Bank of England

Economic Outlook

Mauricio Armellini – North East Agency



Backdrop

- MPC held Bank Rate at 3.75%. Inflation 3.1% (to August)
- Oil and gas prices continue to be high and volatile.
- Services and wage inflation continue to moderate
- Key uncertainties for MPC: how the outlook for global energy prices evolves and how that might feed into the strength of any second-round effects.
- MPC can’t do anything about what happens to global energy prices, but it’s setting policy to make sure they don’t lead to high inflation becoming embedded and so instead that we get back to the 2% target and stay there.
- The policy stance required to achieve this will depend on the scale and duration of the energy shock and how it propagates through the economy

Current approach to setting policy is based on two key policy judgements

Key policy judgement 1

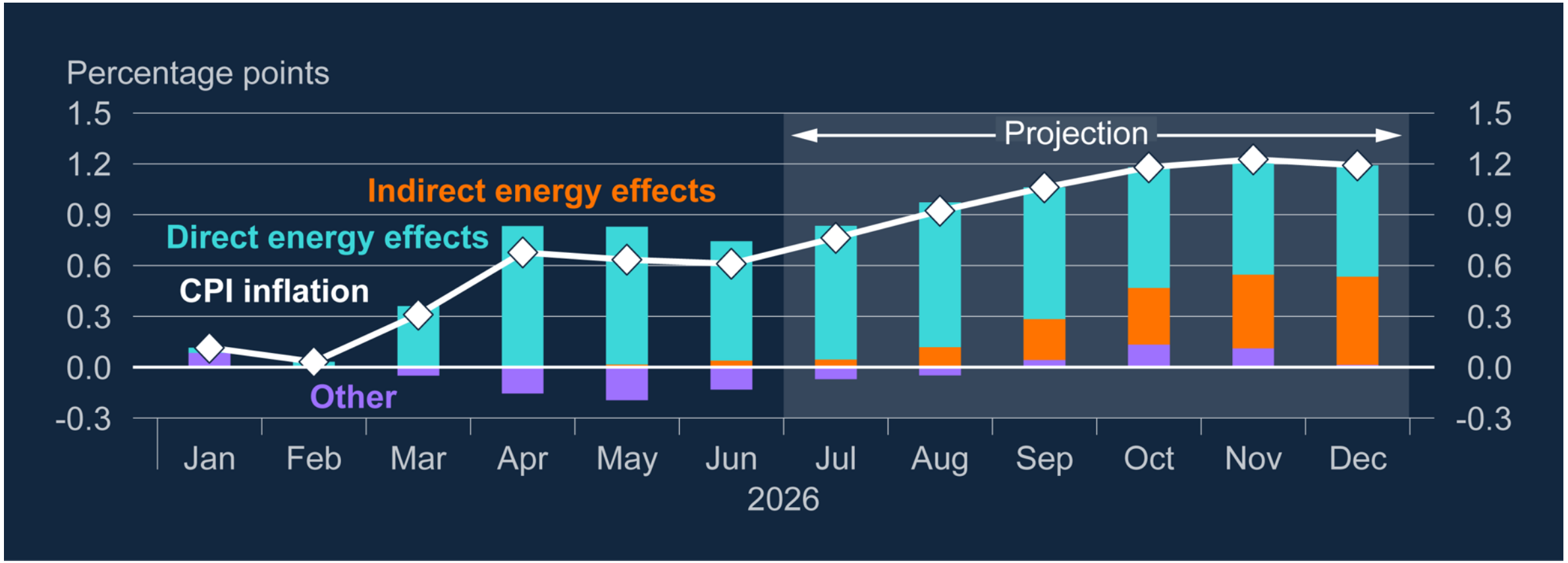
- Weakness in economic activity and demand for labour is likely to help contain the strength of second-round effects from higher energy prices.
- But the outlook is uncertain and the risk of strong inflationary pressures continues to be greater than the risk of weak inflationary pressures.

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.

