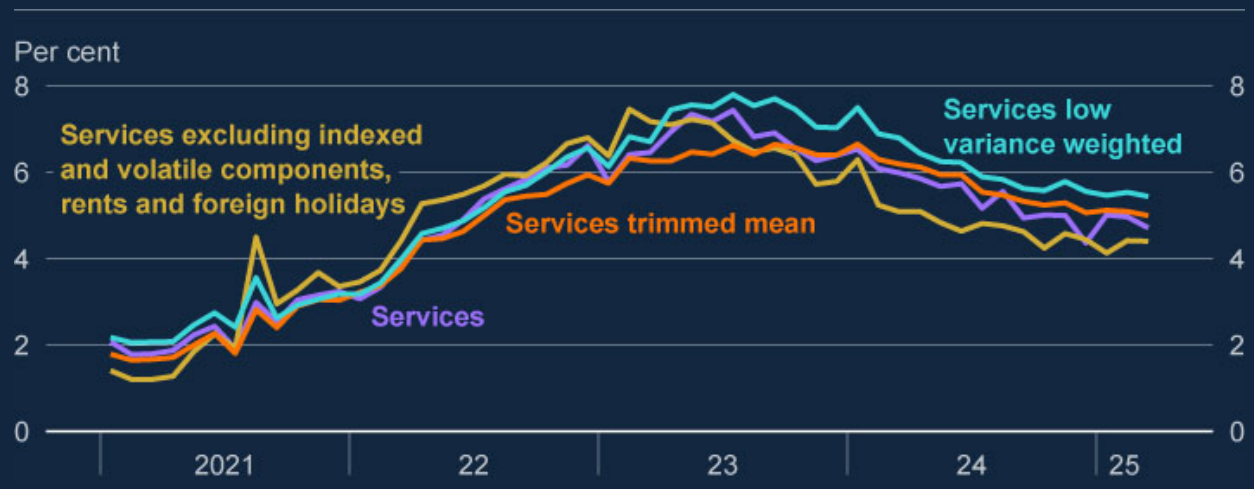
Annual services price inflation has fallen from its peak but remains elevated relative to past averages (Chart 2.21). Headline services price inflation has risen since December 2024, in part reflecting the introduction of VAT on private school fees and the rise in the cap on single bus fares in January, as well as volatility in airfares, but fell back slightly to 4.7% in March, somewhat below the February Report projection. Services inflation is expected to rise slightly to 5.0% in April, reflecting the impact of higher employer NICs, and higher sewerage bills, broadband and phone charges and Vehicle Excise Duty, before falling back a little to 4.6% in

June. Notwithstanding volatility caused by airfares inflation, services inflation is projected to be broadly flat over the coming six months as the effects of higher employer NICs and indexed and regulated prices offset the impact of an easing in pay growth.

Measures of underlying services price inflation have been gradually easing since their peaks in 2023 but remain elevated (Chart 2.24). Results from a model estimated by Bank staff that allows for non-linear relationships between a large range of variables (**Buckmann et al (2023)**) suggests that, as the upward pressure from higher non-labour domestic input costs has faded (aqua bars in Chart 2.25), persistence from wage growth, inflation expectations and past inflation is now the main driver of continued high services inflation (orange bars). As inflation rose in the wake of the pandemic, and high rates of inflation began to influence wage negotiations, the contribution of this component rose sharply. Over time its estimated contribution has fallen but has not yet returned to its past average.

Chart 2.24: Underlying services inflation measures have continued to slow

Measures of underlying services price inflation (a)

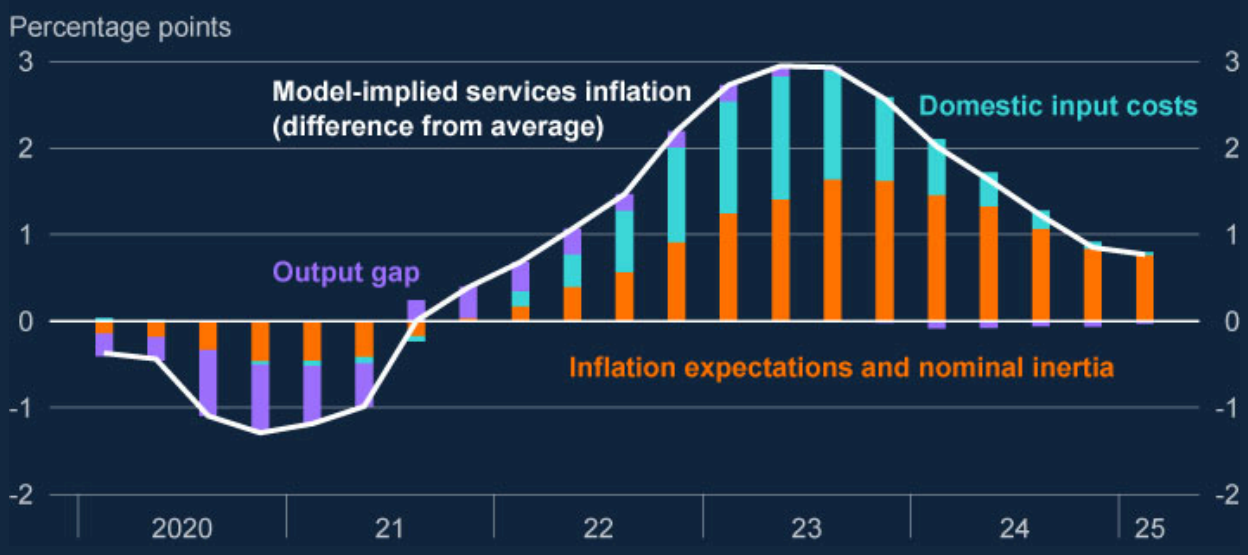


Sources: ONS and Bank calculations.

(a) The low variance measure is calculated by weighting each component of services inflation by the inverse variance of the change in 12-month inflation of that component from 12 months previously. The maximum adjusted weight is capped at twice its original value. Details of the components that have been included/excluded from the 'Services excluding indexed and volatile components, rents and foreign holidays' measure are included in the accompanying spreadsheet published online. All measures are seasonally adjusted. The trimmed mean measure excludes the 10% largest and 10% smallest price changes. The latest data points shown refer to March 2025.

Chart 2.25: The estimated contribution of inflation expectations and past wage and price growth to services inflation is declining but remains elevated

Contributions to model-implied services inflation relative to 1997–2019 average (a)



Sources: OECD, ONS, World Bank and Bank calculations.

(a) Outputs are from a machine-learning model based on a version of the model proposed by **Goulet Coulombe (2024)** and discussed in the Bank Underground post: **Dissecting UK service inflation via a neural network Phillips curve**. Model outputs show one quarter ahead out-of-sample forecasts. Quarterly growth rates are annualised and quarterly fluctuations are smoothed. Bars show contributions to the model-implied services inflation forecast (white line) relative to the mean of 3.3% between 1997 and 2019. Domestic input costs reflect the contribution from past domestic goods inflation, food inflation, energy inflation and input prices. Nominal inertia components include ONS private sector regular pay growth, past services inflation, selected services inflation subcomponents and output prices. Inflation expectations includes household and financial market-based measures of short and long-term inflation expectations. The output gap bars show the impact of a model-implied service inflation-relevant output gap estimate that reflects the contribution from a range of activity indicators as well as the Bank's output gap measure. Contributions may not sum to total due to rounding. The latest data points are for 2025 Q1.

Households' inflation expectations have continued to rise.

