BoE Preview: May 2022

Statement/Minutes release: 12:00BST, Thursday 5 May
Summary/Minutes: https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2022/may-2022
Monetary Policy Report:
https://www.bankofengland.co.uk/monetary-policy-report/2022/may-2022
Press conference: 12:30BST

Contents

MNI View: 25bp Now, What Next?

Tim Davis, 3 May

Along with every analyst preview that we have read, the MNI Markets team expects a 25bp hike this week. Markets are pricing in just under 31bp for the meeting, which if at least a 25bp hike is assumed, equates to just over a 20% probability of a 50bp hike. Since the March meeting, market pricing has stayed relatively stable in a 24-33bp range (with a brief spike up to around 40bp around Catherine Mann's hawkish comments).

Recent data and MPC Comments

Since the March meeting we have once again seen another couple of upside surprises to CPI (the February and March prints). Labour market data has been largely in line with expectations (including pay data) but consumer confidence has fallen more than expected in the latest survey. We have heard from four MPC members since the last meeting on the subject of monetary policy. Broadbent was non-committal, leaving the door open to every avenue while making the point that market participants would be better served analysing the data themselves to decide what they thought the appropriate rate path was rather than to be fixated on every single word a central banker says. Cunliffe still sounded dovish (as would be expected from the only member in March to vote to keep Bank Rate unchanged. Mann was particularly hawkish and in our view was weighing up whether to vote for a 25bp or 50bp increase in Bank Rate. Although note that she has been one of the most hawkish members for some months now – dissenting in favour of a 50bp hike in February and to end asset purchases early in November.

Governor Bailey's comments have been most interesting, however. Late in March he was asked whether market pricing was appropriate and said that "it's complicated" and stated that there was a tight labour market with the vacancy to unemployment ratio high but that there was a big shock coming down the line. He has reiterated the importance of this real income shock in more recent speeches and raised the question of whether this would ease the tightness in the labour market. His most recent comments at the IMF concerned gilt sales, as he said that the Bank would not conduct active gilt sales "in a period of very fragile markets".

Gilt Sales: Don't expect them now, but we don't rule them out

Liquidity in the gilt market has been reduced for some time, and volatility has been relatively high so some have taken Bailey's comments as an indication that gilt sales will not be announced at this week's meeting. Recall that the Bank's guidance on QT was that when Bank Rate reaches 1.00% (which it will this week with a 25bp hike) that the Bank would consider actively selling gilts. However, unlike the passive QT decision which came into effect when the Bank Rate reached 0.50%, this wording is much, much looser. Using previous language from the Bank, it is probably best described as a necessary but not necessarily sufficient condition to begin gilt sales.

The MNI Markets team is cautious about reading too much into Governor Bailey's comments last week, particularly as he made no specific references to the upcoming meeting and markets have made the mistake of reading too much into his comments as recently as November. As we noted above there is indeed a lack of liquidity but we would not necessarily describe the gilt market as "fragile". At least, not any more fragile than it is likely to be in a few months time.

We do, however, see reasons to wait. With the outlook for the economy still very uncertain and the increase in the energy price cap and national insurance coming into effect at the beginning of April in our view it would be worth waiting to see at least some hard data and an extra forecast round in August and analysing how well the economy is holding up before determining the pace of gilt sales. We think that when the pace is set, the Bank will probably want to leave it for some months to assess the impact before tweaking it, so the initial pace is important in our view. We think that the Bank this week will point towards further details being provided at the August meeting, but given Bailey's prevailing view that the balance sheet should be shrunk in the good times, we wouldn't rule out an announcement of gilt sales on a small scale this week.

Forecasts: CPI forecasts would be below 2% purely by rolling forward

Looking at February in the MPR, the 2/3-year ahead modal CPI forecasts under market rates were 2.15% and 1.60% respectively (2.23% and 1.67% median). However, as these forecasts will be rolled forward one quarter it is important to note that the CPI forecast for Q2-24 (which will be 2-years ahead in the May forecasts) was 1.89% for the mode and 1.97% for the median. We have seen lots of discussions about how the forecasts will be revised below 2% at the 2-year horizon, but those forecasts will already be below 2% with no revision. Given the additional hikes that will be in the market curve that the Bank uses, how far below 2% these forecasts go is the more significant question. We think that a downgrade to 1.75% or lower would be a clear signal to the market that the market is pricing in too many hikes. Any downgrade less significant than that would likely in itself not see huge moves – with the rationale being that inflation at 1.75% is still more than manageable by the BoE (and can be sorted by 1-2 cuts in the future if needed) but inflation expectations in the near-term require further action.

Guidance is key: Will "coming months" remain?

Recall that at the March meeting there were two notable changes to the guidance: The Bank still used the wording "further modest tightening in monetary policy" but rather than saying "was likely to be appropriate" it said "may be appropriate". This is still contingent on the "coming months". But the additional caveat is added that "there are risks on both sides of that judgement depending on how medium-term prospects for inflation evolve."

This is already a fairly highly caveated statement and there is a good chance in our view that it remains intact at this meeting. However, if the Bank did want to dial back its guidance somewhat it would remove the time contingency surrounding "the coming months". This would likely see a decent repricing of rate expectations as it would seemingly remove the urgency that from the guidance, and would be the easiest way the Bank could temper market expectations of future hikes, in our view.

Vote split

We expect Cunliffe to continue to vote to keep rates on hold (given the focus of his recent speech, we don't see any compelling arguments that would convince him to vote to raise rates now, when rates are already higher than when he last voted against a rate hike). We also see a good chance that either Mann or Saunders or both vote for a 50bp hike.

Market reaction

At the time of writing, markets are pricing in 31bp for May, 64bp by June, 98bp by August and 122bp by September (so roughly 30bp per meeting for the next four meetings which cumulatively almost mean that one 50bp hike will be required in the period to satisfy expectations). The curve then flattens somewhat with a further 36bp priced by the December meeting and 22bp by the March 2023 meeting. This leaves markets fully pricing over 150bp of hikes this year and a further 25bp hike by March 2023.

We think that the biggest thing that could impact market pricing would be the removal of "coming months" from the forward guidance. Even with a 50bp hike if this guidance was removed the pace of hikes in the future would likely be reduced, so there may still be a move higher in Red SONIA futures and a move lower in 2-year yields. We don't really see much probability of a hawkish shift in the forward guidance, so the main risks seem to be for a more dovish market reaction.

