



Kallum Pickering, Senior Economist | [Kallum.pickering@berenberg.com](mailto:Kallum.pickering@berenberg.com) | +44 20 3465 2672

## UK: ALL INDICATORS POINT TOWARD A RATE HIKE SOON

### Berenberg Macro Flash

#### THE BoE IS PREPARING THE GROUNDS FOR A RATE HIKE

Despite elevated political and economic uncertainty, the Bank of England seems to be heading for a first rate hike soon. Today's minutes of the monetary policy committee (MPC) meeting that ended on 14 June, nearly a full week after the UK general election that ended in a hung parliament and added new uncertainties to the Brexit outlook, revealed that three committee members voted in favour of a rate hike this month. The MPC minutes noted that, 'the inflation overshoot relative to the target could be more pronounced than previously thought. This lessened the trade-off that the MPC was required to balance and, all else equal, reduced the MPC's tolerance of above-target inflation.' This represents the third consecutive step the BoE has taken toward a first rate hike. First, Forbes voted in favour of a hike in March. In May, the MPC then introduced the guidance that, 'monetary policy could need to be tightened by a somewhat greater extent over the forecast period than the very gently rising path implied by the market yield curve', with Forbes again voting for a hike. Today, three members – all known hawks – voted for a higher rates. This gradual shift in stance represents the MPC's efforts to foretell and communicate a forthcoming hike. Don't ignore it.

#### ANY TIGHTENING WILL BE GRADUAL

As a first step, the BoE will undo the 25bps rate cut that occurred in August last year. The minutes suggest this by stating, 'the withdrawal of part of the stimulus that the Committee had injected in August last year would help to moderate the inflation overshoot while leaving monetary policy very supportive.' The glaring admission from the minutes is any reference to any potential impact of economic uncertainty stemming from the election result. Have the BoE learned the lesson of the Brexit vote, that the economy is robust to shocks and risks? It looks that way. MPC members who voted for a hike today could have easily postponed their vote until the next meeting when more post-election evidence would be available. While the BoE remains concerned about downside risks to consumer spending growth coming from the real wage squeeze, and risks from the modest slowdown in house prices, the minutes highlight the continued robustness of soft and hard measures of household demand, improving foreign demand and continued robust hiring and investment. Headline inflation came in above expectations in May. The MPC remains concerned about the building underlying inflationary pressure. Without tighter policy, inflation is likely to overshoot the BoE's 2% target for longer than the MPC would tolerate.

#### SLOWER TREND GROWTH DOES NOT MEAN LOWER INFLATION

Thanks to Brexit, slower growth is the new normal. We expect Brexit to reduce trend growth to 1.8% per year from 2.2% previously. As a best guess, anything around 1.8% real GDP growth from now on should be considered normal. In May the BoE forecast growth of 1.9% for this year. But slower trend growth does not mean lower inflation. Inflation depends upon the relationship between demand growth and supply growth – the output gap. By focusing on the unattainable growth rates of the past the market risks receiving a cold shower surprise when the BoE finally hikes.



**BERENBERG**  
PARTNERSHIP SINCE 1590

## MACRO NEWS

### **POLICYOUTLOOK – FIRST HIKE IN 2018, COULD BE SOONER**

Barring an unexpected, sharp and protracted drop in demand at home or in a major trading partner such as the Eurozone or the US, we look for a first hike of 25bps in Q1 2018. But the risks are clearly tilted toward a hike sooner. The June minutes support our view that the BoE could surprise markets with a hike this year. We see a 40% chance of a that.

Progress to the first hike will not be easy. The BoE faces inflation uncertainty stemming from the different speeds at which current demand and supply are reacting to Brexit. Communicating its policy guidance amid lower long-term growth remains a challenge. For a discussion on these issues, please see our note [‘BoE Inflation Report preview – edging toward a hike’](#), 9 May 2017.

### **POLICY SUMMARY**

Regarding Bank Rate, five members of the Committee (the Governor, Ben Broadbent, Jon Cunliffe, Andrew Haldane and Gertjan Vlieghe) voted in favour of maintaining the Bank Rate at 0.25%. Three members (Kristin Forbes, Ian McCafferty and Michael Saunders) voted against the proposition, preferring to increase Bank Rate by 25 basis points. Regarding the stock of purchased assets, the Committee voted unanimously in favour of maintaining the stock of sterling non-financial investment-grade corporate bond purchases at £10 billion and maintaining the stock of UK government bond purchases at £435 billion.

This message has been produced for information purposes for institutional investors or market professionals, it is not a financial analysis within the meaning of § 34b or § 31 of the German Securities Trading Act (Wertpapierhandelsgesetz), no investment advice or recommendation to buy financial instruments. The message does not claim completeness regarding the information on the developments referred to in it. On no account should it be regarded as a substitute for the recipient's procuring information for himself or exercising his own judgements. The message may include certain descriptions, statements, estimates, and conclusions underlining potential development based on assumptions, which may turn out to be incorrect. Berenberg and/or its employees accept no liability whatsoever for any direct or consequential loss or damages of any kind arising out of the use of this message or any part of its content. -- For full economics reports please visit our website or contact [capitalmarkets@berenberg.de](mailto:capitalmarkets@berenberg.de).

Joh. Berenberg, Gossler & Co. KG  
60 Threadneedle Street  
London EC2R 8HP  
Phone +44 20 3207 7859  
[www.berenberg.com](http://www.berenberg.com)  
[kallum.pickering@berenberg.com](mailto:kallum.pickering@berenberg.com)