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Why we now expect two Bank of England rate hikes

Inflation looks set to briefly top 4% next year and that's likely to trigger a November insurance rate hike from the Bank of England. We tentatively expect that to be followed by another hike in February. But we're still sceptical that we'll see big second-round effects on inflation. We think rates could be cut again by late 2027



The Bank of England has held rates steady throughout the Iran war, but we think that is about to change

Elevated natural gas prices point to a November rate hike

Having kept rates on hold throughout the Iran war, we now expect the Bank of England to deliver two rate hikes, in November and February, for two key reasons:

First, Bank officials have made it increasingly clear that a hike was likely if energy prices didn't significantly fall ahead of the November meeting.

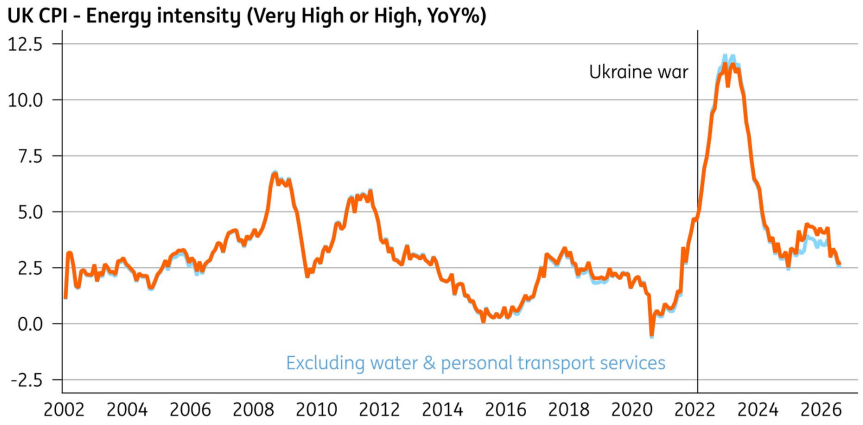
Since early on in the crisis, the Bank has made it clear that, absent the war, it would have cut rates at least twice this year. So by simply not doing that, it has, in effect, tightened policy by 50bp – akin to what the European Central Bank has done so far. A Bank of England hike in November could therefore be placed into the same category as the ECB's well-telegraphed December move.

Second, it's also clear that the inflation profile is likely to become uncomfortably high for the Bank. Last summer, it argued that when inflation surpasses 4%, we are statistically more likely to get second-round effects. And though headline inflation is currently 3.1%, a circa 20% rise in household electricity/gas bills forecast for January could get us there.

That's based on an average of gas futures prices between mid-August and mid-November, so with two-thirds of that window already behind us, there's only limited scope for that rise in bills to be mitigated if wholesale prices suddenly fall. And crucially, our commodities team don't think they will.

Combined with a likely increase in food inflation, it means we're now briefly forecasting 4% CPI in early 2027. The Bank's own November forecasts are likely to show that too.

There's no sign that the energy shock is broadening out



Source: Macrobond, ING calculations

That said, there are still good reasons to think inflation won't become the problem the hawks fear. Last autumn provides a useful precedent: headline CPI got perilously close to 4% yet triggered no discernible pressure elsewhere in the inflation basket. The fundamental reasons for that – like the fragile jobs market and tighter fiscal backdrop – haven't changed. And while it's early days, there's no sign yet that the Iran war is putting upward pressure on energy-sensitive parts of the inflation basket – quite the opposite.

Then there's the forthcoming Autumn Budget, announced a week before November's meeting. This looks increasingly like a non-event – and not something that's likely to add to the case for higher rates. In fact, the Chancellor is likely to do what he can – which isn't much – to cap the rise in inflation next year. That might include taking a greater chunk of 'policy costs' out of household energy bills and funding them out of taxation, thus mechanically limiting the pass-through of gas prices into inflation. We suspect the Treasury will also resist the temptation to boost next year's minimum wage rise over and above independent recommendations (c.4%).

What this all means is that, assuming the BoE does hike, it's likely to be cast as an insurance move. And, like any insurance policy, it can be cancelled later on. Assuming we're right that there won't be big second-round effects, we think rate cuts could be on the agenda before the end of 2027.

That's a very different story from the one markets are telling. Investors are pricing in rates rising by a full percentage point over the next year and remaining at those elevated levels for years afterwards.

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