

FLASH REPORT

May 11, 2023

Contributors**Juan Manuel Herrera**

Senior Economist/Strategist

Scotiabank GBM

+44.207.826.5654

juanmanuel.herrera@scotiabank.com

BoE Hikes 25bps with Higher Inflation Forecast; Pause or Hike to Depend on Data

- The Bank of England surprised practically no one today by choosing to lift its policy rate by 25bps to 4.50% in a 7–2 vote split.
- Based on an initial read of the statement and the updated projections, we would be inclined to project another 25bps increase at the June 22 meeting.
- However, there are dovish elements in today's set of communications that make us unwilling to change our projection for no more hikes.
- What may be the clearest evidence of aiming for a pause is the emphasis that Bailey has placed on the condition for additional hikes ("evidence of more persistent pressures").
- Above all, our BoE call will depend on incoming data. The release of Q1 GDP, and April payrolls and wages next week, and above all CPI/RPI figures on the 24th will be key.

The Bank of England surprised practically no one today by choosing to lift its policy rate by 25bps to 4.50%. Markets went into the meeting with 25bps priced in and all but one of the 48 economists surveyed by Bloomberg had projected a quarter-point move (including Scotiabank).

The vote split of 7 voting for a hike and 2 voting for a pause (again Dhingra and Tenreyro) was also as expected, and so were the higher GDP growth and lower unemployment rate forecasts—in line with firmer macroeconomic data since the February forecast round.

The higher inflation forecast was not fully unexpected, but the magnitude of this change was certainly a surprise. At 5.12%, the end-2023 forecast for CPI was lifted by 1.2ppts from the 3.92% seen in the February Monetary Policy Report; end-2024 was also revised to 2.28% from 1.42%.

It is clear that the new inflation outlook prompted a rate hike today, as the BoE had flagged at its March decision that if "there were to be evidence of more persistent [inflationary] pressures, then further tightening in monetary policy would be required". That condition has been met, so a 25bps increase was required, in line with guidance. This time around, Bailey (during his presser) and the MPR also placed a bit more emphasis on risks around the inflation outlook being "skewed significantly to the upside."

Based on an initial read of the statement and the updated projections, we would be inclined to project another 25bps increase at the June 22 meeting. Markets are on board with that call with 23/24bps in hikes priced in following the statement (a 4bps increase). Or, at least they were before US banking sector risks reared their head and took short-term interest rates lower across the globe; the weak-to-mixed US PPI/jobless claims data also added to this.

Choppy price action makes the market read of the BoE's communications difficult. BoE June meeting contracts are now penciling in only 18bps in hikes and 2y UK yields are down 8–10bps on the day. The spread between 2yr UK and German debt yields is on net 3/4bps lower than before the policy decision, reversing the 7bps widening in the hour that followed. The GBPEUR is also now weaker on the day (0.2%), shortly after strengthening to its best levels of its rally since late-April.

May 11, 2023

Setting the global bid in rates markets and the USD aside, it seems that UK traders were perhaps also prepared for a more hawkish statement and press conference from Bailey, based on the relative performance of gilts and the GBP.

We don't want to give too much credit to erratic market action the past few hours, but there are hawkish takeaways from the statement and MPR that supported the initial moves. A higher inflation forecast, no more recession projection (only one quarter of slightly negative growth), and leaving the door open to more increases support rate hike bets—though could this have already been fairly reflected by the one and a half hikes seen after today?

On the flipside, there are dovish elements in today's BoE decision that make us unwilling to change our projection for no more hikes (which above all depends on incoming data). Bailey and the MPR highlighted that the revision “predominantly reflects higher expected food price inflation” while the services projection was left practically unchanged; higher goods prices also got a shout. The Bank also continues to expect a steep drop in headline inflation starting in April as the Q2-22 surge in energy prices falls out of the year-on-year comparison. Again, the BoE's central forecast sees inflation drop below the 2% target in the last six quarters of the projection horizon (starting in 25-Q1 at 1.52%), in what is a message to markets that rate cuts are underpriced and the UK economy is not fit to handle a 3.50%+ Bank Rate for the next two and a half years.

What may be the clearest evidence that the BoE may not hike again is the emphasis that Bailey has placed on the conditionality of the phrase “if there were to be evidence of more persistent [inflationary] pressures, then further tightening in monetary policy would be required.” The Governor is not closing the door to hikes as the bank sticks to a data-dependent approach.

