

## Bank of England cuts rates and downplays budget impact

Despite big spending increases in last week's UK budget, the Bank of England has signalled that it's not a game changer for future interest rate cuts. We think the Bank will keep rates on hold in December but accelerate the pace of cuts from February onwards



The Bank of England in London

### Don't read much into the BoE's latest forecasts...

Nobody will be very surprised to learn that the Bank of England has cut interest rates this month. Bank Rate has been taken a quarter point lower for the second time this year, which leaves it at 4.75%.

Instead, everyone wanted to know what the Bank made of the latest budget. Big spending increases will, investors have assumed, reduce the scope of the BoE's rate-cutting cycle.

Take a glance at the BoE's new forecasts, and it's tempting to conclude that the Bank agrees. Growth is higher and it expects inflation to be at 2.2% in two years' time. On paper, that's a very subtle way of saying that if interest rates were to follow the path expected by markets, then inflation would still be fractionally above target.

But that would be the wrong conclusion to reach. There's a big caveat to all of this which is that the Bank hasn't accounted for the market reaction to the latest budget in its new forecasts. The numbers are based on market rates averaged out over several days up until 29 October, the day before the budget was announced.

Markets are now pricing Bank Rate some 40 basis points higher this time next year than in the numbers used by these latest forecasts. In other words, if the models were run again today, the upward forecast revisions to growth and inflation would be more muted.

In fact, away from the forecasts, the analysis of the budget looks much more nuanced. Take the tax hike on employers. The hawks might argue that firms are likely to pass on those costs in the form of higher prices, but the committee as a whole is reluctant to reach that conclusion. There's plenty of discussion about the uncertainty of how the budget will affect the economy, and the Bank has also emphasised that fiscal policy will become tighter beyond next year.

## We still expect faster cuts in the spring

In short, the Bank is refusing to be drawn on where interest rates are likely to go next.

It was always very unlikely that Governor Andrew Bailey would also choose to double down on his comments a month ago when he hinted that rate cuts could become "more aggressive". Interestingly, the Bank has used its latest Monetary Policy Report to play down the latest fall in services inflation which, at 4.9%, is well below the Bank's forecast from August. Like us, it expects those numbers to stay broadly unchanged into the end of the year.

So what should we take from all of this? A December rate cut, we think, now looks unlikely. Previously we'd thought that the Bank would accelerate its cutting cycle beyond today, but uncertainty surrounding the budget's impact has changed our mind on that.

But the overarching message from the Bank today is that while the budget will have some impact, it is just one of a number of factors affecting the inflation outlook right now. If services inflation continues to fall more meaningfully next year, as many of the surveys seem to indicate, then we think we are still likely to see rate cuts accelerate.

Remember, markets are pricing fewer than three rate cuts from here on in. That would leave UK rates more than two percentage points above the European Central Bank in a year or so. We don't think that sounds particularly realistic. Our view is that rate cuts will be cut at every meeting from February until rates reach 3.25% next autumn.

### 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>.