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UK: MPC MARCH MINUTES SHOW THE BOE SHIFTING FROM NEUTRAL TO HAWKISH

Berenberg Macro Flash

Hawkishness creeping into the MPC: While the BoE's policy stance did not change today, there was a notable shift in the guidance for future policy amid continued strong growth and rising inflation. Kristen Forbes, a known hawk, voted for a 25bps rate hike. Meanwhile 'some' committee members noted that given the resilient economic performance since the Brexit vote it would 'take very little further upside news on the prospects for activity or inflation to consider that a more immediate reduction in policy support might be warranted'. This is clear evidence the BoE is changing its tune, moving gradually towards an overdue tightening cycle. While the MPC is clearly worried about a stronger than expected slowdown in household spending as inflation rises this year, it raised its nowcast for Q1 real GDP growth by 0.1ppt to 0.6% versus the February Inflation Report. On the outlook for Q2, the minutes noted 'there had been relatively little evidence so far from the output indicators of a slowdown.' Given the ultra-dovishness of the most recent February Inflation Report, that the MPC's guidance changed so notably just one month later is a little surprising, but nonetheless welcome.

A clear change in guidance: The key guidance always comes right before the MPC vote summary at the end of the minutes. In February the minutes noted 'Monetary policy could respond, in either direction, to changes to the economic outlook as they unfolded to ensure a sustainable return of inflation to the 2% target.' This neutral guidance was removed from the March minutes. Instead, it was replaced by a clear signal that the MPC plans to tighten policy over the medium-term 'the conditioning assumption that had underpinned the February projections – that there would be some modest withdrawal of monetary stimulus over the course of the forecast period – remained appropriate.' From the change in guidance we can see the MPC's notable shift from the neutral stance that has persisted since last August's stimulus to a hawkish one.

Policy outlook – BoE to tread carefully

As we have repeatedly argued alongside our above consensus projections for medium-term real GDP growth since the Brexit vote (2.0% and 1.7% in 2017 and 2018 versus Bloomberg consensus of 1.6% and 1.3%, respectively), there is a clear case for tighter monetary policy in the UK. The economy is in its eighth year of expansion, unemployment is at a record low, and households are gearing up again. In a non-Brexit scenario, the BoE would have hiked by now. The coming real wage squeeze in 2017 will strengthen the BoE's conviction to proceed cautiously even as households draw down savings and raise borrowing to smooth consumption. While rate hikes could modestly dampen growth, by encouraging more saving and less debt, they could prolong the lifespan of the current expansion.

As our base case, we look for a 25bp first rate hike in Q2 2018, with a 30% chance the BoE raises the bank rate earlier. After the first hike, the BoE will likely continue to proceed with extra caution, with small and infrequent rate hikes signalled far in advance, and with a strong bias toward remaining in neutral as and when risks to growth surface.

For our detailed analysis on UK monetary policy in the last 20 years see 'UK: lessons from two decades of BoE policy'.

Vote summary

- Bank Rate be maintained at 0.25% (8-1)
- The Bank of England continue with the programme of sterling non-financial investment-grade corporate bond purchases totalling up to £10 billion, financed by the issuance of central bank reserves (9-0)
- The Bank of England maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435 billion (9-0)

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