

Bank of England

Monetary Policy Report

Monetary Policy Committee

July 2026



Monetary policy at the Bank of England

The objectives of monetary policy

The 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.

The Monetary Policy Report

The MPC is committed to clear, transparent communication. The Monetary Policy Report is a key part of that.

We have made some changes to the structure and content of the Report so that it reflects better the wide range of inputs that are informing monetary policy, as explained in this [Quarterly Bulletin article](#). The purpose of the document is to set out the analysis that informed policy discussions.

The Report is produced quarterly by Bank staff under the guidance of the members of the MPC. It 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 www.bankofengland.co.uk/monetary-policy-report/2026/july-2026. The 'Projections Databank' is an additional Excel spreadsheet containing a wide range of information relating to the central projection, as well as projections for the scenarios.

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Monetary Policy Summary

At its meeting ending on 29 July 2026, the Monetary Policy Committee (MPC) voted by a majority of 6–3 to maintain Bank Rate at 3.75%. Three members voted to increase Bank Rate by 0.25 percentage points, to 4%.

In response to events in the Middle East, crude and refined energy prices have remained volatile and higher than pre-conflict. The impact of the energy shock on the UK economy remains uncertain. Monetary policy cannot influence energy prices but is being set to ensure that the economic adjustment to them occurs in a way that achieves the 2% inflation target sustainably. The policy stance required to achieve this will depend on the scale and duration of the shock, and how it propagates through the economy including via financial conditions.

CPI inflation has fallen to 2.6% since the previous meeting, although it is expected to rise later this year as the effects of higher energy prices continue to pass through. The risk of material second-round effects in price and wage-setting, against which policy needs to lean, is greater the longer higher energy prices persist. There is little evidence so far to suggest such effects, and there have continued to be clear signs of underlying disinflation in recent data. Loose labour market conditions, and higher interest rates faced by households and businesses than prior to the conflict, will also act to reduce inflation over time. The Committee judges that the risks to the inflation outlook are tilted to the upside relative to the central projection in the July Monetary Policy Report, but there remains scope for the outlook to change materially as events in the Middle East unfold.

The Committee judges that it is appropriate to maintain Bank Rate at this meeting. The Committee stands ready to act as necessary to ensure that CPI inflation remains on track to meet the 2% target in the medium term.

Monetary Policy Overview

The situation in the Middle East is volatile and continuing to have a material effect on the outlook for UK inflation.

CPI inflation was 2.6% in June, above the MPC's 2% target. There are clear signs that underlying price and wage pressures have continued to ease. But that has been offset by higher global energy prices as a result of the conflict in the Middle East, which have led to higher motor fuel prices for UK consumers.

Inflation is likely to rise over the rest of this year as higher global energy prices continue to feed through into UK consumer prices. That is due to a mix of the direct effects of higher global prices on household utility prices, and indirect effects, as companies at home and abroad pass on increases in their energy costs through supply chains.

The MPC cannot influence global energy prices. What the MPC is doing is setting monetary policy to make sure that the effects of the shock do not become embedded so that inflation falls back to the 2% target and stays there.

The MPC's current approach to setting interest rates, including today's decision, is based on two key judgements.

Key policy judgement 1

Weakness in economic activity and demand for labour is likely to help contain the strength of second-round effects from higher energy prices. But the outlook is uncertain and the risk of strong inflationary pressures continues to be greater than the risk of weak inflationary pressures.

The outlook for UK inflation continues to be shaped by two key uncertainties: the size and duration of the energy price shock; and how higher energy prices transmit through the economy, in particular whether they affect wage and price-setting behaviour and feed through into broad-based inflationary pressures – often referred to as second-round effects.

The size and duration of the energy price shock affects the strength of inflationary pressures through its direct and indirect effects. The more that the prices of oil, gas and refined energy products such as jet fuels and diesel rise, and the longer they stay high, the bigger the direct and indirect effects boosting inflation will be.

Second-round effects are also likely to be stronger the larger and more long-lasting the energy price shock is. For example, higher inflation arising from larger direct and indirect effects could feed through via higher inflation expectations into companies' price-setting behaviour. Higher inflation could also make it more likely that workers will bargain for wage increases to maintain the purchasing power of their pay and that companies agree to those demands – which in turn would push up their costs and could lead them to raise prices by more. These interactions between the energy shock, inflation expectations, wages and prices would amplify the effects of higher energy prices on inflation.

As in April, the MPC continues to judge that weakness in economic activity and demand for labour is likely to help contain the strength of second-round effects, by limiting companies' pricing power and workers' ability to bargain for higher wages. This judgement is also supported by developments in broad money (Box E: What signal can developments in broad money provide for the economic outlook?).

But other factors could lead to greater second-round effects. High inflation over the past five years may have made inflation expectations more sensitive to inflation than in the past. Household inflation expectations could also rise by more as inflation is likely to be driven by the prices of highly visible items, such as energy and food. There could also have been changes to the way that companies adjust wages and prices in response to higher inflation, adding to inflationary pressures.

So far, there are few signs of second-round effects (Box B: Evidence on second-round inflation effects from the recent energy price rise). But there is not enough evidence yet to rule out this risk, and the MPC will continue to monitor evidence closely (Box A: A framework for monitoring second-round effects of higher energy prices).

Aside from energy prices, other global developments could add to inflationary pressures (Box D: What do global developments imply for the UK inflation outlook?). For example, rapid expansion of AI capacity is boosting the price of essential inputs, such as microchips, adding to companies' cost pressures. And disruption to food supplies as a result of extreme weather events, for example a particularly strong El Niño, could lead to higher food price inflation.

Overall, the MPC judges at this time that second-round effects will probably be moderate. But the outlook is uncertain and the risk of strong inflationary pressures continues to be greater than the risk of weak inflationary pressures.

Key policy judgement 2

Monetary policy is weighing on inflation. The MPC is continuing to set policy to balance the costs of leaning too little against potential inflationary pressures and the costs of responding too much. The amount policy needs to lean, and the level of Bank

Rate to achieve that, could change depending on how the outlook evolves.

Because the outlook is uncertain, the MPC needs to consider a range of possible outcomes and balance the costs of leaning too little against potential inflationary pressures and the costs of responding too much.

To inform its policy deliberations, the MPC has considered a central projection that is judged to provide a reasonable baseline alongside two scenarios that help to show how the outlook for UK inflation might differ given uncertainty about the path of global energy prices and strength of second-round effects (Section 3). These projections, which were conditioned on the path implied by market interest rates in the 15 working days to 20 July, are neither all-encompassing nor do they reflect the full distribution of risks. But they reflect key considerations in the MPC's policy discussions.

The model-based policy simulations in Section 3.3 of the Report help the MPC to consider what is the right amount to lean against potential inflationary pressures given the MPC's judgement that the risk of strong inflationary pressures in coming years is greater than the risk of weak inflationary pressures (Key policy judgement 1), by showing how well different monetary policy responses might perform in returning inflation to the 2% target if it were known for sure how the outlook would evolve.

The market curve underlying the projections captures both expectations about the future path of Bank Rate and risk premia (Box F: Developments in UK financial conditions). The interest rates faced by households and businesses are affected by the overall level of market rates, not by what has driven the move. So the illustrative policy paths in Section 3.3 should be interpreted as exploring alternative overall policy stances, rather than being read as alternative paths for Bank Rate.

- For the central projection, the illustrative policy rules are similar to the market curve over the coming year but lower after that.
- For the milder scenario, the illustrative policy rules are also similar to the market curve over the coming year and lower after that, and are somewhat lower than for the central projection.
- And for the adverse scenario, the illustrative policy rules are higher than the market curve.

At this meeting, the MPC decided it was appropriate to hold Bank Rate at 3.75%. Monetary policy is weighing on inflation, particularly once broader financial conditions are taken into account, and helping to insure against the risk of stronger inflationary pressures.

Where Bank Rate goes from here will depend on how the evidence, inflation outlook and risks around the outlook evolve, including the extent to which higher energy prices seem likely to generate strong inflationary pressures as they feed through the economy. However events

unfold, the Committee stands ready to act as necessary to ensure that CPI inflation returns to the 2% target and stays there.

1: Current economic conditions

1.1: Inflation

CPI inflation was 2.6% in June; further progress on underlying disinflation has been offset by higher motor fuel prices.

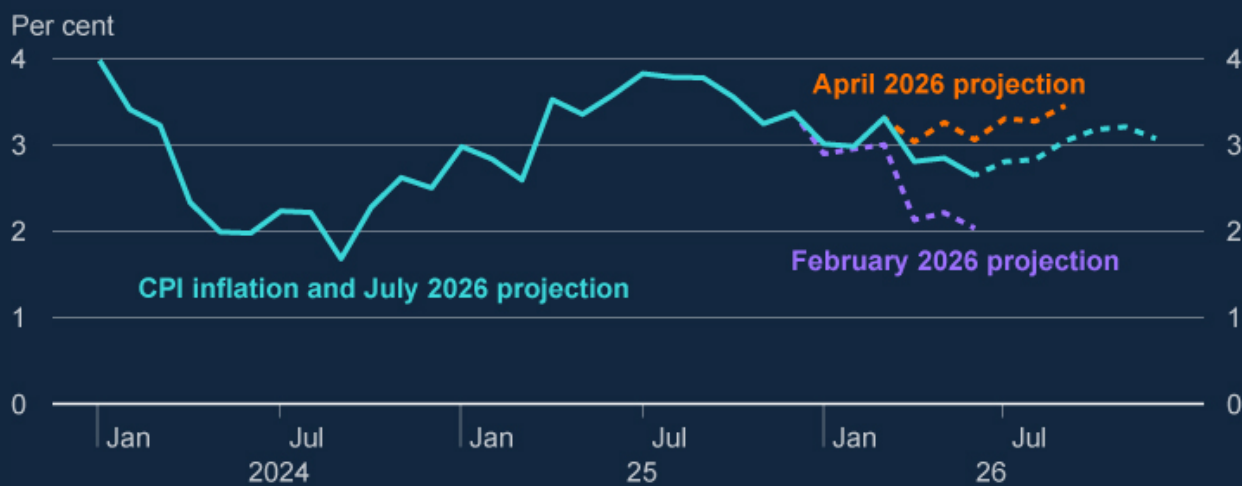
The underlying disinflation process continued in 2026 Q2. That was evident in the June CPI release which, at 2.6%, was 0.4 percentage points lower than expected in the April Report (Chart 1.1). That reflected greater than expected disinflation across a wide range of goods and services, although food prices provided the largest downside news.

The underlying disinflation process has been offset by higher energy prices following the conflict in the Middle East. Motor fuel prices contributed 0.6 percentage points to CPI inflation in June (Chart 1.2, green bars).

Despite the boost from higher motor fuel prices, CPI inflation fell by 0.7 percentage points between March and June. In addition to further disinflation across CPI components, some of that fall reflected base effects, as sharp increases in prices of certain regulated items last year dropped out of the annual comparison from April, as well as the reduction in the Ofgem price cap in 2026 Q2 (Chart 1.2, orange bars).

Chart 1.1: The near-term outlook for CPI inflation has shifted in recent months

CPI inflation and near-term projections (a)

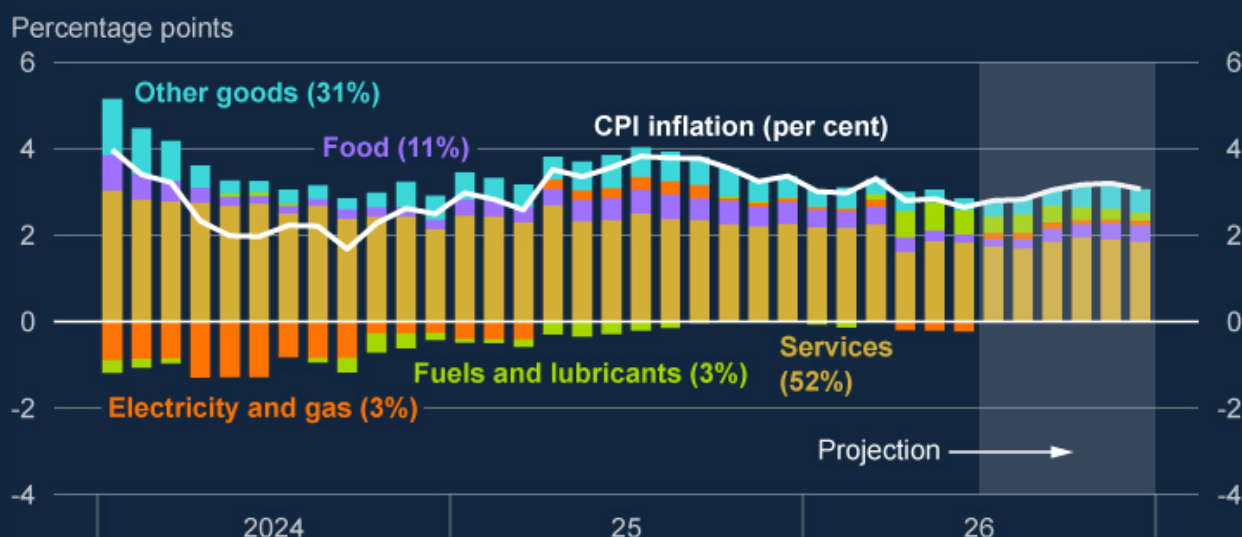


Sources: ONS and Bank calculations.

(a) The solid blue line shows CPI data to June 2026, and the dashed blue line shows Bank staff projections from July to December 2026. The dashed orange and purple lines show the near-term projections at the time of the April 2026 and February 2026 Reports, respectively.

Chart 1.2: CPI inflation was 2.6% in June but is projected to pick up to 3.2% in 2026 Q4

Contributions to CPI inflation (a)



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

(a) Figures in parentheses are CPI basket weights in 2026, which may not sum to 100% due to rounding. Data are shown to June 2026. Component-level Bank staff projections are shown from July to December 2026. The food component is defined as food and non-alcoholic beverages. The fuels and lubricants estimates use weekly DESNZ petrol and diesel price data which cover the first half of July 2026 and are then projected based on the sterling oil futures curve. The electricity and gas bars also include liquid fuels.

The underlying disinflation process continued in 2026 Q2.

Services price inflation fell from 4.5% in March to 3.6% in June (Chart 1.3, gold line), partly reflecting sharp rises in regulated prices in April of last year dropping out of the annual comparison. But annual underlying services price inflation measures also fell to around 3½% to 4% in June (aqua, orange and purple lines). Although still somewhat above Bank staff estimates of their target-consistent levels, the falls in those measures point to a broader slowing in domestic inflationary pressures and are also consistent with spare capacity in the economy helping to reduce inflation.

Chart 1.3: Measures of underlying services price inflation eased further in 2026 Q2

Measures of annual services price inflation (a)

Percentage changes on a year earlier



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. The trimmed-mean measure excludes the 10% largest and 10% smallest price changes. The latest data points are for June 2026.

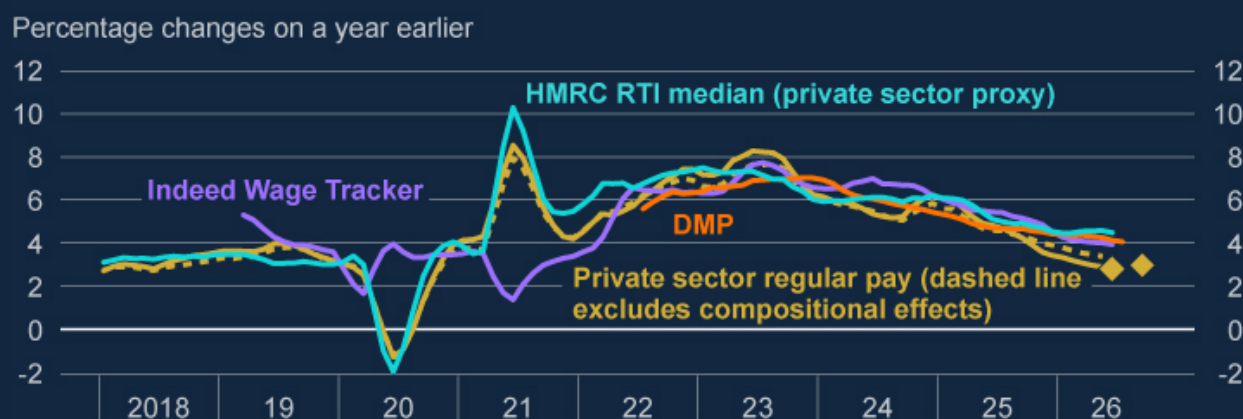
The further easing in domestic inflationary pressures has been supported by a continued slowing in wage growth. Private sector regular AWE growth eased to 2.9% in the three months to May (Chart 1.4, solid gold line). Although compositional shifts towards lower-paid industries continue to weigh on AWE growth by around 0.5 percentage points (shown by the difference between dashed and solid gold lines), momentum in private sector AWE growth has been subdued on a three-month on three-month annualised basis. Measures of pay growth from the DMP survey and the Indeed Wage Tracker remain higher, at around 4%, but have fallen gradually over recent months.

Whole economy total AWE growth has exceeded private sector regular pay growth. That difference largely reflects bonus payments, which do not tend to be a persistent driver of pay growth. Bonuses also appear to explain most of the gap between private sector regular AWE growth excluding compositional effects and the HMRC RTI measure (Chart 1.4, aqua line). Public sector regular pay growth has also been strong, partly reflecting the earlier implementation of this year's NHS pay deal.

Annual private sector AWE growth is projected to average 2.8% in 2026 Q2 and around 3.0% in Q3 (Chart 1.4, gold diamonds), consistent with slack in the labour market continuing to weigh on wage growth (Section 1.2).

Chart 1.4: Private sector wage growth has continued to slow

Measures of private sector wage growth (a)



Sources: DMP survey, HMRC, Indeed, ONS and Bank calculations.

(a) The private sector regular pay growth line shows the ONS measure of private sector regular AWE growth, measured as the three-month average on the same period a year earlier. The DMP line shows average realised pay growth from the DMP survey on the same basis, while the HMRC RTI line shows a proxy of growth in median pay in the private sector, also measured as the three-month average on the same period a year earlier. Bank staff construct the HMRC RTI measure by taking median pay for each industry – excluding public administration and defence, education, health and social work – and weighting them by industry shares in payrolled employment. Annual growth is then calculated using the Laspeyres formula, holding industry weights fixed at their levels a year earlier to reduce the effect of changes in workforce composition. The Indeed Wage Tracker line shows annual average job title matched pay growth for UK job vacancies. The latest data points are for the three months to May 2026 for private sector regular pay, June 2026 for the HMRC RTI private sector median and the Indeed Wage Tracker, and July 2026 for the DMP survey. The private sector regular pay growth projection diamonds are for the three months to June and September 2026.

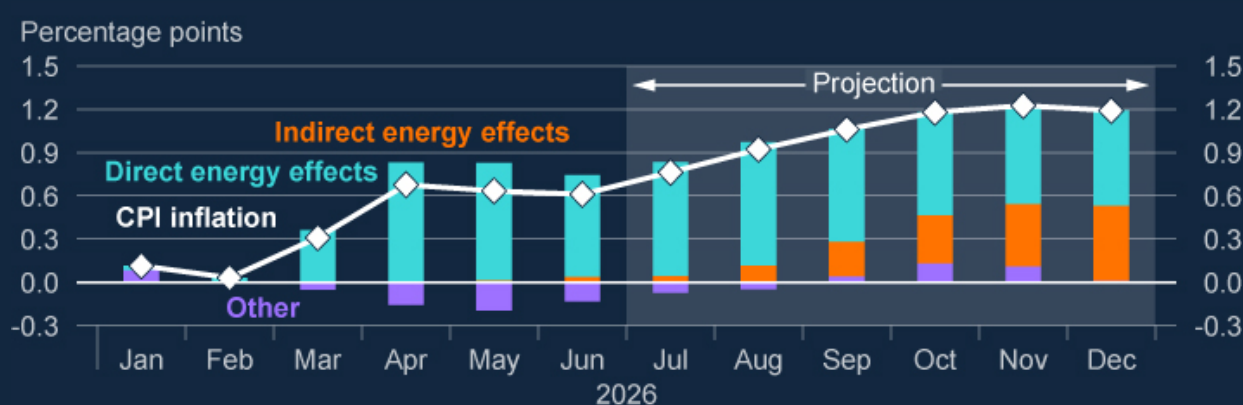
The Bank's Agents continue to report average pay settlements of 3.5% for 2026, below the average settlement of 4.0% in 2025. Contacts cite a lower NLW increase this year, lower inflation at the time of settling and a looser labour market as driving that fall. Most 2026 settlements were agreed before the Middle East conflict, and not many contacts expect to review pay again this year. Some contacts report that knock-on effects from the conflict could slow wage disinflation in 2027. In the three months to July, however, respondents to the DMP survey expected average wage growth of 3.4% one year ahead, below reported realised wage growth of 4% over the past year (Box B).

While the underlying disinflation process appears to have continued, energy prices have pushed up inflation following the onset of the Middle East conflict.

CPI inflation is higher than expected in the February Report, when inflation had been projected to fall back to around 2% from April 2026 (Chart 1.1, dashed purple line). That difference mainly reflects the sharp rise in motor fuel prices, as well as higher fixed energy tariff and other liquid fuel prices. Overall, direct energy effects added 0.8 percentage points to CPI inflation on average in 2026 Q2, relative to the February Report projection (Chart 1.5, aqua bars). That was partly offset by greater than expected disinflation in other components (purple bars).

Chart 1.5: The indirect effects of the energy shock are projected to grow over the remainder of 2026

CPI inflation relative to the projection in the February Report (a)



Sources: ONS and Bank calculations.

(a) The bars show contributions to CPI inflation relative to the projection in the February Report. The bars to June 2026 are based on CPI outturns. The bars from July to December 2026 are based on Bank staff projections. As Bank staff's February 2026 short-term inflation projection covered only six months, the expected direct energy contribution for 2026 H2 at the time of the February Report has been estimated using wholesale energy prices averaged over the 15 UK working days to 26 January 2026, together with the expected impact of the reduction in costs levied on household electricity and gas from April 2026 announced in Budget 2025 (Box D of the [February 2026 Monetary Policy Report](#)). The orange bars capture both domestic and imported indirect effects.

Energy prices have continued to be volatile but, as of the 15 days to 20 July, the direct contribution of energy to CPI inflation is expected to be slightly smaller than in the April Report.

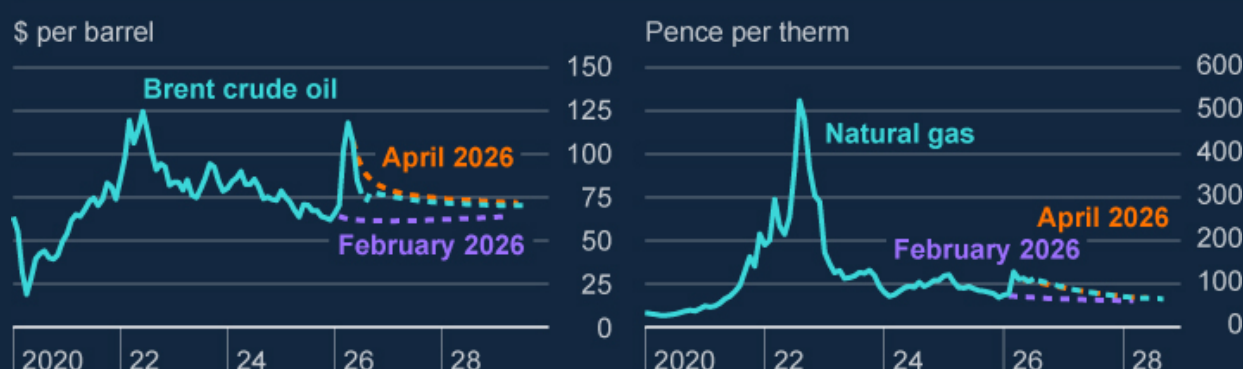
Wholesale energy futures prices have been highly volatile since the April Report. In the 15 UK working days to 20 July, the front-month Brent crude oil futures price averaged \$78 per barrel, below the \$100 average ahead of the April Report but above the \$64 average in the run-up to the February Report (Chart 1.6, left panel). Over the forecast period, the wholesale gas

futures curve was, on average, 1% higher than ahead of the April Report and 33% above its level in the run-up to the February Report (right panel). Energy prices rose following the re-escalation of the Middle East conflict and have continued to be volatile in recent weeks.

Industry intelligence suggests that crude oil and gas flows through the Strait of Hormuz remain well below normal, with disruptions continuing to affect countries unevenly. The re-escalation of the conflict has led to further disruption to shipping flows and could also result in additional damage to Middle Eastern energy infrastructure.

