Article | 11 September 2026

FX RATES UNITED KINGDOM

Why the Bank of England might not be as hawkish as you think

Rising natural gas prices pose a serious headache for the Bank of England ahead of its 17 September meeting. But there s very little sign that inflation is broadening out beyond energy. And unlike the US and even the eurozone, it s harder to argue that rates aren t currently having a restrictive impact. We expect a 6-3 decision to keep rates on hold

Governor of the Bank of England, Andrew Bailey. We're expecting a 6-3 decision to keep rates on hold at next Thursday's meeting

Our Bank of England view in a nutshell

- We expect the Bank of England to keep rates on hold at 3.75% with another 6-3 vote at its 17 September meeting.
- A November rate hike becomes more likely only if energy prices stay consistently high – and there are reasons to think they won't.
- Unlike the ECB, we expect the Bank's doves to hold their ground and reiterate that the risk of second-round effects on inflation remains low. There's even a tail risk that Governor Andrew Bailey pushes back against market pricing for four rate hikes over the next year.

- Our base case is that the Bank keeps rates on hold until next year, when it will cut rates twice (April and November), though clearly the risk is that those cuts come later.
- We expect the Bank to cut the pace of quantitative tightening (QT) to £50bn for the next 12 months, down from £70bn last year.

A tough backdrop - but the case for rate hikes isn't compelling

The backdrop to this month's Bank of England meeting could hardly look more challenging. The rise in oil prices, and especially natural gas prices, raises the very real possibility that inflation could peak at or above 4% this winter. And 4% is a level that the Bank has previously said is statistically more likely to see inflation broaden out beyond energy prices via so-called second-round effects.

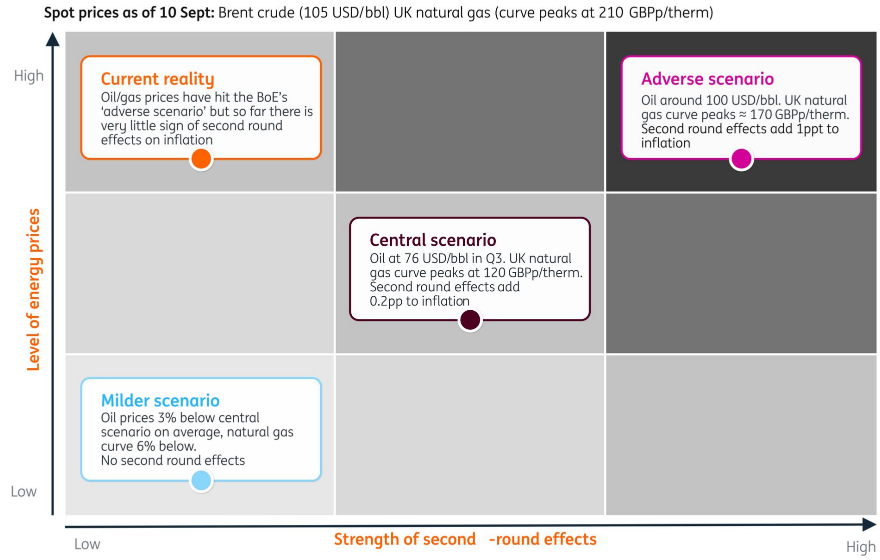
We're now living the Bank's adverse energy scenario that it laid out in its July projections – a scenario which its models suggested could warrant up to four rate hikes.

Yet there are good reasons to think that won't happen. And in sharp contrast to the European Central Bank this month, we don't expect the BoE to turn materially more hawkish at its September meeting.

Firstly, the Bank has consistently said that it is focused on the length of time energy prices stay at elevated levels. Today's prices are a problem if they stay high into November's meeting. But as our team's energy base case outlines, there are valid reasons to think they won't. And the sheer volatility of prices so far in this crisis warns us against extrapolating today's worrisome backdrop.

Secondly – and much more importantly – there is very little sign that the energy shock is broadening out to the wider inflation basket. That undermines a key assumption underlying the Bank's scenario, which was that the severity of second-round inflation effects increases disproportionately with the level of energy prices. Those July projections suggested that indirect energy effects would contribute one percentage point to inflation at the peak. The current evidence suggests it won't be anywhere near as bad as that.

