BoE Preview: August 2022

Statement/Minutes release: 12:00BST, Thursday 4 August
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Press conference: 12:30BST, Thursday 4 August

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MNI View: 70% chance of 50bp

Tim Davis, 2 August

After the June MPC meeting, the MNI Markets team noted that we thought there was around a 60% probability of a 50bp rather than a 25bp hike in August. We then increased our subjective assessment of the probability of a 50bp hike to around 70% following Governor Bailey's Mansion House speech and the release of the June CPI data.

Note that at the June meeting, the language the MPC described to outline the rate outlook was:

"The MPC will take the actions necessary to return inflation to the 2% target sustainably in the medium term, in line with its remit. The scale, pace and timing of any further increases in Bank Rate will reflect the Committee's assessment of the economic outlook and inflationary pressures. The Committee will be particularly alert to indications of more persistent inflationary pressures, and will if necessary act forcefully in response."

We noted at the time that there were four ways in which the language was strengthened:

1. Risks are now seen to the upside, rather than being two-way.
2. The BOE is opening the door to 50bp hikes by mentioning the "scale" of hikes.
3. There is no caveat that the guidance is only supported by "some members" (which was 7 members in May).
4. This part in itself is also particularly hawkish: "would if necessary act forcefully in response."

Domestic developments since the last meeting

Since the last meeting we have seen May GDP come in better than expected, CPI continue to climb marginally higher than expected, PPI remain strong and labour market data remaining tight (and the DMP survey still pointing to strong wage growth). We have also seen PMI data hold up relatively well, remaining comfortably above 50, and in contrast to readings in the Eurozone, with Germany in particular seeing some steep declines in July.

Hawkish pivots from other central banks

Against this backdrop we have also seen the Fed deliver two 75bp hikes - the 75bp June hike was only announced the evening before the MPC's decision was released by which time the MPC had probably already voted on their decision. Furthermore, the ECB abandoned its previous guidance for a 25bp July hike and raised rates by 50bp to lift rates out of negative territory. The more hawkish pivots from other central banks doesn't automatically feed through to the MPC needing to act: the

US economy is still running much hotter than the UK economy and is less sensitive to potential gas supply issues this winter if Russia further restricts supply. And the ECB has waited so long to raise rates, the BOE had already raised rates 115bp before the first ECB hike – this has two implications: first as monetary policy works with time lags, the impact of the hikes will be felt in the UK sooner than in the Eurozone; and second, even after the ECB's 50bp hike it is still at least 100-150bp below the 1.0-1.5% estimate of neutral rates, whereas the BoE's Market Participants Survey puts the estimate of the neutral rate at 1.5-2.0%, only 25-75bp below Bank Rate ahead of this week's meeting. So the BoE is arguably less behind the curve than the ECB.

In essence, although we don't think the more hawkish tilt of other central banks will be the major reason the MPC will vote for a 50bp hike, we do think that it will have at least some bearing on the decision.

Bailey's comments on 50bp at Mansion House

Just to recap Bailey's comments on a 50bp hike during this Mansion House speech:

"At the MPC's last meeting we adopted language which made clear that if we see signs of greater persistence of inflation, and price and wage setting would be such signs, we will have to act forcefully. In simple terms this means that a 50 basis point increase will be among the choices on the table when we next meet. 50 basis points is not locked in, and anyone who predicts that is doing so based on their own view."

The fact that he is discussing a 50bp hike so explicitly could be for two reasons. First, it could be that Bailey is preparing the market for a change in his own vote ahead of the August MPC meeting, and it may be that despite the vote split in June that a number of MPC members seriously considered the prospect of a 50bp hike. Or alternatively, it could just be that Bailey is attempting to clarify to the market what the word forceful means – and his message is merely trying to clarify that optionality surrounding rate moves remains.

Balance sheet: Confirmatory vote expected in September

In addition to the discussion on Bank Rate, the BOE is due to give updated guidance on how it expects to manage active gilt sales. It is very unlikely that the MPC will pull the trigger at the August meeting, with a confirmatory vote expected to be held in September, but the broad principals of the programme may be fleshed out more. In Bailey's Mansion House speech he stated that the BOE was looking at reducing the stock of gilts GBP50-100bln "in the first year". Most market participants think that this implies in the period from which active sales of gilts begins (the earliest being late September or early October). In proceeds terms, there are GBP35bln of gilts maturing between October 2022 and September 2023, which implies active sales of between GBP15-65bln. Scaling this down, it appears the pace of active gilt sales under consideration at the BoE would be in a range of GBP4-15bln/quarter or GBP1.5-5.5bln/month. It is unclear whether the BoE will want to communicate more on the pace or intended start date of active gilt sales at the August meeting, or whether it will wait until September.

MNI Instant Answers

- Ahead of each policy meeting the MNI Markets team select a number of questions that should capture the essence of the central bank meeting in questions that can largely be answered either numerically or with a yes or no, and which represent all of the expected tradable possibilities.
- These questions will be published within the Preview document and 15 minutes before the announcement on both MNI Bullets and the interactive chat.
- We aim to publish the answers within a few seconds of the embargo being released via the MNI Bullets and our interactive chat.

Advantages

- No need to scroll through 30 newswire headlines.
- All of the tradable info you need delivered concisely straight to your bullet feed or the interactive chat.
- Gives you the confidence that you can quickly trade at the announcement time.

August Questions

1) Was the Bank Rate raised, and if so by how much?
2) Number of members voting for a 25bp hike?
3) Number of members voting for a 50bp hike?
4) Number of members voting for a decision other than 25/50bp hike (and if so what?)?
   NB: On questions 2-4 we will name the dissenters
5) Did the MPC announce a likely start date for the active sale of gilts (and if so when)?
6) Did the MPC announce the pace of gilt sales?
7) Did the MPC drop its previously formulated June guidance?
8) Did the MPC still point to the possibility of "forceful" action if required?
9) UK CPI rate in two years' time at market/constant rates (mode)?
10) UK CPI rate in three years' time at market / constant rates (mode)?
11) How were the risks to the CPI forecasts described?
12) UK GDP forecast for Y/Y Q3-2023/Q3-2024 at market rates (mode)?

Summary of Analyst Views

- 14/22 (64%) of analyst previews that we have read look for a 50bp hike this week while the remainder expect a 25bp hike (8 analysts, 36%).
- Most expect the “forceful” language to be removed but optionality to remain for a further 50bp hike.
- In terms of the vote split if there is a 50bp hike, most look for either a unanimous or a 7-2 decision. If there is a 25bp hike, most expect a 6-3 split.
- 15/22 analysts (68%) then expect a 25bp hike in September.
- 4 analysts look for a second 50bp hike in September (GS, Deutsche, SocGen, Berenberg). Citi see potential for at least one 50bp hike at some point this year.
- 3 analysts expect no September hike: Rabobank and UniCredit’s base case sees the August hike as the last while NatWest Markets expects a pause before a further November hike.
- Bank Rate at end 2022 (out of 22 analysts): The median is 2.25% while the majority of analysts expect Bank Rate to end 2022 in a 2.25%-2.50% range.
    - Goldman Sachs looks for 2.75% (5%)
    - 7 analysts look for 2.50% (32%)
    - 7 analysts look for 2.25% (32%)
    - 3 analysts for 2.00% (14%)
    - 2 analysts for 1.75% (9%)
    - 2 analysts look for 1.50% (9%)
- Bank Rate at end 2023 (out of 18 analysts): The median looks for 2.00% (4/18 analysts look for cuts in 2023).
    - Credit Suisse and JP Morgan expect 3.00% (11%)
    - 3 analysts expects 2.75% (16%)
    - 2 analysts expect 2.50% (11%)
    - 1 analysts expects 2.25% (6%)
    - 7 analysts expect 2.00% (39%)
    - NatWest Markets and Pantheon expect 1.75% (11%)
    - UniCredit expects 1.50% (6%)

