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BOE PREVIEW: SITTING TIGHT AMID POLITICAL UNCERTAINTIES

Berenberg Macro Flash

Wait and see mode

The upcoming general election on 12 December has added to the fog of political uncertainty already hanging over the UK economy because of Brexit. With economic momentum subdued, and no immediate inflation risks to contend with, expect the BoE's nine member Monetary Policy Committee (MPC) to keep policy on hold at its meeting on Thursday. We expect the MPC to simply reiterate its previous guidance for gradual rate hikes – eventually - in case of an orderly Brexit. Despite a likely lack of action, we see two good reasons to keep an eye on the BoE the press conference. First, it will probably be Mark Carney's last one as governor of the BoE. He may use the occasion to make a few remarks on the long-run UK economic and policy outlook and, perhaps, even Brexit. Second, it heralds the first 'Monetary Policy Report'. The new report upgrades the old 'Inflation Report' as part of the bank's effort to improve its communications.

Get past the election first

Favourite Boris Johnson (current prime minister) and the Conservative Party plan to deliver an orderly Brexit on 31 January 2020 and enact a fiscal stimulus combining tax cuts and increased spending with pro-growth reform and deregulation if they win the election. This is our base case. In such a scenario, the BoE would need to hike rates to contain the inflation risks from the fiscal stimulus and likely pick-up in demand following the reduced political uncertainty. But elections are unpredictable. The BoE will wait until after the vote before adjusting its forecast or policy setting. The economic and political outlook could change materially if Labour, perhaps combined with the Liberal Democrats, the Scottish National Party (SNP), independents and the Greens wins a majority instead.

Recent economic developments and likely forecast changes

Brexit uncertainty and the global slowdown have weighed heavily on the UK in 2019. After averaging close to the BoE's estimate of trend in 2018 (c1.5% yoy) the annualised quarterly real GDP growth rate averaged just 0.7% in H1 2019. The BoE had projected in August that real GDP would rise by 0.3% qoq in Q3 2019. We estimate that real GDP expanded by 0.2% qoq. Depending on the BoE's Q4 projection, the miss in Q3 may lead to bank to take down its projections for 2019 by 0.1pt. While keeping its inflation forecast broadly unchanged the BoE may nudge up the near-term outlook for the unemployment rate by 0.1pt following the recent uptick from 3.8% to 3.9%.

In its assessment of recent economic conditions the BoE will likely emphasise two developments that matter for the policy outlook: first, the recent appreciation in sterling - after Johnson managed to secure a new Brexit deal - has sharply reduced inflation expectations (Chart 1); second, annual nominal wage growth (now near 4%) continues to accelerate in response to tight labour market conditions (Chart 3). The drop in inflation expectations take some pressure off the BoE to hike soon. However, the strengthening evidence that labour market tightness is generating stronger wage inflation justifies the BoE's hawkish tilt and guidance for rate hikes eventually.

The BoE will likely revise its forecast materially at the next round in February 2020. That would follow the election. We would thus not read too much into any forecast changes on Thursday. Presuming that Johnson wins the election before delivering an orderly Brexit and stimulating the economy with fiscal policy, the BoE will likely upgrade its forecasts significantly early next year. Our own economic projection are conditioned on these key assumptions (Table 1).

More than a facelift

The new 'Monetary Policy Report' will mark a notable change from the old 'Inflation Report', including that: the BoE's analysis of the economic outlook will be brought to the front of the report instead of the back; the analysis of current economic conditions will be shrunk to just one section (four previously); and a new section will be introduced called 'In Focus' which will describe the key issues that have featured in the updated economic projections. Whether this latest step in the BoE's evolving its approach to policy communications makes a positive difference remains to be seen. Exacerbated by Brexit uncertainties, the BoE's own surveys report that a record proportion of households have no idea where interest rates are heading in the next 12 months – Chart 3.

