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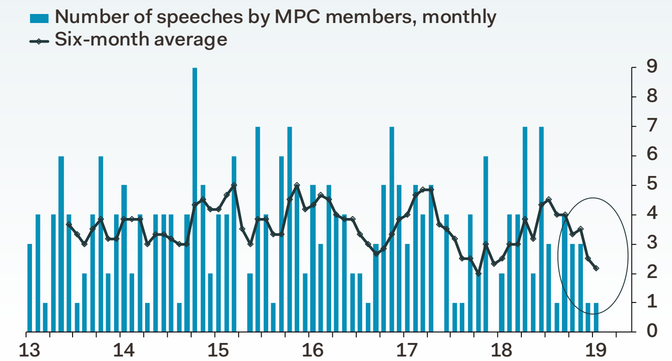
Investors have assumed the MPC has become more dovish, amid a vacuum of official communication...

...But the risk of a hawkish surprise this week is high, given rising wage growth and looser fiscal policy.

The newly dovish Fed won't stop the MPC; its last two hiking cycles began when the Fed was on hold.

..BUT THE MPC HAS GONE QUIET, INCREASING THE RISK OF A SURPRISE

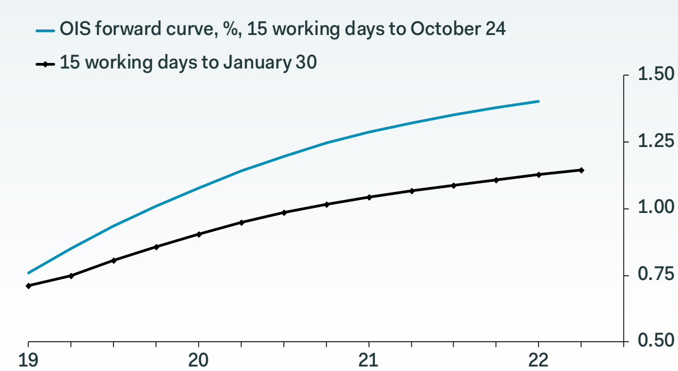


MPC to Break its Radio Silence With a Hawkish Message, Despite Brexit

Investors have revised down their expectations for interest rates since the November *Inflation Report* and now only a 50% chance of a 25bp hike in Bank Rate is priced-in by the end of this year. These revisions have been triggered partly by signals from the Fed and the ECB that they are abandoning their plans to tighten policy this year, as well as a further intensification of uncertainty about Brexit.

But investors have adjusted their expectations during an unusual period of silence from the MPC, so the risk that the Committee surprises investors is higher than normal. Committee members have made only four speeches since the last *Inflation Report*, and only two of those have touched on monetary policy; see page three for a summary of their recent comments. Members Tenreyro, Cunliffe and Vlieghe haven't delivered speeches since June, July and September, respectively, while Jonathan Haskel, who joined the MPC in September, still hasn't spoken out. The MPC has deliberately avoided giving policy guidance at a time of heightened uncertainty, but it will break its silence now.

INVESTORS NOW THINK THE ODDS OF A 2019 RATE HIKE ARE 50:50...



Back in November, the Committee signalled to markets that they were underestimating the pace of future rate hikes. On the assumption of a 53bp increase in Bank Rate over the next two years, the MPC forecast that CPI inflation would overshoot the 2% target by 0.12pp at the two-year horizon. If the Committee changed none of its other assumptions, the decline in markets' rate expectations, which underpins its main forecast, implies that it would revise up its two-year ahead forecast for CPI inflation to 2.18%, the highest since November 2017.

Since then, CPI inflation has undershot the MPC's expectations, by 0.2pp in November and 0.3pp in December. But the shortfall is due entirely to the impact of the decline in oil prices—which will have a transitory impact on the headline rate—as well as a sharp drop in food inflation. Core inflation has held steady since the November *Report*, while wage growth has picked up *much* more than the Committee anticipated. Indeed, data up to November suggest that average weekly wages rose by 3½% year-over-year in Q4, well above the MPC's forecast, 2¾%, and even its projection for Q4 2019, 3¼%.