Inflation expectations can influence CPI inflation through their impact on wage and price-setting behaviour. The MPC monitors a range of indicators, including surveys of households and companies as well as those derived from financial market prices, to assess whether inflation expectations remain consistent with meeting the 2% inflation target in the medium term.

Having fallen significantly from the end of 2022, survey measures of short-term household inflation expectations have risen since mid-2024. Measures of medium-term inflation expectations have also risen. The Bank of England/Ipsos Inflation Attitudes Survey (IAS) measures of median one and five year ahead inflation expectations rose to 3.4% and 3.6%,

respectively, in 2025 Q1, 0.4 and 0.3 percentage points above their 2010–19 averages (Chart 2.26, left panel). The Citi/YouGov measures of households' short-term and medium-term inflation expectations have risen to more materially above pre-Covid averages (Chart 2.26, right panel).

Chart 2.26: Household inflation expectations have increased

Measures of household inflation expectations (a) (b)

Sources: Bank/Ipsos Inflation Attitudes Survey (IAS), Citigroup, YouGov and Bank calculations.

(a) Left panel shows the median responses from the Bank/Ipsos IAS. Data shown are the one year and five year ahead inflation expectations measures. Dashed lines represent the series averages over 2010–19. A methodological break occurred during the Covid pandemic that means a degree of caution should be taken when making long-run comparisons with these data. The methodology notes linked in the latest **IAS release for February 2025** provide more information. Data are not seasonally adjusted and the latest data points are for 2025 Q1.
(b) Right panel shows the monthly Citi/YouGov survey data. Data shown are the one year and five to ten year ahead inflation expectations measures. Dashed lines represent the series averages over 2010–19. Since August 2022, the YouGov/Citigroup survey has been based on updated response buckets. Data are not seasonally adjusted and the latest data points are for April 2025.

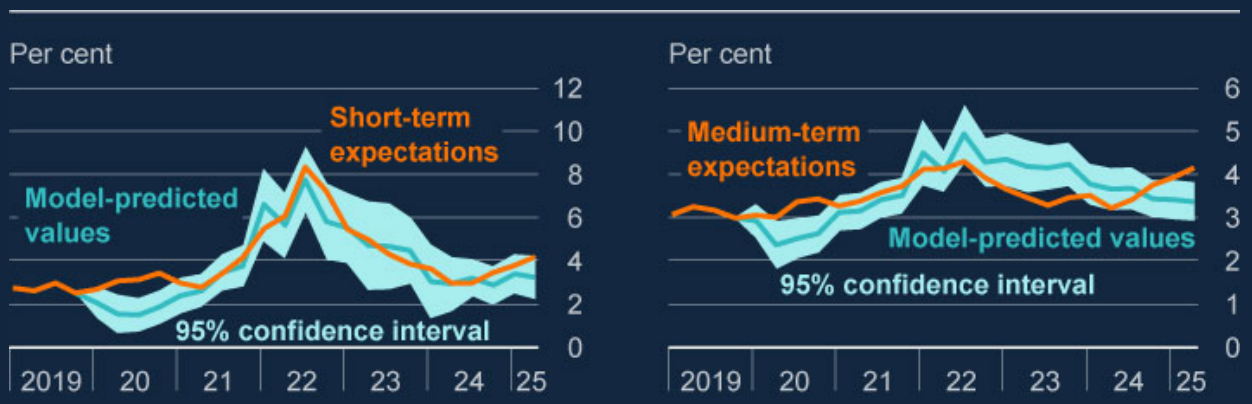
Increases in inflation expectations have been in line with, or a little above, what is implied by the rise in CPI inflation.

Bank staff analysis suggests that rises in short-term household inflation expectations have been towards the upper limit of what would be predicted by a model based on movements in subcomponents of the CPI basket and other economic factors. The estimates shown in Chart 2.27 are taken from models that use lags of food, energy, core goods and services inflation to predict movements in household inflation expectations based on pre-Covid data. The recent rise in short-term inflation expectations has been towards the upper end of what would be expected based on this approach (left panel), while the rise in medium-term expectations has exceeded what the model would suggest (right panel). These results provide tentative

evidence that households' inflation expectations have become more sensitive to price changes since the most recent period of very high inflation. That is consistent with estimates by **Anesti et al (2025)**, which suggest that households' inflation expectations tend to be more sensitive to price changes, specifically changes in food prices, following larger increases in inflation. Box A describes a scenario where elevated responsiveness of inflation expectations to CPI outturns generates second-round effects in CPI inflation that are greater than in the baseline projection.

Chart 2.27: Inflation expectations are in line with, or above, what past relationships would suggest

Citi/YouGov short and medium-term inflation expectations, model-predicted values and confidence intervals (a)



Sources: Citigroup, YouGov and Bank calculations.

(a) Aqua lines show model predictions for short and medium-term household inflation expectations. The dependent variables are quarterly averages of the monthly Citi/YouGov one year ahead (left panel) and 5–10 year ahead (right panel) expectations. The values for April 2025 have been held constant to populate the remaining months in 2025 Q2. The independent variables are lags of food, energy, core goods and services inflation, and controls for economic slack and supply chain disruption. The sample period for estimation is 2005 Q4–2019 Q4 and the confidence intervals shown by the swathes correspond to +/- 2 standard errors.

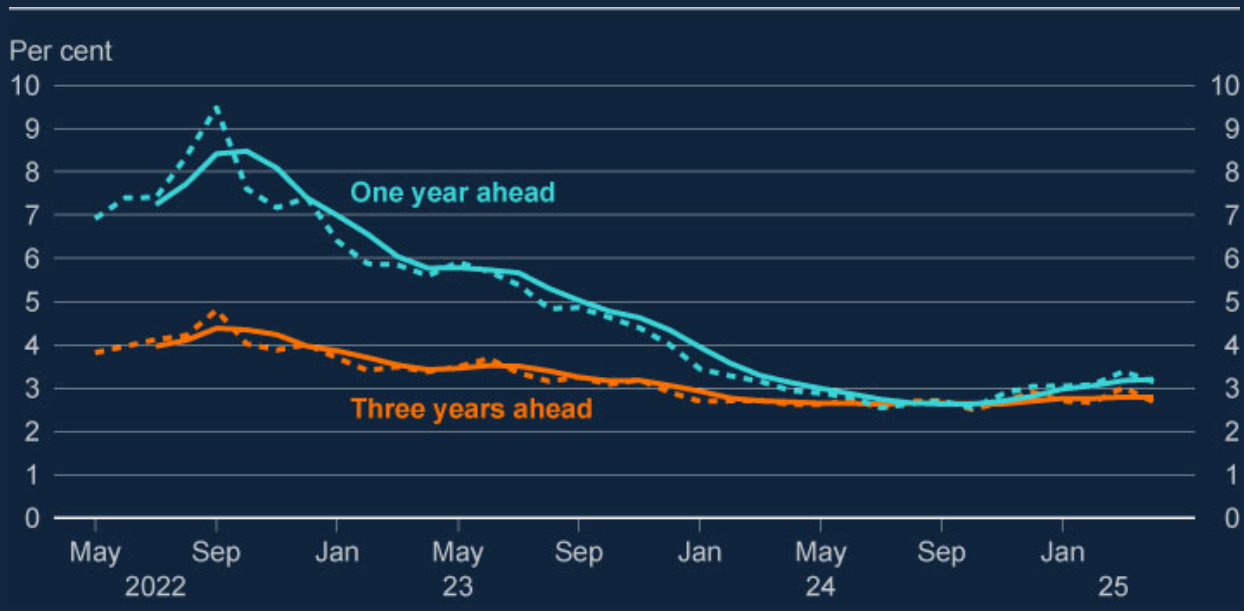
Businesses' medium-term CPI inflation expectations have increased slightly since the start of the year.

