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UK: BOE LETS THE HAWKS OUT, SETTING THE STAGE FOR A MAY HIKE

Berenberg Macro Flash

The hawks come out to signal another hike soon: The Bank of England (BoE) seems to be re-opening the playbook it used ahead of the November 2017 rate hike. Step one, signal to markets that a hike could come soon. Step two, let a couple of known hawks dissent in a policy vote shortly thereafter. Step three, hike rates. After signalling at the February 2018 Inflation Report that a rate hike could come soon, the minutes of the March Monetary Policy Committee meeting published today showed two members of the nine member Monetary Policy Committee – Saunders and McCafferty, both known hawks – voted in favour of raising the Bank Rate by 25bp to 0.75%. These are the same members that dissented ahead of the November hike. The March minutes strengthen the bank's February guidance that a hike could come soon. The real question is, when will it happen?

Today's minutes give the nod to market pricing for a May hike: In the key piece of forward guidance in the March minutes, the committee noted that 'an on-going tightening of monetary policy over the forecast period would be appropriate'. With the knowledge that the market is pricing in a 25bp rate hike in May, with roughly two hikes in total priced in for this year, the BoE had an opportunity today to confirm or squash this expectation. That the BoE did not seek to shift the market pricing away from May, which showed a c55% chance of a hike before today's meeting, is a de facto confirmation that the bank is satisfied with the way the market views the timing of the next hike.

The rationale for rate hikes: While the BoE had initially responded to the risks to demand from the Brexit vote by easing its policy in August 2016, it became increasingly data dependent over the course of 2017, eventually hiking its Bank Rate by 25bp in November – the first hike in a decade. Looking ahead, the BoE expects unemployment to remain below its estimate of full employment (4.5% unemployment) with real GDP growth of 1.8% in 2018 and 2019 – well above its c1.5% estimate of post-Brexit-vote potential. Even though the import-driven inflation from the Brexit vote is fading somewhat quicker than anticipated, at least according to the most recent data point (2.7% in February from 3.0% in January), wage inflation has surprised on the upside in recent months. Nominal weekly earnings (including bonuses) rose to 2.8% in January from 2.7% in December, and up from a low of 1.9% in May 2017. Tight labour markets should push nominal wage growth higher over the medium-term. This suggests upside risk to the inflation outlook in the coming years.

Remember, monetary policy works with a lag. The sustained strong global backdrop, above-potential growth in the UK, and accelerating wage growth, provides sufficient grounds for the BoE to continue to gradually normalise its monetary policy.

Policy outlook: We expect the BoE to hike its Bank Rate by 25bp four times over the next two years, with two hikes in 2018 and two in 2019. This would take the Bank Rate to 1.5% by the end of 2019. We look for the next 25bp hike in May 2018. In our base case, which seems consistent with the BoE's guidance for "gradual" and "limited" rate hikes, the real policy rate would remain negative and the bank's balance sheet large by historical standards. With its negative real rate and large balance sheet, the BoE will remain accommodative well into the medium term. The normalisation of monetary policy reflects the improvement in the economy. It poses little threat to it. See BoE outlook: following the signals in the labour market.

Policy summary (quoted from the March 2018 MPC minutes)
The Governor invited the Committee to vote on the propositions that:

- Bank Rate be maintained at 0.5%;
- The Bank of England maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £10 billion;
- The Bank of England maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435 billion;

Regarding the Bank Rate, seven members of the Committee (the Governor, Ben Broadbent, Jon Cunliffe, Dave Ramsden, Andrew Haldane, Silvana Tenreyro and Gertjan Vlieghe) voted in favour of the proposition. Two members (Ian McCafferty and Michael Saunders) voted against the proposition, preferring to increase Bank Rate by 25 basis points. The Committee voted unanimously in favour of the other propositions.

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