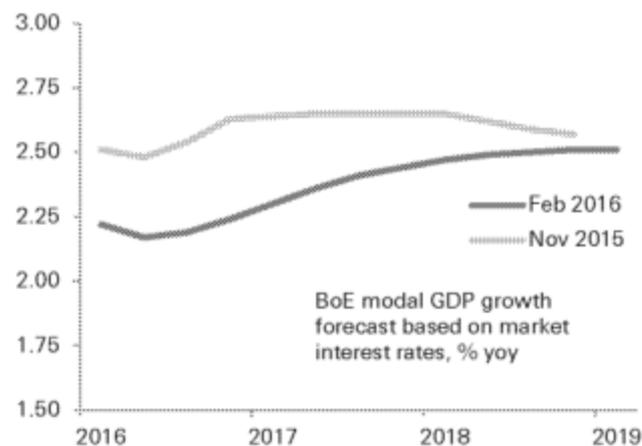




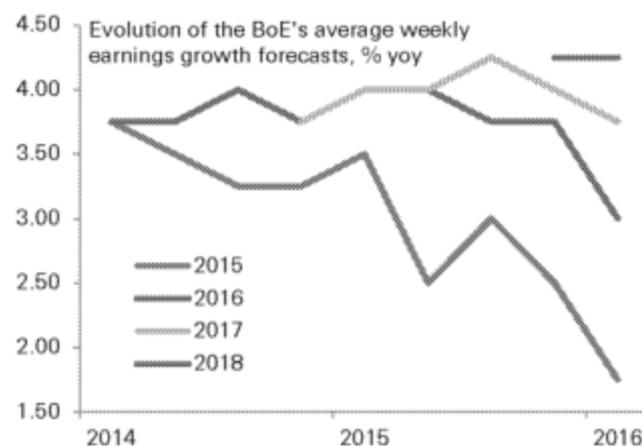
and a resilient financial system. Indeed, in comments to Radio 5's *Wake Up To Money* programme BoE Deputy Governor Broadbent said that it was important not to over-emphasise the reduction in the Bank's growth forecasts which he described as not being a large revision; rather, he focused on the supportive fall in oil prices and continued expectations for robust growth in Europe.

Figure 3: Near-term growth revised down by up to 0.4pp



Source: Deutsche Bank, Bank of England

Figure 4: Wage growth has disappointed



Source: Deutsche Bank, Bank of England

The explanation behind the fact that a weaker economic growth forecast did not generate a fall in inflation below the 2% target 2-3Y hence was that the Bank simultaneously lowered its view on demand and supply growth. The weaker supply story was in part related to lower average hours which the Bank now expects because workers are more confident in taking annual leave given strong real wage growth and increased job security.

In terms of the Bank's other conditioning forecasts, it is worth focusing on the household sector. Consumer spending growth was revised down this year and next, the result of weaker incomes. Indeed, both average weekly earnings and real post-tax income growth were seen as weaker relative to three months ago, which explains why it takes an even larger fall in the saving ratio on the BoE's forecasts (to 2.5% on average in 2017-18) in order to achieve a slower rate of consumer spending growth. This contrasts with the OBR's November 2015 forecast for the saving ratio during the same period of 4.4%, nearly 2pp higher than that of the Bank of England.

Figure 4 shows the evolution of the Bank of England's forecasts for average weekly earnings growth. The scale of revisions to expectations has been sizable, partly reflecting weaker productivity during recent years (which the Bank expects to return to more normal rates) but also to some extent past weakness in inflation. While nominal wage growth in 2015 has surprised on the downside by 200bps relative to what was expected two years ago, the decline in expectations for CPI inflation over the same period has been similar (around 170bps for the year). In other words, real wage growth last year did not disappoint that much relative to BoE expectations made in early 2014.

What are the implications for monetary policy? Interest rate markets (SONIA) are currently pricing in a 40% risk of a 25bps rate cut by year-end, while 3m LIBOR futures rates are not pricing in a rise in rates until the very end of 2017/early 2018. Our view is for a rate rise in November – we pushed this back last month from our previous view of May. With question marks over global growth and emerging economy threats to fragile financial markets, the risks to our rate hike view remain for a delay. However, if the BoE's forecasts prove right – resilient domestic demand, rising inflation and wage growth – then that could yet be consistent with increasing rates later this year.