

Bank of England Review

BoE on hold and keeps neutral stance

Senior Analyst

Mikael Olai Milhøj

+45 45 12 76 07

milh@danskebank.com

15 December 2016

Investment Research

www.danskemarketsecurities.com

Important disclosures and certifications are contained from page 10 of this report

BoE set to remain on hold for the next 12 months

- **As we expected, the Bank of England (BoE) left monetary policy unchanged at its December meeting.** It kept the Bank Rate at 0.25%, while it left the targets for the stock of government bond purchases (APF) and the stock of corporate bond purchases (CBPS) at GBP435bn and GBP10bn, respectively. It made no changes to the new Term Funding Scheme (TFS).
- **The BoE maintained its neutral stance, as it can move *'in either direction'*,** which was also as expected. This said, the BoE noted that the effective GBP has appreciated by around 6% since the November meeting, implying a slightly lower inflation path compared with the November Inflation Report. This also means the BoE has less reason to hike.
- **We expect the BoE to remain on hold for the next 12 months.** While we think it is unlikely the BoE will tighten monetary policy in a time of elevated political uncertainty, we think we need to see slower growth and/or higher unemployment before easing becomes likely again.
- **We think the markets price the BoE too hawkishly, as they price the first full BoE hike around October 2018.** More than two hikes are priced in by year-end 2019.
- **Notice that the BoE reaction function has changed since the financial crisis, so the BoE puts more weight on growth/unemployment relative to inflation** (see also a speech by former Monetary Policy Committee member Martin Weale [here](#), 18 July). In our view, the BoE seems to be more worried about slower growth than too-high inflation if this is only temporary.