Without a change in the guidance, a 50bp hike would be hawkish, even if it is accompanied by a wafer thin majority. Conversely, if there are more than 2 MPC members voting for rates to remain on hold (with Cunliffe and probably Tenreyro joined by one other) this would likely see a dovish reaction.

mni Central Bank Watch - Bank of England

May 03, 2022

MNI Bank of England Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	7.0	5.4	↑	3.1	↑					2.19
Core CPI	% y/y	5.7	4.2	↑	2.9	↑					1.61
PPI Output	% y/y	-1.3	-0.9	↓	-0.7	↓					-1.00
Inflation Swap 5y/5y	%	4.07	3.96	↑	3.76	↑					1.56
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
PMI Manufacturing	Index	55.8	57.3	↓	57.8	↓					-0.15
PMI Services	Index	58.3	54.1	↑	59.1	↓					0.17
Manufacturing Production	% y/y	3.6	0.3	↑	4.5	↓					0.05
Index of Services	% 3m/3m	0.8	1.5	↓	2.7	↓					-0.85
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Consumer Credit	GBP Bn	1.88	1.17	↑	0.75	↑					1.13
Mortgage Approvals	K	70.99	67.65	↑	73.93	↓					-0.20
Lending Sec on Dwellings	GBP Bn	4.67	4.10	↑	5.00	↓					0.18
Nationwide House Prices	% y/y	12.1	11.2	↑	9.9	↑					0.50
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales Inc Petrol	% y/y	0.9	-1.6	↑	-0.7	↑					-0.19
Consumer Confidence	Index	-38.0	-19.0	↓	-17.0	↓					-1.80
Employment Chge 3m/3m	K	10.0	60.0	↓	235.0	↓					-0.83
Ave Weekly Earnings 3m	% y/y	5.4	4.2	↑	7.2	↓					-0.19
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market (All Share)	Index	4156	4192	↓	4129	↑					1.05
10-Year Gilt Yield	%	1.95	1.30	↑	1.03	↑					1.75
Gilt Curve (2s-10s)	bps	32.7	25.7	↑	32.4	↑					-0.25
GBP TWI	Index	80.20	82.35	↓	82.12	↓					-1.54

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

MNI Instant Answers

- Ahead of each policy meeting the MNI Markets team select a number of questions that should capture the essence of the central bank meeting in questions that can largely be answered either numerically or with a yes or no, and which represent all of the expected tradable possibilities.
- These questions will be published within the Preview document and 15 minutes before the announcement on both MNI Bullets and the interactive chat.
- We aim to publish the answers within a few seconds of the embargo being released via the MNI Bullets and our interactive chat.

Advantages

- No need to scroll through 30 newswire headlines.
- All of the tradable info you need delivered concisely straight to your bullet feed or the interactive chat.
- Gives you the confidence that you can quickly trade at the announcement time.

May Questions

1) Was the Bank Rate raised, and if so by how much?
2) Number of members voting for a 25bp hike?
3) Number of members voting for a 50bp hike (and who)?
4) Number of members voting for unchanged Bank Rate (and who)?
5) Did the MPC announce sales of gilts would start (and when)?
6) Did the MPC issue guidance, identical or very similar to, its March line that some further "modest tightening in monetary policy may be appropriate..."?
7) Was the guidance outlined in question 7 specified to take place “in the coming months”?
8) At what level and when does the Bank now expect CPI to peak?
9) UK CPI rate in two/three years' time at market rates (mode): X.XX%/X.XX%
10) UK CPI rate in two/three years' time on constant rates (mode): X.XX%/X.XX%
11) Does the bank forecast 2 consecutive quarters of negative growth in any period, and if so when?

Summary of Analyst Views

- All 22 analyst previews that we have read look for a 25bp hike this week.
- 9 of those analysts expect the subsequent hike to come in June, 11 expect it in August while two expect it to be the final hike of 2022.
- Views on the vote breakdown are more nuanced.
  - Out of 15 analysts, 10 see the only dissent to be for on hold. Of these 6-7 expect just one dissenter. Credit Suisse expects three votes for an unchanged rate this week.
  - Of the 5 who expect to see votes for 50bp, only Goldman Sachs and Rabobank expect more than one hawkish dissenter.
  - Bank of America is alone in explicitly expecting Cunliffe to vote for a hike.
- On QT, Danske Bank and Daiwa are alone in explicitly expecting gilt sales to be announced this week (although more see it as a risk). BofA and Citi also expect active gilt sales to begin before the August meeting.
  - Another 4/16 see a prospect of earlier than Q4-22.
  - Half of analysts (8/16) expect QT to begin in November 2022 or in 2023.
- In terms of the expected pace of active gilt sales, most analysts expect somewhere in the region of GBP2-5bln/month.
- 5 analysts now see cuts in their base case: Citi (50bp in 2023), BofA (cut in 2023), Daiwa (25bp in 2023), Deutsche Bank (50bp by end-2024), Goldman Sachs (25bp in Nov-24)
- Bank Rate at end 2022 (out of 19 analysts): The majority of analysts expect Bank Rate to end 2022 at either 1.25% or 1.50%.
  - SocGen look for 2.00% (5%)
  - 3 analysts for 1.75% (14%)
  - 7 analysts look for 1.50% (32%)
  - 9 analysts look for 1.25% (41%)
  - 2 analysts look for 1.00% (9%)
- Bank Rate at end 2023 (out of 18 analysts): Views are evenly distributed between 1.00-2.00% for the forecast of Bank Rates (with JP Morgan as the outlier).
  - JP Morgan look for 2.50% (6%)
  - 3 analysts expect 2.00% (17%)
  - 4 analysts expect 1.75% (22%)
  - 3 analysts expect 1.50% (17%)
  - 4 analysts expect 1.25% (22%)
  - 3 analysts expect 1.00% (17%)

