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# BOE EMPHASISES UPSIDE RISKS, NO PUSHBACK ON HIGHER YIELDS

## Berenberg Macro View

**Improving outlook:** Reacting to the rapid pace of vaccinations at home and the improving global backdrop, the BoE's nine member Monetary Policy Committee's (MPC) is turning more optimistic about the UK economic outlook. Crucially for markets, policymakers remained comfortable about the recent rise in gilt yields. Judging by the March meeting minutes, policymakers feel no urgency to lean against rising gilt yields with actions or words.

At the March meeting, policymakers voted unanimously in favour of keeping the bank rate at 0.1%, maintaining the stock of corporate bonds at £20bn, and continuing ongoing UK government bond purchases until the target of £875bn is reached (likely by year end).

**Still dovish:** The BoE's policy guidance remains tilted to the dovish side and is broadly unchanged from February:

*'If the outlook for inflation weakens, the Committee stands ready to take whatever additional action is necessary to achieve its remit. The Committee 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.'*

Nevertheless, the minutes suggest that the March meeting was dominated by discussions about the improved near-term outlook and upside risks. These include:
- Stronger-than-expected global conditions relative to the February projections;
- a *'substantial'* new US fiscal stimulus;
- falling rates of Covid infections and hospitalisations in the UK as well as rapid vaccination progress;
- plans for easing restrictions at a quicker pace than the BoE had assumed in February; and
- more near-term fiscal stimulus in the UK following the extension of emergency economic support in the March 2021 budget.

**Turning more positive:** As a rough guide to the improvement in policymaker sentiment compared to the February MPC meeting, consider the following: the MPC meeting minutes for March (published today at 12:00 GMT) mention 'downside' three times - unchanged from the February meeting. However, the March minutes mention 'upside' seven times, up from only twice in the February meeting.

**On this basis, we should expect sizeable upgrades to the BoE's near-term forecast at the May Monetary Policy Report** (see table below for the BoE's February forecasts). The minutes note that the medium-term outlook remains 'uncertain', however.

**No change to the inflation outlook:** Although inflation expectations are rising (current 5 year breakeven at 3.3%, up from c2.7% at the start of the year – based on retail price index not consumer price index) the BoE views them as 'well anchored' and continues to expect inflation to remain at close to its 2% target through 2022 and 2023. The BoE probably will not project a sizeable inflation overshoot until such a scenario is already underway – in the near-term at least, this will underpin the BoE's aggressive easing bias.

**No reaction to recent yield moves:** The minutes note that '*The upward movement in yields appeared to have been driven by positive news on global economic growth'.* Despite the rise, the MPC notes that *'UK financial conditions had been broadly unchanged since the February Report'.* The latter suggests that the BoE views the rise in yields as proportional to the improvement in economic conditions and expectations for growth and inflation – and hence no obstacle to it.

**No change to pace of asset purchases:** The MPC provided symmetrical guidance on the outlook for asset purchases and pushed back against rising expectations of rate hikes:

*'The Committee continued to envisage that the pace of purchases could remain at around its current level initially, with flexibility to slow the pace of purchases later'*

*'Should market functioning worsen materially, the Bank of England stood ready to increase the pace of purchases to ensure the effective transmission of monetary policy'*

*'The Committee did not intend to tighten monetary policy at least until there was clear evidence that significant progress was being made in eliminating spare capacity and achieving the 2% inflation target sustainably'*

See our preview for a further discussion of recent yield moves and the policy outlook.

## 1.2: The MPC's projections

**Table 1.A:** Forecast summary[(a)(b)]

| | Projections | | | |
|---|---|---|---|---|
| | 2021 Q1 | 2022 Q1 | 2023 Q1 | 2024 Q1 |
| GDP[(c)] | -9.2 (-6.5) | 14.2 (10.0) | 1.3 (2.1) | 1.3 |
| CPI inflation[(d)] | 0.8 (0.7) | 2.1 (2.1) | 2.1 (2.0) | 2.0 |
| LFS unemployment rate | 5.5 (6.7) | 5.7 (6.1) | 5.0 (4.7) | 4.5 |
| Excess supply/Excess demand[(e)] | -1 (-2) | +¼ (0) | +¼ (+¼) | 0 |
| Bank Rate[(f)] | 0.1 (0.0) | -0.1 (-0.1) | -0.1 (-0.1) | 0.0 |

(a) Modal projections for GDP, CPI inflation, LFS unemployment and excess supply/excess demand. Figures in parentheses show the corresponding projections in the November 2020 *Monetary Policy Report*.
(b) Unless otherwise stated, the projections shown in this section are conditioned on: Bank Rate following a path implied by market yields; the Term Funding Scheme and Term Funding Scheme with additional incentives for Small and Medium-sized Enterprises; the Recommendations of the Financial Policy Committee and the current regulatory plans of the Prudential Regulation Authority; the Office for Budget Responsibility's assessment of the Government's tax and spending plans as set out in *Spending Review 2020*, updated to incorporate policy announcements made up to 4 January 2021; commodity prices following market paths for two quarters, then held flat; the sterling exchange rate remaining broadly flat; and the prevailing prices of a broad range of other assets, which embody market expectations of the future stocks of purchased gilts and corporate bonds. The main assumptions are set out in the 'Download the chart slides and data' link at *Monetary Policy Report – February 2021*.
(c) Four-quarter growth in real GDP. The growth rates reported in the table exclude the backcast for GDP. Including the backcast 2021 Q1 growth is -9.2%, 2022 Q1 growth is 14.2%, 2023 Q1 growth is 1.3% and 2024 Q1 growth is 1.3%.
(d) Four-quarter inflation rate.
(e) Per cent of potential GDP. A negative figure implies output is below potential and a positive figure that it is above.
(f) Per cent. The path for Bank Rate implied by forward market interest rates. The curves are based on overnight index swap rates.

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