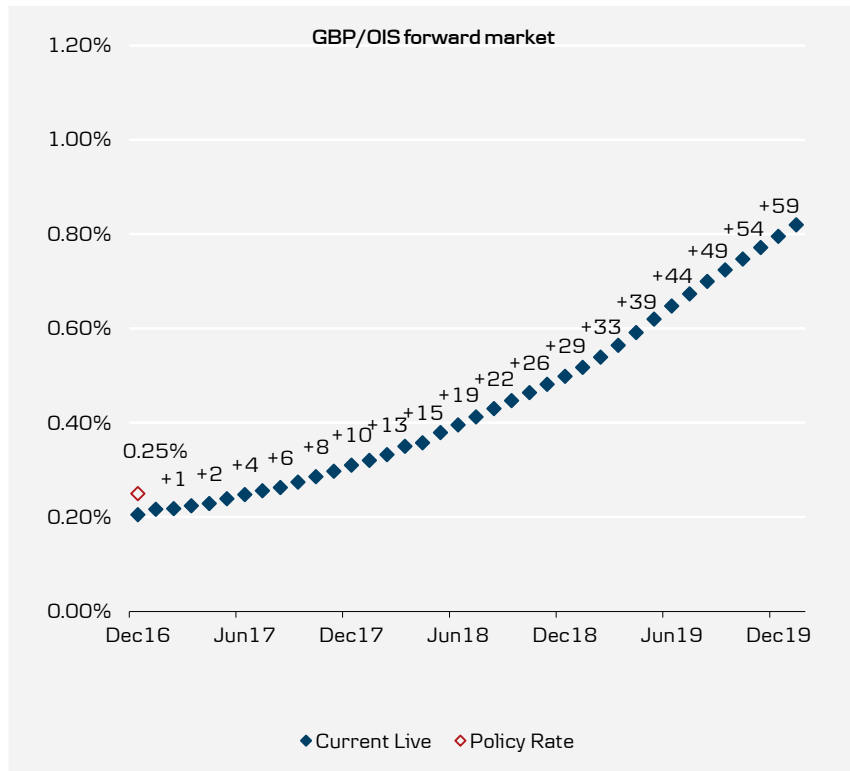
Takeaways from summary

Subject	Comments
Growth	'Output was expected to <u>grow at a moderate pace in the near term</u> , but <u>slow from the beginning of next year</u> .'
Labour market	'The <u>unemployment rate was projected to rise</u> to around 5.5% by the middle of 2018 [...] in the latest November Inflation Report.'
Inflation	'[...] <u>slightly lower path for inflation</u> than envisaged in the November Inflation Report' due to GBP appreciation;' <u>inflation still likely to overshoot the target</u> '
Inflation expectations	Monitors inflation expectations 'closely' as 'there are <u>limits to the extent to which above-target inflation can be tolerated</u> '
Global economy	' <u>slightly greater momentum</u> in the global economy' but 'the <u>global outlook has become more fragile</u> with risks in China, the euro area and some emerging markets and an <u>increase in policy uncertainty</u> '.
Policy bias	<u>Monetary policy can respond, in either direction</u> , to changes to the economic outlook [...]'

Source: Bank of England

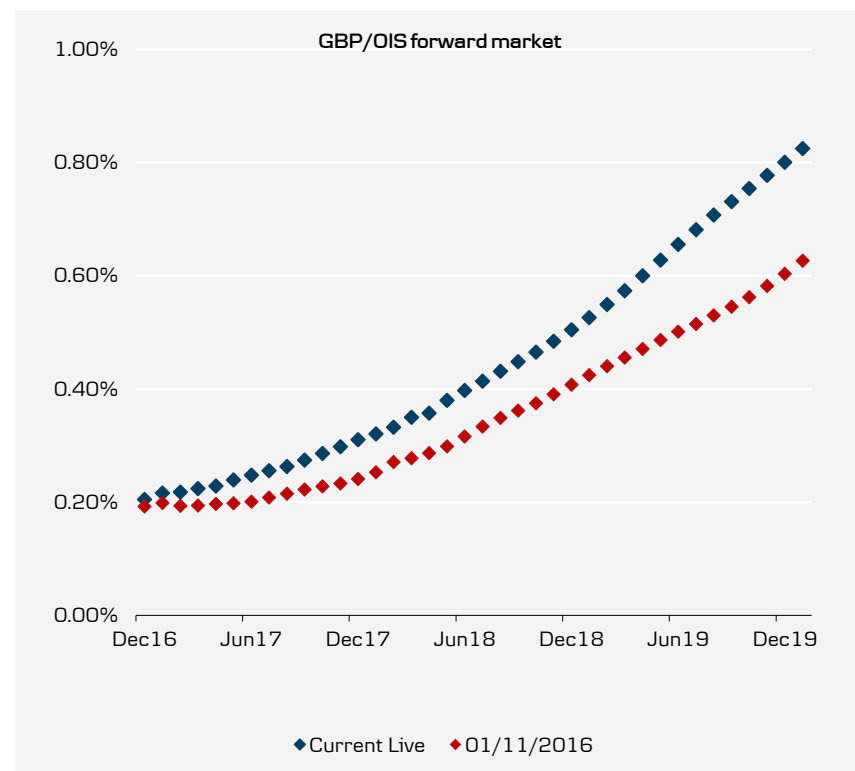
BoE is priced way too hawkishly, in our view

