Easier said than done

Bank of England Post-Meeting Comment

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Summary

- The Bank of England's MPC maintained the policy rate at 5.25%, a decision that was 'finely balanced' for some members. The vote concluded with a 7-2 split, in line with expectations.
- The central bank appears to be preparing the markets for a first rate cut in August, which continues to be our base case. We have, however, removed a subsequent September cut from our forecasts. This follows yesterday's services inflation data.
- Services inflation remains a concern, and whether it is diminishing or persistent is largely a matter of judgment, with notable differences of opinion within the MPC.
- Governor Bailey didn't add additional colour to this meeting outcome and the pre-election purdah means we will hear nothing from members until after July 4.
- The Conservatives will pay the price for the surge in inflation and the incoming Labour government is going to take credit for the upcoming rate cuts.

Finely balanced

At the June meeting, the Bank of England MPC kept the policy rate at 5.25%. Policymakers monitor for indications that inflation is becoming less persistent, but that is easier said than done.

Two committee members, Dhingra and Ramsden again, perceive a decline in inflation risks ahead and advocate for a proactive easing of monetary policy. This approach aims for a seamless policy shift, considering the lagged impact of changes in monetary policy. They argue that as inflation expectations decrease, the effective real interest rate rises, necessitating a corresponding policy adjustment to prevent inadvertent tightening. Currently, this stance is grounded more in theoretical models and in forecasts than in concrete data.

The majority of the MPC members, totalling seven, voted to keep Bank rate unchanged, signalling that while there's a noticeable softening in indicators of inflation persistence, the levels are still higher than preferred. A rate cut is clearly on their radar, but they are waiting for a stronger evidence base to emerge before taking action. This group, let's call them the 'data dependents,' shows a diversity of interpretations regarding the economic data.

'Some' members within this group see the ongoing high levels of service sector inflation and better-than-expected economic outcomes as signs that inflationary pressures will persist, potentially influencing core inflation rates upward going forward. They are closely monitoring wage growth, which has been robust, and an economic outlook that continues to show signs of improvement. While they remain open to the possibility that inflation may be losing its grip, they nonetheless seek more convincing evidence before they can justify a rate cut.

However, 'other' members question the recent upside surprises in service sector inflation, arguing that it's primarily driven by regulated, indexed, and inherently volatile components. They point out that aggregate wage growth has been inflated by the significant 9.8% rise in the National Living Wage and consider this a one-off rather than the start of a trend. For them, the elements that suggest ongoing inflationary pressures appear 'transitory'. **Therefore, they felt that the decision to keep Bank rate steady, instead of reducing it by 25bp, was a 'finely balanced' one.**

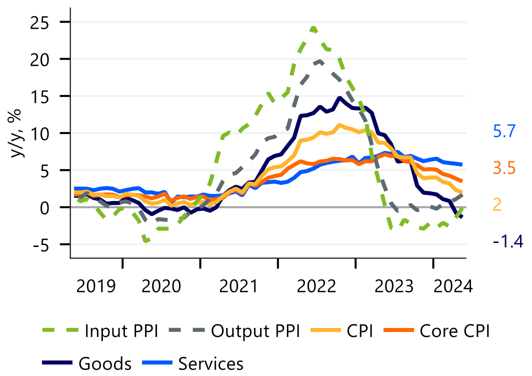
August?

We don't know which member is in which subgroup and with pre-election silence in effect, the specific stances of the seven MPC members remain a mystery until after July 4. Governor Bailey also remained silent after the decision was published. (Recall that he expressed optimism about a potential rate cut in May). Probably, this rather unusual subdivision is one way of communicating that there is a variety of views within the MPC, while giving the opportunity to flag the August meeting without really mentioning 'August' and risk interfering with the July 4 election. Because, indeed, we find added to the guidance that:

> "*As part of the **August forecast round**, members of the Committee would consider all of the information available and how this affected the assessment that the risks from inflation persistence were receding. On that basis, the Committee would keep under review for how long Bank Rate should be maintained at its current level*." (The emphasis is ours.)

