Private Bank

Europe Strategy Bulletin

September 23rd, 2021

Bank of England holds rates; Stronger case for modest hike

Jeffrey Sacks, Head – EMEA Investment Strategy | +44 207 508 7325 | Jeffrey.ian.sacks@citi.com
Maya Issa – Senior Vice President, Global Investment Strategy | maya.issa@citi.com

Announcement summary:

- **At its meeting today, the Bank of England (BoE) kept its deposit rate at 0.1%** on a unanimous vote.
- **It also left its asset purchase programme unchanged at £875 billion on a 7-2 vote**. The two dissenters were seeking a reduction to £840 billion.
- **The BoE expects inflation to breach 4% before peaking.**
- **Markets' expectations of an interest-rate hike have been brought forward.**
- **UK assets were broadly steady after the announcement.**
- **UK assets continue to look well supported. We remain overweight UK equities.** The economic recovery is supporting earnings, low interest rates are supporting equity valuation and the wide yield gap with fixed income is encouraging inflows.

The BoE's Monetary Policy Committee noted that some "developments in the intervening period appear to have strengthened" the case for policy tightening during its forecasting horizon. Dissenting views in favour of halting the asset purchase programme grew, with Deputy Governor Dave Ramsden joining Michael Saunders in citing rising inflation. This puts the BoE on a more hawkish path, following the Federal Reserve's announcement yesterday that officials may taper bond purchasing soon, while Norway raised its interest rate on Thursday.

The BoE highlighted additional concern over rising inflation, predicting that consumer prices will peak at over 4% in the coming months, higher than their 2% target rate – **figure 1**. However, the MPC maintained its outlook that elevated cost pressures would prove to be transitory. The minutes of the meeting noted that the "committee would monitor very closely the risk that domestic and global demand and cost pressures could further affect medium-term inflation expectations."

This UK inflation outlook is similar to the OECD's view. The Paris-based think tank recently raised its forecasts for UK inflation by 1% for this year to 2.3% and by 1.4% next year to an average of 3.1%. The short-term pressures are due to a combination of supply chain disruptions, high shipping and commodity costs, and tight labour markets.

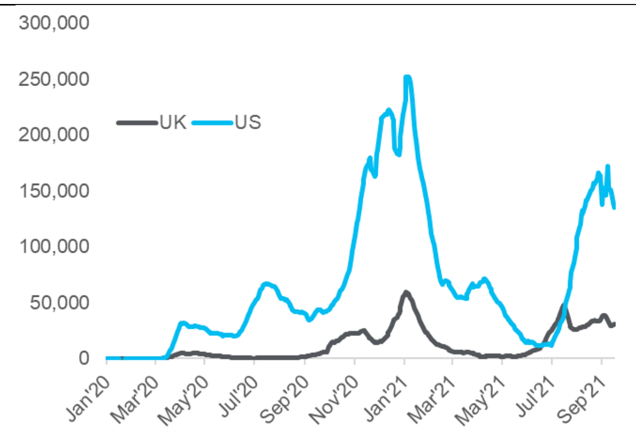
It is possible that the first interest-rate rise will take place before the end of the existing government bond purchase programme in December 2021. A key short-term variable is unemployment, as the furlough scheme ends at the end of September. This is likely to mean that there will not be a rate hike until early next year. Citi expects the deposit rate to move from 0.1% to 0.5% by May 2022, and 1.25% by early 2024.

After the sharp growth rebound from the depths of the pandemic, the pace of growth is slowing somewhat. The BoE revised down its 3Q21 GDP growth forecast slightly. However, the full-year GDP growth should still reach at least 6%, with good indications of further strength into 2022. Economic resilience during the Delta variant wave has been impressive – **figure 2** – with 63% of adults vaccinated twice and boosters now being offered to the elderly. Consumer spending is strong, supported by over £160 billion of net incremental accumulated savings during the pandemic. This is also reflected in the booming residential property market – **figure 3.** Manufacturing activity remains strong – **figure 4** – and investment intentions continue to strengthen. Government spending on infrastructure and alternative energy initiatives is expected to rise as the pandemic emergency spending lessens. Economic output is now back to the pre-COVID level, albeit still 3.5% below than the projected trend from before the pandemic started.

