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UK WEEK AHEAD: ARTICLE 50, LABOUR MARKET, BOE MARCH MEETING

Berenberg Macro Flash

BREXIT NEGOTIATIONS: A GOOD START MATTERS MORE THAN THE TIMING

UK Prime Minister Theresa May should have parliamentary approval to trigger Article 50 – the EU divorce notice - by the end of the week. The legislation for May to kick off the two-year Brexit negotiations returns to the House of Commons (lower chamber) today after the House of Lords (upper chamber) added two amendments; one that de facto gives parliament a veto on the final Brexit deal, and a second that protects EU workers' rights in the UK. Before the bill first went to the upper house, the lower house had passed the bill un-amended. Today the lower house has to either accept or reject the conditions introduced by the upper house. Reuters report that MPs in the House of Commons are expected to overturn the amendments, sending the first draft of the bill back to the House of Lords. The Lords will then decide to pass the bill or re-insert the conditions – as early as tonight. Theoretically, both houses can pass a bill back and forth in a process known as ping-pong until one concedes to the other and an agreement is reached. But if the elected lower house rejects the amendments, the unelected upper house will probably not re-insert them again.

PM May could thus have the approval to trigger Article 50 as early as tonight. She has set a deadline of March 31 to begin Brexit talks. Even if the Article 50 bill passes tonight, we expect May and her team to take a few days to let the dust settle before officially giving the EU notice of divorce. Markets have expected May to trigger Article 50 in March for some time now, the choice of the precise day when she actually files the divorce will probably have little impact. How the negotiations fare in the coming months matters much more for sentiment towards the UK. As before, the value of sterling remains the best barometer of market sentiment. Since June 23, trade-weighted sterling has depreciated c14%. If May takes a non-confrontational approach and signals a desire to maintain a high degree of openness to the UK for EU workers, markets could react positively in the coming months. Unfortunately – based on May's rhetoric up to now – she will likely continue to heed the populists' call to clamp down on migration instead, at least as an opening gambit. This sets the stage for a messy summer and, probably, for some more downside for sterling despite the stable near-term economic outlook.

LABOUR MARKET: HIGH DEMAND FOR WORKERS KEY FOR WAGE OUTLOOK

With the labour market at close to full employment – unemployment below 5% and employment at a record high – job gains are starting to slow. The critical question going forward is whether the economy can sustain a sufficient level of real output growth amid Brexit risks such that firms' labour demand remains high and nominal wage growth can accelerate a little from its current level of c2.5% yoy. As our base case, we project real GDP growth of 2.0% in 2017 and 1.7% in 2018. Such growth should enable firms to offer modest increases in nominal wage gains that will partially offset the forthcoming rise in inflation to 3% by mid-year.

Overall, we do not expect to see a major change in the January numbers released on Wednesday (9:30am) for unemployment (cons. exp. 4.8%) and wage growth ex. bonuses (exp. 2.7% yoy). Instead, we will pay close attention to the more timely data (February) for vacancies and jobless claims change. The number of vacancies signals firms' demand for labour. Since the Brexit vote, it has remained at close to record levels (c750,000). Changes in this indicator normally signal changes in employment, unemployment, and wage growth.

BoE MARCH MEETING: TOO EARLY TO TURN HAWKISH

The BoE will publish the policy decision and minutes from the March MPC meeting on Thursday at midday. Despite a growing gap between economic conditions and the bank's easy-policy setting, the MPC will probably maintain its neutral guidance this month. We expect the nine member rate setting committee to vote unanimously to keep all aspects of policy unchanged. The MPC is highly cautious regarding the long-term supply-side uncertainties from the Brexit vote and potential near-term risks to consumption (2/3 GDP) growth from rising inflation.

The MPC will look for sustained evidence of solid real GDP growth over the coming months before turning more hawkish in late 2017. 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. The hike will be signalled far in advance in order to allow a smooth adjustment in markets. For a detailed analysis on UK monetary policy see 'UK: lessons from two decades of BoE policy'.

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