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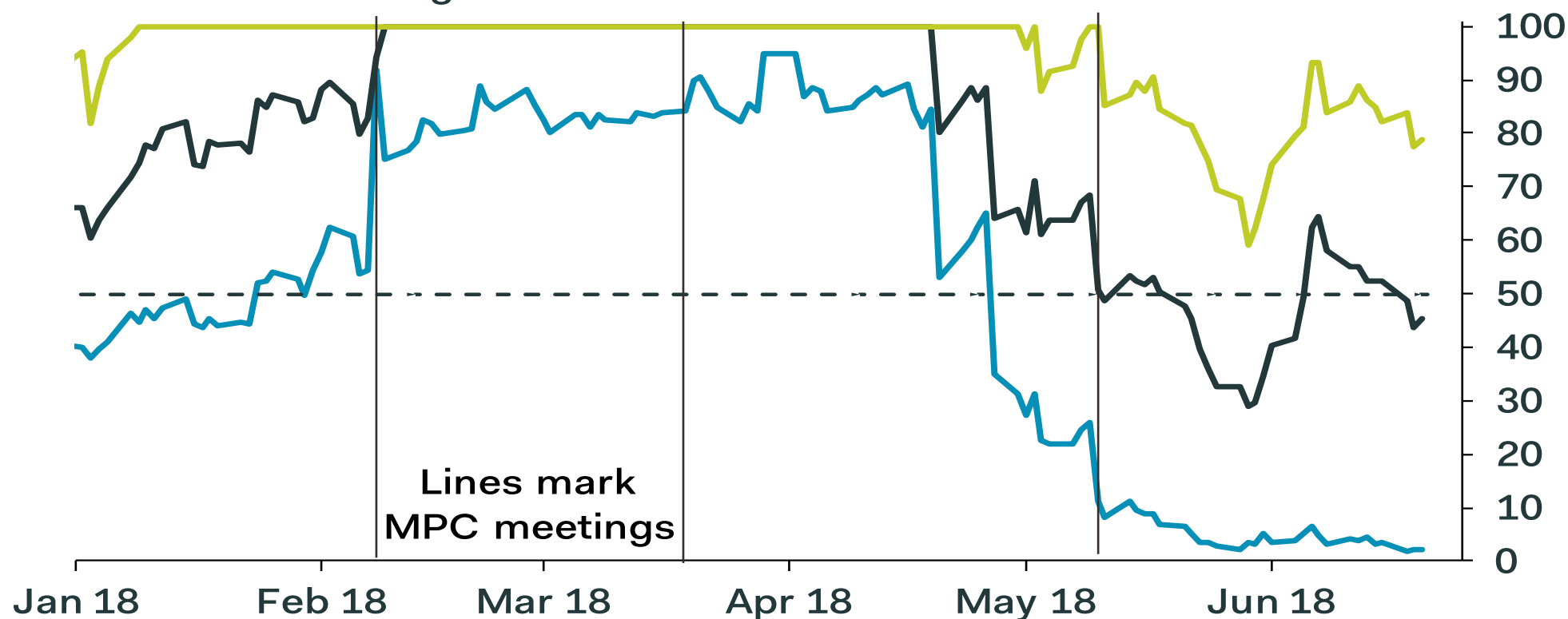
# **THE MPC WON'T BE SO PASSIVE NEXT YEAR...** ...BREXIT PERMITTING

**U.K. WEBINAR, 20 JUNE 2018**

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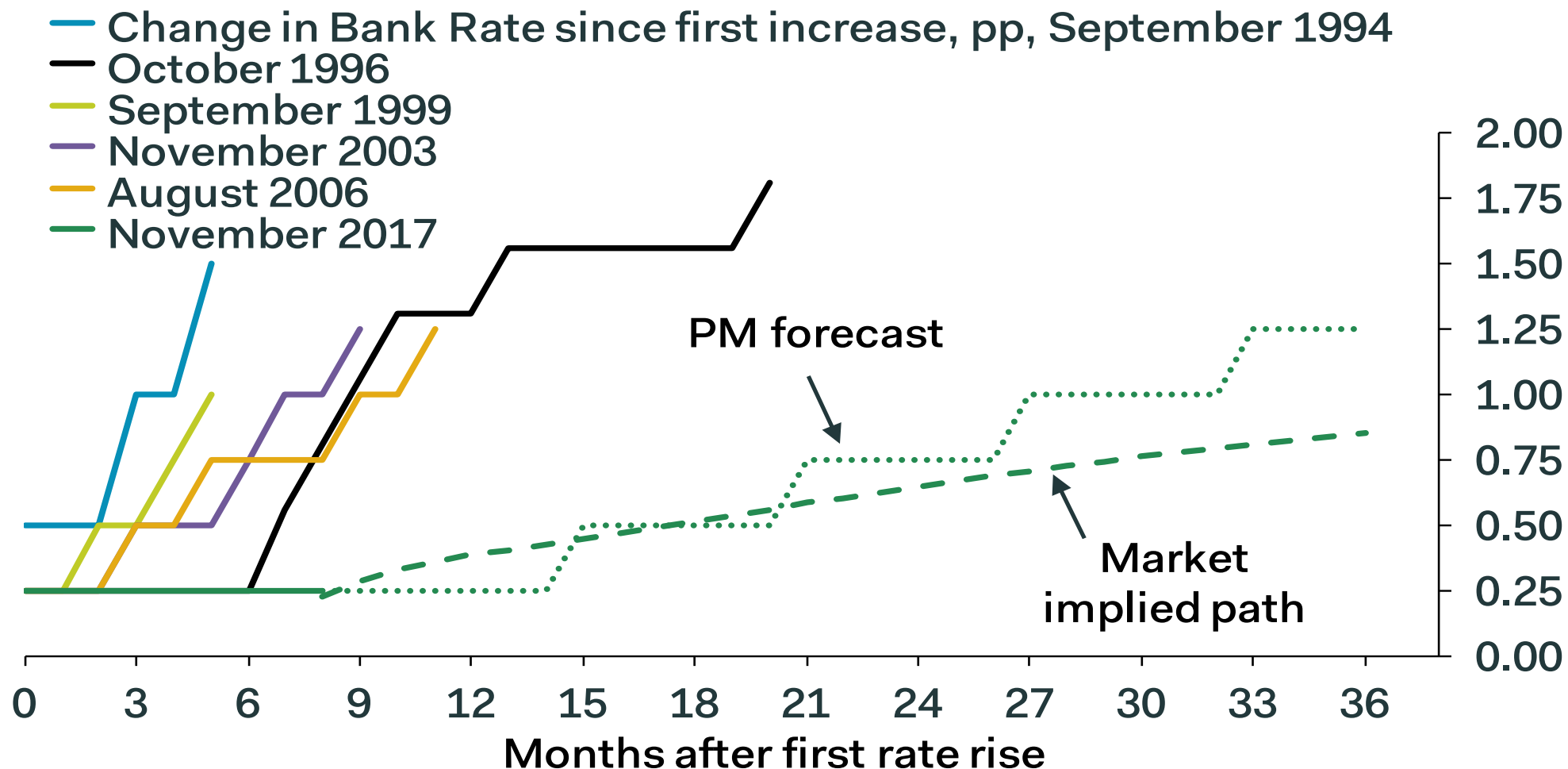
## 1. MARKETS STILL THINK THAT THE MPC LIKELY WILL RAISE RATES THIS YEAR

- % prob. of Bank Rate at or above 0.75%, implied by OIS rates, June meeting
- August meeting
- November meeting





## 2. WE EXPECT THEM TO PAUSE UNTIL 2019, BUT THEN HIKE AT A FASTER PACE

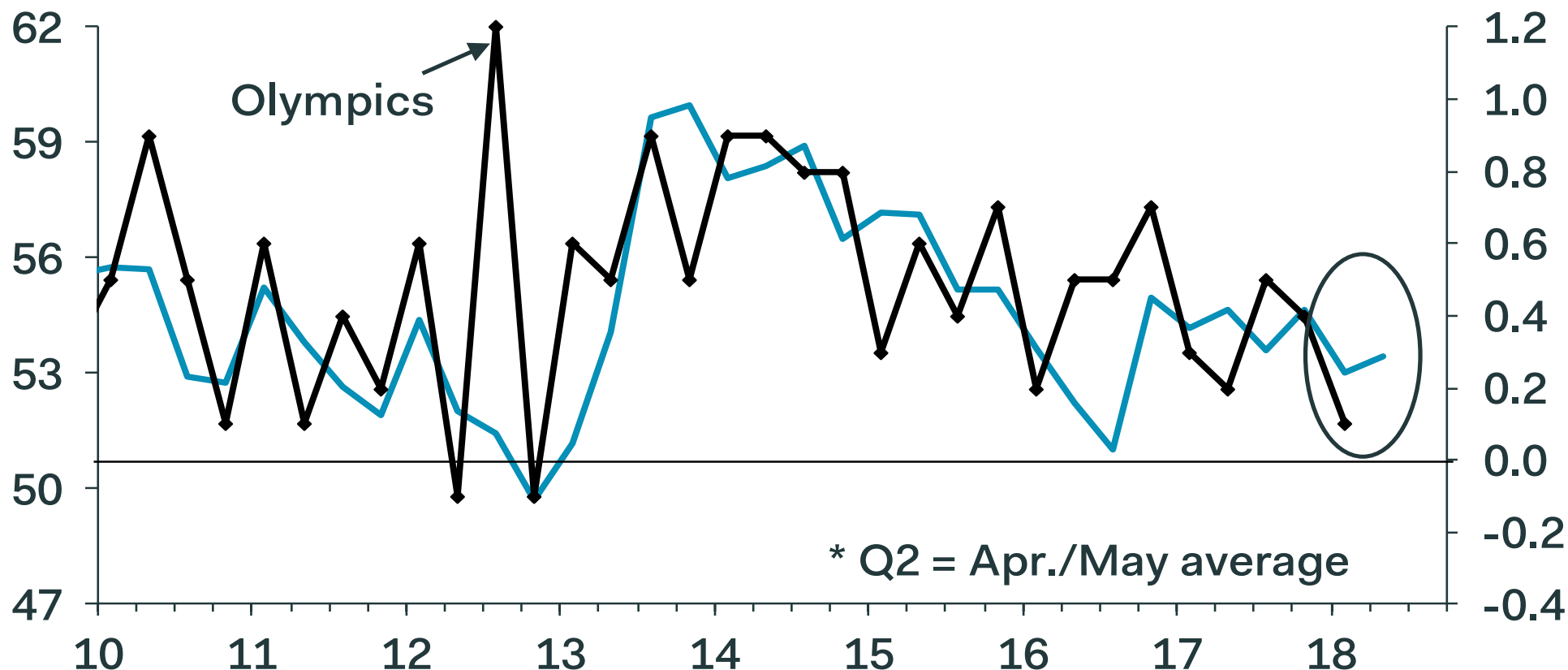




### 3. THE PMIS SUGGEST Q2 GDP WON'T MEET THE MPC'S 0.4% FORECAST

— Weighted ave. of manuf., con. and services PMIs, quarter ave.\* (Left)

