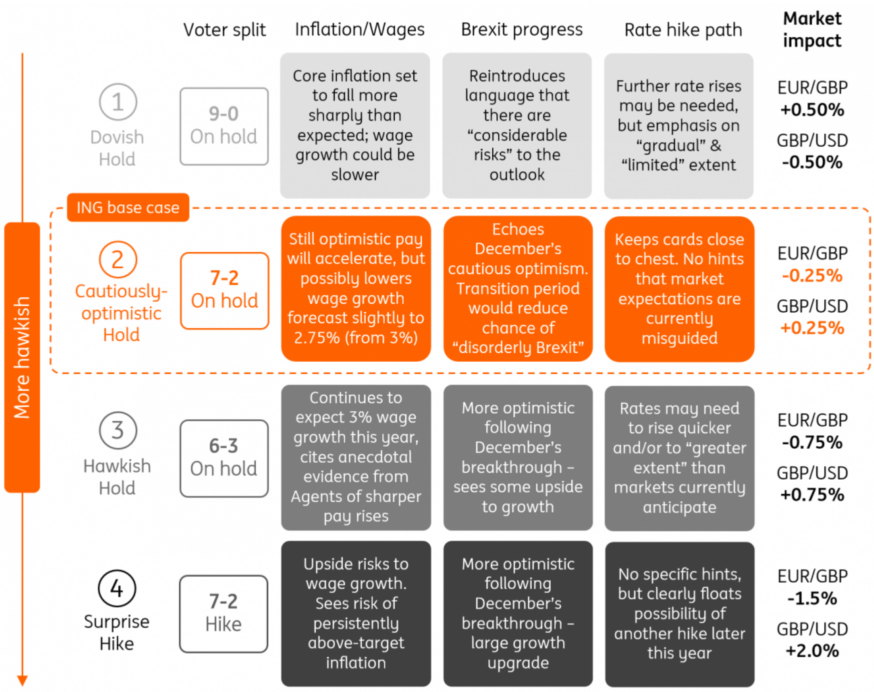
Bank of England dashboard: Why a May hike is a 50:50 call

What we expect from the Bank of England and markets on 'Super Thursday'

Scenario analysis: How markets could react on Thursday



Source: ING

Currency projections by ING's FX Strategy Team

No hike this week, but a May rate rise is a 50:50 call

Back in November, the Bank of England (BoE) hiked rates and hinted that more could be to come. Since then, policymakers have done little to talk up the possibility of a February hike. True, there has been some better news on wage growth, but Brexit remains a big uncertainty. There has been little progress so far towards an agreement on a transition period, nor has there been much further clarity on the UK's desired trade model.

But come May's meeting, steps should theoretically have been made on both of these issues. Assuming wage growth remains on track, that could be enough to satisfy policymakers that another rate hike is required. The Bank will also be acutely aware that the hiking window could close fairly rapidly over the summer as Brexit noise heats up ahead of the October deadline for a deal.

Markets are currently pricing roughly a 50% chance of a May rate hike, and that sounds about right to us at this stage. We suspect the Bank will be fairly comfortable with this too, and this week we expect it to keep its options fairly open, albeit continuing to strike a fairly optimistic tone. But if the BoE opts to upgrade its growth forecasts, remains bullish on wage growth and explicitly sounds more optimistic on Brexit, then that would send a fairly strong signal that another rate hike is likely in coming months.

Here's our Bank of England dashboard with five things policymakers will be watching at the February meeting...

Economic growth

Slowly recovering

Governor Carney's hints about upside risks to growth last week have raised the possibility of the Bank upgrading its 2018 forecasts in the forthcoming Inflation Report. That follows a fairly rosy 4Q growth figure, with the service sector putting in a surprisingly strong performance - although the latest disappointing PMI data have taken some of the shine off this. We're still cautious about the economic outlook, with Brexit-uncertainty and the consumer slowdown set to continue keeping a lid on growth for at least the next few months.

Inflation

Easing

Now that prices have more-or-less adjusted to the new post-Brexit level of the pound, core inflation has started to trend down. Barring one final spike back up to 2.7/2.8% in the next set of data, we expect to see core CPI pretty much back to target around the summer. This downtrend is particularly evident in FX-sensitive items like audio-visual goods, which have seen price rises already begin to moderate. This process will be compounded by the latest rise in the pound (albeit mostly against the USD), potentially forcing the BoE to nudge down its medium-term inflation predictions a touch this week.

Wage growth

Building momentum

There's little doubt that the news here has been better of late. Recent momentum has been stronger (3M/3M annualised growth of 3%), which helps support the BoE's view that low unemployment and mounting skill shortages are forcing firms to raise pay faster. Admittedly it's still early days, and worth noting that the latest rise comes off a low base (last winter was very poor) and at least some of the rise is attributable to a higher minimum wage. It's also likely some firms, faced with reduced demand, low productivity growth and rising input costs, will continue to act cautiously to protect margins. Having said that, there's little reason at this stage for the Bank to doubt its optimistic outlook for pay, although we may see policymakers scale back their 2018 forecast a touch from 3% to a more realistic 2.75%.

Brexit uncertainty

High

Since the BoE's December meeting where policymakers struck a cautiously optimistic tone on Brexit, little has really changed. Nothing has been firmly agreed on the transition period, while technical talks on the finer legal issues continue. Nor has been much further clarity on the trade model the UK is favouring, amidst reports of increasing tension within the government on the direction of travel. Admittedly, the government has now clarified its intention to leave the customs union, allowing room to negotiate its own trade deals. We may get some further hints following the meeting of the Brexit "war cabinet" later this week, but whether the outcome of these internal discussions will be acceptable to the EU, or indeed the overall House of Commons, is still an uncertain question.

Jobs market

Just a blip?

The meteoric recovery in jobs growth in the latest set of data brought some relief following two consecutive monthly falls in employment. Admittedly November's rise in jobs growth looks too large to be driven entirely by fundamentals, but it does tentatively reduce fears that the weak economic conditions through 2017 are beginning to catch-up with the labour market.

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