Summary of Analyst Views (Sorted by Hawkish to Dovish); View changes in bold

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Institution	Post-June meeting	Pre-August meeting
Goldman Sachs	50bp hikes in both Aug22 and Sep22 then 25bp in Nov22 and Dec22 to 2.75% terminal rate. Start of gilt sales uncertain but continue to expect to begin at Nov22 MPC meeting.	50bp hike with unanimous vote. Then further 50bp hike in Sep22 followed by 25bp in Nov22 and Dec22 to 2.75%. Gilt sales of GBP15bln/Q start Nov22 (risk of Sep22).
Deutsche	50bp hikes in both Aug22 and Sep22 then 25bp in Nov22 to 2.50%. Active QT start in Q4-22. Pause as data cools then 100bp of cuts starting mid-2023.	**50bp hike with 7-2 vote in Aug22, further 50bp in Sep22 then 25bp in Nov22 to terminal 2.50%. Risk of further tightening if fiscal support needed to offset injection of demand.**
Société Générale	Maintain forecast for 25bp hikes in Aug22, Sep22 and Nov22. Key risk is for a 50bp hike "at one or more of those meetings."	**50bp hike with unanimous vote, further 50bp in Sep22 then 25bp in Nov22 to peak of 2.50%. Expect 6-month programme to sell GBP60bln gilts.**
Berenberg	25bp Aug hike (30% prob. 50bp). Further 25bp in Sep22 and Nov22. "Aggressive pace" of gilt sales possible in Aug22 as alternative to more hikes (e.g. GBP5-10bln/month).	**50bp hikes in Aug22 and Sep22 with Bailey voting for the larger hikes. Further 25bp in Nov22 to 2.50%. Then 50bp of cuts in H2-23 and further 25bp cuts in H1-24 to 1.50%.**
BNP	50bp hike in Aug22 with 25bp hikes in Sep22, Nov22 and Dec22 to 2.50% (terminal rate 25bp higher than previous). "Another source of tightening" from active gilt sales in 2023.	50bp hike in Aug22 with 25bp hikes in Sep22, Nov22 and Dec22 to terminal 2.50%. If Truss is PM and substantially eases fiscal pol, hikes in 2023. Expect guidance repeated.
RBC	50bp hike in Aug22 with 25bp hikes in Sep22, Nov22 and Dec22 to 2.50%. Latest labour market data softer than expected, hence only see MPC able to deliver one 50bp hike.	50bp Aug22 hike; Bailey's speech "as close as MPC language can to explicitly signalling a 50bp increase." Further 25bp hikes in Sep22, Nov22, Dec22 to 2.50%."
Daiwa	50bp hike in Aug22 with further 25bp hikes in Sep22, Nov22 and Dec22 to 2.50%. "Good chance" of gilt sales commencing in Sep22 if market is stable. Cuts in Q1-24 and Q2-24.	50bp Aug22 hike "with signals of further monetary tightening ahead too (possibly of a similar magnitude)." Further 25bp Sep22, Nov22, Dec22 to 2.50%; cut to 2.00% in 2024.
JP Morgan	50bp in Aug22 as BOE will not get "better news on inflation persistence." Revisit rest of fcast after CPI; currently further 25bp hikes in Aug22, Sep22, Nov22, Feb23, May23, Aug23.	50bp Aug22 hike with 7-2 vote with 25bp dissents. 25bp hike in Sep22 conditional on BoE downgrading guidance, otherwise 50bp. Slow to 25bp pace from Nov22 (or slower).
Bank of America	25bp hikes in Aug22, Sep22 and Nov22. Door wide open to 50bp move in Aug and/or more hikes. Staying at neutral relies on anchored inf exp, that view is "now challenged".	**50bp hike with 7-2 vote with 25bp dissents. Further 25bp hikes in Sep22, Nov22, Feb23 and May23. GBP5bln/month active gilt sales from Oct22 confirmed in Sep22.**
SEB	25bp hikes in Aug22, Sep22, Nov22, Feb23 and May23.	**50bp hike in Aug22. Further 25bp hikes in Sep22, Nov22, Feb23 and May23.**
TD Securities	25bp hikes in Aug22, Sep22, Nov22 and Dec22 to a terminal rate of 2.25% in December. 50bp can't be ruled out and the Aug MPR projections might provide backdrop for a move.	**50bp hike in Aug22 with 3-4 dissenters for 25bp. Further 25bp hikes in Sep22 and Nov22 to terminal rate of 2.25%. Active gilt sales announced Sep22 at GBP5bln/month from Oct22.**
Nomura	Expect 25bp hikes in Aug22, Sep22, Nov22 and Dec22 to 2.25% with two way risks. No futher hikes in 2023. Active gilt sales of GBP10bln/quarter from Q1-23.	**50bp hike in Aug22; 25bp hikes in Sep22 and Nov22 to leave Bank Rate at 2.25%. Active gilt sales announced Sep22, start in Q4-22 at GBP10bln/Q. 25bp cuts in May23 and Aug23.**
ING	Look for 2.00% Bank Rate by year end, "probably roughly consistent with neutral." Could see 50bp in Aug22 with another 25bp in the autumn or 3 consecutive 25bp hikes.	**50bp in Aug22 due to BoE communication and market pricing - not changes in data. Pencil in 25bp in Sep22 to 2.00% terminal rate but wouldn't rule out additional 25-50bp.**
Barclays	25bp hike in Aug22 remains baseline view, but May and June inflation "may result in a 50bp rise". Look for further 25bp in Sep22 to see Bank Rate peak at 1.75%	**50bp hike with 7-2 vote in Aug22, 25bp in Sep22 and on hold thereafter due to slowdown in activity. Upside risks to H2-23 as "cost of living crisis passes and momentum rebuilds."**
Citi	Look for a longer rather than necessarily a more sudden hiking cycle with 25bp hikes in Aug22, Sep22 and Nov22. Still pencil in two 25bp cuts in H2-23 to bring Bank Rate to 1.50%	**Base case for 25bp hike in Aug22 but potential for at least one 50bp hike in 2022 with Bank Rate at 2.50% by year-end. Two 25bp cuts in 2023, but growing risks to this call.**
Credit Suisse	25bp hikes in Aug22, Sep22, Nov22 and Dec22 to 2.25%, then a further three hikes in 2023 to 3.00%.	25bp Aug22 hike with 5-4 vote (Pill joins dissenters). Expect 25bp hikes in Sep22, Nov22, Dec22 to 2.25% then three hikes in 2023 to 3.00%.
UBS	Expect 25bp hikes in Aug22, Sep22, Nov22 and Dec22 to 2.25%. If inflation and labour data indicate "more persistent inflationary pressure" risk of 50bp in Aug22 rises "significantly."	25bp hike in Aug22 but "significant risk" of 50bp. Look for further 25bp hikes in Sep22, Nov22 and Dec22. 50bp hike in Aug22 increases chance of further 50bp hikes.
Morgan Stanley	25bp hikes in Aug22, Sep22 and Nov22. Door open to 50bp in Aug22 as the "currency is adding to imported inflation pressures" but weak growth data should see 25bp.	60% probability of 25bp hike in Aug22 with further 25bp hikes in Sep22 and Nov22 to 2.00% peak. Active gilt sales confirmatory vote in Sep22 at GBP10bln/Q pace.
Pantheon	25bp hikes in Aug22 and Sep22. "The MPC's decision to drop its guidance does not fit markets' narrative that it has turned more hawkish."	25bp hikes in Aug22 and Sep22, then Bank Rate on hold at 1.75% through end-2023. Forecast for 3-year CPI at market rates "even lower than May's 1.3%."
NatWest Markets	Guidance " dampens prospects" of 50bp in Aug/Sep. Continue to look for 25bp hikes in Aug22, Feb23 and May23 with risk of 2023 hikes brought forward to 2022.	25bp hikes in Aug22, Nov22 and Feb23 to 2.00% with risks skewed more to additonal 25bp hikes rather than 50bp hikes. GBP35bln/Y active gilt sales ann Sep22, start Oct22.
Rabobank	Expect final 25bp hike in Aug22 as BOE takes a pause after weak growth, UnE and inflation forecasts in the next MPR. Risk is currency weakens and forces BOE to hike more.	"Stubbornly" stick to 25bp Aug22 hike. If Truss becomes PM and immediately cuts taxes, pressure on BoE to continue hiking. GBP100bln gilt BS reduction vote at Sep22 meeting.
UniCredit	"Looser guidance" than May. Expect final 25bp hike in Aug22. See a high risk of a technical recession and MPC pause when it starts to see margin of spare capacity opening.	25bp hike in Aug22 but with 3-4 dissenters voting for 50bp. Expect this to be the last hike of the cycle but "risks are now clearly skewed to the upside".

Source: Analyst previews and MNI

Note: Sorted by magnitude of next hikes, then hikes this year, then 2023 outlooks

Analysts' Key Comments (A-Z)

Bank of America: 50bp re-calibration to higher inflation rather than start of series of 50bps

- Expect 50bp August hike with 7-2 vote (Tenreyro and Haskell dissent for 25bp).
- "Expect the Bank of England (BoE) to respond to higher peak inflation, and therefore greater risks of inflation expectations and wages remaining high, with faster hikes."
- "Having acted forcefully we would expect the BoE to remove its guidance towards future more forceful responses. This meeting would be sold as a re-calibration to higher inflation risks in our view rather than the start of a series of 50bp hikes"
- Continue to look for 25bp hikes in September and November.
- "We assume an additional £35bn fiscal loosening over the next two years... This will not be incorporated into BoE forecasts until announced later this year. But we now pencil in 25bp rate hikes in February and May 2023, compared to no hikes in 2023 previously. In total we raise our terminal rate forecast by 75bp to 2.75%."
- QT: "expect the BoE to all but announce at their August policy meeting the start of active QT in October. We expect that to be confirmed at the September policy meeting… we look for £5bn a month active sales from October." (Previously GBP5bln in Oct and Nov then GBP9bln/month).

