

6 FEBRUARY 2025

UNCERTAINTY LEADS TO GRADUAL AND CAREFUL

The Bank of England's Monetary Policy Committee (MPC) convened today reducing the base interest rate by 25 basis points, bringing it to 4.5%. This marks the third rate cut since August 2024. The decision was made with a 7-2 majority; two members advocated for a 50 basis-point cut.

The rate cut comes amid weaker-than-expected economic activity and declining business and consumer confidence. As a result, the Bank has halved its 2025 GDP growth forecast from 1.5% (projected in November 2024) to just 0.75%. Inflation, currently at 2.5%, is expected to peak at 3.7% later this year before gradually declining, only reaching the 2% target in 2028. Rising energy prices and higher national insurance contributions remain key inflationary drivers.

Despite the unfavourable near-term outlook for inflation, the MPC's minutes noted that, although uncertainty remains, the Committee sees reduced risks of inflation persistence. Governor Andrew Bailey highlighted concerns over productivity, leading to a significant downward revision in estimates, but the Bank's view on the long-run neutral interest rate (R^*) was revised up, nonetheless, implying that rates would remain structurally higher than previously anticipated. The inflation forecast now points to above-target inflation for an extended period, even with a higher implied rate path than expected in November. The MPC's updated policy guidance—stating future adjustments will be “gradual and careful”—reflects the uncertainty surrounding the economic outlook. Notably, these projections do not yet account for potential trade tariffs.

Markets initially reacted to the dovish voting split, particularly MPC member Catherine Mann's unexpected vote for a 50 basis point cut. This caused front-end interest rates to fall sharply and led to a steepening of the yield curve as investors reassessed the committee's balance of hawks and doves.

However, as markets processed the details of the minutes, a more complex picture emerged. The inflation forecast was revised higher despite the implied rate path, suggesting that concerns remain about underlying price pressures. As a result, yields retraced some of their initial moves, though the steepening bias in the yield curve persisted.

Market expectations for further easing have increased, with pricing now reflecting nearly three rate cuts by the Bank of England over the remainder of 2025. This suggests that investors anticipate cautious but continued rate reductions to support the economy.

What does this mean for portfolios we manage?

The MPC's voting split remains a key driver of market movements, with Catherine Mann's vote for a larger cut drawing attention. Given her traditionally hawkish stance, her shift toward aggressive easing suggests a reassessment of economic risks. However, the two dissenting members had different motivations, highlighting the lack of consensus within the committee. The Bank's adjustment to its forward guidance—adding “careful” alongside “gradual”—suggests a high bar for policy easing outside scheduled forecast meetings. While inflation is expected to be higher in the near term, the weaker growth outlook and reduced inflation persistence risks reinforce expectations for gradual rate cuts throughout 2025.

Given these factors, we maintain a neutral stance on duration within our sterling mandates. While further rate cuts are likely, the lack of MPC consensus and evolving inflation risks suggest that easing will be measured and data-dependent.

Disclosure: Unless otherwise noted, all data is sourced from Bloomberg as of 6/2/2025.

IMPORTANT INFORMATION.

Northern Trust Asset Management (NTAM) is composed of Northern Trust Investments, Inc., Northern Trust Global Investments Limited, Northern Trust Fund Managers (Ireland) Limited, Northern Trust Global Investments Japan, K.K, NT Global Advisors, Inc., 50 South Capital Advisors, LLC, Northern Trust Asset Management Australia Pty Ltd, and investment personnel of The Northern Trust Company of Hong Kong Limited and The Northern Trust Company.

Issued in the United Kingdom by Northern Trust Global Investments Limited, issued in the European Economic Association ("EEA") by Northern Trust Fund Managers (Ireland) Limited, issued in Australia by Northern Trust Asset Management (Australia) Limited (ACN 648 476 019) which holds an Australian Financial Services License (License Number: 529895) and is regulated by the Australian Securities and Investments Commission (ASIC), and issued in Hong Kong by The Northern Trust Company of Hong Kong Limited which is regulated by the Hong Kong Securities and Futures Commission.

For Asia-Pacific (APAC) and Europe, Middle East and Africa (EMEA) markets, this information is directed to institutional, professional and wholesale clients or investors only and should not be relied upon by retail clients or investors. This document may not be edited, altered, revised, paraphrased, or otherwise modified without the prior written permission of NTAM. For US, the information contained herein is intended for use with all current or prospective clients of Northern Trust Investments, Inc (NTI). The information is not intended for distribution or use by any person in any jurisdiction where such distribution would be contrary to local law or regulation. NTAM may have positions in and may effect transactions in the markets, contracts and related investments different than described in this information. This information is obtained from sources believed to be reliable, its accuracy and completeness are not guaranteed, and is subject to change. Information does not constitute a recommendation of any investment strategy, is not intended as investment advice and does not take into account all the circumstances of each investor.

This report is provided for informational purposes only and is not intended to be, and should not be construed as, an offer, solicitation or recommendation with respect to any transaction and should not be treated as legal advice, investment advice or tax advice. Recipients should not rely upon this information as a substitute for obtaining specific legal or tax advice from their own professional legal or tax advisors. References to specific securities and their issuers are for illustrative purposes only and are not intended and should not be interpreted as recommendations to purchase or sell such securities. Indices and trademarks are the property of their respective owners. Information is subject to change based on market or other conditions.

All securities investing and trading activities risk the loss of capital. Each portfolio is subject to substantial risks including market risks, strategy risks, advisor risk, and risks with respect to its investment in other structures. There can be no assurance that any portfolio investment objectives will be achieved, or that any investment will achieve profits or avoid incurring substantial losses. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. Risk controls and models do not promise any level of performance or guarantee against loss of principal. Any discussion of risk management is intended to describe NTAM's efforts to monitor and manage risk but does not imply low risk.

Forward-looking statements and assumptions are NTAM's current estimates or expectations of future events or future results based upon proprietary research and should not be construed as an estimate or promise of results that a portfolio may achieve. Actual results could differ materially from the results indicated by this information.

© 2025 Northern Trust Corporation. Head Office: 50 South La Salle Street, Chicago, Illinois 60603 U.S.A