A hawkish Bank of England raises rates and there's surely more to come

The fact that four out of nine Bank of England rate-setters voted for a 50bp rate rise at the February meeting shows that policymakers are keen to act pre-emptively amid high headline inflation rates. We now expect further rate rises in March and May

Governor of the the Bank of England, Andrew Bailey

The Bank of England hikes rates and signals more to come

Anything the Fed can do, the Bank of England can do better.

That's the central takeaway from the BoE's February meeting. Not only did policymakers hike rates to 0.5%, kick-starting the process of balance sheet reduction, but four out of a total of nine MPC members voted for a larger, 50 basis-point rate rise at this meeting.

It's clear that the Bank sees a need to act pre-emptively, and build a strong hedge against the risk of the current high inflation rates becoming embedded. We strongly suspect that today's rate rise will be followed by more at both the March and May meetings. Importantly, we don't think the initial phases of the Bank's quantitative tightening programme, which by ending reinvestments will see a modest £25bn roll-off the balance sheet, will stop the Bank from implementing further rate rises in the near term.

We suspect markets may still be overestimating the likely tightening required

But what happens thereafter is still pretty uncertain. Today's hawkish decision will only cement market expectations for around five rate hikes this year. But we still think the risks are biased towards a less aggressive tightening path.

And if you look closely enough, there are hints of this view in the Bank's new forecasts. These are based on the latest market pricing, and show a larger output gap (or excess supply as the BoE calls it) towards the end of its policy horizon, with unemployment ticking higher. Inflation is also forecast to be below slightly below target.

Admittedly we need to take these projections with a slight pinch of salt, given they are premised on the unlikely assumption that gas prices stay fixed at unusually high levels. But they could still be read as a subtle sign that policymakers think a little less tightening will be required.

> *We think that the Bank may pause for thought when rates reach 1%*

We also think that the Bank may pause for thought when rates reach 1%. At this point, policymakers have said they will "consider" actively selling government bonds to speed up the process of shrinking its balance sheet. Needless to say, this is uncharted territory for any developed market central bank and could prove to be considerably more challenging than simply ending reinvestments – not least if the Bank finds itself selling into a period of market turbulence.

Even though any sales may initially be in low volumes, we suspect policymakers may still opt to pause rate hikes to monitor the impact. We also suspect the BoE may become a little more relaxed about the risks surrounding inflation as the year moves on and Bank rate moves higher.

For now, we think the Bank will hike two further times this year in March and May.

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