First full BoE hike priced in Autumn 2018



Source: Danske Bank

Significantly repricing of BoE lately

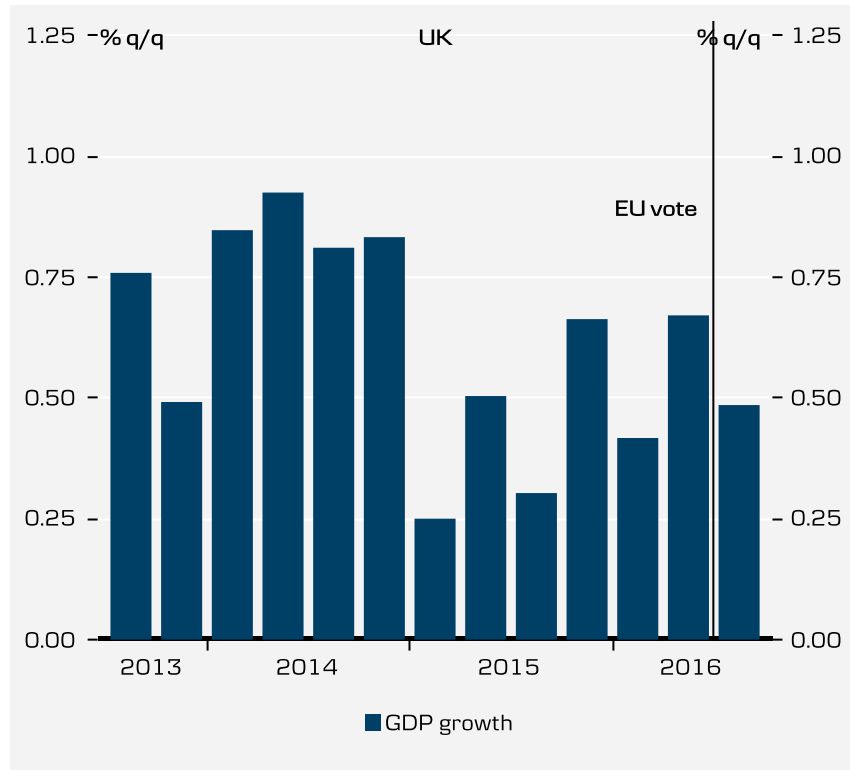


Source: Danske Bank

Macro charts

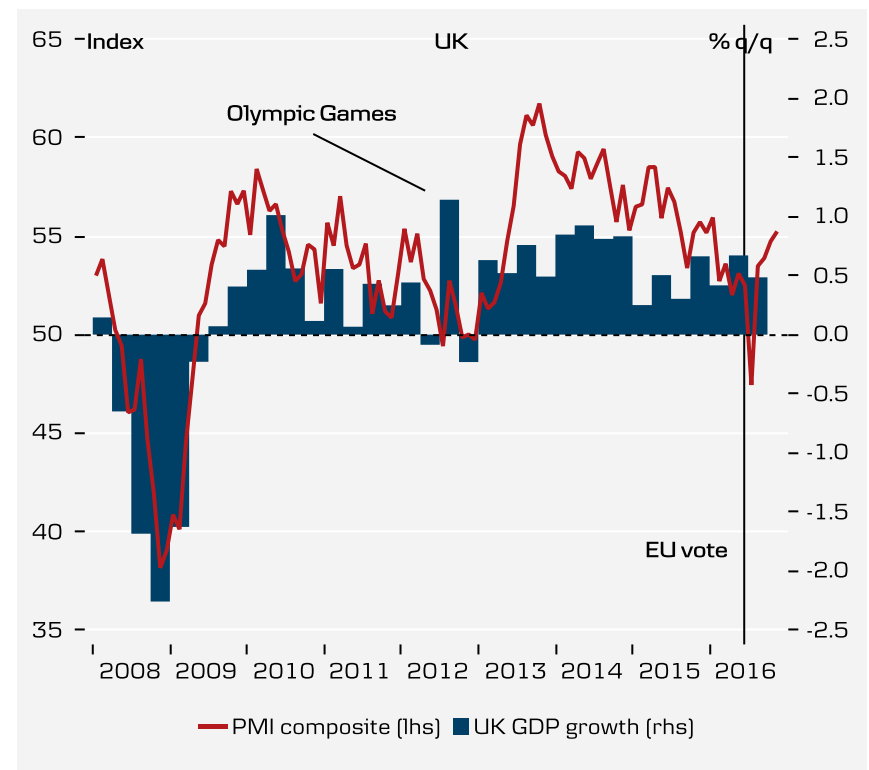
GDP growth has been resilient to Brexit uncertainties