CPI expectations of those responding to the DMP Survey have declined from their peaks in 2022 and were stable in 2024. In the three months to April, DMP firms reported one year and three year ahead CPI expectations at 3.2% and 2.8%, respectively, slightly higher than those at the time of the February Report. The average expectation for firms' own price growth one

year ahead was 3.8%, a little lower than at the start of the year but higher than the recent low of 3.5% in mid-2024. Meanwhile the Deloitte CFO survey measure of two year ahead CPI expectations was 2.6% in Q1, slightly higher than the 2.4% figure reported in Q4.

Chart 2.28: Businesses' inflation expectations in the DMP Survey have risen a little in recent months

DMP measures of short-term and medium-term expectations for CPI inflation (a)



Sources: DMP Survey and Bank calculations.

(a) Solid lines show three-month moving averages and dashed lines show the single-month value. One year and three year ahead CPI inflation expectations are responses to the question: 'As a percentage, what do you think the annual CPI inflation rate will be in the UK, one year from now and three years from now?'. The data are not seasonally adjusted and the latest data points are for April 2025.

Market participants' expectations for near-term inflation fell in April, while medium-term market-based inflation compensation measures have also drifted lower.

Market participants' near-term inflation expectations have declined since the February Report. The median respondent to the latest Market Participants Survey expected CPI inflation of 2.3% one year ahead, down from 2.5% in the February Survey. The median expectation for CPI inflation two years ahead was a little lower at 2.1%. Around 70% of respondents viewed recent tariff announcements as likely to weigh on UK CPI inflation. Medium-term inflation expectations derived from financial markets, such as the RPI-reform adjusted measure of five-year, five-year forward inflation compensation, have trended downwards over the past year and a half but remain a little above pre-Covid averages.

The MPC will continue to monitor closely developments in inflation expectations measures.

CPI inflation is expected to have risen sharply in April, accounted for by a higher contribution from energy prices alongside a number of other regulatory changes. Household inflation expectations are elevated and some appear to be higher than suggested by fundamental economic drivers. Firms' inflation expectations are lower, but have risen slightly, while measures implied by financial markets have continued to trend downwards. With inflation set to rise further in coming months there is a risk that higher expectations add to the persistence of inflationary pressures (Box A).

Box C: Implications of developments in global trade policy for the UK economy

The US has implemented new trade tariffs since the February Report.

The US and some of its trading partners have announced significant changes to tariff policies since the February Report, which has prompted large movements in financial markets (Section 2.1). There remains considerable uncertainty about the evolution of global trade policies over coming quarters, and hence the world outlook. This box describes the recent changes in global trade policies and the expected impact of these changes on UK activity and inflation. Box C of the **February 2025 Monetary Policy Report** discussed in more detail the theoretical channels through which these impacts could occur.

The US average effective tariff rate on global imports has risen to its highest level in over a century.

The MPC's baseline projections are conditioned on global and UK trade policies in place as of 29 April 2025. As of this date, the US administration had placed minimum tariffs of 10% on most goods imports into the US, including those from the UK. The US had also placed materially higher tariffs of 145% on imports of most Chinese goods, and of 25% on imports from all countries of specific goods, such as aluminium, steel and automotive products. China had placed a retaliatory tariff of 125% on most imports from the US, while some other countries, including Canada, had introduced more targeted measures in response to higher US tariffs.

On 2 April 2025, the US announced tariffs in excess of 10% on some of its largest trading partners. But on 9 April, a 90-day pause was placed on the implementation of these measures. In response, the European Union paused its own retaliatory tariff measures over this period. The 90-day pause on higher US tariff rates and retaliatory measures by other countries are assumed to continue over the MPC's three-year forecast period. As of 29 April, assuming existing trade flows remain fixed, the effective US tariff rate on global imports is estimated to have increased from around 2% to 23% under the new US administration, its highest level since 1909 (Chart A, left panel). The US administration has indicated that it may introduce further tariffs on imports of specific goods, but that it would consider reducing tariff rates where trade deals could be negotiated.

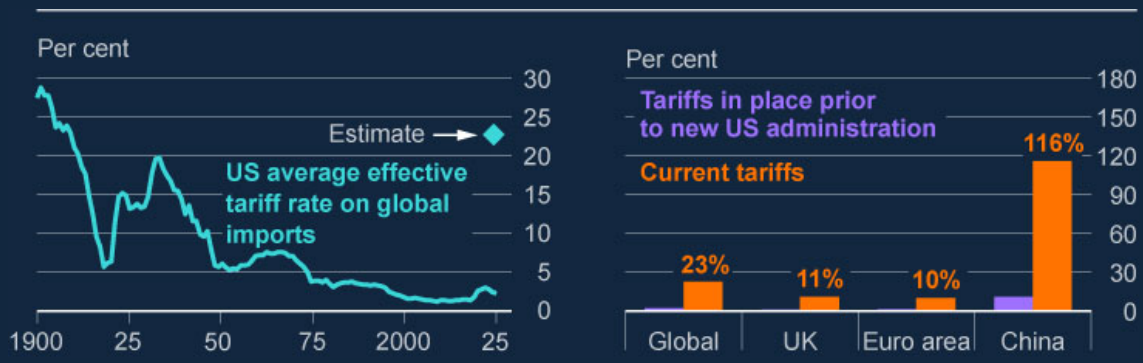
Around £60 billion of UK goods exports, comprising 2% of UK GDP, are directly impacted by new US tariffs.

The US is the UK's second biggest trading partner in both goods and services after the euro area. In 2024, the UK exported £59 billion of goods to the US, accounting for around 16% of total UK goods exports over this period, and 2% of UK GDP. Most UK goods exports are now subject to a minimum US tariff rate of 10%. And around £13 billion of these, comprising £10 billion of automotive goods and £3 billion of raw and derived steel and aluminium products, are subject to a higher tariff rate of 25%. If current trade flows remain unchanged following recent developments, the US effective tariff rate on UK goods exports is estimated to have risen to 11% (Chart A, right panel).

Exports of services, which comprise over two thirds of total UK exports to the US, are not directly impacted by the changes in US trade policies that had been implemented as of 29 April. But some proportion of services exports, for example after-sales services for goods, may be affected indirectly since they are contingent on UK goods exports (Box C of the **February 2025 Monetary Policy Report**). In addition, around £20 billion per year of UK goods and services exports to other countries are used as intermediate inputs to goods and services ultimately destined for the US market. Demand for some of these exports is likely to be impacted indirectly by US tariffs placed on other countries.

Chart A: Effective US tariff rates have risen significantly under the new US administration

US effective tariff rates over time and by region (a)



Sources: US Bureau of Economic Analysis, US International Trade Commission, White House and Bank calculations.

(a) The effective tariff rate is defined as implied customs duty revenue divided by total goods imports for consumption. Bank staff estimates for current effective US tariff rates reflect the trade policies in place as of 29 April 2025 and assume that trade weights and flows remain fixed at 2024 levels. In the current tariff estimates, Bank staff also assume that the share of trade compliant with the free trade Agreement between the US, Mexico and Canada (USMCA) will rise from 2024 levels, with the vast majority of imports from Canada and Mexico adhering to USMCA standards as firms are motivated to demonstrate compliance in response to higher tariffs. A range of external estimates suggest that the US average effective tariff rate on global imports has increased to between 18% and 28% under the new US administration, depending on assumptions, particularly around changes in trade flows and substitution effects in response to tariffs, and the share of USMCA compliant trade.

