# Rates Spark: Markets may take time to reflect BoE caution

No question, an aggressive Fed tightening sets the tone globally. A 50bp hike delivered and signals of more to come also raise expectations for today's Bank of England meeting. A 25bp hike looks more likely as the Bank navigates a narrow path between growth and inflation

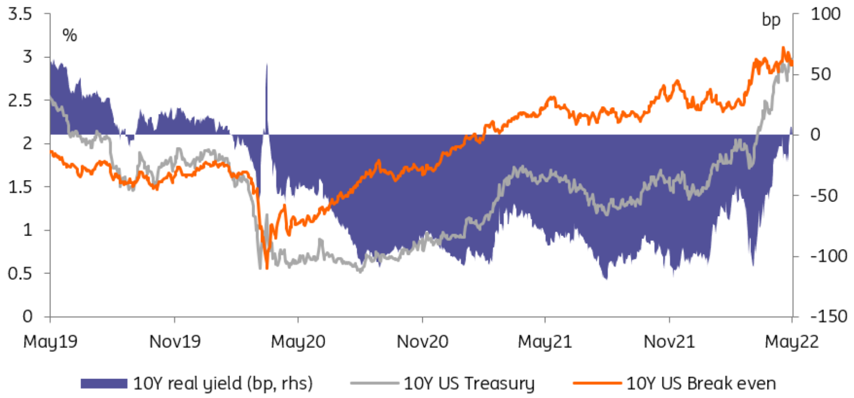

We expect the Bank of England to cut rates by 25 basis points

## The Fed hikes 50bp and signals more to come

The Fed has hiked 50bp and is formally starting quantitative tightening as it seeks to get a grip on inflation. The Fed also acknowledges that "ongoing increases" will be required, although the market repriced lower on Fed Chair Powell's comments that a 75bp increase was not something the FOMC was actively considering.

While the Fed likely won't admit it, we're convinced they will be taking a close look at the impact on long run inflation expectations post the FOMC. Currently in the 2.8% area, the 10yr inflation expectation is just about tolerably below a 3% handle. The Fed would like to keep it that way. Ideally the 10yr inflation expectation would trend back down to the 2.5% area. That would imply that the Fed has control of expectations. The risk, however, is for inflation expectations to break above 3%. Should that occur, the case for a 75bp hike in June would build. The immediate reaction has been muted, on both real rates and inflation expectations, but we need to continue to monitor this important space.

## The FOMC will be mindful of 10Y inflation expectations not rising above 3%




Source: Refinitiv, ING

*Material impact on repo is a number of quarters away*

The repo market has struggled with market conditions that are to a significant extent a legacy of the Fed's bond buying programme. The market has been left with an excess of liquidity over available collateral, pushing down on repo rates, and making it difficult to compete with the 30bp on offer at the Fed's reverse repo window. While strong tax receipts are exacerbating this through less bills issuance, the sooner the Fed rolls off a chunk of its balance sheet the better from a repo market perspective. Here there has been mixed news, with a USD95bn per month roll-off confirmed, but starting at a more gradual space. Based off this, material impact on repo is a number of quarters away.

## BoE to follow the Fed, but with more hints of caution

The BoE will almost certainly also hike its key interest rate today - by 25bp we reckon although the market does see a small probability of a larger move today following the Fed's lead. More importantly though the BoE should strike more cautious tones – not least as it has the advantage of already having three hikes under its belt. We will be looking in the usual spots for hints of that caution:

- The new forecasts should show that the growth-inflation trade-off has only increased in recent weeks. Like February, our economist also expects the BoE to project a rise in unemployment over coming years.
- A growing group of no-change votes within the Monetary Policy Committee would be the clearest signal of more caution, though here our economist suspects that we will see another 8-1 in favour of a hike today.
- Finally, the BoE had previously signaled that it would consider actively selling Gilts back to

the market from its Quantitative Easing portfolio once the key rate reached 1%. This should be reached today, but we argued that poor market liquidity and elevated volatility suggest the committee is more likely to hold off for now and wait for conditions to improve before starting active sales. We expect the Bank to keep its Quantitative Tightening policy under review next week without laying out a firm timeline for starting sales. But it may already lay out a few extra details of how the policy could work in practice.

## We think BoE hike expectations are heavily influenced by the Fed


Source: Refinitiv, ING

So far the BoE's caution and admittedly mild pushback against aggressive market pricing has left little traces. The March meeting had resulted in a brief dovish reaction, but since then SONIA OIS fowards have risen further and now show a market looking for the Bank to hike rates to at least 2.5% within the timespan of one year. One can only explain this by the global context of an ever more aggressive charge of central banks led by the Fed.

While it may take time for GBP front end rates to assume (in our view) more realistic pricing, we have already seen Gilts start to outperform more noticably versus US Treasuries and also German Bunds. That trend may well continue for now.

## Today's events and market view

Main event today is the BoE meeting where we look for a 25bp hike, accompanied by more cautious tones surrounding the macro outlook. The market's reaction could well be a dovish one, similar to last March's meeting.

In the end, such a dovish push may prove short-lived again given global monetary policy is still turning more hawkish. The ECB is increasingly shifting towards an earlier July hike as suggested recently by comments from council members Schnabel and Mueller. Today we will be hearing from ECB's Lane, representing the dovish camp which has been rather quiet of late, as well as from arch-hawk Holzmann.

Sizeable Eurozone government bond supply today comes from France and Spain. France re-opens 10- to 30-year bonds for up to €11bn, Spain re-opens 5- to 50-year bonds plus an inflation linked bonds for a total of up to €5.75bn.

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