



Not the Same Party

In September the Fed and the ECB hiked and the Bank of England held. The market read that as the UK arriving late. The Taylor arithmetic says it was never at the same party, and the front end is priced as if it were.

1 October 2026

Three central banks met in mid-September. Two of them hiked. The Federal Reserve took the funds rate to 3.75–4.00% on 16 September, and the ECB raised its deposit rate to 2.50%, its second hike of the year after June. The next day the Bank of England held Bank Rate at 3.75%, by six votes to three.

The market drew its conclusion immediately: the UK is late to the party and will have to catch up. The SONIA strip now prices Bank Rate close to 4.9% by the end of 2027, roughly four and a half hikes. That is more tightening than the market prices for the Fed from almost the same starting point.

I think that reading is wrong, and wrong in a specific way. The UK was not late to the party. It was never at the same one. The three central banks are reacting to different things, from different distances to neutral, and on the one rule most of us still keep on the screen as a reference, the UK is the only block whose market pricing sits above its prescription on every measure of inflation. That is what makes a long position in the sterling front end a cheap contrarian bet here.

The rule, applied three ways

Taylor's 1993 rule sets the policy rate at the neutral real rate, plus inflation, plus half the inflation overshoot, plus the unemployment gap: $i = r^* + \pi + 0.5(\pi - 2) + (u^* - u)$. Nobody runs policy off it mechanically, and the unobservable inputs deserve wide error bars. But it is a disciplined way to ask the same question of three central banks at once. These are the inputs, at the mid-point of each block's published neutral range:

Input	United States	Euro area	United Kingdom
Real neutral rate r^* (working mid-point)	1.2%	0.1%	1.1%
Core inflation	3.0% (core PCE, Aug)	2.4% (core HICP, Aug)	2.6% (core CPI, Aug)
Headline inflation	3.4% (PCE, Aug)	3.2% (HICP, Aug)	3.1% (CPI, Aug)
Equilibrium unemployment u^*	4.2%	6.1%	4.6%
Unemployment	4.1% (Aug)	6.4% (Jul)	4.9% (3m to Jul)

Run the rule on core and on headline, and set each against the peak the market prices, taken from the December 2027 three-month contract and converted back to a policy-rate equivalent:

	United States	Euro area	United Kingdom
Policy rate today	3.875% (mid)	2.50%	3.75%
Taylor (1993) on core	4.80%	2.40%	3.70%
Taylor (1993) on headline	5.40%	3.60%	4.45%
Market peak, policy-rate equivalent	4.88%	3.39%	4.87%
Priced minus rule, on core	+8bp	+99bp	+117bp
Priced minus rule, on headline	-52bp	-21bp	+42bp
Core inflation the price requires	3.1% (today 3.0%)	3.1% (today 2.4%)	3.4% (today 2.6%)

Market peak: CME 3M SOFR Dec-27 4.885% less the 0.5bp gap between SOFR and the funds-rate mid-point; ICE 3M €STR Dec-27 3.3275% plus the 6bp gap between the deposit rate and €STR; ICE 3M SONIA Dec-27 4.855% plus the 2bp gap between Bank Rate and SONIA. The last row solves the rule for the core inflation rate that would justify the priced peak, holding r^* and the unemployment gap fixed.

The Fed is priced almost exactly at its core rule and well below its headline one. Core PCE is a full point over target with unemployment under its equilibrium rate, and the market is asking the Fed to do roughly what the rule says, no more. On headline it still has some way to go.

The euro area is the interesting case, because the answer depends on the measure. On core, the market is almost a point above the rule. On headline, it is priced just below it. And the ECB has told us which one it is running: it hiked twice this year and took the deposit rate to 2.50%, above the 2.40% its core rule prescribes. Its reaction function is headline, and the market prices it that way, consistently. There is still room on that basis, and more if the September flash estimate, due on 2 October, shows headline rising towards the 3.6% expected: that would lift the headline rule to about 4.2%.

The Bank of England has told us the opposite. It held with headline CPI at 3.1% and its own forecast running above 4% in the first quarter of 2027. The four members who voted to hold but leaned towards a hike all wrote down the same condition: that the energy shock start to show up in wage and price-setting. That is a core rule, and on a core rule the UK strip is priced about 120bp above the prescription. To be right, it needs core inflation at 3.4%, against 2.6% for the fourth month running.

So September was not the UK arriving late. The Fed is dealing with a core overshoot it genuinely has. The ECB is chasing headline because it has chosen to. The Bank is waiting for proof that energy is turning into wages, and on the rule it has said it is using, it is already roughly where it needs to be. One insurance hike in November takes it to 4.00%, which sits between the core prescription and the headline one. The market's 4.9% sits beyond both.

