Four scenarios for the Bank of England's February meeting

We expect a 25 basis-point rate hike next Thursday, and that will kick-start the process of 'quantitative tightening'. Markets are still overestimating the likely amount of tightening required this year, but we expect minimal pushback from the Bank against these investor expectations

Bank of England

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	Bank of England actions/comments			
	Decision	Growth/inflation	Future tightening	Market impact
1	**No rate hike** Unanimous decision	Concerns that Omicron has materially altered growth path. Signs of earlier supply chain recovery	Rate hike still likely, but hints clearly that market expectations are too aggressive	EUR/GBP: **0.8500** 10Y yield: **1.1%**
2	**No rate hike** Split decision	Lifts inflation forecasts but opts to gather more data on Omicron before acting again	Signals clearly that a rate hike is likely at the March meeting assuming economic data is as expected	EUR/GBP: **0.8450** 10Y yield: **1.2%**
3 (ING base case)	**25bp rate hike** 8-1 vote in favour	Medium-term growth unaffected by Omicron. Raises inflation forecast on higher gas prices. Jobs market tight	More 'modest' hikes coming, but vague about when. Quantitative tightening begins (by ending reinvestments)	EUR/GBP: **0.8300** 10Y yield: **1.3%**
4	**25bp rate hike** Unanimous decision	Omicron unlikely to derail UK recovery. Inflation risks have risen since last meeting	Explicitly signals another hike in March/May. Signals clear desire to accelerate QT via bond sales in coming months	EUR/GBP: **0.8250** 10Y yield: **1.5%**

? Will the Bank of England hike at this meeting?

Most likely, yes.

If December's surprise rate hike decision taught us anything, it was, firstly, that the Bank – and especially Governor Andrew Bailey – is clearly worried about elevated rates of headline inflation and the risk of a virtuous wage-price cycle. New forecasts showing both a higher inflation peak and a more gradual down-trend will only amplify those concerns.

Secondly, December's decision – taken when Omicron was very much in its ascendancy – signalled that the committee is no longer fazed by Covid-19. Policymakers posited that the medium-term outlook is unlikely to change due to Omicron, and most of the early data suggest they were right.

True, one lesson from November's surprise on-hold decision was that policymakers are not afraid to wait when much greater clarity will be available within weeks. Back then the Bank of England (BoE) paused to get more jobs market data, and the same logic could apply to Omicron.

But the high-frequency data points to a modest and short-lived impact, and that makes a 25bp rate hike likely at Thursday's meeting.

? How many policymakers will vote for a hike – will it be virtually unanimous?

December's rate hike was almost a unanimous decision, a detail that was arguably much more surprising than the rate hike itself. Only Silvana Tenreyro, the most dovish member of the committee, voted to keep rates on hold.

We expect another 8-1 vote on Thursday, though there's not much recent commentary to go on. Officials have been unusually quiet since the last meeting. But silence often speaks louder than words, and we can probably surmise that most policymakers are comfortable with markets pricing in a February move.

If we're wrong though, and we get a more divided vote, then that should act as a warning for investors. We think we're likely to see more visible disagreement on rate hikes as the year goes on. And note that two BoE hawks – Dave Ramsden and Michael Saunders –see their terms expire in the third quarter of this year, unless extended.

In short, an aggressive tightening cycle may struggle to command enough support from the committee.

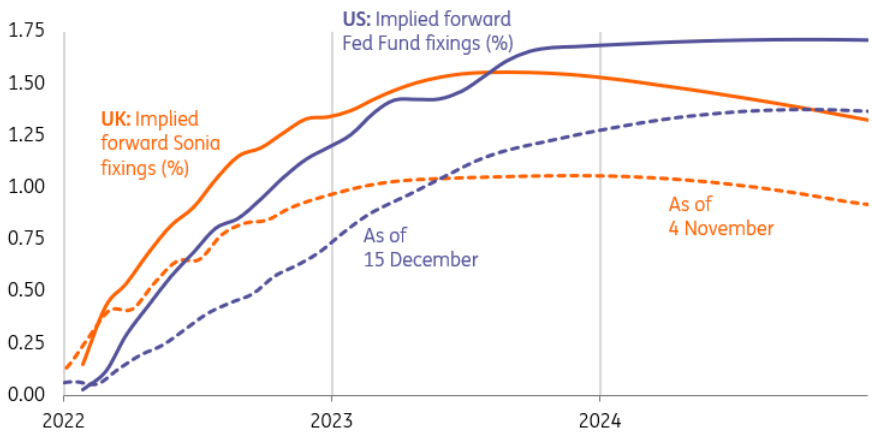
? Will the Bank kick-start quantitative tightening immediately?

Yes. The BoE has said it will stop reinvestments of maturing bonds in its quantitative easing (QE) portfolio when the Bank rate hits 0.5%, which is where we'll be at this meeting assuming there is a hike.

Governor Bailey noted recently that this early phase of quantitative tightening (QT) is unlikely to have a huge impact – in the same way the latter stages of QE didn't either – and that the Bank "certainly cannot rely on it".

That suggests that QT will start before March, which is when a sizable quantity of gilts are due to mature. And it also implies the Bank doesn't view the policy as a rate hike substitute, at least in the near term.

Market expectations: Bank of England vs Federal Reserve



Source: Refinitiv, ING Rates Strategy Team

? Will the Bank hint at a more gradual rate hike path ahead?

In practice, the five rate hikes now being priced in by financial markets for this year sounds like too much. We expect two, or maybe three.

But even if the Bank quietly agrees, we doubt it will say so. By pricing a steep rate hike path, markets are effectively providing the BoE with the inflation protection it is looking for.

That said, watch out for hints in the Bank's forecasts that it thinks market pricing has gone too far. These projections are based on the latest swaps curve, which has shifted higher since November's publication. All else being equal, that would increase 'excess supply' in a couple of years time, which in central bank speak means that less tightening is likely to be needed to achieve the Bank's goals.

But there are some potential offsetting factors. The Bank may well upgrade its wage growth forecast. And the inflation projections are likely to go up too, though that's partly down to a technical assumption that gas prices will remain fixed beyond six months (when in practice they are more likely to fall back).

In short, expect the Bank to keep the door firmly open to further tightening, without committing itself to any specific path.

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