Economic snapshot

by David Fenton, TSB's Chief Economist

The BoE left the UK policy rate on hold at 3.75% in September but seems to be edging closer to a hike. Governor Bailey acknowledged that the conflict in the Middle East is likely to persist "for an extended period" and the BoE now expects inflation to rise to slightly over 4% in early 2027. These developments appear to have shifted the burden of proof: from needing a clear justification to raise rates, to needing a clear justification to hold them. Yesterday's US rate hike may also be a factor. The BoE is keeping its options open, but markets expect a move to 4.0% before the end of the year.

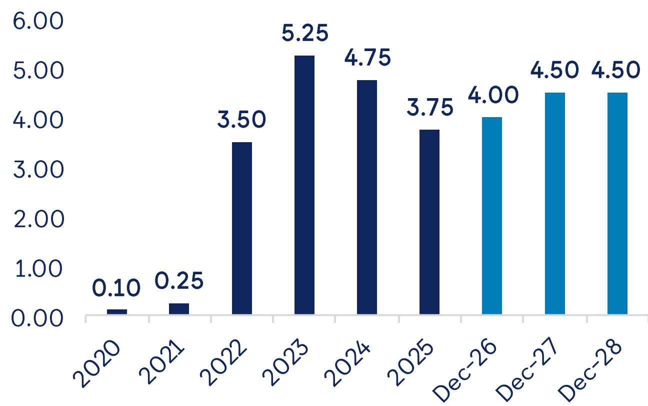
Interest rates

- Bank Rate was left on hold at 3.75% in September. The vote was also unchanged at 6-3, but the Minutes revealed that four members of the majority are starting to lean towards a hike, noting that "the risk of second-round effects was growing in the absence of a lasting resolution of the conflict".

→ 3.75%

- At the risk of stating the obvious, only two of these four need to change their vote to push through a hike. Markets expect a move to 4.0% by year-end, with anther two hikes priced in for 2027 (see chart).

Market implied outlook for Bank Rate (year end)



Housing market

- House prices fell slightly in August, according to Lloyds. This pulled the YoY growth rate into negative territory for the first time since Nov-2023 (-0.4%). Transactions have also edged down, though the market remains relatively resilient given elevated uncertainty about where mortgage rates are headed.
- The mortgage market made a strong start to the year but has slowed over the summer months. The number of mortgage approvals for house purchase fell to 56.1k in July, the lowest since Jan-2024.

Prices and inflation

- UK inflation rose to 3.1% in August, up from 2.9%. This was above the BoE's forecast (2.8%), though this was mainly related to energy prices, with limited evidence of a broader inflationary break-out. For example, core inflation and services inflation were both unchanged in August, at 2.6% and 3.4%, respectively.

3.1%

- The BoE said that inflation could now reach "slightly over 4%" in early 2027, due to higher energy prices. It said there had been little sign so far that this was feeding through to other goods prices

Jobs and earnings

- The number of payrolled employees fell by 26k in August, which continues the trend of small-but-persistent declines. The redundancy rate increased but is lower than it was around the turn of the year. Headline wage growth fell to 3.9%. All told, there was little in the labour market release that would heighten BoE fears about second-round inflation effects.
- Even so, the Minutes contained a subtle shift in messaging. The BoE now seems to doubt whether labour market slack will increase in H2 2026, which weakens a circuit breaker for second-round effects.

Economic activity

- The UK economy clocked up another impressive month of growth in July, with GDP rising by 0.4%. This lifted the YoY growth rate to 1.3%, which isn't especially fast, but represents an impressive performance given low expectations at the start of the year, and the subsequent emergence of the Iran/US conflict as an additional headwind.
- The standout sectors were business services and IT. The ONS noted that many of the businesses reporting the largest turnover in July were involved in activities related to AI and cloud computing.

TSB's economics snapshot summarises key data developments in the UK economy including growth, inflation, jobs, house prices and interest rates.
Data sources are BoE, ONS, Datastream, and Lloyds. Interest rate outlook represents market forward rates as of 17 September inferred from SONIA via Bloomberg.