GDP growth was resilient in Q3



Source: ONS

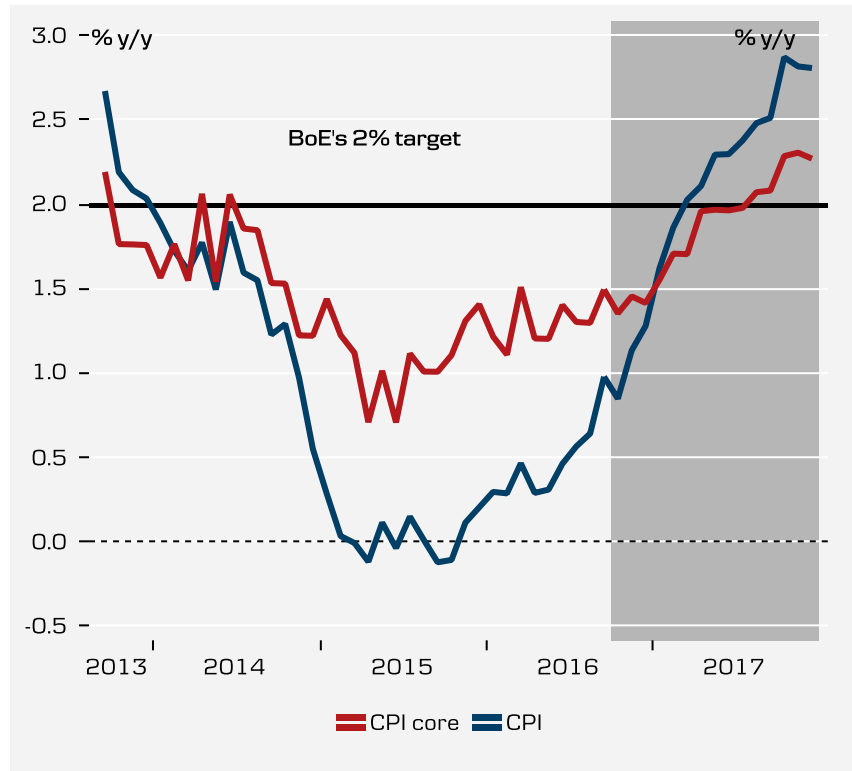
PMI's suggest growth continued around 0.5% in Q4



Source: ONS, Markit Economics

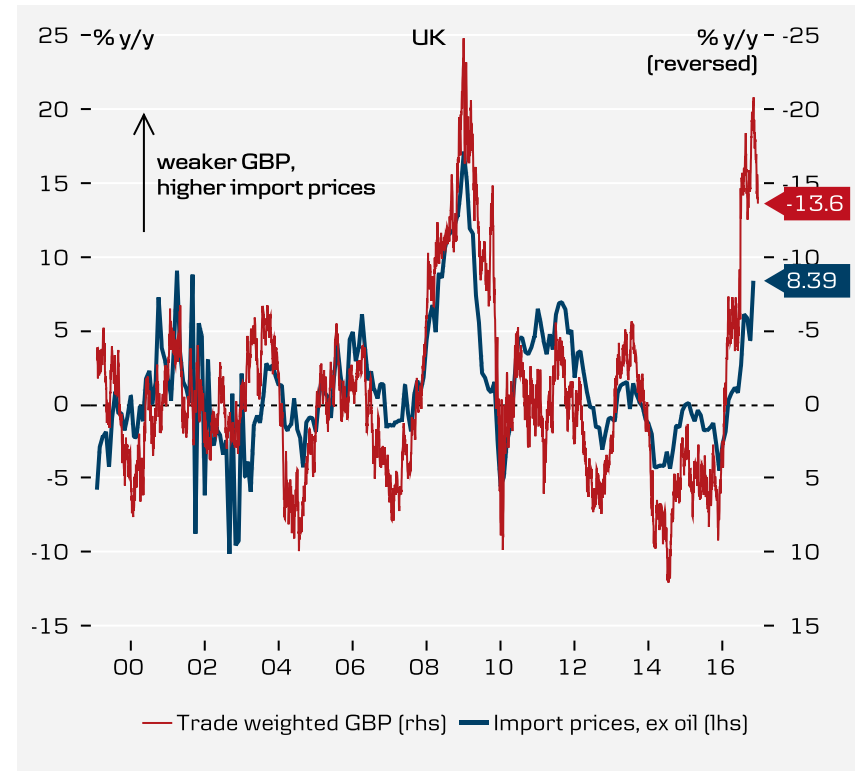
Inflation expected to rise supported by weak GBP

