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SAMUEL TOMBS, CHIEF U.K. ECONOMIST

The MPC likely will press ahead with a rate rise this week, but at least two members will dissent.

The MPC won't feel compelled to talk up sterling or gilt yields after raising rates...

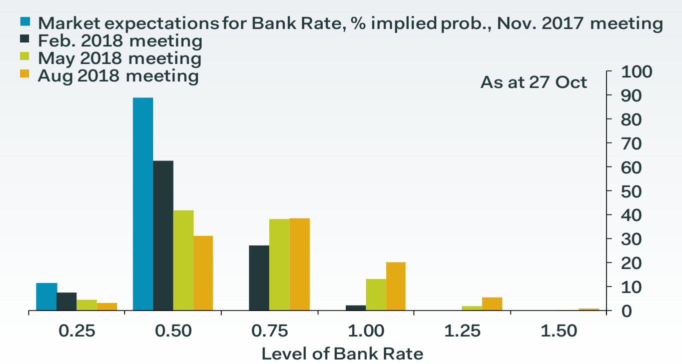
...Its forecast for inflation in two years' time will no longer be materially above the 2% target.

The MPC Will Hike Rates, but Won't Jawbone Sterling Higher

The MPC likely will raise interest rates on Thursday, for the first time since July 2007, in response to the uptick in GDP growth and the upside inflation surprise in Q3. ***The Committee, however, likely will not unanimously vote to hike, and its new medium-term inflation forecast will be lower than in August.*** As a result, we think that the MPC will drop its guidance that interest rates could rise to a greater extent than markets anticipate. Events on Thursday likely won't lift either sterling or gilt yields.

We think the case for the Committee to stand pat on Thursday is still quite strong. Since the MPC last met, in mid-September, employment growth has weakened while domestically-generated inflation has remained subdued. Little progress has been made in Brexit negotiations. Hopes that the fiscal consolidation plans will be softened materially in the Autumn Budget have been dashed, following the OBR's admission that it will revise down its productivity growth forecasts. And credit growth looks increasingly likely to slow, especially from February, when new lending will no longer entitle banks to more cheap funds from the Term Funding Scheme.

WILL THE MPC SUPPORT MARKETS' 2018 RATE HIKE PRICING?



Nonetheless, the 0.4% rate of quarter-on-quarter GDP growth in Q3 exceeded the MPC's expectation in August by one-tenth. The unemployment rate in August, 4.3%, was one-tenth below the MPC's forecast. And wage growth has firmed up, albeit modestly; the annualised rate of month-to-month gains in private-sector wages has averaged 3.2% over the last six months, compared to 1.6% in the previous six months. ***Given these developments, and having primed markets, the MPC would damage its credibility irreparably if it did not follow through now.***

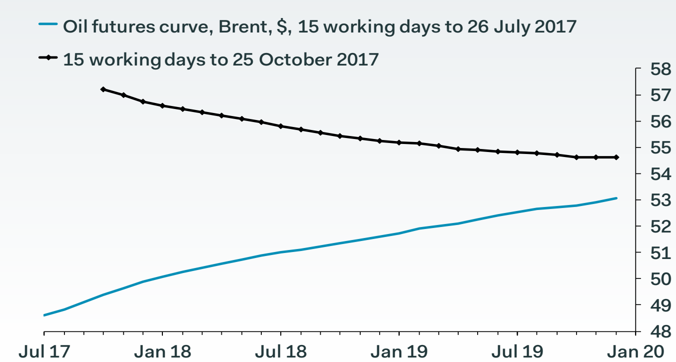
The decision, however, likely will be split; we expect a 7-2 vote. Deputy Governors Cunliffe and Ramsden both have signalled in the last two weeks that they did not—and still do not—share the view of the majority of members in September that rates likely will rise "over the coming months." A summary of MPC members' recent comments can be found on page three. We can't rule out a 6-3 or even a 5-4 division, given that Silvana Tenreyro sounded lukewarm on the need for higher rates in her Treasury Committee appointment hearing, and Ben Broadbent has not spoken publicly in the last three months.

