Mizuho Market Comment

17 July, 2024

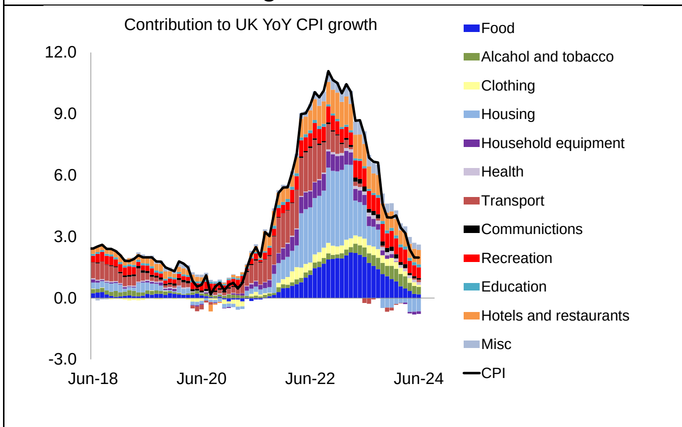
Colin Asher
Senior Economist
colin.asher@mhcb.co.uk | +44 20 7012 5262

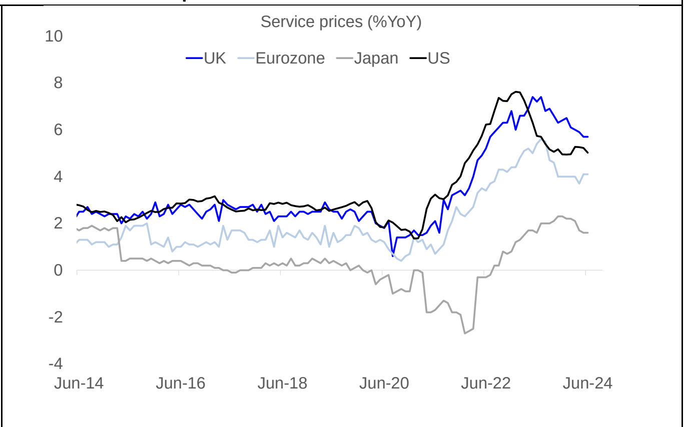
BoE preview – close call in August, but policy rates heading lower sooner or later

- **The BoE meeting on 1 August looks like a close call. We currently see a 5-4 vote in favour of a cut**
- **Even if the BoE leaves policy on hold in August, we still see 2x25bp cuts this year**
- **A more stable political backdrop vs other regions boosts the case for GBP…**
- **…and we expect GBP to continue to appreciate into year end**

Firmer activity backdrop to reduce pressure on MPC for easier policy
Q1 GDP in the UK rose more than expected and was subsequently revised even higher to an above-trend 0.7%QoQ. Monthly GDP was also faster than expected in May, rising 0.4%MoM vs 0.2%MoM expected. Indeed, on the basis of the monthly GDP data our current Q2 GDP forecast is looking a little low, even if we assume negative GDP growth in the month of June. A run of unseasonal weather and the England football team's run deep into the Euro 2024 championships will buffet the data over the next few months. Thanks to Gareth Southgate, England going deep in a major football competition is less of a rarity than it used to be, so the impact on hospitality spending involves a little less guess work these days. Spending in June (retail sales report due Friday) was likely subdued thanks to poor weather. July data will also see weather and football cross-currents. In the meantime, we note that the 2024 GDP consensus forecast culled from the Bloomberg survey nudged higher this month from 0.6% to 0.7%. Our 2024 annual GDP forecast is currently at 0.8% with an upside bias. There do seem to be some reasons for caution on the outlook. The jump in Q1 GDP was surprisingly large. As the ONS notes, expectations of accuracy/reliability in early estimates are usually too high.

UK CPI back at target…	…but service prices remain elevated





Source: Bloomberg

Fiscal outlook not expected to change significantly in the wake of the election
We do not see the recent election as a game changer for the fiscal outlook. The King's Speech later today will lay out the Labour Party's programme for government. Early signs are that the commitment to not make unfunded spending promises seems to be holding reasonably well (eg Deputy PM Rayner's comments on the 2-child cap on Child Benefit). This will be most obvious in the budget, which is not now expected until after Conference Season (so October or even November) given that the OBR requires 10 weeks to produce a new forecast. We continue to see pressure for spending being hard to resist. We expect modestly higher spending, funded by mildly higher borrowing and slightly higher taxes vs stated plans. If anything, this points to marginally faster growth. This is a consensus view, with 8 out of 11 respondents to Bloomberg's monthly poll suggesting saying they wouldn't lift their GDP forecasts as a result of the election. We see some modest upside in the medium term from the plans to get Britain building again but do not see them bearing much fruit in the near term - certainly not enough to impact GDP in 2024.

