Bank of England rates to stay on hold but cuts to accelerate in 2025

Sticky services inflation and the prospect of stronger growth next year means the Bank of England seems content with cutting rates more gradually than its European peers. We don't expect a cut this week, but better underlying inflation data could unlock faster easing in the spring

We expect a total of six rate cuts next year, which would see Bank Rate falling to 3.25%

The Bank of England is in no rush to cut rates

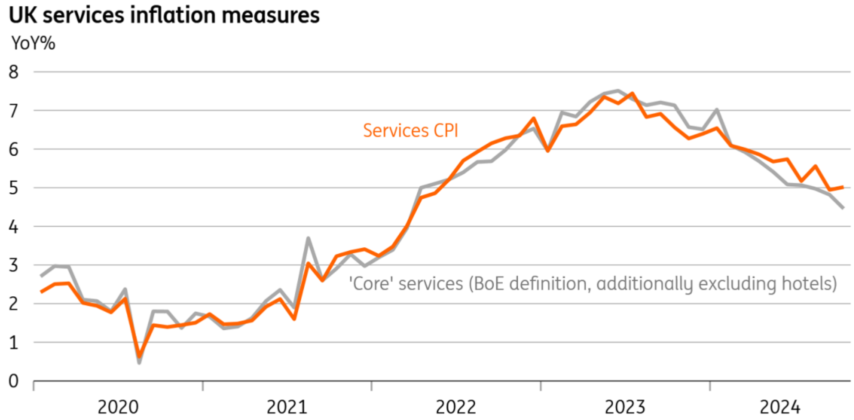
Central bankers across Europe have concluded that rates need to get much lower from current levels as growth concerns build. The European Central Bank is poised to take rates much lower in 2025. Sweden's Riksbank has slashed rates even more aggressively and will do so again this week. The Swiss have done similar.

Against that backdrop, the Bank of England looks like an outlier. The Bank has cut rates just twice so far and there's very little prospect of it doing so again at its meeting this Thursday. We expect an 8-1 vote to keep rates on hold – and remember, there's no press conference or new forecasts this time.

What's more, financial markets think we'll get barely three more cuts in 2025. So far, the BoE has done little to persuade investors otherwise. From the little communication we've had from officials over recent weeks, it seems broadly happy with a base case that sees rate cuts continue once per quarter over the next year.

Above all, that more cautious approach is borne out of services inflation data that still looks unhelpfully sticky. We agree with the Bank's forecast for this to bounce around 5% over the winter months. Pre-Covid, services inflation typically averaged out at 2.5%. Some of this recent stickiness is a legacy of tightness in the labour market that has contributed to equally stubborn private sector wage growth.

'Core services' inflation is looking better



Source: Macrobond, ING calculations

Faster cuts are coming in the spring

Beneath the surface, however, this is starting to change. The jobs market data – or at least that which isn't heavily distorted – show a material cooling through 2024. Vacancies are below pre-Covid levels in most sectors now. Payrolled employment, excluding government-heavy sectors, has fallen.

Those services inflation numbers also aren't quite as bad once volatile/less relevant items are excluded. Our measure of core services, which takes out things like travel, rents and hotels (all of which the Bank of England has said it pays less attention to) has fallen back more noticeably this year and now stands at 4.5%. By the second quarter, we think this core measure will be at around 3%. If we're right, that would be a lot more palatable to Bank officials and may well be the catalyst for rate cuts to accelerate.

The main uncertainty is how the recent fiscal budget will shape the 2025 outlook. Growth is universally expected to be stronger, and we agree. Most of the planned increase in government spending will end up in public sector wages, and that means the fiscal multiplier is pretty high.

Bank of England hawks are also concerned that the sharp increase in employers' National Insurance (social security) will materially feed through to inflation next year. But given the apparent fragility of the labour market, we're less convinced. A recent BoE survey did show that around half of firms expected to raise prices in response to the tax rises, but a similar percentage said they also expected lower employee numbers.

If we're right about that more benign interpretation of the budget, as well as the direction of underlying services inflation, then there should be a window in the spring for rate cuts to accelerate. We expect a total of six rate cuts next year, which would see Bank Rate falling to 3.25%.

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