CPI inflation set to increase to close to 3%



Source: ONS, Danske Bank

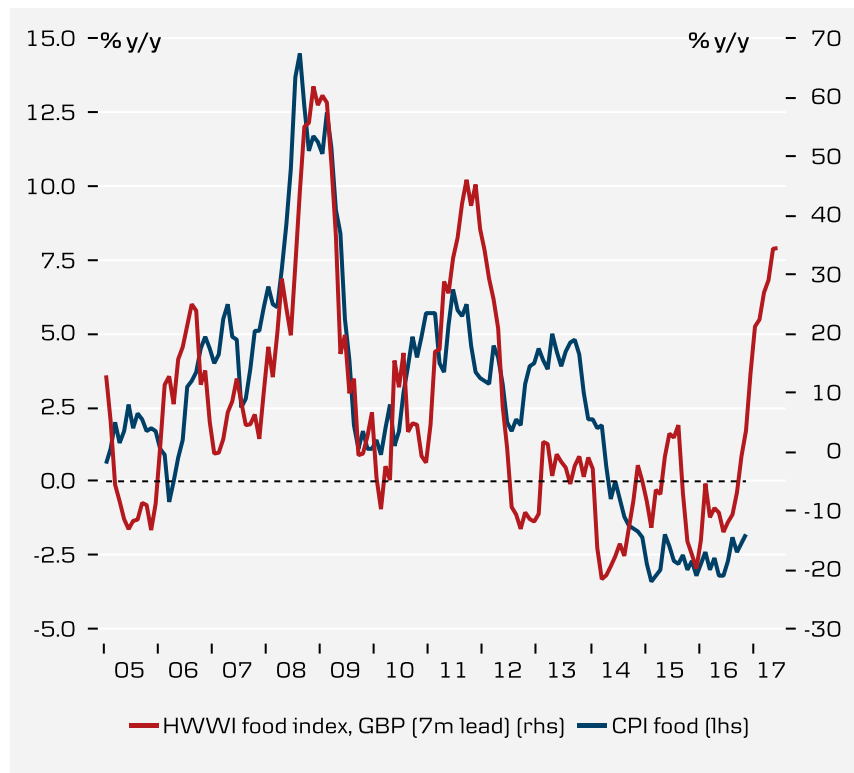
Weaker GBP implies higher import prices



Source: ONS, Bank of England

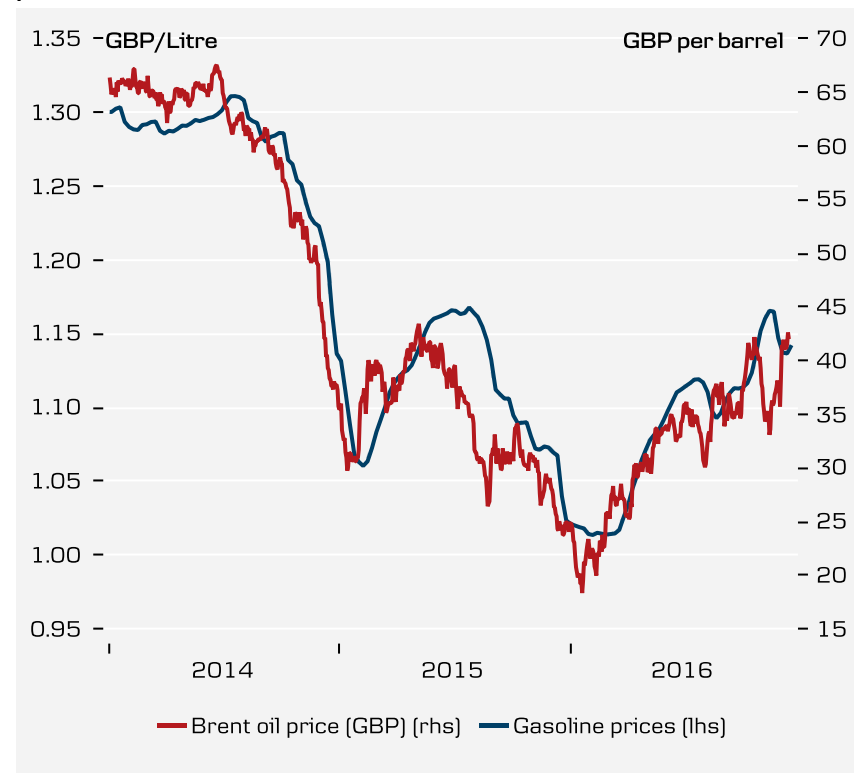
Weaker GBP also pushes up food and energy prices