Chart 1.6: Wholesale energy futures prices remain elevated relative to their levels prior to the conflict, but were a little lower for oil in the run-up to the July Report relative to three months earlier

Wholesale Brent crude oil and UK natural gas prices (a)



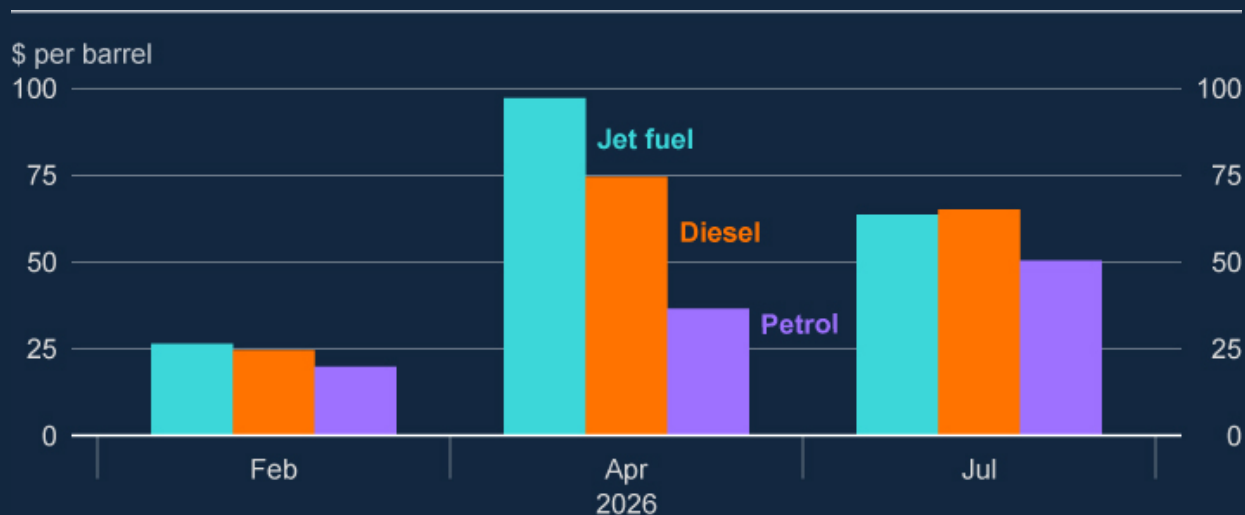
Sources: Bloomberg Finance L.P., LSEG Workspace and Bank calculations.

(a) Oil prices are Brent crude in dollars per barrel and gas prices are Bloomberg UK NBP Natural Gas Forward prices. In the left panel, the solid aqua line shows historical oil prices and the dashed aqua, orange and purple lines show futures curves based on forward prices averaged over the 15 UK working days to 20 July 2026, 22 April 2026 and 26 January 2026, respectively. In the right panel, the solid aqua line shows the historical evolution of the 12-month ahead natural gas futures price. The dashed aqua, orange and purple lines show 12-month ahead average gas futures curves, averaged over the same 15-day periods as the oil curves. The final data points for the July 2026 oil and gas futures curves are September 2029 and September 2028, respectively. The September 2028 gas futures data point is calculated as the average futures price between October 2028 and September 2029.

Crack spreads – the difference between the prices of refined petroleum products and Brent crude oil – have fallen from recent peaks for jet fuel and diesel but have continued to rise for petrol (Chart 1.7). Crack spreads remain well above their pre-conflict levels, and refined product markets remain tight, reflecting continued outages at Middle Eastern refineries, restrictions on Chinese oil product exports, reduced Russian oil product exports following intensified Ukrainian strikes on oil facilities, rapid inventory drawdowns and limited spare refining capacity outside Asia.

Chart 1.7: Crack spreads have eased from their peaks for some products but remain elevated

Jet fuel, diesel and petrol crack spreads (a)



Sources: LSEG Workspace and Bank calculations.

(a) The aqua bars show the spread between spot Northwest Europe (NWE) jet fuel prices and front-month Brent crude oil futures prices, using a conversion of 7.88 barrels of jet fuel per tonne. The orange and purple bars show the corresponding crack spreads for spot ultra-low sulphur NWE diesel and regular unleaded petrol, using conversion factors of 7.45 barrels and 8.33 barrels per tonne, respectively. The February, April and July 2026 bars are averages over the 15 UK working days to 26 January 2026, 22 April 2026 and 20 July 2026, respectively.

The direct contribution of higher energy prices to CPI inflation is expected to be around 0.4 percentage points in 2026 H2, a little lower than in the April Report but 0.7 percentage points greater than in the February Report (Chart 1.5, aqua bars). Within that, petrol and diesel pump prices are projected to contribute around 0.3 percentage points to CPI inflation on average, lower than in Q2 (Chart 1.2, green bars).

By contrast, higher wholesale gas futures prices will feed through more fully to household utility bills from July, following the increase in the Ofgem price cap to £1,663 in Q3 from £1,477 in Q2 (figures based on the [new typical domestic electricity and gas consumption values](#) that apply from Q3). The temporary removal of VAT on household electricity bills from October is expected to limit the rise in the Ofgem price cap in 2026 Q4 to around £1,680, around £45 lower than would have been the case without that measure. Overall, household utility bills are projected to contribute around 0.1 percentage point to CPI inflation on average over H2 (Chart 1.2, orange bars).

The indirect effects of the energy shock are expected to grow over the remainder of this year, but by a little less than projected in the April Report.

Indirect effects arise as firms at home and abroad pass higher energy costs through supply chains to consumer goods and services prices (Boxes A and D). That pass-through typically occurs more slowly than for the direct effects of an energy price shock (Box A of the [April 2026 Monetary Policy Report](#)) and recent CPI data are consistent with modest effects so far (Chart 1.5, orange bars). Indirect effects are projected to build over 2026 H2 and to contribute around 0.5 percentage points to CPI inflation in December, based on intelligence from the Bank's Agents alongside data news and model and survey-based evidence. That combination of evidence is consistent with indirect effects building more slowly than projected in the April Report.

Energy costs are an important component of food production and distribution costs. Models that incorporate energy costs in domestic and imported supply chains, alongside survey evidence and intelligence from the Bank's Agents, suggest pass-through of higher energy costs will be slightly faster for food than for other CPI components. Food price inflation is projected to rise to nearly 3.5% in December 2026 (Chart 1.8, solid orange line). That is less than expected in the April Report, largely reflecting downside news in food prices over recent months – some of which is judged to reflect easing agricultural commodity price pressures – as well as developments in wholesale energy markets.

The lower projection for food price inflation than at the time of the April Report is directionally consistent with recent intelligence from the Bank's Agents. Contacts of the Agents report that they now expect food price inflation to reach around 4%–5% by the end of the year ([Agents' summary of business conditions – July 2026](#) (ASBC)). Supermarkets report fragile consumer demand and intense competition. As such, they are focused on cost management and are resisting proposals for price increases from suppliers.

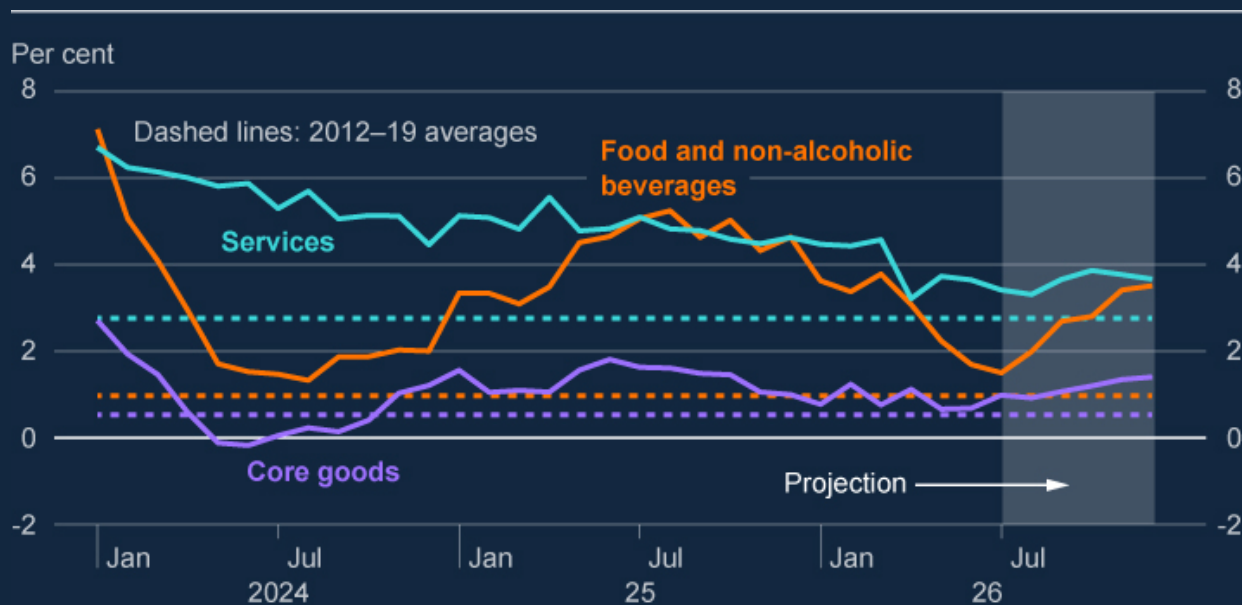
The indirect pass-through of higher energy costs is also expected to raise core goods inflation. Intelligence from the Bank's Agents suggests that, while production of many core goods – such as clothing, footwear and household goods – is less directly affected than food by the energy shock, some producers are facing higher transport costs.

Overall, core goods inflation is expected to rise by 0.7 percentage points to around 1.4% in December (Chart 1.8, solid purple line). Alongside the indirect impact of energy costs, that projection incorporates an expectation that building price pressures for memory chips will raise costs for a broad range of goods over 2026 H2 (Box D).

Services inflation is also expected to increase slightly over coming months, reaching 3.8% in October (Chart 1.8, solid aqua line). Higher energy and food prices are expected to increase non-labour input costs for many firms in the sector, such as airlines and catering services. Underlying services measures are expected to remain broadly stable, however, as further progress in underlying disinflation offsets the indirect effects of the energy price shock.

Chart 1.8: Inflation rates are projected to pick up across CPI components, most notably for food

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. The data are to June 2026, with Bank staff projections from July to December 2026. The dashed lines represent the 2012–19 averages, which are 2.7%, 0.9% and 0.5% for services, FNAB and core goods, respectively.

CPI inflation is expected to average 3.2% in 2026 Q4.

The near-term CPI inflation projection rises to 3.2% in October and November 2026 before easing a little (Chart 1.2, white line). Direct effects of higher energy prices are projected to rise over coming months before fading somewhat in 2026 Q4. As a result, the expected pickup in CPI inflation by the end of this year is primarily accounted for by indirect effects (Chart 1.5, orange bars). Within that, higher food and other goods price inflation are expected to drive much of the increase in inflation. Building price pressures for memory chips are also expected to contribute to the rise in core goods inflation and to some of the remaining difference between the current CPI inflation projection and that at the time of the February Report (purple bars).

Inflation expectations

Inflation expectations remain elevated, especially at shorter horizons.

There is a risk that the energy price shock generates more persistent inflation through second-round effects if higher inflation expectations feed through to wage-setting or pricing decisions. While there is little evidence so far to suggest large second-round effects, some of the most important evidence will only appear with a lag (Box B).

Short-term inflation compensation measures in financial markets remain above pre-conflict levels (Chart 1.9, orange line in left panel) and have been more sensitive than usual to developments in energy markets over this period. By contrast, medium-term measures, such as the five-year, five-year forward inflation swap rate, have been much less volatile and rose by significantly less in response to the Middle East conflict (aqua line in left panel).

The Market Participants Survey (MaPS) may provide a cleaner read of market participants' inflation expectations, since market-based measures of inflation compensation are also affected by liquidity and risk premia as well as technical factors related to the demand and supply of inflation protection. In the latest MaPS, the median respondent expected CPI inflation to be 2.5% one year ahead, a little below the 2.8% expected in the April Report, and for inflation to return to the 2% target at the three-year horizon.

Near-term business inflation expectations eased in July but remain slightly above their pre-conflict levels. One-year ahead CPI expectations among firms responding to the DMP survey stood at 3.4% in the three months to July, 0.3 percentage points above their level in the three months to February (Chart 1.9, orange line in middle panel). One-year own-price expectations rose by 0.4 percentage points over this period, to 3.9%. By contrast, three-year ahead CPI inflation expectations have been relatively stable (aqua line in middle panel).

Household inflation expectations remain elevated but have also fallen from recent peaks (Chart 1.9, right panel). They tend to move closely with observed changes in salient prices such as food and energy (Box C in the [April 2026 Monetary Policy Report](#)). The Citi/YouGov one-year ahead measure fell to 3.4% in July, probably reflecting lower motor fuel prices than in April. The Citi/YouGov 5–10 year ahead measure also eased in the latest data to 3.7%, 50 basis points above its historical average and around 10 basis points higher than its pre-conflict level.

Chart 1.9: Inflation expectations remain elevated, especially at shorter horizons

Market-based measures of inflation compensation (a) and survey-based measures of business (b) and household inflation expectations (c)



Sources: Bloomberg Finance L.P., Citigroup, DMP survey, YouGov and Bank calculations.

(a) The data show cumulative changes in market-based measures of inflation compensation since 31 December 2025. The orange line shows the one-year inflation swap rate, and the aqua line shows the five-year, five-year forward inflation swap rate. A short back-run is shown because of the impact of RPI reform, which distorted the five-year, five-year forward inflation swap rate between April 2020 and March 2025. From 2030, UK RPI will be aligned with the CPIH measure of consumer prices. The final data points are for 20 July 2026.

(b) The data are from the DMP survey and show three-month averages. The data are in response to the question: 'What do you think the annual CPI inflation rate will be in the UK, one year from now and three years from now?'. The latest data points are for July 2026, with the survey conducted between 3–17 July. The DMP survey data have a short back-run, so no historical averages are shown.

(c) The data are from the Citi/YouGov survey and are based on responses to the questions: 'How do you expect consumer prices of goods and services will develop in the next 12 months?', and 'And what do you think will happen to the prices of goods and services, on average, over the longer term – say five to ten years?'. The dashed lines represent the series averages over 2010–19. The latest data points are for June 2026, with the survey conducted between 22–23 June. The chart does not show the July 2026 Citi/YouGov data, which was released after the data cut-off for incorporation in the charts.

1.2: Activity

Domestic demand

Underlying GDP growth is projected to weaken slightly in coming quarters, as subdued momentum persists and the effects of the Middle East conflict weigh somewhat on demand.

Underlying GDP is estimated to have grown by 0.1% in 2026 Q2 (Chart 1.10, orange line) based on the collective steer from business survey indicators. That is below Bank staff's estimate of potential supply growth of around 0.3%–0.4%, consistent with a widening margin of slack. Headline GDP growth is expected to have been higher than underlying growth, at 0.3% in 2026 Q2 (aqua line), although that reflects some remaining strength from Q1 when GDP grew by 0.6%.

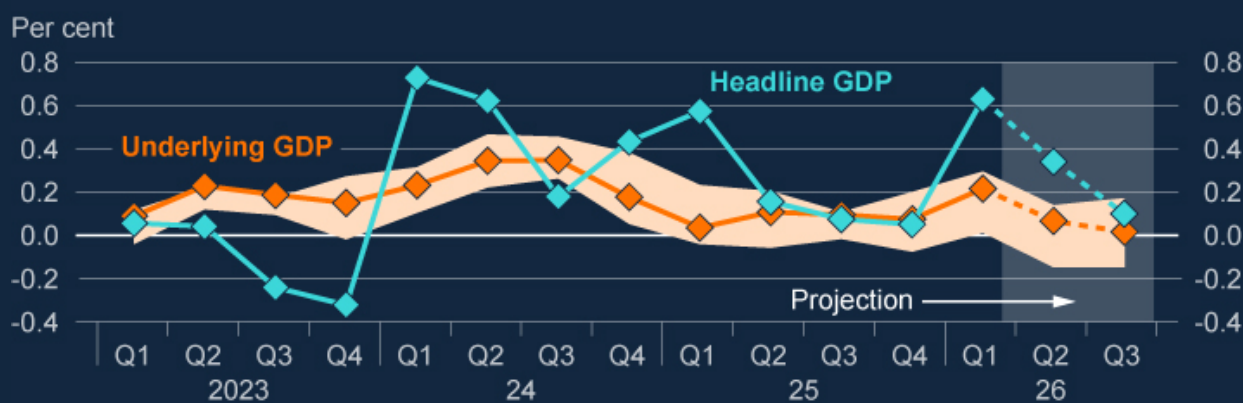
Subdued underlying GDP growth partly reflects a continuation of weak momentum prior to the Middle East conflict, consistent with subdued household and business confidence. But the conflict is also judged to have begun to weigh on demand through lower household real income growth, greater uncertainty and tighter financial conditions. Forward-looking survey indicators have generally been soft, consistent with these channels having started to play out, although the flash July S&P Global UK PMI Survey data signalled an improvement in business conditions and there is little evidence so far that the conflict has triggered a sharp contraction in activity.

Business survey data suggest that growth in the services sector has been subdued. The S&P Global UK PMI Survey services output index fell after the onset of the conflict and remained slightly below its historical average in July, with respondents citing elevated risk aversion and continued weakness in consumer spending. Manufacturing growth has been stronger, although survey indicators suggest some of that resilience may reflect front-loading of purchases ahead of anticipated price rises and supply chain disruption. The S&P Global UK PMI Survey manufacturing stocks of purchases index rose to its highest level since mid-2022 in May before falling back sharply in the latest data. Contacts of the Bank's Agents in the manufacturing sector generally report weak trading conditions.

Underlying GDP growth is projected to slow to around 0% in 2026 Q3 (Chart 1.10, orange line), as the effects of the conflict weigh further on demand. The S&P Global UK PMI Survey composite future output index ticked up in the July flash release although it remains below its historical average, pointing to continued weak momentum in activity. Weak underlying demand conditions should reduce the likelihood of second-round effects in price and wage-setting from the energy price shock (Box B).

Chart 1.10: Underlying GDP growth is projected to weaken slightly in the near term

Quarterly growth in headline GDP and underlying growth implied by business surveys (a)



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

(a) The final data point for quarterly headline GDP growth is for 2026 Q1. The diamonds for 2026 Q2 and Q3 show Bank staff projections. Underlying GDP growth estimates are from a survey indicator model, based on a staggered-combination mixed-data sampling (MIDAS) approach (Moreira (2025)). The orange diamonds to 2026 Q1 show in-sample fitted values of the survey indicator model, and diamonds for Q2 and Q3 show out-of-sample projections. The orange swathe shows the interquartile range of estimates from individual survey indicators in the model, and values have been interpolated between quarters.

Business investment is expected to soften over coming quarters, as lower confidence and higher borrowing costs weigh on investment intentions.

Business investment grew by 0.9% in 2026 Q1 but is expected to soften over coming quarters. Measures of business confidence have fallen since the Middle East conflict, although by somewhat less than after the 2022 energy price shock. Weaker confidence is likely to weigh on firms' investment intentions. Contacts of the Bank's Agents report that investment intentions have fallen since the start of the conflict owing to higher uncertainty and financing costs and are broadly flat for the year ahead.

Household spending is expected to moderate in response to the energy price shock, but not to contract sharply.

Consumption grew by 0.6% in 2026 Q1, stronger than in recent quarters, despite a 0.2% fall in real incomes. As a result, the household saving rate fell by 0.7 percentage points to 8.9%, although it remains above its pre-pandemic average. Early estimates of these data are volatile and can be subject to large revisions.

Consumption growth is expected to have eased to 0.3% in 2026 Q2, in line with slower GDP growth. It is expected to weaken further over coming quarters, as higher inflation and subdued wage growth weigh on real income growth. Recent rises in mortgage rates are also expected

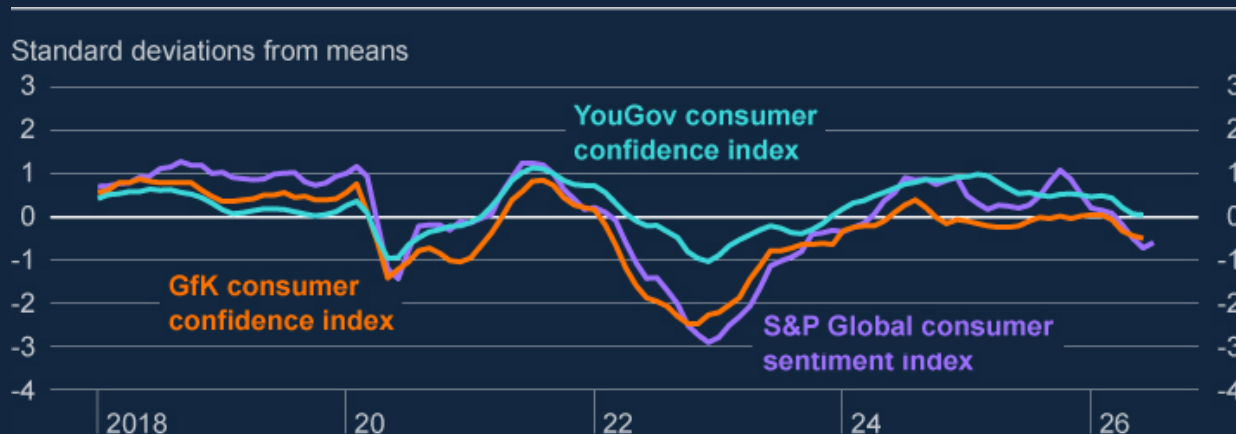
to weigh on consumption growth (Box F).

Households may smooth through some of the impact of the energy price shock by reducing their spending by less than the fall in their real incomes (Box E of the [April 2026 Monetary Policy Report](#)). That may involve households reducing the pace at which they are currently saving, drawing down on existing savings or increasing borrowing. Consistent with that, a forward-looking gauge of households' willingness to save from the ONS Public Opinions Survey, which has broadly tracked the household saving rate in recent years, has fallen since the start of the conflict. Weaker flows into household deposits over recent months also point to further declines in the saving rate. Meanwhile, timelier spending indicators, including ONS retail sales growth, have remained relatively resilient since the start of the conflict, suggesting that households may already have begun to smooth through part of the squeeze in their real incomes.

Overall, consumption is projected to grow by 0.1% in 2026 Q3 and to remain subdued over coming quarters, but not to contract sharply. Consistent with that, consumer confidence measures, which provide a forward-looking signal for consumption, have fallen a little, but by much less than after the pandemic or Russia's invasion of Ukraine (Chart 1.11).

Chart 1.11: Consumer confidence indicators have weakened but by less than in 2022

Measures of consumer confidence (a)



Sources: GfK, S&P Global, YouGov and Bank calculations.

(a) The YouGov Consumer Confidence Index (CCI) asks respondents about household finances, job security, house prices and business activity over the past month and the year ahead. The S&P Global Consumer Sentiment Index (CSI) covers current finances and expectations for the year ahead, sentiment around debt, savings and the labour market, and views on major purchases and cash available to spend. The GfK CCI asks about personal finances and general economic conditions over the past year and the year ahead, as well as attitudes towards major purchases. All series are standardised using data since 2009 and are shown as three-month averages. The latest data are for June 2026 for the YouGov and GfK CCIs, and July 2026 for the S&P Global CSI. The chart does not show the July 2026 GfK CCI data, which was released after the data cut-off for incorporation in the charts.

Labour market

| The labour market continues to operate with a degree of spare capacity.

Bank staff judge that underlying employment growth has been broadly flat since early 2025, based on the signal from a range of measures, with little evidence of a marked change following the onset of the Middle East conflict. HMRC RTI data, which give a timely read on employment, point to a small fall in payrolled employees over recent months, while the S&P Global UK PMI employment index remained below its historical average in July. Contacts of the Bank's Agents report that the conflict has led to greater caution in employment intentions and some delays in hiring, and around a quarter of respondents to the July 2026 DMP survey expected employment to be lower because of the conflict.

Intelligence from the Bank's Agents suggests AI adoption is gradually reducing demand for highly automatable jobs in some industries, with firms often slowing hiring or leaving vacancies unfilled to increase output without a proportional rise in headcount. Consistent with that, respondents to the latest DMP survey expected AI to reduce employment by around 0.4% per year and to boost productivity by around 0.9% per year over the next three years. The effects of AI remain highly uncertain, however. Nearly 90% of DMP survey respondents report no material impact of AI on their employment over the past three years, and the creation of new businesses and jobs may offset some future employment impacts.

The LFS unemployment rate stood at 4.9% in the three months to May (Chart 1.12), 0.2 percentage points lower than projected in the April Report. The headline unemployment rate has been volatile in recent months, reflecting both changes in inactivity and employment.

The unemployment rate is expected to rise a little over coming months. Bank staff project the unemployment rate to rise gradually to 5.0% in 2026 Q3 and 5.1% in Q4 (Chart 1.12). That rise is expected to mainly reflect continued weakness in hiring rather than an increase in job losses, consistent with subdued indicators of employment intentions and recent falls in the ONS redundancy rate. Forward-looking HR1 notifications of potential redundancies among larger firms have risen over recent months, however, which could point to the risk of a slightly sharper increase in unemployment over coming quarters.

Chart 1.12: The unemployment rate is projected to rise a little over 2026 H2

LFS unemployment rate and near-term projections (a)



Sources: ONS and Bank calculations.

