MARKET COMMENTARY

Bank of England surprises by hiking Bank Rate

Author: Christoph Siepmann

December 16, 2021

- **For the second time in a row, the Bank of England (BoE) surprised markets. It voted by a majority of 8-1 to increase Bank Rate from 0.1% to 0.25%. The consensus had expected a postponement to February 2022.**
- **The consensus (and our) expectation were solely built on the spread of the Omicron variant and its unclear effects. Instead, labour market data and the acceleration of CPI inflation spoke for a rate increase.**
- **The Monetary Policy Committee (MPC) noted that "the Omicron variant is likely to weigh on near-term activity". But it had "promised" at the November meeting to raise rates if the economy evolved as it expected and "these conditions had been met".**
- **Moreover, the MPC repeated the phrase that a "modest tightening of monetary policy is likely to be necessary". The consensus forecast (including us) expects two more steps next year, the market sees three to 1%.**

The BoE caught markets again off guard. After postponing the expected rate hike in November, it now raised Bank Rate from 0.10% to 0.25%. Recently, the consensus forecast (including us) had shifted to expect another postponement due to the Omicron uncertainties. However, the Bank stressed that the economy evolved as expected and thus stuck to its announcement in November as these "these conditions had been met". This concerned especially the labour market and the smooth absorption of the end of the furlough schemes. The BoE statement notes that "There is little sign in the available data that the closure of the Coronavirus Job Retention Scheme at the end of September has led to a weakening in the labour market. […] Bank staff continue to estimate that underlying earnings growth has remained above pre-pandemic rates, and the Committee continues to see upside risks around the projection for pay in the November Report." Generally, labour market data were strong.

With regard to Omicron, the MPC acknowledges that "although the Omicron variant is likely to weigh on near-term activity, its impact on medium-term inflationary pressures is unclear at this stage. The MPC will review developments, including emerging evidence on the implications for the economy of the Omicron variant, as part of its forthcoming forecast round ahead of the February 2022 Monetary Policy Report."

Given these contradicting developments, uncertainty within the BoE has obviously risen. This is also made clear from what has been omitted the BoE statement as compared to last time. On the one hand, there is no references to inflation being expected to fall below the target in two years' time. On the other hand, the phrase that it will be necessary to increase Bank Rate "in the coming months" was also removed. Accordingly, the hiking path has also become more uncertain. Whether the next rate hike will already come in February will likely depend very much how Omicron will have developed until this stage. If Omicron were to pose a substantial threat, the BoE would be unlikely to hike within such a period. Otherwise, we would expect the next step already in February to signal continued action against rising inflation.

At the time of the BoE November meeting, markets and the (economists-driven) consensus forecast were very much at odds what interest level would be reached by end-2022. Since then, the gap has narrowed from both sides with market expectations softening to about 1% while the consensus view rose to 0.75%. For the time being, we stick to our 0.75% view, but risks for the outlook on both sides have clearly increased.