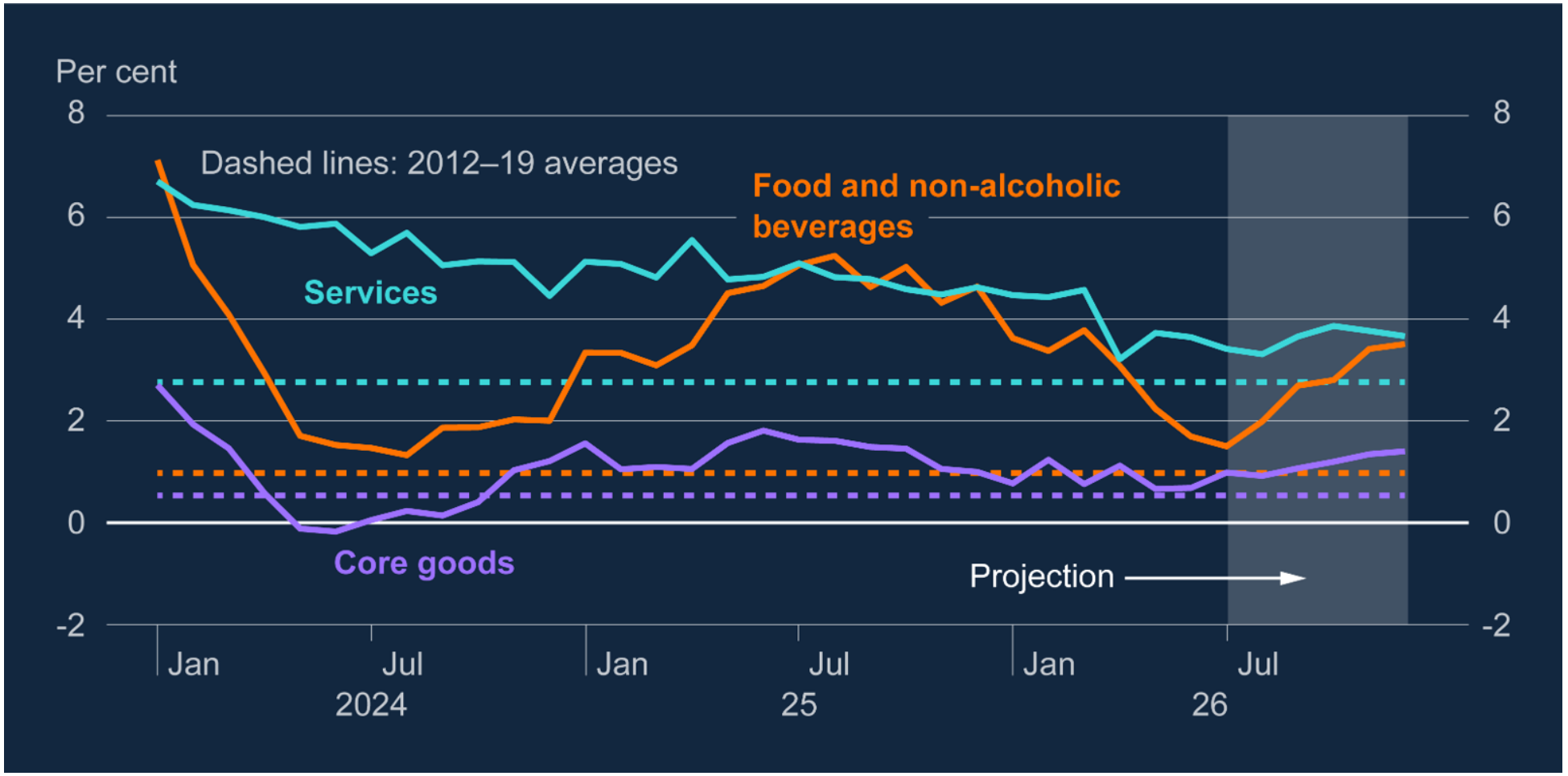
Key policy judgement 1

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



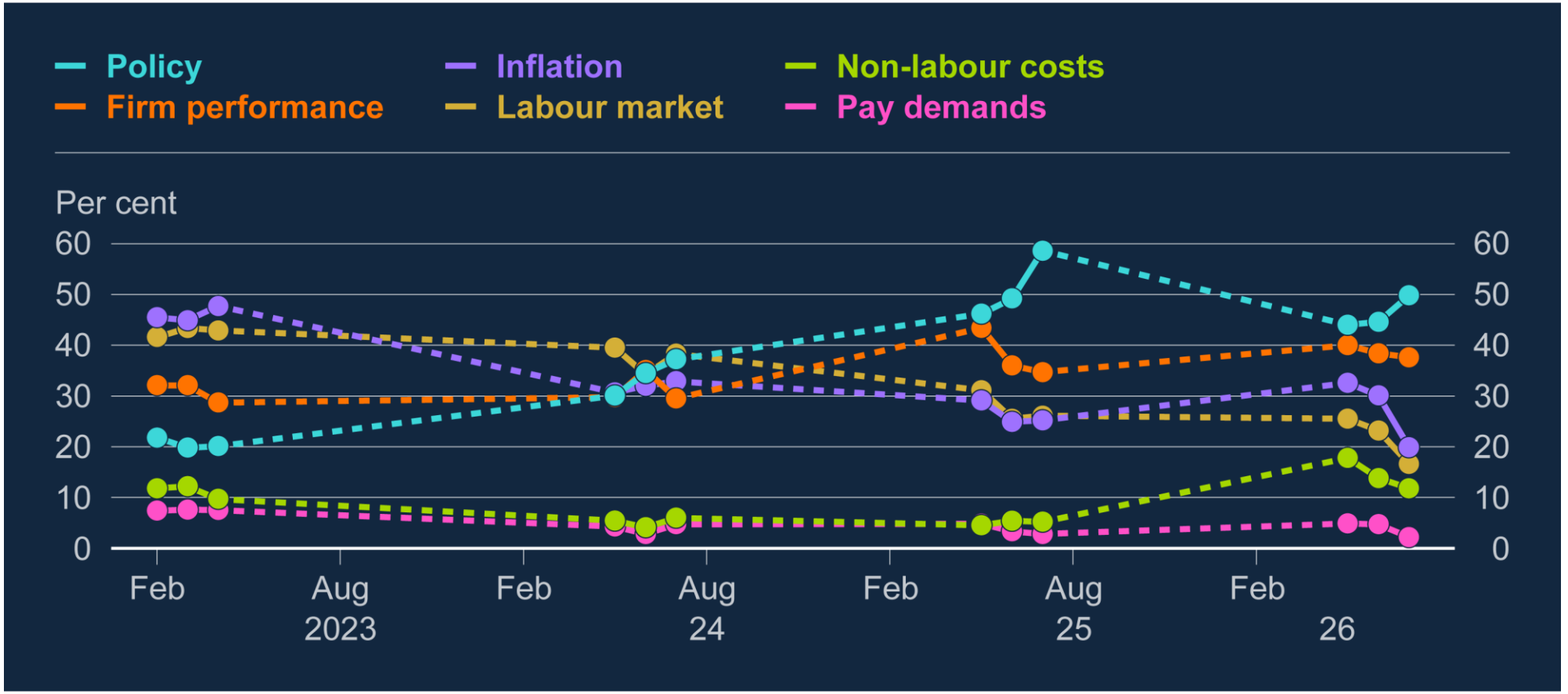
- Also expecting some knock-on supply-chain effects in areas like transport and logistics to add around ½pp to inflation over the second half of the year

