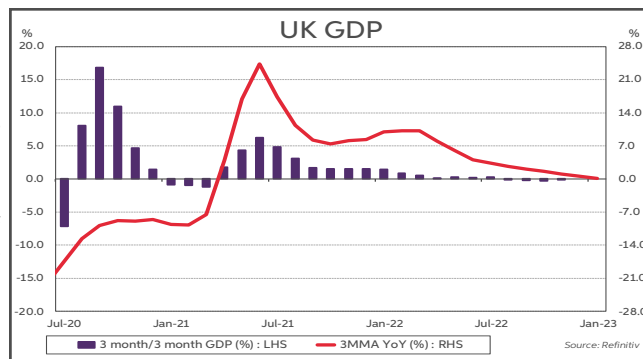


BoE hikes by 25bps, and retains a tightening bias

The March meeting of the Bank of England's Monetary Policy Committee (MPC) saw the central bank announce a 25bps rate hike. This followed a 50bps increase in both February and December. Today's rate hike brings the Bank rate up to 4.25%, and was in line with market expectations. It marks the eleventh consecutive meeting where the BoE has raised rates. The Bank has now hiked rates by a total of 415bps since it commenced its current tightening cycle in December of 2021. In reference to the recent market turbulence, the BoE stated that it will continue to monitor any effects on credit conditions faced by households and business, and in turn, the impact in the macroeconomic and inflation outlook.

The voting breakdown showed that the MPC continued to be split on its rate decision. Similar to February, seven members were in favour of hiking rates, this time by 25bps (50bps hike in February). They were of the view, that given that labour market conditions remained tight, with the unemployment rate now expected to be unchanged in Q2 rather than rising, and near term GDP somewhat stronger than expected, there was a risk of a reinforcement of the persistence of higher costs in consumer prices. Therefore, a further rate hike was justified to ensure CPI inflation returns sustainably to its 2% target over the medium term, as well as ensuring longer term inflation expectations remained anchored at this target. Meanwhile, two members preferred to keep rates unchanged at 4.0%. Their analysis was that headline CPI inflation should fall sharply during the year. They also referenced that the lagged effects from the previous rate hikes implied that no additional rate increases were warranted to get inflation back to target.

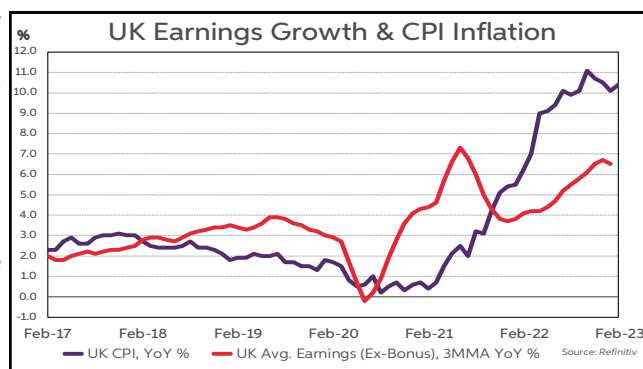


The MPC's assessment of incoming macro data was that indicators suggest GDP is now expected to increase slightly in the second quarter, compared to its previous expectation for a 0.4% decline. The most recent set of detailed macro forecasts from the BoE were released at its last meeting in February with the publication of the Monetary Policy Report (MPR). For this year, the BoE upgraded its growth forecast for the UK economy to -0.5%, from its previous forecast for a -1.5%. Given today's comments, its 2023 GDP forecast could be further upgraded in the May MPR. For next year, the February MPR showed that the BOE was expecting a modest 0.25% fall in GDP. Further out, the BoE is expecting very muted growth of just 0.25% in 2025.

On the inflation front, the central bank commented that despite inflation being higher than envisaged last month, at 10.4%, it now expects it to fall more quickly in Q2 than it had assumed in the February MPR. This is due to changes in the Budget, including in relation to the Energy Price Guarantee and falls in wholesale energy prices. The most recent MPR projections indicated that the BoE is expecting inflation to slow towards 4% around the end of this year. Inflation is expected to fall back below its 2% target in 2024 on the back of more slack in the economy combined with declining external price pressures. The MPC stated that it will incorporate a full assessment of recent macro data as well as the economic implications of recent financial market and banking sector developments in its May MPR, due on May 11th.

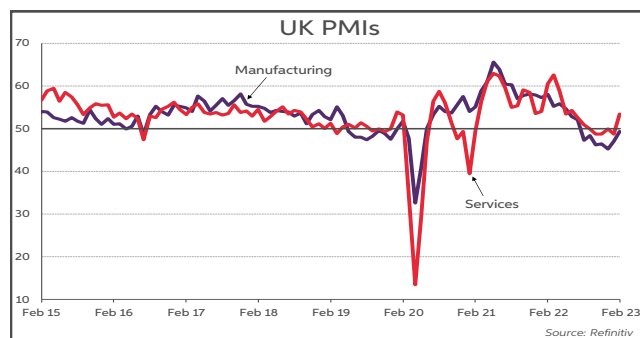
Overall, the BoE retains a willingness to hike rates further if required. It stated that it will continue to monitor closely signs of persistent inflation pressures including metrics on labour market tightness, wage growth dynamics and services inflation. If it sees evidence of more persistent inflationary pressures "then further tightening in monetary policy would be required".

