

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

	Voter split	Inflation/Wages	Brexit progress	Rate hike path	Market impact
<p>1</p> <p>Dovish Hold</p> <p>9-0 On hold</p>	<p>Core inflation set to fall more sharply than expected; wage growth could be slower</p>	<p>Reintroduces language that there are "considerable risks" to the outlook</p>	<p>Further rate rises may be needed, but emphasis on "gradual" & "limited" extent</p>	<p>EUR/GBP +0.50%</p> <p>GBP/USD -0.50%</p>	
<p>2</p> <p>Cautiously-optimistic Hold</p> <p>7-2 On hold</p>	<p>Still optimistic pay will accelerate, but possibly lowers wage growth forecast slightly to 2.75% (from 3%)</p>	<p>Echoes December's cautious optimism. Transition period would reduce chance of "disorderly Brexit"</p>	<p>Keeps cards close to chest. No hints that market expectations are currently misguided</p>	<p>EUR/GBP -0.25%</p> <p>GBP/USD +0.25%</p>	
<p>3</p> <p>Hawkish Hold</p> <p>6-3 On hold</p>	<p>Continues to expect 3% wage growth this year, cites anecdotal evidence from Agents of sharper pay rises</p>	<p>More optimistic following December's breakthrough - sees some upside to growth</p>	<p>Rates may need to rise quicker and/or to "greater extent" than markets currently anticipate</p>	<p>EUR/GBP -0.75%</p> <p>GBP/USD +0.75%</p>	
<p>4</p> <p>Surprise Hike</p> <p>7-2 Hike</p>	<p>Upside risks to wage growth. Sees risk of persistently above-target inflation</p>	<p>More optimistic following December's breakthrough - large growth upgrade</p>	<p>No specific hints, but clearly floats possibility of another hike later this year</p>	<p>EUR/GBP -1.5%</p> <p>GBP/USD +2.0%</p>	

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



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



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.

Author

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.