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GLOBAL ECONOMICS

FLASH REPORT

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Hawkish BoE Hike, with More to Follow

- **The Bank of England raised its policy rate by 25bps to 4.00% this morning, as widely expected, but with a more hawkish 8–1 vote split that included hawk Mann favouring a half-point increase, against expectations for a 7–2 hike-hold divide.**

- **In its decision statement, the BoE noted that while "there remains limited evidence of knock-on effects on other prices and wages," "the degree of inflationary pressure in the pipeline is now sufficient to warrant" a rate hike.**

- **Updated forecasts in the MPR now see headline inflation peaking at 4.8–4.9% in Q2/Q3-27, compared to July's 3.2% peak inflation in Q4-26/Q1-27, with the 2% goal not expected to be reached until Q3-2028. GDP growth projections for 2026 and 2027 got a lift in the medium-term, mainly on the back of stronger business investment.**

- **Markets are pricing in about toss-up odds of a quarter-point rate increase in December, compared to about a one-in-four chance pre-decision, with cumulative additional BoE hikes at around 70bps by July-September of next year.**

- **We expect the BoE to skip December, to then hike again by 25bps in February, with risks building towards additional tightening in the second quarter of next year, all conditional on the path of energy prices in the coming months and evidence of (yet unseen) second-round effects.**

The Bank of England raised its policy rate by 25bps to 4.00% this morning after a long pause that lasted since last December's 25bps rate cut which marked the last in the easing cycle off the 5.25% peak over August 2023–August 2024. Today's broad set of BoE communications was more hawkish than expected and clearly points to additional policy tightening.

Our latest published forecast sees the BoE holding in December, before announcing a final 25bps hike at its February meeting to 4.25%, but risks favour the BoE hiking beyond this level—with a high degree of uncertainty to how many more rate increases, dependent on developments in energy markets and possible evidence of second-round effects on prices.

Markets are pricing in about toss-up odds of a quarter-point rate increase in December, compared to about a one-in-four chance pre-decision, with cumulative additional BoE hikes at around 70bps by July–September of next year (was up to 75bps, +5bps, before global rates markets rallied amid the equities selloff). Cumulative pricing for the February announcement sits at 30–35bps, reflective of the market's certainty that the BoE will hike at least once by then.

U.K. 2s through 30s closed fractionally higher (0-1.5bps on the day), compared to a 5bps decline in U.S. 2s through 10s and -3bps in 30s at the time of the U.K.'s market close (now going on about 10bps decline in U.S 2s). The GBP showed limited reaction to the decision but is somewhat of an outperformer on the day by virtue of holding unchanged in contrast to losses in the high-beta currencies, while the JPY and CHF lead, and the EUR fares a bit worse than sterling.

The move was widely expected by markets and economists, yet the vote split of 8–1 which included hawk Mann voting for a 50bps hike was more hawkish than expectations that saw two preferring a rate hold and none pushing for a larger hike. That perennial doves Dhingra and Taylor voted with the group in favour of a hike today shows an important shift in expectations for inflation and its risks, with inflation projected to rise to near 5% in mid-2027 (more on this later). However, they both framed their hike support as an

insurance hike and Taylor referred to it as a "one-for-now" increase. Mann's comments regarding her 50bps vote give a sense of not wanting to fall behind the curve and to manage monetary policy credibility.

In its decision statement, the BoE noted that while "there remains limited evidence of knock-on effects on other prices and wages," "the degree of inflationary pressure in the pipeline is now sufficient to warrant" a rate hike, and that economic data have been better than expected of late, all building the case for tighter monetary policy. "How likely high energy prices are to feed through to other prices and the economy more broadly" will be the leading influence on the BoE's thinking over the coming months.

In the minutes to the policy meeting, his press conference, and interviews that followed the release of the decision, BoE Gov Bailey struck a tone that pointed to additional tightening but without giving anything away beyond reinforcing a high likelihood of another 25bps hike, saying that in the absence of an end to the war there is as strong case for another rate rise and a further rate hike "may be warranted," "and thereafter taking a more conditional approach."

Bailey stated that consecutive rate hikes are "not inevitable," and that he would not sign up to the idea of "two-and-done," but this speaks more to him wanting to keep guidance loose amid elevated uncertainty. He also said that the decision to hike today would not have changed considering the recent fall in energy prices (in how these would have been reflected in the risk outlook and forecasts), and also that inflation is "baked in" due to the quarterly household energy bills price cap.

Which brings us to the BoE's updated forecasts in its Monetary Policy Report (MPR). These incorporate Brent oil prices averaging $87/bbl and $78/bbl in 2027 and 2028 (up about $10/bbl and $5/bbl, respectively, vs the July round), U.K. natural gas prices averaging GBP 157p/therm and GBP 101P/therm in 2027 and 2028 (up about 35p/therm and 15p/therm, respectively), and Bank Rate peaking at 4.8-4.9% in Q3/Q4-27 (up from 4.2% in the July round). The BoE also notes that the January-March Ofgem price cap on household energy bills (to be announced in late-November) is expected to rise by about 25% q/q, and that Budget measures are expected to reduce Q1 headline CPI inflation by around ¼ of a percentage point.

The BoE projects that headline inflation will rise from the 3.1% y/y Q3-26 average to 3.8% in the current quarter, followed by another large jump to 4.4% y/y in Q1-27, to then peak at 4.8-4.9% in Q2/Q3-27 and not reaching the 2% target until Q3-28. This compares to the July MPR showing peak inflation of 3.2% in Q4-26/Q1-27 and the 2% target being reached in late-2027. So, inflation is now seen 1.5–2ppts higher at its peak and not expected to reach the BoE's goal until well into 2028.

Of the +1.8ppts increase in the Q2-27 inflation forecast, now at 4.9% compared to 3.1% in July, direct energy effects represent +1.4ppts, indirect effects (i.e. pass through) amount to 0.3ppts, balanced by Budget effects at -0.2ppts, while 'other' adds +0.4ppts. The BoE does note, however, that the indirect effects seen in data and incorporated in forecasts from October 2026 to March 2027 are smaller compared to their July round, and that "recent data suggest little impact on CPI inflation so far," but the magnitude of the energy prices shock versus July still leaves having to incorporate a lift from these thereafter.

While there may not be a lot of evidence of upward pressure on prices from higher energy costs, these could be acting to considerably limit the downside in underlying inflation, as BoE measures of services prices that exclude items with high prices variation, or indexed components, rents, and holidays, or a trimmed mean (alike the BoC) show inflation stubbornly sitting around 4% in the past two quarters. The BoE also revised higher its projections for pay growth, 3.5% y/y and 3.4% y/y in Q4-27 and Q4-28, up from 3.1% for each in the July round. Note that in an adverse inflation scenario, inflation closes 2027 at 5.5% and 2028 at 3% while in a weaker demand scenario it comes in at 3.6% and 1.2%, respectively.

Finally, on the GDP growth front, the BoE projects growth at 1.6/1.3/1.1% in 20267/27/28 (from 1.1/1.1/1.7%, previously), with household consumption getting a revision higher in 2026 but lower in 2027 and well lower in 2028 (1.2/0.5/1.1% vs 1.0/0.8/1.8% previously), but business investment got a massive lift in each of 2026 and 2027 (4.3/2.5/1.8% vs -1.5/0.9/1.5% previously), which partly reflects AI-related demand while business investment has generally surprised to the upside. Netting everything out, the U.K.'s output gap is seen wider in the medium-term, at -1.3% of potential GDP in 2028 (compared to -0.8% in the July MPR).

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