

Bank of England raises rates; its tone is surprising

The Bank of England raises interest rates, but a surprising tone of caution suggests future hikes are not guaranteed



Source: Bank of England

0.5%

Bank of England interest rate

From 0.25%

It's no surprise that the Bank of England has taken the historic decision to hike rates for the first time since the financial crisis. But the big news is that the Bank is no longer telling markets that their rate expectations are too low. Markets have roughly two hikes priced in over the next three years, one of which towards the end of next year. There were other signs of caution too. The vote was not unanimous, with two MPC members dissenting against a hike.

Brexit appears to have featured more prominently in the Bank's thinking and phrases like "*considerable risks to the outlook*" suggest the Bank is now more wary about the risks to

investment. True, there have been some more encouraging signs on the Brexit front recently; it's looking increasingly possible that a transition deal can be agreed early next year. But big question marks still hang over what the final deal might look like. Until then, we suspect investment is unlikely to make a massive come back and growth will remain fairly sluggish.

The bank is still fairly bullish on wage growth. The committee still expects this to really take-off next year – the Bank's 3% forecast for 2018 would be a significant pick-up on this year. There has been some renewed momentum in wage growth of late, although some of this is down to the National Living Wage increase. And given that political uncertainty remains elevated, and firms' margins are still being squeezed by higher import costs, we think wages may not pick-up quite as rapidly as the Bank is hoping.

In short, there are still a lot of "ifs". We don't rule out a second hike at some stage next year – it's worth noting that the Bank appears comfortable with having one extra increase priced in for 2018. But that relies on the data, in particular on wage growth, improving and, more importantly, Brexit going smoothly. Until many of these uncertainties are cleared up, we're still yet to be convinced that the Bank will hike much further, if at all.

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