Barclays looks for 50bp in August and 25bp in September

- Barclays has updated its baseline BOE view and now looks for a 50bp hike in August (previously 25bp) and continues to look for a 25bp hike in September.
- See three reasons for a 50bp hike rather than 25bp in August:
    1. "Energy prices are set to derail the inflation forecast yet again... we estimate that the Ofgem price cap will be raised by 75% during next winter"
    2. "The Bank's gradualist narrative is threatened by the return of volatility"
    3. "Data have played into the hand of the hawks"
- Barclays expects a 7-2 vote with Tenreyro and Cunliffe dissenting.
- Barclays expects a £50-100bln balance sheet reduction programme to be discussed in August "to be able to hold a "confirmatory vote" at its September meeting, with actual sales starting sometime thereafter".
- Barclays notes that the 50bp hike will be considered front-loading, will reiterate that QT is not an active tool and that forecasts will see higher inflation and slower growth.
- "By November, the slowdown in activity will be sufficiently intense to dissuade the BoE from hiking further, at least for a while." This will leave the Bank Rate at 2.00% rather than 1.75%.
- "We see upside risk to the status quo in H2 23: as the cost of living crisis passes and momentum rebuilds, we think the Bank could well re-start hiking. This is based on our assessment that the labour market is facing structural supply shortages."

Berenberg: 50bp hikes in August and September as majority vote with Bailey

- Expect 50bp hikes in both August and September following Bailey's Mansion House speech.
- Had previously noted that the magnitude of these hikes would depend "on which way Bailey would vote."
- For September: "With inflation likely still rising by then ahead of a possible peak in October when the household energy price cap increases again, we expect the BoE to keep up the 50bp pace for at least a second meeting." Further 25bp hike in November.
- "Forecast that the BoE will remain on hold in H1 2023 instead of raising the bank rate by a further 50bp [call prior to Mansion House speech]. We continue to expect 50bp of cuts in H2 2023 and a further 50bp in H1 2024 to take the bank rate to 1.5% by end-2024. Amid continued worries about inflation resurging in 2024, we expect the BoE to only partly reverse its hikes while continuing QT in the background."

BNP: 50bp in August, but 25bp at remaining 2022 meetings

- Expect 50bp hike in August due to a "combination of relentless inflationary pressures and some resilience in the growth data".
- "Do not anticipate 50bp becoming the new benchmark pace, not least because growth headwinds are likely to intensify. We envisage 25bp at each subsequent meeting this year, taking Bank Rate to a terminal level of 2.5%"
- "Should Liz Truss become prime minister and substantially ease fiscal policy, we see additional rate hikes next year"
- "We would expect the MPC to repeat June's guidance for the time being, leaving the door open to more forceful action, given that it is entirely data dependent and entails no firm commitment. Keeping a bias for more aggressive tightening is arguably prudent after persistent upside inflation surprises, even though we do not think they will use this optionality given the weakening growth outlook."
- On QT: "The GBP50-100bn suggested first year range implies GBP15-65bn of active sales."
- "Our assumption is for auctions with the same maturity buckets as seen for QE purchases: 3-7y, 7-20y and over 20y… the four gilts maturing in 2025 sum to over GBP87bn, in proceed terms. Although sub 3y, there may be a reason for the BoE to consider selling some of these gilts."
- "As evolution of the monetary base is potentially important to a central bank, we would not be surprised if QT auctions were not consistent and there was a pause around redemptions"

Citi: See potential for a 50bp hike in 2022 with Truss as PM

- With Truss likely to become PM, expect "net fiscal boost of £40bn over the coming 12 months compared to the latest OBR baseline. In total, we expect the boost to add 0.8% to the level of GDP by the end of calendar year 2023, and 0.4pp to underlying CPI inflation by in 2024."
- "Revise up our expectations for rate hikes over the coming months, with policy rate at 2.5% by year end (vs 2.0% previously) and at least one 50bps move."
- "Given 1) the nature of the inflationary risk and 2) questions surrounding the Bank's mandate, we think the MPC will not necessarily wait until these policies are announced before acting. In that sense these risks apply as much to the MPC meeting this week or in September as to those later in the year."

- Base case remains for 25bp August hike with a 6-3 vote split.
- “On QT, a £3bn/mth pace for active sales fits recent guidance and a relatively slow pace seems prudent given market conditions and the weakness of the long-end.”
- Base case is still for two cuts in H2-23 which would bring Bank Rate back to 2.00%. However, there are risks of “a further round of hikes in 2H-23 as the UK responds to further supply challenges (and de-anchored expectations) with greater demand support.”

Credit Suisse: 25bp hike with Pill voting for 50bp; 25bp other 2022 meetings, 3x25bp in 2023

- Expect 25bp hike with 5-4 vote (Saunders, Mann, Haskel, Pill voting for 50bp).
- Expect 25bp hike rather than 50bp because:
    1. “The rise [in June CPI] was driven by higher energy and food prices and not by underlying inflation”
    2. “Inflation indicators in PMIs are softening owing to lower commodity prices (except gas), and there has been a fall in inflation expectations.”
    3. “The latest labour market report showed some signs of stabilization in the labour market”
    4. “Growth risks are rising”
- “It is a close call. Aggressive hikes by other central banks and weaker currency could mean the BoE hikes by 50bps”
- The June guidance “indicates that the hiking cycle is likely to continue [past August]. Even though our base case is for 25bp moves at each [2022] meeting, the guidance raises risks of a larger move”
- “The slower pace of BoE hiking relative to fundamentals is likely to mean that inflation remains higher for longer... We expect three more hikes in 2023, such that rates reach 3% by end-2023.”
- QT: “Expect a program of gilt sales of £4-5bn a month starting from September to be announced”

Daiwa: Expect 50bp hike in August

- Expect 50bp hike in August.
- “With the Bank’s inflation forecast likely to be revised higher, through to 2023, we think the majority on the MPC will favour a larger rate increase of 50bps to 1.75%, with signals of further monetary tightening ahead too (possibly of a similar magnitude).”

Deutsche Bank: Criteria for acting forcefully met; 50bp in Aug / Sep, 25bp in Nov to 2.5%

- “We believe that the criteria for ‘acting forcefully’ has been met” and therefore see 50bp hike in August with 7-2 vote (two dissents for 25bp).
- “We expect any outsized rate move to be accompanied by a marginally hawkish set of forecasts. Growth expectations for 2023 and 2024 will likely be revised up on the back of stronger fiscal policy and a weaker currency. Inflation projections, both near term and medium term, will likely be lifted too given the added fiscal ammunition to the economy, alongside stronger near-term food, energy, and stickier services inflation… we still expect the MPC to project below 2% CPI in three years' time at around 1.5% y-o-y).”
- “Expect the MPC to both retain its forward guidance around being data dependent while also providing some clarity on r-star in the August MPR (refreshing its 2018 analysis).”