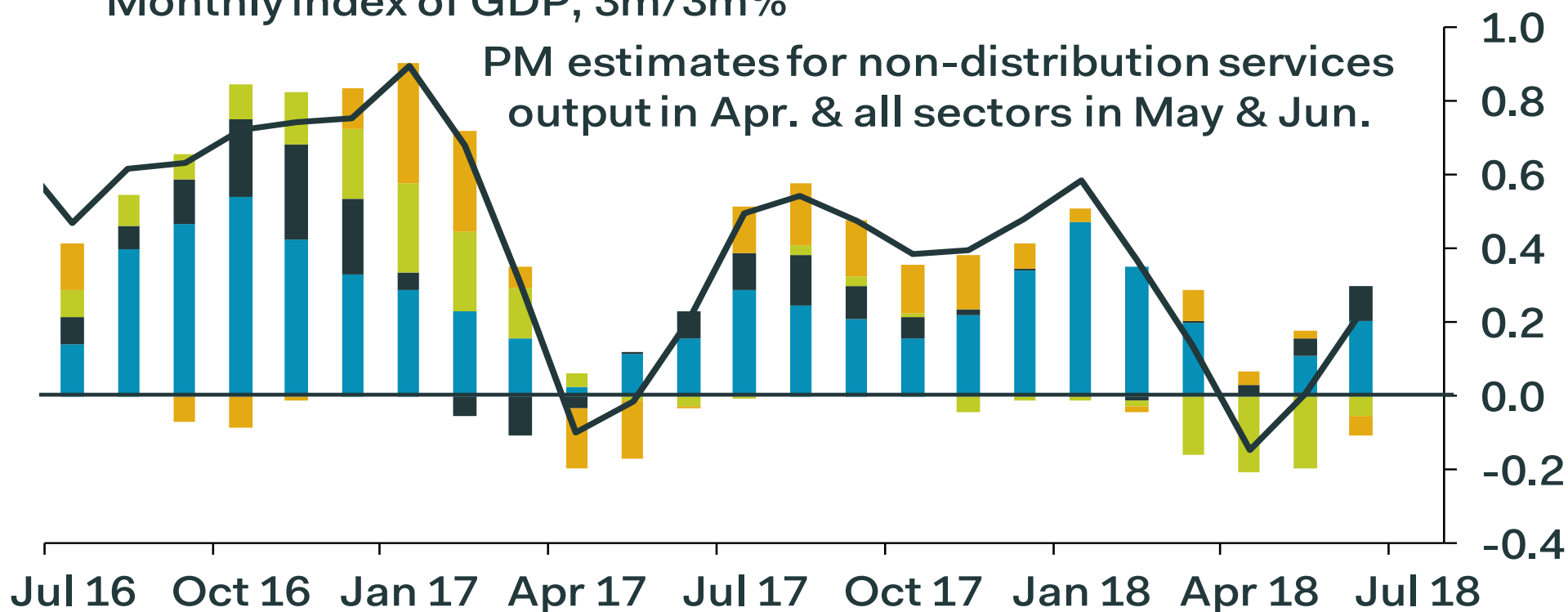
— Real GDP, q/q% (Right)





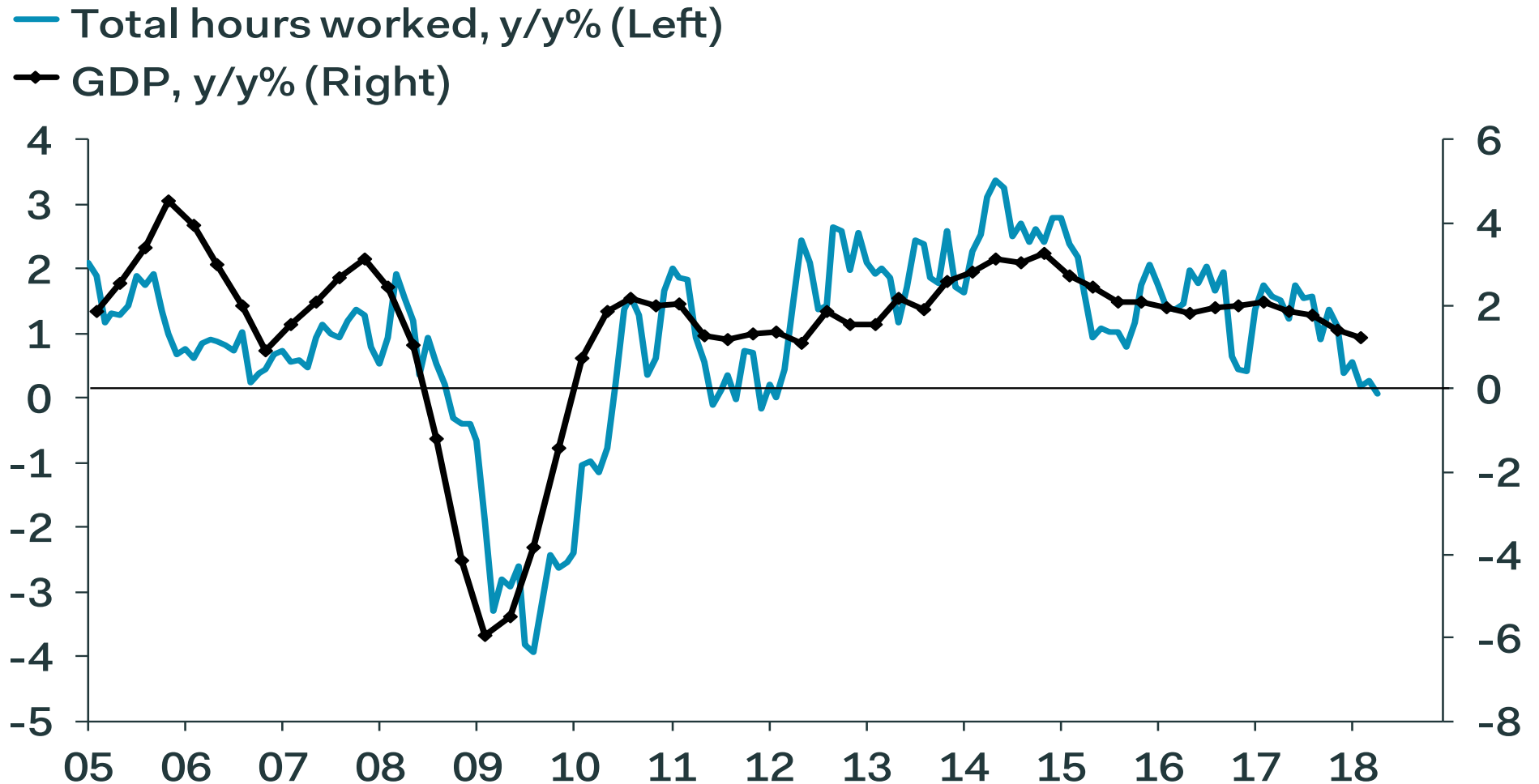
## 4. OFFICIAL DATA FOR Q2 SO FAR POINT TO A MERE 0.2% Q/Q RISE IN GDP

- Contribution from industrial production, pp
- Contribution from construction output, pp
- Contribution from distribution output, pp
- Contribution from non-distribution services output, pp
- Monthly index of GDP, 3m/3m%





## 5. THE DECLINE IN TOTAL HOURS WORKED IS A WORRYING SIGN TOO...

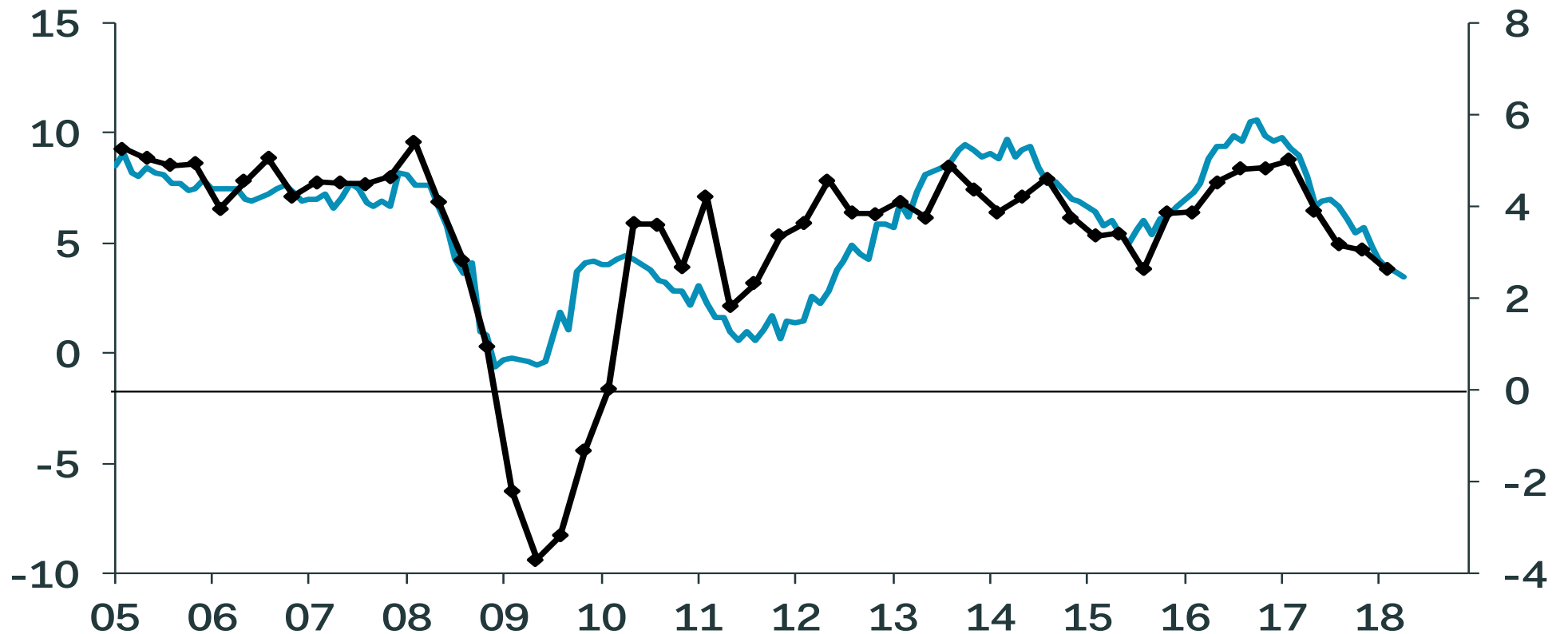




## 6. ...AS IS THE SLOWDOWN IN BROAD MONEY GROWTH

— Households' divisia money, y/y% (Left)

