

## Bank of England hints at tightening but rate hike still some way off

The latest Bank of England statement will only add to the market's sense that a rate hike is growing nearer. But it's clear the committee is divided on how much of an issue rising inflation poses. Given the number of headwinds facing the economy this winter, we think a rate hike is unlikely until the second half of 2022 - later than investors are expecting



Bank of England, in the City of London

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### The latest BoE statement will fuel talk of an early-2022 rate hike

Financial markets have already been toying with the idea of a first Bank of England rate hike coming in February next year. And while there are no huge bombshells in the latest policy statement, it will probably only reinforce the market's rate hike timeline.

Admittedly, there's clearly a wide range of views on the committee - particularly on how problematic the forthcoming rise in inflation is likely to prove. The accompanying meeting minutes contain plenty of 'some people this, other people that' without giving much away on where the

balance of opinion lies. In short, the Bank of England is well aware of how much uncertainty lies in the outlook for this winter.

But there are a couple of aspects which are slightly hawkish. Firstly, the Bank has noted that “some developments” since August have strengthened the case for “modest tightening”. And secondly, we saw two votes to end QE early, compared to one at the last meeting.

At face value this latter development is fairly inconsequential, in that the QE programme ends in December anyway, so we’re talking marginal differences in policy support even if there had a consensus ending it early. But what we can probably glean from this is that we will start to see the hawks voting for interest rate rises fairly soon, and potentially as soon as November.

## It all comes back to wage growth...

In practice though, we think there are too many headwinds facing the growth outlook over the winter for this, or indeed a February rate hike to materialise. The rise in inflation, driven by surging power prices and supply-constrained goods costs, will hit the cost of living. That’ll be amplified by tighter fiscal policy, and probably also a modest rise in labour market slack when the furlough scheme ends. And even barring a return to lockdowns, we think some renewed caution is probable over coming months if healthcare comes under significant pressure once more.

The MPC will hope to have a little more information on all of those factors by the time of the November meeting.

But ultimately the timing of that first hike will likely come down to wage growth. Probably the most important thing the Bank said in its latest statement is that it believes wage growth to be above pre-pandemic rates. The question though is whether this broadens out from the narrow areas that are currently being heavily impacted by staff shortages.

While this is a very tricky question to answer given the noisy data we have on it right now, our feeling is that wage growth is unlikely to be a significant issue for the Bank of England in the medium term.

## Our view

We feel that a rate hike in the second half of next year is more likely than the first. Until now we had pencilled in a November '22 move, though the snippets of hawkishness in the latest statement suggest August is growing more likely. Remember the first hike is likely to be ‘only’ 15bp, as opposed to the usual 25.

That's still later than investors are expecting (February). And unlike market pricing, we think the second ‘full’ hike is unlikely until 2023. At that point a passive reduction in the balance sheet will begin, by ending reinvestments linked to maturing bonds.

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