Food prices set to increase sharply due to weaker GBP



Source: ONS, Bloomberg

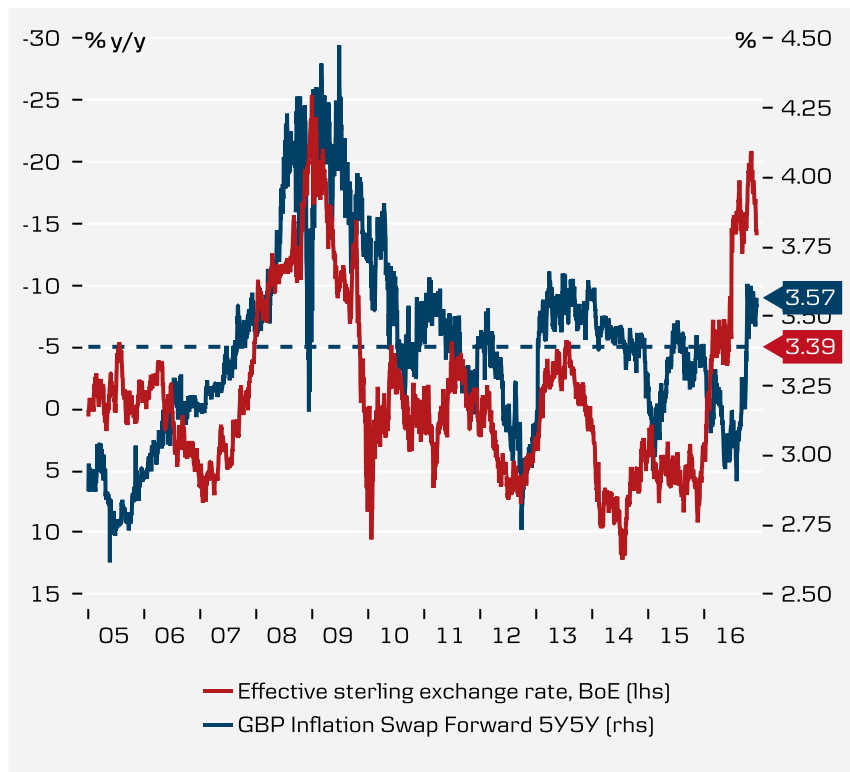
Higher oil price in GBP => higher gasoline prices



Source: Bloomberg, UK Government

Inflation expectations have rebounded

Inflation expectations have risen in recent months



Source: Bank of England, Bloomberg

Disclosures

This research report has been prepared by Danske Research, a division of Danske Bank A/S ('Danske Bank'). The author of this research report is Mikael Olai Milhøj, Senior Analyst.

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and subject to regulation by the Danish Financial Supervisory Authority and is subject to the rules and regulation of the relevant regulators in all other jurisdictions where it conducts business. Danske Bank is subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority (UK). Details on the extent of the regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from Danske Bank on request.

Danske Bank's research reports are prepared in accordance with the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from and do not report to other business areas within Danske Bank. Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank Markets (a division of Danske Bank A/S). It is provided for informational purposes only. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

The research report has been prepared independently and solely on the basis of publicly available information that Danske Bank considers to be reliable. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and Danske Bank, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts responsible for the research report and reflect their judgement as of the date hereof. These opinions are subject to change and Danske Bank does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom or the United States.

This research report is protected by copyright and is intended solely for the designated addressee. It may not be reproduced or distributed, in whole or in part, by any recipient for any purpose without Danske Bank's prior written consent.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/S, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank who have prepared this research report are not registered or qualified as research analysts with the NYSE or FINRA but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.