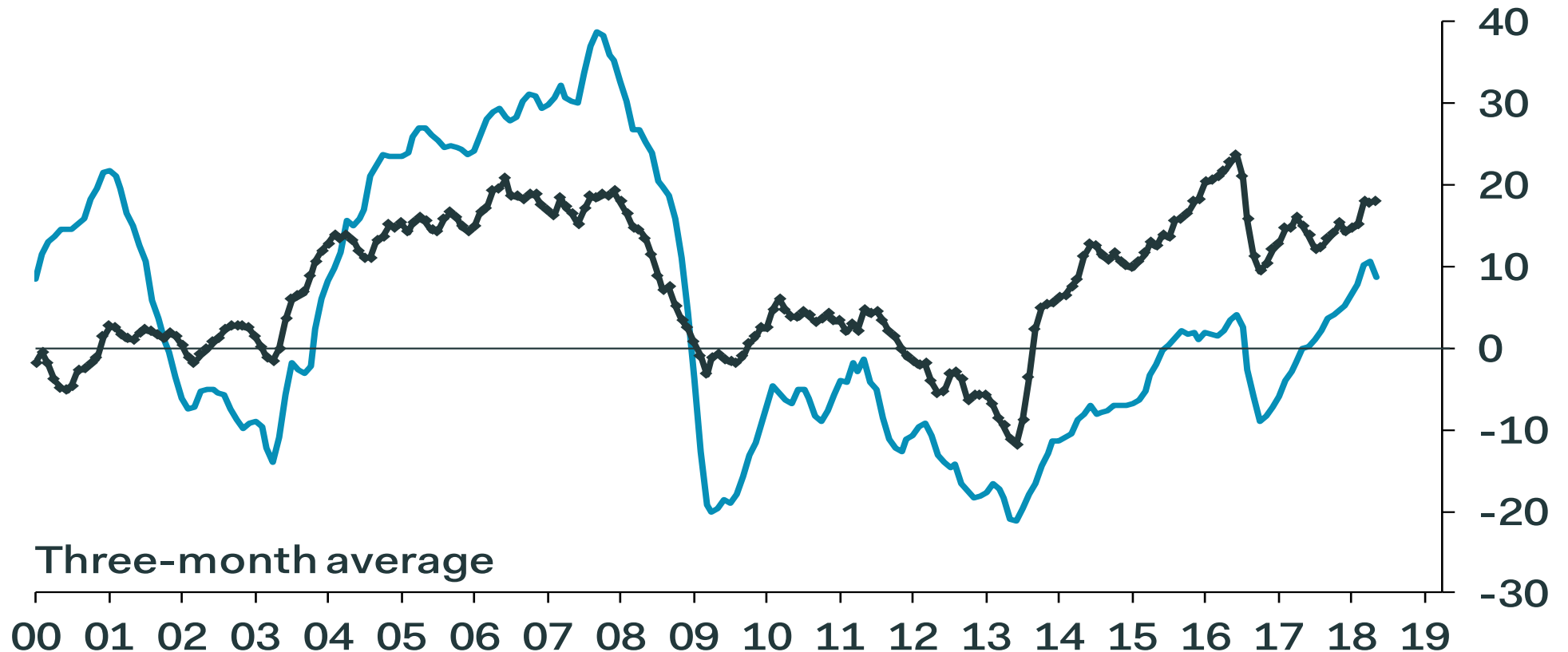
—●— Households' nominal spending, y/y% (Right)





## 7. RISING SAVING INTENTIONS ALSO POINT TO SLOWING SPENDING GROWTH

- Net balance of households reporting now is a good time to save
- Net balance reporting that they will save more over next 12 months

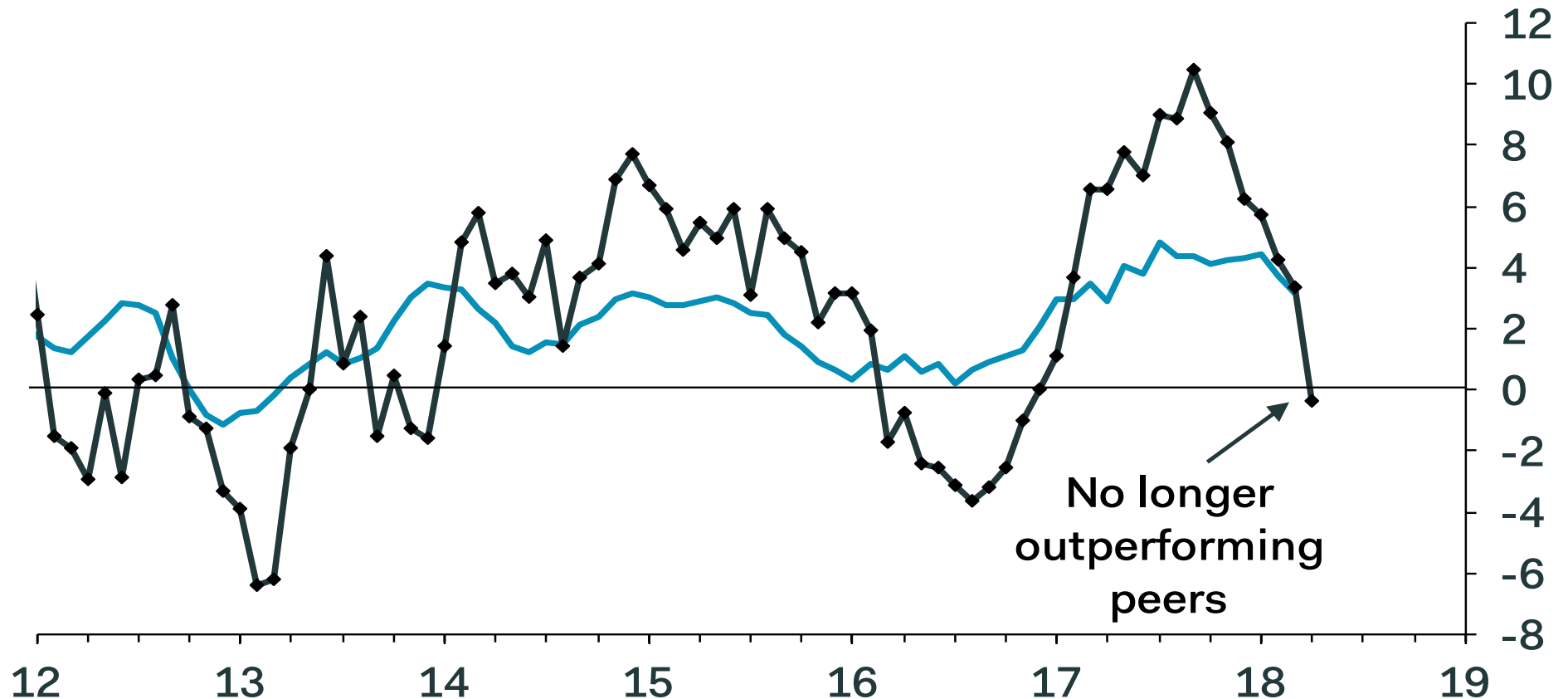






## 8. SUPPORT FROM THE EXTERNAL SECTOR IS FADING

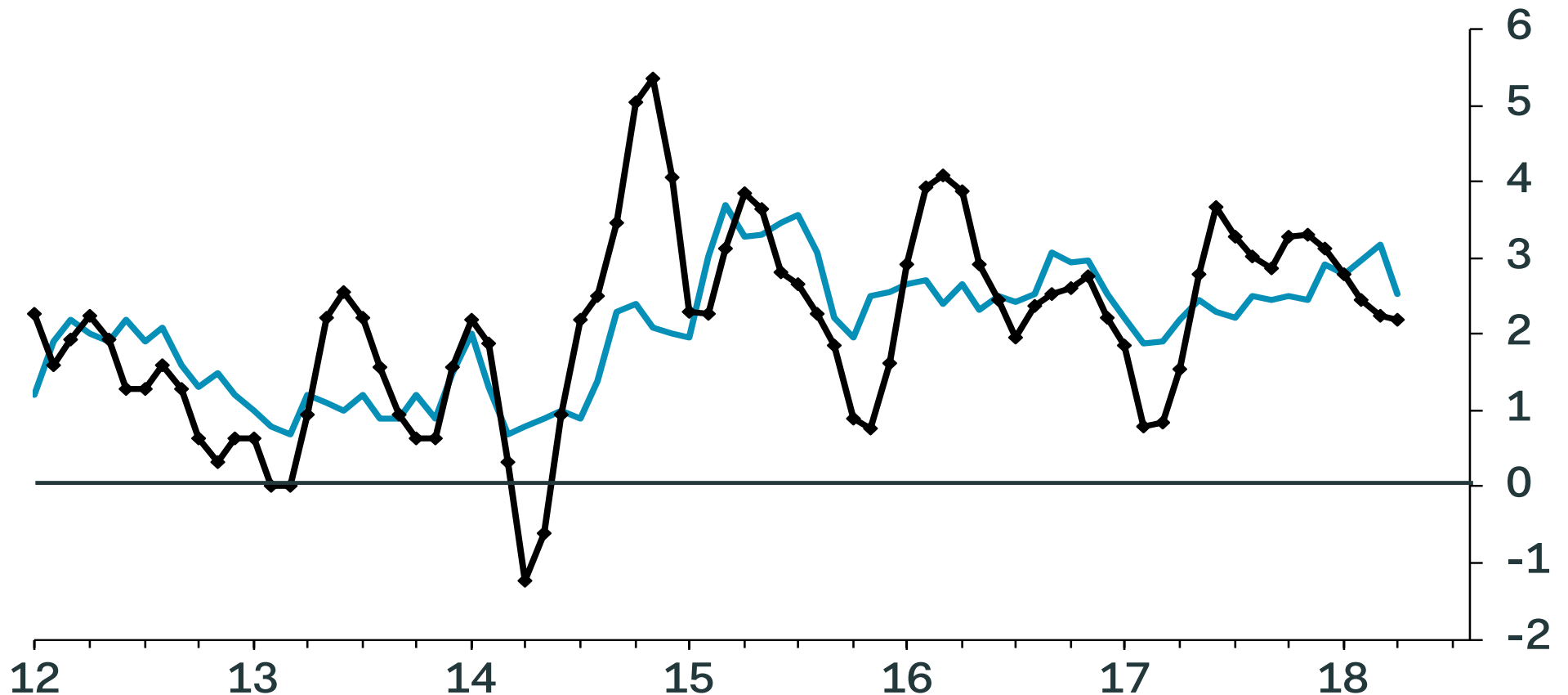
- Advanced economies goods exports, volumes, y/y%, three-month ave.
- ◆ U.K. goods exports exc. oil and erratics, volumes, y/y%, three-month ave.