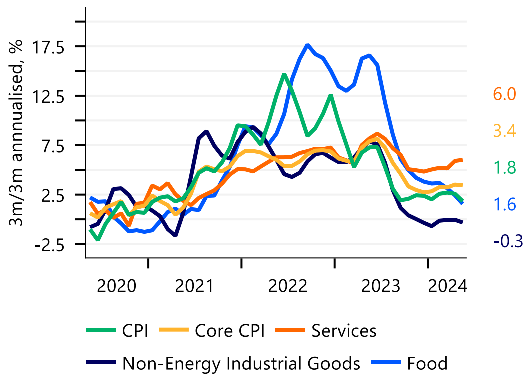
This suggests that the core of the MPC wants to knock a couple of heads together ahead of the August meeting to determine the true nature of inflation. We infer two key points: firstly, **the Bank of England is setting the stage for a potential rate cut in August**. This move comes after market expectations for a cut appeared underpriced, especially since headline inflation has just met the target. Secondly, **the commitment to data-driven decisions still reigns supreme**, with a significant portion of the MPC remaining sceptical about the reliability of forecasts alone to guide policy decisions, **but the renewed emphasis on forecasts suggests this may not last long.**[1]

Figure 1: Headline inflation fell to 2% in May, but services inflation remains sticky



Source: Macrobond, RaboResearch

Figure 2: Bad seasonals for services inflation? We will probably know more later this year...



Source: Macrobond, RaboResearch

Conclusion

The takeaway is that front-end volatility is expected to persist, especially as we approach the release of pivotal inflation and labour market data on July 17 and July 18. The focus remains sharply on services inflation and wage dynamics. Equally critical, though often overlooked, is the Bank of England's Decision Maker Panel (DMP) survey, set for release on July 4. This survey helps the MPC assessing the degree to which inflation expectations have taken hold in the economy.

The recent inflation surprises haven't triggered overt concern, largely because they're attributed to regulated prices and fluctuating factors. **This suggests an August move remains firmly on the table. However, for this to come to fruition, upcoming wage and inflation data must broadly align with expectations.** The market now also favours a 25bp cut in August (c. 62.5% priced).

Indeed, we maintain our call for a first rate cut in August. Nevertheless, following the unexpected rise in services inflation reported yesterday, **we have adjusted our forecast. We now foresee that**

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[1] Recall that the ECB's latest rate cut was also partly data-driven, partly based on the policymakers' economic outlook.

the MPC cuts rates on a quarterly basis from the get-go, with a subsequent move expected in November, rather than initiating a series of three back-to-back cuts and then switching to a quarterly pace (see Table 1 for our forecasts).

As for the election results, we don't foresee them having an immediate effect on the central bank's policy decisions. The Labour party's manifesto does not indicate a significant shift in fiscal policy, as they commit to adhering to the same fiscal constraints as the Conservatives. Yet, the prospect of a rate cut shortly after the election remains intriguing. While the Conservative party faces criticism for the (global) inflation spike, the incoming Labour government looks poised to take credit for the anticipated rate cuts in subsequent quarters – a turn of events likely unanticipated by many Conservatives.

Table 1: Policy rate expectations by meeting

	Bank Rate	*Hike/Hold/Cut*	*Change*
1 February 2024	5.25%	Hold	0bp
21 March 2024	5.25%	Hold	0bp
9 May 2024	5.25%	Hold	0bp
20 June 2024	5.25%	Hold	0bp
1 August 2024	5.00%	Cut	-25bp
19 September 2024	5.00%	Hold	0bp
7 November 2024	4.75%	Cut	-25bp
19 December 2024	4.75%	Hold	0bp
6 February 2025	4.50%	Cut	-25bp
20 March 2025	4.50%	Hold	0bp
8 May 2025	4.25%	Cut	-25bp
19 June 2025	4.25%	Hold	0bp
7 August 2025	4.00%	Cut	-25bp
18 September 2025	4.00%	Hold	0bp
6 November 2025	3.75%	Cut	-25bp
18 December 2025	3.75%	Hold	0bp

Source: RaboResearch

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