The MPC has assessed the possible effects of trade policy developments using several macroeconomic models.

The MPC has considered carefully the impact of recent developments in global trade policy on UK activity and inflation in its May forecast. Its baseline projections were informed by estimates derived from several macroeconomic models used by Bank staff. These include models of trade, which account for some of the key channels through which the economies of the UK and other countries might be impacted by recent tariff policy developments (Box C of the **February 2025 Monetary Policy Report**, **Eaton and Kortum (2002)** and **Lisack et al (2022)**). Estimates of the impact of trade policy developments on UK inflation and real activity from these models are similar to those obtained from other models, including the **Kiel Institute's Trade Policy Evaluation (KITE) model**. A structural vector autoregression (SVAR) model has also been used to identify the impact of increases in trade policy uncertainty on inflation and activity across economies (**Caldara et al (2019)**).

Higher tariffs and continued trade policy uncertainty are projected to weigh modestly on UK activity growth.

Recent increases in US tariffs are expected to result in weaker activity growth, both globally and in the UK. For the UK, that partly reflects weaker demand from the US for UK exports, due to the impact of expenditure switching by US consumers away from imports and towards domestic production (Box C of the **February 2025 Monetary Policy Report**). By raising the prices of imports, higher tariffs will also reduce real incomes in those countries where they have been increased, which will further weigh on demand for UK exports.

While there are limited data available since the increases in US tariffs, evidence to date is consistent with a negative impact on UK demand. Some survey data since the recent announcements suggest that the impact of tariffs may be starting to weigh a little on UK activity growth (Section 2.3). And in the latest DMP Survey, nearly 60% of respondents that export goods to the US expected sales to fall over the coming year because of US tariffs (Chart B, left panel).

Global trade policy uncertainty rose sharply after the US presidential election and has risen further since the February Report (Chart B, right panel). This may also weigh on global demand by causing households and businesses to delay spending decisions until the economic outlook becomes clearer (**Haddow et al (2013)**). In turn, that is likely to reduce demand for UK exports. There is currently limited evidence to suggest that trade policy uncertainty is having a large effect on UK activity. But respondents to the April S&P Global UK PMI survey attributed weakness in new export orders to elevated global uncertainty, and around three quarters of respondents to the latest DMP Survey reported that US tariffs were a source of uncertainty for their businesses (Section 2.3). Contacts of the Bank's Agents have also noted an increase in uncertainty related to trade policy developments, with some citing this as a reason to defer investment (Box E).

Trade-related developments in financial markets will also weigh on UK activity growth, although the fall in short-term market interest rates will act in the opposite direction. In the 15 days to 29 April 2025, risky asset prices had fallen relative to the February Report, and implied volatility measures had increased, while sterling had appreciated (Section 2.1). But partly offsetting the expected impact of these developments on UK GDP growth, the market-implied path for Bank Rate had fallen.

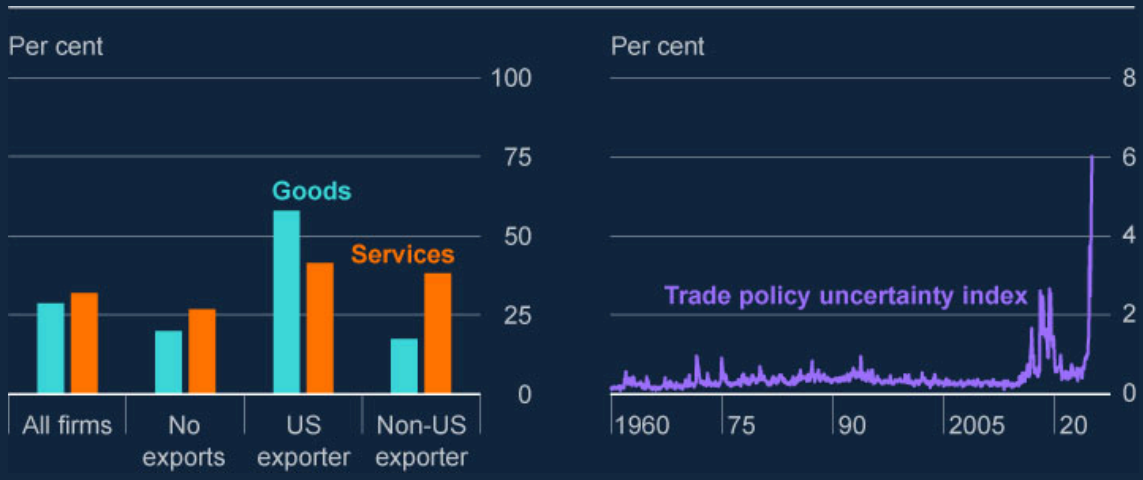
In addition to their impact on demand, the announced increases in US tariffs could also have implications for global and UK supply growth. Empirical evidence shows that there tends to be a significant reduction in productivity in countries that impose higher tariffs (**Furceri et al (2021)**). And over the longer term, any escalation in trade policy

developments that increases global trade fragmentation could result in reduced competition and knowledge transfers between countries (Box C of the **February 2025 Monetary Policy Report**). This would reduce productivity growth in the UK and elsewhere.

In the MPC's latest projections, conditioned on current global trade policies and asset prices, recent trade policy developments are assumed to weigh on UK activity over the forecast period. The negative impact on the level of UK GDP is expected to peak at 0.3% in three years' time. Of this, 0.2 percentage points reflects the direct impact of increases in tariffs due to lower US demand for UK exports and weaker global activity growth. Elevated trade policy uncertainty is assumed to weigh on UK activity by an additional 0.1 percentage point via lower growth in world demand. Falls in risky asset prices and sterling's appreciation since the February Report, which have been largely driven by trade policy developments (Section 2.1), are also expected to weigh on UK GDP over the forecast period. The projected impact of recent trade policy developments on UK activity growth are much smaller than those assumed for the US and China (Section 1.2).

Chart B: Over half of UK firms that export goods to the US are expecting lower sales due to US tariffs, and trade policy uncertainty has continued to rise

Share of respondents to the April DMP Survey that expect a fall in sales over the next year because of US tariffs; share of articles in selected publications discussing trade policy uncertainty (a) (b)



Sources: Caldara et al (2019), DMP Survey and Bank calculations.

(a) The survey results are based on the question: 'How do you expect the implementation of new tariffs on goods entering the United States to affect the sales of your business over the next year?'. The survey took place between 4 and 18 April 2025.
(b) The trade policy uncertainty index reflects automated text search results of the electronic archives of seven newspapers discussing trade policy uncertainty: Boston Globe, Chicago Tribune, Guardian, Los Angeles Times, New York Times, Wall Street Journal, and Washington Post. The data are monthly and the final data point is for March 2025.

Recent global trade developments are also expected to weigh slightly on UK CPI inflation, although the inflationary impacts of higher trade tariffs are uncertain.

While increases in US tariffs are likely to be inflationary for the US (**Barattieri et al (2018)**, the theoretical net impact for the UK is more ambiguous (Box C of the **February 2025 Monetary Policy Report**). On balance, recent data developments suggest that higher tariffs will weigh slightly on UK inflation.

Movements in the sterling exchange rate are important in determining the impact of higher tariffs on UK CPI inflation. While empirical evidence regarding previous increases in tariffs might have suggested a depreciation in sterling in response to recent US measures (**Furceri et al (2021)**), the sterling effective exchange rate has appreciated by a little over 2% since the February Report. This primarily reflects weakness in the US dollar, which market intelligence suggests has been partly driven

by changes in risk sentiment towards US assets and market expectations of weaker US economic growth. Sterling has depreciated against the euro since the February Report (Section 2.1). Overall, the appreciation in the sterling effective exchange rate is likely to weigh on UK inflation by lowering the prices of UK imports.