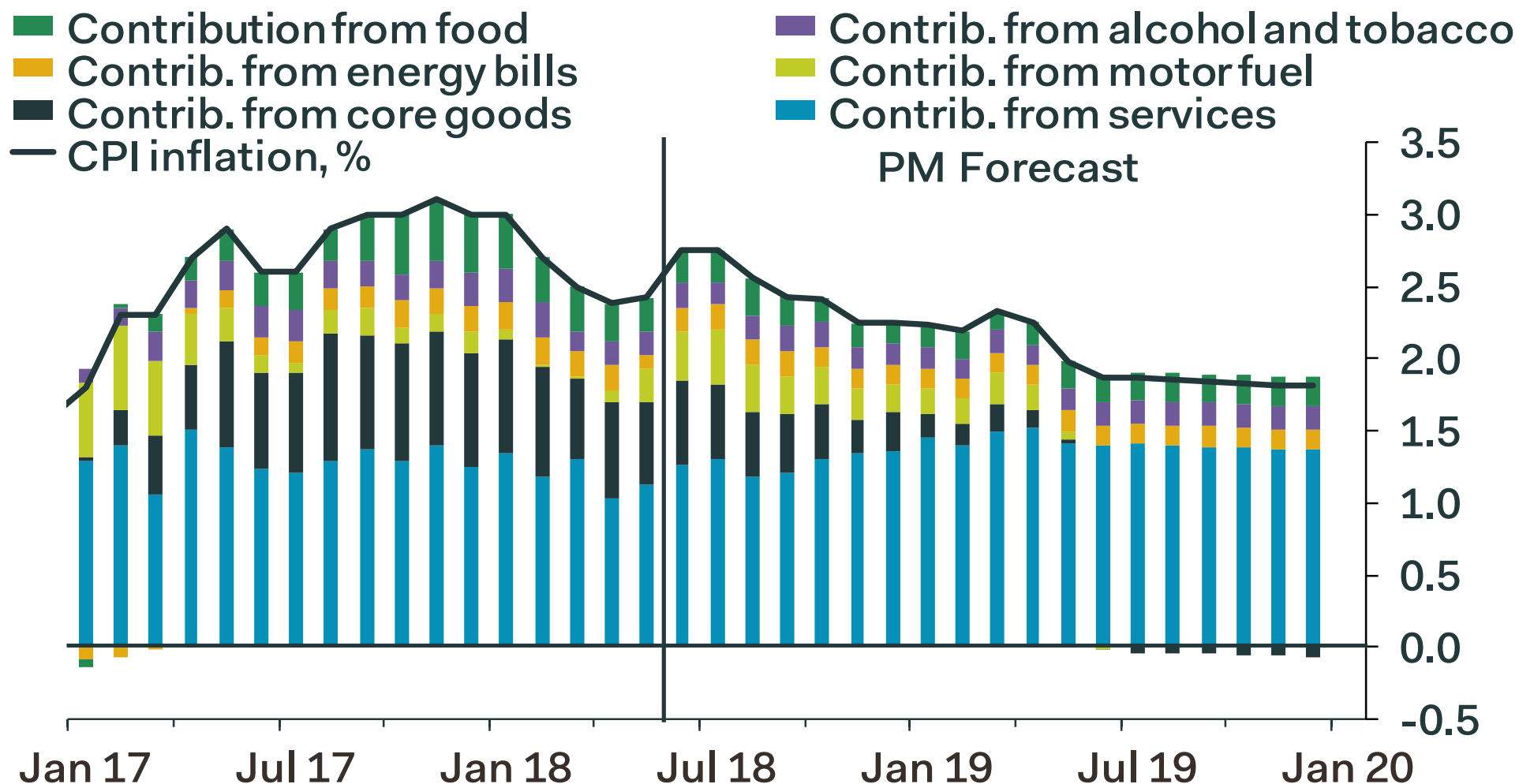
## 9. MEANWHILE, STILL NO SIGN OF A SUSTAINED PICK-UP IN WAGE GROWTH

- Average weekly earnings, private sector, exc. bonuses, y/y%
- ◆— 3m/3m% annualised





## 10. CPI INFLATION LIKELY WILL RISE TEMPORARILY OVER THE SUMMER...





## 11. ...BUT CORE GOODS INFLATION WILL BE MUCH LOWER BY YEAR-END

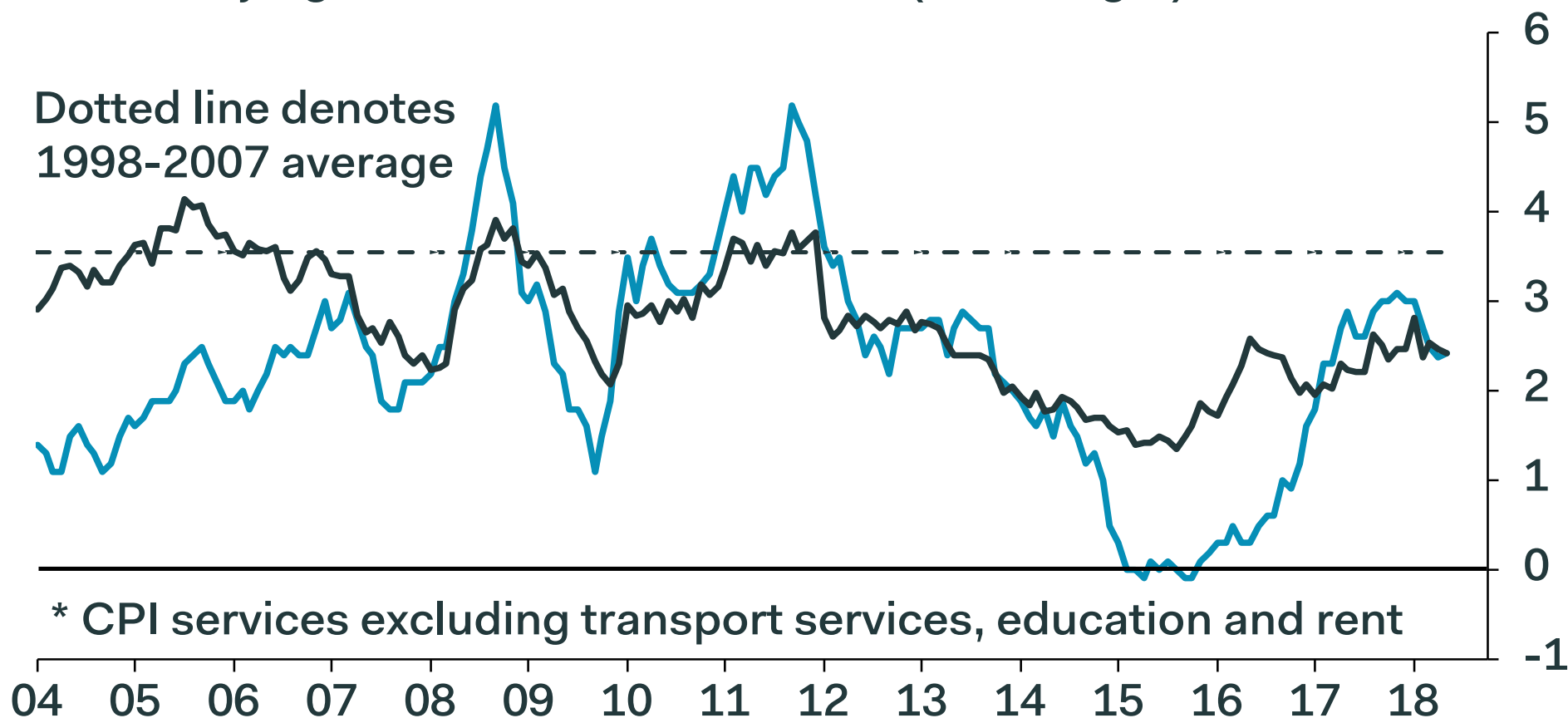
- Sterling trade-weighted index, inverted, adv. 12 months, y/y% (Left)
- ◆ CPI core goods, exc. effect of VAT changes, y/y% (Right)



