

Fast Comment UK

BoE rates held at 5.25%

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Six versus three: Bank of England split on interest rate decision

The BoE has decided to hold rates steady for a second consecutive meeting, leaving the base rate at 5.25%. This, of course, follows the US Federal Reserve's decision yesterday to keep US rates on hold. The Monetary Policy Committee (MPC) was, however, split on its decision, with six members backing a freeze in rates and three opting for an increase of 0.25pp. The three dissenting members backed an increase in rates on the basis that the labour market remains relatively tight and measures of wage growth and services inflation continue to be elevated. A majority of members disagreed with this analysis, arguing that the labour market had loosened sufficiently and that the acceleration in the ONS's average weekly earnings is not reflected in a broader range of wage growth measures. The MPC's job has been made harder by conflicting messages from data sources and problems around the collection of data. For example, the ONS's measure of annual private sector regular average weekly earnings was 8% in August, but other measures suggest the figure is lower. And while metrics such as unemployment, vacancies and inactivity suggest the labour market is loosening, there are concerns around the accuracy of the data.

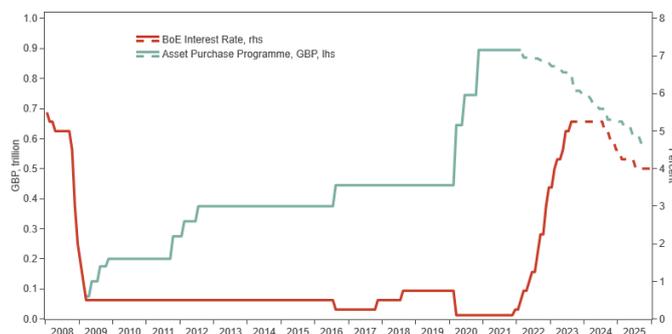
Middle East factor skews inflation risk to the upside; QT continues

The BoE has stated that there is an upside risk to inflation from the situation in the Middle East. However, this should be put into context. For now, the conflict seems to be contained, with the impact on energy markets remaining very small compared to volatility seen in late 2021 and 2022. Even if oil prices saw a substantial increase, it would seem unlikely that this alone could lead to a double spike in inflation. For example, a new USD 110 a barrel price would only add 0.5pp at the peak to UK CPI inflation, according to Bloomberg's SHOK model. Despite the hold in rates, monetary policy tightening will of course continue through the Quantitative Tightening (QT) programme. At the latest MPC meeting, GBP 100bn of QT was signed off to take place over the course of October 2023 to September 2024, although the BoE expects this to have little impact on financial conditions. The BoE forecasts that GBP 80bn of QT in the previous 12 months only led a 10bp increase in 10-year gilt yields.

Hawkish statements reinforce "higher for longer" narrative

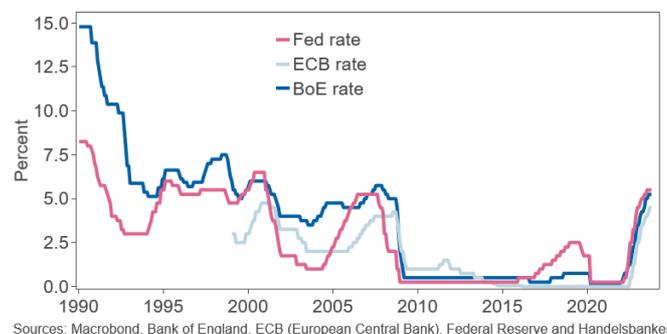
We maintain our view that 5.25% will be the peak of this cycle, and this is a view that the markets agree with. However, there were some relatively hawkish statements in the minutes of this month's MPC meeting. The BoE argues that "monetary policy will need to be sufficiently restrictive for sufficiently long to return inflation to the 2% target sustainably in the medium term" and that "second-round effects in domestic prices and wages are expected to take longer to unwind than they did to emerge". This strongly suggests that rates will remain at 5.25% for some time in order to bear down on domestically generated inflation. Inflation will fall to sub 5% in October, but the route to the 2% inflation target will be challenging. We currently believe that rate cuts will only take place in the second half of 2024.

UK Monetary Policy



Source: Macrobond

US, UK and Euro Interest Rates



Sources: Macrobond, Bank of England, ECB (European Central Bank), Federal Reserve and Handelsbanken
Source: Macrobond

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