Weaker world activity and reduced US demand for imports are also likely to weigh on UK CPI inflation by reducing global export prices. Recent falls in UK wholesale natural gas and oil prices can be partly attributed to weaker global demand (Section 2.1). And market contacts have attributed recent falls in some agricultural commodities prices to lower US demand since the imposition of higher tariffs.

There are also several channels through which higher US tariffs may raise UK CPI inflation. As a relatively small and open economy, the UK is very reliant on global supply chains for both imports and exports (**Freeman et al (2024)**). Some increases in US inflation could pass through to UK CPI inflation via higher prices of US exports, reflecting increased costs for US producers using imported intermediate goods or raw materials (**Dhingra (2025)**). Consistent with that, some respondents to the latest DMP Survey expected higher US tariffs to push up their input costs.

The UK economy will also be sensitive to broader supply chain disruptions, such as container shipping shortages, that could lead to relatively fast increases in prices. Data since the most recent rises in tariffs are limited, but indicators of UK supply chain robustness, including container shipping costs, have so far remained relatively stable. This is corroborated by recent intelligence from contacts of the Bank's Agents (Box E). However, some qualitative responses to the April S&P Global US Manufacturing PMI survey suggest that there has been disruption to supply chains for some industries in the US. In the longer term, some firms may also choose to reconfigure their supply chains to reduce exposures to tariffs. A disorderly fragmentation in supply chains could significantly raise inflationary pressures (Box C of the **February 2025 Monetary Policy Report**).

In the MPC's baseline projections, and conditional on current global trade policies and asset prices, including sterling's recent appreciation, the effects of higher trade tariffs weigh on UK CPI inflation by 0.2 percentage points in two years' time and by 0.1 percentage point in three years' time. Most of the impact at the three-year forecast horizon reflects weaker expected US demand for global exports, which weighs on world export prices. UK-weighted world export prices, excluding oil, are projected to be 2% lower than at the time of the February Report, partly driven by a large reduction in Chinese export prices (Section 1.2). Sterling's appreciation since the February Report is also expected to drag a little on UK inflation over the forecast period.

Risks around the impact of trade policy developments on the UK economy are large.

Although the impacts of global trade developments in the MPC's baseline projections are relatively small, risks around these projections are large and two sided, even if trade policies themselves do not change further (Section 1.2). The future constellation of trade policies is impossible to predict at this juncture, and the uncertainty around the main transmission channels means that the impact of even a given set of trade policies on world growth and inflation is hard to estimate with precision. There is also uncertainty about the response of global financial markets to future trade developments, including exchange rates. The Committee will continue to monitor closely developments in global trade policy and their impacts on the UK economy.

Box D: Assessing recent developments in broad money

Developments in broad money can provide signals about longer-run trends in activity and inflation.

Broad money, which includes sterling notes, coins, and deposits held at UK banks and building societies, is the medium of exchange for goods and services. Changes in money balances can contain information about prospects for nominal spending and provide a signal for the inflation outlook (Box B of the **May 2024 Monetary Policy Report**), but that signal tends to be strongest over longer windows of time. In the shorter term, the signal for inflationary pressures can be difficult to assess because changes in broad money holdings can reflect both money demand and money supply factors (**Broadbent (2023)**). On the one hand, if broad money holdings increase for reasons other than a desire for larger holdings of liquid assets, that would imply a disequilibrium between money demand and money supply. That could then indicate upside risks to future spending growth and hence inflation. On the other hand, a fall in broad money holdings that does not reflect a desire for smaller liquid asset holdings could indicate downside risks to activity and inflation.

The higher level of Bank Rate has reduced the attractiveness of broad money holdings over recent years, although money growth has increased somewhat as interest rates have fallen.

Growth in broad money was very strong during the Covid pandemic (Chart A, left panel), reflecting a combination of resilient bank lending growth, spending restrictions on households, and the effects of quantitative easing (Box B of the **May 2024 Monetary Policy Report**). But growth in broad money subsequently weakened, particularly in 2023.

More restrictive monetary policy tends to weigh on money growth, primarily by reducing growth in net lending, which is typically the main source of money creation. Consistent with that, growth in secured net lending to households has been subdued in recent years, as increases in Bank Rate have incentivised households to pay down existing debt and discouraged additional borrowing. Growth in net bank lending to private non-financial corporations (PNFCs) has also been weak since 2023, as businesses repaid pandemic-era loans and restrictive monetary policy reduced demand for credit.

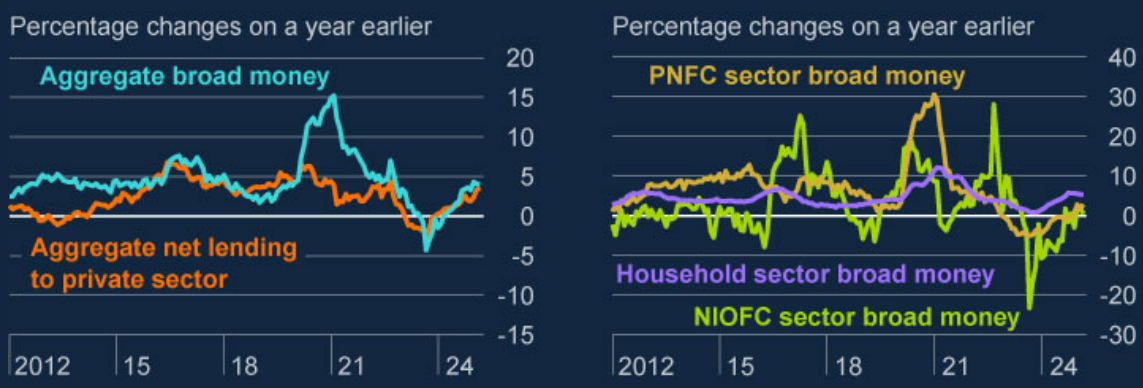
Net secured lending growth to households has started to pick up somewhat as household interest rates have fallen (Section 2.2), which in turn has led to a rise in broad money growth (Chart A). Further market-implied reductions in Bank Rate over

coming years (Section 2.1) should support a continued recovery in net lending to households. That said, market intelligence suggests that some of the recent strength in household secured lending, and in turn household money growth, may have also reflected temporarily increased demand for house purchases ahead of changes to Stamp Duty Land Tax from April. Banks responding to the latest **Credit Conditions Survey** expected demand for secured lending for house purchases to be flat over 2025 Q2 (Section 2.2).

Growth in bank lending to PNFCs has also picked up slightly as some of the restrictiveness of monetary policy has been withdrawn over recent quarters. But the 2025 Q1 **Credit Conditions Survey** indicated that demand for credit was expected to remain weak in the near term, particularly for small and medium-sized enterprises (SMEs).

Chart A: Most measures of broad money growth were weak following the pandemic but have picked up a little more recently

Growth rates in aggregate and sectoral broad money measures (a)



Sources: Bank of England and Bank calculations.

(a) Aggregate broad money captures M4 excluding the deposits of intermediate other financial corporations. **Further details about sectoral analysis of M4 and M4 lending data** provides more information on what is captured within each sector. The final data points are for March 2025.