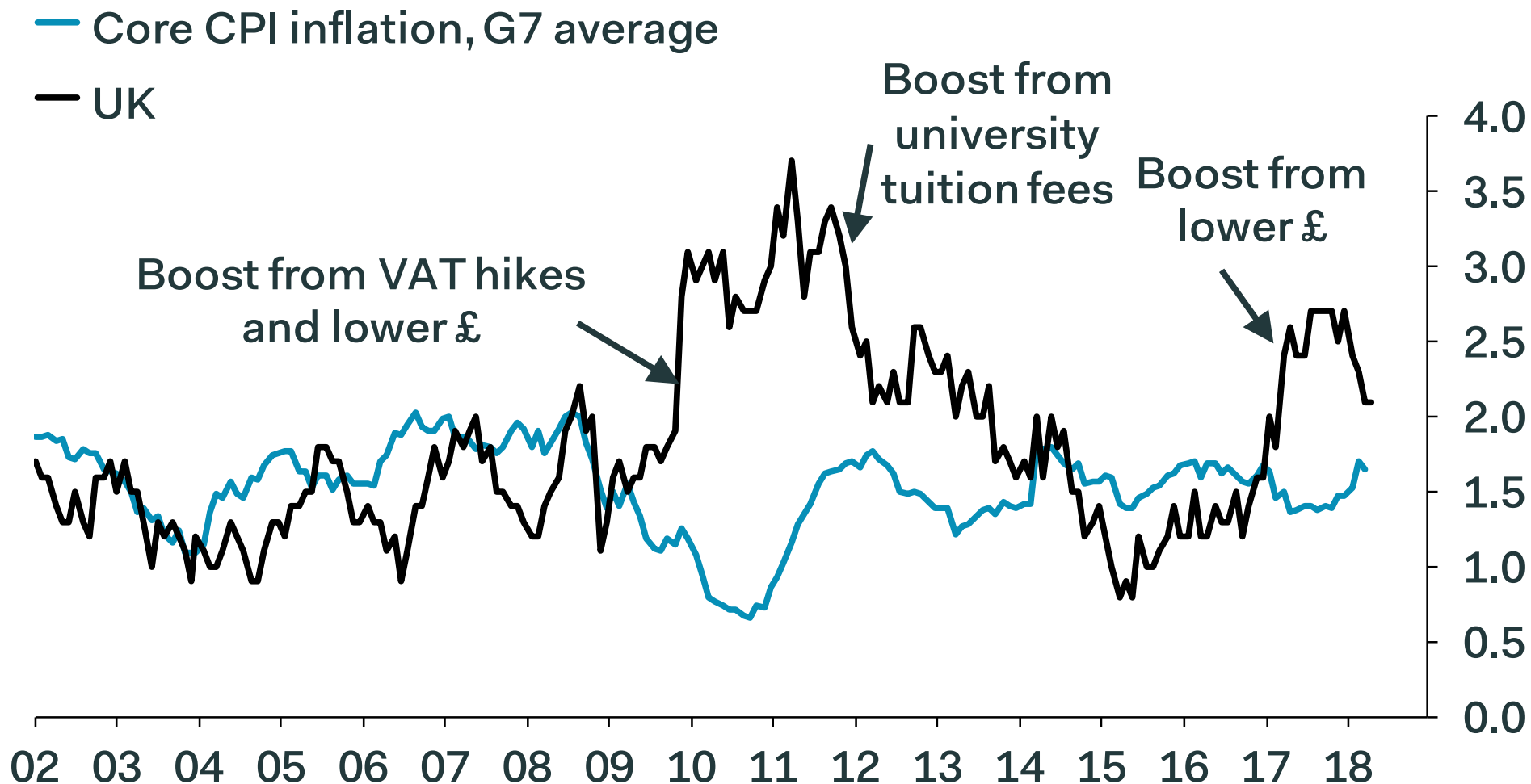


## 12. THE HEADLINE RATE WILL FALL BELOW 2% IN 2019 UNLESS DGI PICKS UP

- CPI inflation, %
- "Underlying" CPI services inflation\*, % (34% weight)



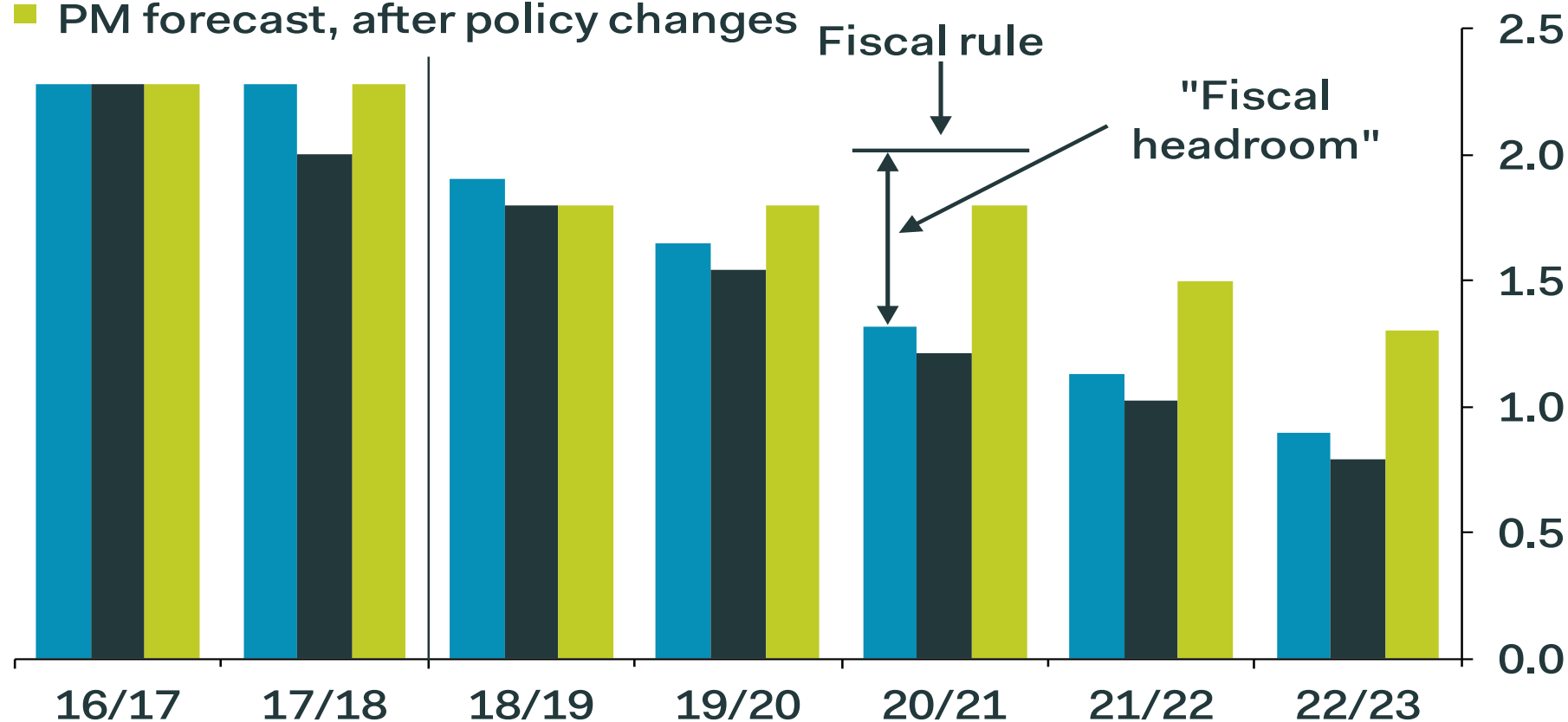
### 13. WHY WON'T CORE INFLATION CONVERGE TO THE SUB-2% G7 AVERAGE?



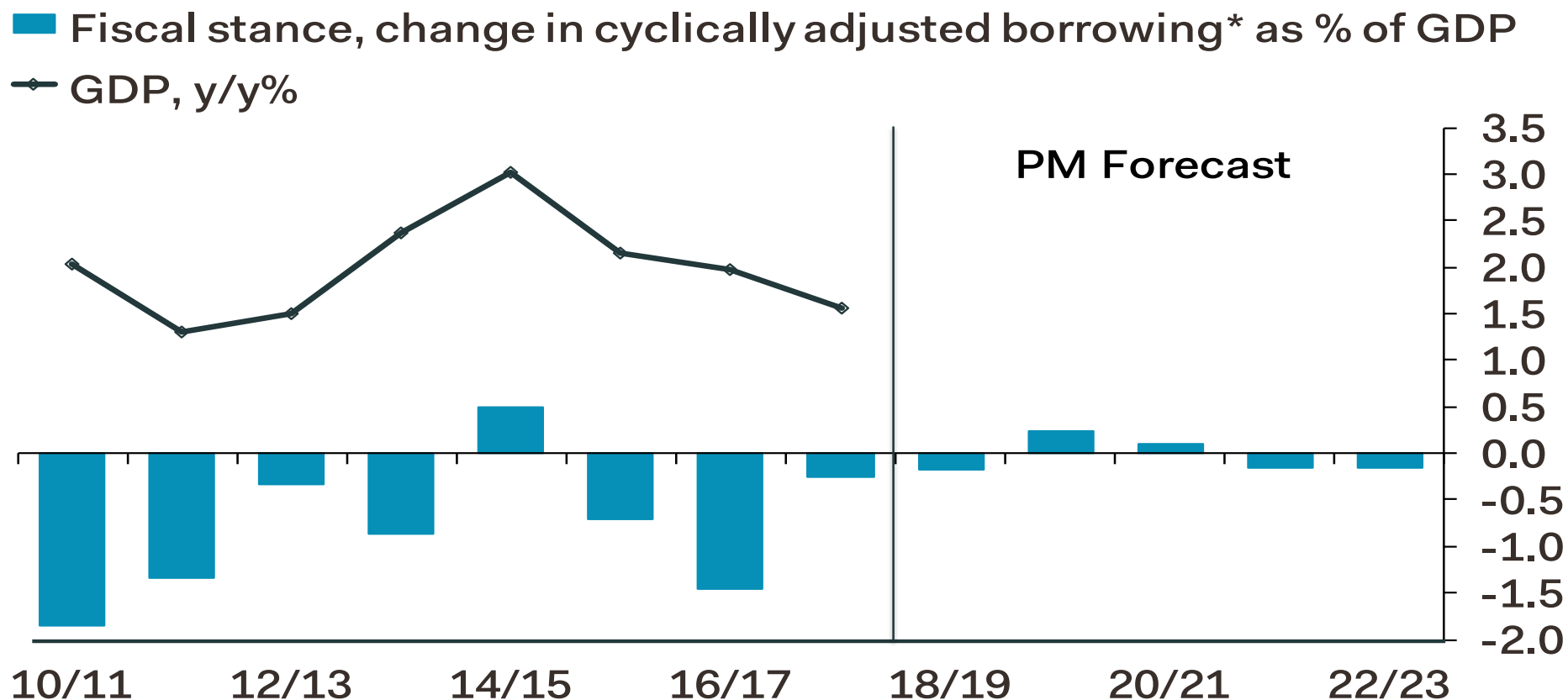


## 14. WHAT WILL CHANGE IN 2019? THE FISCAL SQUEEZE WILL BE PAUSED

- Cyclically-adjusted net borrowing, % of GDP, March 2018 forecast
- PM forecast, assuming no policy changes
- PM forecast, after policy changes