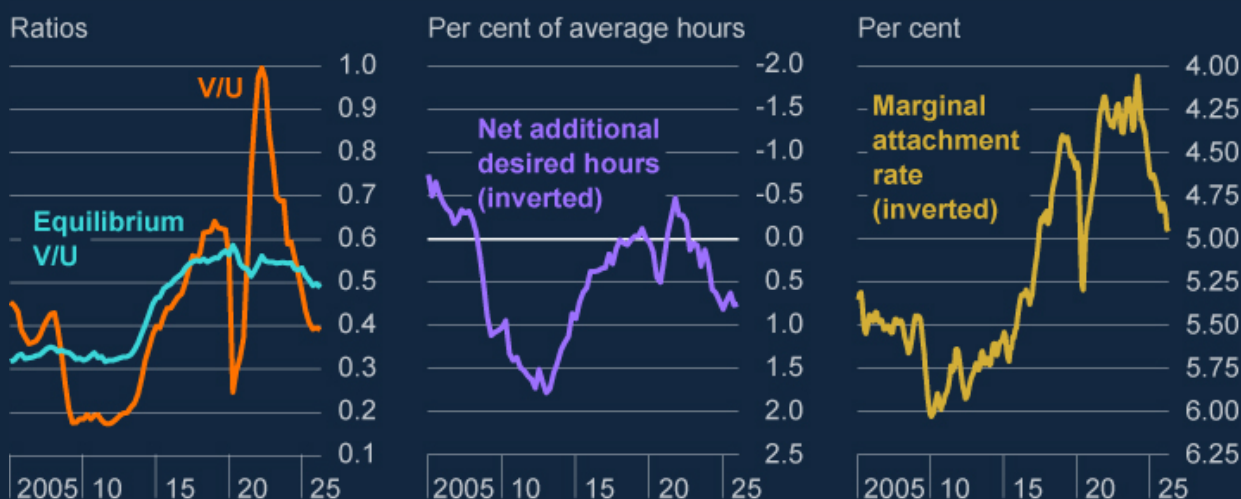
(a) The aqua diamonds show projections for the LFS unemployment rate from 2026 Q2 to Q4, based on official data to May 2026 (shown in the aqua line). Although LFS unemployment data have been reinstated by the ONS, they are badged as official statistics in development and the LFS continues to suffer from low response rates, which can introduce volatility and potentially non-response bias (Box D of the [May 2024 Monetary Policy Report](#)). An [ONS operational error](#) temporarily reduced LFS response rates during May and June 2026, leading to increased use of imputation for this period. ONS analysis to date indicates that the error has had minimal impact on headline employment, unemployment and inactivity rates, although it may have had a slightly larger impact on the estimates of average and total actual hours worked.

Broader indicators continue to point to a margin of slack in the labour market. The vacancies to unemployment ratio (V/U) remains below its estimated equilibrium (Chart 1.13, left panel) and net additional hours desired by workers as a share of average hours worked continue to indicate some degree of underemployment (middle panel). Meanwhile, the marginal attachment rate points to a growing share of people not currently looking for work but who would like a job (right panel), which could indicate some further loosening in the labour market since the April Report. That would be consistent with intelligence from the Bank's Agents, which suggests that recruitment difficulties have eased to a little below normal ([ASBC – July 2026](#)).

There is a high degree of uncertainty over the precise level of slack in the labour market. Bank staff judge that most of the increase in the unemployment rate since mid-2022 has reflected weaker demand, but some structural factors may also have contributed. Higher labour costs reflecting increases in the NLW and employer NICs, for example, may have reduced demand for lower-paid workers in sectors with a high share of jobs near the NLW, such as hospitality.

Chart 1.13: The labour market continues to operate with a degree of spare capacity

Indicators of labour market slack (a)



Sources: Advertising association/World Advertising Research Centre Expenditure Report, ONS and Bank calculations.

(a) The equilibrium V/U ratio in the left panel is estimated using an error-correction model over the period 1982–2025. 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 latest data are for 2026 Q1. The 2026 Q2 data points are projections based on data to the three months to May. The middle panel shows the 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. The latest data are to 2026 Q1 and the vertical axis is inverted. The data in the right panel are three-month averages of the share of people aged 16–64 who report that they are not in work or not actively looking for work but would like a job. The latest data are for the three months to April 2026 and the vertical axis is inverted.

Spare capacity in the economy should reduce the risk of additional second-round effects in price and wage-setting.

The overall margin of spare capacity in the economy is judged to have widened a little further since the April Report. Contacts of the Bank's Agents continue to report modest spare capacity, partly reflecting weak demand. And most model-based estimates of the output gap point to slack having increased slightly, to around 1% of potential GDP. Spare capacity in the economy should reduce the risk of additional second-round effects on inflation by weakening workers' wage bargaining and firms' pricing power (Box B and Section 3).

1.3: Global and financial conditions

Global economic activity

Global growth has slowed over 2026.

The conflict in the Middle East represents a negative supply shock to the global economy. Since the April Report, the Memorandum of Understanding (MoU) between the US and Iran had facilitated the reopening of the Strait of Hormuz and a partial recovery in shipping and energy flows, contributing to a decline in wholesale oil and gas prices. But renewed attacks on shipping and a broader re-escalation of the conflict following the MoU constrained the recovery of oil flows and energy prices have been volatile in recent weeks. Disruption and damage to regional energy infrastructure are expected to constrain energy supply in coming quarters.

The effects of the conflict are judged to be weighing on global demand, but by less than expected at the time of the April Report given the fall in energy prices in the run-up to the July Report (Section 1.1). The effects of the conflict are being partly offset by strong AI-related investment, particularly in the US where it is estimated to have accounted for a substantial share of recent private investment growth (Chart 1.14, aqua bars). In the year to 2026 Q1, US investment in these AI-related components grew by 18%, compared with a four-quarter average growth rate of just over 7% during the period 2010–19. Based on Bank staff estimates that account for the import content of AI-related goods, this investment accounted for as much as a fifth of overall US GDP growth in the year to 2026 Q1. Such investment is also supporting AI-related export demand in developed Asian economies (Box D).

The average global effective tariff rate on US imports remains lower than it was in 2025, although tariffs are judged to still be weighing somewhat on global demand. On 24 July the US imposed new tariffs of 10%–12.5% on a broad range of countries, replacing the previous 10% tariffs which had been time-limited. The bilateral US-UK tariff rate is unchanged and the overall effects are expected to be small for the UK.

Chart 1.14: US investment growth has been driven by AI-related spending in recent quarters

Contributions to quarterly growth in US private fixed investment (a)



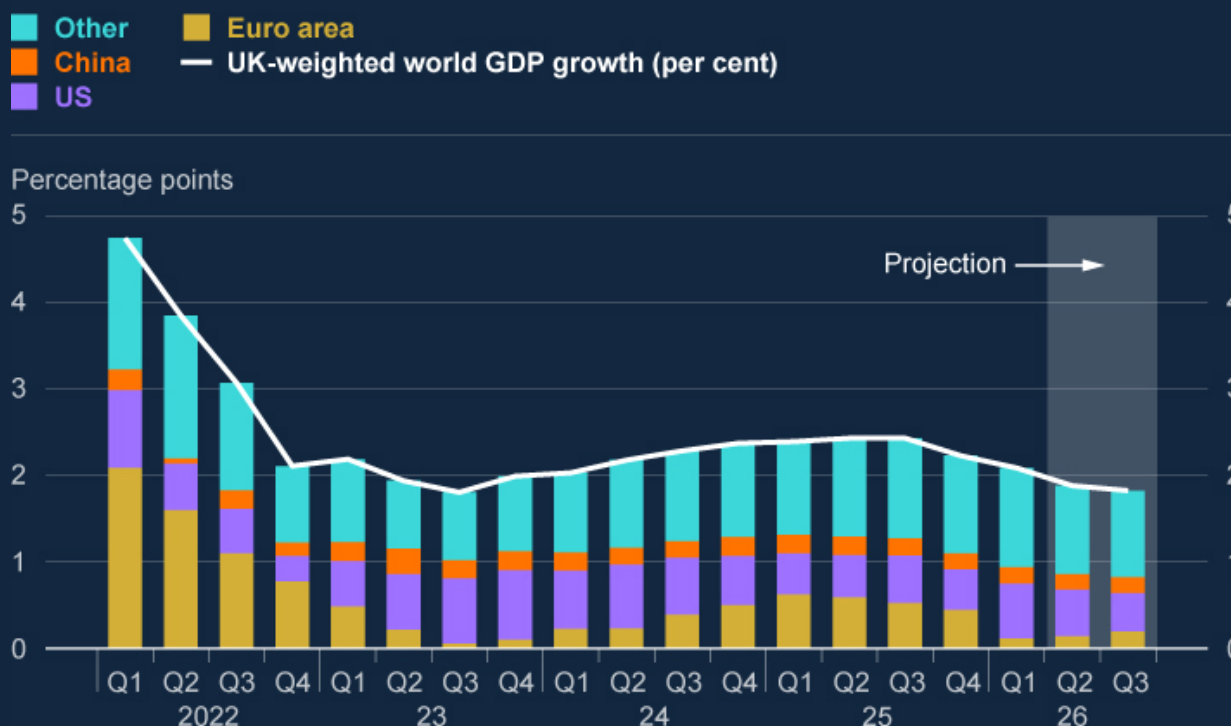
Sources: BEA, LSEG Workspace and Bank calculations.

(a) AI-related investment is defined broadly to include computers and peripheral equipment, communications equipment, special industry machinery, power infrastructure, data centres, software and AI-related R&D. AI-related R&D is assumed to account for 25% of total R&D investment, based on the share of BEA R&D categories judged to be most closely related to AI.

Four-quarter UK-weighted world GDP growth was 2.1% in 2026 Q1 and is expected to have slowed in Q2 (Chart 1.15). The June JP Morgan Global Composite PMI and new orders balances were a little above their recent troughs but lower than prior to the conflict, while the future output and employment balances were below their historical averages. Global growth is expected to be broadly unchanged in Q3 as the negative effects of the earlier energy shock continue to pass through supply chains. Relative to last year, US growth is expected to be robust over 2026 while euro-area growth is expected to be relatively weak, reflecting the effects of the Middle East conflict.

Chart 1.15: World GDP growth has decelerated in 2026

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



Sources: LSEG Workspace and Bank calculations.

(a) The figures for 2026 Q2 and 2026 Q3 are Bank staff projections. UK-weighted world GDP growth is constructed using real GDP growth rates of 188 countries weighted according to their shares in UK exports.

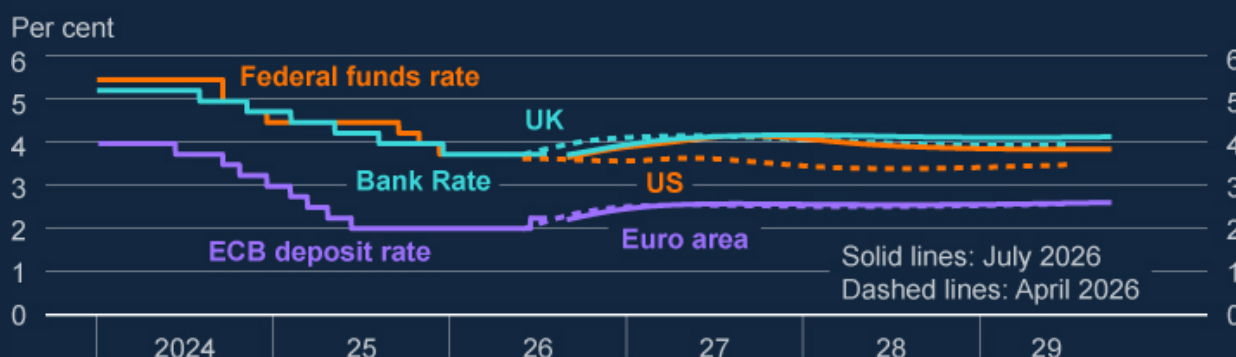
Financial conditions

The UK forward OIS curve is a little higher compared with the April Report.

Based on the 15-day average of forward interest rates to 20 July, the UK market curve was five basis points higher on average over the next three years compared with the path at the time of the April Report (Chart 1.16). The market curve rises to around 4.2% by the latter half of 2027 and remains broadly flat thereafter. The curve has risen further in recent weeks following the re-escalation of the Middle East conflict.

The euro-area forward OIS curve was broadly unchanged over the coming three years relative to in the run-up to the April Report, based on the 15-day average to 20 July, while the US curve was around 50 basis points higher on average from 2027 onwards. Market contacts have mainly attributed the upward shift in the US curve to expectations of a tighter policy stance following the June FOMC meeting.

Chart 1.16: The UK forward OIS curve is a little higher compared with the April Report
Policy rates and instantaneous forward curves for the UK, US and euro area (a)



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

(a) The July 2026 curves are estimated based on the 15 UK working days to 20 July 2026. The April 2026 curves are estimated based on the 15 UK working days to 22 April 2026. 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 September 2029.

UK financial conditions have tightened since the April Report.

UK financial conditions are materially tighter than prior to the conflict in the Middle East, primarily due to higher short-term market interest rates (Box F). They have also tightened further since the April Report, reflecting a 1% appreciation of the sterling ERI and an increase in market rates at the two to three-year horizon (Chart 1.16). Longer-term UK government bond yields have also risen since April and are at around their highest level since 2008. The UK FTSE All-Share index is broadly unchanged while the S&P 500 and Euro Stoxx indices are around 10% and 6% higher, respectively. Market-based measures of uncertainty, such as the VIX and MOVE Index, which capture option-implied volatility in US equity prices and US Treasury yields, have fallen since the April Report and remain well below the peaks seen last year following US tariff announcements and below those observed in 2022.

Domestic credit conditions

Interest rates faced by households and firms have generally fallen a little in recent weeks but remain higher than prior to the conflict.

Mortgage rates and their reference rates remain higher than prior to the conflict in the Middle East (Box F). Reference rates are little changed from the time of the April Report. The rates on mortgage products that are priced based on these are currently around 40 basis points lower than in April (Chart 1.17), reflecting standard lags in pass-through. Reference rates

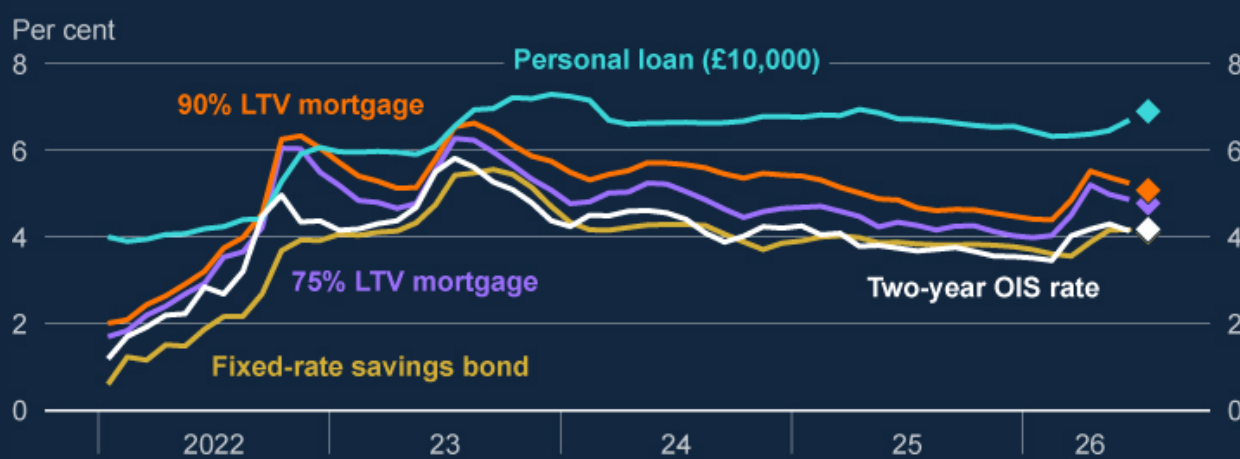
have been volatile, however, and the most recent increases are starting to be passed through to quoted mortgage rates. Bank staff analysis finds that increases in reference rates tend to be passed through to mortgage rates more quickly than decreases when movements in reference rates are large or volatile.

The average quoted rate on two-year time deposits has risen by around 20 basis points since the April Report (Chart 1.17, gold line), although pass-through of changes in reference rates has been broadly in line with historical averages since February. Rates being charged on personal loans have risen by around 50 basis points since the April Report (Chart 1.17, aqua line). Changes in reference rates tend to pass through to rates charged on consumer credit with a lag.

Quoted rates on sight deposits have been little changed since the April Report, consistent with Bank Rate – the relevant reference rate – having been unchanged. Meanwhile rates on new bank lending to corporates have declined a little. Mortgage and corporate credit spreads remain compressed by historical standards.

Chart 1.17: Mortgage rates have fallen since the April Report while time deposit rates have risen a little

Household interest rates and their corresponding reference rate (a)



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

(a) Household loan and deposit rates are based on average quoted rates. 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 fixed-rate savings bonds is the two-year OIS rate. The reference rate for £10,000 personal loan rates is the five-year OIS rate but this is not shown. The two-year OIS rate shows monthly averages. Household quoted rates data are not seasonally adjusted. The provisional July 2026 data are shown as diamonds. For quoted rate series and the two-year OIS rate, these are based on average values to 20 July 2026.

Respondents to the latest [**Credit Conditions Survey – 2026 Q2**](#) reported that availability of secured credit to households and firms had been broadly stable on average since the onset of the Middle East conflict. Housing market activity has been weak, however, and mortgage approvals for house purchase fell by nearly 15% in May, the largest monthly decline since late-2022, and were broadly flat in June. This weakness probably reflects a combination of economic uncertainty and the bringing forward of some mortgage activity into earlier months in anticipation of higher mortgage rates. The RICS new buyer enquiries net balance remains very weak by historical standards, and lenders responding to the Credit Conditions Survey expected demand for secured lending for house purchases to fall in the months ahead. These developments are consistent with reports from the Bank's Agents which point to affordability concerns and the rise in mortgage rates since the conflict weighing on housing market activity ([**ASBC – July 2026**](#)).

2: Topical policy issues

The boxes in this section highlight some of the key pieces of analysis that informed the MPC's discussions.

Box A: A framework for monitoring second-round effects of higher energy prices

Higher energy prices can lead to persistent inflationary pressures through second-round effects. Second-round effects are particularly difficult to assess at the outset of an energy price shock as they may only materialise with a lag. The stance of monetary policy may need to adjust before the impact of second-round effects is clear and so policymakers must draw on the collective steer across a range of indicators. This box sets out the theoretical mechanisms of second-round effects and a set of indicators that can be used to monitor them. Box B provides an assessment of the currently available evidence on second-round effects resulting from the recent energy price rise based on those indicators.

| How do higher energy prices affect inflation?

The rise in energy prices caused by the Russian invasion of Ukraine in 2022 resulted in persistent upward pressure on UK inflation. This pressure had yet to fully fade when energy prices rose again after the onset of conflict in the Middle East earlier this year.

Higher energy prices have both temporary and potentially persistent effects on inflation (Figure A.1). These can be categorised in three ways: direct, indirect and second-round effects (Box G of the [April 2026 Monetary Policy Report](#)).

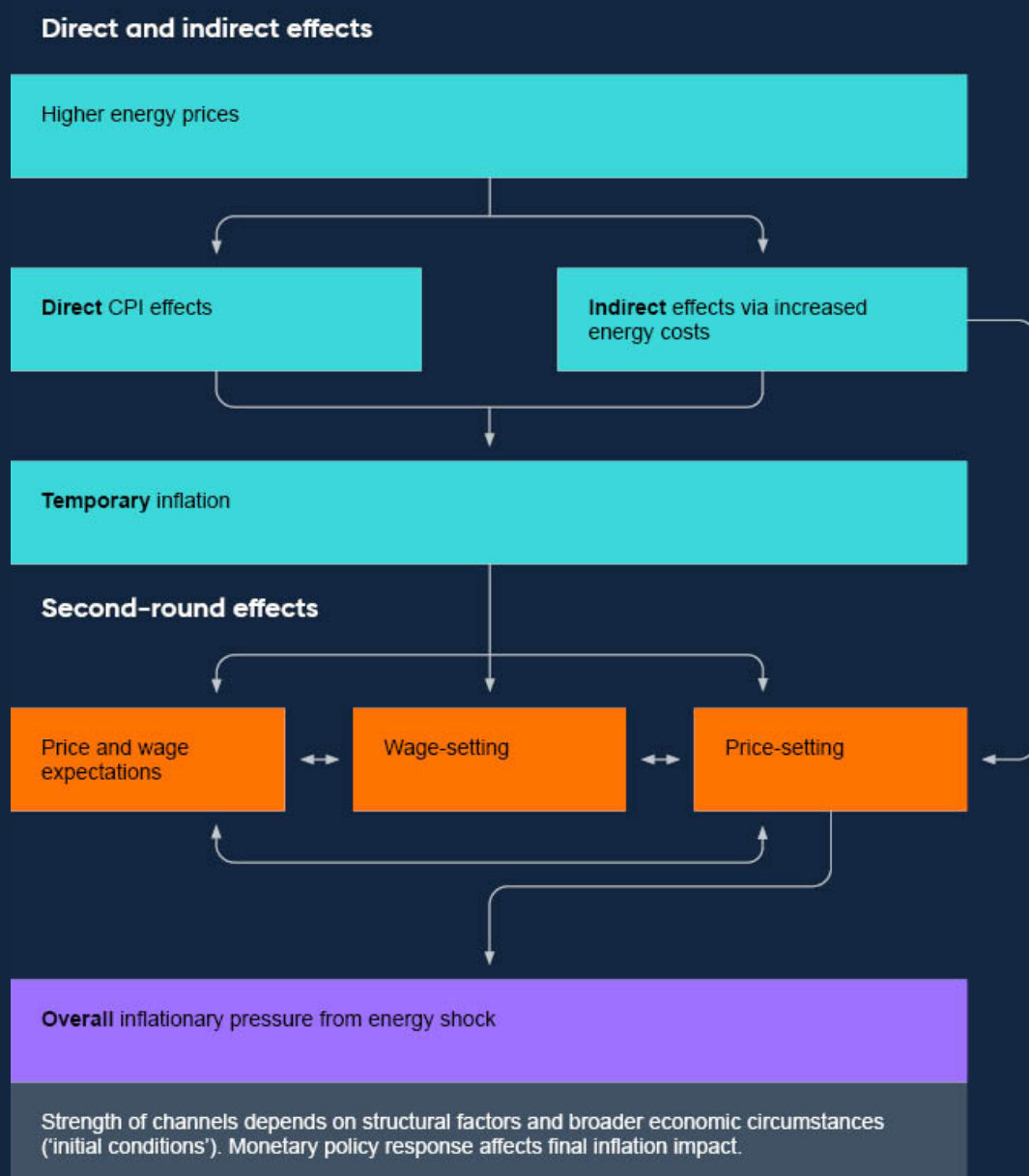
Direct effects result from households consuming energy, for example through motor fuel and utilities. Therefore, higher energy prices directly raise inflation and do so quickly.

Indirect effects result from energy's role as an input into the production of other goods and services. For example, higher jet fuel prices will lead to higher airfares as airlines pass through their higher costs. Indirect effects typically pass through more slowly than direct effects, for example as a result of temporarily fixed energy prices or hedging strategies (Box B of the [April 2026 Monetary Policy Report](#)), and the extent of pass-through can vary. The size and timing of indirect effects also depends on how

companies react to higher costs, for example some may raise prices while others may try to cut other costs, and on broader economic conditions. Direct and indirect effects are shown in the aqua boxes in Figure A.1.

An energy shock can also lead to more persistent inflation through second-round effects (the orange boxes in Figure A.1). Second-round effects materialise when the initial rise in inflation from direct and indirect effects feeds into firms' price and wage-setting decisions in a way that makes inflation more broad-based and longer lasting. These effects are likely to vary depending on economic conditions. Second-round effects are particularly important for the appropriate monetary policy reaction to an energy shock, because they can lead to persistently high inflationary pressures (Box G of the [April 2026 Monetary Policy Report](#)).

Figure A.1: The impact of an energy price shock on inflation



What drives second-round effects?

Second-round effects can materialise through different channels. Changes in firms' and households' price and wage expectations, changes in firms' price and wage-setting behaviour, and the interaction between these factors shapes the overall inflationary pressure which results from the energy shock.

Additional inflationary pressure may arise from price-setting if firms raise prices by more than the changes in their costs from the increase in energy prices. For example, if firms expect their costs to rise further, they may increase prices ahead of those

expected cost changes. This could be driven by the fact that it can be costly for firms to change prices, and so firms try to reduce the need to change prices in the future. Firms may also raise prices further if they expect their competitors to do the same.

These additional price rises may lead to inflationary pressures remaining persistently higher in the future. For example, firms raising prices for goods and services that are then used as an input into other firms' production may lead to subsequent additional price rises from those other firms. And these additional price rises themselves could in turn cause broader inflation expectations to rise, again leading to further price increases.

