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FLASH REPORT
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BoE Holds but Leans Toward Hiking, Overhauls QT

- **The BoE left its policy rate unchanged at 3.75% this morning as widely anticipated with a 6–3 hold-hike split also in line with expectations, in an overall hawkish decision that showed greater openness to hikes as inflation concerns grow.**
- **Four of the hold voters, including Gov Bailey, highlighted that the longer the conflict persists the higher the possibility that tighter policy will be needed due to growing risks of second-round effects on prices—although these have so far failed to materialize, while domestic demand and labour markets remain weak.**
- **If energy prices and the outlook for the conflict in the Middle East do not improve significantly by the time of the November meeting, we think the BoE will hike by 25bps, followed by another rate increase in Q1-27, with permutations of back-to-back or more hikes dependent on how risks evolve over the next few months.**
- **The BoE also announced a change to its gilts holdings plans, outlining a multi-year balance sheet runoff plan that includes pausing all bond sales until April and ending long-dated bond sales altogether which fed a strong rally in long-end U.K. rates.**
- **Markets are pricing in a total of 40bps in hikes by year-end (+2bps on the day) and ~100bps by next summer (+5–7bps). The GBP is the only G10 currency losing ground against the USD today, with a modest 0.3% decline.**

The Bank of England (BoE) left its policy rate unchanged at 3.75% this morning, as universally expected by economists polled by Bloomberg and only minimal rate hike pricing in markets of around 3bps (10–15% chance). The 6–3 hold-hike vote split was also in line with the expectations of economists, repeating the July decision scoreline as Chief Economist Pill and external members Greene and Mann voted to lift Bank rate by 25bps today. Alongside the rate announcement, the BoE voted unanimously to modify its gilts holdings plans, outlining a multi-year balance sheet runoff plan that includes pausing all bond sales until April and ending long-dated bond sales altogether.

Gilts in the 2026–2034 bucket totalling £222bn will be held to maturity, rolling off from holdings naturally, 2035–2049 gilts at £146bn will be sold at a £20bn annual pace, and the remaining £120bn in 2049+ gilts will be held for standard backing of current and future banknotes. Regarding the 2035–2049 envelope, the BoE is consulting with HM Treasury and the DMO on plans to sell these to them with a decision to be made by April 2027. So, the BoE is not only reducing the roll-off pace from the £70bn rate of the past twelve months (maturing debt and active sales) to now a £46bn average annual rate, but it would also keep these £20bn in sales outside of public markets.

The BoE's announcement, despite having a hawkish feel regarding the near-term policy rate path (more below), helped a solid rally in gilts across the curve, with 10s and 30s yields falling 7bps and 12bps on the day against a more moderate decline of 2–3bps in the 2s and 3s space, with investors taken by surprise by the BoE's QT announcement. As for BoE rate pricing, traders are currently pricing in a total of ~40bps in tightening by year-end (up 2bps on the day), with 20–21bps (~80% hike chance) implied for the next BoE meeting in early-November; cumulative hikes total about 100bps (up 5–7bps) at their peak around mid-2027. The GBP is the worst performer in the G10 today, falling 0.3% compared to gains for all other currencies in the complex, with the EUR and JPY up a modest 0.1%.

While today's in-between forecast rounds decision did not come with new forecasts (due in the November Monetary Policy Report) nor a press conference with Gov Bailey (also in November), the BoE delivered a trove of insights across the statement, summary of opinions, and the views of the Monetary Policy Committee (MPC), as is customary, to which it added the gilt sales announcement.

The overall tone of the BoE's communications was hawkish, reflecting greater concerns about inflation that suggest that it will announce a 25bps increase at its next meeting if energy prices remain around current levels and price risks do not abate by early-November—though we think it's unlikely that it would go back-to-back considering the underlying weakness in the U.K. economy and a choice to monitor the situation before tightening in quick succession.

In isolation, we see a high chance that the BoE lifts its policy rate by 25bps in November, assuming that the current backdrop of high energy prices continues (with seemingly no resolution to the conflict in the Middle East coming soon), with another hike in early-2027 to follow, where additional tightening is even more contingent on the evolution of energy prices and whether the BoE has observed yet unseen second round inflationary effects. This compares to our latest published forecast of the 3.75% level holding through end-2027 before cuts likely resumed in 2028. It's looking more like two hikes with the possibility that some of this energy prices-related restrictiveness is lifted in late-2027.