In terms of market expectations, similar to elsewhere, futures contracts have experienced volatility over the last number of weeks in reaction to the stress on the global banking sector and its possible implications for monetary policy. The market is currently pricing that Bank Rate will peak at 4.5% during the summer. This compares to a previous peak rate expectation of 4.75% earlier this month, prior to the recent bout of market turbulence. The market, though is close to pricing in a 25bps rate cut by end year, with almost a further 75bps of easing anticipated in 2024.



UK economy may avoid recession

The UK economy narrowly avoided falling into a technical recession in the second half of 2022. GDP contracted by 0.2% in Q3, before stagnating in Q4. Regarding the underlying Q4 breakdown, private sector consumption edged 0.1% higher. An increase in Government expenditure contributed 0.2 p.p., while fixed investment boosted the total by 0.3p.p. also. Net trade knocked 0.8 p.p. from GDP, as exports fell and imports rose, although, this was partially offset by changes in the inventories and valuables components, which added 0.3 p.p. to output. **Overall, the UK economy grew by 4% last year**, but the annual growth rate had slumped to 0.4% by Q4. UK GDP was still 0.8% below its pre-pandemic level at the end of last year, whereas it was 5.1% and 2.4% higher in the US and Eurozone, respectively.

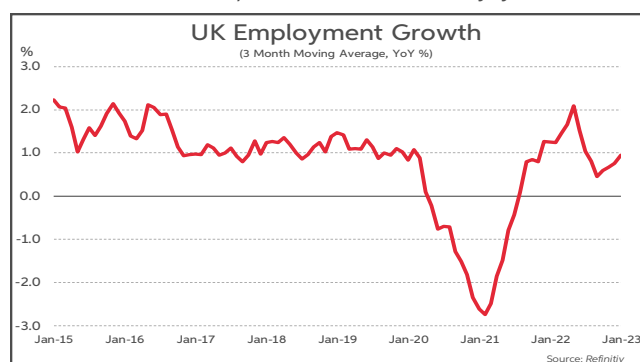


The most recent hard data suggest growth improved at the start of 2023. Having declined sharply by 0.5% in December, the monthly reading of GDP for January registered a 0.3% increase. Meantime, retail sales rebounded by 0.5% in January, after declining by a hefty 1.2% at the end of last year. However, despite January's increase, retail sales have been trending lower since October 2021, and are down 7% since then. Elsewhere, industrial production, which has yet to regain its pre-COVID level, fell in January by 0.3%.

Survey data suggest the economy regained some further momentum in February. The services PMI jumped to 53.5 in February, rising above 50 for the first time since August of last year. The construction sector PMI also moved sharply higher, rising to 54.6 in February from 48.4 in January. The manufacturing PMI remained in contraction territory though, printing at 49.3 in February, but this was its highest level since last July. Meanwhile, consumer confidence remains soft, but improved to -38 in February, its highest level since April 2022.

Meantime, conditions in the labour market remain tight. The unemployment rate was unchanged at 3.7% in the three months to January. This partly reflects, the fact that the fall in participation during the recent economic shocks has not reversed. Despite a recent pick-up in employment, there are roughly 145K fewer people in employment, than before the pandemic struck. Meantime, average earnings growth has decelerated over the past few months, and stood at 5.7% y/y in the three months to January, down from a peak of +6.9% y/y last year. The latest BoE Agent's summary of business conditions survey for Q1 shows that companies pay settlements have averaged 6% so far this year, and recruitment difficulties remain elevated.

In terms of inflation, headline CPI ended a run of three straight falls in February, rising to 10.4%, from 10.1%. This is still below its peak of 11.1% in October though. An increase in food price inflation to 18% y/y from 16.2% y/y contributed to the rise in the CPI. Core CPI also increased in February, rising to 6.2%, from 5.8%. The Government's decision to extend the Energy Price Guarantee (EPG) to cap household energy bills beyond April, and the fall in wholesale energy and commodity prices, suggests inflation has peaked in the UK. The BoE notes that inflation should fall significantly from Q2 onwards, "to a rate lower than had been anticipated", in the last MPR. Previously, the BoE expected inflation to be 8.5% in Q2, before falling to 4% by Q4 2023.



Overall, the UK economy is facing a number of significant headwinds. The cost-of-living squeeze, from higher inflation is weighing heavily on consumers, with the OBR estimating real household incomes fell by 3.1% in 2022, and that they will decline by 3.4% this year. Tighter monetary and fiscal policy are also dampening activity. Meantime, UK exports are continuing to struggle from the double-hit of the pandemic and Brexit. However, the February BoE projections are for a much shallower contraction than in the November update. Furthermore, the OECD now expect the UK economy to contract by just 0.2% this year. **Thus, the UK economy may avoid a recession this year, although, it is still set to perform poorly.**

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