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



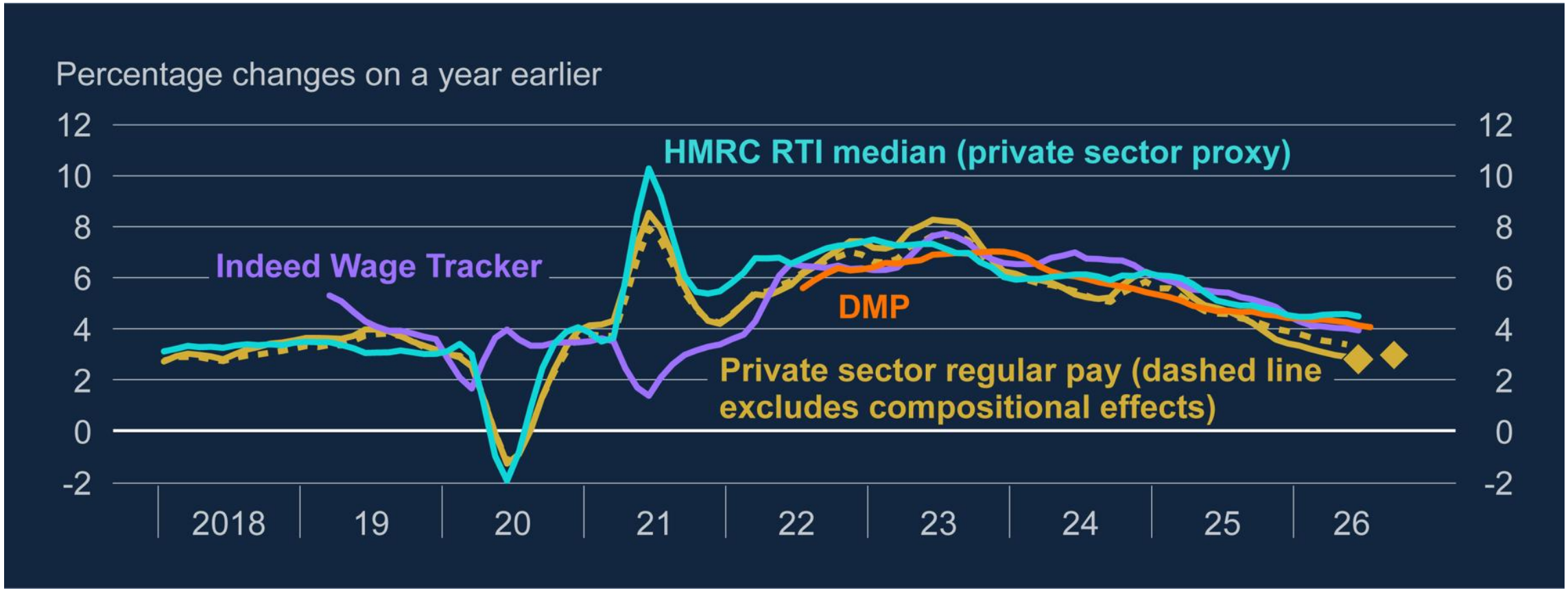
- This is likely to show up in food price inflation over the rest of the year and goods prices
- Other global influences could also push prices here, such as impact of El Niño…

