PREVIEW: BoE rate decision and minutes due Thursday 21st September 2023

- **BoE rate decision and minutes due Thursday 21st September 2023 at 12:00BST/07:00EDT**
- **August CPI data has thrown a September hike into question**
- **Markets assign a circa 53% chance of a 25bps hike vs. 47% unchanged**

OVERVIEW: Following UK CPI metrics, markets now assign a circa 53% chance of a 25bps hike vs. 47% unchanged. The shift in pricing from around 80% for a move at the start of the week comes in the wake of the August CPI report which saw headline Y/Y CPI fall to 6.7% from 6.8% (vs. exp. 7.0%), core CPI drop to 6.2% from 6.9% (vs. exp. 6.8%) and the all services print decline to 6.8% from 7.4% (vs. MPC exp. 7.2%). The data has thrown a spanner in the works for estimating what the vote split on the MPC will be, and therefore volatility for the GBP is likely upon the decision. Beyond the immediate announcement, focus will be on what guidance the MPC provides about any potential further tightening or whether it judges that terminal has now been reached.

PRIOR MEETING: As expected, the MPC came to market with a 25bps rate hike, taking the Base Rate to 5.25% and disappointing some outside calls for a larger 50bps move. The decision to raise rates was subject to an 8-1 vote with Dhingra the lone dissenter, whilst the magnitude of the rate hike was subject to hawkish dissent from Mann and Haskel who backed a 50bps increase. In the accompanying statement, the MPC reiterated that "if there were to be evidence of more persistent pressures, then further tightening... will be required"; it is worth noting that the MPC judges current policy as restrictive. Moving forward, Bailey stated that the MPC needs to make absolutely sure that inflation falls all the way back to 2%. The forecasts embedded in the accompanying MPR saw the 2023 inflation projection held at 5%, whilst the two-year forecast was revised higher to 1.5% from 1.0%, but ultimately still seen below target and therefore indicative that the MPC judges the current rate path to be tighter than required to return inflation back to mandated levels. In the follow-up press conference, Bailey refused to get drawn into hypothesizing what will happen next for the Bank Rate and stressed data dependency, however, he did note that there is more than one path for rates that would deliver inflation back to target. On the balance sheet, Deputy Governor Ramsden said that the MPC will make a decision on QT in September, however, he personally can see the case for slightly increasing the pace.

RECENT DATA: The August CPI report saw headline Y/Y CPI fall to 6.7% from 6.8% (vs. exp. 7.0%), core CPI drop to 6.2% from 6.9% (vs. exp. 6.8%) and the all services print decline to 6.8% from 7.4% (vs. MPC exp. 7.2%); ING noted "some of the downside surprise in services inflation is down to volatile travel categories". Elsewhere on the inflation front, the August BoE Monthly Decision Maker Panel Data noted that the One-year ahead CPI expectation decreased to 4.8% in August, down from 5.4% in July, whilst the three-year ahead CPI expectation dipped slightly to 3.2% in August, down from 3.3% in July. In the labour market, the unemployment rate in the 3M period to July rose to 4.3% from 4.2%, whilst headline earnings growth in the 3M/YY period to July rose to 8.5% vs. prev. 8.4% with the rate affected by the NHS and Civil Service one-off payments made in June and July 2023. Digging deeper, Pantheon Macroeconomics notes "the three-month-average vacancy-to-unemployment ratio—commonly referenced by the MPC as the best indicator of labour-market tightness— declined to 0.69 in July, from 0.72 in June and a peak of 1.06 in August 2022". On the growth front, M/M GDP in July contracted by 0.5% with the ONS noting "this is the first month since June 2022 that all three sectors contributed negatively to GDP on the month." More timely survey data from S&P Global saw the August composite PMI slip into negative territory, at 48.6 vs. prev. 50.8.

RECENT RHETORIC: Since the prior meeting, Governor Bailey (6th Sept) has remarked that "we are no longer in a phase where it was clear that rates need to rise, we are now data-driven as policy is restrictive", adding that "we are much nearer the peak of rates", but refrained from stating whether the peak had been reached. Deputy Governor Broadbent (26th Aug) noted that policy may well have to stay in restrictive territory for some time yet, adding that it is unlikely that second-round effects will unwind as rapidly as they emerged, according to Reuters. Deputy Governor Cunliffe (6th Sept) remarked "We are getting mixed signals about the economy now, which is what you expect when you come into periods where you might be close to turning points." Chief Economist Pill (31st August) stated that inflation is too high and the UK is facing second-round effects, adding that one option would be to hold rates steady for longer, an approach which he tends to favour. Dovish MPC member Dhingra (6th Sept) remarked "policy is already sufficiently restrictive, and the lagged effects of further tightening pose serious risks of output volatility in order to make a small dent on inflation". At the more hawkish end of the spectrum, external member Mann (11th Sept) noted that she would rather err on the side of over-tightening, adding that in her view, holding rates constant at the current level risks enabling further inflation persistence which will have to be unwound eventually with a worse trade-off.

RATES/BALANCE SHEET: 64/65 surveyed economists by Reuters expected the BoE to hike the Bank Rate by 25bps to 5.5%. However, given the August CPI release, this survey is now likely stale and instead traders should focus more on market pricing which has a 25bps hike at circa 53% vs. unchanged at 47%. Consensus had looked for an 8-1 vote split in favour of a hike with Dhingra remaining the lone dissenter. However, the latest CPI data (as detailed above) has very much left this part of the release 'up in the air'. Beyond the immediate rate decision, focus will be on language within the statement and what suggestion/if any it gives about future tightening. As it stands, guidance notes " If there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required". In order to maintain optionality, this guidance will likely be maintained. As it stands, market pricing expects no action beyond this week's meeting in the event that we get a hike, which, as noted by ING shows that markets have "come a long way since July" when they were looking for four more rate hikes. This comes as the UK has made greater progress on inflation in recent months and comments from policymakers are now more concentrated on the duration that rates are held at highs, rather than the actual peak level. This was exemplified by the August statement reading that the MPC will ensure that Bank Rate is sufficiently restrictive for "sufficiently long" vs. the prior guidance of "sufficiently high". Elsewhere, the MPC will be deciding on its QT operations for the coming year whereby, ING "think the Bank will plan to reduce its gilt holdings by roughly £100bn over the next 12 months, up from £80bn over the last".