

14 July 2016

Bank of England Review

Unexpectedly on hold but preannounced easing in August

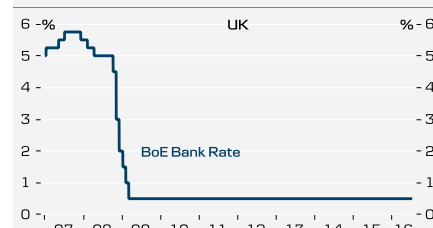
Against our expectation, the Bank of England (BoE) maintained the Bank Rate at 0.50%. Given BoE Governor Mark Carney's very dovish speech two weeks ago in which he said that 'some monetary policy easing will likely be required over the summer' due to a deterioration in the economic outlook, we expected a 25bp rate cut today in line with market pricing. One member of the Monetary Policy Committee, Gertjan Vlieghe, voted for an immediate cut. As widely expected, the stock of purchased assets was unchanged at GBP375bn (vote count 9-0).

While the Bank of England did not ease monetary policy today, it preannounced easing at the next meeting on 4 August, as the minutes state that 'most members of the Committee expected monetary policy to be loosened in August'. The reason is that there are 'preliminary signs that the result has affected sentiment among households and companies with sharp falls in some measures of business and consumer confidence'. The BoE plans to publish its new economic forecasts in the next Inflation Report in connection with the August meeting. We continue to expect it to cut rates down to 0.00% and possibly ease using unconventional tools as well in August but given today's announcement, we believe the risk is the BoE will ease less aggressively, e.g. by cutting only 25bp. If it does not lower the Bank Rate to 0.00% in August, we believe it will do so eventually, as we expect the UK to fall into recession in H2 16. In connection with the May meeting, Mark Carney agreed with this, as he said the UK would probably face a recession in the short term in the case of Brexit (see [Bank of England Review](#), 12 May). MPC members Andy Haldane and Martin Weale are both scheduled to speak in the coming week.

With a full 25bp cut priced in interest rate derivatives markets for today's meeting, the GBP naturally saw an initial knee-jerk reaction higher before losing some of the gains as the outlook for more BoE easing remains (see above). According to our models, the moves in both EUR/GBP and GBP/USD seem fair from a statistical perspective. Going forward, the greatest source of volatility related to the GBP remains the significant UK current account deficit of roughly 5% of GDP. As we expect uncertainty on UK FDI and portfolio flows to remain a key theme in FX markets, we expect balance of payment flows to constitute GBP negatives. Also, while market pricing – even after today's surprise move – remains aggressive (34bp worth of cuts accumulated for H2 16) more BoE easing would also weigh on the GBP. Longer term, we expect the GBP to stabilise on the back of valuation and a narrower current account deficit.

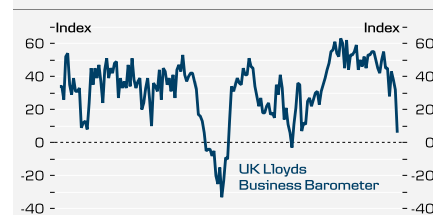
We still forecast EUR/GBP at 0.86 in 1M, 0.88 in 3M, 0.90 in 6M and 0.88 in 12M.

Bank of England stayed on hold



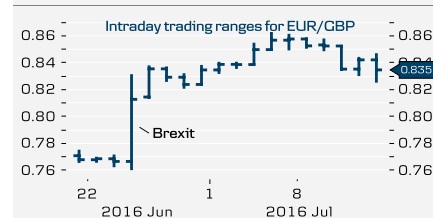
Source: Bank of England

Early signs UK economy is slowing further but BoE waits for additional data



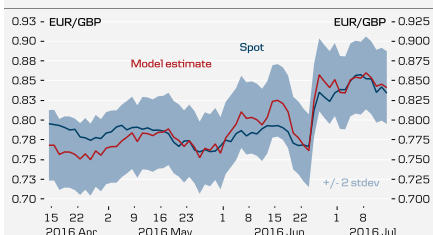
Source: Bloomberg, Lloyds Bank

GBP has lost some of the initial gains from the initial knee-jerk reaction



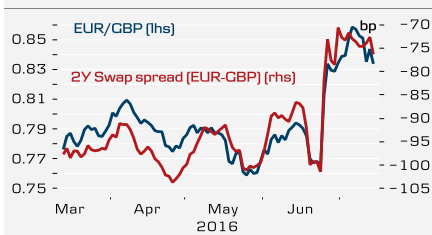
Source: Bloomberg, Danske Bank Markets

GBP spike seems fair from a historical/statistical perspective



Source: Macrobond Financial, Danske Bank Markets

BoE monetary policy remains a key driver for the GBP



Source: Macrobond Financial, Danske Bank Markets

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Disclosures

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Expected updates

None.

Date of first publication

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