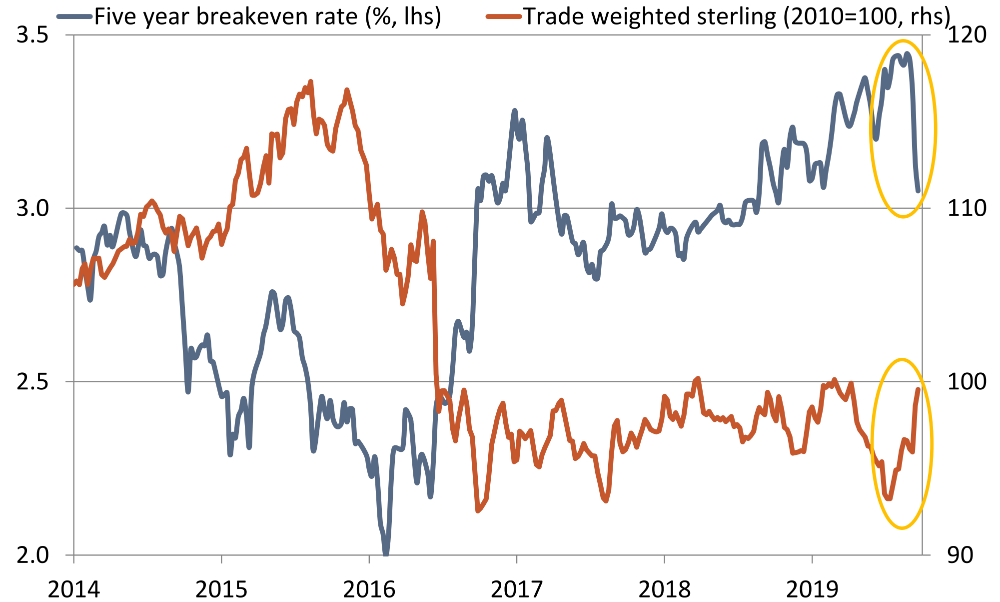
Policy outlook

Expect the MPC to reiterate the guidance from the September meeting that 'in the event of greater clarity that the economy is on a path to a smooth Brexit, and assuming some recovery in global growth....the Committee judges that increases in interest rates, at a gradual pace and to a limited extent, would be appropriate to return inflation sustainably to the 2% target.' If Johnson wins a majority in the election and an orderly Brexit happens on 31 January, we look for the BoE to hike the Bank Rate in Q3 2020 followed by another hike in 2021, by 0.25bp each time. That would take the bank rate to 1.25% by end-2020. Of course, if the election ends in a hung parliament the BoE would change its tune fast and, probably, remain on hold for the foreseeable future.

Table 1: GDP (% yoy)	**2019**	**2020**	**2021**
Bank of England August 2019	1.3	1.3	2.3
Berenberg	1.3	1.8	2.1
Table 2: CPI inflation (% yoy)	**2019**	**2020**	**2021**
Bank of England August 2019	1.6	2.1	2.2
Berenberg	1.9	2.3	2.3
Table 3: LFS unemployment rate (%)	**2019**	**2020**	**2021**
Bank of England August 2019	3.8	3.9	3.6
Berenberg	3.9	3.8	3.7

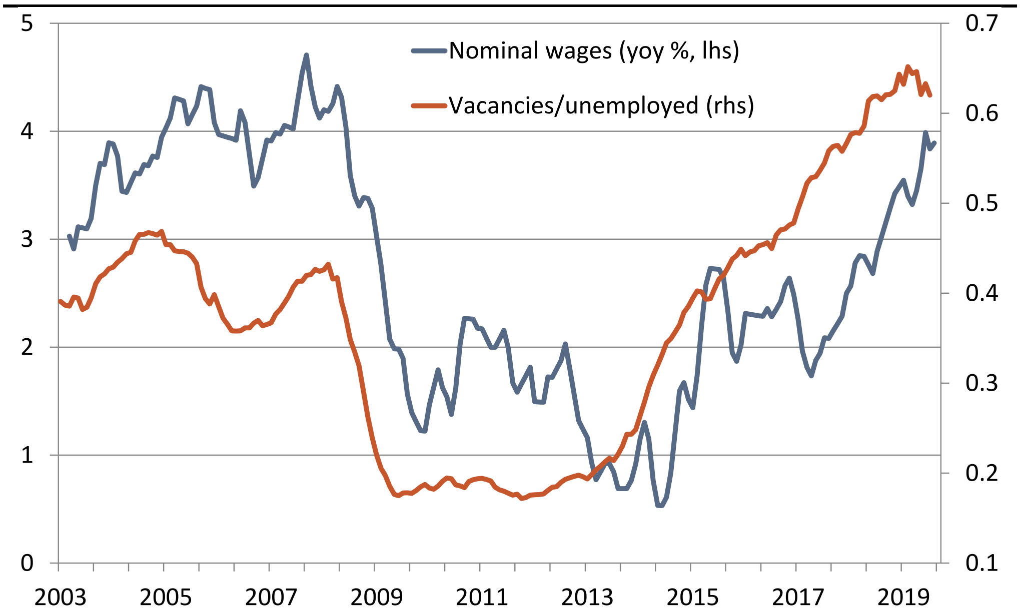
Source: Bank of England, Berenberg.

Chart 1: Sterling versus inflation expectations



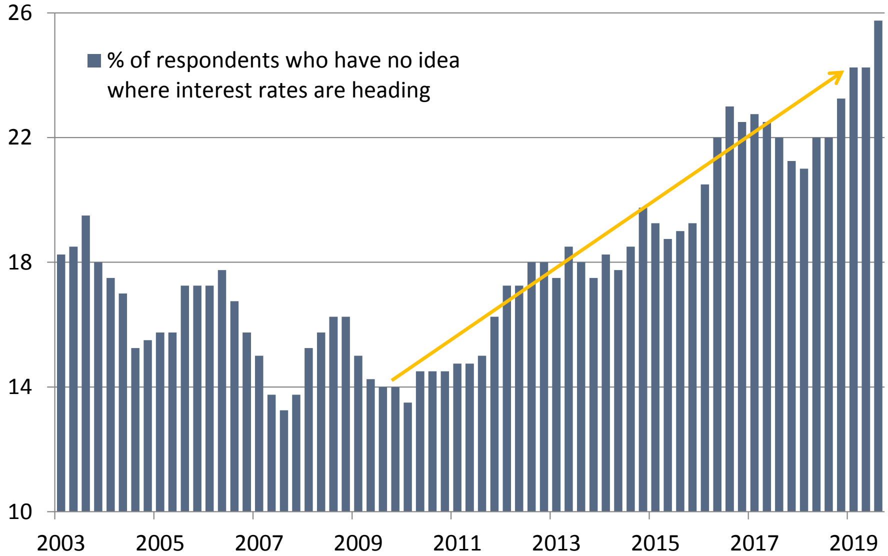
Weekly data. Source: Bank of England, Bank for International Settlements.

Chart 2: Wage growth accelerating amid tight labour markets



Monthly data. Source: Source: ONS, Berenberg calculations.

Chart 3: BoE survey on where interest rates are heading



Quarterly data. Source: BoE, TNS. Three quarter moving average

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