Changes in wage-setting can also lead to second-round effects as firms pass on the costs of higher wages. Higher inflation may lead to workers demanding correspondingly higher nominal wages in an attempt to resist the real income loss implied by higher imported energy costs. Alternatively, workers may demand higher nominal wage growth if they believe inflation will remain higher even after the economy has adjusted to higher energy prices. Some firms may also wish to raise wages in response to higher inflation to motivate staff or to protect their reputation (Box B of the [February 2026 Monetary Policy Report](#)). Higher wage growth can result in additional inflationary pressure if firms pass their cost increases onto their consumers. And this process can be persistent as those additional price increases may themselves lead to higher expectations for future inflation, raising nominal wage growth further.

Second-round effects in both price and wage-setting are likely to depend on the initial conditions in the wider economy at the outset of the energy shock. One notable example is the extent of spare capacity in the labour market: if there are many available workers, firms will be under less pressure to raise wages in response to worker demands, thus limiting the wage-setting channel (Box C of the [April 2026 Monetary Policy Report](#)). The share of firms using 'state-contingent' price-setting, where firms choose to reset prices based on economic developments rather than at fixed intervals, may also be important: if there are more state-contingent price-setters, that might increase the incidence of second-round effects. And the pre-existing level and duration of inflation when the energy shock occurs may be important too. Past research has highlighted threshold effects where inflation expectations may increase by more if inflation is already elevated (Box C of the [April 2026 Monetary Policy Report](#)).

How are second-round effects from the recent energy shock likely to materialise?

Assessing the extent of any second-round effects from the recent rises in energy prices is difficult to do in real time. This is because the full effects will only appear gradually. However, the stance of monetary policy may need to adjust before the extent of second-round effects becomes clear in order to avoid these effects becoming entrenched.

Table A.1 provides a set of indicators through which the potential channels of second-round effects can be monitored. These indicators span a mix of standard and more novel data sources and analytical techniques. The first category of indicators are examples of relevant broader economic conditions and structural factors at the outset of the shock (the ‘initial conditions’ in the economy) which may affect the strength of the mechanisms through which second-round effects materialise. The subsequent two categories represent evidence on those mechanisms directly: first price-setting and second wage-setting.

It is likely that some indicators will provide a stronger signal on second-round effects than others and that different indicators will be most useful at different points in the evolution of the shock’s impact. An assessment of the indicators for which data are currently available is set out in Box B.

Table A.1: Monitoring indicators for second-round effects

Category	Example indicators
Initial conditions	Spare capacity in the labour market and within firms (eg level and deviation from equilibrium of the vacancies to unemployment ratio)
	Demand conditions and firm profit margins (eg the average level of profit margins compared with historical norms)
	Pre-existing inflation conditions (eg the level and duration of inflation prior to the shock)
	Firms' approach to resetting prices (eg the share of firms using state-contingent pricing relative to those setting prices at fixed time intervals)
	Household and business attentiveness to inflation (eg internet search frequency for inflation terms)
Price-setting	Firm price expectations (eg change in DMP survey CPI inflation and own price expectations relative to energy cost changes)
	Firm price responses to the energy shock (eg DMP survey comments mentioning energy affecting the business)
	Changes in firm profit margins (eg DMP survey measure of the share of firms expecting margins to rise or fall due to higher energy costs)
	Evolution of consumer prices (eg change in prices for products driven by second-round effects in the past)
	Distribution of price changes (eg the share of the CPI increase which is common across products)
Wage-setting	Realised wage growth (eg observed changes in the patterns of bonus payments)
	Firm wage responses to the energy shock (eg DMP survey comments mentioning inflation affecting wage growth)
	Expected wage growth (eg Agents' intelligence mentioning energy affecting future wage growth)
	Coincidence of wage and price expectations (eg change in correlation between rising inflation and wage expectations in DMP survey)
	Household inflation expectations (eg average inflation expectations for working people)

Box B: Evidence on second-round inflation effects from the recent energy price rise

There is a risk that the recent rise in energy prices results in additional inflationary pressure through second-round effects, requiring a response from monetary policy to ensure inflation does not remain persistently above the 2% target (Box A). It is too soon to judge precisely the future scale of second-round effects on inflation from the recent shock. There is little evidence so far to suggest large effects. However, some of the most important evidence, for example on pay settlements, will only appear with a lag. And the eventual scale of any second-round effects will depend on the future path of energy prices, with any further rises posing a greater risk of broader inflationary pressure. The MPC will continue to monitor closely the evidence as it emerges.

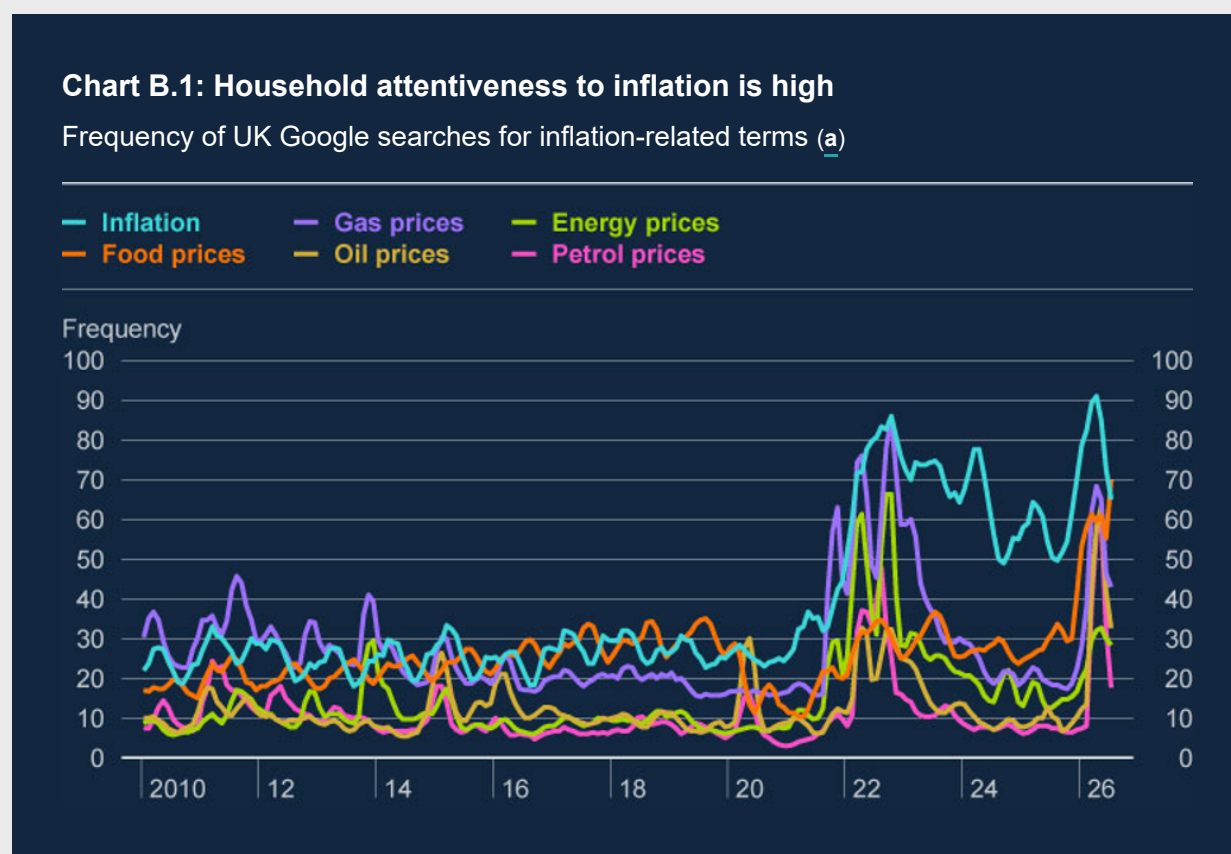
Box A sets out a range of economic indicators that are important for second-round effects, including developments in firms' price and wage-setting and the broader initial conditions in the economy. This box focuses on those indicators for which evidence is already available, including some drawing on novel measures and techniques.

What is the current evidence for how initial conditions in the economy will affect the strength of second-round effects?

The prevailing economic conditions at the outset of this shock are likely to reduce the strength of second-round effects. Most evidence suggests that there is currently a degree of spare capacity in the labour market, in contrast to the historically tight labour market when energy prices rose in 2022 (Section 1.2). This may reduce workers' ability to secure higher nominal wage growth in response to higher inflation (Box C of the [April 2026 Monetary Policy Report](#)). And the backdrop of relatively weak household demand over recent years should reduce firms' ability to pass through cost increases fully into consumer prices. Consistent with that, the Bank's Agents report that contacts typically point to weak demand limiting pass-through of cost increases. Most measures suggest profit margins are slightly below 2019 levels, which is consistent with weak demand. However, low margins could also mean that some firms are unable to absorb cost increases into their margins, raising the likelihood that these costs are passed through to prices.

Elevated household attentiveness to inflation means there is a risk that further rises in energy prices could be accompanied by rises in household inflation expectations that flow into price and wage-setting. Since the 2022 energy shock, households appear to

be more attentive to inflation-related news. For example, media coverage on inflation topics remains elevated and the frequency of Google searches for inflation terms has been well above historical norms (Chart B.1). In addition, evidence suggests that inflation expectations tend to be more responsive to a rise in prices when the prevailing level of inflation is elevated (Box C of the [April 2026 Monetary Policy Report](#)).



Sources: Google and Bank calculations.

(a) The series are three-month rolling averages. The frequency is a relative measure for each individual search term, over 2005–2026, where 100 indicates the highest frequency over that time period. Data are up to July 2026 and are not seasonally adjusted.

What is the current evidence for the strength of second-round effects from price-setting?

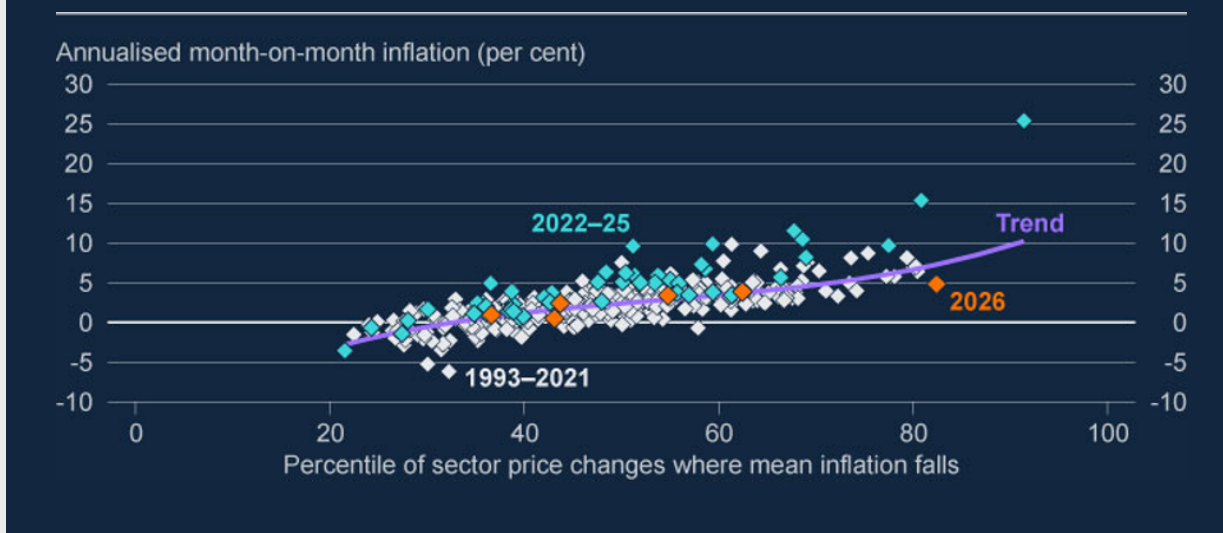
One direct measure of second-round effects is the scale of observed price rises which exceed firms' direct and indirect costs from higher energy prices. Estimates suggest that the contribution of direct and indirect effects – including both directly consumed energy and the impact of energy cost increases passing through broader supply chains – will push up CPI inflation in 2026 Q4 by a little over 1 percentage point compared with prior to the Middle East conflict (Chart 1.5).

Higher energy prices should lead to a rise in the relative prices of energy-intensive goods and services. That will likely manifest as an upward skew to price changes across granular CPI components. Second-round effects tend to be broad-based across CPI components, however. In previous periods of higher energy prices, including 2022–25, average price rises were higher than would be expected given the observed skewness, consistent with the existence of second-round effects (as shown by the aqua diamonds appearing above the trend line in Chart B.2). That pattern has not been reflected in CPI outturns so far in 2026 (the orange diamonds are in line with the trend line in Chart B.2). This could signal no unusually broad-based second-round effects during the current episode. However, there has tended to be a short lag between past rises in energy prices and an increase in broad-based inflation and so it is possible that the signal from the measure will change in coming months as more data become available.

Complementary analysis of changes in the prices of specific CPI components leads to a similar conclusion. An instrumental variable local projections method similar to [Allayioti et al \(2024\)](#) allows the identification of components of the CPI basket that in the past have tended both to react quickly to higher oil prices and where prices have risen by more than the estimated impact of direct and indirect effects. The average price increase for these components since the most recent oil price rise is somewhat larger than for components that have not tended to show large second-round effects in the past, but the differential in price increases is smaller than in the 2022 energy price shock and in line with the observed change following the 2011 oil price shock. As such, these results are not currently suggesting unusually large second-round effects. This is likely to be a noisy measure, however, and the reliability of the signal will improve over coming months as more data are released.

Chart B.2: Observed price rises in 2026 have not been unusually broad-based, suggesting limited evidence of second-round effects so far

Average CPI monthly price change compared with a measure of the skewness of price changes across granular CPI components (a)



Sources: ONS and Bank calculations.

(a) Estimates follow the method of [Smith and Wolman \(2024\)](#). The horizontal axis shows the percentile of the distribution of the 85 class-level CPI components at which the average seasonally adjusted monthly CPI inflation rate occurs – if the mean is high in the distribution this would typically suggest an upward skew to price changes. The trend relationship is estimated using a non-linear function over the period 1993–2020.

Firms' expectations for price rises suggest some pass-through of energy costs but little additional inflationary pressure. Average expected increases in firms' own prices over the next year reported by respondents to the DMP survey rose from 3.5% in the three months to March 2026, prior to the conflict in the Middle East, to 3.9% in the three months to July 2026. This change is less than staff's estimate of the direct and indirect effects of energy in 2026 Q4, suggesting firms on average do not expect to raise prices more than the increase in their costs. That rise is also less than in the corresponding period in 2022 when expectations rose by 1.2 percentage points between February and June 2022, although the magnitude of the 2022 energy shock was larger than in 2026. In July, 55% of firms reported that they expect to raise prices in response to higher energy costs, while 40% expected no change and 5% expected to cut prices. As only a little over half of firms expect to raise prices in response to higher energy prices, that currently suggests firms are not expecting broad-based second-round effects.

Another indicator of emerging second-round effects would be firms raising prices to maintain their real profits in the face of higher inflation. While a full assessment of this channel would require a counterfactual for the evolution of margins in the absence of

the energy shock, there is limited evidence to suggest that firms expect profit margins to increase. The DMP survey shows that only 4% of firms expect the conflict will lead to higher margins, while around two thirds of firms are expecting higher energy prices to result in reduced margins. Given overall price expectations have risen, this is consistent with firms passing through some, but not all, of their cost increases.

Firms passing on only some of their cost increases to customers may reflect the energy shock resulting in weaker demand in the economy. Evidence from a Large Language Model (LLM) used to categorise the free text comments made by respondents to the DMP survey on how they expect the conflict in the Middle East to affect their businesses over the next year shows that firms are generally as likely to mention lower demand as they are costs. And both of these are mentioned more frequently than prices. If consumers are able, and choose, to smooth consumption through the rise in energy prices, however, then demand may remain more robust than expected by some DMP respondents.

Taken together, price changes so far would appear to be driven by direct and indirect energy effects, rather than second-round effects, but comparisons to past energy shocks suggest that more evidence may materialise in the coming months.

What is the current evidence for the strength of second-round effects through wage-setting?

Average nominal wage growth has been falling gradually since its peak in 2023 and so far there are limited indications that the rise in energy prices will lead to higher wage growth. The July DMP survey showed that firms expected wage growth of 3.4% over the coming year, below the reported realised wage growth of 4% (Section 1.1). Firms' wage expectations have averaged close to 3.5% since the start of the year. It is possible that wage expectations would have continued to fall absent the shock and so the overall stability in wage growth expectations may mask some upward pressure. The net balance of firms reporting in the DMP survey that they will raise wage growth in response to higher energy prices is close to zero, however.

Other evidence is also consistent with a limited impact of energy prices on wage growth. Firms responding to the DMP survey that expect to increase prices in response to the energy price shock have not reported higher wage expectations since the conflict began. The DMP survey also collects qualitative comments on the drivers of expected wage growth and, using the same LLM-based approach as set out above, firm performance is more often cited as affecting expected wage growth than inflation and labour market factors, in contrast to 2023 (Chart B.3). And a similar LLM-based analysis of a database of firm earnings call transcripts, covering around 300 UK-headquartered firms each quarter, found that there was no increase in the share of

transcripts mentioning labour cost-related terms between 2026 Q1 and Q2. This contrasts with 2011 Q1 when a higher share of earnings call transcripts mentioned labour costs compared with 2010 Q4, following a large oil price increase, although this measure has tended to be noisy in the past.

There remains a risk that wage-setting could generate second-round effects in the future, particularly because firms tend to make wage settlements by the second quarter of the year, so any impact on wage growth may only emerge by 2027 Q2. Some contacts of the Bank's Agents report that knock-on effects from the conflict could slow wage disinflation in 2027 ([Agents' summary of business conditions – July 2026](#) (ASBC)).

Chart B.3: Firms are less likely to report that inflation is important for wage growth than in the recent past

Share of firms' comments in the DMP survey mentioning economic effects on wage growth
(a)



Sources: DMP survey and Bank calculations.

(a) The results are based on application of a LLM to the DMP survey open-text question: 'In your own words, what are the main factors that will affect average wage growth per employee in your business over the next 12 months?'. The model categorised comments depending on if they mentioned a range of factors, which have been aggregated to the broad groupings shown on the chart. A sample of the responses was validated by a researcher performing the same categorisation – the LLM provided a very high degree of accuracy in the sample. Comparing category shares over time may not be a perfect signal as some firms may have mentioned inflation in the context of falling inflation in 2024 and 2025 leading to slower wage growth while mentioning inflation in the context of rising wage growth in 2023.

Other metrics that identify early indications of additional wage pressures will be available in the months ahead. One draws on insights from Box B of the [February 2026 Monetary Policy Report](#). This analysis exploits the difference in wage-setting patterns across firms, with four wage-setting ‘clusters’ having been identified. Drawing on the intelligence from the Bank’s Agents, they can be interpreted as bargaining, reputational, incentive payers and cost minimisers. Some firms, for example reputational wage-setting firms, may be more likely to raise wages sooner in the face of higher inflation. New work that matches firms responding to the ONS’ Monthly Wages and Salaries Survey to these wage clusters allows a timely estimate of the development in wages across these groups. This may provide an early indication of the wage-channel creating additional inflationary pressure, although it remains too soon to identify changes since the current energy shock because the data are only currently available to March 2026.

Other measures of wage growth may also be useful when they become available, such as: if there is an increase in a common trend in wage growth across sectors or if, as occurred when energy prices rose in 2010–11 and 2022–23, there is an increase in bonus payments for workers and a larger share of bonus payments happening at unusual times of the year. Other measures of wage growth are likely to be most informative in 2027.

Workers’ expectations of prices are also important for wage-setting. Household inflation expectations have risen since the start of the conflict, although they have fallen since the time of the April Report (Section 1.1). The peak increase in one-year ahead inflation expectations in 2026 was smaller than following the energy price rises in 2022, but larger than after the energy price rises in 2011. The fact that inflation expectations have fallen back may be consistent with limited pressure from workers for higher nominal wages to prevent falls in real income. However, there is a risk that inflation expectations increase following the latest rises in energy prices due to the most recent re-escalation of the conflict, particularly in light of the additional household attentiveness noted above. More broadly, household inflation expectations have not returned to historical norms since the 2022 energy shock.

Taken together, the signal from wage data is limited given lags in the impact of energy prices. Early signals of wage settlements in 2027 will be a key indicator of how energy costs are affecting pay demands.

What overall conclusions can be drawn from the currently available evidence on second-round effects?

Although it is reassuring to some extent that early indicators of second-round effects are not signalling material effects, the overall assessment is necessarily tentative as second-round effects often emerge with a lag. Protracted attempts by firms and households to resist the real income losses implied by higher imported energy costs may lead to the required adjustment playing out gradually through wage demands, margins and price-setting. The early indicators outlined in this box are less able to identify these longer-term effects. The eventual scale of any second-round effects will also depend importantly on the future path of energy prices, with a further rise or a more persistent energy shock posing a greater risk of broader inflationary pressures.

Box C: A granular measure of underlying inflationary pressures

Underlying inflationary pressures cannot be directly observed but are often proxied by components such as consumer services inflation or exclusion metrics such as core CPI inflation. Bank staff have developed a granular measure of UK inflationary pressures, designed to complement the wide range of metrics the MPC already monitors. The measure reweights the 85 subcomponents of CPI inflation, assigning greater weight to stickier prices and to prices that play a central role in production networks. These prices should tend to provide a good indication of underlying inflationary pressures. The measure has fallen in recent quarters, suggesting that most of the recent increase in CPI inflation has occurred in more flexible and less central sectors.

When assessing underlying inflationary pressures, monetary policymakers pay close attention to changes in sticky prices.

Some prices are stickier than others. For example, motor fuel prices typically respond to changes in global oil prices within days, while the prices of many manufactured goods tend to be adjusted every three to six months, and many services prices remain fixed for a year or longer. Differences in the stickiness of goods and services prices can reflect a range of factors, including differences in market structure and the relative importance of different production inputs. Firms that use globally traded commodities to produce manufactured goods may need to adjust their prices frequently to remain profitable and competitive in shifting global market conditions. Meanwhile, labour is the most important input in the production of many services, and services firms may reset their prices in line with typically annual wage negotiations.

An increase in inflation in sectors with sticky prices can be a signal of rising underlying inflationary pressures which may require a monetary policy response (Box G of the [April 2026 Monetary Policy Report](#)). For firms in sectors with sticky prices, increases in inflation can lead to distortions as they struggle to keep up with changes in the aggregate price level. The academic literature suggests that, in seeking to meet their inflation targets sustainably over time, monetary policy makers may want to stabilise sticky-price inflation to avoid such inefficiencies ([Aoki \(2001\)](#)). Firms that reset their prices less frequently may also be more likely to anticipate future cost increases and demand conditions. Increases in sticky-price inflation can therefore be a signal that firms expect rising cost pressures or strong demand for their product, both of which could add to underlying inflationary pressures.

| Some prices play a central role in production networks.

Some prices play a more central role in production networks than others ([Dhingra and Page \(2023\)](#)). For example, energy prices are an important input cost in the production of many goods and services, while food prices are a key input cost for the hospitality sector.

Increases in particularly central prices are likely to propagate through supply chains, raising cost pressures and ultimately consumer prices across many sectors. This could keep CPI inflation above target for some time, which could also push up inflation expectations (Box G of the [April 2026 Monetary Policy Report](#)).

| Staff have developed a granular measure of underlying inflationary pressures which gives greater weight both to stickier and to more central prices.

Staff have constructed a granular ‘sticky-central’ measure of underlying inflationary pressures that can complement the many alternative measures that the MPC monitors, such as core inflation, services inflation and measures of underlying services inflation that exclude regulated components or volatility in price movements (Charts C.1 and 1.3).

The new granular measure assigns more weight to CPI components that are particularly sticky and to those that are particularly central, inspired by the method of [Rubbo \(2023\)](#). The stickiness of different prices is assessed using CPI microdata by calculating the probability that a given item changes price over the course of a year and then aggregating these probabilities up into the 85 CPI classes. A measure of the centrality of different prices is constructed based on ONS input-output tables to reflect the sales share of each sector in overall GDP. The resulting weights for stickiness and centrality are then combined and normalised.

Some items that are both relatively central and have sticky prices receive materially higher weights in the granular inflation index than in the CPI. This includes, for example, various repair services that are used throughout business supply chains. For other items, centrality and stickiness can counteract each other. For example, energy receives a much lower weight than its roughly 6% weight in the CPI as the flexibility of its price more than offsets its centrality in supply chains. Nevertheless, the measure does pick up some indirect effects of rising energy prices as they feed through to relatively sticky prices of goods and services that rely on energy in their production, such as new cars and passenger transport by road.

The granular measure of underlying inflationary pressures assesses the stickiness of prices more explicitly and at a more detailed level than broader measures such as those shown in Chart 1.2. It also includes all items in the CPI basket rather than just

services, and it considers the centrality of certain goods and services in supply chains. Taking into account the role of intermediate input prices and considering different degrees of price stickiness along supply chains means that the measure should more closely reflect developments in aggregate marginal costs – and therefore slack – across the economy than broader measures of underlying inflation.

