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FLASH REPORT

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Contributors

Juan Manuel Herrera
Senior Economist/Strategist
Scotiabank GBM
+44.207.826.5654
juanmanuel.herrera@scotiabank.com

BoE Returns to Regularly-Scheduled Programming with 25bps Hike

- **The BoE lifted its policy rate by 25bps to 5.25% this morning, in line with our expectations, the Bloomberg median, and the bias of markets in the lead-up to the announcement. The 2–6–1 vote split for +50bps, +25bps, and no change was a bit more hawkish than the 0–8–1 or 1–7–1 that we expected.**
- **The BoE now claims that current policy settings are restrictive, and we think the bar for hikes beyond the November decision (as markets see) is high and will require inflation and wages data to continue overshooting projections.**
- **However, the BoE has also pointed to a higher-for-longer stance, saying it will ensure that the policy rate "is sufficiently restrictive for sufficiently long to return inflation to the 2% target sustainably".**
- **We hold our call of a final 25bps hike at the September decision to a terminal rate of 5.50%, which we see lasting until Q2-24. Whether the BoE hikes again in November is purely dependent on data over the coming weeks/months, especially for wages growth and services inflation.**
- **The BoE's new forecasts see higher end-2024 inflation, but weaker 2024 growth as a higher level of policy rates weighs, while services inflation strength means a slower return to target.**

The BoE lifted its policy rate by 25bps to 5.25% this morning, in line with our expectations, the Bloomberg median, and the bias of markets in the lead-up to the announcement (34bps priced in). The 2–6–1 vote split across two pushing for 50bps, the six-strong consensus calling for a quarter-point increase, and an unsurprising voter (Dhingra) favouring no change was a touch more hawkish than we expected (only one or none choosing 50bps). The BoE did not tee up a QT acceleration but confirmed in the MPR that a vote on this will take place at the September decision.

The BoE now claims that current policy settings are restrictive, after the significant increase in policy rates since late-2023, and past increases are "expected to increasingly weigh on UK activity and inflation in coming quarters". This suggests the BoE sees it's nearing the end of hikes and are now in the tweaking stage.

The bar for hikes beyond the November decision is high and will require inflation and wages data to continue significantly overshooting projections. Bailey, Broadbent, and Ramsden did not add too much to the printed communications, though the Governor's confidence on inflation coming down and the restrictive level of rates gave the conference a dovish feel.

To balance out this assessment of the current stance of policy, the statement now says that the BoE will ensure that the policy rate "is sufficiently restrictive for sufficiently long to return inflation to the 2% target sustainably".

The BoE will take its time in lowering rates when the time comes. This guidance on how long rates will remain sufficiently restrictive, while still loose, at least gives more away than the BoE's main guidance line, unchanged today at "if there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required."

We maintain our call of a final 25bps hike at the September decision to a terminal rate of 5.50%, which we see lasting until Q2-24; we believe higher-for-longer can do the job for the BoE, and more hikes mean overshooting (and thus having to cut faster) risks become greater. Whether the BoE hikes again in November is purely dependent on data over the coming weeks.

Our call for a return to a lower pace of hikes was predicated on data since the surprise 50bps hike in June being mixed enough to not require another aggressive response from the BoE after having already hiked 490bps in the current cycle (now 515bps).

June inflation was lower than expected, but still high, wages growth remained strong but the unemployment rate rose in May, and inflation expectations remain on a downtrend. The UK economy has barely grown since Q4-2021, and the country's composite PMI fell to its lowest point since January last month (but still in the 50+ expansionary territory). This mixed read of the economic and inflation backdrop is in line with the BoE's thinking in today's statement, minutes, and MPR.

At the June meeting, the BoE highlighted that there had "been significant upside news in recent data that indicates more persistence in the inflation process", and responded accordingly with a half-point hike. This time around, the data were not as convincingly in excess of expectations.

The BoE's new forecasts don't show an optimistic outlook. Sure, gone are the forecasts that projected multiple quarters of contraction, but the 0.25% expansion projected for 2024, down from 0.7% in the May MPR paints a picture of a depressed economy that would fall further behind its peers over the coming quarters.

As for its inflation projections, the BoE now sees headline inflation ending 2023 at 4.9%, slowing to 2.5% at end-2024; this is only a touch lower than the May baseline of 5.1% for end-2023, but higher from the May end-2024 forecast of 2.3%. In the MPR, the bank now has a more pessimistic view of services inflation after this has clearly exceeded the previous round's forecast.

From 6.3% in the May MPR for September 2023, the bank now sees services inflation ending the current quarter at 7.0% y/y, vs 7.2% in June data and falling only to 6.9% in December. This is a clear focus for the BoE alongside wages growth to determine future policy decisions—though if the bar for significantly more tightening is services inflation exceeding their forecasts, then the BoE just raised it. Headline inflation falling below 2% from Q2-25 onward is a clear sign that the market-implied policy rate path that is incorporated in the BoE's projections is too flat and a lower policy rate would be required.

The reaction in markets was relatively muted, with the 5/6bps decline in UK 2-yr yields from pre-decision levels to ~4.90% at writing the most notable of the moves in UK markets as the GBP held mostly unchanged vs the USD and the EUR. Year-end pricing for the BoE fell about 10bps, though the bulk of that simply reflects the 9 or so basis points in excess of a quarter-point hike that the market had penciled in.