- Continue to look for further 50bp hike in September and then another 25bp hike in November to a terminal rate of 2.50%.
- "Risk management considerations warrant policy to a) get to the upper bound of medium-term neutral relatively quickly (~2%), especially given the lags in monetary policy; and b) push above neutral and into modestly restrictive territory (i.e. at least around 2.5%) to bring the economy back into equilibrium. Added fiscal support and the potential for an even bigger fiscal boost later this year, with a new government coming into power after 5 September, raises the risk of even more monetary policy tightening to offset the injection of demand into the economy."
- "We expect the MPC to target QT (both passive and active) of around GBP 50bn in 2022 and GBP 75bn total in 2023, likely beginning in Q4-22 (with a decision coming in the September meeting). We also now expect gilt sales to be targeted across the curve (with the exception of short maturity bonds) in order to both leave passive QT uninterrupted over the forecast horizon"
- "We don't expect the MPC to update its assessment of the balance sheet steady state, or preferred minimum range of reserves (PMRR), in the August MPR… as we calculated in March, we see the Bank's balance sheet steady state somewhere around GBP 300bn - GBP 500bn"

Goldman Sachs: 50bp with unanimous vote; 50bp in Sep, then 25bp in Nov, Dec to 2.75%

- Expect 50bp hike with a unanimous vote (although with a possible dissent from Tenreyro). Two reasons for the 50bp hike:
    1. "Wage growth in the UK has remained elevated and, more importantly, the recent growth in wages is broad-based across sectors and most percentiles of the income distribution, reflecting a uniformly tight labour market".
    2. "Activity indicators have been surprisingly resilient recently and incoming data suggest near-term growth momentum is still positive."
- "Expect a small increase in the 2-year forward inflation projection, signalling a partial endorsement of market expectations for Bank Rate."
- "We think the MPC will choose to move away from strong forward guidance, and emphasise that future decisions are data-dependent… While we think it is more likely than not that the "act forcefully" reference will be removed, this is a close call, and would likely be accompanied by language signalling that a 50bp hike remains on the table in September."
- "Given the strong and broad-based wage and inflation pressures, along with a still resilient domestic activity outlook, we expect the BoE to act decisively to take Bank Rate into contractionary territory. As such we look for 50bp hikes in the next two meetings, raising Bank Rate to 2.25% in September, above our estimate of neutral (1.75%). We then expect 25bp hikes in November and December, reaching a terminal Bank Rate of 2.75% by year-end."
- "Expect that asset sales will occur at a pace of £15 billion per quarter. As corporate bond sales are to begin in September, we think gilt sales are likely to begin shortly after the November MPC meeting but, given Bailey's comments, it is possible that gilt sales start one meeting earlier than assumed in our baseline."

ING: 50bp hike due to communication, not data; final 25bp hike in Sep with upside risks

- Expect 50bp hike “not because the data we’ve received since June’s 25bp hike decision has moved the needle all that much – it hasn’t. But policymakers hinted back in June that they could act ‘forcefully’ to get inflation lower. And with a 50bp move more-or-less priced, that’s what we expect them to do.”
- “We’ve been pencilling in a peak for Bank Rate at 2% (1.25% currently), which would mean just one more 25bp rate hike in September before policymakers stop tightening. In practice, that might be an underestimate and depending on the signal the Bank sends next week, we wouldn’t rule out an additional 25, or at most 50bp, worth of rate hikes on top of that.”
- “Truss has promised cuts to both individual and corporate tax rates, which could total roughly 1.5% of GDP in additional stimulus, should she win the contest. On paper, that could lead the Bank of England to hike rates say 25-50bp further than it might otherwise have done, all else equal”

JP Morgan: 50bp in August; base case for 25bp in Sep, but 50bp if guidance unchanged

- Expect 50bp hike with 7-2 vote with Tenreyro and Cunliffe dissenting for 25bp. “We had thought there was a chance of some dissent for 75bps, perhaps from Saunders at his last meeting, but rising recession fears make this less likely.”
- “Forward guidance to signal more tightening ahead, but leaving optionality for a 25bp or 50bp hike in September”
- “While the UK activity data have remained resilient in the face of sizeable headwinds, the most recent concern is that the Euro area and US economies are slipping into recession - with the UK to follow. This introduces a little more uncertainty around the August decision than we had expected just a week ago. But we think the MPC will respond to its current assessment of inflation risks - which Bailey recently said were still to the upside - rather than second guessing where the global economy might be heading beyond the August meeting.”
- “For the period 2Q22 to 1Q23, we expect the BoE to project growth of -0.2% instead of zero as before. There is a good chance the MPC lowers its 1Q23 forecast and shows two consecutive quarters of negative growth in 4Q22 and 1Q23.”
- “The MPC probably has the scope to water down its June language slightly whilst leaving open the option to deliver another 50bps in September. Instead of saying it “will if necessary act forcefully in response [to more persistent inflation]” it could replace this with something along the lines of “the committee will remain alert to signs of further inflation persistence and is prepared to take the actions necessary...”… dropping the word forceful would tone the guidance down slightly, while at the same time retaining a clear tightening bias with the suggestion that the next move might still involve something more than a 25bp hike.”
- “Our current forecast is for a 25bp hike in September, which we think is close call between that and 50bps. The likely beginning of QT in September… could steer the MPC towards a 25bps in September. But if the BoE maintains its June guidance, or adopts something equally strong in August, we would likely shift the September call to 50bp.”
- “We continue to think by the November meeting there will be enough signs of a weakening in job growth to stabilize the unemployment rate and generate expectations of an increase. Combined with policy rate around the 2% mark - perhaps close to neutral - this would likely be enough to get the MPC slow to a 25bp per meeting pace (or stop if there were a more abrupt downshift).”

Morgan Stanley: 60% probability of a 25bp hike with peak rate of 2% by November

- 60% probability of a 25bp hike (and expect a 6-3 vote) with "unchanged messaging on forceful action if needed, with another set of very dovish forecasts."
- Continue to expect 25bp hikes "in September and November, and a peak rate of 2%."
- If there is a 50bp hike in August, MS "see a high chance that the August 50bp move would be a one and done, with 25bp following in September and November. The risk scenario is another 50bp in September. With two more hikes than in our base case in this scenario, we would see a high chance of cuts towards the end of 2023"
- Expect "active sales will be subject to a confirmatory vote at the September meeting. Barring a dramatic change in the external environment by then, we think that the MPC will vote to confirm the £10 billion/quarter pace of active sales, and start the programme in the last week of September."

NatWest Markets: 25bp hikes in August, November and February

- Expect 25bp August hike. "Whilst there are clear risks of +50bp rise, key data outturns since the MPC's May forecasts do not obviously warrant a larger move."
- Look for further 25bp hikes in November 2022 and February 2023 to 2.00%. Risks "skewed more towards additional quarter-point rises in September and December as more likely than the three half-point hikes being priced by markets."
- "Given the data flow and the fairly pessimistic assumptions incorporated in May (eg, on labour supply), the underlying inflation outlook is probably little altered."
- "We are inclined to view the 'act forcefully' reference as an attempt to provide reassurance around a less hawkish central case (materially less hawkish than market pricing)"
- "Our expectations for the pace of sales remains unchanged at ~£35bn per year… This puts us in the middle of Mr Bailey's £50-100bn range for the total reduction in balance sheet size… We expect the announced pace of sales to be a range (albeit narrower than £50bn) of the estimated total balance sheet reduction at the end of the first year."
- "Bailey's explicit reference to September prompts us to bring forward our expected start date for sales to October, after a vote by the MPC at the September meeting."
- "We expect QT to look very similar to QE – sales will be done in equal proportions across the same buckets (3-7y, 7-20y, 20y+)… sales per maturity bucket could occur once per month, rather than once per week. This would allow auction sizes to be bigger (i.e. £1bn instead of ~£250m) and avoid discouraging participation because of small auction sizes."

Nomura: Now expect 50bp August hike but still expect 2.25% terminal rate and cuts in 2023

- Expect a 50bp hike in August, had previously looked for 25bp.
- "The combination of a willingness on the part of the MPC to be more aggressive in raising interest rates and the fact that the data have generally held up (and in a number of cases strengthened) over the past six weeks since the June meeting suggests to us that the Bank needs to be – and will be – bolder at its August meeting."
- "Continue to expect rates to rise to a terminal point of 2.25%, but now by the November rather than December 2022 meeting. We expect the Bank to revert to 25bp hikes in September and November."
- "Expect the Bank to cut interest rates twice (2x25bp in May and August 2023) in response to recession and slowing inflation. There could be modest upside risks to our near-term rate

view if the fiscal largesse planned by Conservative leadership-hopeful Liz Truss comes to pass"
- Vote to begin active gilt sales in September; "assumed active sales of £10bn per quarter starting in Q4 this year."

Pantheon: 25bp hike with three-year ahead CPI forecast even lower than May's 1.3%

- "Core inflation and unemployment data point to a 25bp hike"
- Expect the same 6-3 vote as in June.
- "The MPC's new forecasts likely will cast doubt on markets' expectations for substantial further tightening… Expect the MPC to predict a recession and 5% unemployment in 2023, and sub-2% medium-term inflation."
- "Forecast for CPI in two years' time likely will be slightly below the 2% target, while the three-year ahead estimate probably will be even lower than May's 1.3%,"
- Continue to expect September 25bp hike to be the last of the current cycle.

