City bets on interest rate rise this year on back of Bank Governor's comments

C
ITY traders today firmed up their bets that UK interest rates will rise faster than previously thought in the face of soaring inflation, wage demands and supply chain problems.

Until very recently economists and others in the City were pricing in a rise in rates from historic lows of 0.1% in the first quarter of next year, at the earliest.

They now think rates will have to rise before the end of the year, and expect them to hit 1% by September next year.

The latest nudge was from Andrew Bailey, the Bank of England governor, who warned yesterday the central bank "will have to act" to curb inflation.

Its view had been that inflation is a passing issue, one that will work its way through the system, and that the bigger concern was tepid economic growth. That view seems to be shifting.

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“The energy storm,” warned Bailey, means high inflation “will last longer”.

He added, in words more explicit than Bank governor’s usually use: “Monetary policy cannot solve supply-side problems – but it will have to act and must do so if we see a risk, particularly to medium-term inflation and to medium-term inflation expectations. And that’s why we at the Bank of England have signalled, and this is another such signal, that we will have to act.”

The next UK inflation figure is due on Wednesday. It is expected to come in at 3.2% before rising to 4% later – the Bank’s inflation target is 2%.

Bond yields rose and prices fell today. A five-year government gilt was today paying 0.85%, the highest since May 2019. There’s a similar picture for bonds in the US and elsewhere.

Andrew Ticehurst, a rates strategist at Nomura, told Bloomberg: “The global theme is that higher inflation will likely be less transitory than earlier expected amid elevated commodity prices.”

The Bank of England’s rate setters – the Monetary Policy Committee – meet next on November 4. That is likely to be a key, closely watched, meeting.

Not everyone in the City thinks the bond markets are calling the situation correctly.

ING said in a note to clients today: “Governor Andrew Bailey’s hawkish comments this weekend suggest a November UK rate hike is increasingly likely. But the rapid succession of rate hikes being priced by investors looks too extreme, not least because any tightening will also involve reducing the size of the BoE’s balance sheet. At most, we expect two rate hikes by the end of 2022.”