



## Could Bank of England defy markets and keep rates on hold?

*Oil prices and events in the Middle East, are increasingly shaping market expectations for central bank policy. While markets and economists broadly agree on the ECB's near-term trajectory—expecting two-to-three rate hikes in 2026—there is a clear divergence thereafter: economists anticipate rates will fall back toward neutral levels (~2%), whereas markets imply persistently tighter policy, the deposit rate remaining above 2.6% late into the decade.*

*The divergence is even more striking for the Bank of England. Options price three 25bp hikes to 4.5% by end-2026, starting in July, professional forecasters see rates on hold at 3.75%, before easing begins in 2027. Crucially, market pricing may be distorted by risk premia and hedging against geopolitical uncertainty, rather than pure expectations. So the signal from market pricing should be treated with care in the current environment. Here, the Sterling exchange rate could be exposed should expectations for near-term BoE rate hikes be disappointed.*

**Events in the Middle East remain a key driver of rate expectations:** Brent crude oil prices are currently trading at \$107 per barrel, with a resumption of traffic through the Strait of Hormuz still proving elusive despite Iran/U.S. peace talks. Of late, market expectations for central bank policy rates have been highly correlated with oil prices. For example, the Sterling forward OIS rate for December 2026 is now 4.4%, rising in recent days in tandem with oil prices (**see chart below**). However, in the current uncertain environment, the market-implied path may give a poor steer on investors' true expectations.

**Expectations for ECB rate hikes in 2026 are closely aligned:** Following the ECB's April 30 meeting, Christine Lagarde did little to push back against market expectations. A June 11th hike to 2.25% is now seen as a near-certainty (83% probability), three hikes to 2.75% by end-2026 now almost fully priced. The ECB's April Survey of Monetary Analysts (**see chart below**) showed the median expectation among professional forecasters (*dashed line*) was for two 25bp rate hikes in 2026, at the June and September policy meetings - similar to that implied by the forward OIS curve (*dotted line*) during the April 13–15 survey period. So markets are not taking an implausible view of the ECB's immediate reaction function.

**That said, there are clear divergences in views for 2027 and beyond:** The median expectation in the ECB's survey of monetary analysts was for rates to be cut to 2.25% from Q2 2027 onwards and back to 2% in the long run. Even at the 75th percentile within the survey, the deposit rate was expected to be eventually cut back to 2.25%. This chimes with the midpoint of the ECB's 1.5–2.5% range of estimates of the '*neutral*' rate, where policy is neither stimulatory nor contractionary. In contrast, the forward OIS curve implies the ECB deposit rate will remain above 2.6% through 2028 and 2029 - a seemingly dour view that tight policy will be required for the remainder of the decade.

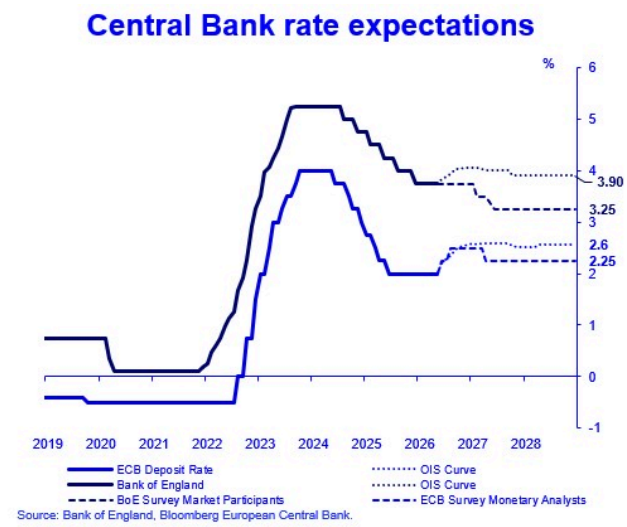
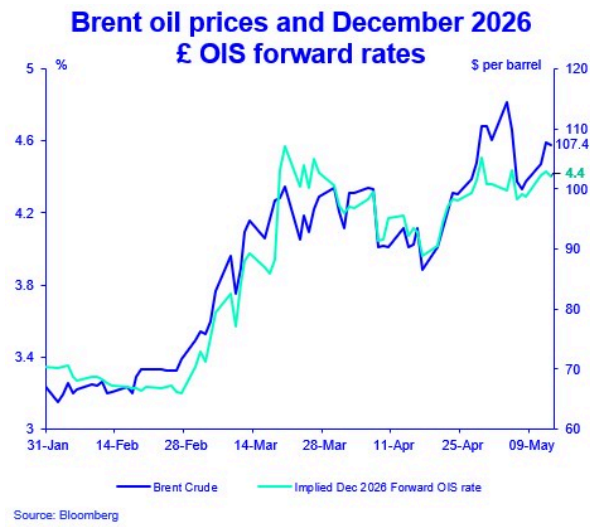
**Uncertainty on Bank of England policy rates is far greater:** Of late a number of investment banks have predicted the Bank of England's monetary policy is already sufficiently restrictive so that rates will remain on hold at 3.75%. Similarly, the Bank of England's Market Participant Survey shows the median expectation is for rates to remain on hold through 2026 and then be cut to 3.25% from Q2 2027 onwards. Again, the market curve implies a very different view—that Bank of England rates will need to keep rates close to 4% over the medium-term to return CPI inflation to the 2% target.

**Professional forecasters may be placing more weight on weak UK activity data than on inflation:** The 0.5% rise in the monthly measure of UK GDP was a surprise, but likely reflects volatility in the data and seasonal factors, the underlying pace closer to a subdued 0.2%. This week, the Recruitment Employers Confederation (REC) survey provided further evidence job creation has stalled, permanent placements contracting at a sharper pace in April. In these conditions, with unemployment close to 5%, 2nd round effects from CPI inflation rising to 3.3% onto wages are less likely - potentially allowing the BoE to leave rates on hold at 3.75%. The Monetary Policy Committee (MPC) will also be mindful of the surge in average quoted retail mortgage rates close towards 5% raising the risk of falling house prices.

**There are good reasons why the market-implied path may give a distorted view:** Options and swaps provide the best available view of how markets perceive the outlook for rates. Nonetheless, in times of elevated uncertainty, the signal may be distorted. The BoE's April Monetary Policy Report noted the market-implied path for policy rates captures not only (a) central expectations, but also (b) the balance of risks and (c) risk premia. The BoE also reported its market contacts had attributed changes in the curve to both (b) and (c), given elevated geopolitical and macroeconomic uncertainty. In short, given 20% of global oil supply remains tied to the Gulf, it is not surprising investors are protecting against extreme events - but this may be distorting the signal on where they expect Bank of England rates to ultimately settle.

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