

MARKET COMMENTARY

BoE: merely a dovish pause in November

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- At today's meeting the BoE's Monetary Policy Committee (MPC) in a very narrow vote left bank rate unchanged at 4.0%. Only five out of nine members opted for keeping the key rate unchanged, four wanted a 25 bps cut.
- The MPC acknowledged progress in underlying disinflation and expects it to continue while judging that headline inflation has peaked. It also sees risks more balanced now but said that more evidence was needed.
- The direction of travel is still towards lower rates but the extent of further reductions will "*depend on the evolution of the inflation outlook.*" The updated forecast sees inflation falling to 2% within two years under the market assumption of a further reduction of the key rate to 3.5%.
- Chancellor Reeves will present the Autumn Budget on November 26. In pre-Budget speeches she made clear that consolidation measures (not even ruling out tax hikes) will compensate for the expected fiscal shortfall leading to increased fiscal tightening in the range of GBP 22 bn to GBP 35 bn.
- We think that the 2026 budget will push the inflation outlook to the downside and ultimately trigger more rate cuts. We increased the expected cumulative rate cuts until year-end 2026 from 50 bps to 75 bps implying a bank rate of 3.25% by the end of next year, somewhat below market pricing. We see the risks even tilted towards further cuts.

BoE kept key rate unchanged today: At today's meeting the MPC left bank rate at 4.00% backed by five members (Andrew Bailey, Megan Greene, Clare Lombardelli, Catherine L Mann and Huw Pill) while four members (Sarah Breen, Swati Dhingra, Dave Ramsden and Alan Taylor) voted against this proposition, preferring a 25 bps cut.

Improving inflation outlook helped by restrictive monetary policy: The MPC found that at the current rate of 3.8% yoy headline inflation has peaked. It expects underlying inflation to recede further. The Bank's new inflation forecast shows inflation falling to the 2.0% target in two years' time based on current markets' expectations that rates will be reduced to 3.50%. Also, the MPC sees that less risks from more sticky inflation whereas the ones from weaker demand became more apparent making overall risks more balanced. At the same time the MPC makes clear that a restrictive monetary policy stance – apart from subdued growth and building labour market slack – is still seen as a factor for underlying disinflation.

Direction travel is clear: The MPC stated that it is in easing mode and that if disinflation progress continues the "*Bank Rate is likely to continue on a gradual downward path.*" All MPC members agree on that while the five members that voted for unchanged rates only placed greater weight on the risks of inflation persistence. Governor Bailey was the swing voter, he had voted for a rate cut in August but was in favour of constant rates today. Once further disinflation becomes visible, which we expect, he will swing towards a rate cut again.

A tough budget ahead: Given the expected fiscal shortfall in the range of GBP 30 bn to GBP 50 bn, Chancellor Reeves delivered a series of pre-budget speeches. She recently signalled that tax rises are imminent and that the government may break its

manifesto pledge not to raise income tax, VAT, or National Insurance. The new Budget will be presented on November 26 and we expect her to walk the talk and to propose additional tightening. Estimates see them in the range of GBP 22 bn to GBP 35 bn which is in the range of 0.8% to 1.2% of UK GDP. Clearly the measures will likely be stretched over 2026/27 but have a clearly negative effect on growth and inflation.

At least 75 bps cumulative cuts ahead: The BoE's new inflation forecast shows inflation falling to the 2.0% target in two years' time based on the markets' expectations that rates will be cut to 3.50%. With a disinflationary budget ahead the MPC will need to reassess its outlook making the reaching of the inflation target consistent with a lower key rate. We therefore look for a 25 bps cut at the December 18 meeting (discounted only by 60% by markets) and lowered our year-end 2026 key rate expectation from 3.5% to 3.25% (vs. 3.35% by markets). We see the risk tilted to even more easing.

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