Summary of Analyst Views (Sorted by Hawkish to Dovish); View changes in bold

Institution	Post-March meeting	Pre-May meeting
Société Générale	Mar22 too early to hike, Bank will be monitoring hit to real income. Expect 25bp hikes in May22, Aug22, Nov22. GBP60bln gilt sales programme announced when Bank Rate 1%.	**Increase in inflation has heightened urgency to tighten; look for 25bp hikes in each 2022 meeting (May22, Jun22, Aug22, Sep22, Nov22) but "difficult to justify" 2023 hikes.**
JP Morgan	25bp hikes in May22 and Aug22; risk of the latter coming in Jun22. Pause of several months after the Aug22 meeting to reassess slowdown but risk of MPC doing more.	**25bp hike; 8-1 vote (unch dissent). Risk of active QT this week; base case GBP2-3bln/mth from Nov22. Further 25bp hikes in Jun22, Aug22, Nov22, Feb23, May23, Aug23 to 2.50%.**
Goldman Sachs	Now look for back-to-back hikes in May22, Jun22, Aug22, Nov22, Q2-23 (to 2.00%). Do not expect asset sales to begin until the summer.	25bp hike with 3-5-1 split (3x50bp, 1xunch). 25bp hikes in Jun22, Aug22, Nov22, May23; 25bp cut in Nov24. QT announcement in May22 at pace of GBP20bln/quarter.
Bank of America	May22, Jun22, Aug22 and Nov22 hikes to 1.75% to combat rising inflation expectations. But expect a rate cut in 2023 as inflation's peak allows more focus on growth.	May22: 25bp hike 8-1 vote (50bp dissent) or 2-6-1 (2 for 50bp, 1 unch). Active QT at GBP5bln/month pace starting in Jun/Jul. Then 25bp in Jun22, Aug22, Nov22, cut in 2023.
Deutsche	Base case remains 25bp hikes in May22, Jun22, Aug22 and Feb23 to 1.75% but now see downside risks. QT later this year (from late summer). Rising risk of easing later next year.	25bp hike with 8-1 vote (unch dissent). QT announced Jun-Aug with GBP3.3bln/month sales from Sep. Further 25bp hikes in Jun22, Aug22, Feb23 then cut to 1.00% by end-24.
RBC	Maintain call that there will be just one more hike in 2022.	**25bp hike this with 8-1 vote (Cunliffe on hold). Consultation on gilt sales announced, to last 3-6 month, so no active sales before Q3. Further 25bp hikes in Jun22 and Aug22.**
Rabobank	Continue to look for 25bp hikes in May22, Jun22 and Aug22 before the BOE "pause and re-assess." "Lack of details" on QT suggest BOE may hold off until markets are calmer.	25bp hike in May22 with 2-3 votes for 50bp. Active gilt sales need a calmer market than now. Look for further 25bp hikes in Jun22 and Aug22 before pausing.
Nomura	Feel more comfortable with below-market forecast of May22, Aug22, Nov22 and Feb23 hikes with terminal rate of 1.75%.	25bp hike; 8-1 vote (unch dissent); risks of further dissent either way. Active gilt sales start early-23 (ann Nov22). Further 25bp hikes in Aug22, Nov22, Feb23, risk of Jun22.
Danske	Expect further 25bp hikes in May22, Aug22 and Nov22.	Continue to expect 25bp hikes in May22, Aug22 and Nov22 "but see risks skewed towards more rate hikes". Expect gilt sales to start in Q4-22 or Q1-23.
UBS	Expect final 25bp hike in May22 to 1% which "would mark the end of the hiking cycle." Risk of additional tightening later in the year if growth holds up and inf surprises to upside.	**Expect 25bp hike in May22 with potential votes for 50bp dependent upon the DMP survey. Further 25bp hikes in Aug22 and Sep22 to leave Bank Rate at 1.50%. Gilt sales in 2023.**
Citi		**25bp hike this week with 7-2 vote (2 votes for unch). QT now expected in Jun22 at a pace of GBP3bln/month. A further 50bp of hikes before pause. 50bp of cuts in 2023 (Aug and Nov).**
ING	Pencil in May22 hike but good chance of pause after that due to gilt sales, weakening growth and less pressure on the BOE after inflation has peaked in April.	**Expect 25bp hike in May22 with 8-1 vote (Cunliffe to prefer to stay on hold). Expect further 25bp hike in Jun22 before staying on hold for the remainder of the year.**
Credit Suisse	25bp hikes in May22 and Aug22 to leave Bank Rate at 1.25% at end-2022. Continued hikes in 2023.	25bp hike with 6-3 vote (3 prefer unch). Details on QT vague with active sales not starting until end-22/early-23. Further 25bp in Aug22 with further hikes in 2023.
Berenberg	The decision by the MPC to hike today suggests that the risks to our call are tilted towards a slightly higher year-end bank rate of 1.25%."	25bp with possibly more than just Cunliffe dovishly dissenting. QT unlikely this week, but will be no more than GBP1bln/week if announced. Further hikes: Q3-22, Q1-23, Q3-23.
BNP	25bp hikes in May22 and Aug22 before a pause as growth concerns bite; two hikes in 2023 when growth picks up. More details on gilt sales in May but more a 2023 story.	"Convincing majority" in favour of 25bp May hike, with next hike in Aug22 before "extended pause for the rest of the year." Gilt sales don't begin until 2023.
SEB	Continue to expect 25bp hikes in May22, Sep22, Feb23, Sep23 to bring Bank Rate to 1.75% by end-2023.	Look for 25bp hikes in May22, Aug22, Feb23 and Sep23 to bring Bank Rate to 1.75% by end-2023.
NatWest Markets	25bp hike in May22 and Aug22. Bank likely to pause in Jun22 as Bank Rate moves closer to neutral.	25bp hike with 7-2 vote (dissents for on hold). No numerical QT targets or firm dates this week. One further 25bp hike in Aug22 then on hold thourh Q1-24 (risk of 2 hikes in H1-23).
Pantheon	Continue to expect a final 25bp hike in May, but a "longer wait cannot be ruled out". Gilt sales to be announced in Aug22 to start in Q4-22 at a pace of GBP10bln/Q.	**25bp hike in May22 with 1-7-1 split. BOE wait until Aug22 to announce plans to sell gilts at GBP10bln/quarter, starting in Q4. Further 25bp hike in Q3-22 before on hold until end-23.**
UniCredit	Expect May22 and Aug22 hikes to take Bank Rate to 1.25% which UniCredit "expect to be the peak in this cycle" as concerns shift from inflation expctations to weak growth.	25bp hike this week with Cunliffe preferring unchanged rates. One more hike in this cycle in Aug22 to 1.25%.
Daiwa	Continue to expect 25bp hikes in May22 and Aug22 with active gilt sales announced in May22. If fiscal support eases impact of household prices, tightening might be smaller.	"The majority" to back 25bp hike this week and announce active gilt sales "for as long as the market is not disorderly." Further 25bp hike in Aug22 then 25bp cut in 2023.
TD Securities	Continue to expect May22 hike before "long pause" to Feb23 and Aug23. QT programme likely starts some time in H2-22.	25bp hike with 8-1 or 7-2 vote (dissents for no change). QT start date possibly announced in Aug22. Risk of Jun22 or Aug22 hikes but base case no further hike until Feb23.
Barclays	Continue to look for single 25bp hike in May22. After then, "meetings will have to be considered one at a time."	25bp hike with scope of a 1-7-1 split. No further hikes. Active QT to begin in 2023 at an initial pace of GBP20-25bln/year (higher if inflation is consistently above target).

Source: Analyst previews and MNI

Note: Sorted by next month to hike, then hikes this year, then 2023 outlooks

Analysts' Key Comments (A-Z)

Barclays: Last Hike of the Cycle

- Expect a 25bp hike and "see scope for a 1-7-1 split vote reflecting uncertainty around the policy outlook, with arguments made by some to lift rates faster and others to leave them at their current level."
- "We expect the narrative to shift away from "normalisation" rhetoric, with an increased focus on inflation expectations and business price strategies in the context of a succession of temporary inflationary shocks, creating the optics of a more permanent regime shift."
- **Forecasts:** "Expect growth for this year to be revised lower and inflation higher, with forecasts using market rates very likely to continue to show a noticeable undershoot in the back end of the BoE's forecasting window."
- **Barclays Outlook:** "Our central scenario is for rates to level off in May at 1% and for active QT to start early in 2023."
- "Expect active gilt sales of £20-25bn a year, beginning in H1 23… we do not expect QT to be a simple mirror-image of QE, where purchases were on a fixed schedule. But nothing is certain, and we think the pace of active sales could be increased if inflation were to remain consistently above target."