Firms are less likely to report that inflation is important for wage growth than in the recent past



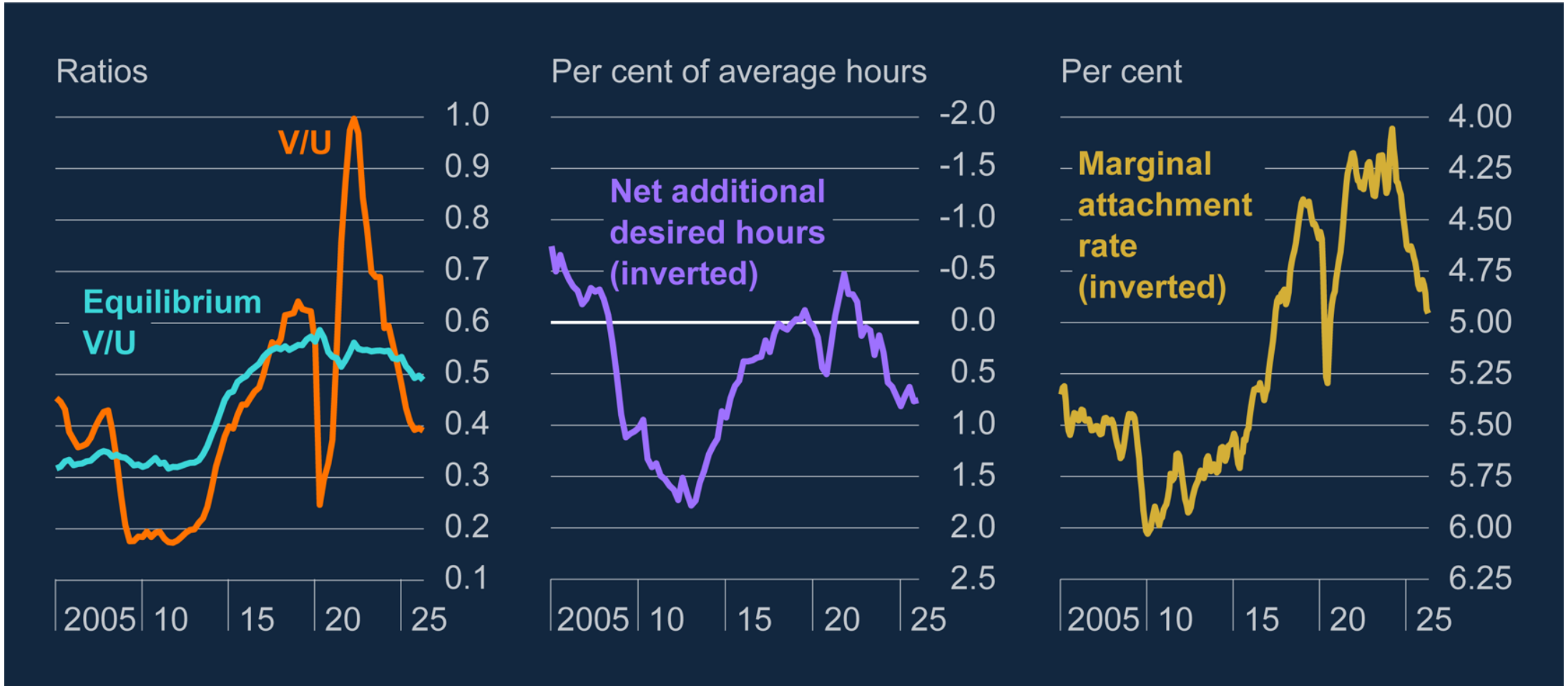
- Over the past couple of months, companies have become less worried about high inflation pushing up on wage growth. Energy prices have since risen again, however
- Still very early days – this year's wage round largely complete before conflict started and we may not observe impact on wage growth until early next year

