

December 18, 2024

## BoE Struggles for Pivot Opening

### “Activism” to kick in if hard wage and price turn south today

- BoE waiting for employment and wage confirmation before easing
- Dovish tilt possible as multiple constraints bear on economy
- Terminal pricing starting to backload easing

### MPC to hold the line as wages and inflation remain stubborn

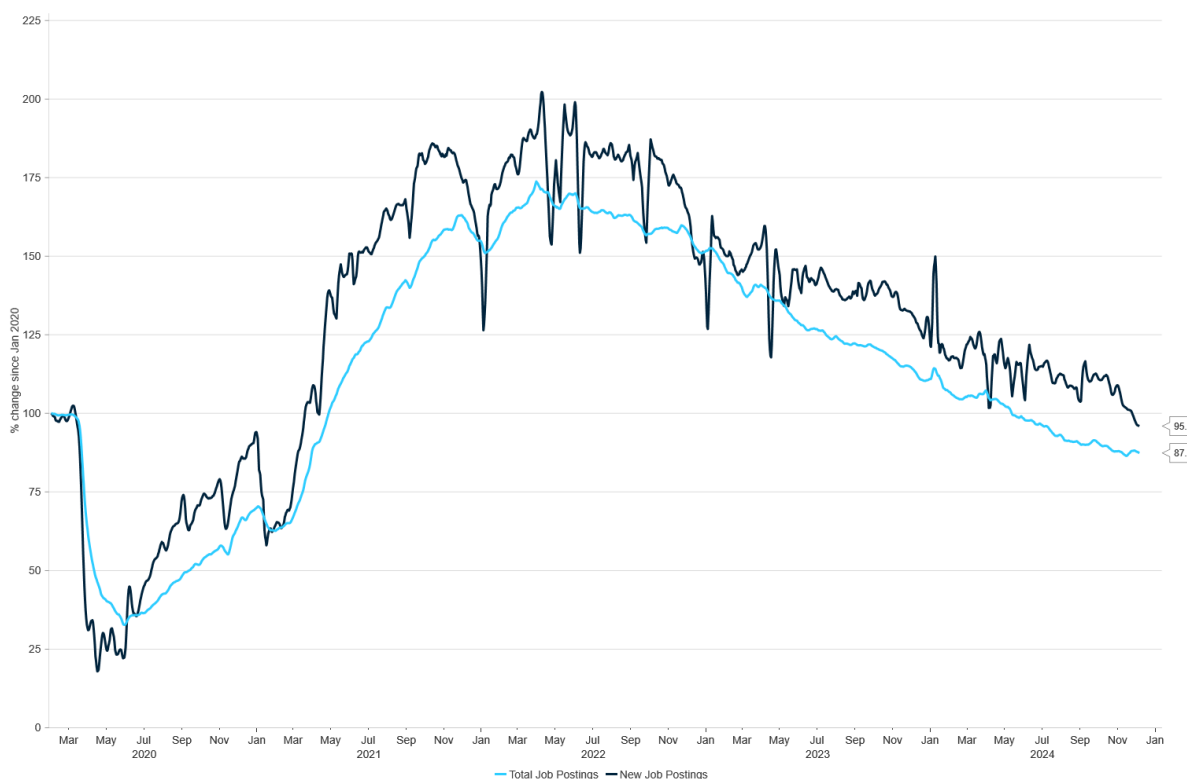
Any lingering hopes for the Bank of England (BoE) to even think about a pivot towards Governor Bailey’s dovish definition of “activist policy” this week were dashed by the labour market report. Today’s inflation numbers will probably not provide enough relief either. Despite the severe reservations of various Monetary Policy Committee (MPC) members about the quality of the labour market survey, it is evident that wage growth is still running well above target, irrespective of what other indicators may suggest. To repeat the phrasing used in the November statement, “[d]ata are difficult to interpret and wage growth has been more elevated than usual relationships would predict.” The word “elevated” itself points to upside risk to inflation and until there is data confidence (from whichever source) of earnings moving in the other direction, the MPC would need to maintain “restrictive” settings.

We agree with Governor Bailey’s assertion that 25bp per quarter in rate cuts from the BoE is the best path forward for the economy. However, the market is currently struggling with the balance of risks due to data challenges. Until the labour market report yesterday, the bias was towards more of a dovish pivot which, given his comments surrounding “activist policy” (implying faster cuts), would have been the preference of Governor Bailey. The past two GDP prints point to the risk of a sharp slowdown in economic momentum towards year-end, especially as the core services side of the economy has barely grown over the past six

months.

