

## Bank of England set for several rate cuts despite current caution

Sticky services inflation and a more hawkish tone from the Bank of England means investors are starting to price a less aggressive easing cycle in the UK relative to the US. We doubt that divergence will last long



Andrew Bailey,  
governor of the Bank of  
England

### Investors are starting to consider BoE divergence from the Fed

Not for the first time in recent years, investors are thinking the Bank of England will take a more hawkish path than the Federal Reserve. Markets expect UK rates to end up 50 basis points above the US in two years' time. They also think the BoE will opt for fewer rate cuts in total this year.

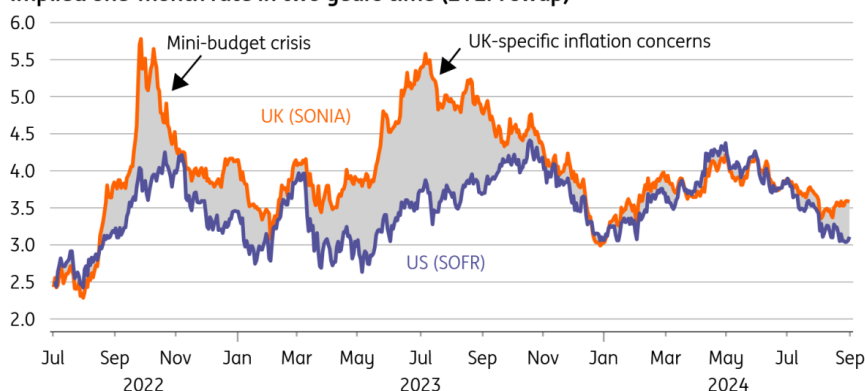
In part, this is because the signals emerging from the Bank of England and the Federal Reserve have been quite different in recent weeks. Where the Fed's Jerome Powell has emphatically endorsed a September rate cut with little hint of gradualism, BoE governor Andrew Bailey is toeing a much more cautious line.

The idea of Bank of England divergence is also not unprecedented. The Fed completed an entire hiking and cutting cycle between 2016 and 2019, where the BoE kept rates largely unchanged. It was a similar story in the early 2000s.

This time, investors are looking at elevated levels of UK services inflation and wage growth, and are concluding that this will limit the scope of rate cuts in Britain. Officials are also questioning whether it'll take more pain for the UK jobs market to lower inflation, or worse, if price and wage setting behaviour has permanently changed, making it much harder to get inflation consistently back to target.

## Markets think UK rates will fall less far than the US

Implied one-month rate in two years time (2Y1M swap)



Source: Macrobond

## We expect BoE rate cuts to accelerate in the fourth quarter

We suspect both concerns are overblown. The fact is, the jobs market has cooled significantly over the past couple of years. True, much of this is down to higher worker supply than a rise in layoffs, but that still implies downward pressure on wage growth.

Meanwhile, the BoE's survey of chief financial officers suggests firms are raising wages less aggressively than they were six to 12 months ago. There are signs that firms are raising prices less regularly too, a hint that pricing behaviour hasn't permanently shifted in the way that some of the BoE hawks have feared.

The Bank is unlikely to cut rates for a second time at its September meeting, but from November we suspect the pace of cuts will accelerate. We therefore don't think the Bank's cutting cycle will look materially different to that of the Fed. We reckon that Bank Rate will fall to 3.25% by next summer, which is further than markets currently expect.

That's despite the UK economy delivering a remarkable performance through the first half of this year. GDP has grown by 1.5% since last December, which has eclipsed most of its European neighbours. Unsurprisingly some of this can be traced back to the recent improvement in real wage growth, though other recent trends are harder to explain.

Like the Bank of England, we suspect the economy will return to more "normal" growth rates of 0.3-0.4% through the second half of this year. As a result, the recent strength is unlikely to make too much difference to the Bank's strategy on rate cuts.

## Author

### James Smith

Developed Markets Economist, UK

[james.smith@ing.com](mailto:james.smith@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.