GENERALI INVESTMENTS

Market Commentary

March 18, 2021

Macro & Market Research, Generali Insurance Asset Management S.p.A. SGR

The BoE implicitly sends a slightly hawkish message

- **While the Bank of England (BoE) unanimously kept its monetary policy unchanged today, it could well change the pace of its QE buying in May.**
- **Given no response to the strong rise in Gilt yields, the bank's implicit message looks relatively more hawkish in comparison to the ECB and the Fed.**
- **We expect the BoE to terminate its QE programme by the end of the year while we see a first rate hike not before H2/2023.**

Today, the Bank of England (BoE) decided to keep Bank Rate, QE and the pace of asset purchases unchanged. All votes were taken unanimously as predicted by the consensus forecast. While this thus came as no surprise, basically markets were seeking hints regarding two underlying questions:

- whether the MPC would judge the recent strong rise in Gilt yields as broadly appropriate and thus won't intend to fight it
- and whether the BoE sees the expected recovery as strong enough so that an earlier hike in Bank Rate could become a realistic prospect?

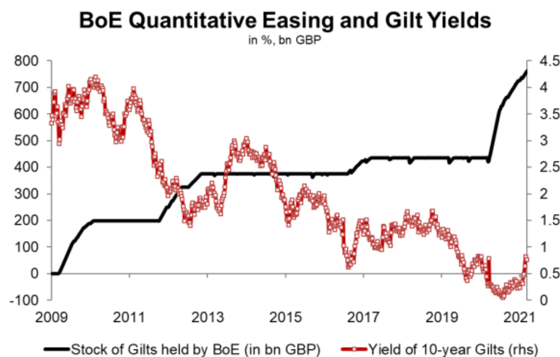
The MPC discussions took place against a substantially changed environment. In its last meeting, negative rates were still on the agenda. The BOE was concerned that asking the banking sector for preparations could be interpreted that such a move was imminent. In the meantime, 10y Gilt yields rose to about 0.88% and markets are pricing a first rate hike to 0.25% by September 2022.

The MPC touched on all arguments: The strong rise in government bond yields was part of a global move, very much driven by the large US fiscal stimulus package. On the UK domestic side, it reflects the prospects for a sustained recovery, made possible due to the fast progress in vaccination against Covid-19 which promises an earlier opening-up of the economy compared to previous expectations and also to European peers. Moreover, in early March, UK Chancellor Rishi Sunak announced his budget plans which included a two stage approach with bigger than expected spending over the next two years. This will be followed by tax hikes and other measures to consolidate the budget thereafter. In addition, the January UK GDP fell less than expected (-2.9% mom).

Acknowledging these developments, the Committee agreed that the news on short-term economic activity had been better than expected in its last February appraisal. At the same time, it stated that it "*is less clear that this represents news to the MPC's medium-term forecast*" and that there remains "*a material degree of spare capacity at present*". Moreover, "*particularly the relative movement in demand and supply during the recovery from the pandemic, remains unusually uncertain*" while "*there was a range of views across MPC members on the degree of spare capacity*".

In sum, the Committee members could not yet agree that the balance of risk has shifted to the positive side and therefore decided to keep all options on the table. Nevertheless, the MPC judges that "*an aggregate measure of UK financial conditions has been broadly unchanged since the February Report.*" Despite the yield rise and the appreciation of the Sterling, this in-action can be interpreted as a kind of hawkish statement endorsing recent market moves. This is in stark contrast to the recent ECB decision to accelerate PEPP buying over the next quarter and yesterday's dovish Fed message. We therefore continue to expect that the BoE will not expand its current QE programme, with the pace of buying to be reduced in May and the programme to be terminated at year-end.

The BoE also kept its forward guidance that it *"… does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably*". In this regard, much will depend on the development of unemployment and inflation. which remains highly uncertain given no experience with a pandemic like Covid-19. We expect the MPC to rather err on the side of caution. We see inflation to come in at 1.5% this year and 1.9% in 2022 and forecast the first key rate hike not before H2 / 2023. Current market pricing of a rate hike already in late 2022 looks too ambitious, in our view.



Author:
Christoph Siepmann
Christoph.siepmann@generali-invest.com

www.generali-investments.com

This document is based on information and opinions which Generali Insurance Asset Management S.p.A. Società di gestione del risparmio has obtained from sources within and outside of the Generali Group. While such information is believed to be reliable for the purposes used herein, no representation or warranty, expressed or implied, is made that such information or opinions are accurate or complete. The information, opinions estimates and forecasts expressed in this document are as of the date of this publication and represent only the judgment of Generali Insurance Asset Management S.p.A. Società di gestione del risparmio and may be subject to any change without notification. It shall not be considered as an explicit or implicit recommendation of investment strategy or as investment advice. Before subscribing an offer of investment services, each potential client shall be given every document provided by the regulations in force from time to time, documents to be carefully read by the client before making any investment choice. Generali Insurance Asset Management S.p.A. Società di gestione del risparmio may have taken or, and may in the future take, investment decisions for the portfolios it manages which are contrary to the views expressed herein provided. Generali Insurance Asset Management S.p. A. Società di gestione del risparmio relieves itself from any responsibility concerning mistakes or omissions and shall not be considered responsible in case of possible damages or losses related to the improper use of the information herein provided. It is recommended to look over the regulation, available on our website www.generali-investments.com. Generali Investments is part of the Generali Group which was established in 1831 in Trieste as Assicurazioni Generali Austro Italiche. Generali Investments is a commercial brand of Generali Investments Partners S.p.A. Società di gestione del risparmio, Generali Insurance Asset Management S.p.A. Società di gestione del risparmio, Generali Investments Luxembourg S.A. and Generali Investments Holding S.p.A..