Berenberg: Question is whether anyone other than Cunliffe cotes for rates on hold

- Expect 25bp hike with the "question for this week is whether the rising risks to demand will motivate other policymakers to side with Cunliffe" [who voted for rates on hold in March].
- **QT:** "Unlikely (although not impossible) that the BoE will announce the start of active sales of gilts this week. In case the BoE does begin active gilt sales, it is likely to start very gradually – probably at a pace of no more than £1bn per week."
- "Amid plunging consumer confidence and evidence of a pullback in household demand, the move is not without risk, in our view... If we are unlucky, the UK is already in the early stage of a recession. Amid unusual uncertainty, policymakers – who should aim to minimise output losses over the business cycle – would better keep policy unchanged for now until incoming data dictate the appropriate policy response."
- **Berenberg Outlook:** Expect further 25bp hikes in Q3-22, Q1-23 and Q3-23 to 1.75% by end-2023. Then a further 50bp to 2.25% in 2024.

BNP: More data dependent after this week's hike

- Look for 25bp hike "with inflation concerns continuing to prevail."
- "Expect a convincing majority in favour, similar to the 8-1 in March but perhaps with another member voting to pause."
- "We see a low risk of a 50bp move at this meeting"
- **Forecasts:** "modest upward revisions to near-term GDP and inflation profiles where there has been new information to incorporate."
- **Forward guidance:** "The forward guidance should also resemble March's, moderate assessment where the MPC indicated that "some further modest tightening in monetary policy might be appropriate in the coming months""
- **QT:** Expect the May "MPC meeting to provide further details on the broad principles that will govern this process, including the timing, size, pace and operational aspects of QT."

- BNP notes that it does not expect gilt sales to begin before 2023.
- **BNP Outlook:** “Combined with the more circumspect guidance over future rate hikes, we think the MPC is shifting towards more of a data-dependent outlook.. our bias remains that the MPC will take a breather at the June meeting and wait to hike again in August... We then expect a more extended pause for the rest of the year as the trade-off between growth and inflation becomes more balanced, with growth concerns likely taking prominence.”

BofA: Look for a cut in 2023

- “We expect BoE to hike 25bp [this] week with the vote potentially split three ways… We assume 8-1 in favour of a 25bp hike with one dissenter preferring a 50bp hike, but see a possibility of 1-6-2, with Jon Cunliffe preferring no change and Mann and Saunders preferring 50bp.”
- **QT:** Expect the BOE to announce this week that it “will begin active QT, at a pace of £5bn a month, from June or July. Or at the very least we see the BoE giving details of how it would operate active QT and a likely pace even if there is no start date.”
- **Forecasts:** “Expect the BoE to raise the inflation peak to around 9%... but cut growth and medium-term inflation.”
- **BofA Outlook:** “We continue to look for 3 more 25bp rate hikes (June, August and November)… and a cut in 2023. We think 50bp hikes are unlikely given recession risks.”

Citi: Now look for QT to begin in June 2022

- 25bp hike with Tenreyro and Cunliffe dissenting in favour of an unchanged policy rate.
- “Expect a pause in current tightening to come only in August, once weak demand has arrested pass through, and the labour market has softened. However, with the UK data in now deteriorating at an accelerating rate, we cannot rule out an earlier pause or a dovish surprise (especially on the guidance) next week.”
- **QT:** “Active QT, we think, will likely begin in small size in June.”
- “Change our call here for the start of active QT from November 2022 to June, at a rate of £3bn p/m” Also expect the Minutes this week “will note the policy is now being actively considered”.
- Citi see three factors to their QT call: “First, the MPC are likely to suggest this means only a very marginal additional tightening… Second, the committee are likely to delineate QT from counter-cyclical policy (and rates)… Third, the MPC seem to be flying blind both with respect to the impact of the policy, and lack a backstop should issues develop.”
- “Waiting longer without an obvious technical rationale risks the start of such a policy being interpreted as an indication of the direction of policy overall – exactly what the committee has sought to avoid.”
- **Forecasts:** “expect CPI inflation two and three years out, conditioned on market rates, to show inflation at 1.8% and 1.2%, respectively, with unemployment increasing to well above 5%. Even on constant rate assumptions, CPI three years out will likely be converging on 2%.”
- Expect a peak in the inflation forecasts around 9% in Q4-22; GDP forecasts to be revised lower and unemployment higher.
- **Guidance:** “The MPC’s message to markets is likely to remain that any further tightening will be ‘modest'.”

- **Citi Outlook:** "As pass through softens and adjustment to higher costs is absorbed via weaker demand, we expect the Bank to cut in 2023, with two 25bps moves in August and November."
- **"**We continue to expect more hikes through the summer, but at any given meeting in 2022, we think the risk of no change in Bank rate is more likely an a 50bps jump."

Credit Suisse: Looking for three dovish dissenters

- 25bp hike with 6-3 vote (3 members voting for unchanged rates).
- **Guidance:** "Expect the BoE to keep the updated softer guidance in May… also likely to signal that after delivering back-to-back hikes, it is not necessary that the BoE will hike at every subsequent meeting in the future."
- **QT:** "Expect the details to be vague and our view is that the BoE sets out a more detailed framework on active sales in coming months (with a view to begin active sales only at the end of the year or early 2023)."
- **CS Outlook:** "The tight labour market and higher-than-expected inflation prints are likely to mean the BoE continues to hike in May and August, we expect the hikes to be dovish"

Daiwa: Look for a cut in 2023

- "Expect the majority of MPC members to vote for another 25bps hike in Bank Rate to 1.0%"
- **QT:** "The Committee is also likely to agree to start a programme of active Gilt sales to smooth the profile of its balance sheet reduction for as long as the market is not disorderly"
- **Forecasts:** "Updated economic projections are likely to suggest that, on unchanged monetary policy, inflation risks remaining above target over the medium term"
- **Guidance:** "Think that the MPC will maintain relatively cautious forward guidance, suggesting again merely that "some further modest tightening in monetary policy might be appropriate in the coming months""
- **Daiwa Outlook:** Look for further 25bp hike in Aug22 and then a 25bp cut in 2023.

Danske Bank: Look for two further hikes after this week

- Expect 25bp hike.
- **QT:** "Expect active gilts selling to start in Q4 22 or Q1 23."
- **Danske Outlook:** "Two additional rate hikes (August and November) but see risks skewed towards more rate hikes."