The approach has limitations, however. For example, the granular inflation measure is based on average estimates of price stickiness over the available sample period. But there is evidence that the share of firms setting prices in response to changing economic conditions rather than at fixed intervals has increased in recent years ([Bunn et al \(2026\)](#)), and also that the frequency of prices changing has increased (Box B of the [April 2026 Monetary Policy Report](#)). This means that the measure would miss relative changes in the frequency of price adjustments across sectors. More generally, there is no unique way of quantifying the concepts of price stickiness and network centrality that this approach seeks to capture. It is possible to refine further the method in multiple ways, including by reweighting components at an even more granular level.

The granular measure of underlying inflationary pressures peaked at 7.5% in December 2022 and has since gradually fallen back, standing at 2.8% in June 2026 (Chart C.1). The measure averaged 3.0% between 2000 and 2019, which may suggest that it has returned to a level that is broadly consistent with the 2% inflation target. The decline in this measure suggests that the recent increase in CPI inflation has been driven mainly by price changes in more flexible and less central sectors, rather than by sticky and central prices.

Chart C.1: Inflation currently appears to be driven by relatively flexible prices that are less central to supply chains

Measures of annual inflation (a)



Sources: ONS, [Davies \(2021\)](#) and Bank calculations.

(a) The granular measure of underlying inflationary pressures reweights the 85 COICOP 4 CPI classes based on measures of price stickiness and centrality. Centrality is measured through Domar weights based on the UK Leontief inverse from the 2019 industry input-output tables, mapped from industry into consumption space based on the ONS CPA-COICOP converter. Where one industry feeds several consumption categories, its column is split across them, using the weights from the CPA-COICOP conversion tables, to avoid double-counting its upstream importance. The Domar weight of a category is then the consumption-weighted sum of its upstream multipliers. Price stickiness is measured through microdata at the item-quote level provided by [Davies \(2021\)](#), whose work is in turn based on the original ONS data. Subcomponents for which no microdata is available have their stickiness weight imputed based on the observed volatility of price changes at the subcomponent level, and the stickiness of prices in heavily regulated sectors is set to the cross-sector median. Package holidays are excluded from the measure due to a missing CPA-COICOP mapping. Core inflation is measured as CPI inflation excluding food and non-alcoholic beverages, alcohol, tobacco and energy. Latest data are to June 2026.

Box D: What do global developments imply for the UK inflation outlook?

World export prices are a key determinant of the cost of the goods and services that the UK imports. Higher global energy prices and supply chain pressures have raised UK imported inflation and are expected to drive further increases in coming quarters. And strong demand for AI-related components is creating sector-specific price pressures, which is also feeding through to UK import prices. Acting in the opposite direction, higher trade tariffs have exerted some downward pressure on UK import prices via trade diversion. Overall risks to the UK inflation outlook from global developments are judged to lie to the upside.

World export price inflation is expected to have risen sharply in 2026 Q2 and to remain elevated over the second half of the year.

UK-weighted world export price inflation was relatively subdued prior to the conflict in the Middle East. That partly reflected weakness in Chinese export price inflation due to weak Chinese domestic demand, policies supporting export-oriented growth, and a depreciation of the renminbi effective exchange rate index over the first half of 2025. It also reflected some downward pressure from trade diversion.

Four-quarter UK-weighted world export price inflation (excluding the direct effect of oil prices) rose to 1.7% in 2026 Q1 and is expected to rise further to a little over 5% in 2026 Q2 and Q3 (Chart D.1), before slowing somewhat in 2026 Q4. The expected pickup over 2026 mainly reflects the impact of the conflict in the Middle East, although the indirect contribution from energy is expected to be lower than at the time of the April Report reflecting the fallback in oil prices since then based on the 15-day average to 20 July (Section 1.1). AI-related demand is also expected to put upward pressure on UK-weighted world export price inflation over the remainder of the year. Acting in the opposite direction, the continued effects of trade diversion are assumed to push down very slightly on world export price inflation over 2026.

Higher world export prices will feed through to UK non-energy import prices, which are projected to increase by 2.4% on average over 2026, providing a positive contribution of around $\frac{1}{2}$ percentage point to UK CPI inflation this year. The sterling ERI has been relatively stable over recent quarters, with a depreciation against the euro partially offset by an appreciation against the US dollar, and so has had little impact on UK import price inflation.

Chart D.1: World export price inflation is expected to have risen sharply in 2026 Q2

UK-weighted world export prices (excluding the direct effect of oil prices), UK non-energy import prices and the sterling ERI (a)



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

(a) UK-weighted world export prices are based on goods and services exports of 51 countries weighted according to their shares in UK imports, each measured in their domestic currency. The sample does not include any major oil exporters (except for the US). The final data point for the UK-weighted world export prices and UK non-energy import prices series is 2026 Q1. The final data point for the sterling exchange rate index series is 2026 Q2. Diamonds show Bank staff projections for UK-weighted world export prices excluding the direct impact of oil and UK non-energy import prices excluding fuel for 2026 Q2–Q3.

Energy prices will be a key driver of UK-weighted world export prices this year and there are upside risks if they rise further or if supply chain pressures worsen.

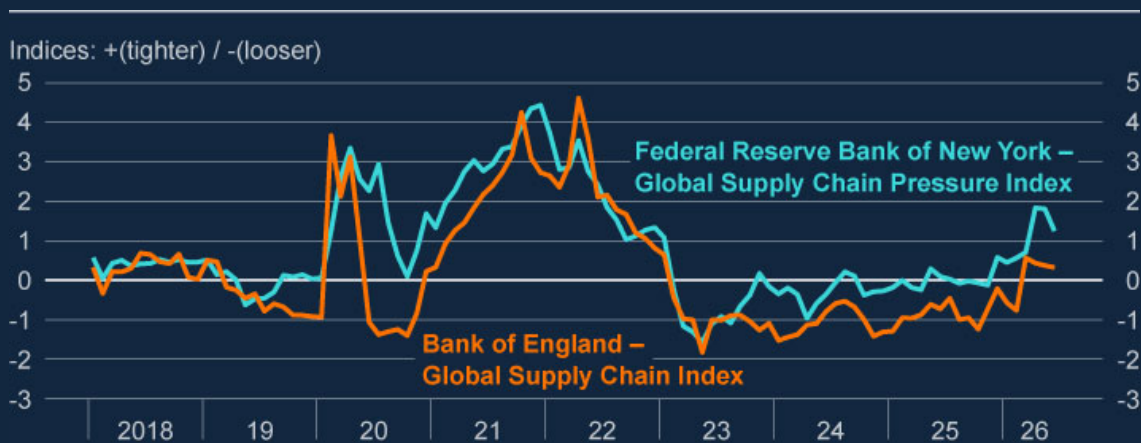
The conflict in the Middle East has added to cost pressures globally. Besides their direct impact on UK CPI inflation (Section 1.1), higher energy prices have raised production and transportation costs for UK trading partners. This has started to feed through to UK-weighted world export prices and consequently UK non-energy import costs (Box F of the [April 2026 Monetary Policy Report](#)).

Global oil prices have been volatile in recent weeks but the fallback in oil prices between the run-up to the April Report and the 15-day average to 20 July means that the indirect impact on world export prices is somewhat lower than assumed at the time of the April Report (Section 1.1). Based on that same comparison period, the prices of some energy-intensive inputs such as fertilisers had receded towards pre-conflict levels. Global agricultural commodity prices had also fallen since the April Report, although they remained higher than at the start of the year.

Indicators of supply chain disruption have also declined since their recent peaks in April, although they remain tighter than last year (Chart D.2). There is a risk that these measures pick up if the conflict continues.

Chart D.2: Indicators of supply chain pressures are signalling a tightening in conditions since the onset of the conflict but have eased slightly since April

Indicators of supply chain disruption (a)



Sources: Federal Reserve Bank of New York, S&P Global and Bank calculations.

(a) The Bank of England Global Supply Chain Index is estimated by Bank staff using principal component analysis on a range of PMIs for supply constraints in the manufacturing sector (supplier delivery times, stocks of purchases, stocks of finished goods, input prices and backlogs of work). These indices are then weighted into a global index using PPP weights. Before principal components are estimated, these indicators are regressed on the new orders PMI to control for movements in demand. The NY Federal Reserve's Global Supply Chain Pressure Index is also constructed using data from PMI surveys in addition to shipping and air freight data. The final data point for both series is June 2026.

Demand for AI-related products has pushed up specific global export prices and these are judged to be feeding through to UK import prices.

The rapid buildout of AI capacity, including data centres, semiconductor and associated hardware manufacturing facilities, has led to strong growth in demand for exports of AI-related products, particularly from Asian economies to the US. This has been reflected in higher export prices from key upstream suppliers in Asia (aqua line in Chart D.3), particularly Korea, Taiwan and Japan.

The UK imports AI-related products both directly and through their intermediate use in the production of other imported goods. AI-enabling goods, as defined by the [WTO](#), make up 6%–7% of the direct value of UK goods imports, while consumer electronics account for an additional 5%–7%. Memory chips, an important component of consumer electronics as well as an input for data centres, have experienced

particularly strong price pressures. The Bank's Agents report significant investment in UK data centre capacity, though this has been limited by infrastructure, planning and key input constraints. Some contacts have reported upward cost pressure on consumer electronics such as mobile phones, laptops and games consoles that rely on AI-related components ([ASBC – July 2026](#)).

Looking ahead, the pace of the global AI buildout has been rapid and global demand for key components continues to exceed expanding supply. As a result, AI-related demand is expected to continue to boost Asian export price inflation in the near term and to raise the level of UK-weighted world export prices by a little over 1%, with around half of that impact expected to be passed through to UK import prices over 2026 to 2027. Based on the estimated value added of IT-related products originating in East Asia for UK consumption, this is expected to add a little over 0.1 percentage points to UK consumer price inflation by the end of the year. Supply constraints in East Asian production mean that there is a risk that the near-term impact of AI-related demand on UK import prices is higher.

Chart D.3: Global demand for AI-related goods is boosting Advanced-Asia export prices

Export prices of selected countries and UK-weighted world export prices (excluding the direct effect of oil prices) (a)



Sources: LSEG Workspace and Bank calculations.

(a) Advanced Asia refers to Hong Kong, Japan, Korea, Singapore and Taiwan. Euro area monthly series is calculated from Belgium, Estonia, Finland, Germany, Ireland, Italy, Netherlands and Spain series. The final data points for each monthly series are June for Advanced Asia and the US, and May for China and the euro area. The diamonds show staff projections for UK-weighted world export price inflation over the period 2026 Q2–Q3.

Updated staff analysis suggests that trade diversion has put downward pressure on UK import prices.

Since early 2025, the United States has raised tariffs on many of its trading partners and some countries have retaliated with higher tariffs on US goods. Bank staff have undertaken further analysis to assess the importance of trade diversion for the UK, a topic previously discussed in Box F of the [April 2026 Monetary Policy Report](#). Trade diversion occurs when exporters respond to lower demand from a country that has imposed tariffs by attempting to shift some of their trade elsewhere, requiring a fall in the prices of those exports to gain market share in the new destination.

Using product level import data, new analysis conducted by Bank staff suggests that trade diversion has had a material effect on UK import prices since early 2025. Bank staff's analytical approach has a number of stages. First, a difference-in-difference approach is used to identify whether or not UK import prices and volumes moved differently for global exporters that were more impacted by increases in tariffs in April 2025, compared with those that were less impacted. Results suggest that UK import volumes of products exposed to higher tariffs remained stable or rose, while prices fell, consistent with the UK receiving a cheaper supply of goods from exporters exposed to US tariffs. Sensitivity analysis suggests the reduction in UK import prices was largely driven by lower prices from China, consistent with its large role in global goods trade and the fact that it has been disproportionately affected by the trade conflict.

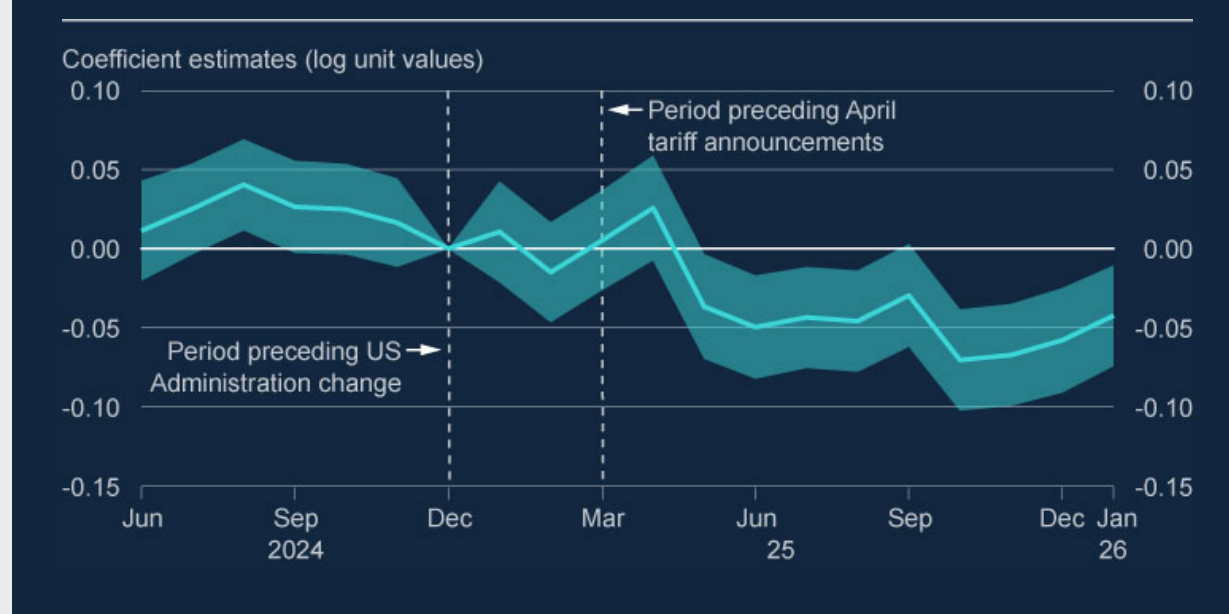
In the second stage, an event-study methodology is used to investigate whether the reduction in UK import prices from China was a result of the changes in global trade policy or a continuation of pre-existing trends such as the deflation in producer prices that had been present in the Chinese economy until the start of this year. Chart D.4 shows the estimated monthly change in UK import prices from China relative to that of other countries over the period from mid-2024 to early 2026. Results show that import prices of goods from China relative to other suppliers for the same goods showed no obvious trend in the months prior to the rise in global trade tariffs but declined steadily in 2025. This suggests that the imposition of US tariffs on China led to falls in UK import prices, consistent with trade diversion.

Using the estimated relationship between changes in UK import prices and quantities at the product level, and the cumulative increase in US tariffs on those products, the results suggest that trade diversion increased UK absorption of imports that were targeted by tariffs and lowered the level of UK import prices by around 1%–1½% from the start of 2025 through to 2026.

Trade diversion is expected to continue to weigh very slightly on UK import price inflation over the remainder of 2026 as export prices continue to adjust to changes in trading arrangements. Bank staff will continue to monitor the effects of trade diversion on import prices.

Chart D.4: Unit values of imports from China, relative to those of the same product imported from other countries, declined after the imposition of higher US tariffs

US tariffs event-study: China-specific difference in UK import prices (a)



Sources: UN COMTRADE and Bank calculations.

(a) The chart shows the China-origin event-study coefficients estimated for the UK. The units are log product unit values. The shaded areas show the 95% confidence interval. The first vertical line denotes December 2024, which is the period preceding the change in the US administration and is used as the omitted period in the event study. Coefficient estimates are expressed relative to this period. The second vertical line denotes March 2025, which is the period preceding the introduction of Liberation Day tariffs announced on 2 April. Coefficients measure the monthly change in Chinese suppliers' outcomes relative to other suppliers of the same Harmonised System (HS) six product-month, compared with the omitted month which is December 2024.

The overall risks to UK inflation from global developments are judged to lie to the upside.

Besides the possibility of continued conflict in the Middle East and greater-than-expected supply constraints for AI goods production, weather-related events could also pose upside risks to global export prices. The El Niño phenomenon is expected to be unusually strong in 2026–27 ([Dhingra \(2026\)](#) and [NOAA \(2026\)](#)). The resulting hotter

and drier conditions across several major agricultural-exporting regions could reduce crop yields and put upward pressure on global food prices, impacting UK food price inflation with a lag.

There is also a risk that global inflationary pressures interact with one another, increasing their combined impact ([July 2026 Financial Stability Report](#)). If a strong El Niño, for example, occurred alongside a re-escalation of the Middle East conflict, that could exert more severe upward pressure on UK food prices via both weather disruption and indirect effects of higher energy prices. And if extreme weather also disrupted key shipping routes, as was the case during the 2023–24 El Niño event when low water levels constrained traffic through the Panama Canal, that could exacerbate any existing supply chain disruption.

Such interactions could result in greater-than-expected upward pressure on UK import prices and potentially lead to further inflation persistence. Given the salience of food prices, for example, global shocks that interact to raise food price inflation could lead to higher inflation expectations and potentially higher wage growth. Separate Bank staff analysis suggests that global supply input shortages could cause the relationship between the output gap and inflation – embodied in the Phillips curve – to steepen ([Cesa-Bianchi et al \(2023\)](#)). This is because, when firms have limited scope to substitute between factors of production, a shortage of imported intermediate inputs restricts their ability to expand output. As such, global supply interactions that exacerbate shortages of key inputs could amplify inflationary pressures.

Acting in the opposite direction, further increases in US tariffs could exert additional downward pressure on UK inflation. Regional weather variation will also matter, for example a milder European winter could result in a slower drawdown of gas storage facilities, reducing upward pressure on energy prices. There are also notable downside risks associated with the AI investment cycle. It is possible that bottlenecks in AI supply chains ease more quickly than expected as additional capacity comes online. In addition, valuations of AI-focused technology firms remain stretched and the equity prices of some AI-focused companies have been volatile. Any material correction could tighten global financial conditions and reduce global real activity and inflationary pressures ([July 2026 Financial Stability Report](#)).

Box E: What signal can developments in broad money provide for the economic outlook?

Developments in broad money can provide useful information about the economic outlook and inflation over the medium term and beyond. If the ratio of broad money to nominal GDP moves away from its equilibrium, that could indicate that households and firms are holding more, or less, money than they would typically wish to given economic conditions. This can signal changes in future spending, which may in turn affect inflationary pressures. Analysis by Bank staff suggests that the broad money to nominal GDP ratio is in line with its estimated equilibrium, implying that developments in broad money are not currently pointing to material risks to the activity and inflation outlook. This contrasts with some previous energy price shocks, including in 2022, which occurred alongside a positive money gap.

Money aggregates can provide useful information about the economic outlook 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. While changes in broad money balances do not tend to be sufficient to explain inflationary pressures in isolation ([Broadbent \(2023\)](#)), they can complement other indicators of prospects for nominal spending and hence can provide a signal for the inflation outlook.

Many economic models used by central banks, including those that support the MPC's economic projections, are based primarily on a New Keynesian framework ([Gali and Gertler \(1999\)](#)). Models based on this framework tend to capture cyclical inflationary pressures that occur through the interaction of aggregate demand and supply, interest rates, and expectations, but do not typically capture longer-term trends or the role of broad money explicitly ([Pill \(2022\)](#)). Money dynamics, which have a stronger relationship with inflation over longer horizons, can therefore provide a useful cross-check for the MPC's assessment of the outlook ([Clements-Partridge and Thomas \(2026\)](#)).

One way to assess whether developments in broad money signal a risk to the economic outlook is by examining the ratio of the stock of broad money to nominal GDP – or how much money is available to finance a given level of spending in the economy – relative to its equilibrium. In the short run, changes in the stock of broad money are largely driven by money supply, including developments in bank lending and central bank asset purchases or sales. When a commercial bank grants a loan, for

example, it simultaneously creates a new money deposit for the borrower, thereby increasing the stock of money holdings which can then circulate through the economy ([McLeay et al \(2014\)](#)). Central bank asset purchases through quantitative easing (QE) can also increase the stock of broad money by directly increasing the bank deposits of investors selling gilts to the Bank. As investors then rebalance their portfolios towards other assets, QE may raise a broader range of asset prices, supporting aggregate wealth and spending ([Busetto et al \(2022\)](#)). By contrast, central bank sales of gilts through quantitative tightening (QT) typically weigh on broad money growth by reducing the deposits of investors who use these to purchase gilts sold by the Bank (Box G and [Ellington et al \(2026\)](#)).

If a rise in money supply is not matched by an increase in underlying money demand, for example because households and firms do not wish to hold larger money balances for precautionary or transaction purposes, the ratio of broad money to nominal GDP can rise above its equilibrium level. Money holdings tend to adjust back to the underlying level of demand only gradually, for example because it may be costly for investors to quickly buy or sell assets, or fixed debt repayment schedules may prevent borrowers from quickly changing how much debt they hold. This slow adjustment process creates what is known as a positive money gap.

A positive money gap could close via a fall in money supply, for example as households and firms repay money they have borrowed, or else through a rise in nominal GDP. The latter could come through a rise in real activity, an increase in the price level, or a combination of the two ([Pill \(2022\)](#)). By contrast, a negative money gap, whereby money holdings are lower than those desired by households and firms, could close via a rise in money supply or a fall in real activity or prices.

Analysis by Bank staff suggests that the ratio of broad money to nominal GDP is in line with its estimated equilibrium level, and so is not suggesting material risks to the activity and inflation outlook.

Over the past year, aggregate broad money growth has increased slightly (Chart E.1, aqua line in the left panel), largely reflecting stronger bank lending growth as monetary policy became less restrictive. At a sectoral level, growth in household broad money, which accounts for around two thirds of aggregate broad money, has slowed slightly, but remains close to its pre-pandemic average (orange line in the left panel). That is despite an elevated household savings rate (Section 1.2), which has largely reflected an accumulation of financial assets, including equities, rather than an increase in deposits. The slight slowdown in household money growth has been offset by an increase in the growth of money holdings of non-intermediate financial companies, which includes pension funds, insurance companies, and asset management firms.

Overall, growth in aggregate broad money has been broadly in line with growth in nominal GDP, such that the ratio between the levels of the two has been little changed (green line in the right panel).

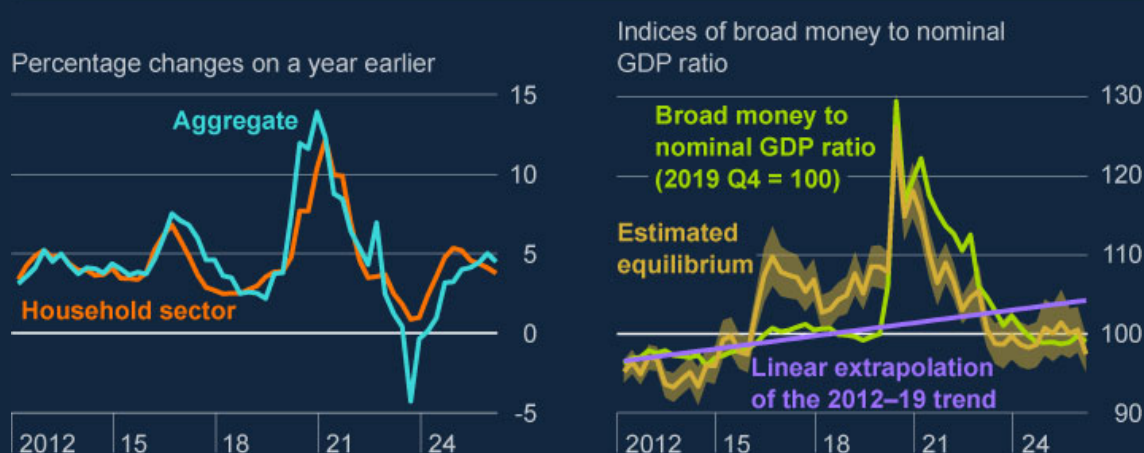
To understand whether the ratio of broad money to nominal GDP is currently suggesting risks to the economic outlook and inflation, it is necessary to compare it with an estimate of its equilibrium level. Bank staff have developed a new measure of that equilibrium by estimating the level of underlying money demand, following a similar approach to [Ellington and Milas \(2019\)](#). Underlying money demand as a ratio of nominal GDP is estimated based on the ratio of aggregate wealth to nominal income, a measure of economic uncertainty and the cost of financial intermediation (measured by the spread between the effective rates on the stocks of deposits and loans).

This approach is judged to provide a more accurate estimate of the money gap than the one used in previous Reports, which was based on a simple linear extrapolation of the pre-pandemic broad money to nominal GDP ratio (Box D of the [May 2025 Monetary Policy Report](#)). As noted in the May 2025 Report, that previous, simpler, estimate was subject to significant uncertainty. In particular, it did not capture the possibility that alongside the increase in the money supply during the Covid pandemic, underlying money demand may also have changed. The new equilibrium estimate suggests that underlying money demand relative to nominal GDP rose at the start of the pandemic before falling (Chart E.1, gold line in the right panel), primarily because wealth did not keep pace with rising prices, such that households and firms wanted to hold smaller money balances relative to their spending.

