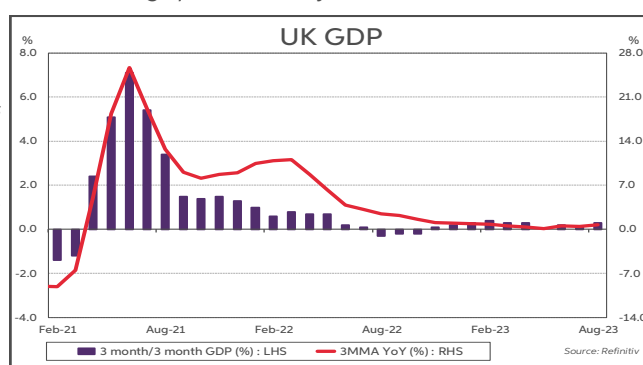


BoE holds rates at 5.25% for a second straight meeting

The November meeting of the Bank of England's Monetary Policy Committee (MPC) saw the central bank keep its key interest rate unchanged at 5.25%. This decision was very much in line with market expectations. It marks the second meeting in-a-row where the BoE has remained on hold. Its previous meeting in September represented its first pause after hiking for fourteen consecutive meetings, dating back to December 2021.

Similar to September, the decision this month to leave rates on hold was not unanimous. The minutes noted that the decision whether to increase or maintain the Bank Rate was again "finely balanced", although, the 6-3 voting split was not as close as the 5-4 divide at its previous meeting. For a majority of MPC members, they judged that maintaining the Bank Rate at 5.25% was warranted. They stated that incoming data since September has provided minimal new insight into the UK economy. They expected CPI inflation to decline significantly in the coming quarters. They remained of the view that a restrictive monetary policy stance was likely to be warranted for an extended period of time, to bring inflation back down to its 2% target and they did not rule out a further rate rise. One member of this group did highlight that the risks of "overtightening policy had continued to build".

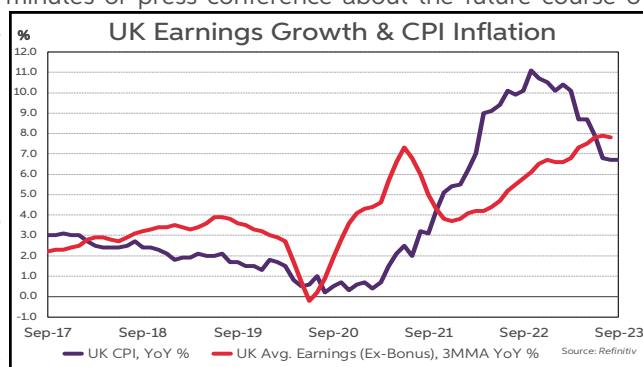
Meantime, three MPC members, voted in favour of hiking rates by 25bps. They noted that the labour market remained relatively tight, real household incomes had continued to rise and forward looking output indicators remain positive. They also referenced that wage growth and services inflation had remained elevated. In their view, there was evidence of more persistent inflationary pressures that required a further hike in interest rates to address the risk of this becoming more deeply embedded.



The BoE's latest set of detailed macro forecasts were also released today, with the publication of its quarterly Monetary Policy Report (MPR). The BoE's GDP growth forecast for 2023 was left unchanged at 0.5%. However, it revised lower its 2024 growth projection to 0.0% (from 0.5%), which is partly due to carry over effects from weaker growth in the second half of this year than previously envisaged, as well as recent signs of less resilience in economic activity. Meanwhile, the BoE's GDP forecast for 2025 remained at just 0.25%. Its also released its first forecast for 2026, with a 0.75% growth rate expected. In short, the BoE anticipates a period of stagnation for the UK economy over the period 2024-25.

On the inflation front, the November MPR projections indicate that the BoE envisages that the CPI rate will slow to 4.75% by the end of this year, which is slightly lower than the 5% rate contained in the August MPR. For next year, it revised higher its end-year forecast to 3.25% (from 2.5%). Meanwhile, it is anticipating inflation will decline to 2% by the end of 2025, which represents an upward revision compared to the 1.5% rate it had expected at the time of its August forecasting round. Thus, the BoE is no longer expecting inflation to have below its 2% by the end of 2025. However, the central bank continued to emphasise that the risks to these inflation forecasts are skewed to the upside. Therefore, its mean inflation projections for end-2024 and end 2025 are 3.4% and 2.2% respectively, with the rate falling to 1.9% in Q4 2026.

