

Special Coverage: BoE's dovish hold as budget looms

Key takeaways

- ◆ The Bank of England (BoE) struck a cautious tone at its November meeting, voting 5-4 to hold the Bank Rate at 4%, with a narrow minority favouring a 0.25% cut. The decision reflected a fine balance between subdued growth and lingering inflationary pressures.
- ◆ The Monetary Policy Committee acknowledged that CPI inflation has likely peaked, with the headline rate expected to ease to 3.2% by March 2026 and gradually return to the 2% target by mid-2027. Governor Andrew Bailey said the path ahead for monetary policy will depend on how the two opposing forces – cooling inflation and weaker growth – play out in the coming quarters. We now expect the BoE to begin cutting rates earlier, in February 2026 (previously April), following clearer evidence of disinflation and potential fiscal tightening. Governor Bailey's balanced tone suggests a shorter pause before the easing cycle resumes.
- ◆ With productivity growth flat over the past five years and the fiscal deficit forecast at 4.4% for this year, investors have questioned the fiscal sustainability of the UK economy. To meet the fiscal rules and restore investor confidence in the gilt market, which is crucial for reining in yields and lowering the Treasury's interest burden, Chancellor Reeves is expected to raise taxes in the upcoming budget. The BoE's decision reinforces our neutral stance on UK assets. UK equities continue to offer compelling value, but near-term fiscal tightening and a fragile growth outlook limit upside potential. Similarly, the BoE's steady-hand approach supports gilts in the short term, though we expect the pace of easing to remain gradual and data-dependent as the Bank balances the final mile of disinflation against the risk of an overly sharp slowdown.



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What happened?

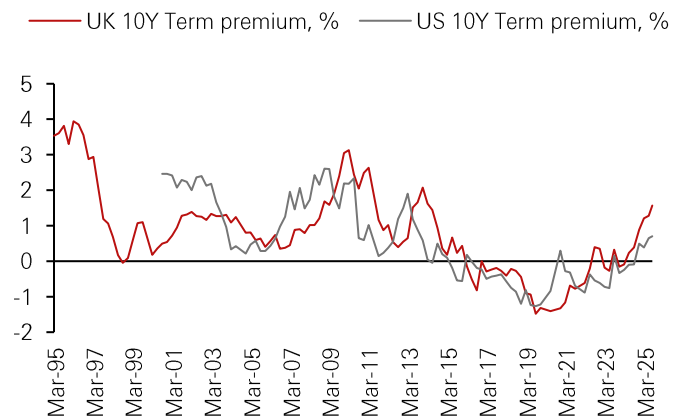
- The BoE delivered a “dovish hold” at its November meeting, keeping the policy rate unchanged at 4% in a close 5-4 vote. Governor Andrew Bailey's swing decision and a shift in tone suggest the next move will be a cut, possibly as early as December, as per current market pricing. The minutes revealed that inflation risks are now viewed as “more balanced”, and September's CPI print of 3.8% is likely the peak.
- Markets responded by firming up expectations of a December cut – now trading at just over a 2-in-3 chance. Rates fell across the curve, with markets pricing in around 0.60% of easing by mid-2026, while gilts rallied modestly, with the 10-year yield slipping to 4.44%.
- This latest BoE decision arrives against a backdrop of mounting fiscal tension. The government's upcoming November Budget is expected to reveal a £30bn deterioration in the fiscal position since March, driven by softening revenues and higher borrowing needs. We estimate that restoring fiscal stability may require £20-30bn of tightening measures, whether through targeted tax increases or spending restraint.
- While fiscal consolidation should help contain inflation, it also heightens near-term growth risks, reinforcing the BoE's inclination to ease. That said, the BoE's cautious tone signals it wants more evidence that the disinflation trend is durable, especially across services inflation and wage data.

- Normally, slowing growth weighs on inflation as it creates spare capacity in the labour market, which pushes down wages. But if inflation expectations are elevated, inflation can persist even amid slow growth because there's an embedded expectation across households and businesses that prices will continue to rise. Essentially, there could be a "new normal" where inflation stays above the BoE's 2% target. Therefore, if the BoE doesn't get a handle on inflation expectations, even slowing growth might not be able to bring inflation closer to its target.
- We believe the BoE would like to see a downtrend in inflation before delivering further cuts, reinforcing that above-target inflation will not be tolerated over the medium term.
- The UK faces a fiscal deficit of 4.4% this year, with about half of that coming from interest costs on government debt. Without a pick-up in productivity and given limited growth in labour supply, it seems that Reeves can only plug the deficit through tighter fiscal policy. If Reeves succeeds in restoring market confidence in the UK's fiscal stability, gilt yields are more likely to fall.

Investment implications

- The risk to gilt yields is skewed to the downside, in our opinion. However, with the budget just a few days away, we prefer to see how the dust settles before adopting a more bullish stance on gilts, hence our current neutral positioning.
- We take fixed income exposure through our overweight on medium-to-long duration investment grade bonds, while remaining cautious on high yield.
- We have brought forward our expectation for the next rate cut to February 2026 (from April previously), noting that the MPC's tone has shifted towards cautious optimism on disinflation.
- UK equities continue to offer compelling value against their global peers, with the FTSE 100 up over 20% year-to-date, outperforming the Euro Stoxx 50's 16%. The London stock market's value and defensive bias, coupled with minimal tech exposure, have provided resilience amid global volatility.
- The FTSE 100 still trades at roughly a 35% discount to global peers on a forward P/E basis, and strong earnings revisions have reinforced its appeal as a low-cost, income-rich and defensive market. Sterling's recent weakness has also become an additional tailwind for the export-heavy FTSE 100 companies. However, the FTSE 250, which is a better proxy for the UK economy, continues to underperform amid investor anxiety over the November Budget and potential fiscal tightening.
- On balance, we maintain a neutral stance on UK equities. The market's defensive qualities, high dividend yield, and discounted valuations support inclusion in diversified portfolios, especially relative to its richly valued US peers. However, fiscal headwinds, policy uncertainty, and sluggish domestic sentiment temper our enthusiasm for an overweight, at least for now.

Investors want to be paid for taking gilt risk



Source: Bloomberg, HSBC Private Bank and Retail Wealth as of 6 November 2025. Past performance is not a reliable indicator of future performance.

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