MARKET COMMENTARY

BoE hiked by 25 bps and warned Bank Rate could stay higher for longer

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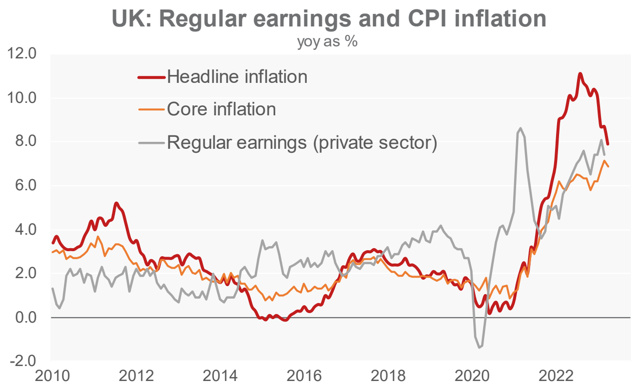
- **The Bank of England (BoE) hiked its Bank Rate today by 25 bps to 5.25%. This was in line with the predominant market view. The decision was taken by a 6-3 majority vote with two members preferring a 50 bps hike and one member voting to keep the 5% rate.**
- **After two upside and one downside surprises in headline CPI inflation, June CPI inflation was back in line with the May Inflation Report projections. However, the Monetary Policy Committee (MPC) expects that services price inflation – regarded as being informative about the persistence of inflationary pressures – will remain elevated. It also considers risks of more persistent inflationary pressures, notably wage growth, to "have begun to crystallise".**
- **Regarding its forward guidance, the BoE stressed again the unusually high data dependency but introduced a new formulation that monetary policy will "ensure that Bank Rate is sufficiently restrictive for sufficiently long to return inflation to the 2% target".**
- **In sum, stressing the persistence of higher inflation suggests more rate hikes to come. We currently expect a peak rate of 5.75% which could be kept at least until mid-2024. Markets responded rather calmly to the news. The pound continued its recent weakness against the US-dollar and euro.**

After a 50 bps hike in its previous meeting in June, the MPC returned today to a 25 bps hike to 5.25%. This is the highest level of Bank Rate since March 2008. The decision was taken by a 6-3 majority vote with two MPC members (Haskel and Mann) in favour of 50 bps. While latest CPI inflation dynamics has obviously calmed moods (the rate dropped 0.7% mom in May to 0.1% mom in June, compared to 0.4% mom consensus expectation), the BoE sees upside risks to tend to materialise. It used the formulation that more persistent inflationary pressures have begun to "crystalise" for the first time. The main reasons are sticky wage growth and –not independently – service price inflation which is expected to remain elevated. Annual private sector regular pay growth (+7% in the 3 months prior to May) came in materially above the May report expectations. Services price inflation is forecast to remain elevated. Nevertheless, the MPC sees inflation at 5% by the end of the year, due to lower energy and to some extent receding food and core goods prices. Food prices have been a major driver of inflation, with a rate still staying just below 15% yoy.

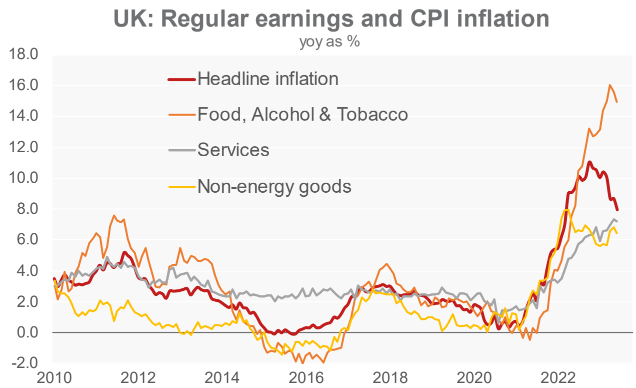
The higher persistence of inflation is coherent with an upward revision in the model results. In Q4 2025, the market mode inflation rate (which assumes Bank Rate to develop as market's forecast) has risen to 1.6%, up from the May result of 1%, despite a higher market Bank Rate expectation. At the same time, the mean forecasts were revised down, showing that Bank has incorporated some of the upside risks.[1] The model results imply a BoE inflation forecast of 7.7% this year and 3.25% in the next. While the BoE's and our forecast for this year are identical (vs consensus 7.4%), the BoE's 2024 forecast is materially higher than ours (2.7%).

As a consequence of that materially higher forecasts, the BoE will make sure that Bank Rate is “sufficiently restrictive for sufficiently long to return inflation to the 2% target”. At the same time, the central bank already considers its current policy stance as restrictive. While acknowledging that GDP growth held up better that previously expected, it nevertheless revised growth down 0.5% in 2024 (from +0.75%) and to 0.25% in 2025 (from 0.75%). We are still more pessimistic for this year and expect a stagnation.

All in, we see the MPC’s stressing of inflation persistence as indication that the bank is willing to continue hiking. We currently expect a peak rate of 5.75% which could be kept at least until mid-2024.



Source: Datastream, GIAM calculations



Source: Datastream, GIAM calculations

[1] For an explanation, see BoE [Monetary Policy Report August 2023](): “The modal projection is the single most likely outcome. If the risks are symmetrically distributed around this central view, this will also provide a view of the average outcome or mean forecast. But when the risks are skewed, as in the current forecast, the mean projection will differ from the mode.”