## 15. GDP GROWTH HAS BEEN SENSITIVE TO FISCAL POLICY IN THE PAST



\* Excluding interest payments, self-assessment receipts  
& the 2011 transfer of the Royal Mail pension fund

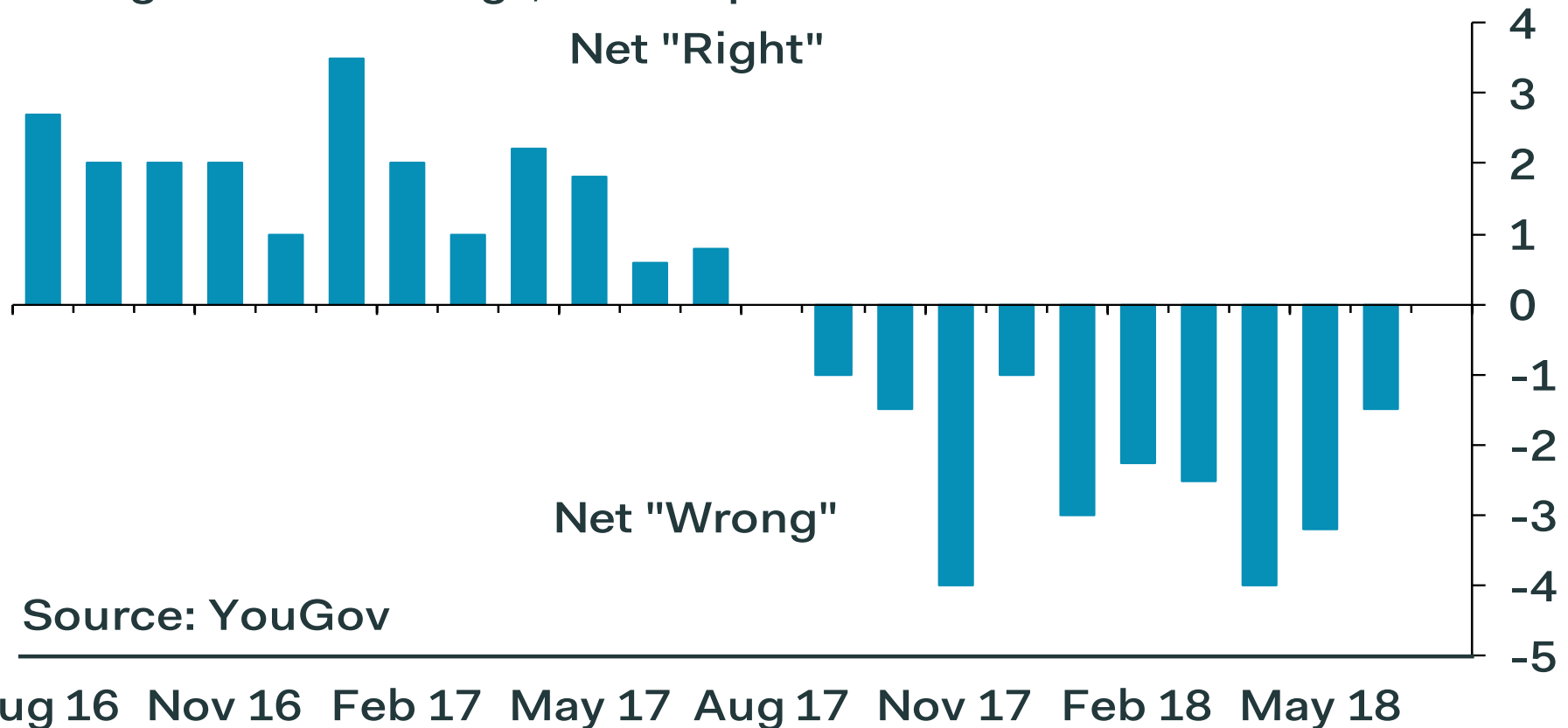


## 16. THE GOVERNMENT LIKELY WILL CHANGE TACK AND GO FOR A SOFT BREXIT

	No Deal, Cliff Edge Brexit	Hard Brexit - "Max Fac" (Maximum facilitation)	Hard Brexit - Customs Arrangement	Semi Brexit - Leave single market but stay in customs union	Soft Brexit - Stay in the EEA, or never-ending transition	Brexit reversed
How could it happen?	Theresa May loses a confidence vote and a Brexiteer becomes PM. They call a general election and win a majority. Britain leaves without a deal in March 2019.	The U.K. would attempt to minimise the needs for customs checks by employing new technologies and "trusted trader" schemes. About half of the Cabinet favours this option.	The U.K. would levy the Common External Tariff on all goods arriving from non-EU countries, enabling them to travel on freely to the EU. Businesses could claim a rebate from the government if the goods stayed in Britain. About half of the Cabinet supports this option.	Theresa May is forced by parliament to abandon her plan of leaving the customs union.	The government and the public become more fearful of the economic impact of a hard Brexit. No other option solves the issue of the Irish border. Alternatively, Brexit is delayed beyond the next election, which Labour then wins, causing a shift in policy.	The government or parliament decides to check that the public supports an agreed Brexit deal. The public changes its mind, as opinion polls currently suggest they would do.
Obstacles	More than 50% of MPs would have to vote Mrs. May out. The Tories' poll lead likely would vanish if another election was called. Most voters don't want a no deal Brexit.	Not enough support in parliament. The E.U. will insist that Northern Ireland is treated separately, which the DUP won't accept. It will take at least five years for the U.K. to install the necessary infrastructure. Extra bureaucracy will cost businesses £20B a year.	Not enough support in parliament. The EU thinks this plan is "unworkable" too. It has concerns about fraud. This option doesn't preserve the status quo in Northern Ireland.	Doesn't preserve the status quo in Northern Ireland. Services firms still will be shut out of the single market. Mrs. May might still face a confidence vote, if Brexiteers feel betrayed.	Eurosceptics in the Conservative party might trigger a leadership contest, which Mrs. May might lose if fewer than 50% of MPs back her. Public concern about immigration is low now, but might surge if free movement continues.	At present, neither the Tories nor Labour want another referendum. Another referendum would require an Act of Parliament, which could take months to pass. The E.U. might not allow the Article 50 period to be extended.
Likelihood	5%	5%	10%	25%	40%	15%
Impact on MPC	The hit to demand likely would outweigh the supply shock. We think the MPC would cut rates to zero, do £100B more QE and start another TFS.	Bank Rate on hold for foreseeable future.	The MPC would hike rates at a slower rate than anticipated now. Perhaps just one 25bp increase in Bank Rate over the next three years.	The MPC has assumed a middle-of-the-range Brexit, so they would stick to plans for 75bp of tightening over three years.	Enables a faster tightening than the MPC currently expects. We envisage two 25bp rate hikes every year from 2019 for four years until Bank Rate hit 2.5%.	Enables a faster tightening than the MPC currently expects. We envisage two 25bp rate hikes every year from 2019 for four years until Bank Rate hit 2.5%.
Impact on sterling	\$1.15	\$1.25	\$1.28	This scenario is priced-in.	\$1.40	\$1.45

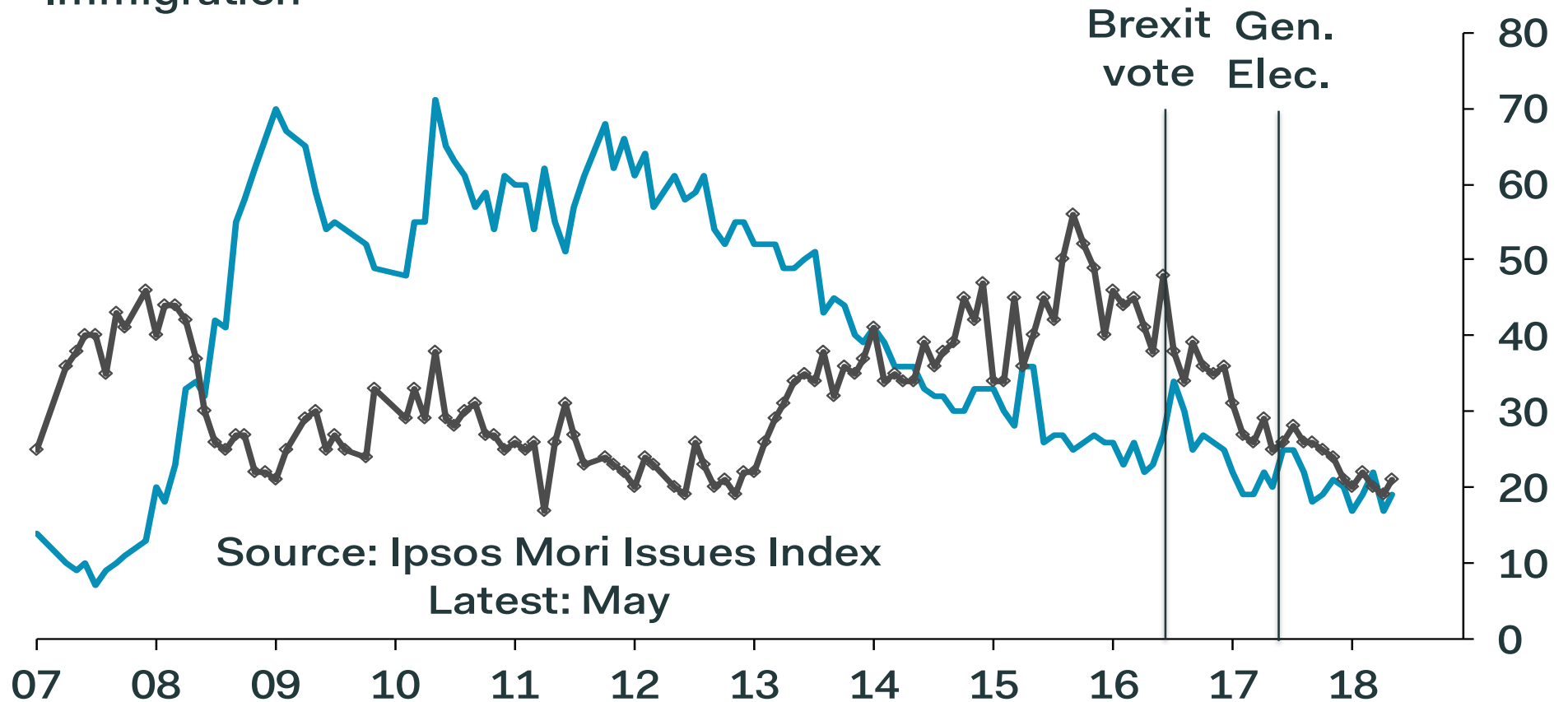
## 17. A HARD BREXIT IS A LOSING STRATEGY FOR CONSERVATIVE MPS

- "In hindsight, was the UK right or wrong to vote to leave the EU?", "Right" less "Wrong", % of respondents



