markit

Markit Economic Research

05/06/2014

United Kingdom

Bank of England policymakers hold off on rate rises again

- **Bank of England leaves policy unchanged**
- **MPC members likely to have increasingly debated need for tighter policy**
- **Wage growth likely to hold key to rate rise timing**

No surprises as the Bank of England's Monetary Policy Committee left interest rates unchanged at a record low of 0.5% at its June meeting. The stock of asset purchases made under its Quantitative Easing programme was also left unchanged at £375bn.

Bank Governor Mark Carney has so far enjoyed unanimous backing among the nine MPC members to support his view that higher interest rates are not warranted until at least the spring of next year, allowing the economy to continue to repair itself from the recession.

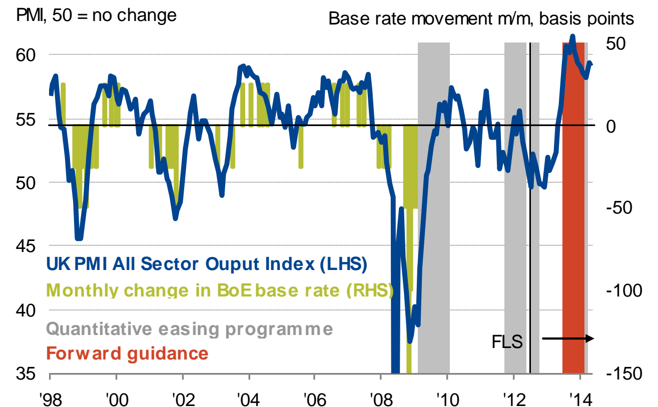
However, it's reasonable to assume that this unanimity is waning. Members such as Martin Weale and Charlie Bean have become increasingly worried that the speed with which the economy is growing could warrant earlier rate hikes to prevent the possible need for larger rate hikes at a later date, on the basis that inflation could pick up more than expected.

In essence, there is a growing suspicion that the risk of delaying rate hikes outweighs the risk of postponing too long, which means some MPC members may start to break ranks and vote for the base rate to be raised to 0.75%.

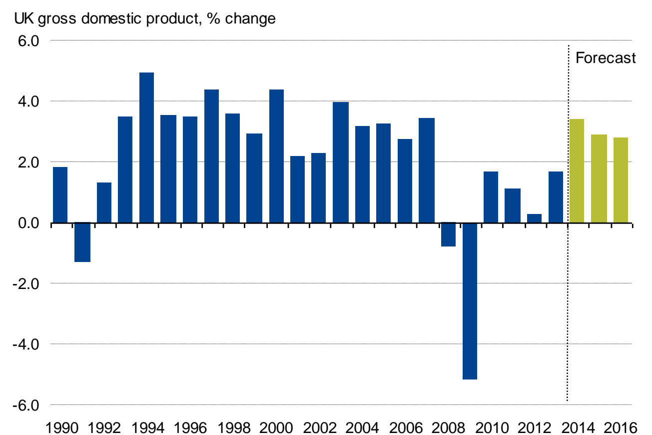
There's no doubt the economy is firing on all cylinders. The Markit/CIPS PMI surveys point to a further impressive 0.8% rise in GDP in the second quarter, which will lift the economy above its pre-crisis peak. The Bank itself is expecting the economy to grow by 3.4% this year.

Importantly, this growth is being accompanied by record job creation, according to the surveys. This upturn in hiring has resulted in a far steeper than anticipated drop in unemployment over the past year, which looks set to continue over the summer.

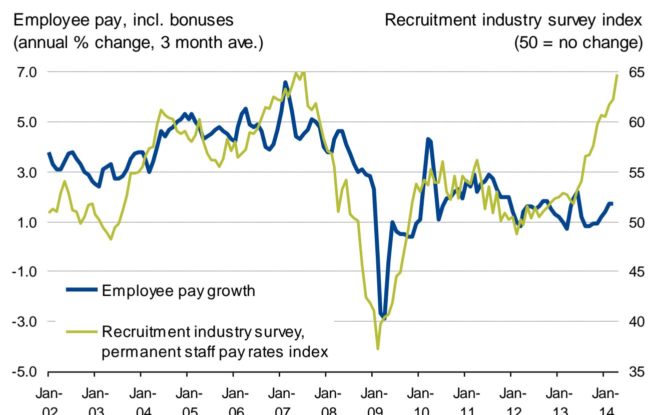
PMI and policy decisions



Bank of England GDP outlook



Employee pay



Sources: Markit, ONS via Ecowin.

Perhaps the key determinant of when rates will start rising, however, is wages growth. Official data have so far shown pay pressures remaining surprisingly muted, given the speed with which employment is growing, which has supported the dovish stance of the MPC to date. However, survey data – and notably Markit's poll of recruitment agencies – is now finding evidence of pay rising sharply as skill shortages become more widespread.

If official data start to show similar upturns in wage pressures as we move through the summer, the likelihood of rates rising in either February 2015 or even November this year (coinciding with the Inflation Report) will inevitably increase.

While house prices are also becoming an increasing concern among policymakers, the Bank has stressed that rising interest rates will only be used as a last resort to deflate any signs of a potential housing market bubble, choosing instead to use other tools such as capping the amount households can borrow or watering down Help to Buy. However, if these untried new tools fail to cool the housing market, interest rates may need to be used after all.

Chris Williamson
Chief Economist
Markit
Tel: +44 207 260 2329
Email: chris.williamson@markit.com
Click here for more PMI and economic commentary.
For further information, please visit www.markit.com

Purchasing Managers' Index™ and PMI™ are either registered trade marks of Markit Economics Limited or licensed to Markit Economics Limited.