PREVIEW: BoE rate decision and minutes due Thursday 16th June 2022

- **BoE rate decision & minutes due Thursday 16th June 2022 at 12:00BST/07:00EDT**
- **Expectations are for the MPC to hike rates by 25bps to 1.25% via a 9-0 vote**
- **Traders will be looking for signs of the MPC pushing back on market pricing**

OVERVIEW: Policymakers are expected to continue with the rate hiking cycle by delivering another 25bps rise, taking the Bank Rate to 1.25%. The decision to move on rates is expected to be unanimous, however, the split of views regarding the magnitude of the move remains to be seen, given that there were three dissenters at the May meeting. The need to continue raising rates was underscored by the jump in April's CPI metrics, which printed 9.0% from 7.0%. With further increases in inflation likely in the months ahead, the MPC expects consumer prices to average a little over 10% at its peak in Q4 2022. From a growth perspective, the recent survey data from S&P Global highlighted the difficult economic backdrop in the UK, and the likelihood of a stagflationary environment going forwards, with the services metric slipping to 53.4 in May from 58.9. Accompanying commentary from S&P Global noted "the monthly loss of momentum for business activity expansion was a survey record outside of lockdown periods." That said, policymakers will have found some comfort in the latest government support measures aimed at addressing the cost-of-living crisis, which could boost nominal GDP by around 0.7% in H2 2022. In terms of guidance from the MPC itself, Governor Bailey has flagged concerns that pay growth will feed into inflation and is prepared to raise rates again if needed. Furthermore, Chief Economist Pill has stated that when it comes to lifting interest rates, "further work needs to be done." Note, current market pricing has continued to pick up since the prior meeting and now looks for around another seven 25bps hikes by year-end. This continues to remain at odds with guidance from the MPC, which at the May meeting noted that the implied market path would see inflation firmly below target in three years time, at around 1.3%. Therefore, as the year progresses, desks are still widely of the view that some of this exuberant pricing will need to be taken out of the market.

PRIOR MEETING: As expected, the BoE opted to hike the Bank rate by 25bps to 1.0%. The decision over the magnitude of the hike was subject to hawkish dissent from Mann, Haskel and Saunders who voted for a 50bps increase on the basis that doing so would "help to bring inflation back to the target sustainably in the medium term, and reduce risks of a more extended and costly tightening cycle later". The decision to raise rates was in reaction to the current inflationary outlook, which now looks for CPI to "rise further over the remainder of the year, to just over 9% in 2022 Q2 and averaging slightly over 10% at its peak in 2022 Q4". This sentiment was reflected in the accompanying MPR which saw the 2022 CPI forecast lifted to 10.25% from 5.75%. With this in mind, the MPC judged that "some degree of further tightening in monetary policy may still be appropriate in the coming months"; a view which was not supported by all members on the basis that risks around activity and inflation over the policy horizon were more evenly balanced. With regards to market pricing, the MPC once again attempted to highlight that the implied rate path is too aggressive by stating that such a path would see the inflation rate pushed down to 1.3% in three years, well below the target. During the press conference, Bailey stated he does not agree with those who think that the MPC should be raising interest rates by a lot more. The MPC revised lower its 2023 growth outlook to -0.25% from 1.25% with 2024 GDP is seen at just 0.25%. Now that the Bank Rate has hit 1%, the MPC offered an update on the future of its balance sheet given that current guidance noted that Gilt sales will commence when its key rate hits this level. Accordingly, the MPC has asked Bank staff to work on a strategy for UK government bond sales, and will provide an update at its August meeting.