Deutsche Bank: Continue to see rates cuts as likely at the end of next year

- Expect 25bp hike with 8-1 vote (Cunliffe preferring on hold).
- "While Catherine Mann opened the door to the possibility of a bigger rate move, this was conditioned on the strength of economic activity holding up better than expected. This has not been the case thus far." So unlikely to have any members voting for 50bp hike.
- **QT:** "expect the MPC to confirm its intention to sell government bonds – but only later this year… expect the MPC to set out its framework on how it plans to actively wind down its stock of government bond purchases sometime between June and August, with gilt sales only commencing in September. Risks are tilted to an earlier start, however."
- "Gilt sales to amount to roughly GBP 3.3bn/month from September until year end. A 'QT envelope' of GBP 75bn next year would increase monthly sales to GBP 6.25bn/month in

2023, which would include both passive and active QT. In total, we expect the Bank's gilt holdings to drop to GBP 750bn (from GBP 875bn) by end of the 2023”

- “With regards to corporate bond sales, we expect the MPC to set out further details at the May meeting, followed by (very modest) sales commencing in June.”
- **Forecasts:** Inflation: “The near 100bps of additional tightening expected over the next three years (above what was baked into the Feb MPR) should push down on the Bank's Feb MPR projections by around 15-20bps two to three years' ahead.”
- **Guidance:** “Think the MPC sticks to its guidance that "some further modest tightening in monetary policy might be appropriate". But, we expect the MPC to introduce more optionality to the policy outlook by dropping any reference to "the coming months".”
- **DB Outlook:** “stick to our view of two further hikes this year (June, August) and another one early next year (Feb-23), taking the Bank Rate to a high of 1.75% by Q1-23. There is a risk that our third pencilled hike is pulled forward a quarter to November.”
- “Continue to think that rate cuts remain likely at the end of next year… the MPC to move towards a more neutral, or slightly accommodative, policy stance gradually taking the Bank Rate down to 1% by around mid-2024.”

Goldman Sachs: Look for three votes for 50bp

- Expect 25bp hike with 3-5-1 split with Mann, Saunders, Ramsden to vote for 50bp and Cunliffe to vote for unchanged rates.
- **QT:** GS expects an August announcement of sales at GBP20bln/quarter (and illustrates alternative paths with GBP10bln/quarter and GBP30bln/quarter).
- **Guidance:** “We expect the MPC to move away from “coming months” guidance to emphasising that the committee will monitor closely the incoming evidence and stands ready to respond to changes in the economic outlook.”
- **GS Outlook:** “continue to think the BoE’s “narrow path” is consistent with back-to-back 25bps hikes until August, followed by asset sales and a slowdown in the pace of hikes, reaching 2% in May 2023.”
- GS pencils in hikes for June, August, November 2022 and May 2023 before a cut in November 2024.
- “Given the risk of pushing the UK economy into a recession with over aggressive monetary tightening, we do not think the BoE is likely to hike by 50bps in the upcoming meeting.”

ING: Hike in May and June, then on hold for the rest of the year

- Expect 25bp hike this week with a 8-1 vote with Cunliffe dissenting.
- **QT:** “Expect the Bank to keep its QT policy under review [this] week without laying out a firm timeline for starting sales. Assuming market conditions improve, there's still a fair chance the Bank will start selling at some point within the next 9-12 months.”
- **Forecasts:** Expect “an inflation forecast that peaks around 9% in April”
- **ING Outlook:** The Bank will hike again “in June, but is more likely to then hold-fire for the rest of the year.”

JP Morgan: Bank Rate at 2.50% by August 2023

- Expect 25bp hike with 8-1 vote (Cunliffe preferring no change).
- "There is a risk that some dissent for a 50bp hike reappears, although we do not expect this in our base case… it possible that there is more than one dovish dissent next week, e.g. in a potential 7-2 vote with Tenreyro voting no change too"
- **QT:** "we think the BoE will be in no rush to begin straight away... Our best guess is that the BoE will begin gilt sales in November after launching a consultation or at an open dialogue with market participants before deciding on the pace and start date. This might also be the preferred strategy given that markets have been volatile this year, and against the backdrop of recession risks and ongoing geopolitical uncertainty. Aside from laying out a timeline, [this] week may hence not bring a great deal of new information on QT."
- **"**The alternative option would be for the BoE to offer more color by announcing a pace and deferred start date for sales - albeit with clear conditionality. If this were to happen we think the BoE would go for a very small pace (we have previously argued £2-3bn per month) such that it can be reasonably confident that this will not cause undesirable volatility"
- **Forecast:** "expect the MPC to show inflation conditioned on the market path of rates… to fall back below 2% after the two year horizon"
- **Guidance:** "expect the Bank to communicate the same message through the use of similar guidance to before, for example by repeating that some further modest tightening "may" be necessary. Alternatively it could be more specific by saying that a further tightening is "likely", provided there is further evidence that the cost of living squeeze is not producing a sharper deterioration in growth and the labor market than assumed in its forecasts."
- **JPM Outlook:** Further 25bp hikes in Jun22, Aug22, Nov22, Feb23, May23, Aug23 to 2.50%.

Nomura: Looking for hikes in MPR months through February 2023

- 25bp hike with 8-1 vote (Cunliffe voting for unchanged rates).
- Votes for "unchanged rates or a 50bp hike are also possibilities at this meeting"
- **QT:** "Expect sales to begin in early 2023 with our view being that the Bank will make a formal announcement on this later in the year (we think at its November meeting)… there is a clear risk that the process of active balance sheet wind-down begins earlier than we think."
- **Nomura Outlook:** "Expect the Bank to raise rates again in August, November and February next year, each by 25bp. We think a turn in the economic cycle, driven in part by Fed monetary tightening and China's slowdown, will limit the need for BoE policy tightening and effectively 'stop-out' the Bank early next year."
- "There is a clear risk, relative to our view, that the Bank raises rates again in June."

NatWest Markets: Hike in May and August then on hold through 2023

- Expect 7-2 vote for 25bp hike with Tenreyro and Cunliffe preferring no change.
- "A three-way split, with Mann and/or Saunders voting for 50bp, is certainly possible."
- **QT:** "Do not at this stage expect numerical QT targets or firm dates for active sales to commence. Low-liquidity summer months are not the most obvious point to begin sales, while an earlier start to QT would sit uneasily with more cautious guidance on Bank Rate rises."
- "Active sales might be in the region of ~£50bn a year, from 2023, in order to halve the APF stock in 5 years' time."