Meanwhile, “soft data” is proving inconsistent: services PMIs indicate a declining pace of expansion while manufacturing continues to contract. High-frequency data surrounding new and existing job openings (Exhibit #1) also point to sustained declines in labour demand, which supports the BoE’s agents reports, pointing to further easing in recruitment difficulties. The Labour Force Survey (LFS) notes that total vacancies remain 2.9% above pre-pandemic levels (vs. 13% in high-frequency numbers), but they have fallen by 14.3% from last year. Taking the LFS at face value, the direction of the labour market is clear and continues to support an easing path, but there will be lack of consensus over the pace of declines and the severity of the current situation. Given the traditional labour supply dynamics in the UK, we suspect the MPC will continue to err on the side of “less negativity,” which supports the view on wage growth elevation as noted in the policy statement.

### Exhibit #1: Openings Now Below Pre-Pandemic Levels



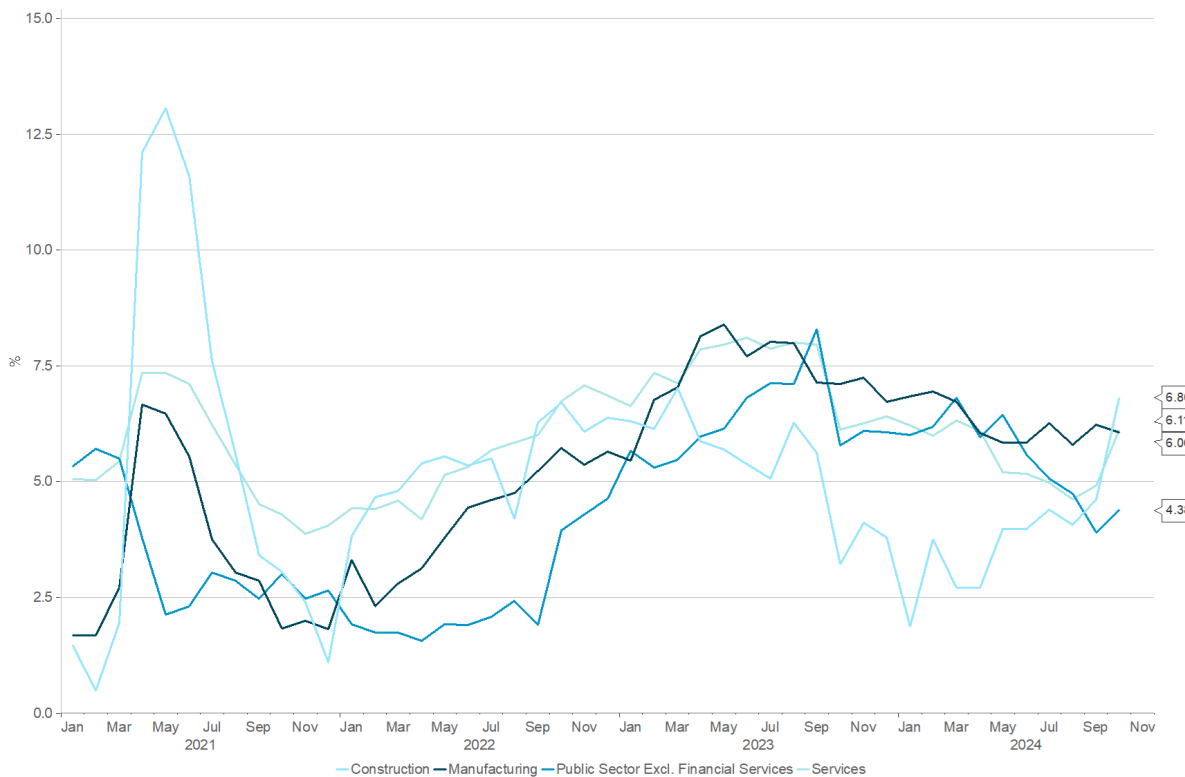
Source: Macrobond, BNY

The decomposition of wage growth (Exhibit #2) is equally problematic for the BoE. Services wage growth is now back above 6%/y/y in six months and sequential growth remains robust. There was an even stronger rise in construction wages, which supports the criticism of government household building plans as the country simply does not have the labour force in place to meet current targets. At 6.80%/y/y, this sector – which is generally considered to have

relatively poor productivity – is now back at the highs seen in 2022. Based on the Purchasing Manager Indices (PMIs), the construction sector is by far the most expansionary in the country, suggesting that demand is only going to increase and further strengthen the bargaining power of labour.

