15 September 2016

Bank of England Review

Another rate cut later this year is a close call as near-term indicators have been better than expected

- **Today, the BoE kept its monetary policy unchanged as expected.**
- **The BoE left the door open for more easing later this year if data meet expectations of the August projections. However, the BoE signals that the probability has declined, as near-term indicators have been better than expected.**
- **We expect the BoE to cut by 15bp from 0.25% to 0.10% in November, but it is a close call and will be data-dependent.**
- **Market is currently pricing in a 6bp rate cut at the November meeting and 11bp in total in a year's time.**
- **We expect EUR/GBP to trade higher in coming months due to BoE easing, the large current account deficit and political uncertainty.**

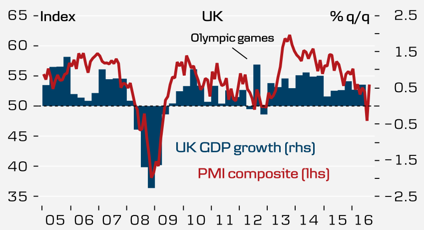
As expected, the Bank of England (BoE) kept its monetary policy unchanged after the launch of the big easing package in early August: Bank Rate was kept at 0.25%, the target for the stock of government bond purchases and the target for the stock of corporate bond purchases were kept at GBP435bn and GBP10bn, respectively, and there were no changes to the new Term Funding Scheme (TFS). As this was one of the 'small' meetings without updated economic projections and a press conference, the focus was on the minutes.

As expected, the minutes showed that the BoE is still on an easing bias although it recognises that *'near-term economic activity has been somewhat stronger than expected'* (see also our *Post-Brexit Status presentation* for illustrative charts, 13 September). The BoE now expects Q3 GDP growth of 0.2-0.3% q/q compared to 0.0-0.1% q/q previously. Most importantly the minutes repeated that *'a majority of members expected to support a further cut in Bank Rate'* if the updated projections in November are broadly consistent with the August projections. Overall, the BoE left the door open for more easing later this year but is signalling that the probability has declined.

We maintain our view that the BoE will cut the Bank Rate by 15bp from 0.25% to 0.10% in November, but it is a close call and will largely depend on economic data in the coming months. It is noteworthy that the BoE focuses on activity indicators and not inflation as it accepts that inflation may overshoot target to support economic activity in coming years. The market is currently pricing in a 6bp rate cut at the November meeting and 11bp in total in a year's time.

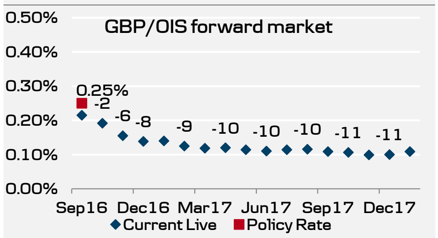
We still expect EUR/GBP to trade higher in the coming months. Our forecast of a weaker GBP is driven not only by BoE easing but also by the considerable imbalances in the UK economy, not least the significant current account deficit. In addition, net foreign debt accumulated through several years of current account deficits has made the GBP very fragile. The political uncertainty stemming from the forthcoming Brexit-negotiations will also weigh on GBP.

BoE keeps easing bias despite near-term indicators being better than expected



Source: Markit Economics, ONS

Market's pricing of Bank of England



Source: Danske Bank Markets

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None.

Date of first publication

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