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**Markit Economic Research**
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# United Kingdom

## Policymakers mull over timing of first rate hike amid wage growth uncertainty

- **Bank of England leaves policy unchanged…**
- **…but minutes reveal growing discussion on timing of rate hike**
- **Policy muddied by wage growth uncertainty**

Policymakers at the Bank of England's latest Monetary Policy Committee meeting continued to stress that interest rates are likely to only go up very gradually when they do start to rise, but the debate over the timing of the first hike appears to have intensified.

The MPC once again left interest rates at a record low of 0.5% and the stock of asset purchases unchanged at £375bn at its regular meeting earlier this month, but the minutes from that meeting suggest that policymakers are becoming increasingly torn on whether interest rates should be kept low to support the recovery, or whether they should start edging rates higher to avoid falling behind the curve.

### Pay growth key to first rate hike

It looks like the issue of pay dominated the discussion on the timing of the first rate hike. Higher wages are seen by many policymakers as the most important driver of wider inflationary pressures. The Bank of course also wants to see wages rising in real terms to be confident that households will be able afford any increases in their borrowing and mortgage costs, otherwise the recovery could be jeopardised.

The problem the MPC faces is that it looks like recent official pay data are being distorted downwards due to last year's changes to higher rate income tax. The minutes note that survey evidence from the recruitment industry indicates that starting salaries are rising at a record pace, reflecting a combination of surging demand for staff and increasingly widespread skill shortages. The official measure of pay growth could therefore suddenly spike higher in the second half of the year.

If the Bank were to not respond to this upturn in pay, it would risk falling behind the curve, necessitating higher interest rates next year than may otherwise have been required to control inflation. Inflation is already at 1.9%, just shy of the bank's 2.0% target.

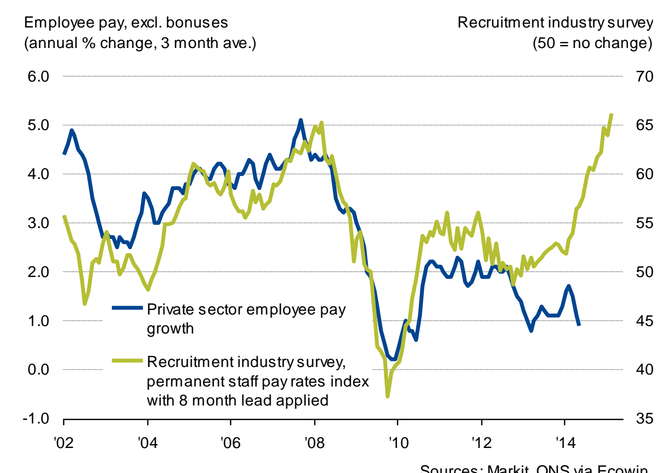
An alternative view discussed at the meeting was that a lack of wage growth could simply be a result of workers simply being willing to accept lower wages, or work more for the same money. At the same time, there are signs that economic growth will slow slightly in the second half of the year and that global economic uncertainties have increased, notably with the escalation of the situation in Ukraine since the meeting. In this scenario, raising interest rates too early could have a disproportionally large impact on the economy.

### Data-led decision making

The Bank has made it clear that any decision on rates will be led by the data. In that sense, with house prices growing at 10.5% per annum (and double that in the capital), inflation almost at the Bank's target, unemployment plummeting amid record job creation and the economy growing at a surprisingly strong clip, it's increasingly hard to see how record low interest rates can be justified for much longer if pay growth starts to pick up in the second half of the year.

Unless the pace of economic growth weakens substantially in coming months, we would therefore expect to see policymakers seek to talk up the likelihood of a first rate hike in November.

**Employee pay indicators**



Sources: Markit, ONS via Ecowin.

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