- "By definition, the natural run-off of the portfolio will be concentrated at the front-end, hence active sales could well be weighted a bit more towards medium and longs."
- **Forecasts:** Inflation: "Likely to raise the CPI peak in Q2 to around 8.75%... the 2-year point to be lowered to 2.00% (from 2.15%) and the 3-year point to be lowered further below target to 1.40% (from 1.60%)."
- **NWM Outlook:** Expect a further 25bp hike in Aug22 "The likelihood of a pause in the rate-raising cycle in the latter part of 2022 appears to be increasing given that consumer confidence surveys have plunged to recession-like levels and retail sales faltering."
- Base case is then on hold at 1.25% through Q1-24 (the end of NWM's forecast horizon).
- "Our 'risk case' is for two 25bp hikes in H1 2023 to 1.75%.
- "There is a rising probability that our 'risk case'… becomes our central forecast."

Pantheon: BOE will wait until August to set out plans for QT

- Expect 25bp hike with 1-7-1 split – Cunliffe to vote for no change and one of Mann or Saunders to vote for a 50bp hike.
- **QT:** "We still think the BoE will wait until August to set out plans for sales of £10B per quarter, starting in Q4."
- **Forecasts:** Expect peak inflation "most likely in April—to about 9.0%"
- **Guidance:** "Expect the Committee to double down on its view that future tightening needs to be only "modest"."
- **Pantheon Outlook:** Expect further 25bp hike in Q3-22 before staying on hold until at least the end of 2023.

Rabobank: 2-3 votes for a 50bp hikes

- Expect 25bp hike "with two or three policy makers voting for a 50 bps increase."
- **QT:** For active gilt sales "to happen markets need to be calmer than they are right now"
- **Rabobank Outlook:** "Expect two more 25 bps hikes in June and August before the cycle should pause."
- "This would lift Bank rate to 1.50%, which we estimate to be already slightly above the neutral rate."

RBC: Now expect two further 25bp hikes in June and August

- Look for 25bp hike with an 8-1 vote (Cunliffe to vote for unchanged rates).
- **QT:** Expect "the MPC will announce that is beginning that consideration process, possibly in the form of a formal consultation with market participants, rather than provide details at this stage as to the modalities of how it will actively sell its Gilt holdings… We would imagine a process of at least 3-6 months which would imply no active sales before Q3 at the earliest."
- "We don't think that the MPC views QT as an active tightening tool but rather as a 'technical' exercise in reducing the size of the balance sheet."
- **Forecasts:** "expect the MPR to revise the near-term CPI forecast higher but continue to show inflation below target at the two-year horizon."
- **RBC Outlook:** Changed view and now expect two further 25bp hikes in June and August. "We think that the window for further rate rises is likely to close beyond that point."

SEB: Bank Rate at 1.75% by end-2023

- Look for 25bp hikes in May22, Aug22, Feb23 and Sep23 to bring Bank Rate to 1.75% by end-2023.

Societe Generale: Look for 2.00% Bank Rate this year

- Change forecast: Had expected “that the MPC would pause at the May meeting to assess the impact of the likely jump in inflation in April, accompanied by the introduction of the 1.25% National Insurance levy. However, such has been the pace of the increase in inflation… that the MPC will have a heightened sense of urgency and feel that it has to continue tightening. We therefore predict a 25bp increase at [this] week’s meeting, and with some risk of 50bp.”
- **SocGen Outlook** “Whilst inflation continues to soar… (increasing the risk of second-round effects through the labour market), it must act promptly to prevent higher wage demands becoming embedded… expect the committee to tighten by 25bp at each meeting up to and including the November meeting (there are five [including May]), taking Bank Rate to 2%. At that time (if not before), we think its macro forecasts will project even lower growth next year as it takes full account of the hit to demand feeding through from the April inflation surge and the NI measures. That will make it difficult to justify further rate increases into 2023.”

TD Securities

- Expect 25bp hike this week with 8-1 or 7-2 vote (with dissenters preferring unchanged rates).
- **Guidance:** “Expect broad guidance on the framework, but expect the MPC to remain noncommittal on the amount or a start date for now. That's likely to come later in the year, perhaps at the August meeting, and will be at a very gradual pace to start.”
- **Forecasts:** “Expect Q2 inflation of over 9% y/y (with May approaching 10% y/y)”
- “Year 2 inflation further below 2% and the mid-2025 projection closer to 1.5%.”
- **TD Securities Outlook:** “While we expect a pause after this hike (until Feb 2023), we wouldn't completely rule out one more hike at either the June or August meeting.”

UBS: If DMP survey shows further strengthening, a few votes for 50bp expected

- “Expect the majority of the Committee to vote for a 25bps hike.”
- If the Decision Maker Panel “survey were to show further strengthening, we would expect to see a few votes in favour of a 50bps hike.”
- **QT:** “We think that operational preparations could take at least a few months, with the start of sales potentially pushed out into 2023.”
- **UBS Outlook:** “Expect the MPC to deliver two additional rates hikes of 25bps on 4 August and 15 September, bringing Bank Rate to 1.5%, and to stop there. By August, the MPC will have had April and May GDP data, which should provide a good gauge of how activity has held up following the April inflation spike and the increase in National Insurance contributions”

UniCredit: One more hike after today

- Look for dovish 25bp hike this week. Expect Cunliffe to vote for an unchanged rate.
- **UniCredit Outlook:** “We think the MPC will probably only be able to hike once more in this cycle, in August.”

MPC Member Key Comments

Bailey notes language change in March meeting significant

28 March

- Bailey says shock from energy prices will be bigger than any single year in the 1970s (but caveats that with the 1970s seeing a sustained rise over many years).
- He says the Bank doesn't have any policy tool to make that go away. Reiterates this is a terms of trade shock.
- What might disrupt the temporary nature? Supply chains have two side risks. Omicron is having less impact than the Bank thought (and they hadn't expected a large impact). Labour market is very tight.
- Very high level of uncertainty. Task is clear but hard. Appropriate to tighten policy, but do so recognising uncertainty and know that there are risks to both side. Going forward need to recognise uncertainty. This is why they changed forward guidance at the last meeting - it is a recognition of the uncertainty.
- Bailey asked if the current implied rate path is appropriate. Bailey largely avoiding the question and saying "it's complicated". Notes that vacancy to unemployment rate is so high, they can't see it going another way. But then there is a big shock coming down the line. The degree of which we get second round effects determines what the Bank does or doesn't have to do. Notes again its a very big trade-off situation which is why the forward guidance language is so cautious, because it is so uncertain.

Bailey: Walking Fine Line Between Inflation Growth – Bailey

21 April, Peterson Institute

- Bank of England policymakers are walking a very tight line between tackling inflation and recession caused by the hit to real income, Governor Andrew Bailey said.
- "We are walking this very, very fine line between these two things," Bailey said at a Peterson Institute event. The BOE head said that "the real income shock is going to cause a slowdown in growth" and a key question was whether the tight labour market was going to ease.
- Bailey said that the UK labour force was smaller than it would otherwise have been due to a mix of older people entering economic inactivity and a fall in migrant labour, and it was an open question if business would hoard labour given problems recruiting. With uncertainty high Bailey stressed that policy setting had become a high wire act, with the Bank now working on its May forecast round.