Figure 1: UK Inflation vs BoE Target Rate

Source: Bloomberg as of September 21, 2021.

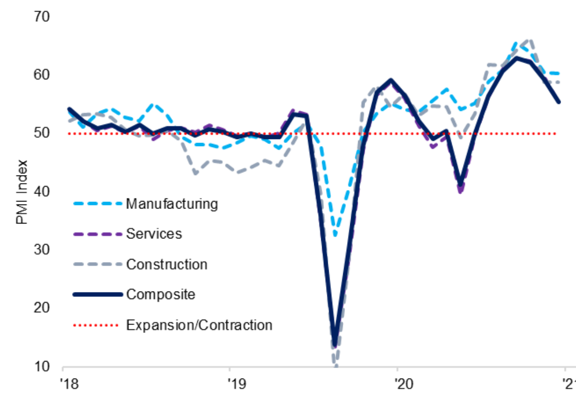
Figure 2: New COVID infections in US and UK



Source: Haver Analytics, Oxford University Our World in Data, as of September 22 2021.

Figure 3: Rebounding UK house prices – Nationwide House Prices Y/Y%

Figure 4: UK Purchasing Managers' Index

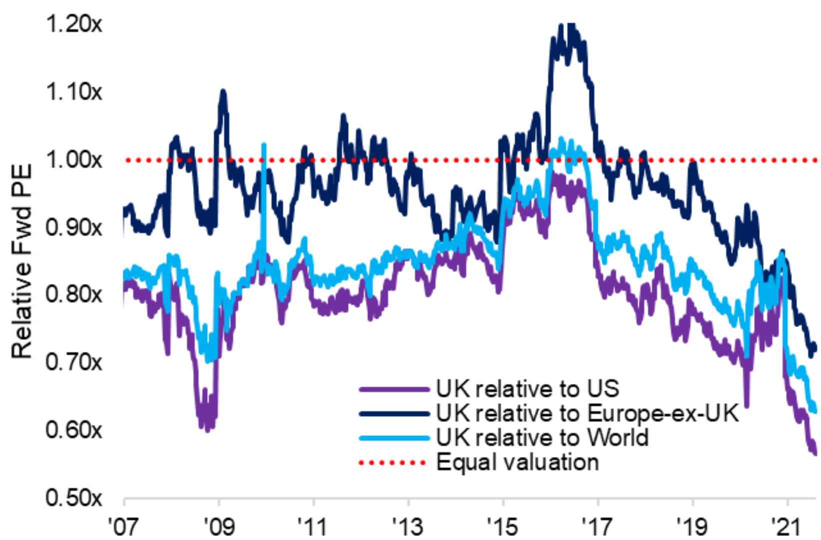


Source: Bloomberg as of August 31, 2021. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. For illustrative purposes only. Past performance is no guarantee of future results. Real results may vary. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events.