Private sector wage growth has continued to slow



- …and wage inflation continues to slow towards rates more consistent with the 2% inflation target…

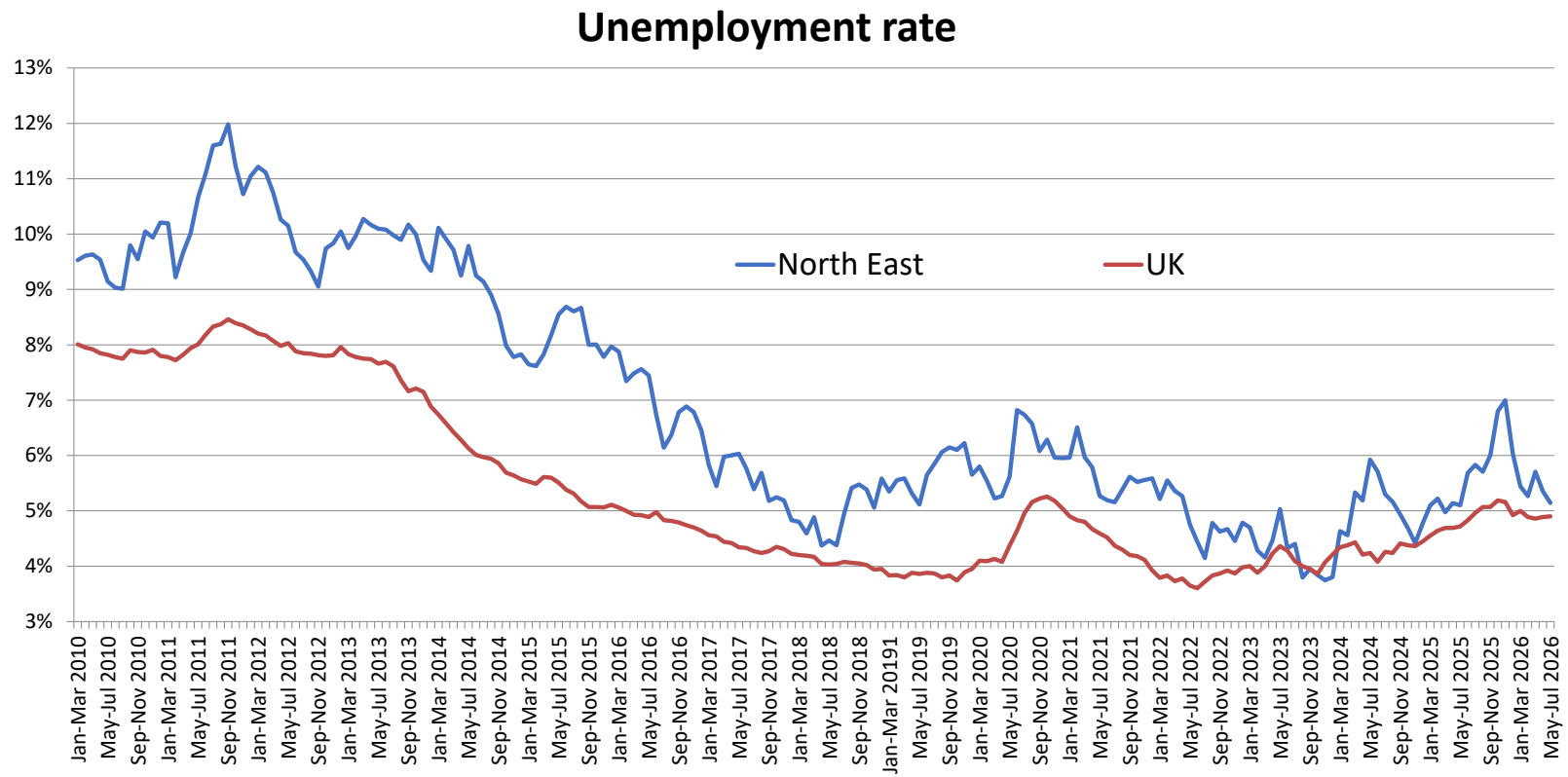
The labour market continues to operate with a degree of spare capacity



