

Bank of England Review

BoE leaves door open for August hike

- The Bank of England (BoE) kept its monetary policy unchanged, with a 6-3 vote, and changed its QE guidance saying it will not reduce QE stock before the key interest rate reaches 1.5%.
- We stick to our call for one hike in H2 18 and one in 2019, with the next hike likely to be in August, but stress that the timing remains data dependent.
- We expect EUR/GBP to continue trading within a range of 0.8650-0.8850 in coming months, targeting 0.8800 in 1M and 0.8650 in 3M.

Hawkish BoE keeps August hike alive

As expected, the BoE kept its monetary policy unchanged at today's MPC meeting. The vote to keep the interest rate unchanged was 6-3, in contrast to the consensus expectation of a 7-2 vote (the vote was 7-2 in May), as BoE Chief Economist Andy Haldane shifted to the hike camp and called for a 25bp rate increase this time. The split vote combined with the BoE's relatively confident view that the dip in activity in Q1 was temporary, indicates that a hike of the Bank Rate in August is still an option.

In addition, the BoE made a significant change to its QE guidance and now says it will not consider reducing the stock of debt securities purchased under the QE programme until the key interest rate reaches 1.5% (previously 2.0%). The BoE stressed that reductions would happen at a gradual and predictable pace.

We stick to our call for one hike in H2 18 and one in 2019, with the next hike likely to be in August, but stress that the timing remains data dependent.

FX outlook: EUR/GBP range for now but lower eventually

The GBP appreciated and Gilt yields rose across the curve on the hawkish signals from the Bank of England. The market is now pricing in above 65% probability of a rate hike in August (17bp priced) compared with around 45% probability prior to the announcement, while a November hike is now almost fully priced in. Prior to the announcement, the next rate hike was priced to arrive in February 2019.

Given the hawkish signals from the BoE, we expect relative interest rates largely to mitigate the EUR/GBP upside risks stemming from Brexit uncertainty, especially as it is likely the big debate Brexit clashes are postponed to the October EU summit. Near term, a break below 0.8650 would, in our view, require a more pronounced repricing of the BoE's future rate path, which we do not expect. Hence, we expect EUR/GBP to continue to trade within a range of 0.8650-0.8850 in coming months, targeting 0.8800 in 1M and 0.8650 in 3M.

Longer term, we still expect EUR/GBP eventually to trade lower, driven by Brexit clarifications and fundamental valuations. The turn in capital flows and FDI flows back into the UK, as indicated in the latest balance of payments data, suggest that a key headwind to GBP seen in Brexit is reversing, supporting the case for additional GBP appreciation over the medium term. We target EUR/GBP at 0.84 in 6M and 0.83 in 12M.

Market now prices in 17bp for August



Source: Danske Bank

Danske's GBP forecast

	Spot	+1m	+3m	+6m	+12m
Exchange rates vs GBP					
GBP/USD	1.32	1.33	1.35	1.43	1.51
EUR/GBP	0.87	0.880	0.865	0.84	0.83
GBP/DKK	8.52	8.46	8.61	8.86	8.97
GBP/SEK	11.81	11.48	11.79	12.38	12.29
GBP/NOK	10.79	10.68	10.75	11.07	11.08

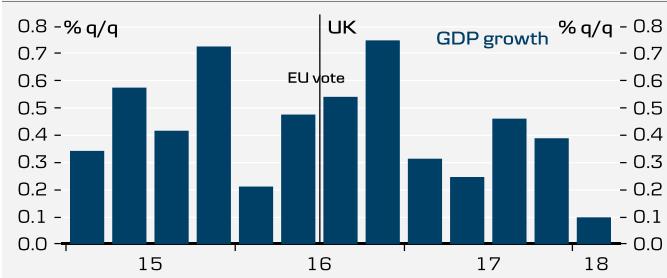
Source: Danske Bank

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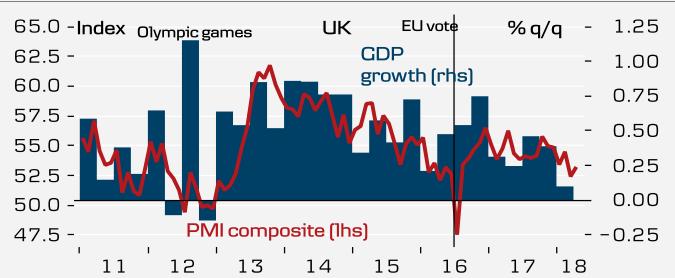
Macro charts