UK political stability contrasts with developments elsewhere

The election does seem to have lifted sentiment somewhat. The shallowness of the Labour election victory (winning extra 200 seats with almost exactly same share of the vote) makes little difference to the near-term policy outlook, which is driven by the huge 172 seat majority in parliament. The stability in the UK's political outlook contrasts with less stable outlooks elsewhere. France has a caretaker government and Germany has an weak coalition that struggles to agree budgets. Japan has an unpopular PM, whose days may be numbered and the political outlook in the US is potentially volatile. Furthermore, UK assets are not expensive, making them more attractive for investors. GBP sits at a 12-month high against both USD and EUR, reflecting both upward revisions to GDP and hopes that a more stable political backdrop can help foster a backdrop conducive to investment. Recent political events have left the UK better off from a relative perspective, which we see as a modest boost for GBP.

August cut in the balance

The June BoE meeting came in midst of the election campaign which was called by the PM on 22 May. The BoE was silent during the election campaign and as such we have heard a lot less from them than usual. The upcoming BoE meeting on 1 August is likely to be a close call. The 20 June meeting saw a 7 votes to leave policy on hold, with 2 members voting for cuts, as was the case at the May MPC meeting. However, the June statement noted:

"*There continued to be a range of views among these members about the extent of accumulated evidence that was likely to be needed to warrant a change in Bank Rate…. For some members within this group, the return of headline inflation to 2%, while welcome, was not necessarily indicative of the required sustained return to target. Continued high levels of, and upside news to, services inflation supported the view that second-round effects would maintain persistent upward pressure on underlying inflation. Wage growth had continued to exceed model-based estimates. Indicators of domestic demand were stronger than had been expected, and the risks to the outlook for activity were skewed to the upside. For these members, more evidence of diminishing inflation persistence was needed before reducing the degree of monetary policy restrictiveness……For other members within this group, the upside news in services price inflation relative to the May Report did not alter significantly the disinflationary trajectory that the economy was on. This view was supported by evidence that the recent strength in services inflation included regulated and indexed components of the basket, and volatile components. The impact of the increase in the NLW this April on aggregate pay growth was unlikely to be as large in future. Such factors would not push up medium-term inflation. For these members, the policy decision at this meeting was finely balanced*".

Counting votes….

Dhingra and Ramsden will likely continue to vote for cuts, while Greene, Mann and Haskel (August is his last meeting) will likely vote to leave policy unchanged. Since the election Chief Economist Pill has spoken noting "*At annual rates still not far from 6%, annual services price inflation and wage growth continue to point to an uncomfortable strength in those underlying inflation dynamics*." This suggests to us that he is among those happy to wait for more information before easing policy, especially in the wake of the CPI data, that saw services prices remain elevated at 5.7%YoY.

…leaves a lot hanging on the vote of the untested Lombardelli

In the wake of the May MPC meeting, we though we detected a willingness on the part of the Governor to vote for lower rates in the near future. Obviously he passed in June but we suspect that he is happy to start easing in August. We suspect that he will be more susceptible to arguments that elevated service prices in June (esp hotels/Taylor Swift) are a one-off development. Despite the fact that we have not heard from him for about two months, we assume the Governor is set to vote for easier policy in August. We also assume the Deputy Governor for Financial Stability Breeden, will also vote for a cut. She has said very little of late but has yet to vote against the Governor since she joined the Committee in November 2023 (6 meetings). This leaves new member Deputy Governor Lombardelli. Our baseline assumption, on minimal evidence, is that she will also vote with the Governor, giving 5 votes for a 25bp cut. It is rare, but not unheard of (Dhingra), for new members to vote against the Governor.

The August vote is, in our opinion, a close call. So much so that upcoming data on wages, retail sales and the flash PMIs may swing the decision. A 25bp cut in August remains out call for now but we would note that in the event that policy is left on hold in August, we would expect the easing cycle to start in mid-September. We expect that the pace will remain the same – one cut/quarter, which would mean a second cut in December rather than November as we currently expect. GBP has been firm since Chief Economist Pill suggested that August was not a done deal. If the BoE cuts in early August, we suspect that any currency weakness will be short lived. The BoE decision will likely be accompanied by firmer GDP forecasts, a slightly narrower output gap and slightly higher inflation, which should limit any downside for GBP. We look for GBP to continue to outperform in coming months, with EUR/GBP pushing down towards the 0.80 level and Cable pushing up towards 1.35 on a 12-month horizon.