The ratio of broad money to nominal GDP is estimated to be close to Bank staff's new estimate of its equilibrium (Chart E.1, right panel), which suggests limited additional risks to the economic outlook and inflation over the medium term and beyond. While there is uncertainty around this estimate of the equilibrium, the absence of a material money gap is also consistent with an alternative estimate of the equilibrium that is calculated by smoothing through short-term fluctuations in the ratio of broad money to nominal GDP.

Chart E.1: Broad money growth has increased slightly over the past year and the ratio of aggregate broad money to nominal GDP is in line with its estimated equilibrium

Four-quarter growth in aggregate and household broad money; (a) ratio of broad money to nominal GDP and its estimated equilibrium (b)



Sources: [Baker et al \(2016\)](#), 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 detail on what is captured within the household sector. Final data points shown are for 2026 Q1.

(b) The shaded area shows the 95% confidence interval around the model estimate of the equilibrium. The purple line shows the 2012–19 linear trend in the ratio of broad money to nominal GDP, projected forward. The estimated equilibrium and linear extrapolation of the 2012–19 trend are shown as percentages of the 2019 Q4 value of broad money to nominal GDP ratio. The final data shown are for 2026 Q1.

The current absence of a money gap contrasts with some previous energy price shocks, including in 2022, which occurred alongside a positive money gap.

Exploratory Bank staff analysis based on historical money gap data suggests that, following large oil price shocks, inflation has tended to rise by more and remain higher for longer when those shocks occurred alongside a material positive money gap. That is consistent with, for example, households having more spending power and so providing more support to nominal aggregate demand, such that companies are better able to pass through increases in costs to prices. Although these findings are tentative, the current absence of a money gap could imply a smaller risk of second-round effects from the current energy shock than in periods when these shocks occurred alongside material positive money gaps.

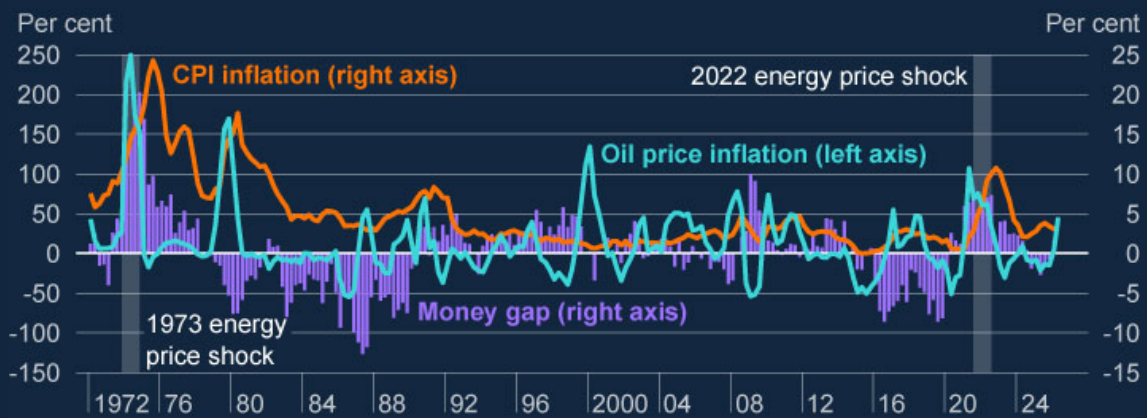
One example of an energy price shock coinciding with a material positive money gap is from 2022 (as shown by the positive purple bars for that period in Chart E.2). That positive money gap emerged during the Covid pandemic, though it was not a pre-pandemic feature, and was eroded due to the effects of restrictive monetary policy as well as rising inflation. It is possible that elevated money balances might have contributed to the level and persistence of inflation during that period. However, high inflation will also have reflected the impact of a tight labour market as well as global supply chain disruption following the pandemic and the effects of Russia's invasion of Ukraine ([Broadbent \(2023\)](#)). The MPC monitored developments in broad money closely at the time, including the elevated level of household deposits, and considered what that might imply for the demand and inflation outlook (Section 1 of the [February 2021 Monetary Policy Report](#)).

The energy price shock of the early 1970s also coincided with a large positive money gap. However, that period was characterised by a markedly different monetary and fiscal regime than the current one, which may have contributed to the persistence of inflation following the initial shock ([Bordo et al \(2025\)](#)).

The current absence of a material money gap is similar to the early-to-mid 2000s when oil price shocks were followed by only a limited rise in inflation (Chart E.2), although other factors such as labour market flexibility, which reduced employees' ability to negotiate higher wages in order to maintain their living standards, also played a role ([Barwell et al \(2007\)](#)).

Chart E.2: Some previous energy price shocks that coincided with large positive money gaps were followed by periods of high CPI inflation in the UK

Four quarter oil price and UK CPI inflation (a) and estimated money gap (b)



Sources: [Baker et al \(2016\)](#), Bank of England, LSEG Workspace, ONS and Bank calculations.

(a) Oil price inflation is annual growth in the price of Brent crude per barrel, in US dollars. The final data point shown is for 2026 Q2.

(b) Money gap is calculated as aggregate broad money as a ratio of nominal GDP as a percentage of its estimated equilibrium, expressed as a logarithm. Shaded areas represent periods of oil price shocks that occurred alongside a positive money gap in 1973 Q4–1974 Q4 and 2021 Q3–2022 Q3. The final data point shown is for 2026 Q1.

Box F: Developments in UK financial conditions

Financial conditions have tightened materially since the onset of the conflict in the Middle East, driven primarily by a rise in shorter-term market interest rates. That rise reflects both higher expectations for Bank Rate, consistent with the inflationary nature of the energy supply shock, and higher risk premia, reflective of uncertainty around the scale and duration of the conflict and associated upside risks around inflation and interest rates. Policymakers take into account financial conditions when setting Bank Rate. Higher shorter-term market interest rates have fed through to the rates faced by households and businesses, which in turn will weigh on inflation.

| How have financial conditions evolved since the Middle East conflict began?

Financial conditions have tightened materially since the onset of the conflict in the Middle East. Based on the 15 UK working day average to 20 July, the largest driver of that tightening has been shorter-term market interest rates. The UK forward OIS curve (hereafter the market curve) is around 77 basis points higher than it was prior to the conflict, and 5 basis points higher than in the lead up to the April Report, on average over the next three years (Chart F.1). The market curve has risen further recently owing to the re-escalation of the Middle East conflict (Section 1.3). Since the start of the conflict, there has also been some accompanying tightening from lower UK equity prices and sterling's appreciation, but these moves have been modest.

Chart F.1: The UK market curve has risen sharply since the conflict in the Middle East began

Instantaneous forward curves for the UK (a)



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

(a) The latest UK curve is estimated based on the 15 UK working days to 20 July, while the April 2026 Report curve is based on the 15 UK working days to 22 April 2026. The pre-conflict curve is the single day curve estimated on 27 February 2026. The range of daily curves covers the period from 2 March to 20 July 2026.

The increases in market interest rates have fed through to the rates facing households and businesses (Section 1.3). Two-year 75% loan to value (LTV) quoted mortgage rates have risen by 79 basis points on average since 27 February, just prior to the start of the conflict, a little less than the rise in the reference two-year OIS rate over that period (Chart F.2, Section 1.3). Five-year 75% LTV mortgage rates have risen by somewhat less, reflecting a smaller rise in the five-year OIS rate. Both mortgage rates and OIS rates have fluctuated since the conflict began, as shown by the aqua ranges in Chart F.2.

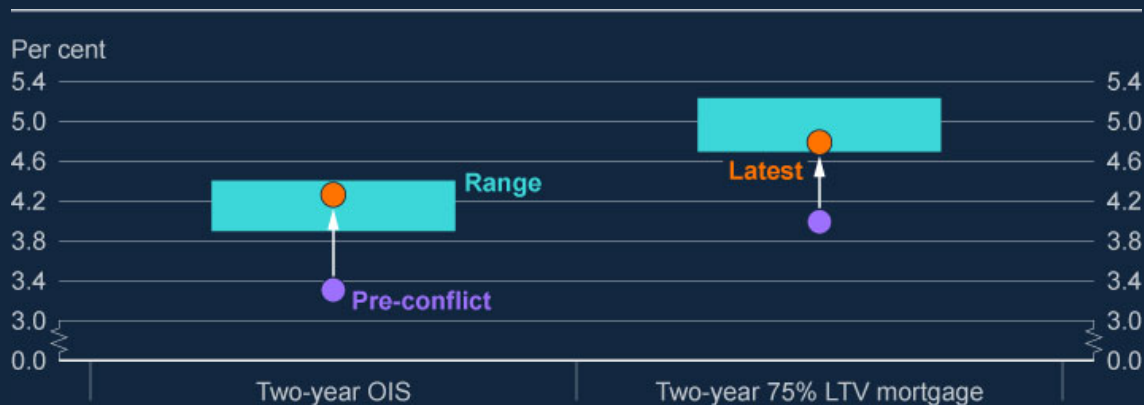
The rise in mortgage rates means that around five million households are projected to see their repayments increase by the end of 2028, compared with nearly four million just before the conflict began, although over one million households are still expected to see a decrease. For the typical owner-occupier mortgagor rolling off a fixed rate in the next two years, monthly mortgage repayments are projected to increase by approximately £45 more than anticipated prior to the conflict.

Pass-through to corporate bond yields from risk-free rates has been full and fast, with investment-grade and high-yield corporate bond yields rising by 75 basis points and 93 basis points respectively since prior to the conflict. A substantial portion of bank lending to corporates is priced using Bank Rate and so the effective rates on the stock of lending are little changed since the conflict began.

Chart F.2: Mortgage and OIS rates have risen but both have fluctuated since the start of the conflict

Changes since pre-conflict in two-year OIS and two-year 75% LTV quoted mortgage rates

(a)



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

(a) The shaded regions show the range of moves for two-year OIS and two-year 75% LTV mortgage rates since their initial peaks after the rapid tightening phase early in the conflict (20 March – 20 July for two-year OIS and 8 April – 20 July for two-year 75% quoted rate). The latest data are provisional and are as of 20 July 2026.

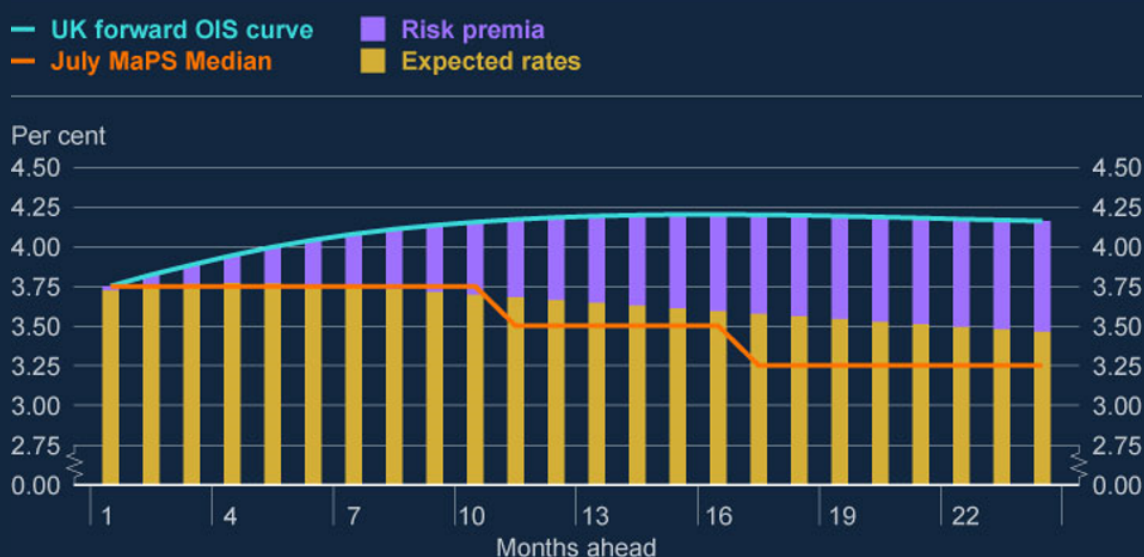
What has driven the rise in shorter-term interest rates since the start of the conflict?

The OIS curve captures both expectations about the future path of Bank Rate and risk premia. The rise in the market curve since before the conflict began reflects increases in both components.

Results from a term structure model estimated by Bank staff ([Lengyel and Walker \(2026\)](#)) suggests that the average expected path of Bank Rate for the year ahead is broadly flat (gold bars in Chart F.3) in contrast to the 50 basis points of cuts implied prior to the conflict. Survey-based estimates from the July Market Participants Survey (MaPS) similarly point to median expectations for Bank Rate being unchanged until June next year before declining further out (orange line). The higher average expected path of Bank Rate relative to the pre-conflict period is consistent with the inflationary nature of the shock. And when forming their expectations for the near-term path for Bank Rate, respondents to the most recent MaPS report that they place the most weight on energy and other commodity prices.

Chart F.3: The upward slope in the market curve is estimated to reflect risk premia

Model decomposition of the UK forward OIS curve and most likely expectations of Bank Rate implied by the MaPS (a)



Sources: Bloomberg Finance L.P., Consensus Economics and Bank calculations.

(a) This chart decomposes the aqua line into risk premia and expected rate components, based on the methodology outlined in [Lengyel and Walker \(2026\)](#). The model uses OIS rates and survey estimates from the MaPS and Consensus Economics to identify expected rates. The MaPS captures the median of most likely expectations. The July survey was conducted between 15–17 July. There are minor differences between the aqua line on this chart and the aqua line in Chart F.1 due to model estimation.

Given the broadly flat implied path for expected Bank Rate, the results from both the term structure model and market intelligence such as the MaPS imply that the upward slope of the OIS curve is primarily driven by risk premia. Risk premia compensate investors for risks around future interest rates.

Risk premia increased following the outbreak of the conflict in the Middle East and are currently somewhat higher than their historical norms at the 2–3 year horizon. The increase may have been driven by uncertainty around the scale and duration of the Middle East conflict and associated upside risks around inflation and interest rates. Relative to the period prior to the conflict, the one-year SONIA option-implied probability density function – which provides an illustration of the potential distribution of future interest rates – has widened materially to above historical averages and has a large positive skew. Realised volatility in one-year forward OIS rates has also increased, broadly in line with model-implied estimates of risk premia, and has become more highly correlated with volatility in near-term financial market inflation expectations

measures which have risen as energy prices have fluctuated. This is suggestive of elevated investor uncertainty over the possible impact of the conflict on near-term risks to inflation and subsequently the necessary path for Bank Rate.

Box G: Reviewing the process of quantitative tightening

Since February 2022, the MPC has been reducing the stock of assets held in the Bank of England's Asset Purchase Facility (APF) for monetary policy purposes, a process known as quantitative tightening (QT). This box updates the MPC's assessment of QT from its last published assessment in Box B of the [August 2025 Monetary Policy Report](#).

The Bank's balance sheet grew after the financial crisis and again after the EU referendum and during the Covid pandemic, as the MPC used quantitative easing (QE) to meet its 2% inflation target and to support the economy (Chart G.1).

The size of the stock of assets held in the APF for monetary policy purposes peaked at £895 billion at the turn of 2022.

Chart G.1: The Bank's APF holdings grew markedly through QE but have shrunk since 2022

Stock of gilts held for monetary policy purposes in the APF (a)



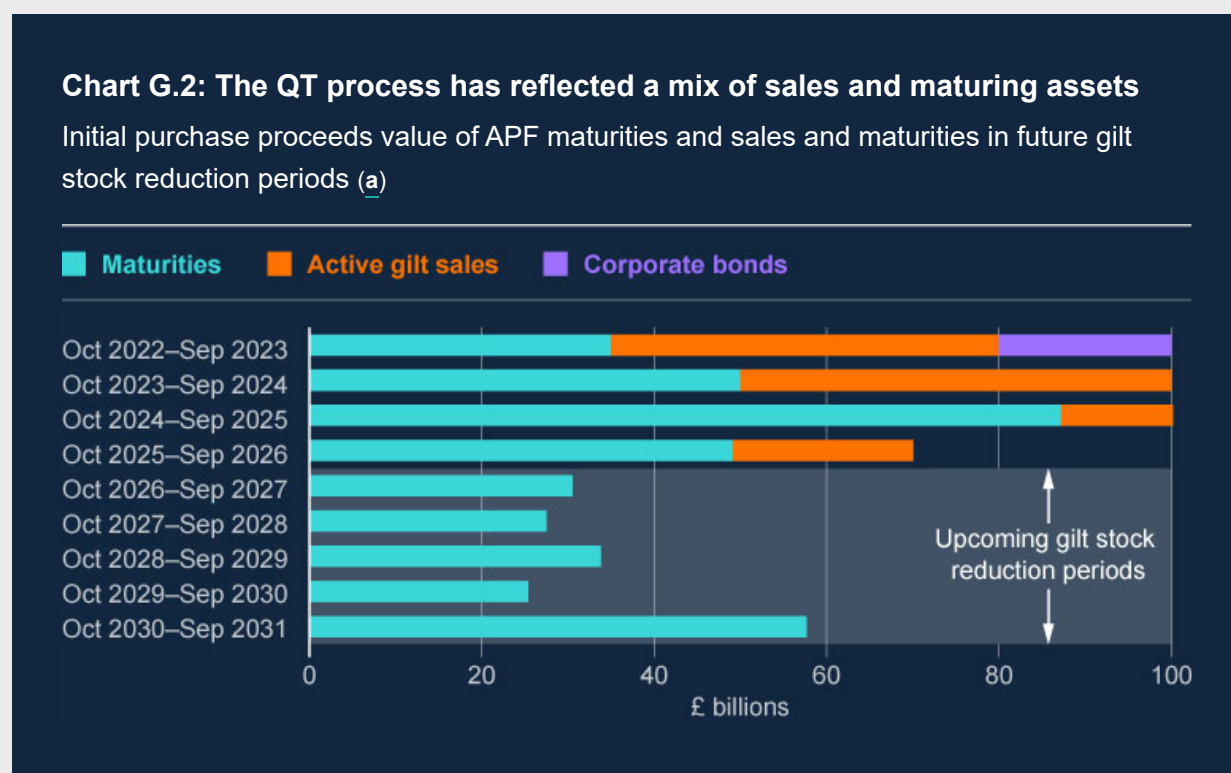
(a) Gilt value is measured as the 'initial purchase proceeds' value. Dashed line shows projection from latest data point (end-June 2026) to September 2026.

Since 2022, the stock of purchased assets has been reduced and will reach £488 billion by September 2026.

In 2022, the Bank started to unwind its holdings of assets previously purchased as part of QE. This unwind began once Bank Rate had been raised to a level that provided scope to reduce it as may be required by future monetary and financial conditions.

Reducing the size of the APF has the benefit of reducing the risk of a ratchet upwards in the size of the Bank's balance sheet over time, increasing the headroom and flexibility available to the Bank to use its balance sheet in the future if needed.

From February 2022, the Bank stopped reinvesting the proceeds of maturing assets in the APF. Since November 2022, QT has comprised of a mix of sales of gilts, maturing gilts and, until September 2023, sales of corporate bonds. The size of each of these has varied from year to year (Chart G.2), reflecting the maturity profile of assets held in the APF.



(a) Each year shows maturities in the period between October and September of the following year (ie a yearly QT review cycle). From October 2022 to September 2026 these bars show the target gilt stock reduction voted for by the MPC, including both maturities and active sales, as well as sales of corporate debt purchased under the Corporate Bond Purchase Scheme. The Committee is yet to vote on the target gilt stock reduction from October 2026 so only the path of expected maturities is shown.

The MPC's QT process has been guided by three key principles...

The MPC has previously set out key principles under which QT should be conducted.

First, the MPC has used Bank Rate as its active policy tool when adjusting the stance of monetary policy.

Second, sales have been conducted so as not to disrupt the functioning of financial markets, and only in appropriate market conditions.

Third, to help achieve that, sales have been conducted in a gradual and predictable manner over a period of time.

| ...which have helped to reduce the impact of QT on financial conditions.

The main way that QT affects financial conditions is through the portfolio balance channel (refer to [QE at the Bank of England: a perspective on its functioning and effectiveness](#), for more detail on the transmission channels).

The principles under which QT has been conducted help to limit financial market impacts outside this direct channel. Conceptually, QT could also affect gilt rates by changing market expectations for the future path of Bank Rate. This would be the case if market participants believed news about QT contained information about the future stance of monetary policy. As the MPC has been using Bank Rate as the active tool of monetary policy, this should not be the case. And market intelligence suggests that market participants' Bank Rate expectations have not been affected by QT announcements. QT could, in principle, also have effects on gilt market liquidity and thus affect liquidity risk premia. However, as sales have been gradual, predictable and only conducted in appropriate market conditions, there has been no marked effect on market liquidity.

| A range of factors have pushed up UK term premia in recent years.

Longer-term gilt yields are the sum of short-term rate expectations and a term premium. Term premia are the additional interest return that investors require to hold long-term assets compared with purchasing equivalent short-term assets in sequence over the life of the long-term bond.

Given that QT has been conducted in a way that does not communicate any changes to future Bank Rate, any impact of QT on gilt rates should come through higher term premia.

Between QT commencing in February 2022 and the end of June 2026, 10-year gilt yields rose by around 350 basis points. Term structure model estimates indicate that around 200 basis points of this increase was driven by term premia, with the remaining rise accounted for by higher expected rates.

Higher term premia have been driven by a wide range of factors, including a structural reduction in future domestic demand for long-term government debt, for example due to a decline in demand from defined benefit pension schemes. Global factors, such as economic policy uncertainty and high issuance of government bonds across countries, have also contributed to a rise in term premia across advanced economies.

Estimates of the impact of QT on term premia suggest QT has accounted for a modest increase in long-term interest rates.

Bank staff have updated their analysis of the effects of QT on gilt yields and the wider macroeconomy. While difficult to measure precisely, Bank staff continue to judge that the impact of QT on gilt yields has been modest.

Isolating the specific effect of QT is not simple because term premia are influenced by a wide range of factors, and these factors change over time. One way to estimate the specific effect is to look at movements in term premia in short periods directly around announcements of QT policies or around the time of QT auctions. This helps to identify the impact of QT because gilt market pricing tends to adjust quickly in response to market news, and the short window helps to limit the influence of other factors on the estimates. But, given that there have been a limited number of QT announcements and auctions and that QT has been operated in a predictable manner, there remains some uncertainty around these estimates.

Notwithstanding the challenges in estimating these impacts, updated analysis by Bank staff points to an estimated total increase in 10-year gilt rates from cumulative QT to date of 20–30 basis points. This estimate is based on modelling the change in the 10-year gilt rate term premium on the day of QT policy announcements, combined with the effects on the day of QT auctions. Given the overall increase in the term premium for 10-year gilt yields since February 2022, this suggests QT has driven between a tenth and a sixth of that total.

Bank staff's most recent estimate of the impact of QT on term premia is slightly higher than in the 2025 QT review (Box B of the [August 2025 Monetary Policy Report](#)), when the estimated range was 15–25 basis points. This reflects a small impact on term premia from QT announcements since September 2025. But the incremental increase from year-to-year is small relative to the uncertainty around these estimates.

There is also uncertainty around the persistence of QT's effects on term premia. One drawback of event study estimates of QT (or QE) is that they cannot identify effects that fall outside of the short window used for the estimation. Bank staff's estimate of 20–30 basis points cumulates effects across QT announcements and auctions going back to 2022 and therefore assumes that the effects of QT are highly persistent. While there is limited evidence yet on the persistence of QT's effects, Bank staff analysis of QE has assumed, based on available studies, that impacts may start to fade after one to four years (refer to Box A of the [Asset Purchase Facility Quarterly Report – 2025 Q3](#) for a discussion). If the same is true for QT, then these central estimates could overstate its impact on the current level of yields.

QT auctions have had little impact on market functioning.

Measures of gilt market functioning suggest that the market has continued to function in an orderly manner, with measures of gilt market liquidity proportionate to volatility. More broadly, QT auctions have been fully covered over the past year.

In response to evolving demand for gilts, the Debt Management Office (DMO) amended its 2025–26 financing remit by reducing sales of long-term bonds, increasing short-term financing and increasing the proportion of issuance for which an issuance method has yet to be decided. And, as part of implementing the MPC's 2025–26 decision on stock reduction, the Bank announced it would aim to sell fewer long maturity sector gilts than gilts at other maturities, to better reflect demand conditions.

Academic research estimates of the impact of QT on rates vary, but are broadly consistent with Bank staff analysis.

Staff also consider the growing body of academic research as supplementary evidence when assessing the impact of QT. There are a range of different methods and individual estimates but, taken together, staff judge these to be broadly supportive of the view that QT has had a limited impact on government bond yields.

