

Bank of England set to cut rates further than markets expect

We no longer expect another Bank of England rate cut this year, though lower inflation and higher taxes should unlock further easing in 2026



Governor of the Bank of England, Andrew Bailey

Financial markets are giving up on further UK rate cuts...

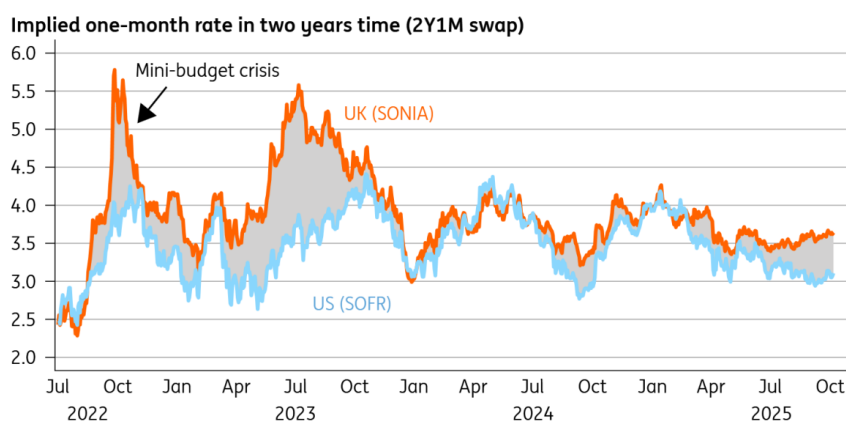
According to financial markets, the Bank of England's rate-cutting cycle is virtually over. Investors are pricing little more than one 25 basis-point cut and not until next April. Not for the first time, markets think the UK's inflation problem is likely to be more enduring than elsewhere.

They aren't alone. The Bank itself has turned more cautious this summer, as higher food prices have driven headline inflation to almost 4%. The good news is we're almost certainly close to the peak, but we aren't likely to see CPI dip much below current levels before year-end. Scarred by the experience of the 2022 energy crisis, the BoE and particularly its Chief Economist, Huw Pill, are worried that we could be on the verge of another persistent bout of above-target inflation.

We think those fears are overblown, not least because, unlike that episode, the jobs market is in a much more fragile state, limiting the ability of workers to shield their disposable incomes through higher pay. Markets, we think, are underpricing the extent of the Bank's easing cycle that's still to come. Comments from both hawks and doves at the BoE have emphasised that further cuts are

likely.

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



Source: Macrobond, ING

We now expect the next cut in February

Timing is admittedly less clear. We no longer expect the next cut in November.

But by December, the data should be in a more comfortable position for the Bank. Our forecasts for service-sector inflation – the bit of the basket officials are usually most focused on – are roughly half a percentage-point below the BoE's projections.

We also expect private-sector wage growth – currently 4.7% – to fall to within a whisker of 4% in data available before December's meeting, and below by February's. Admittedly, this is already reflected in the Bank's forecasts. But having consistently failed to fall as fast as officials expect, simply seeing wage growth come down in line with expectations would be a major reassurance.

Then there's the budget, which should add to the case for further easing. Tax hikes are widely expected, yet the details matter. Given the Bank's extreme focus on headline rates of inflation, officials would likely take a dim view of any measures that add to it, even if, in the longer term, tax hikes tend to alleviate price pressure. The BoE will also be monitoring spending plans and whether next year's budgets get a top-up. If they don't, then government expenditure should be much less of a support to the economy in 2026 than it has been in 2025 so far.

Where does that leave our forecasts? We've taken out a November cut, but December is possible. However, we narrowly favour February for the next move, on the basis that headline inflation should be a little lower at the start of next year. In total, we expect three rate cuts in 2026.

Author

James Smith

Developed Markets Economist, UK

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 www.ing.com.