Dovish Bank of England follows Fed and slows rate hike pace

The Bank of England's (BoE's) 50bp rate hike decision was coupled with signs that the Committee is prepared to move more cautiously over the coming months. We expect a final 50bp hike in the first quarter – which may ultimately be delivered in smaller 25bp chunks – although we think the UK will be slower to turn to rate cuts than the US

Andrew Bailey, governor of the Bank of England

Fed caution has given the Bank of England cover to slow rate hikes too

The Bank of England's inaugural 75bp rate hike back in November came accompanied by a strong signal that it was likely to be a one-off move. Since then, the Federal Reserve's decision to slow the pace of rate hikes in the US, and the associated appreciation in the trade-weighted pound, has given the Bank of England the cover it needs to do the same. In a move that will come as little surprise, the Bank hiked rates by half a percentage point to 3.5% on Thursday.

But the new policy statement – that this time isn't coupled with either a press conference or new forecasts – contains some interestingly dovish signals. While the Committee is clearly divided, and the meeting saw another three-way vote-split, only one policymaker voted for a more aggressive 75bp hike at Thursday's meeting, while two voted for no change at all. While it's hard to say what the consensus for this would have been, one or two more voters in the 75bp camp, and the doves opting for a 25bp hike over no change, would have seemed more likely.

We expect Bank Rate to peak at 4% in the new year

Admittedly the Monetary Policy Committee is no longer warning investors that they're pricing too much tightening for coming months, though perhaps this isn't hugely surprising. Market rates have fallen markedly since the political drama and LDI (Liability Driven Investing) pensions issues in October. Markets expect Bank Rate to peak at roughly 4.5% next summer, and while that's probably still a tad on the high side, this mispricing is much less significant than it was.

The Bank is nevertheless still warning that it could act 'forcefully' if required, though curiously the meeting minutes suggest that a 50bp rate hike meets this definition. Not only does that suggest there's a high bar for returning to 75bp rate hike increments, but at a stretch you could also say it lays the groundwork for a further slowdown in the pace of hikes to 25bp increments from the new year.

Our view: 50bp in February and done

For now, our best guess is the Committee implements another 50bp hike in February before calling it a day. The hawks can continue to point to 6% wage growth and the fact that core services inflation is running higher than expected in November. But today's meeting is a further demonstration of the delicate balancing act facing the BoE, between mitigating the risks of a tight jobs market on the one hand against mounting concerns about the housing market and the health of corporate borrowers on the other.

We expect Bank Rate to peak at 4% in the new year, although we aren't yet convinced a rate cut will be as quick to follow as in the US (where we expect cuts shortly after the summer).

Author

James Smith
Developed Markets Economist, UK
james.smith@ing.com