MARKET COMMENTARY

BoE signals Bank Rate close to peak

Christoph Siepmann

February 02, 2023

- **The Bank of England (BoE) raised its Bank Rate by 50 bps to 4% today. In the 7-2 split vote, two Monetary Policy Committee (MPC) members preferred to maintain Bank Rate at 3.5%.**
- **The Bank considers inflation to have probably peaked and accordingly dropped its previous pledge to raise Bank Rate "forcefully".**
- **Given lower energy prices, it reduced its inflation outlook for end of this year to about 4% yoy (previously 5% yoy) and sees it to fall substantially below its targeted 2% already in Q2 2024. The recession is expected to prove "shallower" than feared last November with GDP contracting by 0.5% in 2023 compared to -1.5% before.**
- **The BoE's macro scenarios conditioned on either a market (implied) rate of 4.5% or on 4% do not have a significant impact on the inflation path anymore until the end of 2024. However, the current widespread strikes and their possible impact on wage growth remain a wild card. Thus, we (cautiously) add another 25 bps hike in March for the BoE to signal vigilance and see 4.25% as the final rate (up from 4%). We do not expect the BoE to cut back on rates already this year.**
- **Market took a dovish interpretation of the decision. 10y Gilt yields dropped by almost 25 bps (at the time of writing) while the pound ended sideways reflecting both, the BoE and ECB decisions. The market implied rate softened to just one hike until June. We see this market response as justified as the BoE also opened up the possibility of no further rate hike at all.**

The BoE increased its key rate today by 50 bps to 4%. This was the 10th hike in this cycle, reaching a 15-year high. The MPC vote was split by 7-2, as widely expected, as two members preferred to keep Bank Rate at 3.5%. The was no vote for a 75 bps increase as last time.

More importantly, the BoE changed its language substantially. It dropped its previous wording that it would act "forcefully" if needed. It replaced the previous phrase that "further increases in Bank Rate may be required" with a much more conditional sentence of "if there were to be evidence of more persistent pressures." Thus, the BoE has become more data-dependent and signals that it is "close" to a peak rate. At the same time, Governor Bailey stressed that the BoE still needed to be ensure that inflation had been beaten.

Given lower energy prices, the BoE's forecast has also become less pessimistic than its predictions as of November. Regarding inflation, the scenario conditioned on the (implied) market rate of 4.5% does not deviate much from the 4%-implied outlook. In both cases, inflation falls slightly below 4% by the end of this year and to about 3% yoy (exactly 3.01% yoy vs 2.91% yoy) in one year's time (Q1 2024). It slows further to below 1% only one quarter later, followed by some fluctuation between 1.3% yoy and 1.7% yoy. This does not imply any strong case for further rate hikes. Similarly, also the growth scenarios do not deviate much. Towards the forecast horizon, the "market rate" based growth outcome even improves slightly more, probably driven by assumed rate cuts in 2024 which are not present in the constant 4% scenario.

That said, the MPC also stresses, that "the path for inflation beyond the near term is uncertain, and risks around the central projection are judged to be skewed significantly to the upside". In this regard, we see the current large strikes as posing significant uncertainty. We therefore (cautiously, and data-dependent) add another 25 bps hike in March for the BoE to signal vigilance and see 4.25% as the final rate (up from 4%).