> **Quantitative tightening (QT) and the unwinding of the Term Funding Scheme with additional incentives for SMEs (TFSME) have weighed on broad money growth.**

The Bank has conducted sales of gilts since November 2022. This typically weighs on growth in broad money by initially reducing the deposits of those buying the gilts. Market intelligence suggests that non-intermediary other financial corporations

(NIOFCs), which include pension funds and asset managers, have been buyers of gilts during this period. And this sector has generally experienced weak money growth since the start of QT, despite some stronger flows over recent months (Chart A, right panel). But various second-round effects mean that, as expected, the overall impact of QT on broad money balances has been smaller than the aggregate reduction in gilt holdings in the Bank of England's Asset Purchase Facility. For example, UK banks have been significant buyers of gilts, which has led to a lower reduction in deposits, and hence broad money, than if UK private sector residents had been the sole buyers of gilts during QT. Bank staff continue to judge that the tightening impact of QT on the real economy is smaller than the stimulus associated with quantitative easing (Box A of the **August 2024 Monetary Policy Report**).

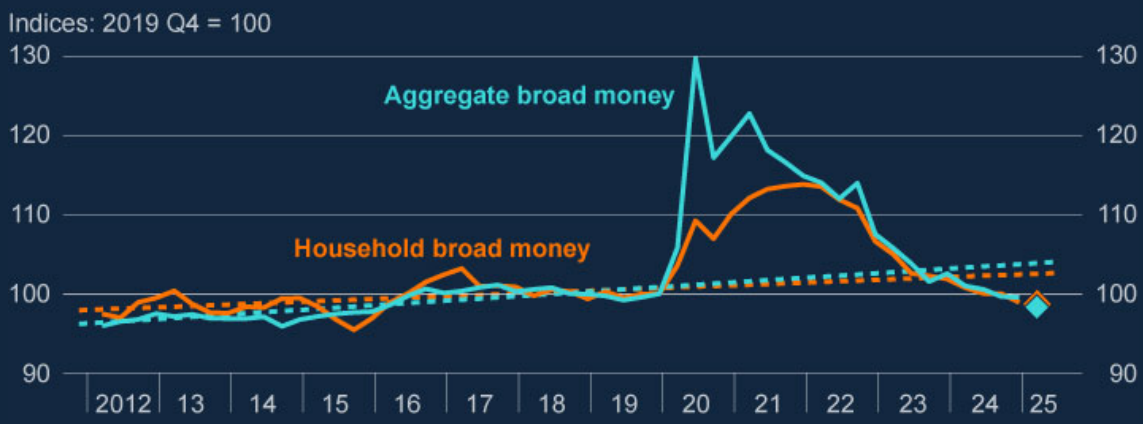
The continued unwinding of the TFSME also appears to have weighed indirectly on broad money growth in recent years. Banks have increased wholesale debt issuance alongside repayment of TFSME drawings, which will have reduced the deposits of those purchasing this debt.

> **The ratio of aggregate broad money to nominal GDP has fallen below its pre-pandemic trend.**

Strength in broad money growth during the pandemic meant that the ratio of aggregate broad money to nominal GDP increased markedly over this period. But the money overhang that emerged during the pandemic was subsequently eroded (Box B of the **May 2024 Monetary Policy Report**), in part due to the effects of restrictive monetary policy. And while broad money growth has picked up since 2024, it has risen more slowly than nominal GDP, meaning that the ratio of aggregate broad money to nominal GDP has continued to fall and is below its pre-pandemic trend (Chart B).

Chart B: Following the erosion of the money overhang from the pandemic, the ratio of aggregate broad money to nominal GDP has fallen below its pre-pandemic trend

Ratios of aggregate broad money to nominal GDP and household broad money to household gross disposable income (a)



Sources: Bank of England, ONS and Bank calculations.

(a) Aggregate broad money captures M4 excluding the deposits of intermediate other financial corporations. **Further details about sectoral analysis of M4 and M4 lending data** provides more information on what is captured within the household sector. Aggregate and household broad money data are break-adjusted time series. The dashed lines show the 2012–19 linearly estimated trends in the ratios of aggregate broad money to nominal GDP, and household broad money to household gross disposable income, projected forward. The final data points are diamonds showing provisional estimates for 2025 Q1, using the latest Bank staff projections for nominal GDP and household gross disposable income.

> **The fact that the broad money to nominal GDP ratio is below trend could indicate downside risks to nominal activity and inflation, but there are significant uncertainties around this conclusion.**

Taken at face value, the continued fall in the ratio of aggregate broad money to nominal GDP to below its previous trend could indicate some downside risks to activity and inflation. But there are significant uncertainties around this conclusion. The trend in the broad money to nominal GDP ratio may have flattened since 2016 (Chart B), and that would reduce the extent of any downside risks to the outlook for activity and inflation. Furthermore, if the continued fall in the broad money to nominal GDP ratio has been driven by a reduction in desired money holdings, rather than a shortfall in the amount of money supplied relative to desired holdings, that would also imply much smaller risks to activity and inflation. All else equal, continued transmission of previous

and further market-implied reductions in Bank Rate to household and corporate interest rates should continue to support net lending growth, and hence growth in broad money (Sections 2.1 and 2.2).

The MPC will continue to monitor developments in broad money closely for any signals about longer-run trends in nominal activity and inflation.

Box E: Agents' update on business conditions

This box presents a summary of the Agents' intelligence gathered in the six weeks to end-March (prior to the 2 April US tariff announcements) that was considered by the MPC at its May meeting. It has been complemented with more focused discussions during April to understand UK firms' early reactions to the US tariff announcements.

Abstracting from the tariff-induced uncertainties, there has not been a lot of news since the **Agents' summary of business conditions – 2025 Q1** across most areas of activity, although sentiment is worse. Contacts are more uncertain about a meaningful recovery over 2025, owing to the international outlook and increased concerns over domestic demand.

Employment intentions remain slightly negative. Recruitment difficulties remain at normal levels. Firms across sectors report some spare capacity emerging where there is subdued demand.

There has been little news on pay settlements or planned responses to the changes to employer National Insurance contributions (NICs) and the National Living Wage (NLW). Recent company visits continue to suggest average pay settlements for 2025 of 3.5%–4%, consistent with the 3.7% from the 2025 Agents' annual pay survey. In response to NICs changes some firms say they are likely to offer pay settlements of 1–2 percentage points less than otherwise. All employers are looking to try to mitigate higher costs somehow.

Inflation in raw materials and imported finished goods is turning modestly positive. Contacts still expect a pickup in goods CPI inflation. Services CPI inflation is easing only gradually.

> **Most contacts expect consumer demand to remain weak in 2025 but are cautiously optimistic of a slight improvement later in the year should household confidence improve.**

Supermarkets report relatively modest volume growth but have needed to discount more heavily to drive demand. Other retailers have also relied on discounting to boost sales, especially in clothing where there is some evidence of sales starting earlier than usual. Despite increased discounting behaviour, goods prices are still rising.

Casual dining venues are also offering discounts and promotions to a greater extent than usual and are still only maintaining stable volumes at best. Demand for foreign travel services is as robust as last year as households prioritise holidays over other

discretionary spending.

Investment intentions remain marginally negative for the year ahead.

Many contacts continue to cite pressures such as a weak demand outlook and higher labour costs as reasons to defer investment. Uncertainty about the global outlook, including in relation to US trade policy, and the impact on domestic demand have increased since the previous round. There are exceptions including from sectors with strong demand such as aerospace and defence, and there are significant utilities infrastructure investments commencing or planned.

Labour cost inflation is encouraging some contacts in manufacturing and business services to prioritise spending on automation even while they cut or delay investment elsewhere.

Contacts expect the growth rate of services export values to remain steady and consider the impact of tariffs to be mostly a risk to a recovery in goods exports.

