

Bank of England delivers a cautious hike

The Bank of England has raised its Bank Rate to 0.75% today but the tone has turned more cautious. The energy shock will accentuate both the inflation peak and its subsequent decline. This will help front-end sterling rates decline, and long-end rates tighten relative to USD peers. GBP has sold off and looks more vulnerable against the dollar



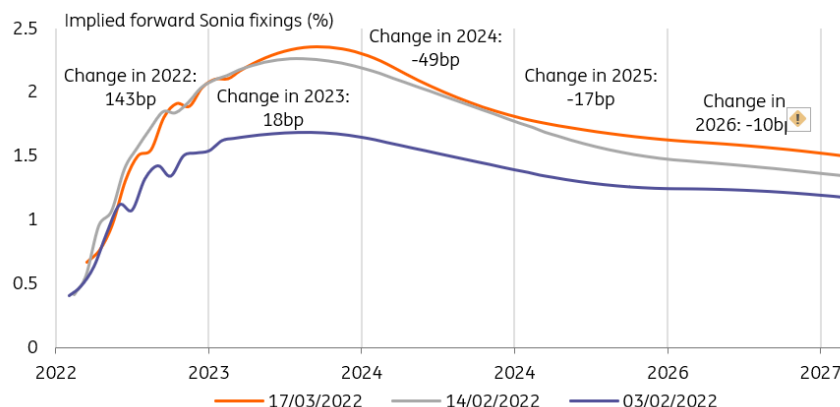
Governor of the Bank of England Andrew Bailey, London

Source: Shutterstock

A cautious hike and a of lot of question marks

As was widely expected, the BoE hiked the Bank Rate by 25bp today to 0.75%. The committee voted 8-1 in favour of the hike with one dissenter preferring no change. This is a more dovish split than the four members voting in favour of a 50bp hike at the February meeting. The change seems to be motivated by the war in Ukraine, which is likely to accentuate both the near-term inflation peak (to around 8% in April, and potentially even higher later this year), but also its subsequent drop. Like in the previous meeting, the MPC said 'some modest further tightening in monetary policy may be appropriate' in the coming months but noted risks on both sides.

Sonia swaps anticipated six more hikes this year prior to this meeting



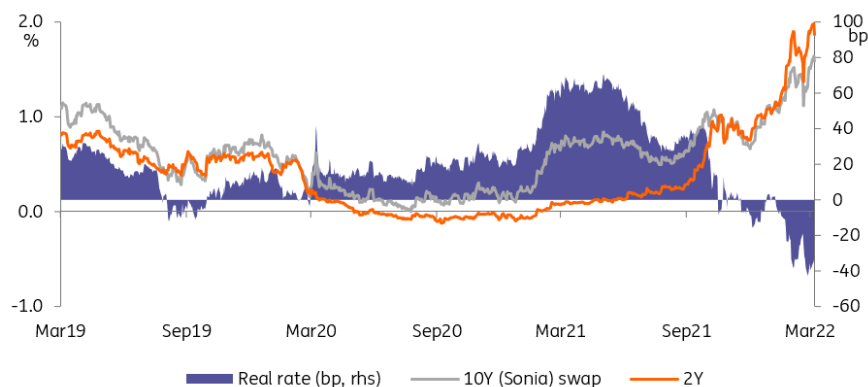
The UK economy is facing an energy shock that will dent disposable income

Regarding future moves, we have a fourth hike pencilled in for May but there is a good chance of a pause after that. One reason is that active gilt sales should begin after the Bank Rate reaches 1%, arguing for a more cautious hiking process as markets deal with the unprecedented policy. The other reason is growth. The UK economy is facing an energy shock that will dent disposable incomes. This has to be weighed against higher inflation. We expect it to peak at 8% in April. After that peak, we expect less pressure on the BoE to stay hawkish.

Downside to front-end rates, and relative to USD

Our view of only one more hike this year contrasts with market expectations of five more hikes this year prior to today's dovish surprise. [We think this is excessive and expected some form of pushback](#) from the committee. This has materialised in the form of the BoE signalling that inflation would fall below the 2% target within the forecast horizon premised on current market hike pricing. We expect the front-end to come down after today's decision, as the market reassesses the BoE's reaction function.

An inverted swap curve shows the market shares the BoE's caution



Source: Refinitiv, ING

The committee didn't update its policy on 'passive' [quantitative tightening](#), ie passive balance sheet reduction by not reinvesting the proceeds of gilts maturing in its existing portfolio. Neither did it mention active sales of gilts.

We expect 10Y sterling rates to tighten relative to their dollar peers

The inversion of the GBP swap curve is a sure sign that markets share our scepticism, even if most think the current inflation surge will require the BoE to tighten above what would be considered to be a neutral level for the economy. For now, gilt yields and swap rates are set to rise, alongside their developed market peers. Taking into account excessive market expectations for tightening, and a subdued economic outlook, we think we're closer to the end of the adjustment higher in rates than to its start, and expect 10Y sterling rates to tighten relative to their dollar peers after the Fed showed it has far fewer qualms about tightening.

FX: GBP softens, but no knock-out blow

Sterling has sold off close to 1 % against the dollar after today's cautiously dovish BoE hike. Going into the decision, GBP had been at its highs – perhaps fearing some further hawkish dissent from the consensus 25bp hike. Dissent arrived, but it turned out to be dovish with the BoE's Jon Cunliffe understandably concerned about the impact on real incomes following another energy shock.

One standout is that the BoE is being far more cautious than the Fed last night. That is a reminder that the UK, like Europe, is an energy importer and more susceptible to events in Ukraine. With the US more exposed to demand-driven inflation, a confident Fed should keep the dollar in the ascendency. We see a greater risk of GBP/USD trading 1.28 than 1.34 over the coming weeks.

Against the euro, however, GBP weakness should be more contained. This is the case because the same factors restraining BoE hawkishness will be playing out across continental Europe, too. And

at least the BoE has already now delivered three hikes. We, therefore, see the EUR/GBP upside as more limited and do not see a strong case for it sustaining gains above the 0.8450/70 area. Indeed, focusing on a further BoE rate hike on 5 May, a time when UK CPI will be pushing to the 8% area, could see EUR/GBP trading back down to the 0.83 area.

Author

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.