Two honest caveats. A half-point error in r^* moves every level rule by half a point, so the numbers are a map, not a destination. For the UK conclusion to fail on r^* , though, nominal neutral would have to be near 4%, against a 3.25% median in the Bank's own survey of market participants and the 2.75–3% that Alan Taylor, one of the two MPC members who argued for waiting, put on it in a speech on 29 September. And the headline rule will rise mechanically as CPI heads towards 4%. That is precisely why a committee facing a supply shock does not run policy off headline. Taylor put it plainly: policy “should respond to the risk that a relative-price shock becomes a general inflation process, not mechanically to every movement in the relative price itself.” That is also how the MPC's conditional hawks framed their trigger.

Already restrictive, and tightening on its own

The second leg of the argument is that UK policy is already restrictive before anyone hikes. The Bank's September survey of market participants put the neutral Bank Rate at 3.25% (interquartile range 3.00–3.50%). At 3.75%, Bank Rate is half a point above that median. The more important point is that nobody in the UK borrows at Bank Rate. Mortgages, corporate loans and the government all price off the curve, and the curve has done the tightening the Committee declined to do.

Taylor made the same point in that speech: “by holding Bank Rate fixed while financial conditions have tightened, policy has already become materially more restrictive relative to the outlook.” He judges that “both Bank Rate and the OIS curve remain substantially restrictive” against it. The sharpest line in the speech is a comparison with the last cycle: “beyond the two-year point, market rates are more restrictive than they were when we delivered the final hike of the previous cycle in August 2023, at the time when inflation stood at 6.8%.” Inflation is now 3.1%. A comparison across the three blocks shows why the UK is the extreme case:

Measure (30 Sept close)	United States	Euro area	United Kingdom
Policy rate minus nominal neutral (mid)	+68bp (vs 3.2%)	+38bp (vs 2.125%)	+63bp (vs 3.125%)
2-year yield	4.89%	3.19%	4.90%
2-year minus policy rate	+102bp	+69bp	+115bp
2-year minus nominal neutral	+169bp	+107bp	+178bp
10-year yield	5.29%	3.58%	5.44%
Unemployment minus u*	−0.1pp (tight)	+0.3pp (slack)	+0.3pp (slack)
Overshoot the central bank reacts to	core +1.0pp	headline +1.2pp	core +0.6pp
2-year restriction per point of overshoot	≈169bp	≈89bp	≈296bp

Neutral mid-points: Fed longer-run median 3.2% (September projections); ECB published nominal range 1½–2½%; UK 3.0–3.25% from the Bank's survey and MPC commentary. The last row divides the 2-year restriction by the inflation overshoot each central bank has shown it responds to (headline for the ECB, core for the Fed and the Bank).

Measured against the inflation it is actually reacting to, the UK front end is running close to twice the restriction of the US and three times that of the euro area, into a labour market that is loosening rather than tight. The transmission is visible. The Bank's own data on 29 September showed the effective rate on newly drawn mortgages at 4.60% in August, up 15bp on the month, with approvals at 54.9 thousand, below the 56.1 thousand expected. The 10-year gilt yields 5.44%, the highest of the three and 185bp over Bunds. The exchange rate is not offsetting it either: at 0.854, EURGBP sits near the bottom of its twelve-month range, so sterling is firm against the currency of its largest trading partner.

On the short-run natural rate, the US picture is different again. The New York Fed's staff model puts the short-run real natural rate near 1.9% this year, which would make US policy barely restrictive at all. Two of these central banks are still at the party. The third was never there, and the market has not noticed.

What the data said in September

Any fair reading has to start with the fact that the UK activity data have been better than expected. Of thirteen releases since 11 September, seven beat consensus and three missed. The price and pay data have done something different: all three came in exactly on consensus.

Release	Actual	Consensus	Read
GDP, July (m/m)	+0.4%	0.0%	Beat
Unemployment, 3m to July	4.9%	5.0%	Beat
Average earnings incl. bonus, 3m y/y	3.9%	3.9%	In line (from 4.2%)
CPI, August (y/y)	3.1%	3.1%	In line
Core CPI, August (y/y)	2.6%	2.6%	In line (unchanged)
Retail sales, August (m/m)	+0.5%	-0.2%	Beat
CBI industrial orders, September	-9	-34	Beat
Flash services PMI, September	51.7	52.0	Miss
Flash manufacturing PMI, September	52.0	51.4	Beat
CBI distributive trades, September	-55	-50	Miss
Consumer confidence, September	-13	-16	Beat
Mortgage approvals, August	54.9k	56.1k	Miss
Consumer credit, August	£2.5bn	£1.9bn	Beat

Sources: ONS, Bank of England, CBI, GfK and the flash PMI; consensus as compiled on the economic calendar.