Global growth has been weaker than the MPC expected, and it wasted no time in December to revise down its forecast for quarter-on-quarter growth in Q4 GDP to 0.2%, from 0.3% in November's *Inflation Report*. But since the November forecast round, the Chancellor has loosened fiscal policy; the MPC estimates that this will boost GDP by about 0.3% over its forecast period. It will conclude that it needs to counter fiscal stimulus with higher interest rates, given its view in November that no spare capacity is left. *Indeed, the Bank's own model implies that around 50bp of extra monetary tightening will be required to offset the boost to demand from looser fiscal policy.*

The MPC's annual stocktake of the economy's supply side, meanwhile, should not magically yield more scope to keep Bank Rate so low. The jump in wage growth means it cannot lower its estimate of the natural rate of unemployment from its current 4¼% estimate. In addition, secondary measures of labour market slack have declined dramatically over the last year; see here for more details. Productivity growth also undershot its expectations again last year.

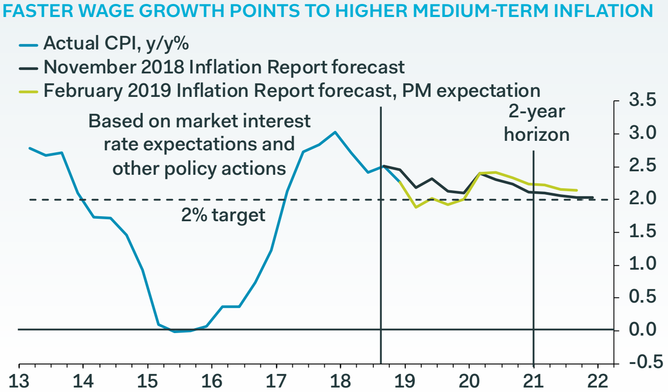
Accordingly, we expect the MPC to revise up its forecast for CPI inflation in two years' time, on the basis of markets' rate expectations, to about 2.2%. That would give a clear signal to markets that they have misread the Committee's reaction function.

Admittedly, the Committee's forecast still will be conditioned on "...a smooth adjustment to the average of a range of possible outcomes for the UK's eventual trading relationship with the E.U." Households and firms are preparing for the worst and the near-term downside risks to the outlook from Brexit have risen. As a result, the MPC likely will sound more dovish than its forecasts will imply and markets might not put much weight on the hard numbers. We doubt any members will vote to hike Bank Rate this week.

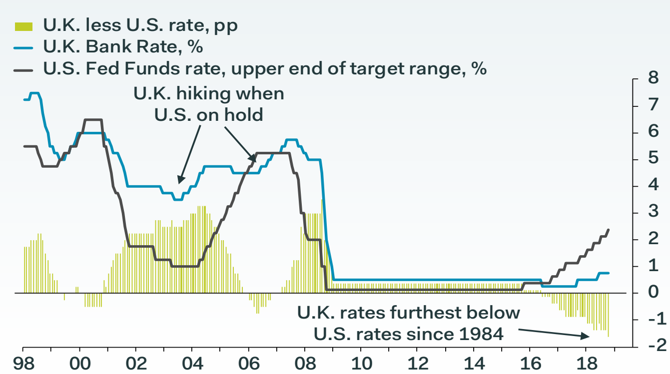
But when that uncertainty lifts—we still expect MPs to sign off a deal by the end of March—the Committee likely will surprise investors by how quickly it moves to tighten policy. It already has been much more patient than other central banks; U.K. short rates haven't been as far below U.S. rates since April 1984, even though the two economies' labour markets look very similar. ***Our final chart also shows that the MPC's last two tightening cycles—in 2003 and 2006—commenced when the Fed was on hold.*** If, as we expect, a period of above-trend GDP growth soon comes into view, driven by loose fiscal policy, lower commodity prices and a rebound in investment, a dovish Fed won't stop the MPC from hiking rates.