However, the BoE's assessment that a tightening of financial conditions since early-2026 "would help to lean against inflationary pressures" would, at the margin, suggest that they're comfortable with markets 'doing their job for them' without having to lift the policy rate. The yield on 10yr gilts has gone from ~4.40% at end-2025 to 5.2% currently (it was 5.4% at Tuesday's close pre-CPI and the QT announcement), while 2yr yields are up from 3.7% to 4.7% over the same period. This roughly 100bps increase in U.K. bond yields, with knock-on effects on consumer borrowing rates, has somewhat helped limit growth in the U.K. to an even more tepid pace, keeping second-round inflationary risks at bay.

These yield increases, of course, are based on the fact that markets are expecting that the BoE will hike (or hold off on rate cuts during the initial leg higher). The BoE has so far benefitted from this bet, but it is nearing the point where it will have to deliver on expectations to maintain the degree of restrictiveness needed to keep inflation on track to the 2% target. And this is explicitly noted in today's overview of the BoE's discussion, that notes that "members placed different weights on whether this tightening in financial conditions would endure in the coming months if there were no increase in Bank Rate.," and that while "for most members, movements in UK short-term market interest rates […] were imparting a broadly sufficient degree of monetary policy restraint," others believe that "risk premia [particularly beyond the short-term] were not a substitute for changing the level of Bank Rate, including as they were partly driven by factors not related to the UK economy. These premia could therefore change in an unpredictable way."

The BoE believes that upside inflation risks "were further titled to the upside" compared to the July announcement (thus in relation to the forecasts presented in the MPR). While we'll have to wait for the November MPR for fuller forecast updates, the BoE said that based on energy prices as of Monday's close, headline inflation is expected to pick up to around 3.75% in Q4-26, up significantly from the 3.2% projection in the July MPR, accelerating from 2.9% in Q2-26 and a July–August average of 3.1%. For Q1-27, inflation is expected to come in "slightly above" the psychological threshold of 4%, double the BoE's target, and about 1ppts higher than the 3.2% Q1-27 forecast printed in the July MPR baseline projection, and near the 4.3% estimate in the adverse scenario—one which saw three quarters of 4%+ headline inflation, albeit incorporating a market-implied rate path that included only one hike.

That "there has been little evidence so far of material second-round effects in price and wage-setting" remains a key development that has restricted BoE hikes, but as echoed by central bank peers "the risk of such effects, against which policy needs to lean, is greater the longer higher energy prices persist or are more volatile." A key development in the section outlining the MPC's views is the growing number of officials that pointed to the fact that an extended conflict in the Middle East would justify tightening. Members also voiced concerns about higher food prices.

Gov Bailey alluded to the conflict possibly going on for longer than previously thought, saying that "the geopolitics of the situation makes the upside [inflation] risk more prominent with a seeming loss of urgency to find solutions." While he followed this by saying that indirect energy pass through has so far been weaker than previously expected and that labour markets remain soft, he said that "if the conflict in the Middle East persists for an extended period, as appears to be the case, and the risk of second-round effects emerging increases, it is likely that policy may have to tighten."

Other non-hike voters had similar opinions. Breeden said "if risks to the outlook for second-round effects crystallise, it becomes increasingly appropriate for Bank Rate to respond," Lombardelli noted that "the case for raising Bank Rate is building the longer the conflict continues without lasting resolution," and while Ramsden did not single out the conflict, he said "whilst the policy stance continues to provide restrictiveness, were upside pressures on the inflation outlook to continue to build, there could be a case for increasing Bank Rate." Doves Dhingra and Taylor had more guarded views, naturally, saying respectively that waiting for how things evolve "would still allow time to adjust Bank Rate appropriately to mitigate second-round effects, while avoiding pre-emptive tightening before there is greater clarity on first-round effects" and that "I therefore favour holding while monitoring closely whether expectations, wages, prices, and margins begin to react. Clearly, any evidence of emergent second-round effects would build the case for tightening. Equally, if geopolitical tensions abate and inflation pressures ease, an easing of policy should be in sight."

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