Weak GDP growth in Q1



Source: ONS, Macrobond Financial

PMIs signal growth of approximately 0.2% at the beginning of Q2



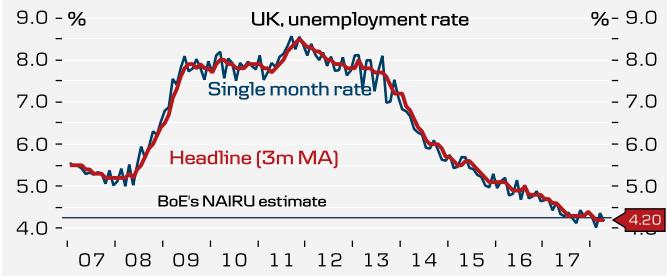
Source: ONS, Markit Economics, Macrobond Financial

Annual growth in UK GDP has decelerated, while other advanced economies have accelerated



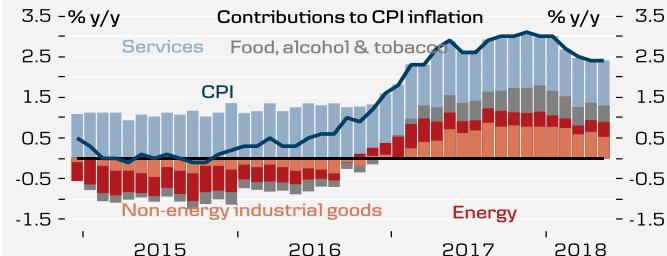
Source: ONS, Eurostat, BEA, Macrobond Financial, Danske Bank calculations

Unemployment rate is exactly at BoE's new NAIRU estimate



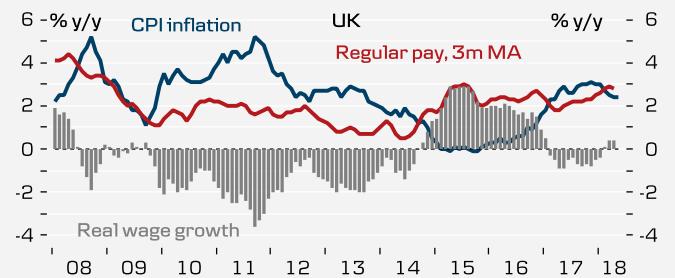
Source: ONS, Bank of England, Macrobond Financial

CPI inflation is set to move down gradually



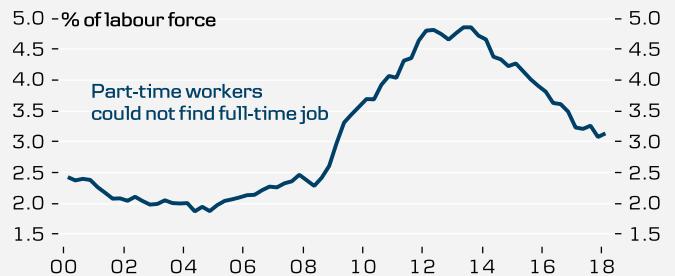
Source: ONS, Macrobond Financial, Danske Bank

Negative real wage growth has come to an end



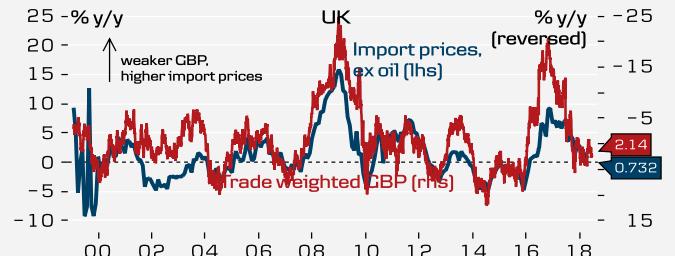
Source: ONS, Macrobond Financial, Danske Bank

