

CENTRAL BANKS

Bank of England hikes rates again, adopts dovish tone as Ukraine war adds to inflation concerns

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The war has sent energy prices surging and will exert more upward pressure on the central bank's inflation projections.

At its last meeting in February, the Monetary Policy Committee imposed back-to-back interest rate hikes for the first time since 2004.

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Dan Kitwood | Getty Images News | Getty Images

LONDON — The [Bank of England](#) on Thursday raised interest rates for the third consecutive meeting but struck a more dovish tone as the Russia-Ukraine conflict is expected to keep inflation higher for longer.

The Bank's Monetary Policy Committee voted 8-1 in favor of a further 0.25 percentage point hike to its main Bank Rate, taking it to 0.75%.

[U.K. inflation was already running at a 30-year high prior](#) to Russia's invasion of Ukraine, which sent energy prices surging and will exert more upward pressure on the central bank's inflation projections.

At its last meeting in February, the Monetary [Policy Committee imposed back-to-back interest rate hikes](#) for the first time since 2004 and upped its forecast for inflation to a 7.25% peak in April, against a backdrop of strong growth and a robust labor market in the U.K.

The Bank said at the time that any further tightening of monetary policy would depend



Moscow's assault on Ukraine and subsequent threats to energy supply.

Two-sided risks

“Global inflationary pressures will strengthen considerably further over coming months, while growth in economies that are net energy importers, including the United Kingdom, is likely to slow,” the Bank said in Thursday's report.

The Bank now expects inflation to increase further in the coming months to around 8% in the second quarter of 2022, and perhaps even higher later in the year.



VIDEO 04:06

Conditions for rate lift-off not met yet, argues Portuguese central bank governor

Given the tightness of the labor market and persistent domestic cost and price pressures, the MPC also said that “some further modest tightening in monetary policy may be appropriate in the coming months,” though the risks are two-sided depending on the development of medium-term inflation prospects.

[Sterling](#) retreated following the announcement, shedding 0.3% against the dollar, while the [euro](#) gained around 0.5% against the pound.



Paul Craig, portfolio manager at Quilter Investors, said in reaction to the Bank's increased inflation projections that it now seems "ultimately a double-digit inflation rate is not off the cards."

"The BoE had no choice but to keep raising rates. It is looking to build in some insurance now should there be a slowdown in economic growth or employment comes in worse than feared," Craig said.

"With global risks and the Russia-Ukraine war having a significant economic impact, growth will be challenged and thus the Bank may need to reverse course later in the year."

For now though, Craig suggested the Bank will need to continue its tightening path to prevent a further devaluation of sterling, which would exacerbate the cost of living crisis gripping U.K. households.

"Savings rates could improve from here which might offset some of the cost of living crunch, but with inflation proving difficult to contain it might all be a little too late," he added.



VIDEO 04:57

The ECB is even more behind the curve than the Fed is on inflation: Professor



Vivek Paul, U.K. chief investment strategist at BlackRock Investment Institute, said the normalization of policy rates to their pre-pandemic levels and the end of quantitative easing made sense, with the country's strong economic rebound showing further stimulus is no longer necessary.

The U.K. economy grew by 7.5% in 2021, clawing back much of its pandemic-era contraction.

“Yet headwinds caused by the Ukraine war including sharply higher energy prices could slow the economy's momentum later this year,” said Paul.

“With market expectations yesterday for the base rate close to 2.2% by the end of the year – higher even than before the Ukraine war began – markets are betting that the Bank's rate path from here will be extremely aggressive in the near-term.”

Although BlackRock does see more tightening over the coming years, Paul suggested that there is “excessive hawkishness” in most developed markets, since overly aggressive hiking from central banks would exact a heavy toll on growth.

“Current market pricing points to a front-loading of rate hikes followed by a series of cuts, illustrating the risk of overtightening,” said Paul.

“Clear communication will be key, in our view, for the Bank to avoid creating confusion by over-tightening financial conditions and hurting the real economy.”

