

## The Bank of England holds, so what next?

We still think the Bank of England is unlikely to hike rates this year, even as it continues to ramp up its hawkish rhetoric



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### Investment still expected to drive the economy as consumer spending lags

The Bank of England says it expects low interest rates and high profitability to lift investment over the next few years, even as firms compete with Brexit uncertainties. But there's a big 'if': that the transition to Brexit is a smooth one. That's obviously quite a big assumption, and until details on a potential transition deal are firmed up, we suspect companies will continue to take a cautious approach to investment.

The Governor, Mark Carney, and the Monetary Policy Committee voted to keep rates on hold at 0.25% this Thursday. The MPC was split 6 votes to 2.

### BoE still very optimistic on wage growth, despite lower forecast

Most people, including the BoE, accept that virtually all the recent inflationary pressures stem from the pound's post-Brexit fall. The bigger question is what happens to domestic inflationary

pressures in the medium term?

Here, the Bank has cut its 2018 wage growth forecast from 3.5% to 3%, but that still implies a significant recovery from the sub-2% readings we've seen in recent months. By the MPC's reasoning, the UK has reached full employment and that should start to drive up pay over the forecast period. The Bank has also, in the past, pointed to temporary factors, such as pension changes and the apprenticeship levy, as keeping a lid on wage growth so far this year.

However, with political uncertainty likely to persist for some time, flagging consumer demand and rising import costs, we think it's unlikely we'll see a drastic acceleration of wage growth anytime soon. We suspect wage growth will stay at or below 2% for much of this year

**3%** BoE 2018 wage growth forecast  
(YoY%)

## A wide range of views on the growth-inflation trade-off.

When you dive into the minutes of Thursday's meeting, it's clear the MPC still isn't united around the baseline views outlined above. The hawks continue to have "limited tolerance" to inflation rises, whilst the more dovish members think the effect of uncertainty on investment could be "larger than assumed".

But unless we do start to see clear signs of domestic inflationary pressures emerging, we think the MPC as a whole will continue to look through the latest price spikes and focus more heavily on the weaker growth outlook.

### We still don't expect a rate hike this year, despite BoE signals

Perhaps the most interesting part of today's statement is the fact that the Bank still think investors are too cautious on the outlook for interest rates. That's despite the UK swap curve steepening noticeably since Haldane & Carney's hawkish comments in June.

However, with wage growth likely to stay below 2% for much of this year, and businesses likely to remain cautious on investment, we still think the Bank of England is unlikely to actually follow through with their hawkish signals and hike rates this year.

But what if they do hike? Well, we think it is much more likely that we enter a "one (or two) and done" scenario rather than the start of a more prolonged hiking cycle. For one thing, the MPC will want to tread very carefully given the rapid accumulation of household debt we've seen over the past few years.

The challenge for the Bank will be to communicate effectively this rate outlook to the markets, and they would most likely characterise a hike as simply removing the emergency stimulus put in last year. Whether markets interpret it this way is a different question.

[Click here to find out what implications a UK rate hike would have for the pound](#)

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