Hawkish Bank of England cuts rates but pushes back on faster easing

The Bank of England has lowered rates by a quarter point, but has failed to endorse market expectations of faster rate cuts. Our base case is that the Bank keeps cutting rates once per quarter, though we wouldn't rule out a quicker pace of cuts if we're right that services inflation falls faster than the BoE currently expects

Bank of England Governor Andrew Bailey

Quarterly rate cuts to continue as Bank of England stays cautious

The Bank of England has cut interest rates to 4.25%, but crucially gave no indication that it's about to speed up the pace of its easing cycle.

Investors were primed for signals that the committee was preparing to pivot, and ahead of the meeting, two further cuts were priced at the next three meetings. That would mark a deviation from the once-per-quarter rhythm of rate cuts the BoE has so far employed.

Instead, the Bank stuck to its previous script, simply reiterating that future cuts are likely to be "gradual and careful". Changing that language would have heavily implied the Bank was prepared to cut rates again in June, something we suspect it's reluctant to do – or at least, pre-commit to at this stage.

That lack of change, combined with the fact that two out of the nine committee members voted for no change in rates today, saw roughly 10bp of easing priced out over the coming year.

Part of the issue, we suspect, is that investors had overstated the role tariffs would play in the Bank's decision-making. While the added uncertainty and weaker outlook for global growth will become a headwind, the reality is that the direct impact of US tariffs so far looks very limited – particularly if Britain is granted sizable carveouts from US President Donald Trump's sectoral tariffs later today.

Indeed, the Bank has made minimal changes to its growth forecasts. It hasn't really changed its inflation outlook either, beyond slightly lowering its headline CPI forecasts to reflect the fall in oil prices.

Given all of that, we still think the path of least resistance is for the Bank to keep cutting rates once per quarter this year, which would see its next move in August.

That said, we wouldn't fully rule out the BoE moving faster at some point. The major uncertainty surrounding April's services inflation figure, due in a couple of weeks' time, was, we suspect, a key factor keeping the Bank more cautious today.

April saw a lot of annual price hikes kick in, and previous years have shown how unpredictable this can be, with both the April 2023 and 2024 CPI releases surprising to the upside, providing the catalyst for some of the biggest one-day moves in UK swap rates over that period.

The Bank's latest forecasts show services inflation rising back to 5.0% (from 4.7%) in April, though we think the risks are to the downside. And indeed, later this quarter, we think services inflation will be much closer to 4% than 5% – unlike the BoE, which expects it to stay broadly unchanged.

If we're right – and the Bank will have both April and May data by its June meeting – then there is a small chance the committee votes to cut rates again next month. That's not our base case, but in general, we think the Bank will become less nervous about inflation as the year wears on, and that will enable it to eventually cut rates a little closer to 3% than markets are currently pricing.

Sterling enjoys some support

Having initially sold off on the 5-4 voting pattern today (two voting for no change, two voting for a 50bp rate cut), sterling has since rebounded on the view that BoE is not yet ready to accelerate its easing cycle. EUR/GBP is pressing support at 0.8475/80, and the near-term bias is that it can drop a little further.

Helping that move over the next couple of weeks should be the run-up to the first UK-EU summit on 19 May. Here, leaders should sign a new Security and Defence Pact (SDP) and talk warmly about future deals regarding alignment on carbon trading and youth mobility.

Typically, sterling performs better on warmer UK-EU relations, which in this case could involve the Office for Budget Responsibility (OBR) scoring UK growth prospects higher this November – providing more fiscal headroom for UK Chancellor Rachel Reeves.

A less dovish than expected BoE can only help this political support for the pound, and 0.8400 looks the EUR/GBP bias for this month.

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