

Contributors

Juan Manuel Herrera

Senior Economist/Strategist

Scotiabank GBM

+44.207.826.5654

juanmanuel.herrera@scotiabank.com

BoE: Dovish Hold Strikes Hawkish Markets

- The BoE followed the Fed's hawkish cut with a dovish hold at 4.75% with a more dovish-than-expected 6 hold vs 3 cut vote split accompanied by a statement where the BoE seemed relatively unfazed by recent inflation and wage growth data that has left markets expecting only two cuts next year.
- The BoE stuck to a "gradual" approach to policy setting in its statement that points to a quarterly cadence of 25bps cuts continuing in 2025—in line with our latest forecasts—well in contrast to the now 60bps in implied cuts in markets by next December (up from around 50bps yesterday).

This morning, the BoE followed the Fed's hawkish cut with a dovish hold at 4.75% where a 6–3 vote split across those favouring a hold and those preferring a quarter-point reduction surprised economists and markets that expected an 8–1 decision. Joining perennial dove Dhingra were Dep Gov for Markets and Banking Ramsden and new joiner (and external member like Dhingra) Alan Taylor. While the vote split surprised markets and led to a material reassessment of rate cut expectations for 2025, the net impact of today's announcement on gilts was relatively small as markets bide their time and monitor data, while maintaining a cautious view on the rates long-end that is weighed by fiscal uncertainty and risks at home and abroad, the GBP has fallen about half a ppt since, but is holding unchanged on the day.

In its Monetary Policy Summary, the BoE maintained its wording on a "gradual approach" to policy remaining appropriate, suggesting that the BoE believes (or continues to believe) that a quarterly cadence of 25bps cuts remains the way forward. Understandably, the Bank highlighted the rise in inflation from the 1.7% for September that they had at their latest decision to the 2.6% that it printed in November amid continuously high services inflation joined by overshoots in core goods and food, though they did not sound particularly alarmed about this as it relates to their outlook. On the other hand, officials believe that growth will close out the year less strongly than believed at the time of the November Monetary Policy Report forecast round, as "most indicators of UK near-term activity have declined," and they "now judge that the labour market is broadly in balance."

Following stronger-than-expected wages growth data released earlier this week, markets had been conditioned to expect not only a landslide 'hold' win but also a hawkish statement that may have vindicated market pricing. In today's statement, the BoE addressed the data, saying that regular private wage growth "picked up quite sharply" in the quarter. However, the BoE highlighted that these ONS data are more volatile than other pay indicators, pointing to the banks "Agents" intelligence saying wage settlements should sit between 3% and 4% next year. It also highlighted that higher national insurance contributions announced in the Budget would result in various adjustments, not just via higher wages, like "raising prices, accepting lower profit margins and/or laying off existing workers."; put another way, it's tough to set policy based on a wide possibility of reaction functions.

Overall, the BoE's statement made a bit less of recent data that would support the conservative cuts pricing observed in markets while devoting a bit more time to highlighting weak PMIs and the information gathered by its Agents. According to the minutes of the decision, the BoE's staff now thinks that the economy stalled in Q4-24, with 0% growth versus a previous forecast of 0.3%—also coming after a 0.1ppts undershoot of their 0.2% projection for Q3 growth (actual at 0.1% q/q). In any case, it's worth highlighting that the UK economy is not strong, but rather sluggish while structural issues keep pay and services inflation elevated, and as these dissipate the BoE should have a license to help out the economy with more easing than that priced in by markets.

December 19, 2024

As of yesterday's close, markets were pricing in around 50bps in cuts over the whole of 2024; now, following the BoE's announcement, implied pricing shows roughly 60bps in cuts. Our latest forecasts show 100–125bps in cuts through 2025 starting with a 25bps move at the February meeting which currently sits at 17bps implied from 15bps yesterday. The 6–3 vote split supports our expectation for a February move, and it's also noteworthy that of the 6 that voted for a hold, one member noted that the evolution of data and prospects for the economy and inflation “could warrant an activist strategy”. The three that preferred a cut believe that a “very restrictive” stance risked undershooting the 2% target and “opening an unduly large output gap”—which is in line with our thinking.

As far as market moves are concerned a few hours after the decision, the front end of the GBP curve shifted sharply to reprice the more dovish BoE but moves further out the curve were relatively small as 2s are only trading about 3/4bps lower vs pre-decision while 10s are practically unchanged—albeit outperforming bunds and US 10s dragged by US fiscal risks over recent hours. The GBP is down about 0.5% against the dollar since the announcement, but is still holding unchanged on the day, though clearly lagging the EUR that is up 0.4% today while clearly outperforming the JPY which is down 1.5%+ on a dovish BoJ Gov Ueda at the Bank's overnight decision.

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