On the other hand, even though the LFS highlighted ongoing strength in public services employment, with “central government employment” approaching 4 million (+3.96%/y/y), wage growth in the public sector is now the lowest of the key segments at just above 4%/y/y. New pay settlements will continue to make their way through the economy in the coming months, but the MPC will hope that the government exercises greater restraint up ahead as the prime minister and chancellor will most likely attempt to avoid further tax increases in the spring Fiscal Statement, (confirmed for March 26 next year).

### Exhibit #2: Wages Risk Rebounding

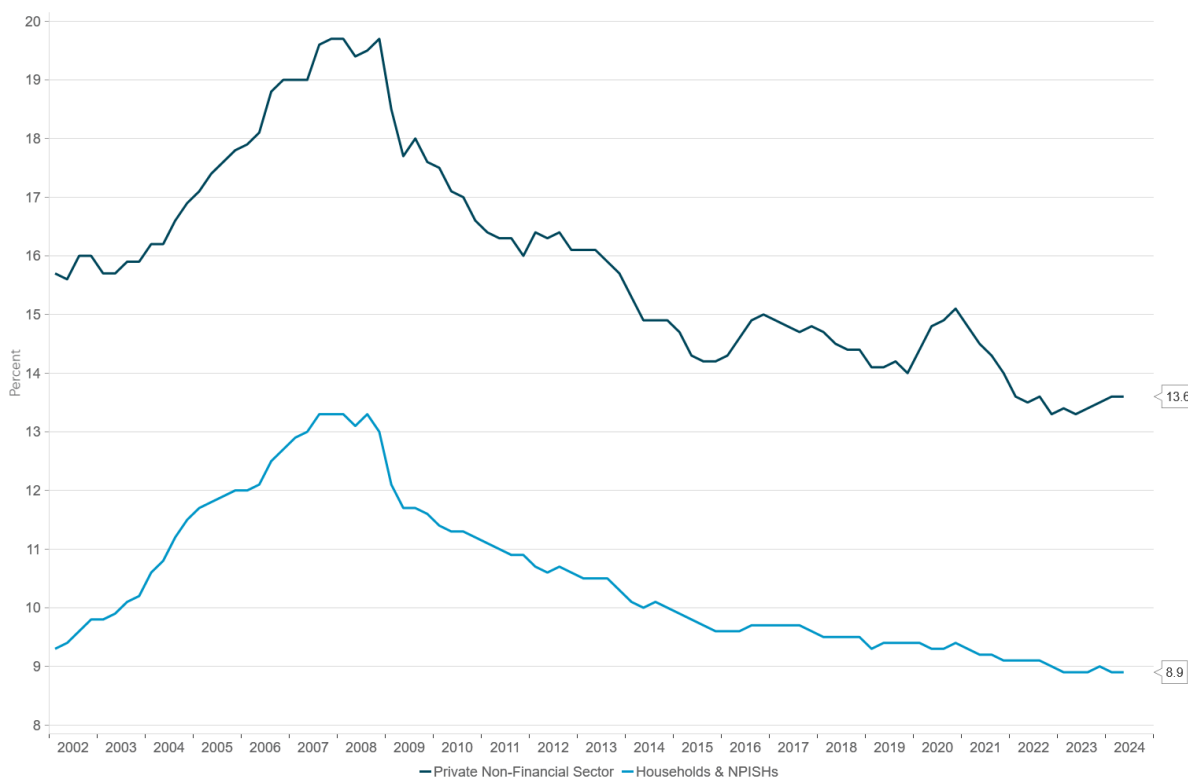


Source: Macrobond, BNY

Another reason for the BoE to have some confidence in softer demand next year is that restrictive monetary policy, perhaps coupled with fiscal adjustments, is finally starting to have an impact on disposable income. One of the biggest surprises in the UK and US over the recent business cycle which has kept rates higher for longer, is that despite relatively higher levels of household debt in absolute terms, debt servicing costs have generally been falling. This was particularly acute in the UK as the putative “mortgage cliff,” whereby mortgage

holders moved onto higher rates after fixing at the lows during the pandemic, did not generate any rise in debt servicing costs (Exhibit #3), measured as a share of household disposable income. This is because nominal and real income growth increased at a fast enough pace to offset higher servicing costs. There are initial signs, however, that the declines in such costs have stopped, while financing for corporates has rebounded. As UK mortgages and other shorter-duration credit facilities are linked to swap rates, BoE guidance has ensured that swap rate levels have not fallen in line with expectations. The hope up ahead is that wage growth moderates relative to debt servicing costs and generate incremental restraint on the economy. Once the impact is apparent the MPC can then choose to cut rates more assertively.