Rabobank: "Stubbornly" stick to final 25bp final hike with neutral rate between 1.0%-1.5%

- "We (stubbornly) stick to our call for a 25 bps hike at the August meeting."
- "The impact of the rate hike could be 'beefed up' by some hawkish notes on gilt sales."
- "The actual decision on gilt sales is however scheduled for the September MPC; we expect the balance sheet to be reduced at a pace of £100 billion a year through a mix of active sales and gilt redemptions."
- "If Liz Truss wins the leadership election, as we expect, and follows through on her pledge to immediately cut taxes, the pressure on the central bank to continue its hiking cycle increases. It may therefore want to set some hikes aside for future use."
- "By our estimates, rate increases beyond 1.00%-1.50% lift the UK's monetary policy well into restrictive territory. This is expected to deepen an already impending recession."
- "To move into restrictive territory at a time of such weak growth is unprecedented in the central bank's 25 years of independence. This means that, as soon as inflation readings allow, the potential for interest rate cuts to neutral increases."

RBC: Bailey's comments as close as possible to explicitly signalling a 50bp hike

- Expect 50bp hike and note that "Governor Bailey's comments in his July 19th Mansion House speech appeared to come as close as MPC language can to explicitly signalling a 50bps increase in Bank Rate."
- "Firming domestic inflationary pressures alongside upward revisions to near-term CPI inflation forecast in the latest MPR are likely to provide the justification for a larger than hitherto rate rise"
- "See the MPC reverting to 25bps rate hikes at its remaining meetings this year taking Bank Rate to 2.5% by the end of the year"

SEB

- Expect 50bp hike.

SocGen: 9-0 vote for 50bp hike with 50bp in September and 25bp in November to 2.5%

- Expect 50bp August hike with a unanimous vote.
- “We would then expect another 50bp hike in September with the tightening cycle completed with a 25bp increase in November, taking Bank Rate to a peak of 2.5% (previous forecast was 2%). We will update or confirm that view after the meeting.”
- On Dhingra: “All else equal, one might then expect her to vote for 25bp hikes when she joins (first meeting in September) but, of course, all else is NOT equal. The inflation outlook has deteriorated significantly since she spoke but so too has the growth outlook. We should not prejudge her vote. I suspect that she will go with the majority at her first meeting.”
- On QT: “We project a 6-month programme to sell £60bn.”

TD Securities: 50bp hike with 3-4 dissents; caution against extrapolating 50bp hikes in future

- Expect 50bp hike “with likely 3-4 members preferring a 25bps hike, and a message that cautions against extrapolating 50bps hikes into the future.”
- “Past messaging about market expectations being too high are likely to be repeated. With such a wide range of views on the MPC, the Governor is unlikely to provide much further guidance beyond this meeting.”
- “Expect the MPC to hike rates in 25bps increments at its September and November meetings, reaching a terminal rate of 2.25%. From there, it's likely that the continued stagnation of the UK economy on the back of a cost-of-living crisis begins to dominate the MPC's concerns.”
- “Large-scale fiscal stimulus such as a broad VAT cut could see the MPC hiking more rapidly and to a higher terminal rate, and that's an outcome that should be kept under serious consideration.”
- “We anticipate a policy decision on active Gilt sales at the September meeting, setting a pace of about £5bn/month in sales from October.”

UBS: Expect 25bp hike with “significant risk of 50bp”; increase in probability of more 50bp hikes

- Expect a 25bp hike but “the decision on the size will be finely balanced with a significant risk of a 50bp hike”
- “Chief Economist Pill later clarified that evidence of higher inflation becoming embedded in price and wage setting behaviour would be a sign of more persistent inflation. However, the incoming data since that meeting has been mixed… Against this backdrop and given possible concerns that a 50bp hike might fuel expectations of a string of larger hikes, we stick to our forecast of a 25bp hike in August.”
- “Our baseline assumes that following a 25bp hike on 4 August, the BoE will deliver another 75bps of hikes this year (25bp each in September, November and December) and then stop. However, if the BoE were to hike by 50bps in August, the chances of more 50bp hikes in the following meetings would likely rise.”
- “We have previously expected active sales to start only in 2023. However, given the relatively small size of "£50-100bn in the first year", as indicated by the Governor, we don't exclude the sales starting shortly after September”

UniCredit: 25bp hike last of the cycle but “risks are now clearly skewed to the upside”

- Expect 25bp hike “but it’s a close call between a 25bp and 50bp hike” and expect 3-4 dissenters in favour of 50bp.
- Expect the August hike “to be the last in this hiking cycle, but the risks are now clearly skewed to the upside. The MPC would likely need to see some spare capacity opening up in the labor market in order to feel confident that the risk of high inflation becoming entrenched has diminished. We still think this will happen in 2H22, but uncertainty is very high”.

Central Bank Watch - Bank of England

August 02, 2022

MNI Bank of England Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	9.4	7.0	↑	5.4	↑					1.99
Core CPI	% y/y	5.8	5.7	↑	4.2	↑					0.73
PPI Output	% y/y	-1.3	-0.9	↓	-0.7	↓					-1.00
Inflation Swap 5y/5y	%	3.73	4.11	↓	3.96	↓					-1.60
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
PMI Manufacturing	Index	52.1	55.8	↓	57.3	↓					-1.52
PMI Services	Index	53.3	58.9	↓	54.1	↓					-0.81
Manufacturing Production	% y/y	2.3	3.4	↓	0.3	↑					-0.02
Index of Services	% 3m/3m	0.1	0.7	↓	1.5	↓					-1.40
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Consumer Credit	GBP Bn	1.78	1.31	↑	0.99	↑					1.24
Mortgage Approvals	K	63.73	69.42	↓	70.31	↓					-1.47
Lending Sec on Dwellings	GBP Bn	5.27	7.18	↓	3.99	↑					-0.23
Nationwide House Prices	% y/y	11.0	12.1	↓	11.2	↓					-0.54
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales Inc Petrol	% y/y	-5.8	1.9	↓	1.3	↓					-0.99
Consumer Confidence	Index	-41.0	-38.0	↓	-19.0	↓					-0.93
Employment Chge 3m/3m	K	296.0	10.0	↑	60.0	↑					1.84
Ave Weekly Earnings 3m	% y/y	6.2	5.6	↑	4.2	↑					0.65
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market (All Share)	Index	4098	4185	↓	4192	↓					0.64
10-Year Gilt Yield	%	1.74	1.91	↓	1.30	↑					0.44
Gilt Curve (2s-10s)	bps	13.8	31.4	↓	25.7	↓					-1.51
GBP TWI	Index	80.07	80.20	↓	82.35	↓					-0.76

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

MPC Member Key Comments

Bailey: Mansion House speech explains “forceful” and sets expectations for QT

19 July

- “our job is to hit the inflation target, and in the current circumstances to return inflation to target, always remembering the importance of understanding time lags in policy, and lags in the impact of economic shocks. Let me be quite clear, there are no ifs or buts in our commitment to the 2% inflation target. That’s our job, and that’s what we will do.”
- “I think we can already see the effects, with the economy slowing (I would urge caution in interpreting the May GDP number as strong – given the changed pattern of public holidays).”
- “We recognise a trade-off in a situation of high inflation and weakening growth. In my view this trade-off explains why we have raised Bank Rate progressively since last December in increments of 0.25% after the first rise. We have judged what we need to do in the face of these very big external shocks which, assuming Bank Rate following the market path used for the May MPR forecast, will see inflation fall very rapidly next year, and return to target in 2023, and then go below target.”
- “We see the balance of risks to inflation as on the upside. Here, I would pick out the risks from domestic price and wage setting, and this explains why at the MPC’s last meeting we adopted language which made clear that if we see signs of greater persistence of inflation, and price and wage setting would be such signs, we will have to act forcefully. In simple terms this means that a 50 basis point increase will be among the choices on the table when we next meet. 50 basis points is not locked in, and anyone who predicts that is doing so based on their own view. We do not pre-announce Bank Rate decisions for the very simple reason that MPC decisions are based on deliberation at the time among nine people focused on returning inflation to the 2% target sustainably.”
- “Based on analysis conducted in conjunction with colleagues at the DMO, we are currently looking at a total reduction in the stock of gilts held by the APF, which covers both sales and gilt redemptions, of something in the region of £50-100bn in the first year. Our Market Intelligence suggests that’s broadly in line with what market participants are expecting.”

Saunders: 2% Bank Rate or higher not "implausible or unlikely"

18 July

- SONIA futures moved to their lows of the day after the Saunders speech - even though his last meeting is in 2.5 weeks and he's a recognized hawk. His key quote:
- "Without wishing to endorse those views too strongly, I do not regard such an outcome (ie that Bank Rate will have to rise to 2% or higher during the next year to return inflation to target) as implausible or unlikely. But, rather than focus on a precise forecast for Bank Rate over the next year, the key point is that the tightening cycle may (in my view) still have some way to go."

