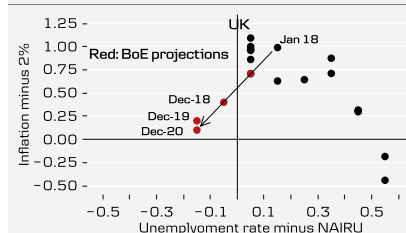


Bank of England Review

BoE still on track for a May hike

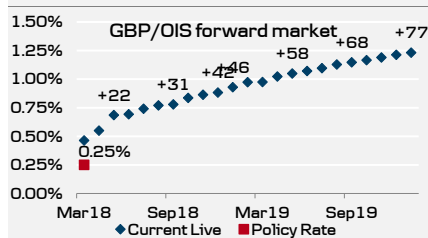
- The Bank of England maintained monetary policy unchanged but two BoE members (Ian McCafferty and Michael Saunders) voted for an immediate rate hike (**vote count 7-2 for an unchanged Bank Rate**). While Mark Carney has already revealed that the BoE no longer wants to pre-commit to a hike, this was as close to a pre-commitment as we could get.
- Looking at the meeting summary and minutes, **there were no major shifts in the policy signal** from the Bank of England, as economic data have been in line with the projections in the February Inflation Report. **The BoE says ‘ongoing tightening of monetary policy’ is needed over the forecast horizon.**
- While the positive contribution to CPI inflation from GBP depreciation is fading, the BoE thinks domestic cost pressure is increasing, as slack has been more or less absorbed. In order to avoid a more persistent CPI inflation overshoot, it is appropriate to raise rates. The BoE still expects growth to remain above potential GDP growth over the forecast horizon.
- With respect to Brexit, the Bank of England did not alter its communication despite the agreement on transition. Based on Mark Carney’s comments at a press conference after the February meeting, **the BoE had already pencilled in a high expectation of a Brexit transition agreement so it does not really alter the outlook for the BoE.**
- **We still believe the BoE is heading for a May hike and we also believe another hike in November is likely**, which is more than the one BoE hike forecast by consensus. As we argued back in February after the last meeting, the BoE seems to have launched a regular hiking cycle and this meeting has not changed our view (see *Bank of England Review – Launching a hiking cycle*, 8 February). Markets have priced in approximately 42bp hikes this year, so we are more hawkish than both other houses and market pricing.
- **Although the Brexit transition deal is, other things being equal, positive news, it is in our view not a game-changer for EUR/GBP** in the short-run and we forecast 0.87 in 3M. The negotiations on what the future relationship looks like are going to be much more complicated, not least with respect to the Irish border. **We still think EUR/GBP will move lower in 6-12M on Brexit clarification and higher UK interest rates. We target EUR/GBP at 0.86 in 6M and 0.84 in 12M.**

BoE is concerned about a combination of high inflation and low unemployment



Source: Bank of England, Macrobond Financial

Markets have priced in 42bp hikes this year



Source: Danske Bank

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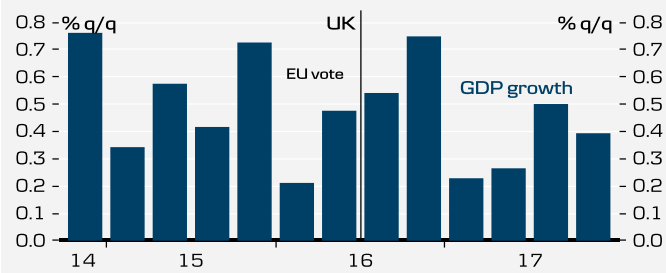
Bank of England – policy signals

Subject	Comments	Direction
Growth	Underlying GDP would grow by around 0.4% in Q1 18, in line with expectations in February Inflation Report. Above potential GDP growth.	Unchanged
Labour market	"The steady absorption of slack had reduced the degree to which it was appropriate for the MPC to accommodate an extended period inflation above target"; NAIRU estimate 4.25% (versus 4.4% actual).	Unchanged
Inflation	GBP depreciation to "[...] make a positive, but diminishing, contribution to inflation" but " <u>domestic cost pressures were expected to firm</u> ".	Unchanged
Global economy	"The prospects for <u>global GDP growth remain strong</u> "	Unchanged
Brexit	"[...] the <u>most significant</u> [...] source of uncertainty about the economic outlook"	Unchanged
Policy bias	"[...] <u>ongoing tightening</u> of monetary policy over the forecast period will be appropriate [...]", rate hikes will be "at a <u>gradual pace</u> and to a <u>limited extent</u> ".	Unchanged
Vote count	7 BoE members voted for unchanged, 2 for an immediate hike	Hawkish

