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UNITED KINGDOM

December Bank of England cut more likely after latest decision

The Bank may have left rates on hold, but its latest decision leaves us more convinced that a rate cut is coming in December. Everything hinges on Governor Andrew Bailey's vote – and his comments make it abundantly clear that he is siding with the doves

Governor of the Bank of England, Andrew Bailey

Everything depends on Governor Bailey

If you take one thing away from the Bank of England's decision to keep rates on hold this month, it's that the prospect of a December rate cut hinges on Governor Andrew Bailey – and him alone.

The backdrop is that the Bank voted to keep rates at 4% by a narrow 5-4 margin. Reading through the meeting minutes, which now include a paragraph from each official outlining their views, it's clear that the four dissenters are resolutely convinced that more easing is needed. And four out of the five who voted for "no change" think the polar opposite. It feels unlikely that either of these camps will shift between now and December.

But Bailey was visibly torn. His view boils down to: yes, September's inflation was encouraging, but it's still only one data point. But it's also clear that he is much more sympathetic to the view of the doves, which is that the downside risks to inflation are more obvious than the upside. That was reflected in the key sentence in the Bank's latest statement, which said the risks surrounding inflation are now more balanced.

Barring any major upsets in the two inflation releases between now and December's meeting – and assuming no surprises in the Autumn Budget – then it sounds like Bailey will vote for a cut at that meeting. That's our base case – and we're more convinced of that following the latest decision.

Inflation data and Autumn Budget to help cement December cut

On the data, we think the next two inflation reports will show headline CPI down a touch, at 3.5% from 3.8% in September. But interestingly, the Bank thinks food inflation will move back above 5% into year-end. That's despite September's data showing a sharp pullback to 4.5% – and eurozone data hinting that price pressures in the supermarket have peaked. This is an obvious potential source of downside to the Bank's inflation forecasts in the short term.

On the budget, we struggle to see an outcome now where it isn't net-dovish for the Bank. The vibe coming from the Treasury suggests material, front-loaded tax hikes – perhaps in the region of £15bn/year – are likely. And while there's little it can do to actively lower inflation, it's clear that Chancellor Rachel Reeves won't be doing anything that could reignite it in the short term.

The Bank can only act on government policy as it stands today, so delivery of those expectations later this month should help cement a vote for a cut before Christmas. And we expect two more cuts by next summer, taking Bank Rate down to 3.25%. Markets are more or less pricing that too now, and Bailey himself confirmed this is broadly in line with his current thinking.

Rates and pound soften

Financial markets have taken today's MPC communication as slightly dovish. This is presumably because of the read on Andrew Bailey's position as leaning towards a December cut.

Looking at the money market strip, the moves at the shorter end of the curve look a bit more muted compared to the 4-5bp rally in Sonia interest rate futures for next summer. Sterling is modestly lower, and the Gilt curve has actually bullishly steepened a little, perhaps reflecting greater confidence in the short-end of the curve and ongoing concerns about the long end.

Actually, in an audience poll of our UK webinar yesterday, 59% of respondents felt Gilt yields were more likely to rise than fall in the aftermath of the budget. Presumably, this represents ongoing scepticism that the Chancellor can deliver later this month, plus a recognition that most of the recent rally in Gilts has been driven by a more dovish read of the BoE.

Looking ahead, we see sterling staying soft but not necessarily needing to fall a lot more from here. The BoE cycle is now better priced at a terminal rate of 3.25% next summer. And barring dramatic fiscal tightening in the budget, which could reprice the BoE cycle even lower, a credible budget might just be enough to take a little more risk premium out of Gilts and the pound.

We think EUR/GBP can hang around these 0.88 levels into the budget rather than pushing much further ahead.

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