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

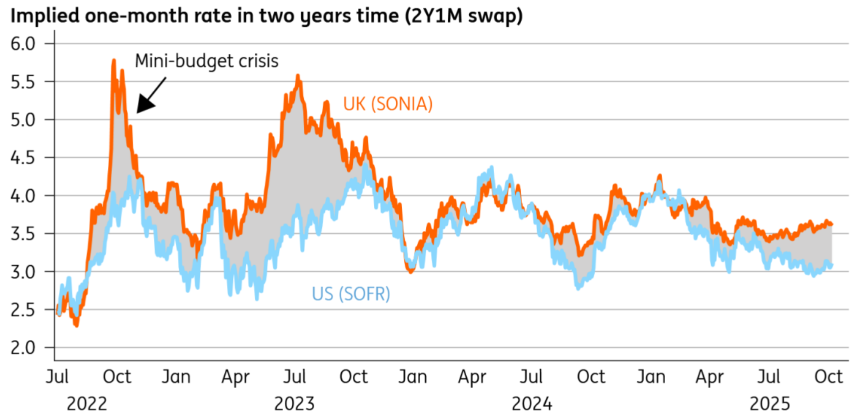
Financial markets are giving up on further UK rate cuts...

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.

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