Bank of England hikes more aggressively following shock inflation data

Consistent inflation surprises convinced the BoE to hike by 50 basis points this month, and it now seems unlikely that the committee will be content with hiking only once more in August. We're tempted to say that today's 50bp move won't become a new trend, but two further 25bp hikes seem like the most likely route after today's meeting

The Monetary Policy Committee voted by a majority of 7-2 to increase Bank Rate to 5%

Bank of England surprises markets – and there are more hikes to come

The Bank of England has surprised markets with a 50 basis point rate hike, following a series of smaller moves this year. It seems that the most recent inflation figure – which crucially saw a big spike in services inflation – as well as the pick-up in wage growth, was enough to tempt the committee into acting more aggressively.

Unsurprisingly, the Bank hasn't offered up many – or really any – hints on what might come next, though of course markets think subsequent hikes could take rates to 6% from today's 5% level. It was always quite unlikely that the Bank would pre-commit to any particular course, or push back against market pricing, given the recent tendency of inflation to overshoot expectations.

But even if the Bank hasn't offered up any new guidance, the rate decision itself is revealing. BoE policymakers are always keen to stress they don't take decisions on future rate hikes in advance. Still, they will be acutely aware that investors will read the decision to hike by 50bp today as an implicit endorsement of market pricing for the rest of this year.

We doubt that's entirely true in reality, but equally it seems unlikely that the committee will be content with hiking only once more in August.

> *Two further 25bp hikes seem like the most likely route after today's meeting*

Reading through the meeting minutes, it seems as though policymakers are now squarely focused on actual inflation prints, whereas at previous meetings there was perhaps greater emphasis on a broader range of inflation surveys/forward-looking indicators.

Many of those still suggest inflation should begin to ease more noticeably through the second half of this year. The Bank of England's own survey of CFOs has been pointing to more muted price and wage rises over the coming months, while producer price inflation has eased considerably. We also think some of the recent stickiness in services inflation is a lagged impact of higher energy prices, and we should see some of that ease off through the remainder of this year.

But it's clear that until we begin to see some improvement in the official inflation statistics, the committee won't be content with pausing. We're tempted to say that today's 50bp move won't become a new trend, but two further 25bp hikes seem like the most likely route after today's meeting.

Very inverted yield curve may help the pound

Sterling initially jumped on the larger-than-expected rate hike only to fall back again – presumably on views that the BoE is ready to engineer a harder slow-down to get inflation under control. One could argue that as a growth-sensitive currency, this is all bad news for the pound.

However, sterling overnight rates at 5.00% will now be high by reserve currency standards – making sterling an expensive sell. And the sharply inverted UK yield curve makes it even more expensive for foreign investors in the UK Gilt market to hedge currency exposure. Foreign bond investors lowering FX hedge ratios could prove a net sterling positive.

In the back of our minds as well, we recall how well the dollar performed in the 1980s on the back of inverted yield curves – even though the US economy went into recession. On balance then we are happy with our year-end GBP/USD forecast for 1.33 (largely on the back of dollar weakness), and today's large BoE hike – and the promise of more – probably delays a return in EUR/GBP to the 0.88 area.

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