The Bank's scenario framework - and where we stand now



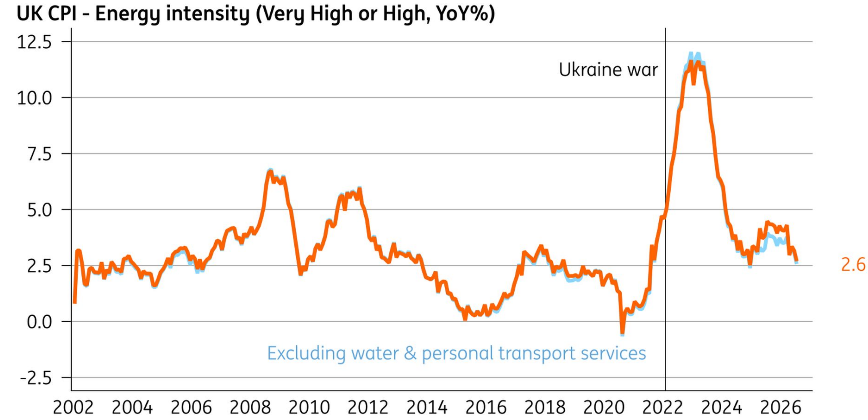
Source: Bank of England, ING

We've been tracking inflation for goods and services that are particularly energy-intensive, and it has actually fallen this year, even after you account for last year's water and car tax hikes. Food inflation has plummeted – from 3.6% in January to 1.3% in July – and producer price data suggests this could actually go to zero in the short term.

Sure, it's early days. All the models will tell you that you're unlikely to see the peak impact of higher energy prices on these categories for 12-18 months. But we should be seeing something already – and we're not.

It's a similar story with wage growth. At a little over 3%, once adjusted for quirks in the data, private sector wage growth is bang on the level the Bank believes is consistent with achieving its 2% inflation target in the medium term. And while this, too, is a slow-moving beast, there's next to no sign in the surveys that this is going to change.

Energy intensive inflation has fallen this year



Source: Macrobond, ING

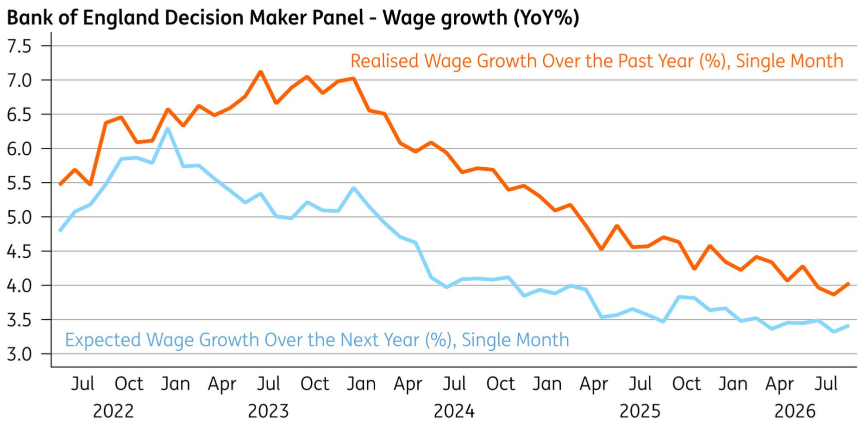
It's hard to argue that rates aren't currently restrictive

The jobs market remains fragile. Rate-sensitive sectors like construction are particularly weak, even if the overall UK growth story is receiving an increasingly noticeable boost from AI. So unlike the US or even the eurozone, where there is a live debate about whether monetary policy is restricting activity at the current level of interest rates, that is a much harder argument to make in Britain.

That's particularly true when you consider that the UK is virtually the only major economy engaging in material fiscal tightening this year. Tax as a share of GDP is set to rise by half a percentage point in the current fiscal year, given the ongoing freeze in tax thresholds. There remains a question mark over how this will change in the October budget, but the scope for material fiscal stimulus under the current fiscal rules is extremely limited. The recent rise in bond yields appears to be focusing minds in Westminster, too.