Source: Bank of England, Danske Bank

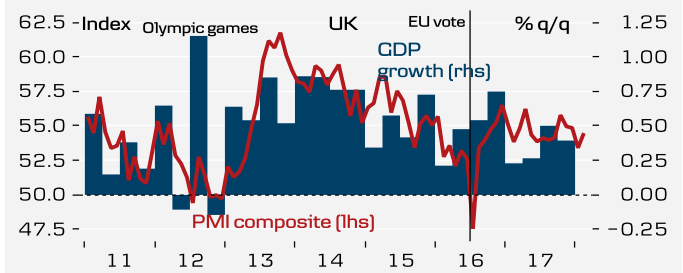
Macro charts

GDP growth was slightly stronger in H2 17 than in H1 17



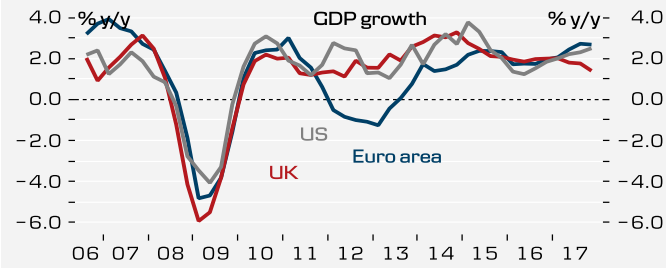
Source: ONS, Macrobond Financial

PMIs signal growth continuing around current pace



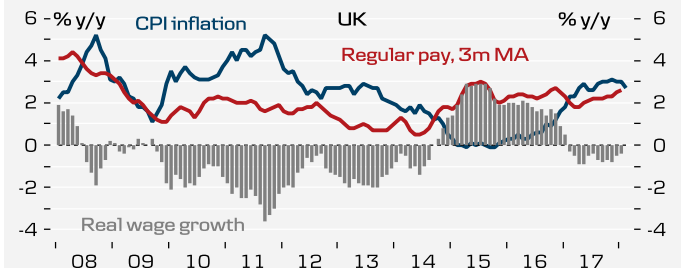
Source: ONS, Markit Economics, Macrobond Financial

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



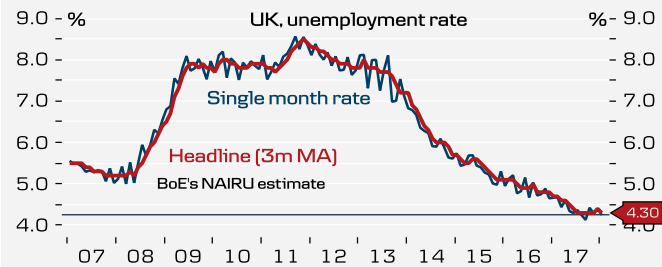
Source: ONS, Eurostat, BEA, Danske Bank calculations, Macrobond Financial

Negative real wage growth limits scope for private consumption



Source: ONS, Danske Bank, Macrobond Financial

Unemployment rate is exactly at BoE's new NAIRU estimate



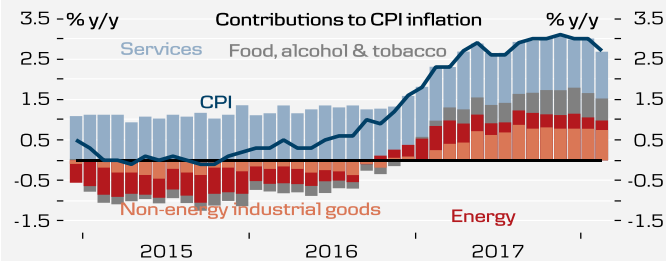
Source: ONS, Bank of England, Macrobond Financial