Bailey Sees Global Equilibrium Rate Staying Low

12 July

- The key factors that have driven down the global equilibrium interest rate, R*, are likely to persist and the rate is likely to stay low, Bank of England Governor Andrew Bailey said Tuesday.
- Bailey stressed, however, in a speech at an OMFIF event, that the R* was not a guide to current policy setting and said that there was no read across to what the Monetary Policy Committee would do in coming months.
- "The key drivers of Global R*, particularly increasing longevity, are expected to persist .. So it is not unreasonable to expect that Global R*, the long-run anchor for UK equilibrium interest rates, will remain low," he said.
- The UK has seen almost no growth since the Covid-19 pandemic struck and had been hit by large supply side shocks but "we think inflation should come down rapidly next year as those shocks wear off,".
- Speaking in a question and answer session at an OMFIF event, he downplayed the likelihood of persistently large pay increases, saying many firms had told them they were making one-off pay increases given the spike in cost of living costs.
- On the framework for active gilt sales, set to be unveiled in August, Bailey said that Bank Rate would be the active policy tool, gilt sales would be steady and predictable and he stressed that while it was right to shrink the balance sheet the end point was unknown. "We don't know what the sustainable level of demand for reserves is," he said.

Pill's reason for change in forward guidance

6 July

- BOE Chief Economist Huw Pill says "Much remains to be resolved before we vote on our August policy decision. How I vote on that occasion will be determined by the data that we see and my interpretation of it."
- Pill also notes there are four reasons for the change in forward guidance and his personal interpretation:
  1. "By focusing on the ‘scale, pace and timing’ of further changes in Bank Rate, the statement clearly widens the discussion beyond the interest rate decision at the next meeting.... this represents the desirable introduction of greater flexibility in our communication of the policy outlook... and the likelihood that we will have to take finely-balanced decisions over rates not just in August but also beyond that, in the face of two-sided risks to the economic outlook into next year."
  2. "The reference to ‘any’ increases allows for the possibility of remaining on hold, which helps to capture the potential breadth of opinions on the Committee"
  3. "The statement gives an indication of how the MPC intends to respond to future data developments... this places emphasis on identifying potential second-round effects in price and wage setting behaviour. This helps to clarify how the MPC defines it policy ‘reaction function’ at present, prioritising the more persistent component of inflation developments over the headline spot measure."

4. "By signalling preparedness to 'if necessary act forcefully in response' to indications of greater persistence in inflation, the statement reflects both my willingness to adopt a faster pace of tightening than implemented thus far in this tightening cycle, while simultaneously emphasising the conditionality of any such change in pace on the flow of new data and analysis."

Cunliffe: Hints at further rate hikes by saying BOE will do what is "necessary"

6 July

- Highlights below from Cunliffe's BBC Radio 4 interview:
- He gives little away other than saying the BOE will do what is necessary to stop inflation expectations being embedded - he gave no more explicit expectation of future voting intentions or the path of Bank Rate, but did at least sound as though he would for a hike at the August meeting. As he is considered one of the most dovish MPC members (alongside Tenreyro) this in itself is notable, but probably expected already.
- Cunliffe asked if BOE is behind the curve - said they started hiking in December before other DM central banks.
- Then asked a loaded question saying that rate hikes have been small.
- Cunliffe says different factors are affecting different economies. Says doesn't want to leave inflation as the new normal and embedded and that Bank will act to give people confidence.
- Cunliffe says looking at domestic pressures and can't impact international factors such as food prices.
- Asked about whether "domestic factors" means wage rises he says "we're not responsible for industrial relations... Those are decisions taken by firms up and down the country...we set the economy conditions in which pay bargaining takes place and in which companies decide whether to pass on prices... Will use tools to ensure economic conditions are not those where inflation becomes embedded in the economy."
- Cunliffe asked if higher unemployment is necessary to squeeze out unemployment. Says at the moment international factors are driving inflation at the moment and those rises won't last for ever. As that chock passes, econ conditions must not allow a wage-price spiral and that's where BOE will do what is necessary.

Tenreyro: Tackling Inflation Early Would Have Hurt Jobs

5 July

- Speaking on a panel discussion, BOE MPC member Tenreyro said responding earlier to inflation would have driven unemployment to levels last seen in the 1990s, creating an "enormous recession" and leading to below target inflation in the medium-term.
- She notes the bank rate will be the main tool to manage the economy with unwinding QE not expecting to have a material effect on the UK economy.
- She also adds that climate changes is a problem for governments rather than central banks, which have few tools to tackle it (going against Governor Bailey earlier saying its important for central banks to be involved).

Bailey: BOE Left Option Open For Bigger Aug Hike - Bailey

29 June

- The Bank of England will take policy decisions meeting by meeting and a 50 bps hike in August is not a forgone conclusion, although clearly is could be an option if the conditions warrant it, Bank of England Governor Andrew Bailey said Wednesday.
- Bailey said the Monetary Policy Committee had been very careful in the words it used in the June policy statement and left the option of a bigger than 25 bps hike on the table. But Bailey clarified that it was only an option and other outcomes were also in play.
- Bailey said the move to a bigger hike would be needed if inflationary pressures became more persistent, if second round effects took hold, but, he noted, we are not there yet with a month still to go to the next meeting.

Dhingra Sees Further Economic Contraction Risk

29 June

- Perceptions that the UK labour market is very strong are a concern, incoming Bank of England Monetary Policy Committee member Swati Dhingra told the Treasury Select Committee Wednesday, adding that there could be further economic shrinkage ahead.
- The labour data "worries me a little bit," with headline unemployment low but "total hours worked below pandemic levels," she said. In her written evidence she noted that "the UK has done worse than other G7 nations in terms of consumer confidence and inflation" and warned that "there are significant challenges as the risks of worsening global conditions remain and could cause an economic contraction and further supply shocks."
- Her evidence was even handed on inflation pressures, however, as she said that firms' elevated inflation expectations suggest that they will try to maintain profit margins and pass through higher input costs to consumers.

Mann: MNI Connect Event

Full playback available here.

- "I voted for a 50 basis point increase at the last MPC meeting. In my view, a more robust policy move, based on both domestic conjuncture and commensurate with the global factor, reduces the risk that domestic inflation already embedded is further boosted by inflation imported via a Sterling depreciation. I open the door to a policy rate reversal in the medium term when the domestic supports to demand fade and when weakness in external sources of demand bite. In my view this monetary policy path supports an inflation-output combination superior to that of the historical reaction."

- Interesting part of the opening comments from Mann's speech as part of the MNI Connect event is that she "opens the door to a policy rate reversal in the medium term"
- This suggests she would probably be less worried about over-tightening in the near-term, as she seems more concerned with stopping inflation expectations being embedded in the near-term. So it doesn't sound as though there is any reason to suggest she would not continue to vote for a 50bp hike in August.
- Question: On the forward guidance statement being omitted in the Minutes referring to tightening in the coming months. Why has this been removed?
  Mann: That sentence was wearing thing in terms of our view on what it was communicating to markets and we have market intelligence as part of the internal workings of the bank, where they talk to market participants about what markets think we are communicating to them. We thought it was appropriate to recalibrate market thinking about prospects for monetary policy. Gave important guidance about size, timing and pace of future increases - as you know from the votes there were differences in views on size, timing and pace. Also that section included an important assessment about being vigilant about persistence in inflation as well as to act forcefully if such persistence became apparent. We did change the language, but replaced it with language that gives more information about what it is we are looking for going forward and how we will react to get the market back to 2% in the medium-term. One thing you need to remember from the previous meeting was there was not a forward guidance that all members agreed to. It's important as a Committee who all have our own vote and speeches and give assessments on what we think is important and how we will interpret the data and respond. Also important for there to be a Committee view that is presented not just to financial markets, but people in the real world deciding to buy a house or make a business investment. This tells you there are differences in views of Committee members. But also tells you what we are looking for and that is persistence.
- Question from Jan Vlieghe: Lots of CBs have communicated in terms of neutral rate and where we want to be versus that neutral rate. Some have communicated they want to be above neutral rate, or get close to neutral rate. Why has the MPC not done this?
  Mann: We have not given the path that rates will peak above neutral. But the market path we use includes a reversal in the path, according to market participants. Can derive from the individual votes from members what their views are and it is the democracy of one person, one vote that will ultimately outline the policy path going forward. I gave a pretty clear outcome of what I think will happen, and also in previous speeches gave an outline on what are the difficulties on putting a number on the neutral rate / r*.
- Mann asked on the process of the decision: Decision on Wednesday, announce on Thursday and have a big meeting on the preceding Friday to discuss. Given the Fed changing course and data released since that Friday, how much should we look at data announced close to the decision?
- Also on GDP weakening, how does that impact the decision?
  Mann: Friday is an important meeting, even before Friday have a lot of discussions, and then ultimately make a final decision on the Wednesday. There was a fair amount of information that came in in that time period. My view is that on the data that came in on GDP and employment, accounting for the test and trace and Jubilee give a negative to the picture going forward. I am saying real income is being harmed by the energy etc price increases. However, when thinking about the various schemes in place e.g. fiscal packages that

significant offset some of the price shocks for a range of the population. Also outlined in the household surveys that many people will be drawing down accumulated savings to stabilise their consumption pattern. There are people who will consume more out of their pay check, high marginal propensity to consume. Quality trade down - not something people want to do but it still represents consumption. Additional borrowing - which is a vulnerability in the longer-term. This gap between propensity to consume and real income gives firms more pricing power in the near-term. This is an important part of the domestic conjuncture on to which we must then add the global factor. For example your comment on the Fed hiking 75bp or even 50bp, the stylised exercises would still be valid, and we have to acknowledge the direction of travel for the Fed vs the BoE had already been incorporated into some sterling depreciation.