As a result, we still expect the MPC to raise Bank Rate by 25bp every six months, once Brexit uncertainty has subsided, though our forecast for this tightening cycle to start in May recently has become a closer call. ***The Committee won't seek to rock the boat too violently given the current fragility of markets, but even a gentle reminder of the need for higher interest rates could be enough to shake investors' uber-dovish expectations.***

FASTER WAGE GROWTH POINTS TO HIGHER MEDIUM-TERM INFLATION



THE LAST TWO U.K. HIKING CYCLES HAPPENED WITH THE FED ON HOLD



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Summary of MPC members' views

MPC member	Term end	Last vote	Past non-consensus votes	Latest key comment
Mark Carney (Governor)	Jan. 2020*	Keep BR at 0.75%.	None	"We know from our contacts with business, others know from their contacts, that less than half the businesses in the country have initiated their contingency plans for a no-deal Brexit." BBC Radio 4 Interview, Nov. 29.
Ben Broadbent (Deputy Governor, Monetary Policy)	Jun. 2019*	Keep BR at 0.75%.	Voted against increasing QE by £50B in July 2012.	"There is only a one-in-seven chance that mortgage interest payments will return to the pre-crisis (post-inflation-targeting) average (within the next five years). This makes it slightly puzzling to read (as one often does) that household debt is 'unsustainably' high." Speech in London, Jan 23.
Jon Cunliffe (Deputy Governor, Financial Stability)	Oct. 2023	Keep BR at 0.75%.	Voted against raising interest rates in November 2017.	"Domestic inflation pressures, while strengthening a little are not yet established at levels consistent with inflation at target." Report to Treasury Committee, Oct. 9.
David Ramsden (Deputy Governor, Markets & Banking)	Sep. 2022*	Keep BR at 0.75%.	Voted against raising interest rates in November 2017.	"Looking ahead, we expect that, if the economy continues to evolve, as it has done so far, broadly in line with our August forecast, then further limited and gradual rises in Bank Rate will be appropriate to return inflation sustainably to the target." Speech in London, Sep. 28.
Andrew Haldane (Chief Economist)	June 2020*	Keep BR at 0.75%.	Voted to raise Bank Rate in June 2018.	"With growth in money wages running at close to 3%, and with productivity growth running closer to zero, domestic cost growth in the U.K. is already running at, if not slightly above, rates consistent with the inflation target, even before any further (limited and gradual) build in wage pressures." Speech in London, Oct. 10.
Jonathan Haskel (External Member)	Aug. 2021*	Keep BR at 0.75%.	None	"There may well be much more slack than we think." Evidence to Treasury Committee, Jun. 26.
Michael Saunders (External Member)	Aug. 2019*	Keep BR at 0.75%.	Voted to raise rates by 25bp in June, August and September 2017, as well as March, May and June 2018.	"My own hunch is that, conditioned on our Brexit assumptions, capacity pressures will probably build somewhat faster than envisaged in our latest Inflation Report projections, reinforcing upward pressure on pay growth. In this case, we would probably need to return to something like a neutral stance rather earlier than implied by the current yield curve." Speech in Bath, Nov. 22.
Silvana Tenreyro (External Member)	Jul. 2020*	Keep BR at 0.75%.	None	"Brexit aside, while my central forecast is that inflation will remain slightly above target, I think there are some downside risks; in particular, core services inflation might remain soft and unit labour costs might end up below our central forecast. As of now, I think it is prudent to let the last move sink in." Report to Treasury Committee, Aug. 23.
Gertjan Vlieghe (External Member)	Aug. 2021	Keep BR at 0.75%.	Voted to cut interest rates by 25bp in July 2016.	"To avoid sending conflicting signals in the future, the MPC has made it clear that, once Bank Rate is around 1.5%, Bank Rate will once again become 'the primary instrument for monetary policy'. This is important because it means that expectations of future policy rates can once again be influenced by changing current policy rates and continuing communication." Speech in London, Sep. 25.
* Term could be extended				

THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, February 4

• **D: Markit/CIPS Construction Survey (1)/09:30 GMT**
Unusually wet weather reportedly set back work at some building sites in December, though Brexit uncertainty also meant that the pipeline of new orders was weak. As a result, we look for only a marginal rise in the construction PMI to **53.0** in January, from 52.8 in December. **Consensus: 52.5.**

Tuesday, February 5

• **D: BRC Retail Sales Monitor (1)/09:30 GMT**
Year-over-year growth in like-for-like sales values probably rose from December's -0.7% rate, but not by much, given the still-subdued level of consumers' confidence; we look for an increase only to **-0.2%** in January. **Consensus: -0.2%.**