Most likely still some slack left in the labour market



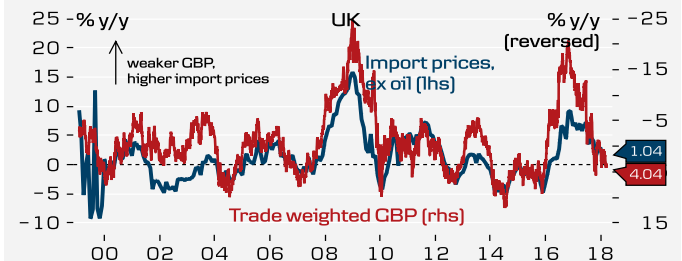
Source: ONS, Macrobond Financial

CPI inflation is set to move down gradually



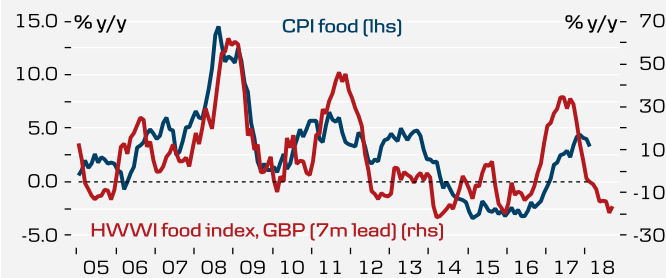
Source: ONS, Danske Bank, Macrobond Financial

Import price inflation has peaked



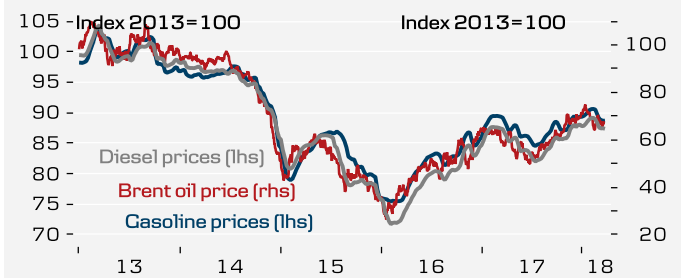
Source: ONS, Bank of England, Macrobond Financial

Food price inflation has peaked



Source: ONS, Bloomberg, Macrobond Financial

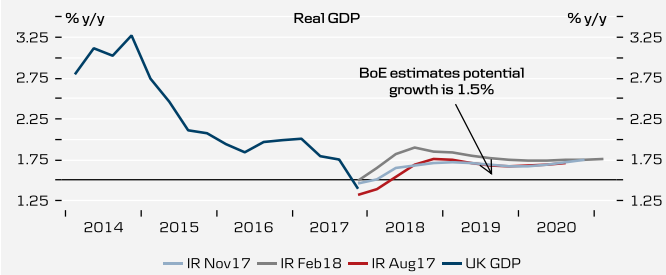
Higher oil prices have led to higher fuel prices



Source: Bloomberg, UK government, Macrobond Financial

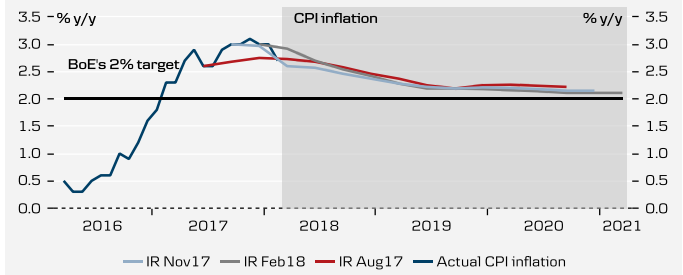
Bank of England's projections

BoE thinks the growth outlook is unchanged



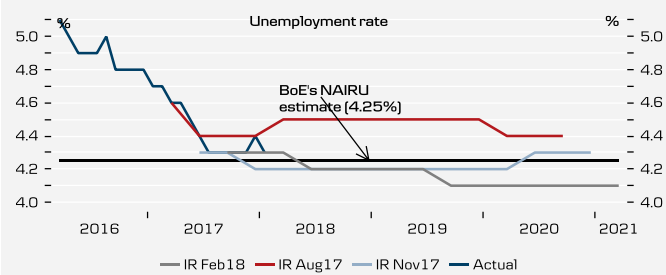
Source: ONS, Bank of England, Macrobond Financial

CPI inflation slightly lower than projected in February



Source: ONS, Bank of England, Macrobond Financial

Unemployment rate in line with the February projection



Source: ONS, Bank of England, Macrobond Financial

BoE expects wage growth to increase due to the tighter labour market (Phillips curve argument)



Source: ONS, Bank of England, Macrobond Financial

Disclosures

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

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Expected updates

None.

Date of first publication

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Report completed: 22 March 2018, 13:58 GMT

Report first disseminated: 22 March 2018, 17:45 GMT