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## Dovish BoE Keeps 1Q Cut in Play, ECB Sticks to Neutrality

To no one's surprise, neither of the Bank of England (BoE) nor the European Central Bank (ECB) chose to tweak policy settings in this morning's announcements, keeping Bank Rate at 3.75% and the Deposit Facility Rate at 2.00%, respectively, with the BoE having just rolled out a 25bps cut at its December meeting and the ECB staying put at this level since last June. ECB President Lagarde mostly stuck to her script about settings being in a good place, while BoE Gov Bailey sounded fairly neutral at his own press conference.

That's about where the similarities end, as the BoE surprised with a more dovish vote split than expected and the meeting minutes suggested that cut voters will be the majority group at the next decision; the BoE's statement also had a few tweaks here and there. At the opposite end, the ECB made no changes to its guidance paragraph nor significant modifications to its assessment of economic conditions and inflation, coming off the December forecast update.

Following today's decisions (which we discuss in further detail below), we maintain our call for the ECB to keep to a 2.00% depo rate over the forecast horizon to 2027, while our expectation for the BoE to announce a 25bps reduction to 3.50% at its March decision got a boost from today's communications—although it may be a close one depending on upcoming data—to be followed by another 25bps cut to a 3.25% terminal rate at some point in 2Q26.

### BOE SURPRISES DOVISHLY IN VOTE SPLIT, FORECASTS, AND MPC VIEWS

The BoE's hold at 3.75% is about where it ends for meeting consensus expectations as the combination of a 5–4 vote split, some deeper than expected revisions lower to inflation and growth projections, and the balance of the Monetary Policy Committee's views tilted more dovish, prompting markets to re-add to bets on a March rate cut.

At writing, markets are pricing in 15bps in cuts for next month's announcement, or about a 60% chance of a quarter-point reduction, compared to the 5bps (20% chance) pencilled in prior to the decision. By end-2026, markets have a cumulative 45bps in total cuts priced in compared to about 38bps (or one sure-thing cut and toss up odds of another) at yesterday's close.

The BoE's communications leave 2yr gilts 5bps lower on the session, in contrast to the under-pressure long-end where 10s are flat and 30s are 4bps higher amid calls for PM Starmer to resign over the scandal regarding the U.K.'s former ambassador to the U.S., Peter Mandelson (which we leave to our readers). The BoE-politics double whammy has the GBP trading 0.7% weaker against the USD and the EUR.

First, against ~60% and ~30% of economists polled by Bloomberg expecting a 7–2 or 6–3 hold-cut votes split, the BoE delivered a hold on a razor-thin 5–4 majority where Governor Bailey again acted as the tiebreaker—as he often has over the past year. As has been the case for now three consecutive meetings, perma-doves Taylor and Dhingra (external members) were joined by Deputy Governors Ramsden (Markets & Banking) and Breeden (Financial Stability) in opting for additional easing.

To add to the more dovish vote divide, perma-hawk Mann positioned herself as a possible cut vote at the March decision, as per the MPC member's views that have accompanied the BoE's decision and minutes since the November meeting. In these, she stated that “new analysis and current developments have moved the appropriate time for a cut in Bank Rate closer.” Although she spoke to this timing depending on the effect of one-off policies impact the underlying disinflation process over the 2H25–2H26 period, it would seem that she may be amenable to voting with a cut majority at the next decision.

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Gov Bailey, meanwhile, noted that he sees scope for some further easing of policy, going “into the coming meetings asking whether a cut is justified.” It would seem then that it’s a matter of time for the Governor to vote for a cut. After his press conference, when speaking to Bloomberg, Bailey said that the market’s roughly 50–50 bet on a 25bps cut at the March gathering is “not a bad place to be.”