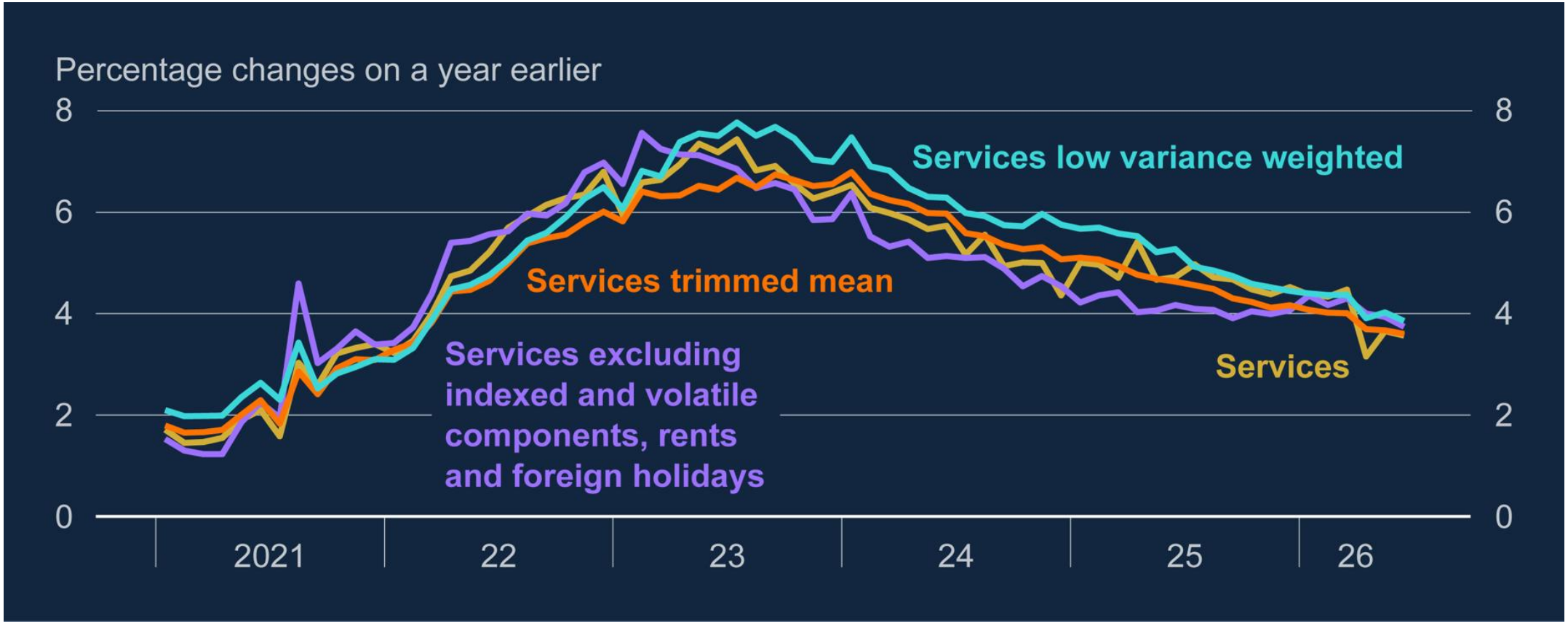
- …reflecting spare capacity in the labour market

North East labour market

		North East			UK		
		May-Jul 2025	May-Jul 2026	Change	May-Jul 2025	May-Jul 2026	Change
Employment	*Number*	1,218,025	1,270,695	52,670	34,235,236	34,478,000	242,764
	Rate (%)	68.8%	71.3%	2.5%	75.2%	75.1%	-0.1%
Unemployment	*Number*	65,487	68,867	3,380	1,695,512	1,778,000	82,488
	Rate (%)	5.1%	5.1%	0.0%	4.7%	4.9%	0.2%
Inactivity	*Number*	975,725	942,927	-32,798	20,331,337	20,540,619	209,282
	Rate (%)	27.3%	24.7%	-2.7%	21.0%	20.9%	-0.1%

