2. November 2023

Bank of England Review

BoE paves the way for more EUR/GBP topside

- **At today's monetary policy meeting the BoE left the key policy rate unchanged at 5.25% whilst maintaining a data dependent forward guidance.**
- **With limited success, the BoE tried to push back on the market pricing of rate cuts.**
- **EUR/GBP ended the meeting higher and we continue to see headwinds for GBP, targeting the cross at 0.89 in 12M.**

As expected, the Bank of England (BoE) decided to keep the Bank Rate (key policy rate) unchanged at 5.25%. 6 members voted for an unchanged decision, including the newest member Sarah Breeden, while 3 members voted for an increase of 25bp.

The majority of the Monetary Policy Committee (MPC) voted to keep the Bank Rate unchanged citing that GDP growth had weakened, the labour market had continued to loosen and that CPI inflation "*was expected to decline significantly in the coming quarters*". Importantly, it was noted that "*Bank staff estimates that more than half of the impact of higher interest rates on the level of GDP is still to come through*". The BoE reiterated that that "*monetary policy will need to be sufficiently restrictive for sufficiently long*". The BoE retained its forward guidance repeating that "*further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures*".

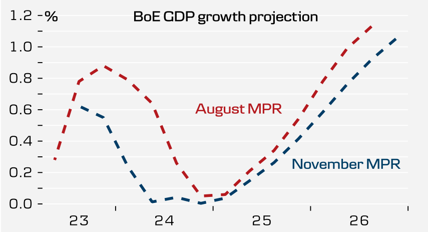
In the press conference Governor Bailey tried to push back expectations on rate cuts - stating that it was "*much too early to be thinking about rate cuts*" - in order to prevent financial conditions from easing prematurely. However, with lower GDP and higher unemployment forecasts alongside other indications that the UK economy increasingly looks fragile, markets were not buying the narrative. Likewise, coupled with global momentum and more rate cuts being priced in for peers, this is spilling over to the BoE pricing (in line with our call). We think the potential for further BoE rate hikes has fallen following today's message and we maintain our call that the peak in policy rates has already been reached. We expect the UK economy to show further signs of weakness, inflation to level off and wage growth to have peaked.

Rates. Overall, the reaction in rates markets was relatively muted. Rates markets rallied on the decision and statement. 2Y Gilt yields moved 7bp lower on the decision and declined 10bp from the close on Wednesday, significantly outperforming European peers. Markets are pricing in 5bp for the December meeting and while the SONIA-curve inverts from Q1'24 the first 25bp rate cut is not priced before September 2024.

FX. The initial knee-jerk in markets was to send EUR/GBP lower but the move quickly retraced with spot ending the press-conference at higher levels. On balance, we continue to see relative rates as a moderate positive for EUR/GBP with room for further cuts being priced in for 2024. We still expect the relative performance of the euro area and UK economy to be a relevant driver. We target a modest rise in EUR/GBP to 0.89 in 2024.

Our call. We continue to expect the peak in the Bank Rate to have been reached and see another rate hike as unlikely at this point. This is broadly in line with current market pricing. We expect a total of 75bp cuts in 2024, which is more cuts than priced in by markets (60bp).

Chart 1. Lowering GDP growth forecast across the entire period



Source: BoE, Macrobond
Note: Projections based on market implied rates

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Report completed: 2 November 2023, 16:00 CET

Report first disseminated: 2 November 2023, 16:30 CET