

The Bank of England's tightening cycle may well be over

The Bank of England keeps rates on hold and, barring any unpleasant surprises in the next round of wage and inflation data, we suspect the tightening cycle is now over. But today's vote was close



Bank of England governor Andrew Bailey says there's 'no room for complacency'.

5.25% UK interest rate
No change at the latest meeting

The Bank of England has voted to keep rates on hold, and we suspect that means the tightening cycle is now over. What's striking, though, is just how close the decision was, with a 5-4 split on the committee between those wanting 'no change' and those opting for a 25bp rate hike. That degree of division is actually pretty unusual and shows just how close a call this meeting was.

What's very clear is that the Bank is leaving all options on the table for November. Remember, the BoE has three key metrics for setting policy right now – services inflation, private sector wage growth, and the vacancy-to-unemployment ratio. It was the former of those variables that

presumably convinced the committee to pause today, now that services inflation is noticeably below the Bank's most recent forecasts from August.

Then again, it makes the valid point that much of the fall in services CPI last month can be put down to volatile air fares/package holidays. And we'd argue the same was true the month before when a surge in social rents drove a surprise increase in services CPI. This volatility makes the data tricky to read.

Markets have pared back UK rate expectations

Expected 1M rates in December 2023 (SONIA/SOFR futures) %



Source: Macrobond

Still, on the dovish side, the Bank has also acknowledged that most data on wage growth was more dovish than the headline readings on private sector wage growth (still above 8%) suggest. Data from firms' payrolls has actually shown median pay falling for two consecutive months.

So how likely is another rate hike in November? It's worth saying we only get one set of inflation and wage data before November's meeting, so there's not a huge amount for the Bank to go on. If there's enough in the recent data to convince the Bank to pause this month, then we suspect the same will be true in November. Certainly, it looks like wage growth is at a peak, even if the downtrend is likely to be gradual. And services inflation should trend downwards over the coming months now that gas prices are so much lower.

We think the Bank will remain on hold for the foreseeable future

We therefore think the Bank will remain on hold for the foreseeable future. We don't rule out a hike in November, but it will probably require a big upside surprise to either the services inflation or wage data. Formally, policymakers are telling us that further tightening is possible, and it could well be that the Bank privately wants to take a leaf out of the Fed's book by "skipping" September's meeting in a bid to draw out the current tightening cycle. There's little evidence of that in today's policy statement, though.

Bigger picture, the Bank has made it abundantly clear that it now thinks the length of time rates stay high is much more important than how high they go in the short term. That's because the UK

mortgage market is heavily fixed, albeit typically for less than five years. The average rate on existing mortgage lending has gone from roughly 2% to 3%, and as more people refinance, will head to 4% by the spring and probably 4.5% by the end of next year. In other words, without hiking rates again, the impact of rate hikes will continue to ramp up.

What about rate cuts? Publicly, the Bank of England has been clear that it won't be lowering rates any time soon. But in practice, we suspect we could see some initial cuts by the middle of next year, especially given our base case that the Fed and ECB will have begun cutting by that point too. The risk is that the first move comes a bit later, but ultimately the UK economy can't sustain rates above 5% indefinitely, and we think something closer to 3% is a more likely medium-term level.

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