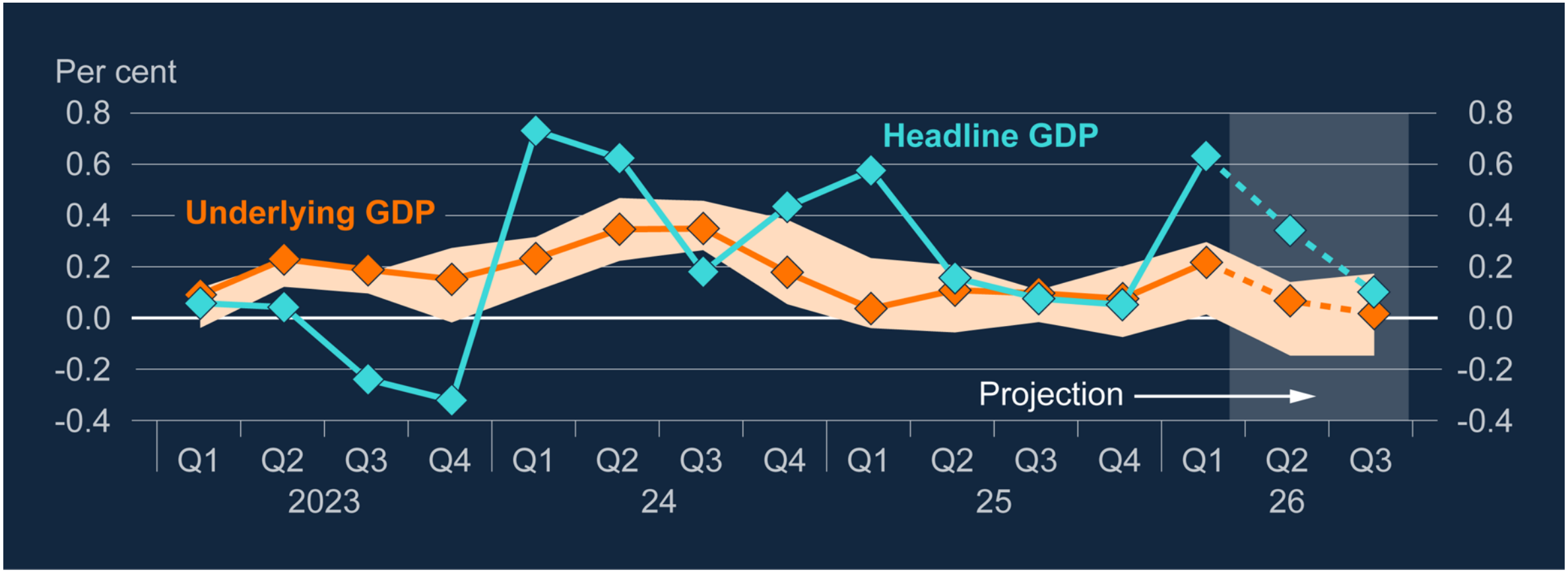


Measures of underlying services price inflation eased further in 2026 Q2



- Continuing to learn about the path the economy was on before conflict broke out
- Measures of more persistent domestic inflation such as services price inflation eased further…

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



- Underlying activity growth remains relatively weak and is likely to slow a little further, but no immediate signs of a dramatic impact on confidence or business sentiment.

Key policy judgement 1

- 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.

- 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.

- But other factors could lead to grater second-round effects and there is not enough evidence yet to rule out this risk.

Key policy judgement 2

Baseline forecast and scenarios

- MPC members have to make a judgement call meeting by meeting about how to balance the costs of leaning too little against inflationary pressures against the cost of leaning too much.