- Question: It looks like hiking cycles are fairly well correlated if you eyeball them, but the model assumes the UK lowers rates in response to a Fed hike, but is this consistent with the correlation in aspect. Also asked when you look at broadening of inflation pressures, it seems odd the BOE are being more timid in hiking rates, particularly in response to other central banks - what is driving the resistance to be more aggressive?
  Mann: On the latter: There are important differences in views on the Committee on the degree to which there is resilience in consumption. We use very similar models, but assess the data very different. For some there is a different weight for a significant deterioration in demand - that impacts pricing: firms having to discount etc if demand slows. That impacts the differences to consumption. My view is that there is a gap between consumption and a fall in real income. That gap won't stay for ever. In 2023 that gap may close and consumption slows - that would be when I would change my view on tightening. In terms of challenges - how are the inactive getting back to work is a key question.
  On the former: We have to remember there hasn't been a hiking cycle for a very long time. The historic experience is that the UK policymaker doesn't follow the global policy in the model. In our model they do follow. In the market curves, this is a new phenomenon, what we are looking at is market's new assessment on what they think the strategy might be going forward.
- Question: How much do you worry about how the market takeaway from the speech is to raise rates to help support the pound, how will you communicate the message?
  Mann: I don't see this as defending sterling, that's not what we're doing. If you compare these scenarios, sterling is more volatile, what we are doing would increase volatility in the model so is not consistent with defending. Currencies are always a summary statistic of much more fundamental variables. From those two angles, I don't see that some would infer that what I am doing with this model is defending sterling.
- Mann asked about how to assess the change in vote from May to June for both herself and the Committee. 2) Should we interpret that the variance of MPC members views has increased between May and June?
  Mann: On marginal info: Relevant for me: The extent to which the data is increasingly concerned about second round effects and prevelence. Upside risks to inflation. Before, but also now, the more aggressive Fed making the global factor more relevant. Can see this global factor has already become more relevant for me. It was fortuitous that the timing of this speech is being delivered now in terms of the global developments.
  On second question, there is one guidance now - that should tell you something.

- Question: To what extent should the slowdown in demand in the US lead to a downside in prices and lead to downside imported inflation in the UK?
  Mann: It is true that imported inflation is important, but one thing we have noted is that the domestic components of inflation are becoming more apparent. UK goods prices are running around 4ppt above global goods pricing. If US prices slow, might see more decoupling of UK vs global goods prices.
  When you have high inflation and you have another shock, this can lead to more persistent inflation expectations being higher. This could mean that the relationship between short-term inflation and medium-term inflation is stronger now than usual. Also inflation expectations from consumers (who buy food, energy etc) and financial markets. Need to be concerned about these expectations moving higher and driving medium-term inflation.

MNI POLICY TEAM INSIGHTS

Shrunk, Sick Workforce Adds To BOE Hike Pressure

By David Robinson, 29 July

Fresh data highlighting constraints on the UK's ageing and increasingly sickly workforce are buttressing arguments for the Bank of England to tighten monetary policy.

With a first 50-basis-point rate hike of the cycle on the table for Aug. 4, the Monetary Policy Committee is already worried double-digit headline inflation will feed into wage demands in a very tight labour market. Research published this month by MPC member Jonathan Haskel and Bank economist Josh Martin will only deepen those concerns.

They noted that Covid seems to have accelerated a long-term trend towards a less healthy workforce, with the number of working-age long-term sick increasing by 4.1% a year in the two years of the pandemic, up from around an annual 0.5% in the 20 preceding years. Covid not only directly sickened many, and left a proportion with lingering effects, but also crowded out much non-urgent medical care, so that now some 7 million people, 17% of the working-age population, said long-term ailments affected their work, the research showed.

This constrains "labour supply through both lower participation rates and lower average working hours, reducing potential output," the paper said. Haskel backed 50-basis-point rises at meetings in June and May.

Bank surveys of firms indicate that they expect recruitment difficulties to persist for at least the next twelve months, due to structural shortages of labour and skills, something which will tend to increase workers' bargaining power.

SECOND-ROUND EFFECTS

Labour market tightness has been on the minds of other MPC members. Chief Economist Huw Pill is monitoring second-round inflation effects on wages from the energy price spike. And fellow MPC member Michael Saunders, who advocated tightening even before the Ukraine war, pointing to negative supply shocks caused by Covid and Brexit, used his farewell speech before he leaves the committee after the August meeting to highlight pressures on the supply of workers, with the prime working age and retirement age groups getting ever closer in size, and as a flexible supply of additional labour is no longer available as a result of Brexit.

More dovish members, though, may still be concerned that the predicted sharp slowing in the UK economy, with the IMF forecasting growth of just 0.5% in 2023, will feed through into a drop in hiring and a substantial undershoot of the inflation target down the line. High inflation may also be pushing some people back to the workforce, with the participation rate recovering over the past few months. (See MNI INTERVIEW: UK Jobs Market Risks "Wile E Coyote" Plunge)

But the Bank's overall assumption is that potential, or non-inflationary, growth has fallen to just 1.2% a year, meaning that even historically weak rates of expansion would add to inflationary pressure. The MPC is also concerned that price rises will be aggravated by projected sterling weakness as other central banks hike even more aggressively.

BOE economists will trawl through the labour market material for the Monetary Policy Report to be released at the next meeting, which should see, according to most analysts, and market pricing, another 50-basis point hike, albeit on a split vote.

BOE's QT Pace Known, Terminal Point Unknowable

By David Robinson, 25 July

The Bank of England is unlikely to provide a precise numerical estimate of the end point for quantitative tightening when it publishes its framework for running down its gilts holdings in August, but it will set a pace for combined sales and redemptions, with the counting set to start from the time active sales begin.

It will also need to provide detail on how it plans to ensure liquidity and avoid a snap back in market rates by maintaining reserve supply if needed as gilt sales proceed.

In his July 19 Mansion House speech, Governor Andrew Bailey said the BOE was looking at reducing the stock of gilts held by GBP50-100 billion "in the first year," sparking debate among analysts over whether redemptions prior to active sales would be included. But, as the Bank will not want to sell substantial amounts of gilts at the same time as large redemptions fall due, the straightforward interpretation of his comments is that the count will only commence once active sales begin, possibly in September.

The BOE’s Monetary Policy Committee decided at its February meeting to begin shrinking the stock of government bonds by not reinvesting proceeds of maturing gilts, and by the August meeting its holdings will have dipped below GBP844 billion, from a peak of GBP875 billion.

NO NUMERICAL TERMINAL POINT

Even as it sets a pace for sales in August, questions will remain as to how long the Bank expects sales to go on and how far balance sheet shrinkage could extend.

The BOE, through its market intelligence side, has asked banks about the levels of reserves they think they will require. But the experience of the U.S. Federal Reserve, which found in 2019 that money markets froze when reserves were still at levels well above those banks had suggested would be required, highlights the dangers of placing too much weight on the expectations of financial institutions, which tend to underestimate their own future needs.

Central banks will be very cautious with quantitative tightening, as former senior BOE official David Aikman told MNI in a recent interview, in which he noted that they will probably err on the side of leaving balance sheets slightly too large over the next five to 10 years. (See MNI INTERVIEW: Risk BOE Gilt Sales Spark Volatility – Aikman).

As it releases its gilt sales framework, the BOE will also be expected to detail mechanisms to ensure a sufficient supply of liquidity to markets if needed.

In a speech last September, the Bank’s Executive Director Markets Andrew Hauser pointed to the existence of an unknown level of reserves below which short-term market rates would jump significantly above the target interest rate, undermining monetary policy. While the QE unwind would not need to stop when reserves hit that level, the BOE would need to replace long-duration QE assets with shorter-term repos or other Open Market Operations to maintain the size of the balance sheet, Hauser said.