A rate hike in November is not impossible, but it is not inevitable. We're sticking to our base case that the Bank will keep rates on hold into next year. If energy prices ease and become less volatile, there is still a valid case for rate cuts in 2027.

Wage growth expectations remain low



It's worth remembering that the Bank's committee is deeply divided. Three officials have already voted for a hike – and will do so again this month. But the gap between them and the six doves appears large. Even Clare Lombardelli, who was previously closely aligned with the hawks, said after July's meeting that the decision to keep rates on hold wasn't a difficult one.

The Bank's doves appear increasingly confident that the UK economy is much less susceptible to another 2022-style inflation wave. The July meeting minutes show that, if anything, those views have hardened since the start of the crisis.

The key question for this meeting is whether there's any sign that the doves, en masse, are moving closer to a hike. We suspect they won't. There's even a risk, though probably small, that Governor Bailey opts to push back against market pricing – which now looks extreme.

Back in April – when the ECB was busy talking up the chances of a hike – Bailey came out and said that markets were "getting ahead of themselves" on rate hikes. Back then, two rate rises were priced in. Now, there are four. This would be a bold shout in the current market environment, but it is definitely something to watch for at next Thursday's meeting.

Quantitative tightening – keeping it simple

With all that in mind – and given how fragile bond markets are right now – it might be tempting to conclude the Bank should significantly wind down its quantitative tightening programme. That looks unlikely, though officials are widely expected to slow the pace of balance sheet reduction for the next 12 months, relative to the last.

Over the past 12 months, the Bank's bond holdings have shrunk by roughly £70bn through a combination of circa £50bn redemptions and £20bn active sales. The level of redemptions over the next 12 months is set to be reduced to £28bn – and we suspect the Bank will opt to keep its active sales roughly stable.

That points to a QT 'envelope' of £50bn for the coming year, which is fairly consensus. And the Bank has a habit of delivering on those consensus expectations. The strong rise in gilt yields is still mostly an inflation story, which means a slowdown in QT does not change the bigger picture.

GBP rates gripped by external factors

Given the sharp contrast between our own (and the consensus) Bank of England view and market pricing right now, it begs the question of when the two might start to converge.

The truth is that external factors currently have a stronger grip on rate markets than the Bank of England. That means oil and US rates will likely stay in the driving seat for now. For every $10 increase in oil prices, gilt yields rise by some 10-15bp. Meanwhile, a strong rise in US real rates is adding upward pressure to UK interest rates too. Higher real rates are being driven by better-than-expected growth but also concerns about significant bond supply to absorb, from both governments and AI investments.

We therefore expect volatility in the gilt market to remain high for the time being. Only when second-round inflation risks soften in 2027 do we see more scope for yields to settle lower.

Sterling – remarkably low volatility

EUR/GBP continues to trade in exceptionally tight ranges, suggesting some kind of equilibrium has been found in the 0.85-0.86 range. The big cyclical question for sterling is when expectations of a 100bp BoE tightening cycle drop out of money markets and weigh on the pound. Were Governor Bailey to push back against those expectations at the September meeting, EUR/GBP would probably break higher. We have a 0.86 EUR/GBP forecast for end-September and a 0.87 view for year-end on the assumption that some of that aggressive BoE tightening is priced out.

But the main observation for EUR/GBP is its incredibly low volatility. Three-month realised volatility is about the lowest in twenty years. That makes it cheaper to buy FX options protection for corporates ahead of what could be a volatile period for financial markets. Be it the threat of higher bond yields taking down global equity markets or the new Burnham government trying to thread the needle of higher social spending and fiscal restraint, volatility levels will struggle to get much lower. Higher volatility not only weighs on sterling by undermining the carry trade (which is helping sterling currently), but the source of that volatility – probably from the financial sector – is a sterling negative too.

Author

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Michiel Tukker
Senior UK & Eurozone Rates Strategist
michiel.tukker@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("**ING**") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

 ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.