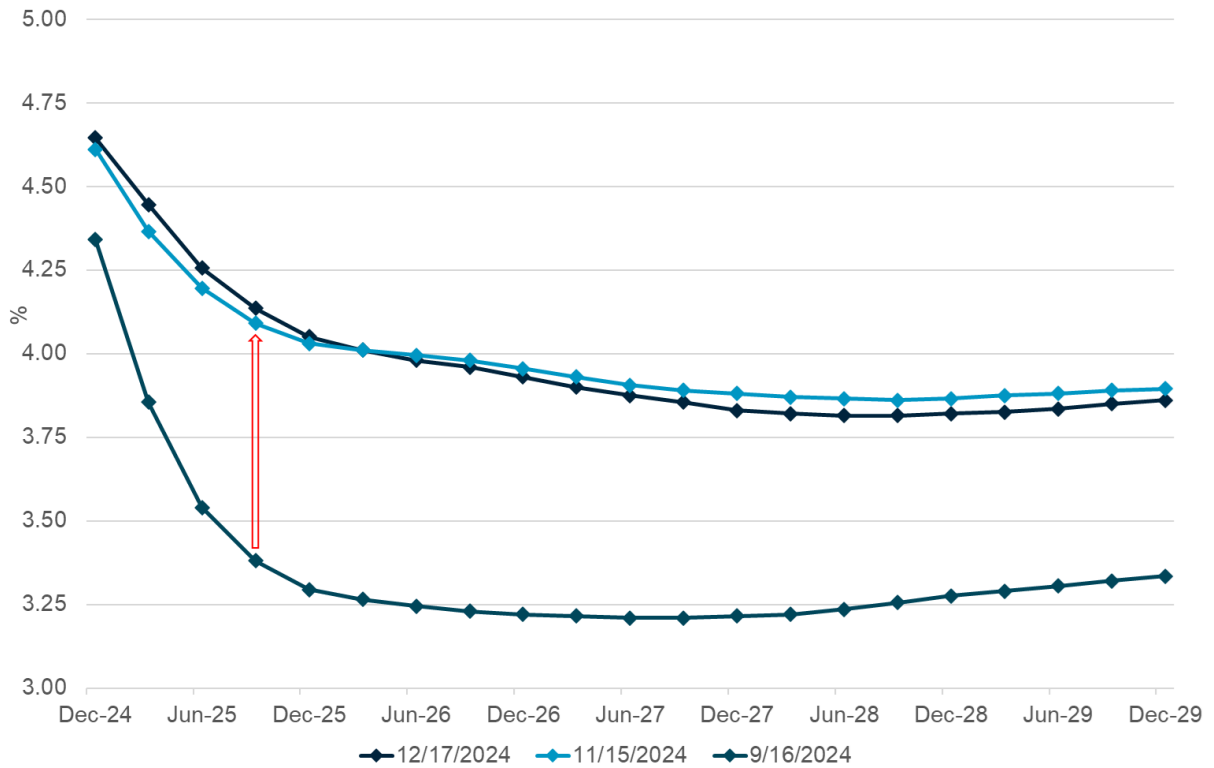
**Exhibit #3: Debt Servicing Edging up for Households**



Source: Macrobond, BNY

Market pricing is now moving in this direction in the wake of the labour market report (Exhibit #4). The more significant repricing occurred over the past three months as cuts were aggressively priced out. The main shift over the past month, however marginal, points to cuts being more backloaded though terminal levels are still in the 3.75%-4% range, which is far higher than countries with similar growth profiles. That is probably a debate for next year as the data simply refuse to provide any opening for an acceleration in the cycle.

**Exhibit #4: SONIA Backloading Cuts**



Source: Bloomberg, BNY

Please direct questions or comments to: [iflow@bny.com](mailto:iflow@bny.com)

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