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Special Coverage: BoE rate view change; ECB holds with hawkish tone

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Key takeaways

- The Bank of England (BoE) cut its Bank Rate by 0.25% to 3.75%, while the ECB left policy rates on hold, as expected. With the BoE hawks standing firm, we now lean towards the next cut in April and differ from the market with our more dovish expectations of two further cuts in July and November 2026.
- The BoE expects the budget policies, particularly on energy, to cut about 0.5% off inflation by April. The lower November CPI sealed the cut, but the BoE reiterated that they remain data-dependent. The next Agents' survey of wage expectations in February will play a key part in steering the pace of further cuts. For the ECB, while growth-inflation projections were lifted higher, policymakers opted to maintain maximum flexibility for the next move. We expect the ECB to leave rates unchanged at 2.0% throughout 2026.
- We believe EUR could benefit from any further modest USD weakening, more so than GBP, but in the absence of domestic catalysts in both economies, rallies should be capped. We prefer EUR periphery debt over core and Gilts and maintain our overweight stance on EUR and GBP investment grade credit. Our view on UK and European equities remain neutral, and our preference for Eurozone periphery equities lies in better sector-driven opportunities, particularly in Italy and Spain.

What happened?

- The BoE nudged the Bank Rate down by 0.25% to 3.75% at its December meeting. Thanks to Governor Bailey flipping sides, there was just enough of a majority at 5:4 in favour of a rate cut. He pointed to the weakness in the labour market and noted that "forward-looking wage growth indicators are hard to reconcile with the downward momentum in current indicators of inflation and pay, as well as rising unemployment".
- The budget also played a key role in the committee's decision-making. The BoE expects measures, such as reducing regularity costs on energy bills and the cap on rail costs, to cut 0.5% from inflation by April next year.
- Bailey pointed to the Agents' annual pay survey in February as the key upcoming indicator for the future rate path. If this aligns more closely with the broader weakness in the labour market, there is a chance of another cut. Given that some BoE members are not budging from their hawkish stance, we now lean towards the next cut in April, followed by two more in the subsequent two quarters. At this point, the Base Rate would be 3.0%, and the BoE would join the ECB in finding its happy place, where they will have hit the neutral point on rates (which is probably about 1% higher than the ECB's).
- The BoE's decision to cut rates acknowledges that the balance of risks has shifted away from persistent inflation and towards protecting jobs, incomes and confidence. The UK labour market has been losing momentum for some time, and the latest data - with unemployment now rising to 5.1% (the highest level since 2021) – have made it harder for policymakers to justify holding rates any longer. The latest GDP

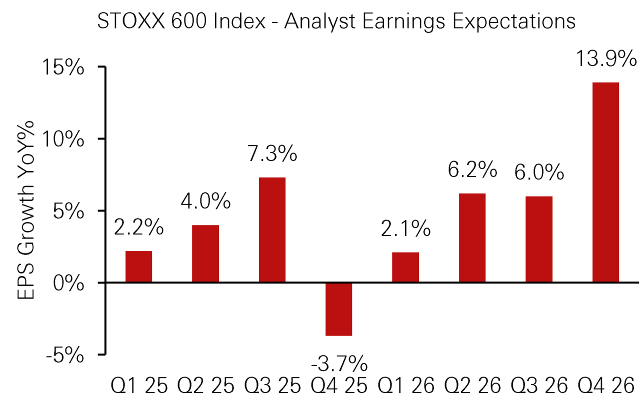
data also indicated that the UK economy is set to limp through the year-end line, with output unexpectedly contracted in October, while the dominant services sector is seeing a clear slowdown. Lower inflation has yet to translate into stronger spending momentum.

- The ECB left policy rates unchanged (with deposit rate at 2.0%) as widely anticipated, with incoming growth and inflation data since the last meeting in October confirming that it still stands in "a good place", as reiterated by ECB President Lagarde.
- The ECB believes growth will continue to be driven by services and domestic demand and highlighted that private and business investment has been an "important driver for the economy", with "AI impacting growth." With uncertainty remaining elevated and recent upside surprises in wages, policymakers preferred to retain full flexibility and refrained from giving any guidance on future decisions, despite the higher growth-inflation projections.

Investment implications

- With the Eurozone economy in "a good place," and expectations of growth acceleration counterbalancing any external disinflation risks, we believe the ECB will keep the deposit rate on hold at 2.0% throughout 2026.
- In contrast, the BoE is coming from a more restrictive policy stance, and we therefore expect three further 0.25% rate cuts in April, July and November, bringing the Bank Rate to 3.0%. The easing would be happening at a time when most other G10 central banks have signalled a likely end to their easing cycles, leaving a dovish bias for GBP assets.
- Eurozone core sovereign yields trade near multi-year highs amid increased fiscal spending expectations and ongoing political hurdles. Instead, improving fiscal dynamics in periphery countries have been driving a narrowing in spreads, supporting our constructive view there. EUR investment grade bonds of medium-to-long duration (7-10 years) offer the best risk-reward profile in our view. For Gilts, while risks from the Autumn Budget have receded, we prefer to keep a neutral view and favour GBP investment grade credit, which can offer attractive all-in yields.

The consensus of equity analysts widely anticipates a recovery in European earnings into 2026



Source: Bloomberg, HSBC Private Bank and Premier Wealth as of 18 December 2025. Forecasts are subject to change.

- In equities, our overweight preference for Financials and Utilities underpins our constructive view on Italy and Spain. This is counterbalanced by our bearish view on France, supporting our neutral stance on European equities. UK equities are caught between attractive valuations and one of the highest dividends yields but are missing catalysts to trigger a re-rating and international investor flows, so we remain neutral.
- Looking into next year, currency effects will fade for both EUR and GBP equities, and there is a broad consensus expectation of an earnings recovery. Our global equity positioning continues to favour the US and China, while complementing our diversification positioning with opportunities in Asia, such as Japan and South Korea.

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