MNI INTERVIEW: UK Jobs Market Risks "Wily E Coyote" Plunge

By David Robinson, 21 July

The UK risks a sudden surge in joblessness as firms which have kept hiring despite deepening pessimism among businesses and consumers encounter a “Wily E Coyote” moment and stop recruitment, the Bank of England’s former head of international research Greg Thwaites told MNI.

“We have seen consumer confidence plummet. We haven’t seen labour demand or employment fall a great deal yet,” Thwaites, now at the Resolution Foundation, said in an interview in which he pointed to the danger that the labour market and employment could find themselves suspended over thin air in a similar manner to the classic cartoon character as the economy falls away beneath them.

“One of the big uncertainties I have is whether that is just a few months down the road or whether something else is going on,” he added.

With the latest data showing pronounced falls in economic activity, it would be historically typical for the labour market to catch up a few months later, he said.

“It could be that that is what we are seeing, or it could be the fact that vacancies are so high, the labour market is so tight, that it can cool a bit, and people can still find their way into work because there are still 1.3 million vacancies to fill,” he said.

Vacancies have for some months matched or exceeded unemployment levels, but skilled workers are in short supply. Participation rates, which fell during the Covid pandemic, are rising, perhaps as more people seek work to cope with higher prices. (See MNI INTERVIEW: Great Resignation Arrives In UK, Saps Workforce)

COST OF LIVING DRIVES PARTICIPATION

“We have seen participation in the labour force increase for a few months now and reverse part of the fall that we saw since the pandemic started, and it is concentrated among particular groups, clearly people over 50,” Thwaites said. “It is easy to think of reasons why it might be happening, principally the cost-of-living crisis."

In the 2010s participation also increased at a time when real wages were declining, he noted, though he added that following Brexit the UK can no longer rely on a flexible flow of workers from the EU. Instead, under the UK’s new migration system, the government lists shortage occupations and sets a pay threshold.

“We have a much more centrally-planned labour market now … that is likely to be a less flexible one. And so one of the things that used to be the case was that if the UK economy was running hot it would naturally suck in labour from the EU and that is going to happen less than it used to,” Thwaites said.

The trajectory of the labour market will be a key consideration for the Bank of England at its meeting next month, though Monetary Policy Committee members disagree on how to gauge its impact on inflation, a calculation complicated by a fall in potential growth caused by factors including the UK’s departure from the EU and demographic ageing.

Thwaites said the MPC would also examine any signs of "real wage resistance. Whether workers try very hard to bargain for higher wages to protect themselves against inflation, leading to a wage-price spiral."

MPC member Michael Saunders made similar points about the loss of flexibility in labour supply in his speech at the Resolution Foundation this week, although Governor Andrew Bailey tends to avoid commenting on Brexit.

MNI INTERVIEW: Risk BOE Gilt Sales Spark Volatility – Aikman

By David Robinson, 11 July

The Bank of England should get on with shrinking its balance sheet, even if quantitative tightening is more likely to prompt market volatility than some at the BOE had hoped, the Bank's former technical head of division, David Aikman, told MNI.

With the BOE set to launch its framework for active gilt sales in August, some officials have argued that the effect on liquidity and bond yields from active gilt sales should be minimal, given that the main effect of quantitative easing had been to restore liquidity to markets via a flow of purchases. But a rival view, expressed by Stanford Professor Hanno Lustig at a conference hosted by Aikman last week, is that a decade of unconventional monetary policy may have suppressed interest rates at artificially low levels, and yields may snap back once stocks of bonds begin to fall.

"That argument would suggest the signal we are deriving from markets right now is hugely distorted by the fact that central banks own lots of the asset class that we are talking about here. It does give us a little bit of pause in thinking about what the right strategy is for the Bank from August onwards," said Aikman, now director of the Qatar Centre for Global Banking and Finance,

"I still think it is the right thing to get on with unwinding the balance sheet," he added in an interview. "If anything, we have waited too long to begin this process. There are risks to maintaining a very large balance sheet. There are risks basically to the independence of the institution if we continue in the state of the world where a vast amount of the gilt market is owned by the Bank of England." (See MNI INTERVIEW: BOE Gilt Sales Should Be Slow, Steady - Forbes)

PROCEED, BUT WITH CAUTION

Still, central banks should monitor the impact on yields and liquidity as they proceed with quantitative tightening, he said.

"I think central banks will have a lot of caution in the way they approach this, rightly so. Given what we saw with U.S. money markets seizing up in September 2019, we're likely to end up with a slightly too large balance sheet over the next five to 10 years," he said.

The Bank has to decide whether to include an estimate of what the endpoint for balance sheet shrinkage will be when it publishes its sales framework.

Aikman believes that it should, at least, set out the factors that they are looking at to try and establish that endpoint, such as banks' need to meet liquidity capital requirements, and that "will let people form their own views as to where that terminal point should be," he said.

Despite years of experience with quantitative easing, central bankers are still unsure as to its mechanisms, Aikman noted.

"Whether the effects on markets and the economy derive from the stock of QE or the flow of QE .. it is still unknown if we are being totally honest. The flow view would suggest that you should probably have already begun the unwinding and you just get on with it," he said, following a conference at the centre which included BOE Chief Economist Huw Pill and many others.

"We have heard arguments that cast some doubt as to whether this view is correct … that suggest the effects arise much more from the stock of purchases that are sitting on central banks' balance sheets," Aikman said.

MNI INTERVIEW: BOE Should Look More At Fiscal Risks - OBR Chief

By David Robinson, 11 July

The Bank of England should give more prominence to fiscal risks in its deliberations rather than take government spending and revenue plans at face value, Office for Budget Responsibility Chair Richard Hughes told MNI, pointing to a consistent record of under-performance in balancing official books.

"The risks in public finances are skewed to the downside and you see that in the pattern of debt over the post-war years, especially in recent years ... When governments have windfalls they tend to spend them but when they have shocks they don't adjust, they just accommodate them within the fiscal stance," Hughes said in an interview.

The OBR delivers a central projection alongside each budget, which is then incorporated into BOE projections and which takes government assumptions as givens, but Hughes said monetary and fiscal policymakers should pay more attention to the alternative scenarios, also produced by the OBR, which anticipate plausible risks to revenue and spending.

""We base our forecast on the government's policy of the day. Some of these risks are the result of wishful thinking on the part of governments. For example, we base our forecast on the government's legislated policy that fuel duty will go up by RPI inflation, by it has been either frozen or cut in every Budget over the past decade," said Hughes.

"It is just as important for monetary policymakers to think about alternative scenarios as for fiscal policy. We do try and discuss ... our alternative scenarios with the Bank. The issue is getting people to take us seriously."

SPENDING OVERSHOOTS

Recent governments have tended to exceed the amount of spending initially promised in response to economic shocks, he noted, pointing as a case in point to the repeated extensions of the furlough scheme introduced in response to the Covid pandemic. By accepting government assumptions, the BOE therefore runs the risk of systematically under-estimating fiscal support or over-estimating tightening.

"The fiscal policy response to shocks is also getting bigger and these often pan out seemingly more frequently, more severely, and the fiscal policy response is bigger and that means all these downside shocks hit harder," Hughes said.

Speaking as several candidates vying to replace Boris Johnson as leader of the governing Conservative Party promise significant tax cuts, including proposals to reverse an increase in national insurance contributions or lower corporation tax, Hughes noted that the fiscal challenges facing the UK will be intensified by rising interest rates. (See MNI INSIGHT: BOE Multipliers Imply Rate Expectations Overblown)

"One thing that has actually been an upside windfall for government in recent years … has been interest rates, which had been falling in response to shocks and gave the government a bit more breathing room but has not been enough to make up for the massive cost of these shocks. That one is now reversing," Hughes said.

TAX CUTS

Tax cuts would do little to address the supply side hits of the Covid pandemic and the war in Ukraine which have driven higher prices, while any resulting boost to demand could prompt higher interest rates in future.

“Tax cuts can have a mild stimulative effect in the near-term ... but in the long-term the effect on economic activity is driven by the supply side of the economy … and the sort of things that work on the supply side take a very long time to work," he said. "We take a multiplier effect from tax cuts on the economy in the near-term but in the medium-term any excess demand is taken care of by monetary policy.”

In its fiscal risks and sustainability report, published Thursday, the OBR said that official support during the pandemic peaked at 10.4% of GDP and that another 1.25% of GDP has been allocated so far this year to help households cope with the cost of living shock. Key spending has been announced between budgets, it noted.