In its updated projections, the BoE’s staff slashed the forecast path for headline inflation to reflect measures unveiled in last November’s Budget (namely reductions to energy bills kicking in from April). The BoE now thinks that headline inflation will average 2.1% y/y in 2Q26, down from the 2.9% y/y it had forecasted in the November Monetary Policy Report (MPR), with inflation expected to close 2026 and 2027 at 2.0% (from 2.5%) and 1.8% (from 2.0%). Under these new forecasts, which also consider that household and firm inflation expectations are pulled lower by observed inflation, the BoE predicts that inflation will oscillate around the 2% inflation goal from 2Q26 until the end of their forecasting horizon lasting until 1Q29; this is three quarters sooner than in the November MPR where inflation didn’t slow to 2.2% until 1Q27.

The Bank also trimmed its GDP growth forecast, now seen at 0.9% in 2026 compared to the 1.2% forecast in November, rising to 1.5% in 2027 (down from 1.6%), with 2028 upgraded to a 1.9% expansion (from 1.8%). In tandem with this more conservative view for GDP growth, the BoE lifted its projection for the unemployment rate to rise to 5.3% at end-2026 from the latest 5.1% reading as of November 2025, and compared to the end-2026 projection of 5.0% in the November MPR; at end-2027, the unemployment rate is projected at 5.2% (up from 4.9% in the November round).

Between today and the BoE’s March 19<sup>th</sup> decision, economists and markets will parse 4Q/Dec and Jan GDP reports, January CPI data, and Jan/Feb payrolls, among other releases to shift expectations. Political developments could also influence the BoE’s decision-making via their possible impact on business and consumer sentiment, or U.K. assets, mainly the GBP and gilts.

### ECB STICKS TO DATA-DEPENDENCE, WITH NO BIAS

As was universally expected by markets and economists, the European Central Bank (ECB) left all policy settings unchanged, chief among them keeping the deposit facility rate at the 2% level where it has sat since last June. There were no noteworthy insights in its decision statement compared to the December version, when the bank unveiled new economic projections that were the focus of that meeting.

In the (very brief) statement, the ECB highlighted that the Eurozone economy “remains resilient in a challenging global environment,” an assessment that is brought back from the October text, while pointing to the supportive effect of public defence and infrastructure spending and past interest rate cuts. As always, the outlook remains uncertain due to trade and geopolitical risks. Its key guidance paragraph maintains a data-dependent, meeting-by-meeting stance, with no bias whatsoever regarding the direction of the next move in rates; up or down.

ECB president Christine Lagarde gave only a little bit to sway markets away from their muted reaction upon the release of the statement, with European yields moving slightly higher from intraday lows, seeing German 2s close flat on the day compared to the 5bps decline in U.S. and U.K. 2s at the time of the European market close. She highlighted the role that a stronger EUR could have in pushing inflation further below the 2% goal, though in a more objective matter rather than highlighting as something that the ECB is clearly worried about—for now—and that recent moves remain within the baseline’s views. Lagarde also said that ECB policy and inflation are “in a good place,” thus denting small bets in markets that the ECB could consider a rate cut in the near future.

We believe the ECB will keep its deposit facility rate unchanged at 2% over a multi-year forecasting horizon, with marginal odds that it opts for an additional 25 bps rate cut at some point over the coming year considering downside risks to growth and EUR strength—although we remain a ways away from assigning higher odds to this, in line with the ECB’s data dependence. In general, it may take a significant, unexpected, shock to see the ECB shift away from its on-hold position.

The Eurozone economy will remain challenged by the U.S.’s 15% tariff baseline rate on its imports from the E.U., with sporadic flareups of trade tensions (as seen recently over Trump’s tariff hike threat regarding Greenland) due to keep business confidence subdued over coming quarters. Tariffs and tariff threats aside, the bloc’s economy is holding up decently according to data published last Friday, having closed 2025 with a 0.3% quarterly expansion in 4Q and 1.5% for the year as a whole—picking up from 2024’s 0.9% gain despite strong external headwinds as fiscal support (and some Irish GDP accounting) helped the headline figures.

The ECB is at ease with current and expected economic conditions but may not be too keen on the trajectory of inflation, having been perhaps more muted than thought and with EUR strength standing as an additional drag on headline price gains. In December, year-over-year inflation came in at 1.9%, down from 2.1% in November, and economists estimate that it slowed further to 1.7% YoY in January data due tomorrow.

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