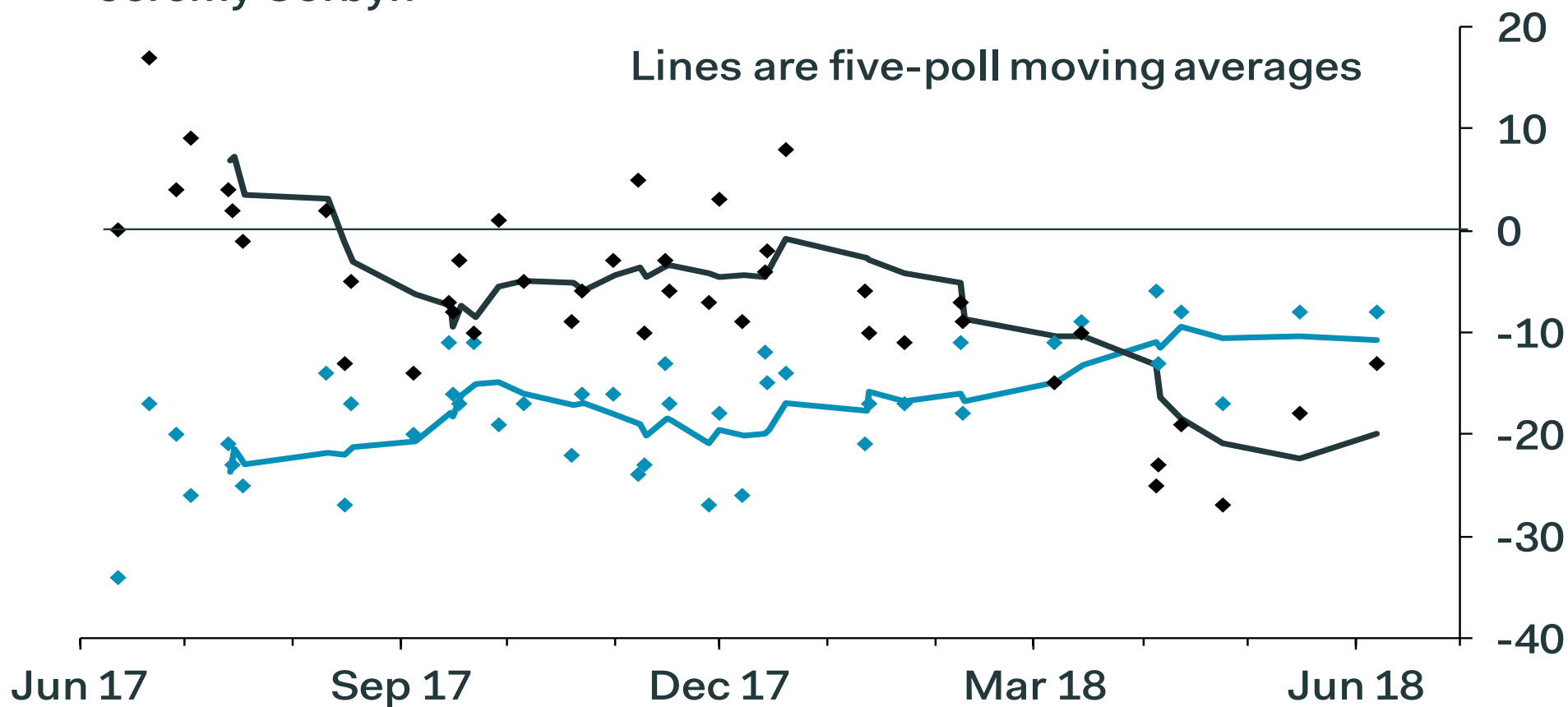
## 18. CONCERN ABOUT IMMIGRATION HAS COLLAPSED SINCE THE BREXIT VOTE

- % of people reporting issue as most/other important facing UK, economy
- Immigration



