

FLASH REPORT

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Market Reaction (at time of writing, 7:45ET)

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BoE Holds, Does Not Give an Inch

- **The BoE held its policy rate at 5.25% as expected by economists and markets. Guidance on the time to be spent at the peak was left unchanged, and the door was left equally open to another hike if needed.**
- **The 6–3 vote split may have prompted a leg higher in the GBP and a small selloff in gilts that were carrying a strong rally from the Fed’s decision yesterday, and as some expected a larger 7–2 consensus.**
- **Recent labour market and inflation data were somewhat discounted by the BoE, reflecting that the bank is not ready to be confident that inflation is being tamed quickly enough that they can soften language on the policy rate outlook.**
- **Today’s decision does not change our view that the first BoE rate cut will come at the June 2024 meeting, for a total of 125bps by end-2024. As far as markets are concerned, cut bets were initially pulled back to later end up virtually unchanged at 115–120bps in cuts expected by end-2024.**

Today, the BoE held its policy rate at 5.25%, as was widely expected by all economists and markets. After the fuller decision in early-November which included updated forecasts and a press conference, today’s affair was only a refreshed statement and the customary minutes that accompany it.

The core guidance sentence in the statement, “monetary policy is likely to need to be restrictive for an extended period of time”, was left unchanged. Today’s decision does not change our view that the first BoE rate cut will come at the June 2024 meeting, for a total of 125bps by end-2024.

Like at the November decision the council was split 6–3 between those favouring a hold and those favouring a hike. There was a chance that one of the November dissenters switched their vote from a hike to a hold for a 7–2 vote split, so the 6–3 result contributed, at the margin, to weaken gilts on the announcement and lift the GBP through the 1.27 level (a 0.8% gain on the day).

The unchanged vote breakdown pushes out the possible start of rate cuts and the minutes even note that within the six-strong group “a further rise in Bank Rate remained a possibility.” One member (very likely Dhingra) noted that “the risks of overtightening policy had continued to build.” That this late in the cycle some officials think nominal rates are not high enough, and in contrast to the Fed and ECB already clearly happy with the current levels, pushes out the start of BoE rate cuts.

Earlier this week, BoE officials got two additional clues that likely provided greater comfort that the current policy rate level was appropriate enough. In Tuesday’s employment report, headline wages growth came in well below expectations (albeit with only a small miss in ex. bonus wages growth), and yesterday’s GDP release showed that the UK economy contracted more than expected with relatively broad-based weakness. In October, inflation also fell from 6.7% y/y to 4.6% thanks to helpful base effects and energy price cap resets.

However, the BoE was not yet prepared to be confident that inflation is being tamed quickly enough that they can soften language on policy rates. Regarding both inflation and wages, the BoE still believes that risks are skewed to the upside. Specifically, on prices, the BoE discounted the progress made in services inflation, saying that the downside surprise relative to the November MPR “reflected movements in components that may not provide

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a good signal of underlying trends” (accommodations and airfares). Next week’s November inflation data will be key for BoE cut expectations that remain well lower than what is priced in for the Fed and ECB.

Market Reaction.

Wednesday’s Fed decision had already set a relatively high bar for the BoE in terms of dovish surprise, having resulted in a 16bps increase in end-2024 rate cut expectations in the UK from pre-Fed level up to before today’s announcement.

The combination of a still-hawkish vote split and the fact that the BoE did not give an inch to markets triggered a sharp 8bps rise in UK 2yr yields that has now normalized to about 4bps. Rates cuts pricing has been chopping around and initially had taken out 7bps in end-2024 expectations but this move has now been erased to still see between 115 and 120bps in cumulative reduction by December 2024; the first rate cut is still seen at the May meeting.

The GBP added to its gains on the day to reach the 1.2725 level at writing on a 0.8% rally vs the USD, and a 0.4% appreciation versus the EUR at 1.1645 after trading about 0.2% weaker versus the common currency in the lead-up to the statement.

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