Academic research estimates of the impact of QT rely heavily on event studies. For example, [Du et al \(2024\)](#) find that QT programmes in various countries have had limited impact on government bond yields, market functioning and liquidity. [Joyce and Lengyel \(2024\)](#) analyse the market reaction of yields to UK DMO announcements to quantify the potential impact of QT. Their estimate for the Bank's first annual QT programme is in line with the Bank staff analysis, though when extrapolated to estimate the cumulative impact of QT to date, the impact is materially larger. One reason for this difference is that their underlying model has been calibrated to the 2022/23 QT programme, when the gilt free float – the total stock of gilts held by the private sector – was smaller and the duration of gilts in the APF higher, both leading to larger effects. Moreover, the use of event studies means that these research estimates have similar limitations to the Bank staff analysis outlined above. A recent paper by [Ellington et al \(2026\)](#) applies a different method, yet despite differences in their approach, their results are broadly comparable to event-study estimates for the UK.

When the MPC sets Bank Rate, it takes account of financial market conditions that reflect the effects of announced and expected APF reductions.

The small rise in long-term rates driven by QT will have had a slight contractionary effect on GDP and will have slightly reduced inflation. The MPC takes account of these impacts when taking its decisions on Bank Rate.

The MPC will continue to monitor the impact of QT. The analysis summarised in this box will support the MPC's decision over the appropriate pace of gilt stock reduction.

The MPC will take its next decision on QT via sales and redemptions in September. Bank Rate remains the MPC's active tool of monetary policy and will be set to meet the 2% inflation target sustainably in the medium term.

3: Outlook, scenarios and risks

There continues to be uncertainty around the impact on the UK economy from the shock to energy prices related to the Middle East conflict. This impact will depend on the scale, duration and propagation of the shock, including the extent to which it generates material second-round effects in price and wage-setting.

This section presents a central projection and two scenarios to help explore the outlook and key sources of continued uncertainty around the future paths of global energy prices and the strength of second-round effects. The central projection is a baseline that the majority of the MPC agree is reasonable, with energy prices conditioned on futures curves and moderate, persistent second-round effects from the latest energy shock. A ‘milder’ scenario for inflation assumes a lower energy price path, and weaker underlying demand resulting in no additional second-round effects from the energy shock. An ‘adverse’ scenario assumes higher energy prices for the entire period with significantly larger second-round effects. The scenarios help to illustrate that, relative to the central projection, the risk of strong inflationary pressures continues to be greater than the risk of weak inflationary pressures.

The MPC sets monetary policy taking into account the likelihood and impact of a range of outcomes, balancing the costs of leaning too little against the risk of stronger inflationary pressures against the costs from responding too much. For the central projection and the milder scenario, illustrative policy rules are similar to the market curve over the coming year but lower after that. For the adverse scenario, the illustrative policy rules are higher than the market curve.

3.1: Key assumptions and judgements in the central projection and scenarios

As was the case in the April Report, the outlook for UK inflation and activity is being shaped by two key uncertainties. The first is the outlook for global energy prices. Energy prices continue to be elevated and volatile. For example, since the start of the conflict, front-month Brent crude prices have fluctuated between lows of around \$70 to well over \$110 per barrel, and measures of oil price volatility have remained above historical norms. Moreover, the spread between the price of refined petroleum products and Brent crude oil, known as crack spreads, remains well above pre-conflict levels (Section 1.1).

The second uncertainty is the strength of any second-round effects in domestic price and wage-setting, which may be closely related to the magnitude and persistence of the global energy shock. A monitoring framework suggests that it will take time to learn about the strength of these effects (Box A), and the MPC will closely evaluate emerging evidence to ensure that inflation does not remain persistently above target.

This section sets out some projections for the economy to help explore the range of outcomes. The central projection is based on a staff proposal which the majority of the MPC agrees is a reasonable baseline. There are two scenarios, labelled as ‘milder’ and ‘adverse’, which explore impacts of plausible alternative assumptions for energy prices and second-round effects (Table 3.A).

These projections and scenarios are deemed to be particularly relevant to the MPC’s policy discussions, but they are neither all-encompassing nor do they reflect the full distribution of risks. For example, other global risks to UK inflation not directly related to the Middle East conflict, such as from AI and weather disruption (Box D), are not explored in these scenarios.

Table 3.A: Key assumptions and judgements in the central projection and scenarios

	Central projection	Milder scenario	Adverse scenario
Energy prices	Energy prices for wholesale oil and gas follow the market futures curves over the 15 UK working days to 20 July.	Energy future prices follow the paths around 1 July, capturing the lower prices after the signing of the Memorandum of Understanding (MoU).	Energy prices rise materially above the central projection and remain persistently higher over the forecast period.
Second-round effects from recent energy shock	Moderate additional second-round effects, consistent with some effect on short-term inflation expectations and hence wages. In addition, heightened attentiveness to inflation also contributes to second-round effects.	No new second-round effects from the recent energy shock, owing to weaker worker bargaining and firm pricing power. This partly reflects weaker demand, driven by a greater degree of saving than in the central projection.	Stronger and more persistent additional second-round effects relative to the central projection and milder scenario. This stems from a greater effect of the energy shock on long-run inflation expectations and hence wages and prices.

The central projection and scenarios are conditioned on the market curve for short-term interest rates in the 15 UK working days to 20 July. The market curve rose over this period, particularly following the breakdown of the MoU between the US and Iran, and subsequent

risers in energy prices. Section 3.3 illustrates the impact on inflation of changing that interest rate conditioning assumption for the central projection and scenarios by drawing on some policy rules.

Other standard conditioning assumptions are set out in the [Projections Databank](#) accompanying this Report. The projections are conditioned on the Government's fiscal plans as set out in Budget 2025, as well as recent additional fiscal announcements of a removal of VAT on household electricity bills from October 2026 for six months (Section 1.1) and a £2 bus fares cap over 2027.

Energy price assumptions

Chart 3.1 illustrates the conditioning paths for wholesale oil and gas prices in the central projection and both scenarios.

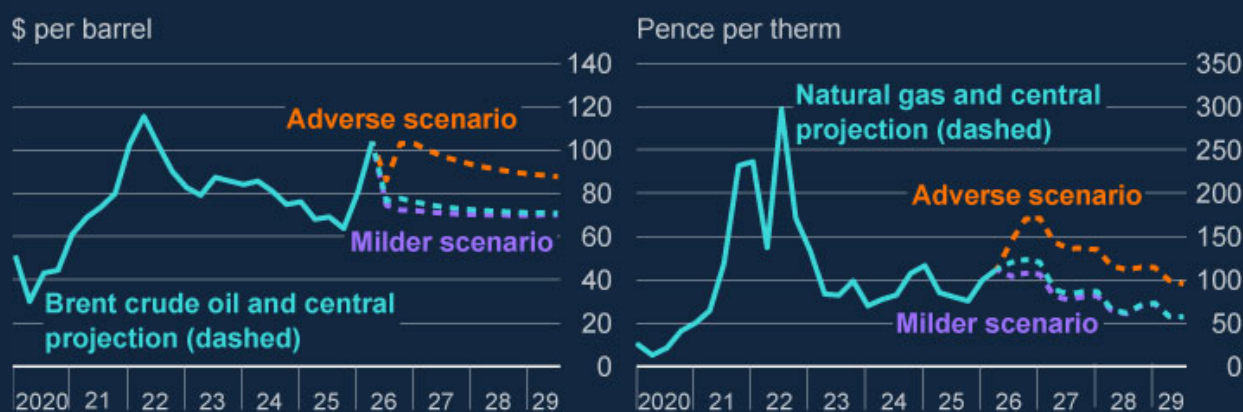
The central projection is conditioned on wholesale energy prices evolving in line with gas and oil futures curves in the 15 UK working days to 20 July. In this projection, oil prices gradually decline from \$76 per barrel in 2026 Q3 to around \$71 per barrel at the end of the forecast period. Gas futures prices peak at a little over 123 pence per therm in 2026 Q4 before declining to a little under 60 pence per therm at the end of the projection. The central projection for inflation additionally accounts for the currently elevated spreads of refined petroleum product prices over and above Brent crude oil (Section 1.1), and the outlook for them embedded in futures prices.

In the milder scenario, energy prices follow a slightly lower path than in the central projection. The assumed Brent crude oil futures curve is around 3% lower than in the central projection, while the gas futures curve is around 6% lower, on average. These paths were calibrated to the futures curves around the beginning of July. These prices are consistent with the period of lower energy prices after the MoU was signed, and so are judged to be a reasonable proxy for an external environment in which a ceasefire agreement is fully implemented, and energy price volatility is relatively lower.

In the adverse scenario, energy prices rise materially above the path implied in the central projection and remain above that path over the forecast period. The assumed Brent crude oil price is around 30% higher on average than in the central projection and the wholesale gas price is around 60% higher. Both oil and gas paths are assumed to remain well above the central projection throughout the forecast period. These paths are judged to be a reasonable proxy for a state of the world in which the conflict continues, perhaps in an episodic manner and with no clear resolution, which leads to a persistent energy shock over the entire forecast period. The path for energy prices is, nevertheless, less severe than in Scenario C published in the April Report.

Chart 3.1: Energy price paths are higher in the adverse scenario relative to the central projection and milder scenario

Brent crude oil (a) and natural gas (b) price paths in the central projection, milder scenario and adverse scenario



Sources: Bloomberg Finance L.P., LSEG Workspace and Bank calculations.

(a) Historical spot prices are quarterly averages of Brent crude oil prices and are in US dollars. The dashed lines refer to the conditioning assumptions for the central projection, and the milder and adverse scenarios, as outlined in Table 3.A. The final data are for 2029 Q3.

(b) Historical spot prices are quarterly averages of Bloomberg UK NBP Natural Gas Forward Day prices and are in sterling. The dashed lines refer to the conditioning assumptions for the central projection, and the milder and adverse scenarios, as outlined in Table 3.A. The final data are for 2029 Q3.

Assumptions around second-round effects on inflation

The central projection assumes moderate additional second-round effects from the recent energy shock. That is consistent with a margin of slack in the economy (Section 1.2), in part reflecting the loosening in the labour market since the energy shock in 2022. The calibration of the impact is informed using the model in [Bernanke and Blanchard \(2025\)](#), applied to the UK. Energy shocks affect inflation via expectations and wage-setting, although they could be consistent with some degree of firm pricing power ([Haskel et al \(2025\)](#)). In this Report, these effects have been calibrated using an augmented version of the model estimated on data that includes a period when attentiveness to inflation was elevated (Box B). This adapted calibration results in inflation expectations responding slightly more to inflation shocks than assumed in Scenario B of the April Report, and generates more persistence in second-round effects in the medium term.

The milder scenario assumes that there are no second-round effects in response to the current energy shock, because greater slack in the labour market and weakness in demand limits worker bargaining and firm pricing power. This scenario explores similar downside risks

to activity as in Scenario A published in the April Report, but assumes that a greater degree of precautionary savings, rather than a reduction in real incomes due to the energy shock, leads to weaker demand (Box D of the [November 2025 Monetary Policy Report](#)).

In the adverse scenario, persistently elevated energy prices lead to inflation expectations drifting higher, leading to disproportionately stronger second-round effects than assumed in the central projection, generated using the same mechanism as underlying Scenario C published in the April Report. Similar inflation paths could also be generated by intrinsic persistence stemming from potential structural changes in price and wage-setting behaviour (Box B of the [November 2025 Monetary Policy Report](#)).

3.2: Central projection and scenario outcomes

Table 3.B sets out how key economic variables evolve across the central projection, milder and adverse scenarios, conditioned on the market curve for interest rates. The central projection and scenarios collectively explore a reasonable range of risks around energy prices and second-round effects discussed by the MPC. The choice of projections has been partly based on new Bank staff analysis ([Brignone et al \(2026\)](#)), which sets out one way to assess the calibration of the span of scenarios against a benchmark reference distribution. The fan charts around the central projection in Chart 3.2 continue to be based only on the distribution of historical forecast errors, and do not attempt to represent the skew of risks around the current outlook.

Overall, the scenarios span outcomes that are considerably higher than in the central projection as well as outcomes that are lower. Outcomes with higher inflation than the adverse scenario, such as Scenario C in the April Report, remain a possibility, though are judged to be less likely.

Table 3.B: Summary of outputs of the central projection and scenarios (a)

	2026 Q3	2027 Q3	2028 Q3	2029 Q3
Central projection				
CPI inflation (b)	2.9	2.6	1.8	1.9
GDP (c)	1.1	1.1	1.7	1.6
Excess supply/ excess demand (d)	-1.1	-1.0	-0.7	-0.6
Unemployment rate (e)	5.0	5.3	5.2	5.0
Private sector regular average weekly earnings (f)	3.0	3.1	3.1	3.2
Energy prices – direct contribution to CPI inflation (g)	0.6	-0.1	-0.2	0.1
World export prices (h)	5.4	0.2	-0.2	-0.2
Bank Rate (i)	3.8	4.2	4.2	4.2
Milder scenario				
CPI inflation (b)	2.7	2.4	1.7	1.7
GDP (c)	1.1	1.1	1.6	1.6
Excess supply/ excess demand (d)	-1.2	-1.1	-0.9	-0.8
Unemployment rate (e)	5.0	5.5	5.3	5.2
Private sector regular average weekly earnings (f)	2.9	2.9	2.6	2.7
Energy prices – direct contribution to CPI inflation (g)	0.3	-0.1	-0.1	0.1
World export prices (h)	5.1	0.1	-0.1	-0.2
Bank Rate (i)	3.8	4.2	4.2	4.2
Adverse scenario				
CPI inflation (b)	3.1	4.1	2.8	2.4
GDP (c)	1.1	0.9	1.6	1.7
Excess supply/ excess demand (d)	-1.1	-1.2	-1.0	-0.9
Unemployment rate (e)	5.0	5.5	5.4	5.3
Private sector regular average weekly earnings (f)	3.2	4.4	4.4	3.9

	2026 Q3	2027 Q3	2028 Q3	2029 Q3
Energy prices – direct contribution to CPI inflation (g)	0.7	0.4	-0.3	-0.1
World export prices (h)	6.0	3.0	-0.1	-0.3
Bank Rate (i)	3.8	4.2	4.2	4.2

(a) The numbers shown in this table are conditioned on the assumptions described in Table 3.A and the Projections Databank accompanying this Report. All three scenarios are conditioned on the same market curve for Bank Rate.

(b) Four-quarter inflation rate. Based on ONS series D7BT.

(c) Four-quarter growth in real GDP. Based on ONS series ABMI.

(d) Per cent of potential GDP. A negative figure implies output is below potential and a positive that it is above.

(e) International Labour Organization (ILO) definition of unemployment. Based on ONS series MGSX.

(f) Private sector average weekly earnings excluding bonuses and arrears of pay. Based on ONS series KAJ2.

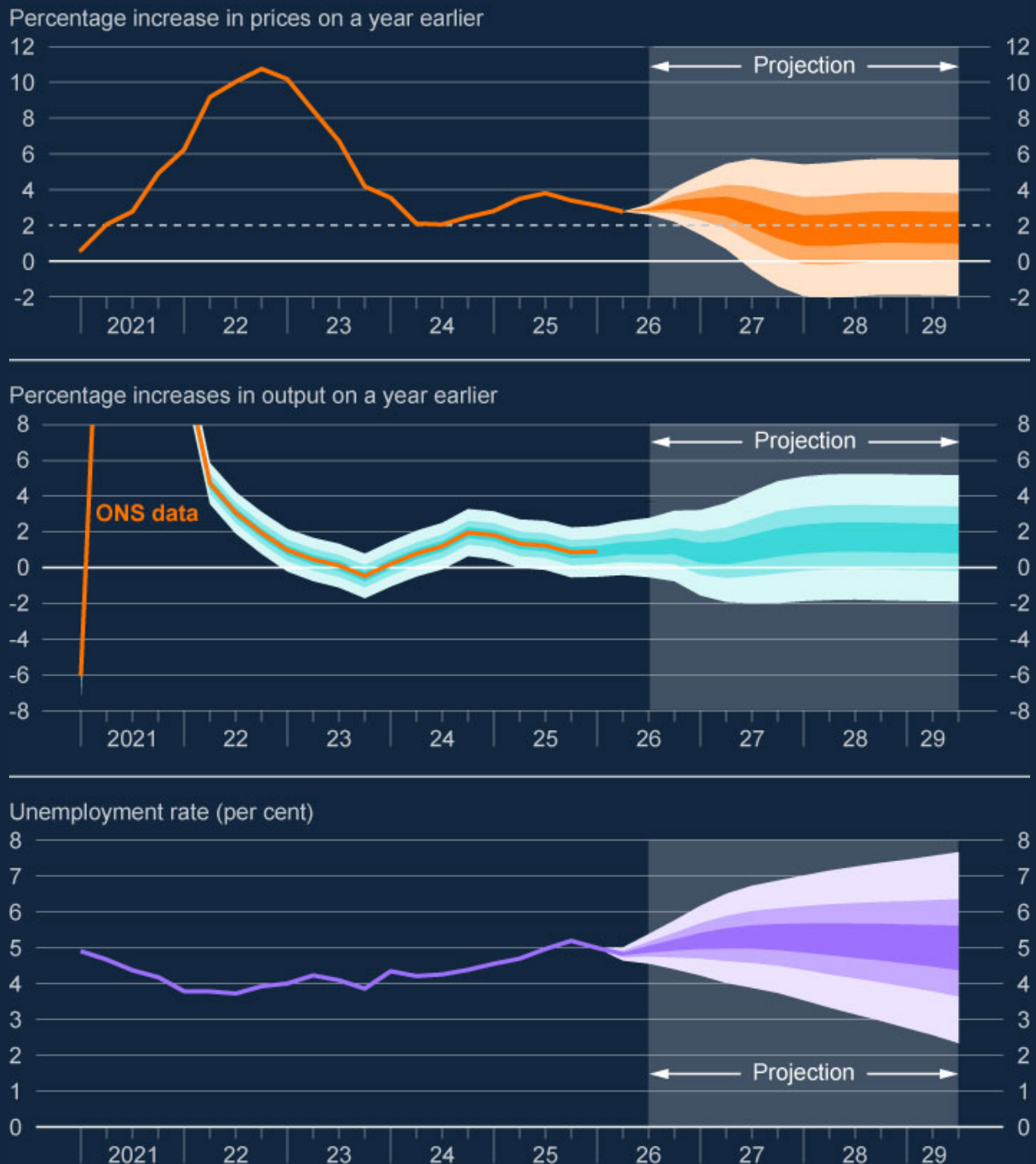
(g) Contribution of fuels and lubricants and gas and electricity prices to four-quarter CPI inflation.

(h) Four-quarter growth in UK-weighted world export prices excluding the direct effect of oil prices.

(i) Per cent. The path for Bank Rate implied by forward market interest rates. The curves are based on OIS rates.

Chart 3.2: CPI inflation in the central projection is expected to return to the 2% target in 2027 and remain around that rate in the medium term. GDP growth and the unemployment rate is projected to rise modestly in the medium term

Annual CPI inflation , GDP growth and unemployment rate (a)



Sources: ONS and Bank calculations.

(a) The fan charts depict the probability of various outcomes for GDP growth, the International Labour Organization (ILO) definition of unemployment and CPI inflation in the central projection. The uncertainty parameters determining the width of the fan charts have been calibrated to match the historical forecast errors since 2004 and up to 2025 Q2 for each variable at

different horizons but exclude errors during the pandemic given its exceptional nature. The fan charts are constructed so that outturns are expected to lie within each pair of lighter areas on 30 occasions, with outturns expected to lie within the fan on 90 out of 100 occasions. On the remaining 10 out of 100 occasions, outturns can fall outside the respective aqua, orange and purple areas of the fan chart, depicted by the blue background. For GDP growth, the distribution reflects uncertainty around past data revisions and future evolution, so that the mature estimate would lie within the darkest central band on only 30 out of 100 occasions. The Committee no longer uses the calibration of the fan chart skew to reflect judgements on the balance of risks to the central projection.

Inflation

Conditioned on the market curve, CPI inflation rises in the near term in the central projection, peaking at around 3.2% in 2026 Q4 (Chart 3.3, left panel). The increase in inflation in the near term is accounted for primarily by the direct effects of higher energy prices (Chart 3.4, aqua bars). The indirect effects of higher energy prices are also expected to push up on inflation in the near term (Section 1.1). The rise in inflation is supported by upward pressure from non-fuel import prices, which, in addition to the pass-through of the energy shock, are also stronger due to AI-related global export price pressures (Box D).

CPI inflation in the central projection ends the forecast at 1.9%. The projected decline in inflation from its near-term peak largely reflects a fading contribution from non-fuel import prices and energy-related base effects. CPI inflation excluding direct energy contributions is higher than CPI inflation for much of the second half of the forecast. Second-round effects push up on CPI inflation by around 0.2 percentage points at their peak over 2028, before fading slightly by the end of the forecast period (Chart 3.3, right panel). Private sector regular wage growth is projected to remain stable at a little above 3% over the forecast period. A degree of slack weighs on inflation and wage growth over the forecast period.

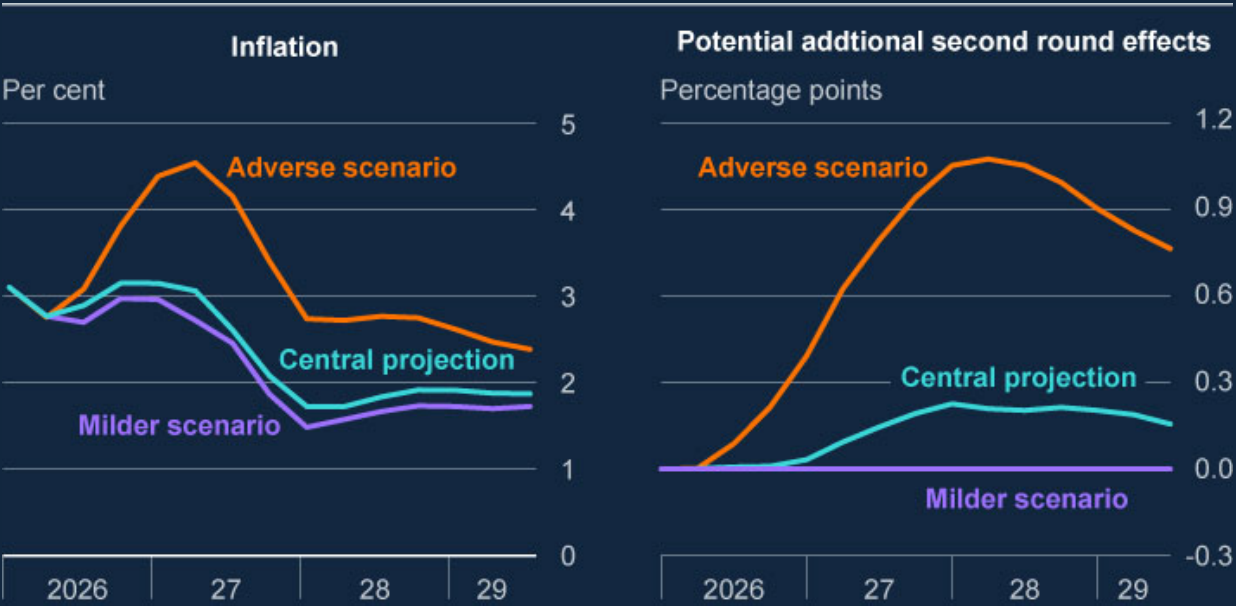
In the milder scenario, the near-term peak in CPI inflation is slightly lower than in the central projection at 3% in 2026 Q4, reflecting smaller contributions from direct energy effects (Chart 3.4, purple bars). CPI inflation and inflation excluding energy are projected to be somewhat lower than in the central projection over the forecast period, mainly reflecting the assumption of no second-round effects from the recent rise in energy prices. Wage growth is also a little lower than the central projection. These also reflect a greater drag from slack on inflationary pressures, as demand is weaker than in the central projection.

In the adverse scenario, CPI inflation rises well above the central projection, peaking at 4.5% in 2027 Q2. That largely reflects the direct effects from substantially higher energy prices (Chart 3.4, orange bars). Thereafter, CPI inflation and inflation excluding energy are expected to be persistently above the central projection, with CPI inflation ending the forecast period at 2.4% (Chart 3.4, right panel). That largely reflects much stronger assumed second-round effects than in the central projection, which contribute a little over 1 percentage point to

inflation at their peak (Chart 3.3, right panel). These effects also mean that wage growth peaks at a higher rate than in the central projection at 4.4% in 2027 Q2, well above target-consistent rates (Box A, [February 2026 Monetary Policy Report](#)).

Chart 3.3: Relative to the central projection, inflation is higher in the adverse scenario and lower in milder scenario, in part due to second-round effects

Annual CPI inflation and the additional impact on inflation from potential second-round effects in the central projection and scenarios (a)



Sources: ONS and Bank calculations.

(a) The central projection and scenarios shown here are conditioned on the same market curve for Bank Rate. Further details on conditioning assumptions can be found in Table 3.A and the Projections Databank accompanying this Report. The final projections are for 2029 Q3.