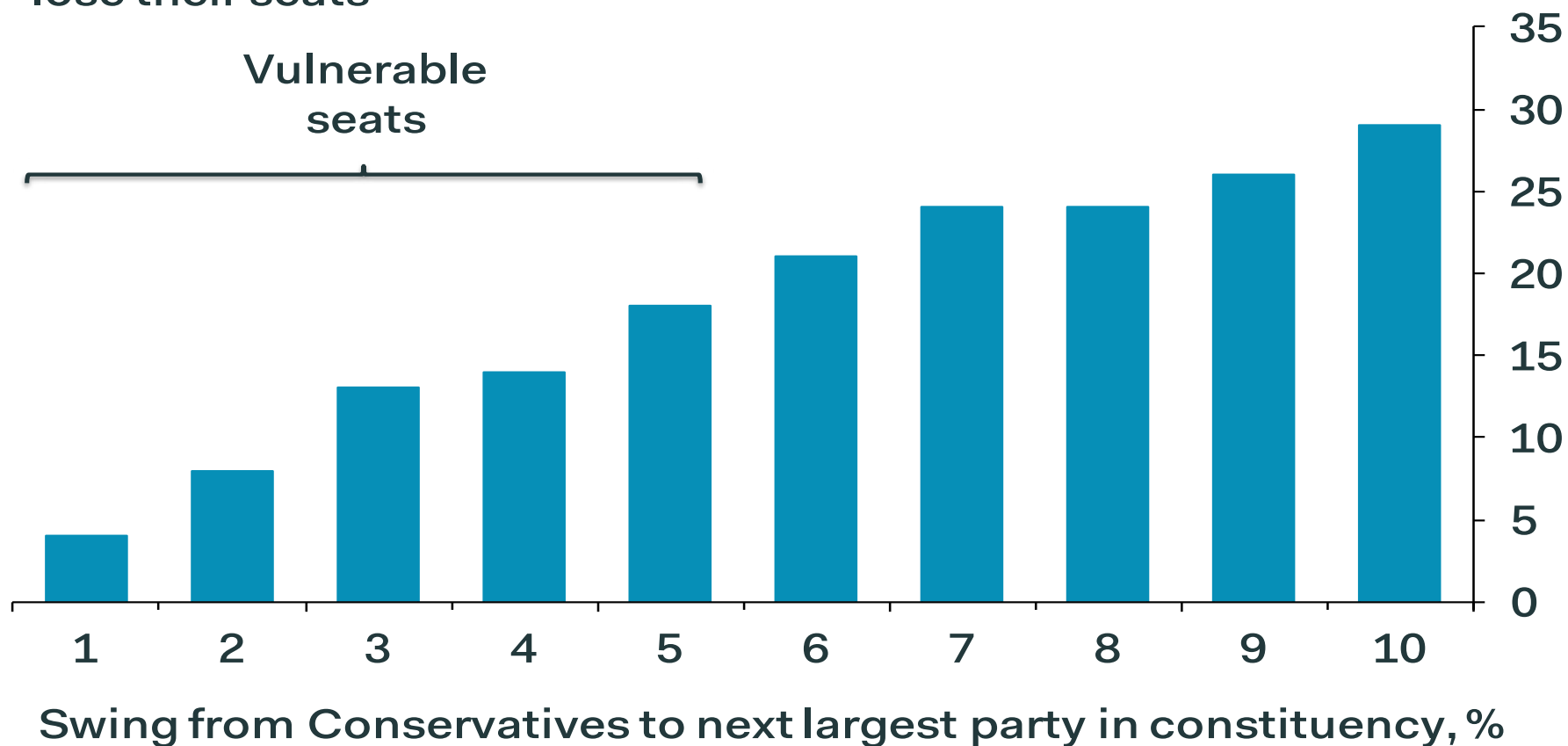
## 19. DESPITE BREXIT CONCESSIONS, MRS. MAY'S APPROVAL RATING IS UP

- ◆ Net approval rating, %, Theresa May
- ◆ Jeremy Corbyn

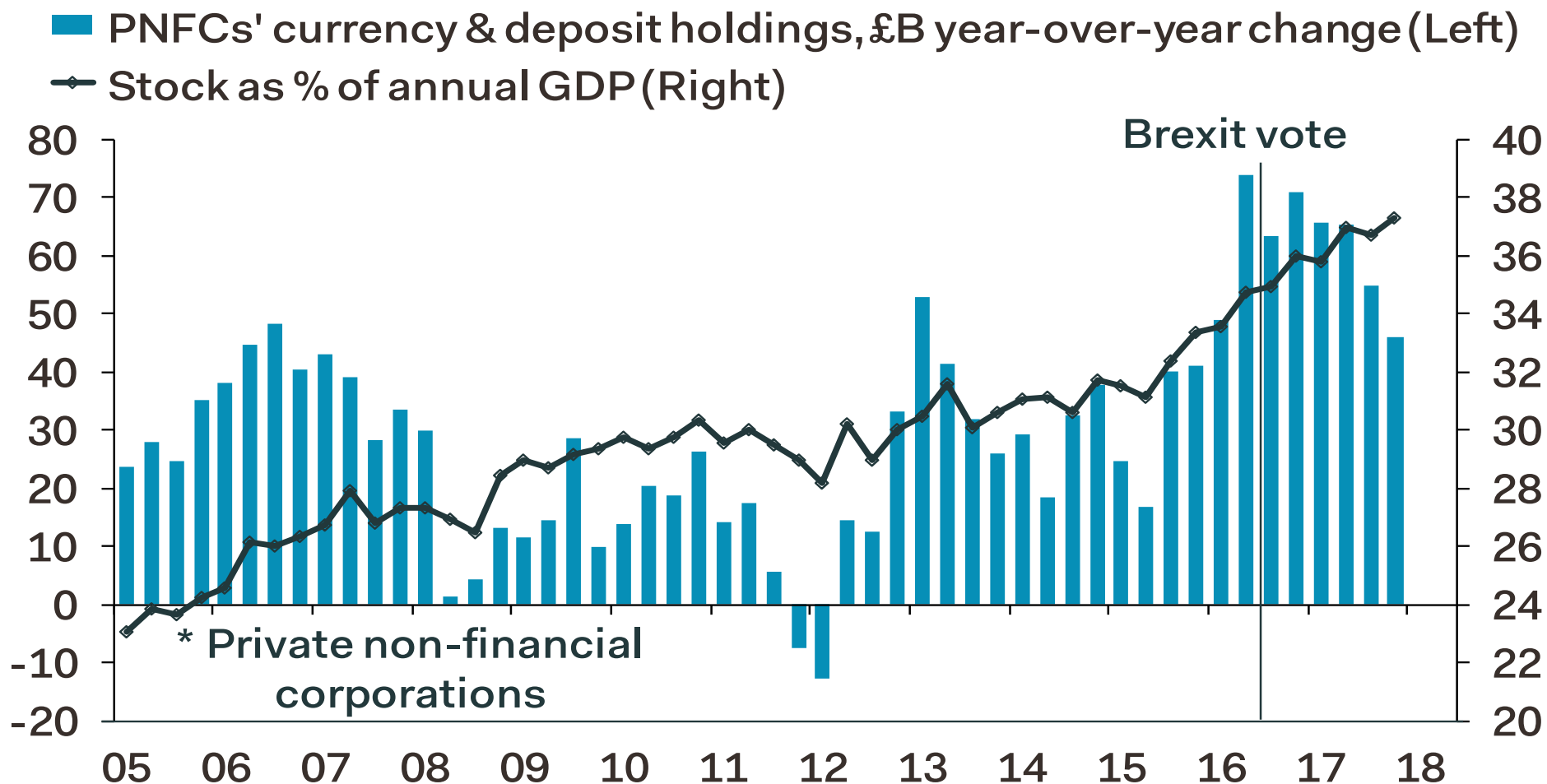


## 20. MANY EUROSCEPTIC MPS HOLD SWING SEATS; WHY RISK AN ELECTION?

- Number of European Research Group Conservative MPs that would lose their seats

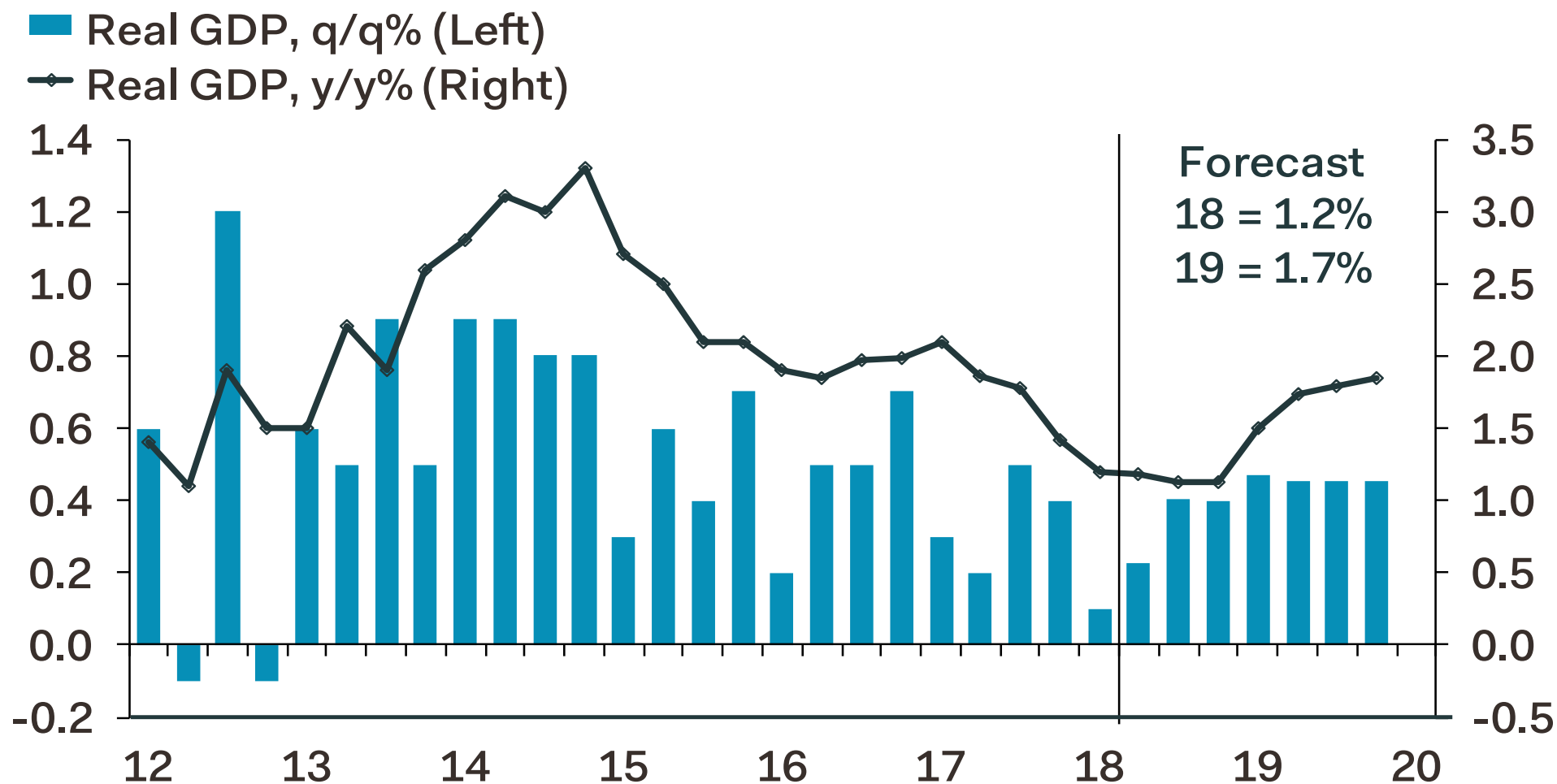


## 21. A HUGE VAULT OF CORPORATE CASH MAY BE DEPLOYED IF BREXIT IS SOFT



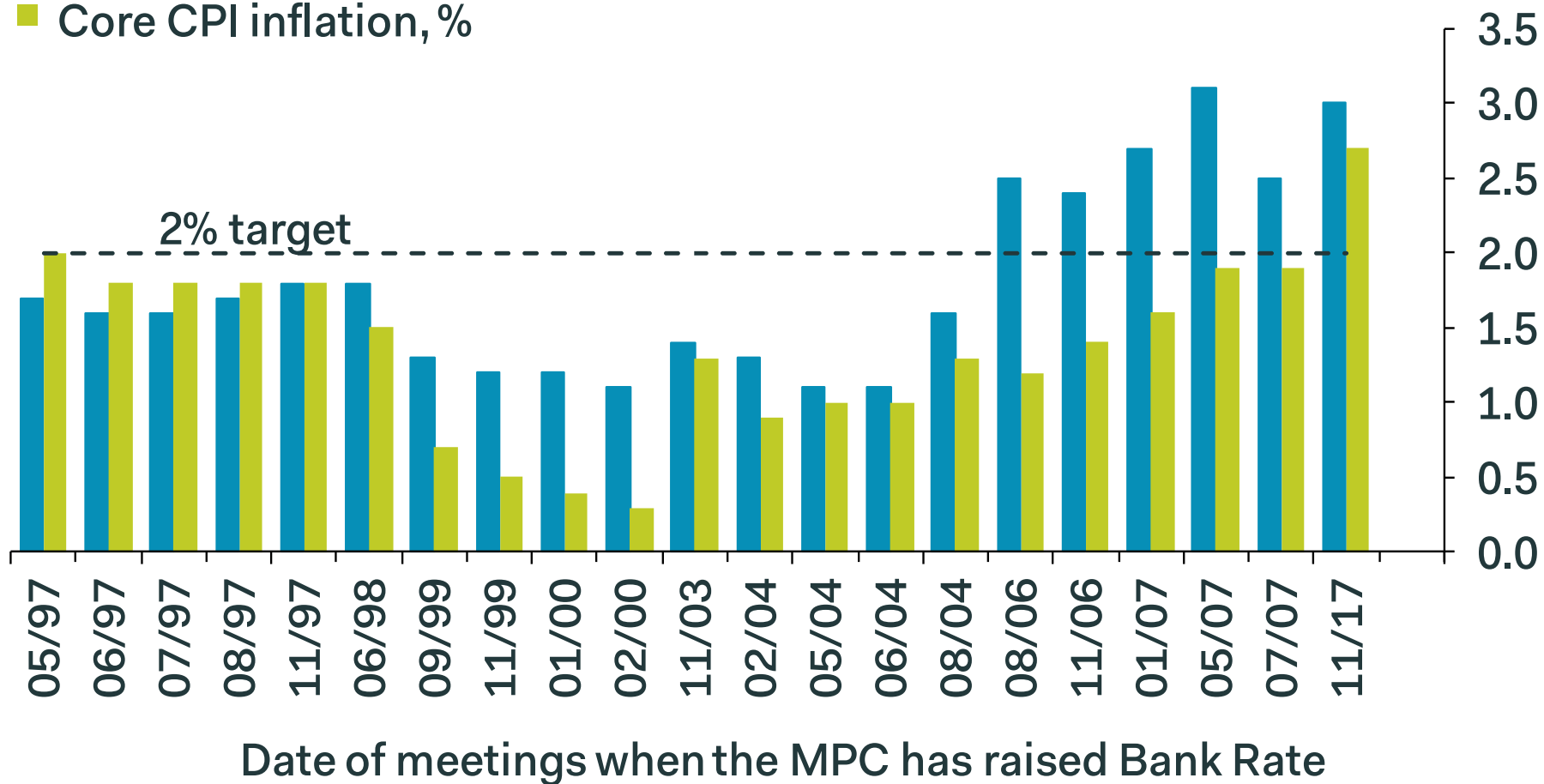


## 22. GDP GROWTH SHOULD SPEED UP NEXT YEAR



## 23. BELOW-TARGET INFLATION WON'T RULE OUT RATE HIKES ALTOGETHER

- CPI inflation, %
- Core CPI inflation, %





## 24. SUMMARY

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- \* **GDP growth will be too weak for the MPC to hike this year.**
- \* **Inflation is set to fall below the 2% target in 2019, but that needn't rule out tightening altogether.**
- \* **Fiscal policy will boost growth next year for the first time since 2014.**
- \* **The Government likely will change course and opt for a soft Brexit, spurring a revival in business investment.**
- \* **The MPC likely will stand pat this year, but raise Bank Rate twice in 2019, and twice again in 2020.**