MARKET COMMENTARY

BoE hikes Bank Rate to 4.5%

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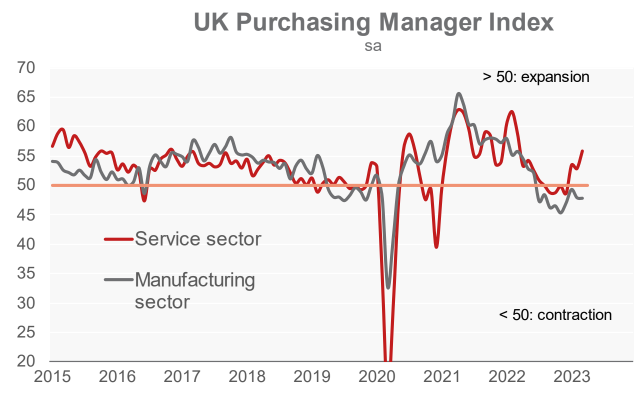
- **As widely expected, the Bank of England (BoE) raised Bank Rate by 25 bps to 4.5% today. The decision was taken by a 7-2 majority vote. For the fourth meeting in a row, two members (Tenreyro and Dhingra) voted to leave rates unchanged.**
- **The decision follows upside surprises in inflation and wage data. The BoE repeated its data-driven forward guidance, stating "If there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required".**
- **The Bank dropped forecasting a recession. Model results see CPI inflation to fall to 1.1% in two years' time if Bank Rate followed the market path (expecting first cuts by the end of the year), and to 0.7% in Q2 2025 if Bank Rate were held constant at 4.5%.**
- **While we expect headline inflation to drop quite significantly with the April data release, core inflation as well as wage growth could prove sticky. We therefore see another hike in the next meeting now more likely than not. Even a second one cannot be excluded although weakness in global growth in H2 might well prevent this.**

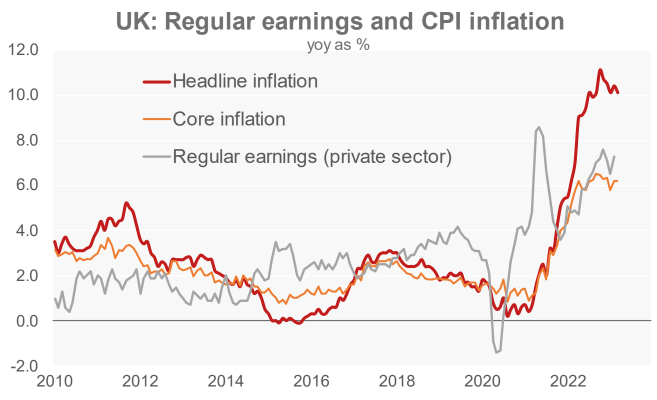
In its March meeting, the Monetary Policy Committee (MPC) of the BoE set a range of criteria (including the tightness of labour market conditions and the behaviour of wage growth and services inflation) which it would monitor to determine the persistence of inflationary pressures. Upside surprises would lead to a further tightening of monetary policy. In fact, overall data surprised on the upside (see graphs), Headline inflation – the highest among Western countries – only receded to 10.1% yoy (after 10.4%yoy before) and core inflation remained sticky at 6.2% yoy. In addition, average weekly earnings (3-months rolling) stayed at 5.9% yoy, compared with market expectations of a drop to 5.1% yoy. Moreover, consumer confidence improved and latest final PMIs were revised upwards, especially the services PMI to 55.9 index points while the manufacturing PMI – like in other countries – is in contractionary territory (47.8). However, on the negative side, retail sales growth was weak with –3.1% yoy and overall lending towards the overall economy (M4 lending) turned negatively at -1.3% yoy. **Against this backdrop, the BoE Bank Rate hike was widely expected.**

Today, the central bank renewed its data-driven stance. The Bank's model no longer forecasts a recession. While in February, the model predicted seven quarters of negative growth, GDP expansion remains modestly positive now and is likely to converge to about 0.6% yoy by the end of the year. CPI inflation is expected to fall to 1.1% in two years' time (market path) resp. to 0.7% in Q2 2025 if Bank Rate were held constant at 4.5%. Thus, as mentioned before, the model does not suggest a systematic need for further tightening. **This in turn confirms the data driven approach of the BoE.**

Accordingly, the BoEs next decisions will depend on actual developments. We see headline inflation to drop quite significantly in April (even assuming last month's high 0.8% mom growth, yoy CPI inflation were to fall to 8.2% yoy on base effects) and beyond, but core inflation is likely to stay sticky. Food prices (a main driver of upside surprises of CPI headline inflation, given the food shortages), rising in March by 19.1% yoy and utilities inflation (up in March by 26.1% yoy) suggest core service inflation to see still ongoing second round effects. For example, inflation in the CPI subcomponent "Hotels, Cafes and Restaurants" saw price increases of 11.3% of late, rolling over higher food, utility, and labour costs. Together will tightness in the labour market, **we see another hike in the next meeting now more likely than not.** Even a second one cannot be excluded, although weakness in global growth in H2 might well prevent this. We stress that ultimately next data releases will be decisive. Markets responded calmly to the news.



Source: Datastream, GIAM



Source: Datastream, GIAM calculations