PREVIEW: BoE rate decision, MPR and minutes due Thursday 5th May 2022

- **BoE rate decision & minutes & MPR due Thursday 5th May 2022 at 12:00BST/07:00EDT, press conference at 12:30BST/07:30EDT**
- **Expectations are for the MPC to hike rates by 25bps to 1% via an 8-1 vote**
- **Policymakers will refrain from commencing QT despite by the Bank Rate hitting 1%**

OVERVIEW: The BoE is expected to continue its hiking cycle at the upcoming meeting by delivering another 25bps hike, taking the Base Rate to 1.0%. In terms of market pricing, 27bps of tightening is factored in for the upcoming meeting with an additional five hikes priced in by the end of the year. The previous decision was subject to dovish dissent from Cunliffe. This time around, the vote split is expected to remain 8-1. The meeting comes amidst the backdrop of rampant inflation in the UK, and a hot labour market, however, March's retail sales report was a cause for concern. With this in mind, Governor Bailey has cautioned that the BoE is walking a tightrope between tackling inflation and avoiding a recession. With a rate hike a near given for the Bank, focus will turn towards signalling for the coming months. In the previous statement, the Bank tweaked guidance so that it reads “modest tightening in monetary policy may be appropriate in the coming months” as opposed to the February statement which noted it is “likely to be”. Any further softening of forward guidance on rates will be of note given how aggressive market pricing remains. Elsewhere, current guidance from the BoE suggests that it will actively start selling Gilts when the Bank Rate hits 1%. However, policymakers have stated that selling Gilts when the Bank Rate hits 1% will not be an automatic process. ING thinks now is not the best time to sell bonds and therefore will hold off and instead opt to lay out details of how the policy could work when implemented. In the accompanying MPR, inflation and growth forecasts are set to be revised higher and lower respectively.

PRIOR MEETING: As expected, the BoE opted to raise the Bank Rate by 25bps to 0.75% in what was a third consecutive hike. After unanimously deciding to move on rates in February, the March decision was subject to dissent from Deputy Governor Cunliffe who voted to leave rates unchanged. The majority of the MPC deemed a 25bps hike as appropriate on account of the tightness in the labour market, price pressures and concerns that those pressures would persist. Cunliffe acknowledged the aforementioned factors, however, he placed greater weight on "the very material negative impacts of higher commodity prices on real household incomes and activity". In terms of the accompanying statement, recent events in Ukraine prompted the MPC to revise its inflation outlook and it now sees inflation rising to “around 8%” in Q2 (vs. prev. view of peaking at around 7.25% in April) whilst cautioning that the rate could move higher thereafter. From a growth perspective, policymakers continued to warn that GDP is expected to slow to subdued rates during the course of the year. Guidance on rates saw a subtle change as the MPC now “judges that some further modest tightening in monetary policy may be appropriate in the coming months” vs. previous guidance of “likely to be”. The MPC also continued to imply that market pricing going into the meeting was too aggressive, suggesting that the current rate path would imply an inflation rate below target in three years.

RECENT DATA: The meeting comes amidst the backdrop of rampant inflation in the UK with the Y/Y CPI metric rising to 7.0% in March from 6.2% ahead of the inclusion of the OFGEM price cap hike in April. The core metric also remains at highly elevated levels with the March print rising to 5.7% from 5.2%. Furthermore, the CBI reported that manufacturers are raising prices at the fastest rate in over 40 years to cover rising raw material and energy input costs. The labour market remains hot with the unemployment rate at multi-decade lows whilst wage growth remains elevated with headline earnings running at a clip of 5.4% in the 3M/YY period to February. GDP metrics for February saw a cooling in the pace of Q/Q growth to 0.1% vs. the 0.8% observed in January amid a decline in health spending as COVID testing and vaccine activity slowed. Timelier survey data from S&P Global for the month of April saw the composite PMI metric decline to 57.6 from 60.9 amid a drop-off in the services print. Respondents to the survey cited "subdued consumer demand due to squeezed household finances and rising prices for essential items". The April GFK report was also a disappointment with the UK consumers' personal finances expectations component declining to a record low. Finally, March’s retail sales report was particularly soft as headline retail sales contracted 1.4% with ING noting that “it's getting increasingly difficult to see how UK consumer spending avoids a downturn over coming months”.

RHETORIC: Comments from Governor Bailey (Apr 21st) have drawn the most attention of markets when he noted "We are walking a very tight line between tackling inflation and the output effects of the real income shock, and the risk that could create a recession.” Deputy Governor Broadbent (Mar 30th) cautioned that "it’s doubtful that the UK has ever experienced an external hit to real national income on this scale. From the narrow perspective of monetary policy it will result in the near term in the difficult combination of even higher inflation but weaker domestic demand and output growth". Deputy Governor Cunliffe (4th April) who dissented at the previous meeting, remarked " I am not at present convinced that we will inevitably have to lean heavily and constantly against an embedding of an inflationary psychology as we progress through this challenging period". Elsewhere, external member Mann (Apr 21st) stated "monetary policy needs to keep inflation expectations anchored; by doing so now, less tightening will be required later, when demand may still be weak." The remaining MPC members have not commented since the prior meeting.