- In thinking about that this round, they've looked at a central forecast and two scenarios which they found useful as they came to their decision

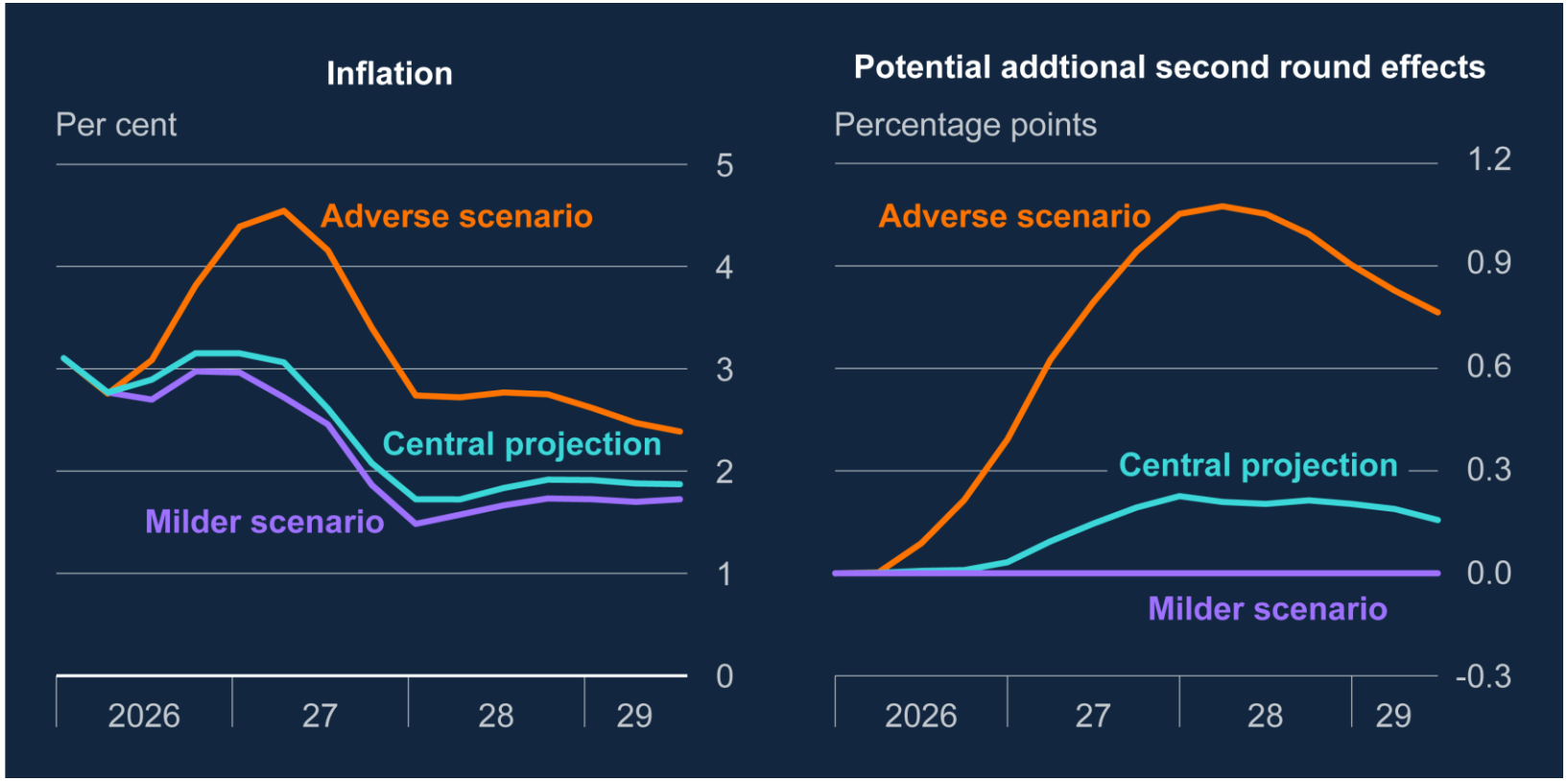
- Not all encompassing and don't cover the full set of risks, and none will be exactly correct.

- Not aiming to keep with every single up and down in oil prices – focus instead on potential implications for the medium term.

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 as observed on 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.

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



- Central forecast has with inflation spending several quarters above 3% before falling back as futures prices fall, and finishing the projection a little below 2%.
- Milder scenario sees inflation fall more quickly and end the projection further below 2%
- Adverse scenario is associated with nastier second round effects and inflation staying well above 2% under the market curve for interest rates.

Outcomes across central forecast and scenarios (assuming market interest rates)

	CPI Inflation			GDP growth			Unemployment rate		
	Central	Milder	Adverse	Central	Milder	Adverse	Central	Milder	Adverse
2027Q3	2.6	2.4	4.1	1.1	1.1	0.9	5.3	5.5	5.5
2028Q3	1.8	1.7	2.8	1.7	1.6	1.6	5.2	5.3	5.4
2029Q3	1.9	1.7	2.4	1.6	1.6	1.7	5.0	5.2	5.3

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

