Economic Research Unit

Economics Weekly

Bank of Ireland

Bank of England signals rate cuts to come in 2026

Today's Bank of England decision to keep rates on hold at 3.75% was in line with expectations, but the tone of the minutes and press conference was not, indicating that the Bank rate was likely to be reduced further, and dropping the reference to gradual cuts. The Bank revised down it's projection for UK GDP growth to 0.9% in 2026, CPI inflation to just 1.8% by end-2027 and the unemployment rate up to 5.3% on average this year. Governor Andrew Bailey refused to be drawn on whether 3.25% was a likely end-point for rates this year, but said the curve was in a 'reasonable' place. Sterling pushed through 87p against the euro, 3-swap rates fell to 3.55%, with options pricing in an 80% probability of two cuts in Bank rate to 3.25% by end-2026, following today's decision.

When, not if, the Bank of England will cut rates: This morning's Bank of England decision to hold rates at 3.75%, was no surprise. Nor was the 5-4 split vote, the minority in favour of a 25bp cut. However, the minutes noted the entire Monetary Policy Committee (MPC) judged that the bank rate was likely to be reduced further, although there were different views on the timing and extent. The minutes indicated two members (Andrew Bailey and Catherine Mann) might soon be swayed to vote for a cut - given they '*placed greater emphasis on the risks to inflation from weaker activity, but neither member judged that the weight of evidence was yet sufficient to warrant reducing Bank Rate at this meeting*'.

Bank's forecast for GDP growth and CPI inflation revised down: The Bank revised down it's projection for UK GDP growth to 0.9% in 2026 and 1.5% in 2027 (vs 1.2% and 1.6% previously). Notably, the MPC's projection is that CPI inflation will fall to 2% by May 2026 and fall to 1.8% by Q4 2027. This is the two-year time horizon over which monetary policy takes effect, signaling rate cuts will soon be required. The MPC now expect the unemployment rate to average 5.3% through 2026 (vs 5% previously).

Bailey stresses deterioration in labour market: A striking feature of the Bank's new projection is that the unemployment rate is expected to remain above 5% through 2026-2028. Bailey indicated that the underlying pace of job creation was now close to zero and that redundancies had started to pick-up. Hence, private sector earnings growth was expected to slow from 3.6% in November (itself below the bank's previous forecasts) to 2.7% by end-2027, a level more than consistent with the 2% CPI inflation target.

Projection for UK CPI inflation revised down: The MPC now expect UK CPI inflation to fall abruptly to 2.1% in Q2 2026, revised down by 0.7pp since November. This revision largely reflects the package of measures in the UK Budget, on energy prices, frozen rail and prescription charges. Also, the fall in wholesale gas prices is expected to lead to a fall in the OfGEM price cap in April to £1,616 from £1,758 for the average household. The MPC minutes noted several members took comfort from the likely fall in CPI inflation in Q2, which would itself depress households' wage-price inflation expectations.

Sterling weakens as markets price in 80% probability of 2nd cut to 3.25%: Sterling broke through 87p against the euro following the MPC's decision - reflecting the more dovish tone of the minutes. Specifically, that the reference to 'gradual' rate cuts was removed. Similarly, options now price in an 80% probability of a second 25bp cut to 3.25% by end-2026 (vs 45% earlier in the day). Three-year UK swap rates fell abruptly following the decision, from 3.63% to 3.55%. Moving forward we would still expect growing signs of disinflation to weigh on UK rate expectations. At his press conference, Governor Bailey said he would not endorse two rate cuts to 3.25% this year, but the curve was in a '*reasonable*' place.

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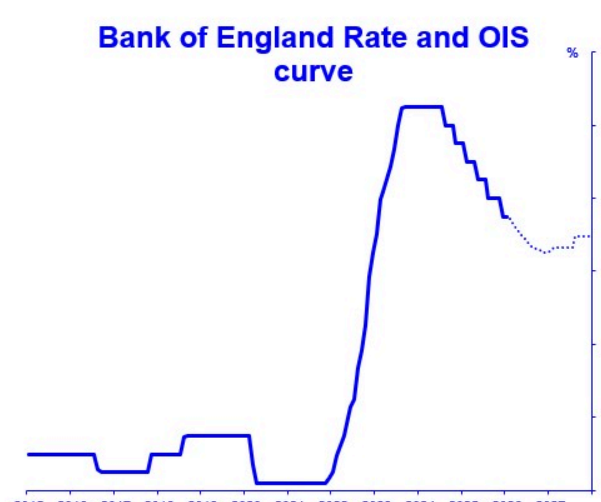

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