

## The Bank of England not quite as dovish as expected

No change from the Bank of England this Thursday but sterling and UK market interest rates nudged higher after two members of the Monetary Policy Committee continued to vote for a 25bp rate hike. Like many other central banks, the BoE awaits further evidence of disinflation before cutting rates. Our house view remains for a first cut in August



Bank of England Governor, Andrew Bailey, at Thursday's media briefing

### BoE drops its tightening bias

Heading into today's Bank of England MPC meeting, the market had been leaning towards a dovish outcome. The consensus seemed to have been that the three hawks voting for a 25bp rate hike in December would relent. Additionally, this would be the first major BoE communication of the year, and it would be the first opportunity for the BoE – like other central banks – to welcome disinflation trends and perhaps even talk about rate cuts.

Instead, two of the hawks, Catherine Mann and Jonathan Haskel, continued to vote for a 25bp rate hike – a move only partially offset by Swati Dhingra, who is now voting for a rate cut. Additionally, even though the BoE said it would keep under review how long the policy rate would need to stay in restrictive territory, the tone of the statement maintained the BoE's concern over the

persistence of inflation given that lower market interest rates would see slightly higher growth than was expected back in November.

At the same time, the Bank's forecast for inflation – largely above the 2% target for much of the forecast horizon – pushes back against those expectations for an early rate cut. In effect, the Bank is making clear it needs more time and more evidence that the disinflation trend is a true one before it is prepared to firmly step into dovish territory.

As is very much the case elsewhere in the world, the Bank's path for policy will be very data-dependent as the Bank continues to focus on the labour market, wage growth and services price inflation. We think there will be [more evidence of this through the second quarter](#) and that, ultimately, the Bank will have enough information this summer to start an easing cycle in August. This is slightly later than the market and the Bank's survey respondents, who favour June as the start of the easing cycle.

## Market reaction: Rates back up and sterling edges higher

Money markets shaved off 3-4bp of its pricing for the May meeting so that the implied probability of a first rate cut then now stands at around 50%, down from more than 60%. That puts it back to where we were around the middle of last week. June pricing was pared, but a cut by this date remains more than fully discounted. The discount over the entire year did nudge up a bit, but it remains above 100bp of easing.

The slight bear flattening of the money market curve also translated into a bear flattening of the gilt curve by around 3bp after the BoE decision, pushing it to its most inverted for this year. The 10Y nudged back above 3.8%. It had tracked wider developed markets lower over the past few days, even slightly outperforming Bunds. But this merely returned the 10Y Gilt Bund spread to the average since October last year. Our base case remains that this spread tightening should have further to run, near term also premised on the view that pricing for the ECB is too aggressive but remains more balanced for the BoE.

Sterling has ticked higher in response to the less-than-dovish statement. We doubt it needs to embark on a major rally, however, given that we think UK inflation will ultimately play catch-up with the disinflation trends seen in the US and the Eurozone. We think EUR/GBP can probably trace out a 0.85-0.87 range over the coming months, while a strong dollar environment can keep GBP/USD near the 1.26/27 region this quarter.

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