Whatever the vote, the MPC likely will reduce its forecast for GDP growth, modestly. In August, the Committee's central forecast—assuming interest rates follow the path anticipated by markets—was for GDP to rise by 1.7% in 2017, then 1.6% in 2018 and 1.7% in 2019. But with recent growth having depleted labour market slack more quickly than anticipated, and with no compelling reason for the Committee to revise up its productivity numbers, the MPC will conclude that the economy is even closer to its potential than previously thought. We expect, therefore, that the MPC will lower its forecasts for growth in 2018 and 2019 to 1.5% and 1.6%, respectively.

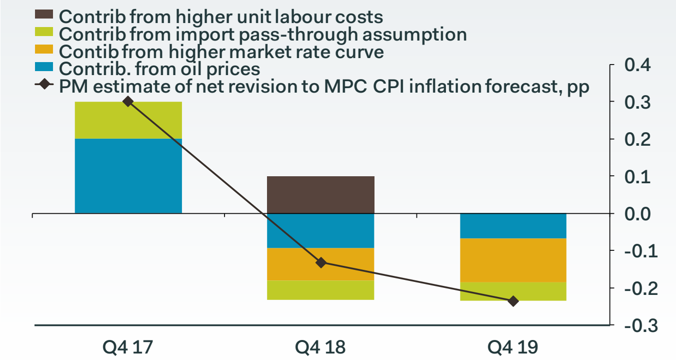
The Committee will make bigger changes to its inflation forecast. September's 3.0% inflation rate was 0.2 percentage points above the August forecast, primarily due to higher oil prices and faster pass-through from import prices than expected. The MPC will have to pull up its forecast for CPI inflation in Q4 to 3.1%, from 2.8%, given that one main energy supplier recently hiked prices, while retailers look set to continue to passing on higher import prices to consumers more quickly than the MPC had expected.

Nonetheless, the MPC will be forced to revise down its forecast for inflation in 2018 and 2019 in response to three developments. First, the MPC will base its forecast on oil futures in the 15 working days to October 25. Markets then anticipated the oil price would fall gradually to $55, from $57. By contrast, the MPC's inflation forecast in August was based on a steadily *rising* oil price. Second, the MPC's forecast is conditioned on the market's implied interest rate path, which has shifted up by an average of 15bp for the next three years. And third, retailers have been more successful than the MPC anticipated in passing on higher import prices to consumers, which means that less of the total price shock lies ahead.

THE OIL FUTURES CURVE NOW IS *DOWNWARD* SLOPING



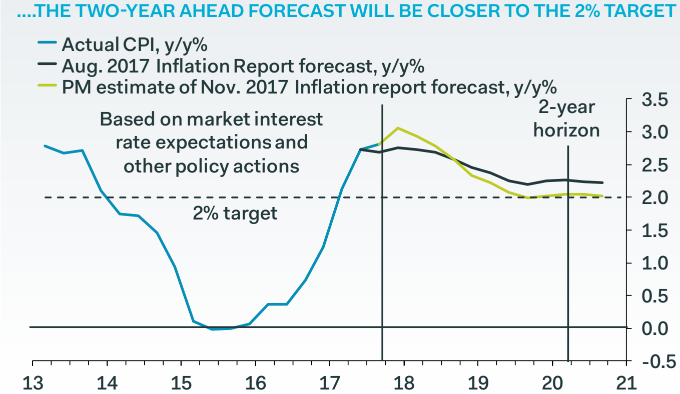
THE MPC WILL REVISE DOWN ITS MEDIUM-TERM INFLATION FORECAST...



The recent pickup in year-over-year growth in unit labour costs to 2.4% in Q2—well ahead of the MPC's forecast of ¾% growth in Q3—will exert upward pressure on the inflation forecast in 2018. But we estimate, using the MPC's rules of thumb, that the Committee will need to revise down its forecast for inflation in Q4 2018 and Q4 2019 by 0.15pp and 0.25pp, respectively, as our chart above shows.

As a result, we expect the MPC to forecast that CPI inflation will return to the 2% target at the policy-critical two-year horizon, provided interest rates rise in line with market expectations. We doubt, therefore, that the Committee will feel compelled to jawbone sterling or gilt yields higher. Our view remains that GDP growth and inflation will surprise the Committee to the downside in 2018, leading to a 12-month hiatus before the next hike.