Chart 3.4: The direct contribution from energy prices to CPI inflation is a key contributor to the different inflation outcomes across the central projection and scenarios

Annual CPI inflation, CPI inflation excluding energy and direct contribution of energy to CPI inflation across the central projection and scenarios (a)

Solid lines: CPI inflation
Dashed lines: CPI inflation excluding energy
Bars: Direct contribution of energy to CPI inflation (percentage points)



Sources: ONS and Bank calculations.

(a) The central projection and scenario shown here are conditioned on the same market curve for Bank Rate. Further details on conditioning assumptions can be found in Table 3.A and the Projections Databank accompanying this Report. The final projections are for 2029 Q3.

Activity and slack in the economy

In the central projection, UK GDP growth is expected to remain subdued over 2026 and early 2027, as the energy shock weighs on real income growth, resulting in weak household spending growth. Tight financial conditions are also assumed to exert a drag on the economy over this period, in part reflecting the recent rise in market interest rates (Box F). GDP growth is expected to pick up from the second half of 2027 as the drag from lower real incomes fades, boosting consumption. Underpinning this is an expected fall in the saving ratio from a little under 9% to around 7.5% at the end of the forecast period. Four-quarter UK GDP growth is expected to be 1.6% at the end of the forecast period.

In the central projection, the margin of spare capacity in the economy is projected to widen slightly to -1.3% in 2026 Q4, before narrowing gradually thereafter (Chart 3.5, aqua line). The near-term widening in slack in part reflects the drag on demand from higher energy prices described above. Restrictive monetary policy, which is judged to be weighing on demand, is also pushing down the output gap in the near term. The output gap begins to narrow from the

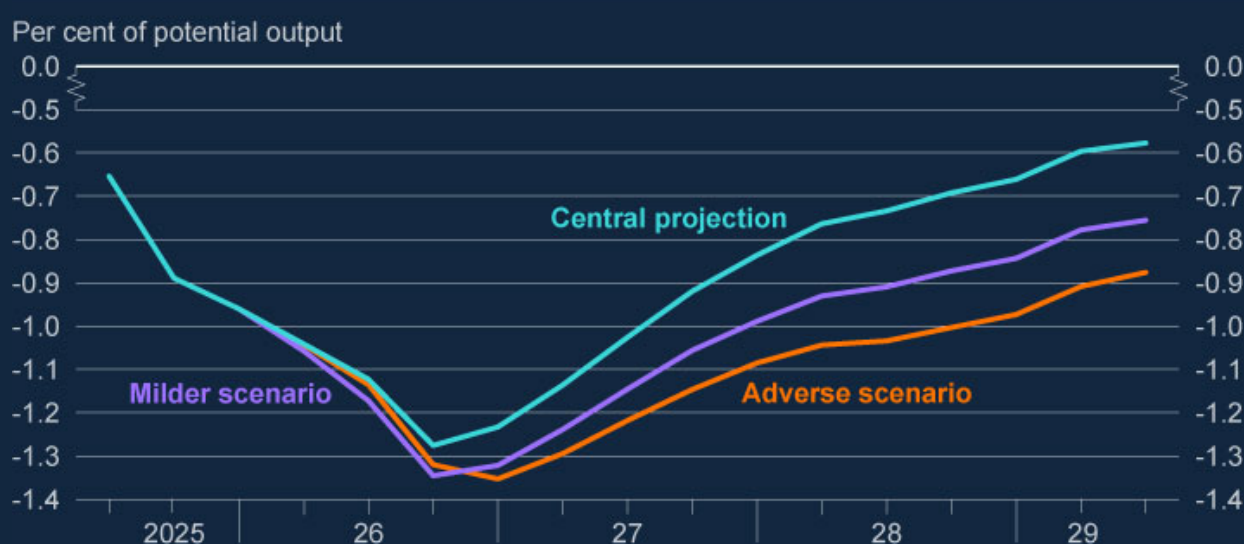
start of next year as the drag from restrictive monetary policy is expected to fade. The overall stance of fiscal policy, (Box D of the February 2026 Monetary Policy Report), is expected to exert an increasing drag on the output gap throughout the forecast period.

In the milder scenario, four-quarter UK GDP growth is projected to trough at 0.7% in 2027 Q1 and growth rates are projected to be a little lower on average than in the central projection. The output gap is slightly more negative at its trough relative to the central projection (Chart 3.5, purple line), reflecting a weaker path for consumption growth and a higher saving rate.

In the adverse scenario, activity is weaker than in the central projection, with four-quarter GDP growth troughing at 0.6% in 2027 Q2. The sustained rise in energy prices acts as a substantial and persistent terms of trade shock, reducing households' purchasing power and increasing firms' costs. As a result, the output gap is around 0.2 percentage points more negative than in the central projection (Chart 3.5, orange line) on average over the forecast period, and the unemployment rate slightly higher.

Chart 3.5: The output gap is wider in the adverse and milder scenarios relative to the central projection

Level of the output gap in the Central projection, Milder and Adverse scenario (a)



Sources: ONS and Bank calculations.

(a) The central projection and scenarios shown here are conditioned on the same market curve for Bank Rate. Further details on conditioning assumptions can be found in Table 3.A and the Projections Databank accompanying this Report. The final projections are for 2029 Q3.

3.3: Model-based policy simulations

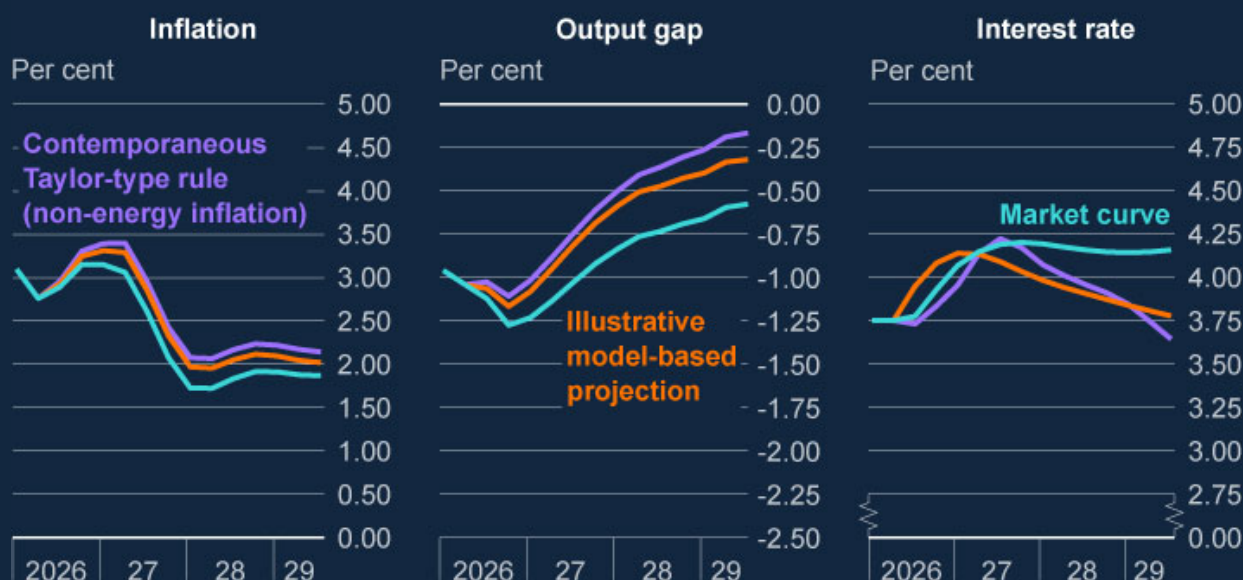
The central projection and scenarios described above are conditioned on the market curve for interest rates; if the assumptions underlying any particular projection or scenario came to pass, the appropriate stance of policy would likely vary from that path. Simple policy rules can provide information about the effects of alternative monetary policy stances for different scenarios.

The market curve captures both expectations about the future path of Bank Rate and risk premia (Box F). The policy rules presented here should also be interpreted as exploring alternative overall policy stances, comparable to the stance implied by the market curve, rather than a path for future Bank Rate decisions. The MPC discussed two alternative model-based paths for the central projection, as well as for the milder and the adverse scenario.

For the central projection, staff's illustrative model-based projections, which balance the speed at which inflation is returned to target with avoiding undesirable volatility in output, are similar to the market curve over the coming year but lower after that (Chart 3.6). On average, they point to a looser overall policy stance than implied by the market curve. Under this alternative stance, inflation would return to target in 2028 Q1 and then stay around the target – rather than slightly undershooting it – and the output gap would close more quickly. A similar policy stance is suggested by a contemporaneous Taylor-type rule that excludes the direct effects of energy price changes but responds to indirect and second-round effects.

Chart 3.6: The economic outlook in the central projection would be consistent with a looser policy stance than implied by the market curve

Central projection under the market curve, staff's illustrative model-based projections, and a contemporaneous non-energy Taylor-type rule (a)



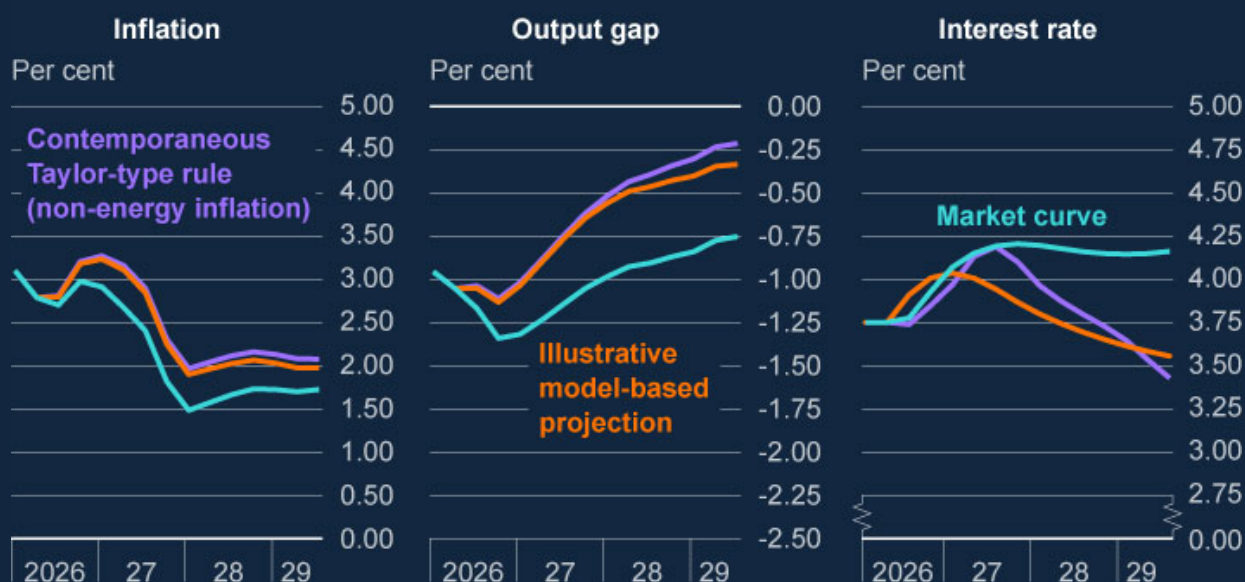
Sources: Bank of England and Bloomberg Finance L.P.

(a) The interest rate paths shown are Bank Rate up to 2026 Q2 and subsequently the OIS curve or alternative curves based on policy simulations up to 2029 Q3. The [Projections Databank](#) provides additional detail on the definition of the model-based projections and the simple policy rule shown here. These should not be interpreted as a prescription for how policy is likely to evolve. In these simulations, the paths for inflation and the output gap within the forecast period can also be affected by the evolution of policy paths beyond the forecast horizon.

For the milder scenario, staff's illustrative model-based projections and a contemporaneous non-energy Taylor-type rule are broadly similar to the market curve over the coming year, but lower after that, and are somewhat lower than for the central projection (Chart 3.7). On average, they point to a materially looser policy stance than implied by the market curve.

Chart 3.7: The economic outlook in the milder scenario would be consistent with a looser policy stance than in the central projection

Milder scenario under the market curve, staff's illustrative model-based projections, and a contemporaneous non-energy Taylor-type rule (a)



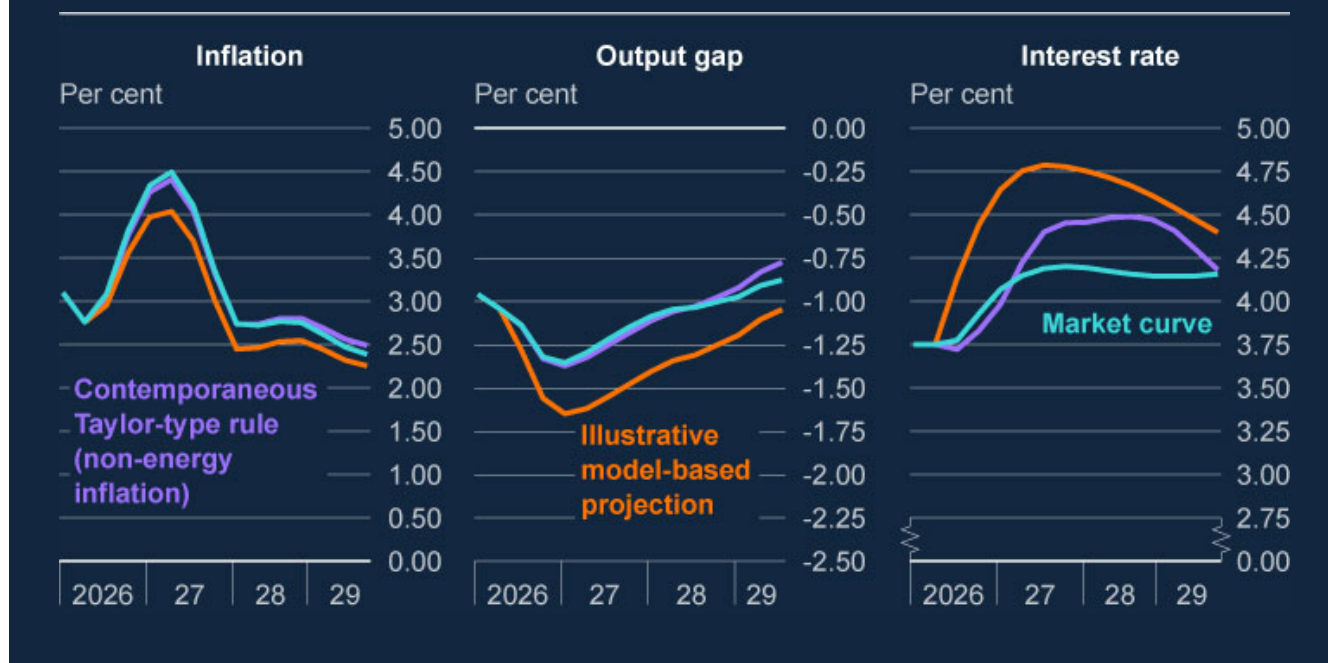
Sources: Bank of England and Bloomberg Finance L.P.

(a) The interest rate paths shown are Bank Rate up to 2026 Q2 and subsequently the OIS curve or alternative curves based on policy simulations up to 2029 Q3. The [Projections Databank](#) provides additional detail on the definition of the model-based projections and the simple policy rule shown here. These should not be interpreted as a prescription for how policy is likely to evolve. In these simulations, the paths for inflation and the output gap within the scenario period can also be affected by the evolution of policy paths beyond the scenario horizon.

For the adverse scenario, staff's illustrative model-based projections suggest that a tighter policy stance than implied by the market curve would help to bring inflation back towards the target more quickly (Chart 3.8, left panel), although at the cost of a larger output gap (Chart 3.8, middle panel). That is because the scenario embodies persistent and material second-round effects which policy would need to act to offset if they came to pass. To ensure that inflation returned to target within the scenario period, an even tighter stance than implied by the illustrative model-based projection or the contemporaneous non-energy Taylor-type rule would be needed, although that would also be associated with even more slack.

Chart 3.8: Policy would need to be materially tighter in the adverse scenario to ensure that inflation returns to the 2% target in the medium term

Adverse scenario under the market curve, staff's illustrative model-based projections, and a contemporaneous non-energy Taylor-type rule (a)



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

(a) The interest rate paths shown are Bank Rate up to 2026 Q2 and subsequently the OIS curve or alternative curves based on policy simulations up to 2029 Q3. The [Projections Databank](#) provides additional detail on the definition of the model-based projections and the simple policy rule shown here. These should not be interpreted as a prescription for how policy is likely to evolve. In these simulations, the paths for inflation and the output gap within the scenario period can also be affected by the evolution of policy paths beyond the scenario horizon.

All of the illustrative policy paths described above assume that monetary policy makers know which scenario is going to unfold with certainty. In reality, policymakers are likely to want to set policy to mitigate the outcomes that may occur across a range of possible scenarios given current uncertainties. As a result, their preferred policy stance is likely to depend on the likelihood they attach to different potential paths for the outlook.

Policymakers who judge that, relative to the central projection, outcomes with higher inflation may be more likely in the current environment than lower inflation outcomes, may want to set somewhat tighter policy to lean against such risks. Because monetary policy affects the economy with a lag, policy may need to pre-emptively lean against second-round effects before their exact extent is evident in the data. A staff analysis suggests that the costs in terms of a quadratic loss function of leaning against upside risks that fail to materialise can be

smaller than the potential costs of leaning too little against upside risks. The benefits in terms of reducing the risk of higher inflation have to be judged, however, against the costs in terms of lower activity in the economy and the risk of inflation undershooting the target.

Annexes

Annex 1: Central projection tables

This annex provides additional details on the central projection. Further forecast variables are provided in the Projections Databank, available from [**Monetary Policy Report – Download chart slides and data – July 2026**](#).

Table A1.A: GDP (a)

	Average 1998– 2007	Average 2010– 19	2025	2026	2027	2028
World GDP (UK-weighted) (b)	3.1	2.5	2.4	1.9	2.2	2.3
UK GDP (c)	2.8	2.0	1.3	1.1	1.1	1.7
Household consumption (d)	3.2	2.1	1.1	1.0	0.8	1.8
Real post-tax labour income (e)	3.3	1.5	1.4	0.1	0.5	1.2
Household saving ratio (f)	7.4	8.2	9.7	8.8	8.4	8.0
Business investment (g)	3.4	4.2	4.3	-1.5	0.9	1.5
Housing investment (h)	3.7	3.6	3.4	0.2	1.5	6.6
Government expenditure (i)	3.6	0.9	2.0	3.5	2.1	1.0
Exports (j)	4.2	3.5	1.9	2.4	2.7	2.3
Imports (k)	5.8	4.1	4.1	2.3	2.0	2.5
Excess supply/ Excess demand (l)	0.0	-1.7	-0.6	-1.1	-1.1	-0.8

(a) Figures show annual growth rates (excluding 'Excess supply/**Excess demand**') and are chained volume measures.

(b) Constructed using real GDP growth rates of 188 countries weighted according to their shares in UK exports.

(c) Based on ONS series ABMI.

(d) Includes non-profit institutions serving households. Based on ONS series ABJR+HAYO.

(e) 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 ONS series using this formula: $[ROYJ+ROYH-(RPHS+AIIH-CEAN)+GZSL]/[(ABJQ+HAYE)/(ABJR+HAYO)]$, where the series AIIH, CEAN and GZSL have been seasonally adjusted. Some changes between Reports reflect official revisions to past data.

(f) Percentage of total available household resources. Based on ONS series NRJS.

(g) Based on ONS series GAN8.

(h) Whole-economy measure. Includes new dwellings, improvements and spending on services associated with the sale and purchase of property. Based on ONS series DFEG+L635+L637.

(i) Based on ONS series NMRY+G93X.

(j) The historical data exclude the impact of missing trader intra-community (MTIC) fraud. Since 1998 based on ONS series IKBK-OFNN/(BOKH/BQKO).

(k) The historical data exclude the impact of MTIC fraud. Since 1998 based on ONS series IKBL-OFNN/(BOKH/BQKO).

(l) Annual average level. Per cent of potential GDP. A negative figure implies output is below potential and a positive figure that it is above.

Table A1.B: Wages and prices (a)

	Average 1998–2007	Average 2010–19	2025 Q4	2026 Q4	2027 Q4	2028 Q4
Private sector regular average weekly earnings (b)	4.1	2.2	3.4	3.0	3.1	3.1
Private sector regular pay-based unit wage costs (c)	1.9	1.6	3.9	3.2	2.1	1.9
UK import prices (d)	-0.5	1.3	4.3	0.8	0.6	0.4
CPI (e)	1.6	2.2	3.4	3.2	2.1	1.9
Energy prices – direct contribution to CPI inflation (f)	0.3	0.2	0.1	0.4	-0.1	-0.2

(a) Four-quarter growth in Q4 (except for Energy prices – direct contribution to CPI inflation).

(b) Private sector average weekly earnings excluding bonuses and arrears of pay. Based on ONS series KAJ2.

(c) 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.

(d) Excludes fuel and the impact of MTIC fraud.

(e) Based on ONS series D7BT.

(f) Contribution of fuels and lubricants and gas and electricity prices to four-quarter CPI inflation.

Table A1.C: The labour market

	Average 1998– 2007	Average 2010– 19	2025	2026	2027	2028
Labour productivity output per worker (a)	1.8	0.7	-0.3	0.1	0.7	1.0
Employment (b)	1.0	1.2	1.6	1.0	0.4	0.6
Working-age (16+) population (c)	0.7	0.7	1.1	0.9	0.7	0.7
Participation rate (d)	63.0	63.5	63.8	63.9	63.9	63.9
Unemployment rate (e)	5.3	6.0	4.8	5.0	5.3	5.2
Average hours (f)	32.4	31.9	31.9	31.8	31.7	31.7

(a) Annual average level. Real GDP divided by total 16+ employment. Based on ONS series ABMI/MGRZ.

(b) Annual average growth rate. Based on ONS series MGRZ.

(c) Annual average growth rate. LFS household population, all aged 16 and over.

(d) Annual average level. ILO definition of labour force participation as a percentage of the 16+ population. Based on ONS series MGWG.

(e) Annual average level. ILO definition of unemployment rate. Based on ONS series MGSX.

(f) Annual average level.

Annex 2: Monetary policy since the April 2026 Report

At its meeting ending on 17 June 2026, the Monetary Policy Committee (MPC) voted to maintain Bank Rate at 3.75%.

Global energy prices had fallen since the previous meeting in response to events in the Middle East. But they remained higher than pre-conflict and had continued to be volatile. The impact of the energy shock on the UK economy remained uncertain. Monetary policy could not influence energy prices but was being set to ensure that the economic adjustment to them occurred in a way that achieved the 2% inflation target sustainably. The policy stance required to achieve this would depend on the scale and duration of the shock, and how it propagated through the economy.

CPI inflation had fallen to 2.8% since the previous meeting, although it was expected to rise later this year as the effects of higher energy prices continued to pass through. The risk of material second-round effects in price and wage-setting, against which policy needed to lean, was greater the longer higher energy prices persisted. But the labour market continued to loosen, and signs of a weakening economy could contain inflationary pressures. Interest rates faced by households and businesses remained higher than prior to the conflict, which would act to reduce inflation over time.

Taking all the risks to the economic outlook into account, the Committee judged that it was appropriate to maintain Bank Rate at its June meeting.

The Committee would continue to monitor closely the situation in the Middle East and how its impact propagated through the economy. The Committee stood ready to act as necessary to ensure that CPI inflation remained on track to meet the 2% target in the medium term.

Glossary and other information

Glossary of selected data and instruments

ASBC – Agents’ summary of business conditions.

AWE – average weekly earnings.

CCI – Consumer confidence index.

CPI – consumer prices index.

CPI inflation – inflation measured by the consumer prices index.

CSI – Consumer sentiment index.

DMP – Decision Maker Panel.

GDP – gross domestic product.

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.

MaPS – Market Participants Survey.

OIS – overnight index swap.

PMI – purchasing managers’ index.

SONIA – Sterling Overnight Index Average.

Abbreviations

AI – artificial intelligence.

APF – Asset Purchase Facility.

BCC – British Chambers of Commerce.

CBI – Confederation of British Industry.

DESNZ – Department for Energy Security and Net Zero.

DMO – Debt Management Office.

FNAB – food and non-alcoholic beverages.

GfK – Gesellschaft für Konsumforschung, Great Britain Ltd.

HMRC – His Majesty's Revenue and Customs.

ICAEW – Institute of Chartered Accountants in England and Wales.

IT – Information Technology.

LTV – loan to value.

MIDAS – mixed-data sampling.

MoU – Memorandum of Understanding.

MPC – Monetary Policy Committee.

NBP – National Balancing Point.

NHS – National Health Service.

NICs – National Insurance contributions.

NLW – National Living Wage.

NOAA – National Oceanic and Atmospheric Administration.

NWE – Northwest Europe.

Ofgem – Office of Gas and Electricity Markets.

ONS – Office for National Statistics.

Pdf – probability density function.

QE – quantitative easing.

QT – quantitative tightening.

RTI – Real-Time Information.

S&P – Standard & Poor's.

UK – United Kingdom of Great Britain and Northern Ireland.

US – United States of America.

VAT – Value added tax.

V/U – vacancies to unemployment.

WTO – World Trade Organisation.

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.