RATES: The BoE is expected to continue its hiking cycle at the upcoming meeting by delivering another 25bps hike, taking the Base Rate to 1.0%. 33/44 surveyed analysts expect a 25bps hike, 1 expects a 50bps hike and 10 look for no change. In terms of market pricing, 27bps of tightening is priced in for the upcoming meeting with an additional five hikes by the end of the year. The previous decision was subject to dovish dissent from Cunliffe who voted for a pause in the hiking cycle on account of concerns over the current squeeze on real household incomes. This time around, the vote split is expected to remain at 8-1 with no other MPC members set to join Cunliffe in the pause camp. Note, there could be a split over the magnitude of the vote, with Goldman Sachs suggesting that Mann, Saunders and Ramsden could opt for a larger hike of 50bps. With a rate hike a near given for the Bank, focus will turn towards signalling for the coming months. In the previous statement, the Bank tweaked guidance so that it reads “modest tightening in monetary policy may be appropriate in the coming months” as opposed to the February statement which noted it is “likely to be”. Any further softening of forward guidance on rates will be of note given how aggressive market pricing remains. SGH Macro suggests that the Bank is on the precipice of what it describes as “a ‘second phase’ of tightening, characterized by less frequent moves over a longer time horizon, with data dictating meeting-to-meeting outcomes”.

GILTS: After the Base Rate reached 0.5%, the BoE announced that it will "cease to reinvest any future maturities falling due from its stock of UK government bond purchases." As it stands, current guidance from the BoE suggests that it will actively start selling Gilts when the Bank Rate hits 1%. With the Bank Rate set to hit 1% at the upcoming meeting, the MPC will need to offer some sort of guidance on this front. Previously (Feb 23rd) Governor Bailey has noted that "Gilt sales are not automatic when the Bank Rate reaches 1%." The decision to stop reinvesting in Gilts and actively selling them are viewed as two very different things at the Bank with the latter likely to have more of an impact on borrowing costs. Given how quickly the Bank has needed to move on rates since last December and guidance from the MPC that interest rates will remain the main tool for controlling inflation, policymakers are likely instead to present details on how such a policy could work when implemented; a view backed by analysts at ING. Such a view is also backed by comments from Governor Bailey (Apr 22nd) that the BoE would not sell Gilts into "unstable markets", which was a comment that was viewed as guidance ahead of the upcoming meeting. Furthermore, given that the BoE is viewed to be in unchartered territory when it comes to QT, policymakers will likely wish to proceed with caution and seek as much feedback as they can from market participants on how such a policy would work. As such, a recent survey by Reuters revealed that analysts expect sales to commence at some point between June and well into 2023. In terms of how the policy could work, Pantheon Macroeconomics suggests that the MPC could wait until August to unveil a programme of GBP 10bln asset sales per quarter, which would bring the APF to its pre-pandemic level in Q4 2026. The Consultancy suggests that a GBP 10bln per quarter pace would equate to hiking the Bank Rate by 17bps per year.

PROJECTIONS: Given the Russian invasion of Ukraine (Feb 24th), the forecasts outlined in the February 3rd MPR will need to be updated. From a growth perspective, with the UK economy slowing down, real incomes declining and the fact that the implied market rate path (which has become more aggressive since February) is incorporated into the MPC's projections, the 2022 GDP forecast is expected to be downgraded to 3.5% from 3.75%, whilst Rabobank suggests that the 2023 print could come in at around 1.2%. On the inflation front, the March statement saw the MPC revise its guidance on inflation by stating that it now expects inflation to reach around 8% in 2022 Q2, and perhaps even higher later this year (vs. prev. guidance of peaking at around 7.25% in April 2022). As such, an upward revision to the 2022 forecast of 5.75% is very much expected to be on the cards with some desks touting a figure around the 8% mark. That said, of potentially greater interest will be the medium-term projections, on which, Pantheon Macroeconomics suggests that the implied market rate path could prompt a material undershoot to the Bank's 2% target for 2023 and 2024 with the rate path exerting a 0.7pp downward pull on both years. Such a downward revision to these projections would suggest that the MPC is particularly uncomfortable with market pricing dynamics.

Previous forecasts:

Inflation: 2022 5.75% (prev. 3.5%), 2023 2.5% (prev. 2.25%) and 2024 1.75% (prev. 2%)

GDP: 2022 3.75% (prev. 5%), 2023 1.25% (prev. 1.5%), 2024 1% (prev. 1%)

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