However, in the same way that in the March decision this sentence indicated that the BoE would pause today (based on the data and the outlook at the time, see our write-up [here](#)), it suggests today that if the economy evolves in line with the latest MPR forecasts then the BoE will not need to hike again. If that's the case, then there would be no evidence of persistent inflationary pressures in excess of those present in their revised outlook. This forecast already shows a notable improvement in GDP projections and a large increase in inflation that would give the BoE a wide berth for upside risks in incoming data. Maybe more MPC members will join the two doves in calls for a pause at the next meeting, and Bailey noted that the discussion of overtightening is “a lively subject of debate” among policymakers.

In an interview with Bloomberg after the press conference, Bailey said that the BoE is nearing a point when they should be able to “rest in terms of the level of rates” and that he hopes the BoE is close to a pause, citing that today was the twelfth consecutive rate increase from the BoE, while sticking to the need to be data dependent. Overall, this reinforces the view that if data evolve as planned, the BoE may pause next month—or hike once more, at most.

The dissection of the statement, presser, and MPR suggests, to us, that a June pause is not a done deal, and we acknowledge that the odds of another 25bps hike have risen, particularly on the back of the new inflation projections. But there's only so much speculating that can be done when, ultimately, it will be the data that determines the BoE's next move. Over the remainder of the month, the release of Q1 GDP, and April payrolls and wages next week, and above all CPI/RPI figures on the 24th will determine our forecast for the June meeting and lock in, or fade, a full 25bps hike in markets. A lot may happen over the next six weeks to change our, and the market's perception, above all a widespread banking crisis or a US default. Neither of these are in our baseline scenario, though headwinds to global growth and policy rate bets may be building.

This report has been prepared by Scotiabank Economics as a resource for the clients of Scotiabank. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Scotiabank nor any of its officers, directors, partners, employees or affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.

These reports are provided to you for informational purposes only. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any financial instrument, nor shall this report be construed as an opinion as to whether you should enter into any swap or trading strategy involving a swap or any other transaction. The information contained in this report is not intended to be, and does not constitute, a recommendation of a swap or trading strategy involving a swap within the meaning of U.S. Commodity Futures Trading Commission Regulation 23.434 and Appendix A thereto. This material is not intended to be individually tailored to your needs or characteristics and should not be viewed as a “call to action” or suggestion that you enter into a swap or trading strategy involving a swap or any other transaction. Scotiabank may engage in transactions in a manner inconsistent with the views discussed this report and may have positions, or be in the process of acquiring or disposing of positions, referred to in this report.

Scotiabank, its affiliates and any of their respective officers, directors and employees may from time to time take positions in currencies, act as managers, co-managers or underwriters of a public offering or act as principals or agents, deal in, own or act as market makers or advisors, brokers or commercial and/or investment bankers in relation to securities or related derivatives. As a result of these actions, Scotiabank may receive remuneration. All Scotiabank products and services are subject to the terms of applicable agreements and local regulations. Officers, directors and employees of Scotiabank and its affiliates may serve as directors of corporations.

Any securities discussed in this report may not be suitable for all investors. Scotiabank recommends that investors independently evaluate any issuer and security discussed in this report, and consult with any advisors they deem necessary prior to making any investment.

This report and all information, opinions and conclusions contained in it are protected by copyright. This information may not be reproduced without the prior express written consent of Scotiabank.

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable.

Scotiabank, together with “Global Banking and Markets”, is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including: Scotiabank Europe plc; Scotiabank (Ireland) Designated Activity Company; Scotiabank Inverlat S.A., Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat, Scotia Inverlat Casa de Bolsa, S.A. de C.V., Grupo Financiero Scotiabank Inverlat, Scotia Inverlat Derivados S.A. de C.V. – all members of the Scotiabank group and authorized users of the Scotiabank mark. The Bank of Nova Scotia is incorporated in Canada with limited liability and is authorised and regulated by the Office of the Superintendent of Financial Institutions Canada. The Bank of Nova Scotia is authorized by the UK Prudential Regulation Authority and is subject to regulation by the UK Financial Conduct Authority and limited regulation by the UK Prudential Regulation Authority. Details about the extent of The Bank of Nova Scotia's regulation by the UK Prudential Regulation Authority are available from us on request. Scotiabank Europe plc is authorized by the UK Prudential Regulation Authority and regulated by the UK Financial Conduct Authority and the UK Prudential Regulation Authority.

Scotiabank Inverlat, S.A., Scotia Inverlat Casa de Bolsa, S.A. de C.V., Grupo Financiero Scotiabank Inverlat, and Scotia Inverlat Derivados, S.A. de C.V., are each authorized and regulated by the Mexican financial authorities.

Not all products and services are offered in all jurisdictions. Services described are available in jurisdictions where permitted by law.