BoE hikes rate by 50bps, MPC deeply divided

The Bank of England has raised Bank Rate by 50bps, but the MPC is divided. We think rates will reach 4.5% by early next year, and then expect a more aggressive cutting cycle than the market has priced.

Key takeaways

- The Bank of England increased interest rates by 50bps, taking Bank Rate to 3.5%. This was in line with market pricing.
- Policy makers are clearly divided about the appropriate path of policy, with two voting for no change in rates at all, and one voting for a 75bps increase. This division is unlikely to fade anytime soon.
- In contrast to November, the Bank did not push back aggressively against market pricing in this meeting. While markets have moved more in line with the Bank's signals, we suspect most policy makers still think the market path is too aggressive to achieve the inflation target over the medium term.
- We continue to think Bank Rate will reach 4.5% early next year, which is broadly in line with market pricing. Where we disagree with the market is the speed and the extent of the cutting cycle we expect to start in the second half of next year.

50bps hike, deeply divided MPC

The Bank of England's Monetary Policy Committee (MPC) hiked rates by 50bps, taking Bank Rate to 3.5%. This was broadly in line with what the market had priced in. We had thought that a 75bps move today would have been more appropriate, but the Bank doesn't seem inclined to shock market pricing at the moment.

As we had expected, the voting pattern revealed deep divisions within the MPC about the appropriate path of policy. The 6-3 vote in favour of the decision actually masks what was in fact a three-way split. Catherine Mann voted for a 75bps move, while Silvana Tenreyro and Swati Dhingra both voted to keep rates unchanged at 3%.

Given the difficulty navigating the conflicting shocks hitting the economy at the moment, it is hard to see these divisions going away soon. As such, forthcoming Bank of England speeches are likely to reflect a wide variety of competing views.

It is worth noting though that the statement repeated the phrases from the November meeting that "further increases in Bank Rate may be required" and that the MPC would respond "forcefully" to "more persistent inflationary pressures". This shows that the MPC is a long way from being persuaded by the more dovish camp.

No pushback on market pricing

After pushing back heavily against market pricing at its November meeting, the Bank's statement this time was notable for not doing the same thing. This in part reflects that the market has moved in the Bank's direction since November, and is now pricing a terminal rate of 4.5% rather than the 5.25% terminal rate seen in November.

However, it would be wrong to see the lack of further pushback as an implicit endorsement of the new market pricing. It is likely that the majority of MPC members still think the market path is too aggressive, but they would prefer to have this argument again with the benefit of a new set of forecasts following the February Monetary Policy Report.

We continue to think the Bank is underestimating how much monetary tightening it will ultimately deliver. While the November inflation report was encouraging, with headline inflation now likely past its peak and likely to fall reasonably rapidly through 2023, the labour market report confirmed that underlying inflation pressures continue to grow.

Wage growth is running well in excess of a rate consistent with the inflation target. Indeed, the Bank's statement noted that private sector regular pay had been "0.5 ppts stronger than the expectation at the time of the November Report". As such, inflation is likely to be sticky even as the economy falls into recession next year.

We see rates reaching 4.5% before cuts start in H2 2023

As such, we are sticking with our terminal Bank Rate forecast of 4.5%, with two further 50bps increases early next year. The risks to this forecast are now probably skewed to the downside, should the economy deteriorate even more rapidly than we expect or should the Bank prefer to slow its hiking pace ever further.

Where we agree with the Bank and disagree with the market is that keeping policy at that level for an extended period of time will put the economy into a much deeper recession. As such, we still think a sharp cutting cycle will begin in the back end of 2023 in the context of a broader global recession and monetary easing cycle.

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