Bailey: Won't Do Asset Sales In Fragile Markets, IMF

22 April

- Bank of England Governor Andrew Bailey said that the Bank would not yet actively reduce its balance sheet, by selling gilts, if it posed a risk to financial stability. "We are not going to do this in a period of very fragile markets," Bailey said at an IMF event.
- He said that it was important, though, that the Bank does reduce its balance sheet rather than allow it to ratchet it up with every fresh crisis. The BOE Monetary Policy Committee's guidance is that it will consider selling gilts when Bank Rate hits 1% but Bailey stressed that sales were contingent on financial stability.

Broadbent highlights: Views on CB communication

30 March

- Broadbent makes the point that he doesn't set interest rates in the future, so there's not much point in him committing to a rate path (like the Riksbank/Norges Bank) as there are bigger risks than benefits (1: that the market doesn't fully understand the conditionality of the forecast. 2: That it would be hard to pin down with 9 members in a democratic format).
- He also says that if central banks overcommunicate then markets pay too much attention to CBer's comments and not enough attention to the economic data - and it is the economic data that should be guiding markets not CB speeches.
- The final pullout point is that he thinks that CBs don't need to steer guidance over for the next meeting. If something changes and it is appropriate to change/not change policy then having to have communicated that to the market previously only slows down the CB's ability to act fast.
- So all in all, he was making the point markets should pay more attention to economic data and possibly central bankers should speak less!

BOE: Cunliffe looking towards May forecasts, but still sounds dovish

4 April

- BOE Deputy Governor and MPC member Cunliffe gave a speech in which he sounded unconvinced about the need for more rate hikes. Recall that he was the only MPC member to note vote for a hike in March, instead preferring to vote to keep policy unchanged. He explains some of the rationale for the reasons below but places more emphasis on higher inflation as being conditional on the tightness of the labour market (rather than commodity prices) and doesn't seem to see urgency in the need to act (although does not rule out further tightening). Key quotes below:
- "I do not think we are yet seeing a psychology of persistently higher inflation emerge. The predominant driver of the growth we have seen in pay has been the tightness of the labour market. There may also now be some element of catching up with inflation that has already happened."
- "While I recognise the risk of second-round effects and that further tightening of monetary policy might be necessary, I am not at present convinced that we will inevitably have to lean heavily and constantly against an embedding of an inflationary psychology as we progress through this challenging period and as the impact of higher commodity prices on real

household incomes depresses activity. Rather, we will need carefully to judge the risks on both sides, weighing the evidence on the evolution of domestic prices, wages, activity and employment as it emerges. The MPC's next forecast will be the first opportunity since the invasion to do that."

Mann: 25bp vote for March to bide time ahead of May forecast round

- Mann says that she voted for 25bp in March to bide time with the extra uncertainty ahead of the full forecast round in May. So she's seemingly very much waiting to see where those forecasts land before deciding on whether she will vote for 25bp or 50bp in May...However, the fact that a 25bp can be used to bide time suggests more front-loading of hikes is appropriate in her move and she is erring closer to 50 than zero. Key part in her speech:
- "For the May meeting, key topics for me are an assessment and judgment on how much and when the expected consumption drag materialises, and whether we start to see any indication of price forecast revisions in the DMP survey. If they do, this potentially would short-circuit the expectations-formation process underpinning the domestic inflation ratchet, which has been my central concern. Tracking these price expectations and forecast revisions is of paramount importance since inflation ultimately is due to firms systematically able to raise their prices."
- "At the March meeting, I evaluated the uncertainty in the purchasing power hit against these uncertain, but very strong sales and price forecasts. With a full forecast coming in May, and energy prices gyrating, raising the Bank Rate by 25 basis points was appropriate, to bide time to see how some of the uncertainties would resolve."
- "In March I was willing to wait to see more information on the size and timing of the demand slow-down, even as the ratchet-effect on inflation was clear to see. If the consumption hit is moderated by other policies or by savings and other smoothing behaviours, it may be well into 2023 before firms receive the demand signal. The consequent embedding of current overall inflation into firms' own-pricing is a concern because it may point to a situation in 2023 where pricing remains robust even as demand remains weak."
- "I would like to review why I thought that the next policy move, at the February meeting, should have been 50 basis points. Key for me was that both the DMP and the agents' survey reported continued strengthening of expectations by workers and firms for wage increases and price increases, which could generate a domestically-driven wage-price dynamic with higher inflation embedded in forward-looking pricing decisions... For me at the February meeting, research argued that monetary policy needed to lean against these expectations with a front-loaded policy path."
- Mann asked: Do you think more than 25bp is needed in May and do you agree with the market's multiple pricing?
    - Mann: We are in the middle of the forecast round now. We have data, models and judgment and these are all important inputs to this process. We are still seeing how these issues are unfolding in these forecasts. The type of balancing in demand conditions and how this is a signal to firms to evaluate their sales and prices. Based on that can look at whether an additional 25bp or more might be necessary to keep inflation anchored. The market has its own expectations and have their own

judgment on what the path should be. We still have more information before making any final decisions.

- Mann asked on the 1% threshold for considering changes in the balance sheet.
    - She says there is quite a bit of research on the relative importance of stock vs flow at both the BOE and in other institutions which assess the role of the balance sheet to complement the Bank Rate. This is a function the degree to which we judge the stance of overall monpol at the May meeting. Note that financial conditions are changing - has been much more volatility since March - so this also has to be considered in landscape of appropriate combination of balance sheet and Bank Rate. Worth to think about the tenor the balance sheet and consider that as part of the landscape for policy makers when considering whether changing the balance sheet is a relevant and important part of the overall monpol stance.
- Mann asked where long-term nominal rates are going
    - She says the landscape has changed since Covid and that BOE looks at it on a regular basis. Says she focused on risks to productivity growth (which impact long-term equilibrium rate): Brexit and WFH - both have a lot of additional analysis to be done to evaluate which one dominates in the longer-term. We aren't talking about next year, the outcome won't be clear in a year. It's important to keep these in mind along with other components to potential output.

MNI POLICY TEAM INSIGHTS

BOE Eyes Markets As It Ponders Gilt Sales

By David Robinson, 3 May

The Bank of England is widely expected to hike by 25 basis points for a fourth meeting in a row this week, lifting the policy rate to 1.0%, but while this is the level at which it has previously said it will consider beginning active sales of gilts acquired during its quantitative easing programme, it could opt for caution.

Even though some policymakers have argued that gilt sales at a time of abundant liquidity should have negligible effects on yields, others are less certain, and BOE Governor Andrew Bailey, generally strongly in favour of balance-sheet reduction, said last month that the BOE would not sell bonds in fragile markets.

