

BoE December Meeting Preview: MPC to warn against rate cuts?

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MPC to warn against rate cuts?

We expect the Bank of England to hold rates steady for the third straight meeting on Thursday, with the MPC to once again stress that it is too soon to even think about the possibility of policy easing.

Communications from committee members since the previous meeting in November have remained rather hawkish. Governor Andrew Bailey stressed that lowering inflation would be 'hard work', while warning against rate cuts for the 'foreseeable future'. These remarks were largely echoed by messrs Pill, Ramsden and Haskel who all indicated last month that policy will need to remain restrictive for some time in order to defeat inflation. We expect the MPC to reinforce this stance at its meeting this week, and effectively push back against market expectations for rate cuts, which continue to appear excessive.

Following the November meeting, the bank kept in its statement the pledge to raise rates again should inflation prove persistent, while saying that policy would need to be 'sufficiently restrictive for sufficiently long' to achieve the inflation mandate. While we expect the bank to repeat this message, it may somewhat tone down its accompanying communications in light of recent macroeconomic news. October data on both UK inflation and wages were softer-than-expected. Headline inflation fell below the MPC's expectations to a two-year low 4.6%, with the core measure also unexpectedly dropping to its lowest level since February 2022. Meanwhile, wage growth is showing clear signs of easing from its highs, which should calm concerns over the second-round impact on prices.

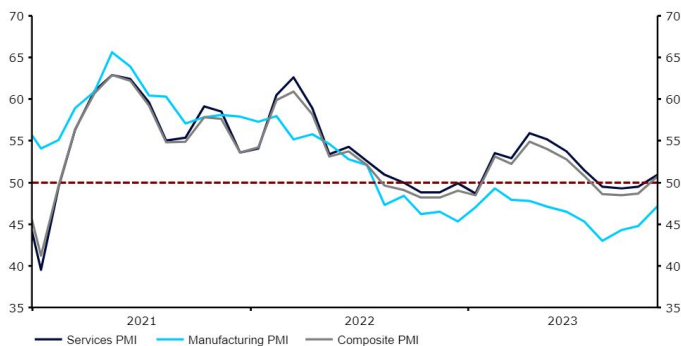
Figure 1: UK Wage Growth (2014 - 2023)



Source: LSEG Datastream Date: 12/12/2023

Indicators of economic activity remain mixed. Britain's economy posted flat growth in Q3, which was in line with the Bank of England's forecast, and modestly above the 0.1% contraction pencilled in by economists. The PMIs of business activity have beaten expectations so far in the fourth quarter of the year, albeit these are consistent with nothing more than anaemic levels of expansion. Weakness exhibited in domestic demand, in particular the recent downside surprises in retail sales, should provide the committee with confidence in their view that tighter policy is being transmitted to the real economy, as acknowledged in the November meeting minutes.

Figure 2: UK PMIs (2021 - 2023)



Source: LSEG Datastream Date: 12/12/2023



It will be interesting to see whether the positive news on both consumer prices and earnings growth will be enough to elicit a dovish shift in the bank's voting pattern. In November, the committee voted 6-3 in favour of no change, which was slightly more hawkish than expected. On balance, we think that the vote will remain unchanged this time around, with external members Green, Haskel, and Mann to once again vote in favour of an immediate hike, which should reinforce the bank's 'higher for longer' attitude to rates. There is a possibility that dove Swati Dhingra votes for an immediate cut, although this would perhaps be counterproductive to the bank's goal of dampening expectations for lower rates.

As mentioned, we think that markets are getting carried away with the extent of policy easing that will be required in 2024. Following Tuesday's labour report, swap markets are now assigning roughly a 50% implied probability of a first 25 basis point rate cut in May, with a total of 90 basis points of cuts now seen through year-end. A 6-3 vote on rates, combined with rhetoric that reiterates no cuts for the foreseeable future, should be bullish for the pound given current market pricing. On the other hand, should the statement express greater optimism on inflation, and one or more MPC members shift their vote in a dovish direction, then we could see some modest downside in GBP towards the end of the week.

The Bank of England's policy decision and meeting minutes will be published at 12pm GMT (1pm CET) on Thursday.

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