• **D: Markit/CIPS Services Survey (1)/09:30 GMT**
We think the PMI recovered only marginally in January to about **51.5**, from 51.2 in December. Lloyds' business confidence balance and the services subcomponent of the E.C.'s Economic Sentiment survey both increased in January, but remain below last year's average level. **Consensus: 51.0.**

Wednesday, February 6

• **No significant data released.**

Thursday, February 7

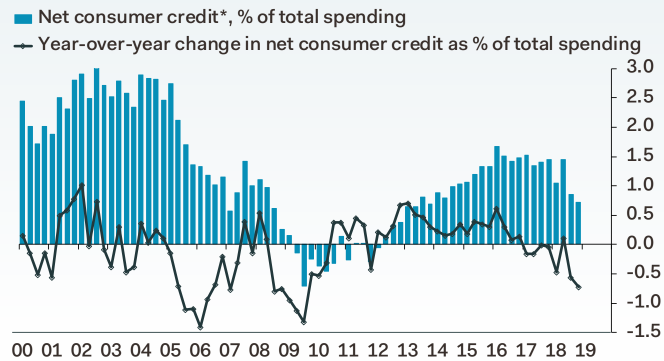
• **D: Halifax House Prices (1)/08:30 GMT**
Most measures of house prices growth have continued to slow in recent months. But a base effect likely means that the three-month average of year-over-year growth in house prices produced by Halifax likely increased to **1.5%** in January, from 1.3% in December. **Consensus: 1.5%.**

• **D: MPC Decision, Minutes & Inf. Report (2)/12:00 GMT**
We expect the Committee to vote **9-0** to keep Bank Rate at 0.75%, but to warn markets once again that their expectations for the future path of interest rates are too low. We expect the MPC to revise up its forecast for CPI inflation in two years' time, on the basis of markets' rate expectations, to about 2.2%, from 2.12% in November. While near-term GDP growth is undershooting the Committee's expectations due to Brexit uncertainty, the forthcoming loosening of fiscal policy and the recent pick-up in wage growth point to upward inflation pressure emerging over the medium term. The MPC's annual stocktake of the economy's supply side, meanwhile, should not magically yield more scope to keep Bank Rate on hold. **Consensus: 9-0.**

Friday, February 8

• **No significant data released.**

CHART OF THE WEEK: THE CREDIT SLOWDOWN IS HITTING SPENDING



PANTHEON'S FINANCIAL FORECASTS

		End-month:				
	5pm Fri.	Mar	Jun	Sep	Dec	Dec 20
Bank Rate	0.75	0.75	1.00	1.00	1.25	1.75
3m Libor	0.91	1.00	1.10	1.30	1.30	1.80
12m Libor	1.17	1.30	1.50	1.60	1.70	2.20
2-year Gilt	0.78	1.00	1.20	1.40	1.60	2.00
10-year Gilt	1.25	1.60	1.80	2.10	2.20	2.40
30-year Gilt	1.75	2.00	2.10	2.20	2.30	2.50
FTSE 100	7020	7000	7200	7400	7600	8000
USD/GBP	1.31	1.35	1.36	1.38	1.40	1.40
EUR/GBP	1.14	1.23	1.24	1.25	1.27	1.27
Sterling TWI	78.3	83.7	84.3	85.6	86.8	86.8

PANTHEON'S ECONOMIC FORECASTS

	Period average:						
	Q3 18	Q4 18	Q1 19	Q2 19	2018	2019	2020
GDP, q/q%	0.6	0.2	0.3	0.5	-	-	-
GDP, y/y%	1.5	1.3	1.4	1.5	1.4	1.6	2.0
Employment, y/y%	1.2	1.0	1.2	1.1	1.1	0.7	1.0
Unemp. rate, %	4.1	4.0	4.0	4.0	4.1	3.9	3.6
Wkly earnings, y/y%	3.1	3.4	3.4	3.2	2.9	3.0	3.2
CPI, y/y%	2.5	2.3	1.9	1.9	2.5	1.8	2.1
RPI, y/y%	3.3	3.2	2.8	2.9	3.4	2.8	3.2
PSNB FY, £B	-	-	-	-	27	32	38
Cur. acc't., % GDP	-3.4	-3.6	-3.7	-3.9	-3.5	-4.0	-4.5
House prices, y/y%	2.6	2.2	2.1	1.6	3.3	2.0	2.5