

## Bank of England stays on hold, but have markets overreacted?

As the Bank of England points to a possible rebound in economic growth and further wage rises, we think markets may have been too quick to write off a near-term rate hike



Source: Bank of England

In light of the dreadful first quarter growth reading, the Bank of England has opted to keep rates on hold this month. Unsurprisingly, two of the more hawkish committee members have again gone against the pack and voted for an immediate rate rise. But markets have interpreted the overall tone of the meeting as more dovish than anticipated – money markets have priced out a 2018 rate hike.

Reading through the statement, we suspect this is a bit of an overreaction. The Bank is keen to emphasise that it thinks the weaker growth will prove to be temporary – and interestingly, that the initial estimate of 1Q GDP has been wildly underestimated. The latest forecasts assume an upward revision from 0.1% to 0.3% QoQ.

It also remains upbeat on the outlook for wage growth. Although it has nudged down its forecast to 2.75% for this year, it appears satisfied that the tight jobs market is translating into higher pay. Remember that Bank Agents have been highlighting that 2018 could be the best year for wage settlements since the crisis.

Importantly, the Bank still feels that further “ongoing” tightening would be “appropriate”, and all of this makes us think that policymakers still have a preference to hike in August if the data allows them to.

That’s not to say there aren’t risks – the biggest of which lies in the consumer sector. By some measures, the first quarter was the worst three-month period for retailers since the crisis. At the same time, consumer credit growth appears to have collapsed in recent months with surveys indicating that banks have significantly tightened lending standards. It’s unclear exactly how this will play out, but this could prove to be bad news for near-term growth. We suspect that this will have been a key reason why policymakers opted to keep rates unchanged today.

Then there’s Brexit. If the lead-up to the December and March EU summits are any guide, the months ahead of the October leader’s meeting could see talks become increasingly noisy. Throw in the fact that core inflation is set to return to target within the next three to four months, and it could become increasingly complicated for the Bank to tighten policy as we move through the year.

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