04 November 2021

UK Research

Bank of England Review: Unchanged but hikes are coming

Key takeaways

- In line with our base case, the Bank of England kept monetary policy unchanged.
- The Bank of England signals that a rate hike will be appropriate in coming months if data is broadly in line with expectations. Governor Andrew Bailey linked rate hikes to labour market outcomes (echoing Fed Chair Jerome Powell yesterday).
- We continue to expect three hikes next year (15bp in February 2022, 25bp in May 2022 and 25 in November 2025, so 65bp in total). Markets are pricing in approximately 90bp over the same period.
- FX: EUR/GBP moved higher on announcement and near-term there are upside risks. We continue to target 0.83 in 12M, however.

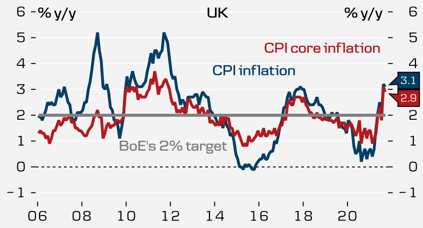
BoE: Rate hikes are looming but more data are needed

Today's Bank of England (BoE) monetary policy decision was definitely one of the key events this week. First and foremost, the re-pricing of Bank of England was one of the main drivers for the sharp move higher in short-term yields. Secondly, there were many different views on what the BoE would do and say ahead of the meeting.

In line with our expectation, the Bank of England kept monetary policy unchanged, i.e. no changes to the Bank Rate (still 0.10%) and no changes to the QE programme (7-2 and 6-3 votes, respectively). **It was, however, a "hawkish hold" in the sense that the BoE signals that a rate hike will be appropriate in coming months if data are broadly in line with expectations.** This supports our base case that the Bank of England will hike in February, although December cannot be ruled out. Bank of England emphasised that it is not going to hike aggressively. **According to the minutes *"some modest tightening of monetary policy over the forecast period was likely to be necessary"* and Governor Andrew Bailey hinted that he thinks market pricing is too aggressive.**

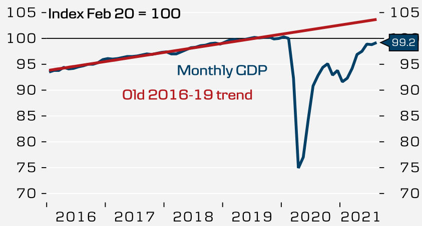
Like other central banks, the Bank of England find themselves in a difficult situation. On one hand, inflation is high with headline inflation above 3% and core inflation close to 3%. Unlike e.g. the ECB, the BoE did not struggle to the same extent with too low inflation and hence the room for patience with high inflation is probably lower. Inflation expectations have risen but data is mixed depending on the source. On the other hand, total employment remains subdued and real GDP is lower than in Q4 19 (and much lower than if GDP had followed the old trend path). It is, however, difficult to interpret the labour market due to a combination of a smaller labour force and many unfilled vacancies.

Inflation is well above the 2% target



Sources: ONS, Bank of England, Macrobond Financial

GDP remains below its level in February 20 and well below the old trend path

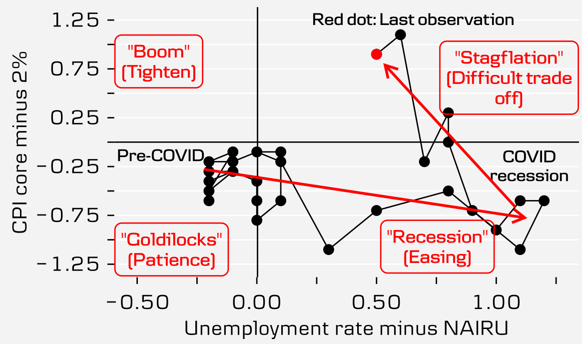


Sources: ONS, Danske Bank trend, Macrobond Financial

Chief Analyst
Mikael Olai Milhøj
+45 45 12 76 07
milh@danskebank.dk

BoE governor Andrew Bailey focused a lot on missing information about what the end of the furlough scheme has meant for the labour market, so the labour market is key for the BoE in coming months. **Bailey said that labour market developments are "*crucial*" for the hiking pace.** Notice that we get two jobs reports ahead of the December meeting. **Bailey also emphasised that the BoE is in the "transitory" camp believing that inflation will come down in the second half of next year**. Bank of England expects inflation to peak at 5% in April. Also Bailey echoed what Fed Chair Jerome Powell said yesterday arguing that the labour force will also start to rebound next year.