RECENT DATA: April's CPI release saw a jump to 9.0% from 7.0% (MPC expected 9.1%), whilst the core metric rose to 6.2% from 5.7%. Note, further increases in inflation are likely in the months ahead with the MPC expecting consumer prices to average a little over 10% at its peak in Q4 2022. Elsewhere, the BoE's Inflation Attitudes Survey saw the median expectation for inflation over the coming 12 months rise to 4.6% in May from the 4.3% pace expected in February. From a growth perspective, April's GDP release posted a M/M contraction of 0.3% and followed a 0.1% contraction in March. Digging beyond the headline, analysts at ING note that pandemic-related health spending shaved a full 0.5ppts off the headline. If this was stripped out, growth would have been marginally positive. That said, the April print means that the economy likely contracted around 0.5% in Q2, which would be in contrast to MPC expectations of a 0.1% expansion. Timelier survey data from S&P Global highlighted the difficult economic backdrop in the UK, and the likelihood of a stagflationary environment going forwards, with the services metric slipping to 53.4 in May from 58.9. Accompanying commentary from S&P Global noted "the monthly loss of momentum for business activity expansion was a survey record outside of lockdown periods." April retail sales saw an unexpected expansion for headline and core M/M metrics, however, the outlook for the sector remains bleak as the cost-of-living crisis squeezes real household incomes and consumers pivot away from goods and back towards services. On the employment front, the unemployment rate in the three months to April unexpectedly rose to 3.8% from 3.7%, whilst headline earnings growth cooled to 6.8% from 7.0%. However, the defining characterisation of the labour market currently is the ongoing labour shortages.

RHETORIC: In terms of guidance from the MPC itself, Governor Bailey stated that "policymakers can and must take the actions needed to return inflation to target over a period that avoids unnecessary volatility. Chief Economist Pill has noted that too much tightening runs the risk of getting stuck in a deep recession, but too little tightening runs the risk that inflation gets self-sustaining momentum. Deputy Governor Ramsden is of the view that based on his assessment "we're not there yet in terms of how far monetary policy has to tighten". Deputy Governor Cunliffe says that rates may well have to rise further and there is a need to ensure that current inflation does not become the new normal. External member Saunders (50bps dissenter) has stated his preference for a quicker move to a more neutral monetary policy stance, albeit he would not necessarily vote for a 50bps hike in the future if further tightening is required. Saunders estimates the neutral rate at somewhere between 1.25-2.5%. In terms of the inflation outlook, Saunders puts more weight on risks of a more persistent period of excess demand and above-target inflation than the central forecast in the May MPR. External member Tenreyro stated that she believes the MPC should return inflation to target on a 2-3 year horizon.

RATES: The BoE is expected to continue its hiking cycle at the upcoming meeting by delivering another 25bps hike, taking the Base Rate to 1.25%. 55/56 surveyed analysts look for a 25bps move with just one survey participant looking for a 50bps increase. Capital Economics is the lone forecaster expecting a 50bps increase on the basis "that the recent loosening in fiscal policy, the latest tightening in the labour market and further signs of rising price/wage expectations will just about tip the balance to a 50bps hike." In terms of the decision to hike interest rates, consensus expects it to be unanimous across the nine MPC members. However, the greater source of uncertainty is the unanimity of the magnitude following the three dissenters (Haskell, Mann and Saunders) at the May meeting who opted for a 50bps increase. Given the fine line the MPC is walking between taming inflation and stoking a recession, the likes of Barclays and Pantheon Macro flag the risk of a three-way split on this front with the latter expecting the same three members seen in May to vote for a 50bps hike, five members to opt for 25bps and one of either Cunliffe or Tenreyro to prefer an unchanged Bank Rate. That said, it is worth noting voting patterns have been very unpredictable in recent months. Looking further ahead, at the time of writing, money markets pencil in a total of 188bps (inc June) of tightening by year-end which would imply the possibility of two 50bps hikes and three 25bps hikes at the five remaining meetings of the year, taking the Bank rate to 2.75%. This appears to be at odds with surveyed analysts who look for just two more 25bps hikes beyond June, taking the Bank Rate to 1.75% by year-end. After which, the MPC would be expected to hike rates by a further 25bps before pausing its hiking cycle. The discrepancy between surveyed analysts and market pricing is unlikely to be resolved at the upcoming meeting, however, it is likely to become an increasingly important issue for BoE-watchers as the year progresses.

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." Guidance stated that when the Bank Rate hit 1%, the BoE would start actively selling Gilts (note, the process was never expected to be automatic). The 1% level was hit at the May meeting, at which point the MPC issued guidance suggesting that it had asked Bank staff to "work on a strategy for UK government bond sales, and will provide an update at its August meeting". As such, no updates are expected for the upcoming meeting. In terms of how the policy could work, Pantheon Macroeconomics suggested (ahead of the May meeting) 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 by Q4 2026. The Consultancy suggested that a GBP 10bln per quarter pace would equate to hiking the Bank Rate by 17bps per year.