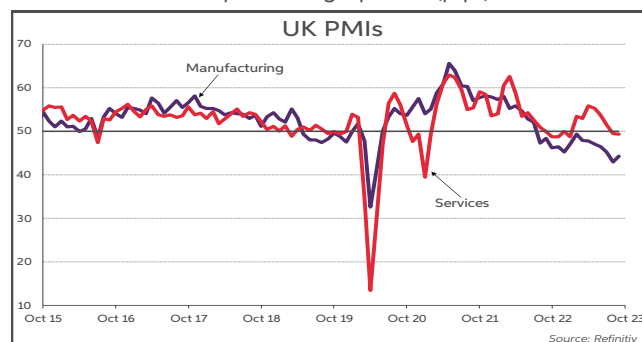
The BoE did not provide any specific guidance in the meeting minutes or press conference about the future course of interest rates. However, it is still clear that the MPC retains a tightening bias. The minutes indicated that a further tightening in monetary policy would be required if there were to be evidence of continued persistent inflationary pressures. In this regard, it stated it will continue monitoring incoming data closely, including the tightness of the labour market and the behaviour of wage growth and services sector inflation. It also once again emphasised that monetary policy would need to be kept sufficiently restrictive for sufficiently long to bring inflation down to the 2% target, which is its "absolute priority".



Futures contracts suggest that the market is of the view that UK rates have now reached their peak. They anticipate that the first rate cut may occur in August of next year and are envisaging rates falling to 4.75% by Q4 2024. A further cut of 50bps in rates to 4.25% is priced in for 2025.

Economy weakening again, inflation falls but still elevated

The UK economy performed better than anticipated in the first half of this year, avoiding the recession that had been widely predicted last winter. GDP expanded by 0.3% and 0.2%, respectively, in Q1 and Q2. The underlying breakdown for Q2, show that consumption contributed 0.2 percentage points (p.p.) to GDP, while government spending jumped by 2.5%, adding 0.5p.p. to the total. Investment boosted growth by 0.2 p.p. Meanwhile, exports fell and imports rose sharply, resulting in net trade knocking 1.0 p.p. off Q2 GDP. However, this was partly offset by changes in inventories and the net acquisitions of valuables components. It should also be noted, that **significant revisions to the data in 2020 and 2021, mean that the UK economy regained its pre-pandemic level earlier than previously thought, with GDP now 1.8% higher than in Q4 2019.**



The available monthly readings of GDP for Q3, show that the economy contracted by 0.6% in July, before rebounding slightly, by 0.2% in August. Meantime, industrial production has continued to struggle, falling by 1.1% in July, and by a further 0.7% in August. At the same time, retail sales remained volatile. Overall, retail sales were 0.8% lower in Q3 compared to Q2 in volume terms, but they were 0.3% higher in value terms, as elevated levels of inflation continued to weigh on spending.

Survey data also indicate that economic growth likely slowed in the third quarter. The manufacturing PMI, which has been below 50 since August 2022, averaged 44.2 in Q3, down from 46.5 in Q2. Meanwhile, the services sector PMI averaged 50.1 in Q3, down from 54.9 in Q2, but it fell into contraction territory, at 49.5 and 49.3 in August and September. Elsewhere, consumer confidence, which had been trending higher in 2023, albeit from a low base, unexpectedly declined in July, before rebounding slightly in August and September. **However, it deteriorated sharply again in October.** The other limited available data for October have also been soft, with both the manufacturing and services PMIs remaining in contraction mode.

In terms of the labour market, conditions have softened somewhat recently, but remain tight overall. The unemployment rate is still very low by historical standards, at 4.2% in the three months to August, but this is up from 3.5% in August 2022. Furthermore, following a marked pick-up in employment at the start of the year, the number of people in full-time work has fallen sharply, by circa 207k since March. On-going tight conditions are placing upward pressure on wages. Private sector average earnings growth accelerated by 7.1% y/y in the three months to August, though the MPC noted other measures pointed to lower and more stable wage growth. The BoE Agent's Summary for Q3, shows pay settlements running at 6.0-6.5% so far this year.

Meanwhile, inflation remains elevated. It fell sharply in early summer, but stalled thereafter. Headline CPI was at 6.7% in August and September, compared to 6.8% in July, and 7.9% in June. Meantime, core-CPI inflation has proven to be very sticky until recently, falling to 6.2% in August and to 6.1% in September, down from 6.9% in June/July. The BoE reiterated today that inflation should decline significantly further over the coming months and throughout 2024, helped in particular by substantial moves lower in energy prices.

The BoE also noted that the UK economy has proven to be more resilient than anticipated this year. However, economic growth has weakened since mid-year, and the outlook contains a number of headwinds. Significant BoE rate hikes are weighing on investment and activity. Housing transactions have already fallen sharply by 20% year-to-date in July, due to the impact of higher rates. As well as this, global growth remains sluggish, with the BoE also noting a waning boost from fiscal policy. **Overall, UK growth is expected to remain very subdued over the next couple of years.** The IMF is forecasting GDP growth of 0.5% this year, and 0.6% next year for the UK. Meanwhile, the BoE sees the economy expanding by 0.5% and then stagnating in 2024.