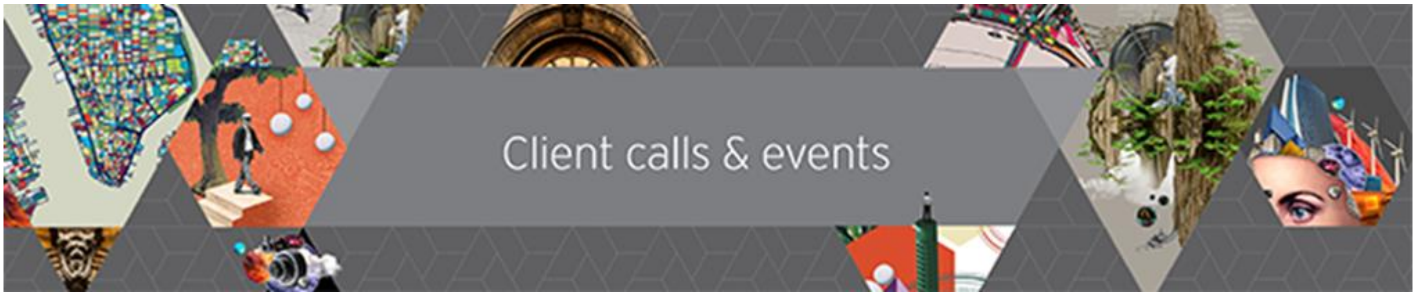
Market outlook

Our Global Investment Committee remains overweight UK equities. The valuation multiple is cheap in absolute terms at 12.3 forward earnings even after the market's 9.7% rise so far this year. It is also well supported by the low discount rate. The relative underperformance remains significant – **figure 5** – even as the UK's Brexit challenges prove to be less than earlier anticipated and the vaccine programme has been effective. EPS growth this year is likely to be very strong this year and the average dividend yield of 3.9% is higher than any other developed market. Rising M&A activity and share buybacks are important catalysts – see our EMEA Bulletin (August 16).

Figure 5: UK market is cheap in absolute and relative terms



Source: Bloomberg as of September 2, 2021. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events.



INVESTMENT PRODUCTS: NOT FDIC INSURED · NOT CDIC INSURED · NOT GOVERNMENT INSURED · NO BANK GUARANTEE · MAY LOSE VALUE

This email contains promotional materials. If you do not wish to receive any further promotional emails from Citi Private Bank, please email donotspam@citi.com **with "UNSUBSCRIBE" in the subject line. Email is not a secure environment; therefore, do not use email to communicate any information that is confidential such as your account number or social security number.**

Citi Private Bank is a business of Citigroup Inc. ("Citigroup"), which provides its clients access to a broad array of products and services available through bank and non-bank affiliates of Citigroup. Not all products and services are provided by all affiliates or are available at all locations. In the U.S., investment products and services are provided by Citigroup Global Markets Inc. ("CGMI"), member FINRA and SIPC, and Citi Private Advisory, LLC ("Citi Advisory"), member FINRA and SIPC. CGMI accounts are carried by Pershing LLC, member FINRA, NYSE, SIPC. Citi Advisory acts as distributor of certain alternative investment products to clients of Citi Private Bank. CGMI, Citi Advisory and Citibank, N.A. are affiliated companies under the common control of Citigroup.

Outside the U.S., investment products and services are provided by other Citigroup affiliates. Investment Management services (including portfolio management) are available through CGMI, Citi Advisory, Citibank, N.A. and other affiliated advisory businesses. These Citigroup affiliates, including Citi Advisory, will be compensated for the respective investment management, advisory, administrative, distribution and placement services they may provide.

Read additional important information

Past performance is not indicative of future results. Real results may vary.

****Citi and its employees are not in the business of providing, and do not provide, tax or legal advice to any taxpayer outside Citi. Any statement in this Communication regarding tax matters is not intended or written to be used, and cannot be used or relied upon, by any taxpayer for the purpose of avoiding tax penalties. Any such taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.**

MBS are also sensitive to interest rate changes which can negatively impact the market value of the security. During times of heightened volatility, MBS can experience greater levels of illiquidity and larger price movements.

Important information, including information relating to risk considerations can be found in the link above.

Views, opinions and estimates expressed herein may differ from the opinions expressed by other Citi businesses or affiliates, and are not intended to be a forecast of future events, a guarantee of future results, or investment advice, and are subject to change without notice based on market and other conditions. Citi is under no duty to update this presentation and accepts no liability for any loss (whether direct, indirect or consequential) that may arise from any use of the information contained in or derived from this presentation.

www.citiprivatebank.com