We (still) don't expect the Bank of England to hike rates

We're sticking to our call for the Bank of England to keep rates on hold this year, in contrast to our forecast for an ECB rate hike in June. A weaker jobs market, tighter fiscal policy and a more restrictive starting point for interest rates set a higher bar for monetary tightening

Bank of England Governor Andrew Bailey

No, the UK is not more vulnerable to the coming inflation shock

Financial markets are still applying the 2022 playbook to the Bank of England. The scale of repricing in interest rate expectations has been more dramatic than either the eurozone or the US. The implied UK rate one year from now has risen a full percentage point since the onset of war, and investors are still pricing close to two hikes by year-end.

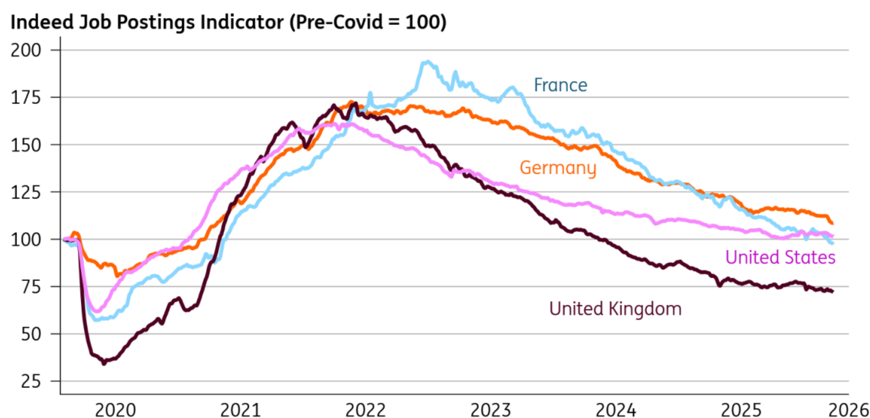
That seems to imply that the UK is facing a more severe inflation shock than elsewhere. We disagree. That may have been true in 2022. And Britain may be a major energy importer. But its dependency is on natural gas. And fortunately, this is not yet a natural gas crisis. Wholesale prices are still a fraction of where they traded in the fallout of the Ukraine invasion.

Based on ING's updated energy price forecasts, we think inflation is set to rise to 3% through May/June and bounce between 3.5-4% from July onwards. That's virtually identical to our new

eurozone inflation predictions. And if anything, the UK may be less exposed to the second-round inflationary effects that keep central bankers up at night.

The jobs market is weaker than in much of Europe, judging by vacancy data, thanks to the effects of last year's tax rises. Those increases had minimal impact on inflation but a notable impact on hiring. It's a reminder that firms have much less pricing power than they did in 2022. Likewise, workers don't have nearly as much power to demand higher pay. Wage growth has already fallen sharply in recent months. Unemployment is set to rise further.

The UK jobs market looks weaker than in the eurozone



Source: Macrobond, ING

We're still not convinced the Bank will hike rates

Fiscal policy is also getting tighter. The structural deficit is still set to fall this year thanks to the freeze in income tax brackets. That's in contrast to the post-pandemic period, but also Germany and its neighbouring economies, which are set to benefit from the wave of infrastructure spending coming online this year. Universal energy bill support looks unlikely.

The other major difference is that Bank of England interest rates are still widely seen as restrictive. The nominal neutral rate – a rate neither expansionary nor restrictive for the economy – is seen around 2.5-3%. Again, that's a difference with the ECB, where its 2% deposit rate is largely seen as neutral. The centre of gravity is still down, if anything; remember the Bank of England was on the verge of cutting rates further before the war began.

Finally, the Bank of England itself has begun to strike a different tone to its continental neighbours. Governor Bailey recently made a rare and not-so-subtle intervention on market pricing, saying investors were "getting ahead of themselves" in pricing hikes.

We took this to mean an April rate hike is highly unlikely. We're sticking with our call for the Bank to keep rates on hold this year. This marks a small divergence with the ECB, from which our team now expects a hike in June.

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