Professional and financial services report increased export revenues, apart from IT. International student numbers are well down on last year, owing to visa changes, a weak Chinese economy and greater competition. Goods exporters to the euro area continue to report falling demand, particularly from France and Germany, only partially offset by growth from the US and elsewhere. Food and drink exporters report marginal growth, except for whisky where global demand has fallen significantly. Exporters to the defence and aerospace sectors report continued strong growth.

The Agents' regular intelligence cycle has been complemented with more focused discussions during April to understand better firms' early reactions to the US tariff announcements. Uncertainty remains the primary concern among manufacturing contacts. Following the 90 day pause in tariffs, those directly exporting to the US are now waiting to see the permanent change in tariffs and how these may impact both their customers and competitors. Those seeking to grow exports to the US are less confident this will be achievable. Manufacturers with international supply chains report little change and expect any changes to be relatively slow given that making adjustments to sourcing is often a complex process. Some contacts report rerouting of shipments from the US to European and UK ports, but the impact on UK pricing remains uncertain at this stage.

Although contacts still expect some increase in business services revenue growth later in the year, many say subdued demand and the international outlook could delay that improvement.

Legal, audit and tax services remain buoyant, supporting professional services revenue growth. Contacts report slower annual growth in banking, consultancy, IT and mergers and acquisitions activity reflecting uncertainty about the domestic and international outlook. Modest recovery in the corporate events and hospitality sectors continues. Recruitment agencies continue to report declining activity, although some noted that the recent weak demand for temporary staff is turning around. Architects report stronger demand, but demand for the services of other construction firms remains weak. Logistics contacts report broadly stable volumes.

Fewer manufacturing contacts expect to see growth in 2025 with low business confidence and the consequences of US tariffs expected to limit activity.

The continuing uncertainty weighing on investment decisions, described above, is reducing demand for capital and intermediate goods. Contacts report improved demand for some suppliers into construction owing to a continuing slight pickup in housebuilding, but overall output remains slightly lower than the same time last year. Food and drink producers continue to report marginal growth, while demand for other consumer goods continues to fall as discretionary spending is reduced. Defence and aviation firms remain strong, with steady output growth.

Contrary to expectations of near-term stabilisation, the annual rate of decline in construction output worsened slightly as more projects were delayed in Q1.

Some larger public sector projects are being delayed but there are signs of pickup in health and education. Some private industrial development is progressing, while some new commercial development starts were paused. Building of private housing is marginally ahead but down in social housing. Planning, utility connections, costs and some labour shortages continue to be cited as constraints on growth. Contacts increasingly expect a meaningful pickup in activity to happen in 2026.

Overall employment is flat and employment intentions remain slightly negative.

Those firms holding headcount flat continue to mention recruitment freezes and taking a wait and see approach as to whether the economy picks up. Sectors that are more likely to be affected by the higher NLW and NICs are more pessimistic about the employment outlook, often mentioning headcount reductions through natural attrition or redundancies. The increase in NICs is encouraging some businesses to seek productivity and efficiency gains through technology. However, others claim to have already maximised potential gains from these efficiencies and will need to explore alternative cost-saving measures or accept reduced profit margins.

Recruitment difficulties remain at normal levels. Some spare capacity has opened up with contacts across different sectors reporting lower utilisation levels, primarily in response to subdued demand.

Intelligence continues to suggest average pay settlements for 2025 will be 3.5%–4.0%, in line with the 3.7% from the 2025 Agents' annual pay survey.

Many contacts face a significant increase in total labour costs due to the employer NIC changes. For those employing relatively high proportions of part-time or low-paid workers, the threshold change has particularly large impact. To offset these increases firms are taking various measures including raising prices where possible, absorbing costs through margins, implementing efficiency gains, reducing headcount, and cutting investment. Some are likely to offer pay settlements of 1–2 percentage points lower than otherwise.

The main upside risk to wage settlements comes from the increase in the NLW and the restoration of eroded differentials for staff whose pay is just above the NLW. Some unions are also requesting above-inflation pay increases, with agreements typically above 4%.

Contacts report that inflation in raw materials and imported finished goods has turned modestly positive.

Inflation for imported finished goods has increased to 1%–2%, reflecting modest increases in underlying costs. Contacts are wary of the impact of US tariffs. While they do not expect changes in market prices in the very short term, they are concerned about future volatility in imported product costs and exchange rates. The price of goods manufactured domestically is increasing modestly, as companies pass on small portions of their higher input and labour costs, when demand and competitive pressures allow.

Business to business price inflation is easing gradually. Contacts continue to report elevated inflation of 5%–10% for cybersecurity, technology support and audit services. There is more client pushback on pricing of services such as accountancy and law resulting in price increases of 1%–3%, which is weaker than last year.

Underlying consumer goods price inflation is rising reflecting producers, wholesalers and grocers passing on their higher labour and extended producer responsibility costs. Contacts expect food price inflation of 3%–4% and non-food goods inflation of 1%–3% over 2025.

Consumer services inflation is easing only modestly. Consumer services companies are passing on their higher labour and input costs. Where demand is weak, there is less pass-through unless margins are already too squeezed. Where supply is constrained by skills, elevated price rises continue.

Contacts report improved credit supply from high street banks and private capital markets. Credit demand is weak but rising, particularly for working capital.

High street banks seem more willing to lend, including to small and medium-sized enterprises, as interest rates fall and property valuations stabilise. Competition between lenders seems to be increasing. But retail, hospitality and construction contacts say banks still seem reluctant to lend to them and small firms often find the only available finance is from expensive alternative lenders.

Regarding credit demand, borrowing for investment remains weak and some small businesses are still paying down Covid debt. More than offsetting that, some property developers are looking to increase their borrowing, and demand for working capital has risen due to growing turnover, a squeeze on liquidity as large clients delay payments, and the rise in NLW and NICs. This is leading to concerns that the business failure rate of small firms in construction, retail and hospitality will remain high in 2025 and could rise.

There was a small improvement in sentiment in the housing market, although caution remains over the direction of the market in the coming months.

Estate agents reported a slightly improving outlook with an increase in activity ahead of stamp duty increases. The exception was the top end of the market where demand has slowed noticeably. House prices are forecast to increase by low single digit percentages this year.

Rent inflation continues to slow, although supply remains tight. Landlords continue to exit the market with the upcoming Renters Reform Bill causing particular concern for those with houses of multiple occupancy and student let portfolios.

Housing associations are awaiting the outcome of the government spending review before committing to building plans in the medium term. Contacts report more instances of increases in rent arrears and tenants struggling with the cost of living.

Annex: Other forecasters' expectations

This annex reports the results of the Bank's most recent survey of external forecasters. Responses were submitted in the two weeks to 29 April and are summarised in Chart A. These are compared with the MPC's baseline projections, which are conditioned on a range of assumptions (Section 1.1) that may differ from those made by external forecasters.