Most likely still some slack left in the labour market

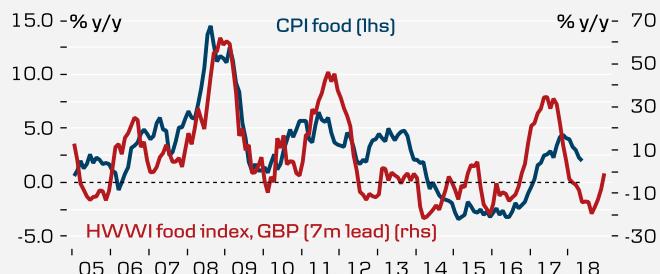


Source: ONS, Macrobond Financial

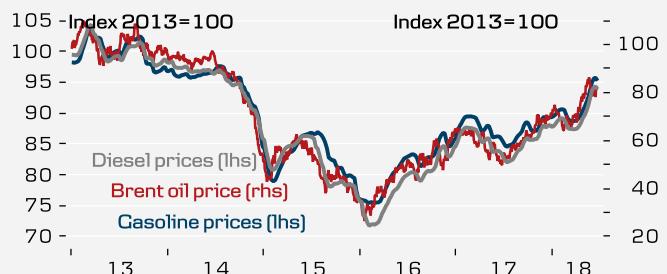
Import price inflation has peaked



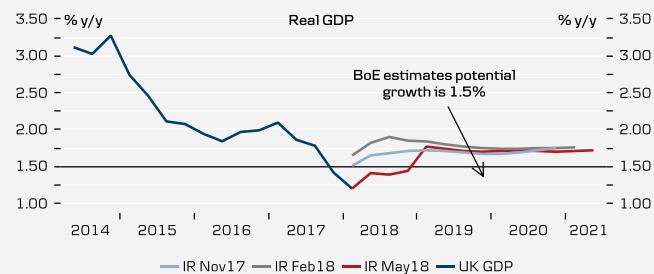
Source: ONS, Bank of England, Macrobond Financial

Food price inflation has peaked

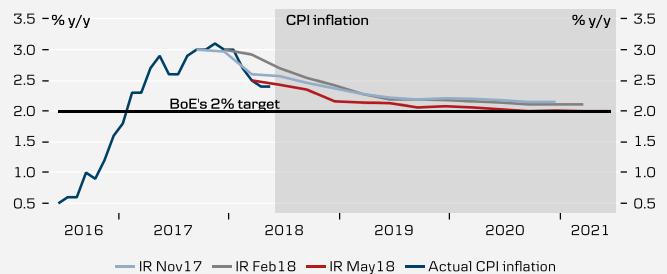
Source: ONS, Bloomberg, Macrobond Financial

Oil prices set to lift inflation

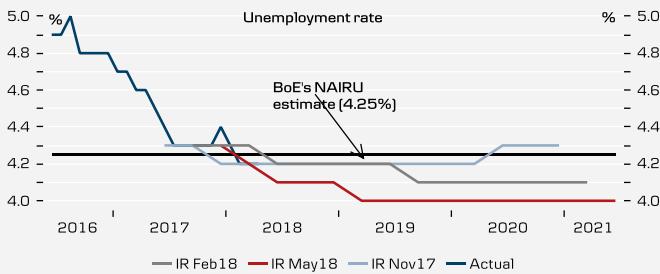
Source: Bloomberg, UK government, Macrobond Financial

Bank of England's projections**Growth to rebound to above-potential rates**

Source: ONS, Bank of England, Macrobond Financial

CPI inflation is also lower but still above targets

Source: ONS, Bank of England, Macrobond Financial

Unemployment rate is expected to fall to 4%, below NAIRU estimate of 4.25%

Source: ONS, Bank of England, Macrobond Financial

BoE still expects wage growth to move higher due to the tighter labour market => higher domestic cost pressure

Source: ONS, Bank of England, Macrobond Financial

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This research report has been prepared by Danske Bank A/S ('Danske Bank'). The author of this research report is Morten Thrane Helt, Senior Analyst.

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None.

Date of first publication

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