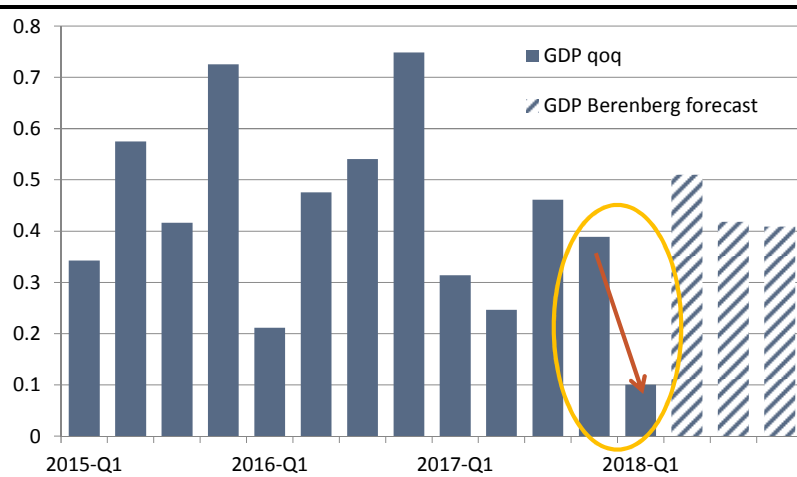


27 April 2018

BoE likely to delay next rate hike after soft Q1

UK real GDP growth (qoq %)



Real GDP growth quarter-on-quarter, in % . Source: ONS

- GDP growth slowdown puts BoE in “wait and see” mode:** UK real GDP expanded by 0.1% qoq in Q1, down from 0.4% in Q4 (see chart). This was well below our and the market’s expectations of 0.3%. According to the Office of National Statistics (ONS) the negative impact of the weather may have been smaller than expected ahead of the data release. Apart from some recorded impacts in construction and retail, the ONS said the overall weather effects were “generally small”. Because a good part of the weakness could be due to a genuine softening in underlying momentum, the typically cautious BoE will probably pass on the opportunity to hike its policy rate in May.
- Broad-based softness in Q1:** Domestic-orientated services expanded by 0.3% qoq. Industrial production increased by 0.7%, with growth of 0.2% in manufacturing. Construction contracted for the fourth quarter in a row (3.3% qoq). The declines in the construction sector alone (c6% of GDP) subtracted 0.2ppt from headline growth.
- Take the Q1 data with a pinch of salt:** Firstly, the initial estimate of GDP is based on c45% of data for the period and is thus prone to revision; secondly, in Q4 2010 when the UK’s economic activity was hit by a lengthy period of bad weather, the ONS initially estimated that real GDP contracted by 0.5% qoq, only to revise it up to a small expansion of 0.1% thereafter; and thirdly, the ONS may be wrestling with some seasonality issues. For the past three years, data for Q1 has usually been weaker than the average for the year. Growth tends to accelerate over the course of the year. Excluding 2018, average qoq growth rates since 2015 are: Q1 0.29%, Q2 0.43%, Q3 0.47%, and Q4 0.62%.
- Expect a modest rebound in Q2:** The softer-than-expected Q1 performance fits in line with the broader trends across Europe of a loss of momentum in Q1, driven by the bad weather and a correction in confidence data linked to the trade war threat. Commonly, the negative weather impact on a quarter is offset the following quarter as households and firms play catch-up. If the US and EU can defuse their current trade spats, probably with some EU concessions, this would strengthen our call that China and the US can also avoid a tit-for-tat escalation. This should help confidence rebound in Q2. In line with a modest acceleration across Europe, we expect the UK quarterly growth rate to rebound to 0.5% in Q2 before stabilising at c0.4% qoq in H2 2018.
- Wait until November for the next rate hike:** Resilient domestic demand, tight labour markets, and healthy external demand should give the BoE enough confidence to conclude that the soft Q1 was just a blip and remain on course for a gradual policy tightening over the medium term. However, the BoE will likely need to clear evidence of a sustained rebound in the GDP growth rate before hiking again. We thus now expect only one hike in 2018, down from two before. We remove our call for a hike in May 2018 but still expect a hike at the November 2018 Inflation Report, followed by two more hikes in 2019. This would take the bank rate to 1.25% by the end of 2019. If GDP growth and wage growth surprises on the upside in Q2, an August hike could come into play.

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