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GLOBAL ECONOMICS

FLASH REPORT

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Market Reaction (at time of writing, 8.29ET)

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BoE Drops Hike Guidance, but Doesn't Eye Cuts

- **Today, the BoE finally dropped tightening guidance from its policy statement while giving little to no indication that they are readying the start of the easing cycle. Forecast and guidance changes were broadly as expected, but the odd 1–6–2 cut-hold-hike vote split was somewhat unexpected.**
- **The immediate reaction in markets, a sharp selloff in UK rates and a sharp gain in the GBP, was influenced by moves ahead of the decision that had gilts rallying and sterling weaken. The global market shift on US data erased the losses in gilts and kept a floor under the GBP.**
- **The BoE acknowledged the progress made in inflation, "moving in the right direction", but highlighted that they need to be more confident that it is heading towards target sustainably and they are not yet at the point that they can lower interest rates.**
- **The Governor could not put it more clearly that they "won't speculate on the next meeting" nor on how long rates must stay on hold. Two CPI and two jobs/wages data releases between now and the March 20th meeting will inform expectations for more guidance changes, but are highly unlikely to prompt a rate cut next month.**

Today, the BoE finally dropped tightening guidance from its policy statement while giving little to no indication that they are readying the start of the easing cycle. The BoE's statement and updated MPR forecasts were broadly as expected in terms of guidance tweaks and mixed inflation revisions. The MPC's 1–6–2 cut-hold-hike vote split was a bit of an odd one, though not terribly surprising (to us, at least).

The immediate reaction in markets, a sharp selloff in UK rates and a sharp gain in the GBP, was influenced by moves ahead of the decision. A strong rally in gilts since the market opened—that contrasted with rising EGB yields—may have reflected some caution ahead of a possibly more dovish announcement. Instead, that two in the MPC (Haskel and Mann) still preferred a hike—despite Dhingra voting for a cut—may have been more than the zero or one hike vote that was expected. No real cuts guidance and only modest, and mostly expected, statement changes weighed on some last-minute dovish fears.

The BoE was not going to hike nor cut today, and there was no serious expectation that they would signal that reductions are around the corner. Bailey and company are divorced from rates guidance. The Governor could not put it more clearly that they "won't speculate on the next meeting" nor on how long rates must stay on hold. Unfortunately for BoE watchers, the Bailey/Ramsden/Broadbent presser did not give too much away aside from a bit more colour on their outlook.

The bank's strict adherence to data dependence means we need to closely watch the two CPI and two jobs/wages data releases between now and the March 20th meeting. These data will determine whether the BoE begins easing in either May or June, but it should not result in a March cut—that would require a massive undershoot vis-à-vis their forecasts. After today's decision, we maintain our forecast for BoE cuts to begin in June, with 25bps, continuing to 4.00% at end-2024 and 3.00% at end-2025. The faster deceleration in inflation in end-2023 means we see risks as tilted towards earlier and/or more cumulative tightening, though this is limited to an extra 25bps and a May start, for now.

Like the Fed yesterday, the BoE acknowledged the progress made in inflation, "moving in the right direction", but highlighted that they need to be more confident that it is heading towards target sustainably and they are not yet at the point that they can lower interest rates. At the margin, this is hawkish as it pushes away the start of rate cuts, but the BoE finds itself in a very different situation to the Fed who already has a good half-year or so worth of encouraging data so this “confidence” pushback was more valuable for the FOMC.

The main guidance change in the BoE’s statement was in going from “further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures” to the BoE “will keep under review for how long Bank Rate should be maintained at its current level”. Most expected this change, the BoE had not hiked since August—to Mann’s and Haskel’s displeasure—and inflation is expected to be two-handled possibly as soon as March. Still, they are not sending a message that they will consider cutting at the next meeting; a review should take a few months, at least.

The BoE now believes that the “risks to inflation are more balanced” in its February forecast. After a sharper than expected fall in headline inflation, the committee’s judgment that inflation risks in their November forecasts were skewed to the upside was clearly stale. Note, however, that the BoE believes that over the first half of the projections their CPI outlook is skewed to the upside but they attribute this to geopolitical factors. From a domestic price and wage pressures standpoint, the risks are “more evenly balanced”. If Red Sea/Middle East shipping and energy risks ease, then the BoE’s near-term inflation upside fears could fade; the opposite holds true, of course.

As for forecast changes, a large decline in UK yields since the November decision had an important upside influence on medium-term inflation projections. Lower energy prices and inflation misses since the November round mean near-term inflation forecasts were revised a good deal lower. The February MPR modal projection has Q2-24 inflation at 2.0%, down from the 3.6% that they had penciled in for this quarter in November. From this point, the BoE believes inflation will rise to 2.7%/2.8% all through Q4-24 to Q3-25; in the November MPR, they saw inflation 0.6ppts lower over Q2/Q3-25. The new forecasts also don’t see a sustained ~2% inflation period until early-2026 while the previous round had it in this area since mid-2025.

The BoE may use these forecasts to push back against market pricing, noting the very slow path towards on-target inflation, but recall the BoE though December 2023, inflation would print 4.6%, a 0.6ppts overshoot over the actual 4.0% reading, so it’s tough to place much weight on these forecasts as a guide to when the BoE may begin to cut rates. Bailey did highlight, however, that it’s not that they need inflation to be at target to cut rates but to have a sufficient level of confidence that it’s getting there. For GDP growth, the BoE nudged marginally higher its 2024–26 projections to still show below potential growth over the forecast horizon (2024/25/26 at 0.2/0.6/1.0%)

Market reaction (at 13.29UK/8.29ET and at 14.30UK/9.30ET):

- UK asset prices reacted immediately to the statement/minutes and MPR release to then trade mostly range-bound through the BoE’s press conference before moving in tandem with global markets that reacted sharply to US data misses. The first market levels noted below refer to those right before the US data run and the release of the BoE’s Decision Maker Panel survey data that showed a strong drop in year-ahead CPI expectations (to 3.4% from 4.0%).
- The GBPEUR sat at an intraday low of ~1.1685 prior to the decision to then rally to around 1.1725. The GBP then slowly gave away those gains to trade around 1.17 at writing, or still down 0.2% on the day versus the EUR. Sterling is also still down 0.2% against the USD at about the same level where it traded before weakening into the BoE’s decision, at ~1.2665.
- UK2s that had rallied about 3/4bps from gapping at the open up until the BoE’s decision, to ~4.24%, weakened sharply to trade above 4.30% on the statement and through the press conference—to sit 4bps higher from yesterday’s close. UK10s followed a similar path but with the rise in yields on the release leaving them at the same level as at the open. Since then, the strong rally in USTs drove UK2s to around the intraday low of 4.24% and 10s to graze the 3.75% level (1/2bps and 3/4bps declines on the day).
- Year-end pricing for the BoE is unchanged (due to the US data run) when compared to pre-decision at 115bps in priced in cuts, but had moved to 110bps on the BoE’s announcement. Similarly, May meeting pricing was reduced by up to 5bps briefly, before coming back down to earth to only 1bps higher vs pre-decision levels for only about toss-up odds of a BoE cut priced in (13bps). The Fed’s pushback yesterday does mean, however, that May BoE pricing is on net 4/5bps higher on the day.