....THE TWO-YEAR AHEAD FORECAST WILL BE CLOSER TO THE 2% TARGET



Samuel Tombs **+44 (0)203 744 7430**
samuel@pantheonmacro.com

Summary of MPC members' views

MPC member	Term end	Last vote	Past non-consensus votes	Latest key comment
Mark Carney (Governor)	Jun. 2019	No change	None	"If the economy continues on this track it's been on—and all indications are that it is—then in the relatively near term, you could expect interest rates to increase." Interview on BBC Radio, Sep. 29.
Ben Broadbent (Deputy Governor, Monetary Policy)	Jun. 2019*	No change	Voted against increasing QE by £50B in July 2012.	"The MPC said given the other assumptions in its forecast it thought probably there would need to be rate rises, and indeed more rate rises than those priced into the interest rate curve in future than the financial markets expect. I do think the time is likely to come when rates will go up generally." Interview on BBC Radio 4, Aug. 4.
Jon Cunliffe (Deputy Governor, Financial Stability)	Oct. 2018*	No change	None	"Over the forecast period of three years rates will need to rise. The exact timing of when that starts? Well, that for me is a more open question." Interview with Western Mail, Oct. 23.
David Ramsden (Deputy Governor, Markets & Banking)	Sep. 2022*	No change	None	"Measures of domestically generated inflation are consistent with there still being some slack in the economy: they generally remain a little below levels consistent with the 2 percent target. Despite continued robust growth in employment there is no sign of second round effects onto wages from higher recent inflation." Appointment hearing with the Treasury Committee, Oct. 17.
Andrew Haldane (Chief Economist)	June 2020*	No change	None	"Higher interest rates would be a sign the economy is healing, so we should see this as a good news story." Interview in The Independent, Oct. 27.
Ian McCafferty (External Member)	Aug. 2018	25bp hike	Voted to raise rates by 25bp since June 2017, between Aug. 2014 & Dec. 2014 and between Aug. 2015 & Jan. 2016. Voted against more gilt purchases in Aug. 2016.	Until recently, financial markets had appeared to believe that, almost regardless of how the economy behaved, Brexit-related uncertainties effectively tied our hands until after the United Kingdom had left the European Union. This, we felt, was a misreading of our reaction function." Speech in London, Oct. 5.
Michael Saunders (External Member)	Aug. 2019*	25bp hike	Voted to raise interest rates by 25bp since June.	"I do not want to dismiss risks that the Brexit process might be bumpy, and could undermine business and consumer confidence," he said. "We should not maintain an overly loose stance as insurance against this scenario. Rather, we should be prepared to respond as needed if it happens." Speech in Cardiff, Aug. 31.
Silvana Tenreyro (External Member)	Jul. 2020*	No change	None	"My view is that we are approaching a tipping point at which it would be necessary or justified to remove some of that stimulus. However, that is very contingent on the data." Appointment hearing with the Treasury Committee, Oct. 17.
Gertjan Vlieghe (External Member)	Aug. 2018*	No change	Voted to cut rates by 25bp in July 2017.	"If these data trends of reducing slack, rising pay pressure, strengthening household spending and robust global growth continue, the appropriate time for a rise in Bank Rate might be as early as in the coming months." Speech in London, Sep. 15.

* Term could be extended

THIS WEEK IN BRIEF

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

Monday, October 30

• D: Money & Credit (9)/09:30 GMT
We think that house purchase mortgage approvals fell to **66.3K** in September, from 66.6K in August, mirroring the fall in the U.K. Finance measure. Meanwhile, September's drop in retail sales points to a sub-par **£1.2B** rise in net consumer credit. **Consensus: Approvals 66.1K, credit £1.5B.**

• D: E.C. Economic Sentiment Survey (10)/10:00 GMT
Confidence likely has been hit by talk of an imminent interest rate hike, so we expect the ESI to fall to **108.5** in October, from 109.2 in September. **Consensus: N/A.**

Tuesday, October 31

• GfK Consumer Confidence Survey (10)/00:01 GMT
We expect the composite index to fall to **-11** in October, from -9 in September. GfK's index is a NSA version of the consumer component of the E.C.'s survey. **Consensus: -10.**

Wednesday, November 1

• D: Nationwide House Prices (10)/07:00 GMT
Nationwide's index likely was flat in October, maintaining the year-over-year growth rate at **2.0%**. **Consensus: 2.2%.**

