

UK Watch

Bank of England review: message loud and clear

Pushing back strongly

We were expecting the Bank of England (BoE) to use votes, forecasts, guidance and the press conference to push back against market pricing of early and fast cuts. We got everything. Yes, good news on inflation allowed the BoE to remove the hiking bias in the statement, as we expected. But a vote with 2 members calling for hikes, 6 for a hold, and one for a cut was marginally more hawkish than the 1-7-1 we were expecting. The rest of the guidance on the need to be restrictive for sufficiently long stayed. And the communication from Bailey during the press conference was flawless, with no room for more dovish interpretations.

More confidence in our call after today

We still expect the BoE to keep the Bank Rate on hold at 5.25% until August, with a cutting cycle of 25bp per quarter from there. The UK will be the last of the major central banks to start and is likely to move more slowly, at least compared with the ECB. The UK still has a bigger persistent inflation problem, despite recent improvements. The BoE this week reinforces our view.

The need to be more confident on beating persistence clearly flags a patient central bank. We doubt the minimum wage, wage settlements in the next few months, and the budget in the spring will allow for earlier cuts than August. Risks are biased towards even later.

Finding the middle ground

At market prices, inflation in two years is clearly above target. With constant rates it falls below target. The truth will be somewhere in the middle. But today's communication clearly shows a bias to be patient and put a bigger weight on the latter. As always, persistence will be measured by looking at services inflation, wages, and employment. We doubt we will see sufficient improvement in the next few months to be confident enough to start a cutting cycle in May.

BoE forecasts: pushing back against early cuts

We read the BoE's new forecasts as a decent pushback vs market pricing of early cuts. At the same time, recent good news and the near term cut allowed to remove the hiking bias. This set of forecasts was built assuming a c100bp cut to Bank Rate in 2024. Oil and especially gas price assumptions were much lower in this round. The BoE incorporated a fast drop in energy prices in the near term, dragging CPI back to target in 2024 2Q. But then it rebalanced that with a re-acceleration back above target in 3Q-4Q.

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Macro
United KingdomGlobal Economics Rates & FX
BofAS

Ruben Segura-Cayuela
Europe Economist
BofA Europe (Madrid)
+34 91 514 3053
ruben.segura-cayuela@bofa.com

Alessandro Infelise Zhou
Europe Economist
BofASE (France)
alessandro.infelise_zhou@bofa.com

Kamal Sharma
FX Strategist
MLI (UK)
ksharma32@bofa.com

Agne Stengeryte, CFA
Rates Strategist
MLI (UK)
agne.stengeryte@bofa.com

Mark Capleton
Rates Strategist
MLI (UK)
mark.capleton@bofa.com

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On the new forecast, we would highlight three key points:

1. The theme is inflation persistence, as we expected – the main figure to look at is the 2.3% mean CPI forecast in 2026 1Q. Despite some recent encouraging signs, the BoE is convinced that the market-implied path would not be consistent with reaching the inflation target in the medium term.
2. The gap between the market-rate forecasts and the constant-rate forecast is (unsurprisingly) widening, showing a clear undershoot to 1.4% in 2026 1Q (from 1.9% in the November forecast) if rates stayed at 5.25%. We could see this as an acknowledgement that cuts are coming. Just not as early as markets think.
3. The output gap projections imply subdued supply growth in the near term. The build-up of economic slack over the BoE forecast horizon must be driven mainly by weak demand dynamics – this implies a hawkish tilt in the near term.

Exhibit 1: Persistent inflation is the theme

BoE forecasts in February Monetary Policy Report

BofA forecast for Feb MPR (Nov MPR figures in parentheses)

	GDP % yoy	Inflation
2024 1Q	0.0 (0.2)	3.7 (4.4)
2025 1Q	0.5 (0.0)	3.0 (2.8)
2026 1Q	0.8 (0.6)	2.3 (2.2)
2027 1Q	1.5	1.9

Source: BofA Global Research, BoE

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Rates: market sees what it wants to see

We read BoE MPC votes, forecasts, and guidance as a strong pushback against market pricing of early and fast cuts, and communication from Governor Bailey during the press conference carefully consistent with that. But the rates market still chose to focus on the more dovish elements of the February's BoE MPC meeting, for example the removal of the hiking bias and Governor Bailey acknowledging that keeping rates unchanged would push inflation "significantly" below the target of 2%.

MPC-dated Sonia was barely changed after the meeting, with June 2024-dated Sonia settling 2bp higher than pre-BoE. Further out on the curve, moves were limited as well, with the 2s10s Gilt curve marginally flatter. For us, the message from the BoE is clear: risks of inflation persistence are high, and current levels (as well as past peaks) in services inflation are much higher than in US or EUR, supporting our base case for a later start of the cutting cycle, and making current market pricing a best-case scenario.

GBP: Measured Pivot

Today's decision was a consummate lesson in expectations management: a firm rebuttal of market pricing which ran through every strand of the decision. From the vote to the statement, to the forecasts and then finally on to the press conference, the BoE did not waiver in its communication. We have not often applauded the BoE on its communication strategy but in comparison to other central banks who have recently announced policy decisions, this was straight down the line consistency. The outcome was in line with our own priors and our key take-away is the inflation forecast for Q1 2026 at 2.3% under the assumption of current market rates. This is a clear riposte to current market pricing which is now hard coded into the Bank's forecasts. We had recommended tactical GBP longs into the BoE decision based on precisely what has been delivered today.

Notwithstanding the recent market turbulence caused by US regional banks, we continue to see the backdrop to GBP as conducive both from a rates and vol perspective. Furthermore, the BoE has sounded a slightly more optimistic tone on the growth outlook

– a factor – which we had have flagged and though growth is likely to be anaemic this year, it will not be the catastrophe that was anticipated last year. These tailwinds should be sufficient to push GBP higher and our favoured tactical expressions remain versus CHF, EUR and JPY. The risks around the view are an extension of the risk-off tone following the Fed rate decision.



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