PREVIEW: BoE rate decision, MPR and minutes due Thursday 3rd August 2023

- **BoE rate decision, MPR and minutes due Thursday 3rd August 2023 at 12:00BST/07:00EDT, press conference due at 12:30BST/07:30EDT**
- **The MPC is expected to step down to a 25bps hike increment**
- **Focus will be on how committed the MPC is to further tightening**

OVERVIEW: The MPC is expected to hike rates by 25bps (vs. prev. 50bps increase), bringing the Base Rate to 5.25%, as forecast by 42/62 economists surveyed by Reuters, an outcome that is anticipated by markets with a 75% probability. Expectations of a smaller hike than previous have stemmed from June's CPI report showing a decrease in Y/Y inflation to 7.9% from 8.7%, matching the Bank's May MPR forecast. Elsewhere, focus will be on how the Bank guides future rate expectations with forecasts in the accompanying MPR set to show inflation materially below target over the medium-term.

PRIOR MEETING: Following the hotter-than-expected May inflation data, the BoE opted to deliver a 50bps hike in the Bank Rate to 5%. The decision to step up to a 50bps increment was based on the judgement that "the second-round effects in domestic price and wage developments generated by external cost shocks were likely to take longer to unwind than they had done to emerge". Not everyone on the MPC subscribed to this view, with Swati Dhingra and outgoing external member Silvana Tenreyro opting for an unchanged rate on the basis that goods inflation is expected to fall sharply, and the lagged effect of existing tightening. Elsewhere, the Bank opted to maintain guidance that "if there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required". Looking ahead, the MPC expected inflation to fall "significantly" over the course of the year, however, market pricing in the aftermath of the release was indicative of further action to come with a 25bps hike for August priced at 69% and a total of 100bps of hikes forecast by December.

RECENT DATA: The June CPI report saw annual CPI pullback to 7.9% Y/Y from 8.7%, matching the forecast of the Bank's May MPR. Note, there have been some encouraging signs for core inflation too with the annual rate pulling back to 6.9% Y/Y from 7.1%, whilst the widely-watched services inflation metric fell to 7.2% Y/Y from 7.4%. Note, the Decision Maker Panel survey will be released on the morning of the announcement. From a growth perspective, May's monthly GDP data revealed a 0.1% contraction, whilst more timely survey data saw the UK's composite PMI slip to 50.7 from 52.8 amid a softening in both the manufacturing and services prints. The accompanying release noted "the UK economy has come close to stalling in July which, combined with gloomy forward-looking indicators, reignites recession worries". In the labour market, the unemployment rate in the three-months to May rose to 4.0% from 3.8% with the timely HMRC employment change metric slipping to -9k in June from 23k in May. Wage pressures remained elevated in the 3-month annualised period to May, with headline earnings rising to 6.9% from 6.5%. Elsewhere, retail sales in June rose 0.7% M/M and fell 1% Y/Y with the ONS noting "when compared with their pre-COVID-19 level in February 2020, total retail sales were 17.9% higher in value terms, but volumes were 0.2% lower".

RECENT RHETORIC: Since the prior meeting, Governor Bailey (10th July) has noted that CPI is "unacceptably" high, however, headline inflation is set to fall "markedly" over the remainder of the year. Bailey added that "it is crucial that we see the job through, meet our mandate to return inflation to its 2% target...". Chief Economist Huw Pill (28th June) stated "the likelihood of second-round effects is much stronger when there is a tight labour market." Dhingra (27th June) noted that "there are some promising signals that UK CPI should ease based on a big fall in PPI". Deputy Governor Dave Ramsden (19th July) stated that the latest UK inflation data shows indicators of inflation persistence are still a bit higher than the BoE expected in May; Ramsden added that the impact of hikes taking quite a bit longer to come through than expected. External member Catherine Mann (7th July) remarked that it is better to front load interest rate moves, adding that there is persistence in inflation but noted that inflation expectations are still anchored.

RATES: After returning to a larger 50bps increment of rate hikes at the June meeting, the MPC is expected to move back to the smaller 25bps cadence, taking its Base Rate to 5.25%. Such a move is expected by 42 of the 62 economists surveyed by Reuters, whilst markets assign a circa 75% chance to such an outcome. Expectations for the BoE to step down to a 25bps increment stemmed from the June CPI report (see above for more details). There are reasons for caution on the MPC when looking at growth and PMI data, but likely not enough to deter policymakers from pulling the trigger on another hike. Of great interest to the market will be how the Bank chooses to guide expectations beyond the August meeting. From a quantitative perspective, Pantheon Macroeconomics suggests that the forecasts from the MPR will “cast doubt on whether interest rates need to rise further at all” given how the medium-term forecasts will align with the Bank’s inflation target (see below for details). That said, it is worth noting that the MPC is currently placing less weight on its forecasting given recent upside surprises in inflation data. In terms of the breakdown of views on the MPC, with Tenreyro having left the Committee and new member Greene unlikely to rock the boat, an 8-1 vote is expected, with Dhingra the sole dissenter; ING flags the risk of a three-way split, with the possibility of some members preferring to stick to a 50bps cadence. In terms of pricing beyond August, the terminal rate is seen at just above 5.75%, which would imply 50bps of additional tightening after this week’s meeting.

FORECASTS: Oxford Economics notes that the assumptions underpinning the forecasts will lead to a lower path for inflation. Firstly, “the Bank Rate is now expected to average 5.8% in Q1 2024, versus 4.6% at the time of the BoE’s last forecast”. The consultancy adds that (citing BoE research) this could take 1ppt off inflation alone. Furthermore, the stronger GBP and decline in wholesale gas prices will also likely act as a drag. That being said, it is worth noting that the MPC has been presenting a series of below-target inflation forecasts for some time now and therefore the implications for policy are “likely to be minimal”. On the growth front, 2023 growth may be revised marginally higher given the more resilient Q2. However, Oxford Economics suggests that the 2024 projection of 0.75% looks “punchy”.

Current forecasts

Inflation: 2023 5%, 2024 2.25%, 2025 1.0% Growth: 2023 0.25%, 2024 0.75%, 2025 0.75%