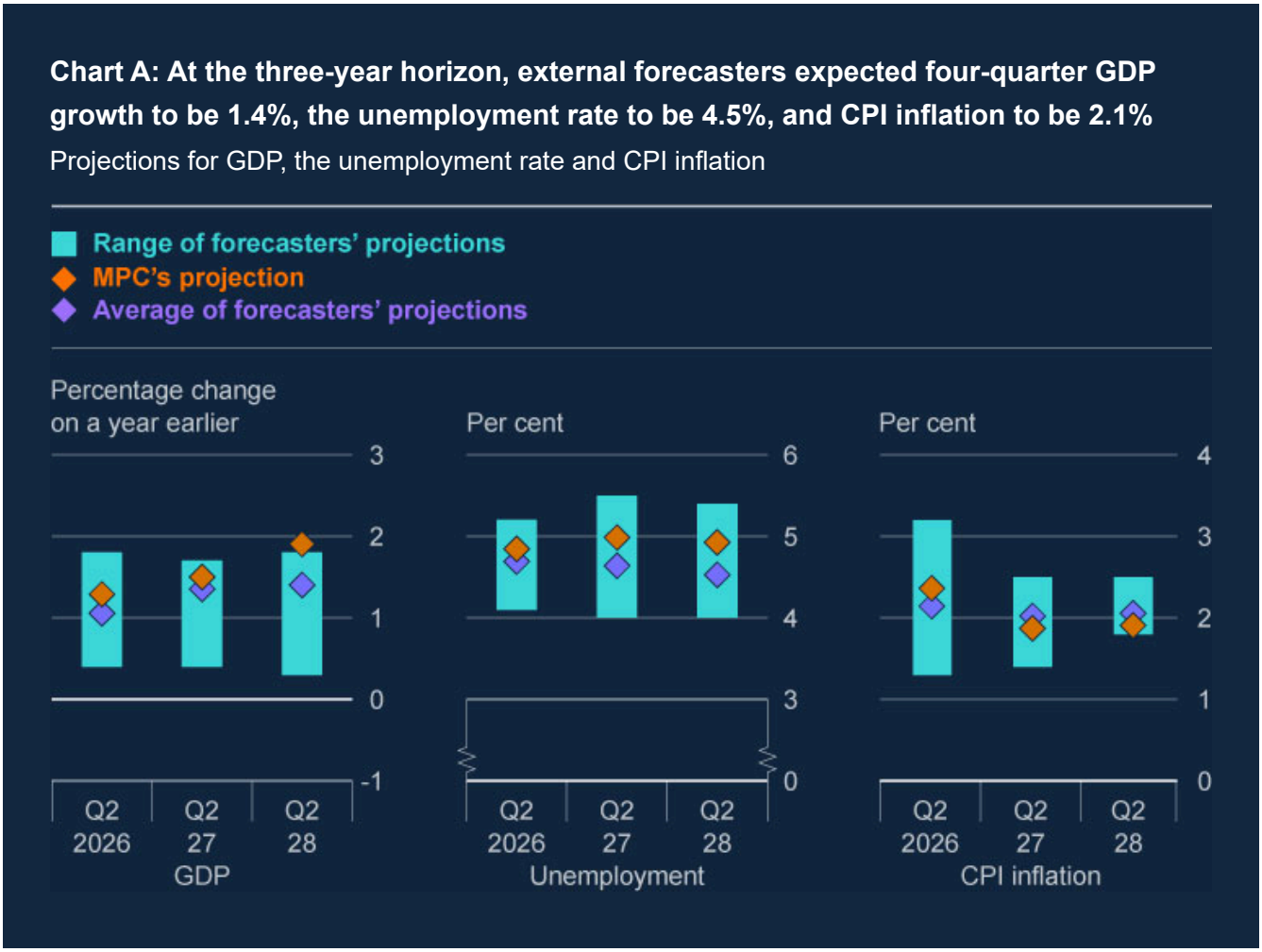
On average, external forecasters expected GDP to rise by 1.1% over the four quarters to 2026 Q2, with four-quarter growth of 1.4% in 2027 Q2 and 2028 Q2 (Chart A, left panel). The average external forecast is a little below the MPC's projections for 2026 Q2 and 2027 Q2 of 1.3% and 1.5%, respectively, and further below the MPC's 2028 Q2 projection of 1.9%.

External forecasters expected the unemployment rate to be 4.7% in 2026 Q2, slightly below the MPC's projection of 4.8% (Chart A, middle panel). They expected the unemployment rate to fall to 4.6% in 2027 Q2 and to 4.5% in 2028 Q2. By comparison, the MPC's projection increases to 5.0% in 2027 Q2 before falling to 4.9% in 2028 Q2.

CPI inflation was expected to be 2.1% in 2026 Q2, below the MPC's projection of 2.4% (Chart A, right panel). The average external forecasts for 2027 Q2 and 2028 Q2 were 2.0% and 2.1%, respectively. The MPC's projections are 1.9% in both 2027 Q2 and 2028 Q2. The range of external forecasts for CPI inflation in 2026 Q2 was fairly wide, but narrower for 2027 Q2 and 2028 Q2.

Chart A: At the three-year horizon, external forecasters expected four-quarter GDP growth to be 1.4%, the unemployment rate to be 4.5%, and CPI inflation to be 2.1%

Projections for GDP, the unemployment rate and CPI inflation



Glossary and other information

Glossary of selected data and instruments

AWE – average weekly earnings.

CPI – consumer prices index.

CPI inflation – inflation measured by the consumer prices index.

DMP – Decision Maker Panel.

ERI – exchange rate index.

GDP – gross domestic product.

HICP – harmonised index of consumer prices.

LFS – Labour Force Survey.

M4 – UK non-bank, non-building society private sector's holdings of sterling notes and coin, and their sterling deposits (including certificates of deposit, holdings of commercial paper and other short-term instruments and claims arising from repos) held at UK banks and building societies.

OIS – overnight index swap.

PCE – personal consumption expenditure.

PMI – purchasing managers' index.

RPI – retail prices index.

Abbreviations

BCC – British Chambers of Commerce.

BICS – Business Insights and Conditions Survey.

CBI – Confederation of British Industry.

CFO – chief financial officer.

CIPD – Chartered Institute of Personnel and Development.

CIPS – Chartered Institute of Purchasing and Supply.

ECB – European Central Bank.

FNAB – food and non-alcoholic beverages.

FPC – Financial Policy Committee.

FTSE – Financial Times Stock Exchange.

GfK – Gesellschaft für Konsumforschung, Great Britain Ltd.

HMRC – His Majesty's Revenue and Customs.

IAS – Inflation Attitudes Survey.

ILO – International Labour Organization.

IMF – International Monetary Fund.

IT – information technology.

KITE – Kiel Institute's Trade Policy Evaluation.

LTV – loan to value.

MIDAS – mixed-data sampling.

MPC – Monetary Policy Committee.

MPR – Monetary Policy Report.

MTIC – missing trader intra-community.

NICs – National Insurance contributions.

NIOFC – non-intermediate other financial corporation.

NLW – National Living Wage.

OBR – Office for Budget Responsibility.

OECD – Organisation for Economic Co-operation and Development.

Ofgem – Office of Gas and Electricity Markets.

ONS – Office for National Statistics.

OPEC – Organization of the Petroleum Exporting Countries.

PAYE – Pay As You Earn.

PNFC – private non-financial corporation.

PPP – purchasing power parity.

QT – quantitative tightening.

REC – Recruitment and Employment Confederation.

RTI – Real-Time Information.

S&P – Standard & Poor's.

SME – small and medium-sized enterprise.

SVAR – structural vector autoregressive.

TFSME – Term Funding Scheme with additional incentives for SMEs.

USMCA – United States, Mexico and Canada.

VAT – Value Added Tax.

Symbols and conventions

Except where otherwise stated, the source of the data used in charts and tables is the Bank of England or the Office for National Statistics (ONS) and all data, apart from financial markets data and results from the Decision Maker Panel (DMP) Survey, are seasonally adjusted.

n.a. = not available.

Because of rounding, the sum of the separate items may sometimes differ from the total shown.

On the horizontal axes of graphs, larger ticks denote the first observation within the relevant period, eg data for the first quarter of the year.