Delay however could pose a communications challenge for the Monetary Policy Committee, which will have to address the question in its statement.

Some analysts suggest that the MPC could say it will wait until August before deciding whether to go ahead with sales. But it is far from clear that uncertainties caused by the war in Ukraine, China's zero Covid policy and the twin threats of high inflation and recession will be significantly reduced by then.

Alternatively, if the MPC were to simply link sales to market conditions, the lack of any published guidance on the BOE's parameters for judging them to be stressed or illiquid could leave the timing cloudy, as former MPC member Kristin Forbes has pointed out.

The Bank could opt to unveil a formal consultation process over gilt sales, although it already has a steady stream of market intelligence to inform its decisions.

Other factors may also influence the BOE's thinking. MPC members might want to ensure that gilt sales do not impede their ability to hike sufficiently in this cycle to have enough conventional policy space to offset a future downturn through Bank Rate cuts rather than by having to resort to quantitative easing. UK easing cycles in recent times have averaged 150 basis points.

GUIDANCE

The OIS curve implies that a 25 basis-point increase is fully priced in for the May meeting with around a 20% chance of 50-bps and then around five further hikes this year. With market pricing so aggressive, there is scope for the MPC to go for 25 bps and to still deliver a dovish surprise, as occurred in March.

The full quarterly forecast round, to be published in the May Monetary Policy Report, may once again show inflation undershooting the 2.0% target at the two- and three-year forecast horizons, suggesting market rate expectations are overblown. While the near-term inflation peak looks certain to be raised again, perhaps to around 9.0%, inflation is likely to be shown fading subsequently as a hefty hit to real incomes kicks in.

Deputy Governor Jon Cunliffe, who opposed the March hike, could find an ally this time round. But, on the other side of the scale, MPC member Catherine Mann has said she might vote for a 50-bps hike, on the grounds that faster action could diminish the chances of inflation ratcheting higher.

The committee will also need to decide whether to stick with its deliberately more dovish guidance from March, which is at odds with market pricing. The guidance pointed to both upside and downside risks and said that further modest tightening in coming months may only be "appropriate", rather than "likely".

BOE Forecasters Challenged By Supply Chain Snags

By David Robinson, 28 April

Supply chain disruptions have been a recurrent factor in the global economy since the Covid pandemic began, but central bank models still fail to accommodate them, with the Bank of England likely to refer to the potential impact of China's spreading lockdowns as merely risks around its central forecasts in its May Monetary Policy Report.

While BOE economists have been researching global value chains and disruptions, so far they have not been incorporated into its main model. In the case of the Chinese lockdowns, which could potentially restrict supply of key goods as well as impact global demand, any assessment is also complicated by uncertainty not only regarding the progression of the virus but also as to whether the government in Beijing might adjust its strict zero Covid policy.

In February's MPR, the Monetary Policy Committee said it "assumed localised restrictions are sufficient for China to implement its zero-Covid policy. If more widespread restrictions are necessary, that would disrupt global supply chains to a greater extent than assumed." This would further constrain GDP and add to inflation, it noted.

As the MPC's practice is to accept government policy at face value, it is unlikely to venture any judgement as to how the zero-Covid strategy might evolve.

In May, the BOE is very likely to again increase its forecast of a near-term inflation peak from the 7.25% it expected in February, but there is deep uncertainty about how soon the erosion of real incomes will hit demand.

VALUE CHAIN RESILIENCE

While BOE economists have published detailed work on global value chains and side models can be constructed to explore them, the differences between individual supply shocks make this task challenging. BOE Governor Andrew Bailey has noted that each successive Covid wave has had less impact on the UK economy, but China's situation is very different.

Even though rolling supply side shocks can have persistent inflationary effects, IMF research highlights the resilience of global value chains during the pandemic due to diversity of supply, supporting the view that disruptions should be temporary.

"It's quite possible for trade flows to be volatile, while economic activity is stable. For example … goods imports were higher in countries and time periods with higher COVID-19 cases and lower mobility, which could indicate that countries facing pandemic waves got the goods that they needed for consumption and production through imports," IMF economists said in response to emailed questions from MNI about the research by Davide Malacrino, Adil Mohommad and Andrea Presbitero.

"Diversification enhances economic resilience," they said.

Their results supporting diversification of supply chains were in line with separate research by BOE MPC member Silivana Tenreyro in collaboration with Francesco Caselli. Bank economists including Lucio D'Aguanno and Rebecca Freeman have also argued that the relationship between global supply chains and volatility is ambiguous in theory and insignificant in the data.

BOE Gilt Sales Not Assured When Rates Hit 1%

By David Robinson, 22 April

While the Bank of England will consider triggering active gilt sales if, as widely expected, it hikes Bank Rate to 1% in May, policymakers have stressed that such a move is not a foregone conclusion, particularly at a time when yields are rising.

Some observers, like former senior BOE economist Stephen Millard, now deputy director at the National Institute, argue that, barring market stress, there will be little reason to delay gilt sales once Bank Rate hits the threshold at which current BOE guidance says that such a move will be considered. The Bank must return its GBP1 trillion balance sheet to desired levels, Millard told MNI in an interview. (See MNI INTERVIEW: Strong Case For BOE Gilt Sales At 1%-NIESR)

But the debate over when to start sales is nuanced, and policymakers have noted in public that 1% is only a point at which they will consider sales rather than suggesting they will crack on without delay.

The marked rise in yields in response to the inflation shock and the Bank's data showing lenders expected to reduce secured credit in the second quarter may be a significant factor giving pause for thought. Asked on Thursday about the case for sales, Monetary Policy Committee member Catherine Mann noted that "financial conditions have been changing."

LEAVING SPACE FOR BANK RATE

MPC members may also be keen to ensure that gilt sales do not tighten conditions to such an extent that they interfere with the use of Bank Rate, which, as they reaffirmed in February, is the BOE's preferred active policy tool in most circumstances. The Bank might want to be able to hike sufficiently in this cycle to have enough conventional policy space to offset a future downturn through Bank Rate cuts rather than by having to resort to quantitative easing.

As repeatedly cited by former Governor Mark Carney, the average change in UK policy rates in easing and tightening cycles has been 150 basis points, with the average cut larger still, at 250-bps in the late 90s and early 2000s easing cycles.

The Bank also remains unsure as to how much tightening effect gilt sales will have.

MPC member Silvana Tenreyro, like former member Gertjan Vlieghe, argues that neither quantitative easing nor tightening have much effect on yields in liquid markets, so long as it is not perceived to be sending a signal about future policy rate setting.

But if QT does reduce space for rate rises, it may complicate the BOE's task at a time when, as noted by Governor Andrew Bailey on Thursday, combatting elevated inflation without triggering a recession will be a delicate balancing act.