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GLOBAL ECONOMICS

FLASH REPORT

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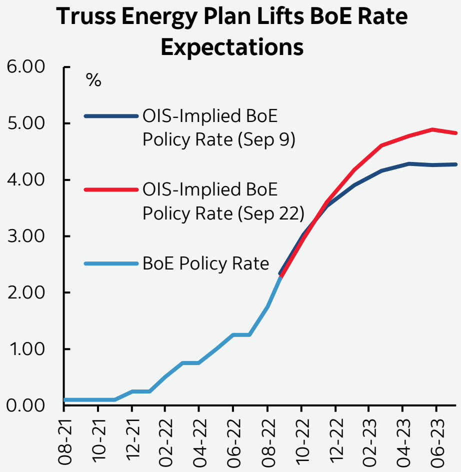
Chart 1



Sources: Scotiabank Economics, Bloomberg.

Markets Let Down by 50bps BoE Hike, but Truss Growth Plan Could See 75bps in November

- **The Bank of England lifted its policy rate by 50bps today in line with consensus forecasts, but disappointed markets that saw around a two-thirds chance of a 75bps hike.**
- **We think the government's Growth Plan should have motivated pre-emptive action from the BoE today with a 75bps rate increase.**
- **Despite the BoE missing our expectation for this meeting, we see upside risks to our latest official BoE forecast.**

The Bank of England lifted its policy rate by 50bps today in line with consensus forecasts, but disappointed markets that saw around a two-thirds chance of a 75bps hike to 2.50% (which was also our forecast).

We think the impact of the government's Growth Plan, with details due tomorrow, will lead to a period of higher core inflation (than previously thought) that should have motivated pre-emptive action from the BoE today with a 75bps hike.

The lower-than-expected hike should have depressed UK yields, but the Bank's announcement that it will begin active gilt sales in early-October as planned (at a pace of £40bn/year) sent the yield on 10-yr bonds higher by up to 13bps versus pre-decision after some speculation had built that the BoE's plans would change due to higher HMT issuance related to Truss's plans.

On the other hand, the disappointingly sized hike nullified the positive impact of higher long-term yields on the GBP, translating into a net roughly unchanged GBP against the EUR and the USD. Sterling gains for the day by and large reflected the broad move against the USD with Japan's MoF intervention in FX markets. The QT impact is also reflected in a more modest increase in 2-yr yields, relative to 10-yr yields, of only ~2–3bps at writing compared to pre-statement levels.

The split vote saw five members (including Gov Bailey and Chief Econ Pill) vote for a 50bps hike against three hawks in favour of a 75bps increase and a surprising 25bps vote from Dhingra at her first MPC appearance (out-doving Tenreyro who voted for 50bps).

The minutes of the meeting accompanying the statement imply that some MPC members preferred to wait for the full details of the Truss/Kwarteng plan before opting for a 75bps increase. This suggests a 75bps hike remains on the table for the November decision where the Committee will "make a full assessment" and incorporate the government's announcements in its updated MPR projections.

Despite the BoE missing our expectation for a 75bps hike, we see upside risks to our latest official BoE forecast. Our **September update** projects that the BoE will continue its hiking cycle with an additional 100bps in tightening by year-end, taking the bank rate to 3.25% and holding there until late-2023, at least.

The tone of today's minutes, teeming with references to inflationary pressures and upside risks (now also from the demand side), highlights that the bank is more concerned about entrenched inflation than previously thought and they're ready to impact demand more harshly to prevent runaway inflation.

The surprising resilience of UK labour markets and robust wages growth as well as fiscal support against the cost-of-living crisis—that should translate into relatively higher and longer-lasting core inflation—opens the door to at least 50bps more in tightening than we have penciled in. **On top of a 50 or 75bps move in November and a half-point increase in December, the Bank looks positioned to roll out at least two additional rate increases next year, perhaps taking its policy rate past 4%.**

Whether this is enough to prevent continued currency weakness remains to be seen. The bar for a strong GBP is high given that markets are already expecting the BoE to lift its policy rate to close to 5% by H2-2023 (chart 1), which seems excessive in our opinion. Moreover, there are a multitude of factors conspiring against the GBP aside from a hawkish Fed and an ECB that is catching up: an economic contraction, energy supply risks, increased public spending without fiscal offsets, poor productivity/investment, and the effects of Brexit.