# Special Coverage:

# BoE leaves door open for more hawkish policy

## Key takeaways

- As expected, but on the dovish side of the market outlook, the Bank of England (BoE) raised the base rate by 0.5%, taking the rate to 2.25%. It also announced that they would start winding down their £838bn holding of gilts purchased as part of previous Quantitative Easing. The BoE expects that sales of around £10bn a quarter, along with redemptions, will reduce the overall holdings by about £80bn.
- The BoE acknowledged that the announced Energy Price Guarantee (EPG) “is likely to limit significantly further increases in CPI inflation and reduce its volatility while supporting aggregate private demand”. It should reduce near-term inflation risks and help restrain inflation expectations but add upside to medium-term inflation because of more resilient than expected household demand.
- The BoE prefers to wait for the next meeting to re-evaluate monetary policy in reaction to policy changes (discussed on 23 Sep). If reports for tax cuts prove to be correct, the new economic forecasts could provide the ammunition for the BoE to act more aggressively on rates, with markets pricing in a 0.75% hike. With the risk of more aggressive tightening and GBP more likely to weaken, we are neutral on equities and prefer higher quality investment grade credit.


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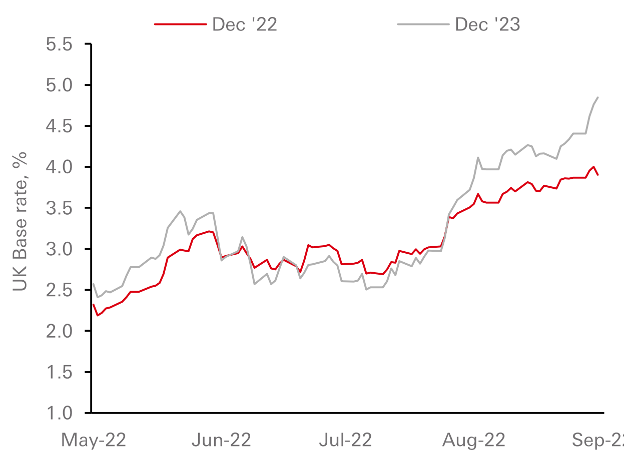
## Market reaction to a dovish BoE

- Market expectations ahead of the meeting were divided, while analysts were calling for a 0.5% move. The more dovish announcement meant that market policy rate expectations fell slightly initially. However, reading between the line that the BoE is kicking the policy decision on the “mini-budget” down the road to the November meeting kept next month’s expectations at 0.75%.
- Policy expectations moved higher towards a 5% peak by the end of 2023 as markets place more bets that the easing of fiscal policy will lead to a more aggressive BoE.
- This expectation of more hawkish longer-term policy also had the effect of pushing gilt yields higher, with the 10-year gilt yields moving almost 10bps higher to 3.4%.
- Within the UK equity market, FTSE 250 companies underperformed as the implied hawkishness of future meetings weighs on market sentiment for more domestically focused equities.

**Market base rate expectations**




Source: Bloomberg, HSBC Global Private Banking and Wealth as at 22 September 2022

## Investment Summary

- The tone of the BoE minutes places a clear upside risk to our forecast of rates peaking at 2.75%. While there was some acknowledgment that growth had softened and that consumer spending had likely peaked in this quarter, there were also signs that the labour market remained relatively tight. Should the growth plan announced result in a material fiscal loosening, the BoE feels a higher policy rate is needed to bring down inflation.
- The EPG will bring down inflation next year, which is expected to peak in October. Also, the BoE still thought inflation would hover above 10% for the rest of the year.
- Even though there are risks to the upside for our rate view, we still think that the peak policy rate is more likely to fall comfortably short of market expectations.
- In the US, the Fed is more likely to follow through with the hawkish market sentiment, in our view. This risk of downward pressure on UK rates would serve only to widen the interest rate differential between the US and UK even further, raising the appeal of the USD vs GBP.
- Gilts are likely to remain volatile as supply increases and the BoE sells downs its bond portfolio. We think there may not be the same level of pension demand for gilts as we saw in lower rate environments. Therefore, we expect near-term volatility before a slowing growth outlook should be more bullish for higher duration gilts.
- In equities, we prefer more defensive sectors and energy. This sector preference favours the FTSE 100, which is also more insulated from slowing UK growth, having a majority of its revenues in non-GBP currencies. This leads to a preference for the FTSE 100 but an overall neutral on UK equities.

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