The Bank of England continues the pauses

Synopsis: The Bank of England has copied the US, Japanese and Eurozone central banks and left interest rates unchanged.

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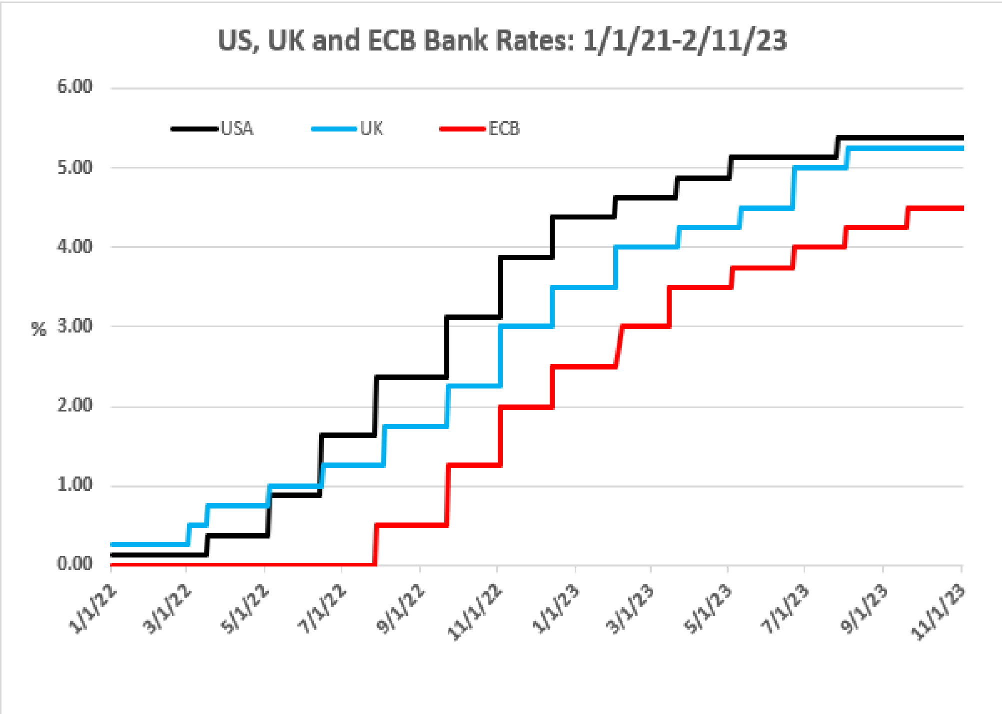

Last Thursday, to no great surprise, the European Central Bank opted to keep its deposit rate at 4.0% and lending rate at 4.5%, the levels first set in September. On Monday the Bank of Japan held its key interest rate at -0.1%, the level it has been parked at since January 2016. On Wednesday, the US Federal Reserve made it a trio of no-changers, holding its Fed funds rate at 5.25%-5.50%, the second consecutive pause at this level.

On Thursday the Bank of England made it a quartet, holding the UK Bank Rate at 5.25% for a second time.

The Bank's statement said that 'Since the MPC's previous [September] decision, there has been little news in key indicators of UK inflation persistence. There have continued to be signs of some impact of tighter monetary policy on the labour market and on momentum in the real economy more generally. Given the significant increase in Bank Rate since the start of this tightening cycle, the current monetary policy stance is restrictive. At this meeting, the Committee voted to maintain Bank Rate at 5.25%.'

As is its norm, in making the Monetary Policy Report's inflation projections, the MPC (Monetary Policy Committee) used the market-implied future path of interest rates rather than any internal assumptions.

Interestingly, the market suggests that 'Bank Rate … remains around 5.25% until 2024 Q3 and then declines gradually to 4.25% by the end of 2026', which is a lower profile than used the August report. The market interest rate path fits with the Bank's statement, repeated from the last MPC minutes, that 'Monetary policy will need to be sufficiently restrictive for sufficiently long to return inflation to the 2% target sustainably in the medium term, in line with the Committee's remit. Further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures.'

The vote in favour of holding the rate was 6-3 against 5-4 in September, but that reflected a change of MPC membership, with Sarah Breeden, who voted for hold, replacing Jon Cunliffe, who voted for an increase in September.

The Bank expects CPI inflation to continue to fall quite sharply in the near term, to an average of around 4.75% in 2023 Q4, 4.5% in 2024 Q1 and 3.75% in 2024 Q2. If the Bank is right, that will mean Mr Sunak will meet his halving inflation pledge.

While the Bank mirrored the Fed and ECB in giving itself the option to raise rates if necessary, the markets appear to have decided that the peak has now been reached. A strong rally in global equity markets and falls in 10-year government bond yields this week are all evidence that the markets believe the long-awaited plateau has arrived.

Comment

The Bank's modal (most likely) projection is that CPI inflation will 'return to the 2% target by the end of 2025', but that risks 'were skewed to the upside'.

The OBR projections issued alongside the March 2023 Budget were for CPI inflation to average 0.9% in 2024 and 0.1% (!) in 2025. When the Autumn Statement is presented, it will be interesting to see how much the OBR moves towards the Bank's projections and what effect that has on government finances.

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