22 June 2018
Opinion

Hike to cut?

The Bank of England Monetary Policy Committee (BoE MPC) has opened the door wide open to an August rate hike. But given the uncertain Brexit outlook, does this make sense?

Poised to hike - Bank of England Monetary policy Committee

WIth Bank of England chief economist Andy Haldane joining Ian McCafferty and Michael Saunders in voting for an immediate rate hike, the Bank of England seems to be giving itself every opportunity for an August hike. We've got further detail on this in the attached note. But the underlying story remains this: The UK economy is currently fairly spotty, and it is really only wage inflation that provides any support for tighter policy. Meanwhile, the outlook for the economy has rarely seemed more uncertain, given the lack of progress on Brexit negotiations. So why hike now?

There are a couple of suggestions, none of which to my thinking are really satisfactory.

1. A hike now will give the BoE more room to manoeuvre if the economy really does not pick up, or the Brexit negotiations lead to the UK crashing out of the EU without a deal.
2. This is just another attempt to talk up the pound, and thereby, talk inflation down.

The problem with argument one is that it basically says that it makes sense for a central bank to hike rates so it can cut them. Say that aloud a few times to see how idiotic it sounds. That is as good a test for the sense of this idea as you can get, I think. That said, I do have some passing sympathy with the notion that it is not the level of rates that is important at very low levels, but the direction of change. So as a one-off, perhaps we can let this pass.

Argument two is not as stupid as it sounds, and there have been a number of occasions where Governor Mark Carney has talked a hawkish story, only to back down. Is he really flip-flopping, as some of his critics aver? Or is this successful jawboning of the economy? If you can credibly talk up the currency to crimp imported inflation, then you never have to deliver in terms of actual policy. Maybe...but we are getting close to the point where the market will want the BoE to either 'put up or shut up'. This strategy does not have an infinite shelf-life.

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No, not the England World cup score

MPC votes for rates on hold vs votes against.

Higher than expected

Japan CPI 0.7% - OK unless you take the target seriously (no-one does)

May headline and ex-food and energy CPI in Japan came in at 0.7%YoY, (0.3%YoY for ex-fresh food and energy), which was a little higher than expected, but still so far below the 2% inflation target that the Bank of Japan is apparently striving to achieve, that it makes no difference.

That is unless you accept that 2% is the wrong number...the wrong target.

If the BoJ were aiming for a more credible and achievable 1%, then you would say, well done, almost there, and start looking for indications of an exit strategy from QQE. Personally, I think most central banks are targeting the wrong (too high) inflation target, and this is delivering excessively cheap credit driving down yields and driving down productivity growth. It also runs the risk of concentrating market risk - a problem if we ever see a rush to unwind positions.

Our base case is that the BoJ is still waiting for some more action from the ECB, under the cover of which it will try to extricate itself from its own qualitative and quantitative easing programme (QQE). But whilst the ECB has provided some more signals recently, it remains in low gear for any change, and this will keep the BoJ sidelined through the rest of this year at least.

Day ahead - desk tidying - long lunch, home early

Its super quiet in terms of the data calendar today, with a motley bunch of second/third tier releases in the Asia-Pacific region. Watch out for some further commentary on trade, as the US' Wilbur Ross has been quite critical (some would say rude) about Chinese claims of openness. A war of words may ensue, which won't help thoughts of a trade deal, though there is also chatter of last-ditch attempts to come up with something on both sides of the Pacific. In my opinion, I don't think the US wants a trade deal. If I'm right, then tariffs will beget more tariffs and the global order will get a significant shake-up. Buckle up, helmets on.

Preliminary June PMI data from Europe provide the main G-7 interest today - this will probably soften a bit further (Composite PMI for May expected 53.9 from 54.1). That is a substantial slowdown from 58.8 in January but would indicate some bottoming out at a still reasonable level, and leave ECB taper plans intact (to the relief of the BoJ no doubt).

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