This is not a collapsing economy, and it explains why the front end has not rallied. But activity is not the trigger the Committee wrote down. The minutes say there is “still little evidence emerging of second-round effects in wage and price-setting”, while noting that such effects usually emerge with a lag, and on 29 September Taylor called the evidence “scant”. Pay growth has slowed from 4.2% to 3.9%, core has not moved, and none of it has surprised. The trade is a bet that the second-round effect the strip is priced for gets depiced, not that the economy turns down.

That lag is why the October data matter, and they arrive in a tight window. The labour market report is out on 20 October, September CPI on 21 October and the Budget on 28 October, all before the 5 November decision and its Monetary Policy Report.

What is priced

Two instruments matter. The MPC-dated SONIA contracts settle on compounded SONIA between one meeting and the next, so each isolates a single decision. The three-month contracts carry the depth of the cycle. With SONIA fixing at 3.73%, two basis points under Bank Rate:

Contract	Price	Implied rate	Above SONIA	25bp hikes
MPC Nov-26 (6 Nov – 16 Dec)	96.0425	3.958%	+22.7bp	0.9
MPC Dec-26 (18 Dec – 3 Feb)	95.890	4.110%	+38.0bp	1.5
3M SONIA Dec-26	95.790	4.210%	+48.0bp	1.9
3M SONIA Mar-27	95.440	4.560%	+83.0bp	3.3
3M SONIA Jun-27	95.250	4.750%	+102.0bp	4.1
3M SONIA Sep-27	95.165	4.835%	+110.5bp	4.4
3M SONIA Dec-27	95.145	4.855%	+112.5bp	4.5
3M SONIA Mar-28	95.155	4.845%	+111.5bp	4.5

ICE daily closes, 30 September 2026. SONIA 3.73% (September fixings).

November is 90% priced. The insurance hike is in the price and I would not fight it. What the curve adds beyond it is where the view lives: another hike in December at about 61%, then three more through

2027. In my own tally of forecaster calls published in September, 16 of 21 expect a hike, but none of the twelve who put a number on it expect more than two. Their modal peak is 4.25%. The strip's is 4.87%.

The trade, part one: against a second hike in 2026

Two meetings remain this year. At 25bp each, 50bp is the most the Committee can physically deliver, and the December contract already prices 38bp of it, 76% of the ceiling. The view is one insurance hike in November and then a pause. Buying the contract at 95.89 pays as follows:

Outcome	Bank Rate	Contract	P&L
Hikes at both meetings	4.25%	95.770	-12.0bp
One hike (the insurance case)	4.00%	96.020	+13.0bp
No hike	3.75%	96.270	+38.0bp

Risk 12bp to make 13bp in the base case and 38bp in the tail. The downside is bounded because the market has already priced most of what the Committee can deliver: it can only disappoint the price by doing less. Assuming the non-double outcomes split 80/20 between one hike and none, the expected value by the probability of back-to-back hikes is:

P(both hikes)	40%	50%	55%	60%	65%	70%
Expected value	+6.0bp	+3.0bp	+1.5bp	0.0bp	-1.5bp	-3.0bp

The position needs back-to-back hikes to be less than 60% likely. Two of the four conditional members would have to move in November and hold the majority in December, on a trigger that has not appeared yet.

On the economics: the contract accrues only between 18 December and 3 February, so there is no carry or roll to pay while the view is held, no repo and nothing to finance beyond margin. Its carry-plus-roll is zero, and the whole return is the repricing. Waiting to see the October data costs nothing.

The trade, part two: the depth of the cycle

The larger mispricing is further out, where the strip carries hikes that no published forecast supports. Scenario P&L for being long the 2027 contracts, with the realised SONIA path settling at each peak:

Peak Bank Rate	Mar-27	Jun-27	Dec-27
4.00% (one insurance hike, then off)	+58.0bp	+77.0bp	+87.5bp
4.25% (the forecasters' two hikes)	+33.0bp	+52.0bp	+62.5bp
≈4.87% (the priced path)	0	0	0
5.00% (five hikes)	-42.0bp	-23.0bp	-12.5bp
5.25% (six hikes)	-67.0bp	-48.0bp	-37.5bp
Roll-down per quarter, constant curve	+35.0bp	+19.0bp	+2.0bp

Roll-down: the price gain if each contract, three months from now, trades where the contract one quarter shorter trades today. Futures carry no financing, so carry is nil and carry-plus-roll equals the roll.

The June 2027 contract is the one I would use. It makes 77bp if the Bank stops at one, 52bp if it stops at two, and it rolls about 19bp a quarter down the steep part of the strip while the market keeps pushing hikes out. December 2027 has the cleaner asymmetry but almost no roll and sits furthest from the data. March 2027 rolls fastest but is exposed to the February and March meetings, the ones most likely to carry a second insurance move.

The roll deserves a health warning. It is not income. It is earned only if the curve keeps its shape, which means the hikes keep being deferred. If they arrive as priced, the roll never materialises and the position

simply goes nowhere. And unlike the December contract, the strip is not bounded: an energy shock that forces five or six hikes costs real money. Size it accordingly.