The Bank of England is in a difficult situation, just like other central banks



Sources: ONS, Macrobond Financial, Danske Bank

Our Bank of England call summarised

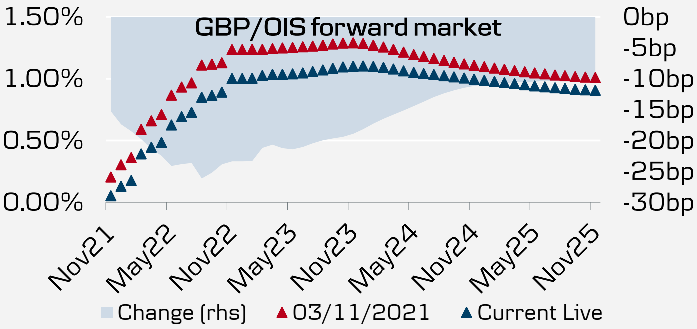
In line with our call, the Bank of England stayed on hold in November but still signalling rate hikes are needed down the road to combat high inflation.

We expect the bank of England to hike the Bank Rate three times in 2022 (15bp in February, 25bp in May and 25bp in November). The reason is that we expect the economic recovery will continue (including increasing employment) amid still high inflation.

FX: Upside risks to EUR/GBP near-term; still set to move lower in 3-12M

As expected, the EUR/GBP moved higher on announcement now trading at 0.856 vs. 0.847 before the announcement. **We are still of the view that the move higher in EUR/GBP will be short-lived but near-term there are upside risks given the current market pricing of Bank of England.** We still expect rate hikes from the Bank of England, while we expect the ECB to stay patient despite recent increases in rate hike expectations, see *ECB Review: Confirmed: Today's meeting was a prelude to December*, 28 October. Also we still believe the environment is more supportive for GBP than EUR, as GBP usually strengthens in an environment where USD does. That said, the potential for a stronger GBP is lower than for USD. **We still target EUR/GBP in 0.83 12M.**

Markets are pricing in fewer rate hikes after the meeting



Note: Past performance is not a reliable indicator of current or future results
Sources: Danske Bank

Disclosures

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

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Authorised and regulated by the Danish Financial Services Authority (Finanstilsynet). Deemed authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority's website.

Danske Bank's research reports are prepared in accordance with the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

Ad hoc.

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank A/S. It is provided for informational purposes only and should not be considered investment, legal or tax advice. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

This research report has been prepared independently and solely on the basis of publicly available information that Danske Bank A/S considers to be reliable but Danske Bank A/S has not independently verified the contents hereof. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation or warranty, express or implied, is made as to, and no reliance should be placed on, the fairness, accuracy, completeness or reasonableness of the information, opinions and projections contained in this research report and Danske Bank A/S, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts and reflect their opinion as of the date hereof. These opinions are subject to change and Danske Bank A/S does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom (see separate disclaimer below) and retail customers in the European Economic Area as defined by Directive 2014/65/EU.

This research report is protected by copyright and is intended solely for the designated addressee. It may not be reproduced or distributed, in whole or in part, by any recipient for any purpose without Danske Bank A/S's prior written consent.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/S, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank A/S is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank A/S who have prepared this research report are not registered or qualified as research analysts with the New York Stock Exchange or Financial Industry Regulatory Authority but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Disclaimer related to distribution in the United Kingdom

In the United Kingdom, this document is for distribution only to (I) persons who have professional experience in matters relating to investments falling within article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the 'Order'); (II) high net worth entities falling within article 49(2)(a) to (d) of the Order; or (III) persons who are an elective professional client or a per se professional client under Chapter 3 of the FCA Conduct of Business Sourcebook (all such persons together being referred to as 'Relevant Persons'). In the United Kingdom, this document is directed only at Relevant Persons, and other persons should not act or rely on this document or any of its contents.

Disclaimer related to distribution in the European Economic Area

This document is being distributed to and is directed only at persons in member states of the European Economic Area ('EEA') who are 'Qualified Investors' within the meaning of Article 2(e) of the Prospectus Regulation (Regulation (EU) 2017/1129) ('Qualified Investors'). Any person in the EEA who receives this document will be deemed to have represented and agreed that it is a Qualified Investor. Any such recipient will also be deemed to have represented and agreed that it has not received this document on behalf of persons in the EEA other than Qualified Investors or persons in the UK and member states (where equivalent legislation exists) for whom the investor has authority to make decisions on a wholly discretionary basis. Danske Bank A/S will rely on the truth and accuracy of the foregoing representations and agreements. Any person in the EEA who is not a Qualified Investor should not act or rely on this document or any of its contents.

Report completed: 4 November 2021, 15:45 CET

Report first disseminated: 4 November 2021, 15:50 CET