• D: Markit/CIPS Manufacturing Survey (10)/09:30 GMT
The flash Eurozone PMI rose to 58.6 in October, from 58.1 in September; it is often a good indicator for the U.K.'s PMI. But the U.K.'s PMI was boosted in September by a sudden lengthening of suppliers' delivery times, which Markit infers means that the sector is running hot. We expect the delivery times index to mean revert in October, depressing the PMI by 0.5pp. As a result, we expect the PMI to fall to **55.5** in October, from 55.9 in September. **Consensus: 55.8.**

Thursday, November 2

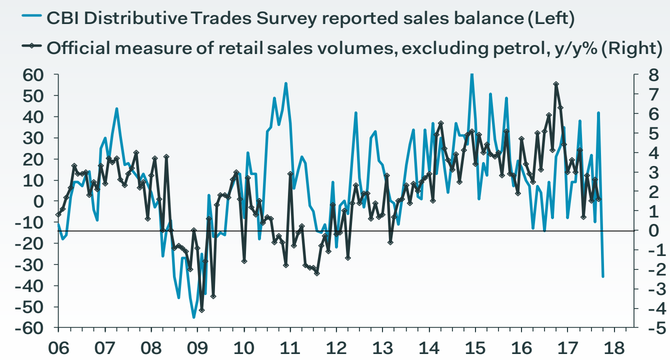
• D: Markit/CIPS Construction Survey (10)/09:30 GMT
The construction PMI plunged to 48.1 in September, from 51.1 in August. We expect it to recover only marginally to about **49.0** in October. **Consensus: 48.5.**

• D: MPC Meeting, Minutes & Inf. Report/12:00 GMT
We expect the MPC to raise interest rates to **0.50%**, from 0.25%. David Ramsden and Jon Cunliffe, however, have signalled recently that they will not vote to hike rates, so we expect a **7-2** vote split. Meanwhile, the Committee will revise down its forecast for inflation in two years' time to 2%, now that the oil futures curve is downward sloping, market interest rates have risen and retailers have passed on more of the import price shock this year than it anticipated.
Consensus: Bank Rate 0.50%, Vote: 6-3.

Friday, November 3

• D: Markit/CIPS Services Survey (10)/09:30 GMT
The new orders index fell in September to its lowest level since August 2016. It points to the business activity index slipping to 53.0 in October, from 53.6 in September. We will update our forecast, however, when Lloyds publishes its Business Barometer Survey on Tuesday. **Consensus: 53.2.**

CHART OF THE WEEK: TENTATIVE SIGNS OF RETAIL SALES WEAKNESS



PANTHEON'S FINANCIAL FORECASTS

		End-month:				
	5pm Fri.	Dec	Mar 18	Jun	Sep	Dec
Bank Rate	0.25	0.50	0.50	0.50	0.50	0.75
3m Libor	0.42	0.50	0.60	0.60	0.70	0.80
12m Libor	0.77	0.80	0.90	1.00	1.10	1.30
2-year Gilt	0.46	0.50	0.60	0.70	0.80	1.00
10-year Gilt	1.35	1.40	1.50	1.60	1.70	1.80
30-year Gilt	1.92	2.00	2.00	2.10	2.20	2.30
FTSE 100	7509	7300	7200	7100	7050	7000
USD/GBP	1.31	1.32	1.32	1.34	1.36	1.38
EUR/GBP	1.13	1.10	1.12	1.16	1.18	1.20
Sterling TWI	77.0	76.7	77.7	79.9	81.6	82.8

PANTHEON'S ECONOMIC FORECASTS

	Period average:						
	Q1 17	*Q2 17*	*Q3 17*	*Q4 17*	*2017*	*2018*	*2019*
GDP, q/q%	0.3	0.3	0.4	0.2	-	-	-
GDP, y/y%	2.0	1.7	1.5	1.0	1.5	1.5	2.0
Employment, y/y%	1.2	1.1	1.2	1.2	1.2	0.9	0.8
Unemp. rate, %	4.6	4.4	4.3	4.2	4.4	4.2	4.0
Wkly earnings, y/y%	2.3	1.8	2.1	2.2	2.0	2.5	3.0
CPI, y/y%	2.1	2.7	2.8	3.1	2.7	2.5	1.8
RPI, y/y%	3.0	3.6	3.8	4.2	3.6	3.4	2.9
PSNB FY, £B	-	-	-	-	48	35	22
Cur. acc't., % GDP	-4.4	-4.6	-5.8	-4.4	-4.8	-4.2	-4.2
House prices, y/y%	4.5	1.9	1.4	1.5	1.5	2.0	3.0