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Bank of England Signals First Rate Rise for 10 Years is Coming

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Michiel de Bruin, Head of Global Rates & Money Markets at BMO Global Asset Management EMEA, comments on the Bank of England's (BoE) Monetary Policy Committee (MPC) rate decision yesterday:

"By changing a single sentence the BoE has dramatically changed the near term outlook for UK monetary policy. Yesterday's summary of the MPC meeting said... 'Some withdrawal of monetary stimulus is likely to be appropriate over the coming months', whereas the previous line was 'some tightening of monetary policy would be required'. An aspiration with no timescale.

"The BoE will have known that markets would interpret this to mean that a rate rise was likely to coincide with the next inflation report in November 2017. That is exactly what has happened, a 65% chance of a 0.25% rise in bank rate is now priced in for November; it is fully priced in before next March 2018.

"Sterling jumped in response, by over 1% against all major currencies and may rise further. Yields on gilt-edged securities increased across the curve by up to 0.1% for shorter maturities and 0.05% at the long and ultra-long end.

"To some extent a rate rise would merely reverse the Bank Rate cut implemented just over a year ago in response to fears that the Brexit referendum would precipitate a recession in the UK, fears that have not been realised, at least in part because of the BoE's actions. But yesterday's announcement also reflects a move towards monetary tightening in other countries. Mark Carney's previous employer, the Bank of Canada, recently raised interest rates and gave a hawkish signal that further rises were to come. The US Federal Reserve has been raising rates since December 2016 and has widely trailed a plan to run down their Quantitative Easing (QE) programme. The European Central Bank has removed its easing bias and is expected to announce a tapering of its QE programme. Against this background, the BoE must have feared that maintaining its easy policy would lead to a weaker sterling and prolong the period of above-target inflation, already expected to last over three years.

"This is nonetheless a surprise move. The UK housing market is weak, Brexit uncertainties are weighing on investment and the Budget is just a few weeks away. Three members of the BoE's MPC did vote for a rate rise in June 2017, but one of those recently stood down and the other two were external members. Yesterday's decision shows that a majority of the MPC expect to raise rates soon.

"Where do we go from here you may ask? The BoE itself says it expects the path of rate rises to be slow and gradual. Much will depend on how markets react at home and abroad. Sterling's rise will dampen inflation. Higher mortgage rates will further depress the housing markets and consumer spending. But if the world economy remains firm and other central banks continue to tighten policy, rates in the UK will continue to rise."

BMO Global Asset Management