For those who prefer cash, the 2-year gilt at 4.90% financed in general collateral, assumed equal to SONIA and to be monitored, carries about 15.6bp a quarter in yield terms and rolls about 7.5bp, for a carry-plus-roll of 23.0bp. A November hike lifts the financing rate for 56 of the quarter's 92 days; on the priced path that raises the average repo cost by about 16bp and takes 2.2bp off, leaving roughly 21bp a quarter as the realistic break-even. It is a decent cushion, but the 2-year also carries term premium the view does not need, and the long-end sell-off in the last days of September, largely on no news, is a reminder of what that costs. The futures isolate the policy path; the gilt does not. A long June 2027 SONIA against a short June 2027 SOFR (4.805%) removes some of the global beta, at the cost of shorting a market the Taylor table says is fairly priced on core and under-priced on headline.

The trigger nobody can forecast

Every call on this curve is conditional on energy, and energy is conditional on a war now in its eighth month. The April ceasefire reopened the Strait of Hormuz and took oil sharply lower, then faded through the summer; the United States reinstated its naval blockade on 14 July. On 25 September Tehran tabled a seven-day plan to reopen the strait and restart nuclear talks in exchange for lifting the blockade and oil sanctions. The President rejected it the next day, and press reports have him privately expecting to strike again after the midterms. On 29 September three tankers were hit by unidentified projectiles in the strait. On 30 September Tehran said it had received a US counterproposal, and the President said a decision would come “very soon, one way or the other”. Front-month Brent closed at \$98.03 that day, after trading between \$71 and \$110 over the past three months.

I cannot forecast that, and with this White House I doubt anyone can. The position is built so that it does not have to. A durable truce brings the inflation forecast down in the November Report and cancels the hikes. A fragile one leaves the conditional members short of their condition, and the hikes are deferred rather than removed. Both pay. Escalation costs the December contract at most 12bp.

The sequencing is the part to respect. The US midterms are on 3 November and the MPC announces on 5 November, two days later. If a political incentive is holding things calm, it expires in between the two UK meetings. That delivers a hold or a single hike in November and a harder December: the December contract marks up, then gives back towards +13bp. That is a give-back, not a loss. For the strip, the same sequence is the main risk, which argues for taking profit into the November Report rather than holding through December.

What would kill it

- **Second-round effects appearing in the October data.** A re-acceleration in regular pay on 20 October or in services CPI on 21 October would satisfy the conditional four. That is the single most important risk.
- **Energy that stays high for long enough.** The conditional members wrote persistence into their trigger. A prolonged escalation validates five or six hikes and the strip loses 20–50bp.
- **A 50bp move or an inter-meeting hike.** The only way the December contract loses materially more than 12bp.
- **A loosening Budget on 28 October.** A week before the MPC, a fiscal giveaway would weaken the case for stopping at one.
- **A higher neutral rate than the evidence suggests.** If UK nominal neutral is nearer 4% than 3%, the core rule sits close to the market and the mispricing disappears.

– **A global term-premium shock.** The US 10-year traded at the end of September at its highest level since 2007, on soft data. A disorderly global sell-off drags every strip, whatever the MPC does.

The trader's view

September looked like the UK falling behind. Read through the Taylor rule, it was the UK declining an invitation. The Fed is chasing core, the ECB is chasing headline, and the Bank of England is waiting for wages, with policy already restrictive and a curve that has done the tightening for it.

One insurance hike in November and off is the path most forecasters and the rule support. The market prices four and a half. Long the December MPC contract is a bounded bet against the second hike this year; long June 2027 SONIA is the larger bet on the depth. Neither needs a view on the war, only on the committee's reaction function, which the members have written down themselves.

September was not the UK late to the party. It was the UK not at the same party.

Levels are TradingView daily closes of 30 September 2026 (ICE SONIA, MPC-dated SONIA and €STR futures; CME SOFR futures; gilt, Treasury and Bund benchmark yields; Brent; EURGBP). Overnight rates: SONIA 3.73% (September fixings, Bank of England), SOFR 3.88% (29 September, Federal Reserve Bank of New York), €STR 2.44% (29 September, ECB). Policy rates from the Federal Reserve and the ECB. Taylor-rule inputs from ONS, BEA (PCE, August, released 30 September), BLS and Eurostat; neutral-rate ranges from the September 2026 FOMC projections, ECB published estimates and the Bank of England Market Participants Survey. Bank of England Monetary Policy Summary and minutes, 17 September 2026; Alan Taylor, "Searching for signposts", 29 September 2026; Bank of England effective interest rates and money and credit, August 2026. Contract terms from the exchange specification. Scenario, carry and roll-down figures are my own calculations on the stated assumptions and are approximate. Views are my own and nothing here is investment advice.