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BOE EXPANDS QE, BUT FAILS TO IMPRESS

Berenberg Macro Flash

Underwhelming: BoE watchers could feel a little short-changed after the policy decisions and communications from the June Monetary Policy Committee (MPC) meeting. The policy outcome was in line with the consensus call that the BoE would expand its balance sheet by an additional £100bn. However, the market had expected a clear signal that the BoE would ease policy significantly further at a later date or that the bank was seriously contemplating further expanding its toolkit in response to the COVID-19 mega-recession (link to June minutes).

For three reasons, the outcome of the meeting is less dovish than expected:

1. **The vote to increase asset purchases was not unanimous:** One key member of the MPC, chief economist Andy Haldane, voted against further expanding the BoE's balance sheet. Instead, he argued that '*the recovery in demand and output was occurring sooner and materially faster than had been expected at the time of the previous MPC meeting*' and that '*existing monetary conditions were extremely accommodative*'.
2. **The pace of asset purchases is set to slow:** The June minutes indicate that the BoE aims to complete its asset purchase programme *'around the turn of the year.'* As of 17 June, the BoE had bought £168bn of the £200bn announced on 19 March – implying an average weekly pace of around £13bn. With around £132bn more purchases planned until the end of the year, the weekly pace will slow materially to around £5bn per week.
3. **No mention of negative rates or yield curve control:** Partly stoked by comments from MPC members, the market had hoped the minutes would include some reference to negative rates or possibly yield curve control. For example, Governor Andrew Bailey had signalled that '*nothing*' had been ruled out and that negative rates were '*under review*'. As the BoE sent no such signal today, 30 year gilt yields jumped 15bps to 0.7% after the decision was published.

Policy outlook: Absent a major downside surprise for GHDP or inflation, today's announcement makes it unlikely that the BoE will raise its asset purchases beyond the £100bn announced today for this year. Prior to the meeting, we, along with many in the market, had expected the BoE to add a total of £200bn to its purchases in 2020. While the BoE signalled that it 'stands ready to take further action', the market will likely now expect the BoE to stay on hold for the remainder of 2020. In our view, with global economic risks still tilted to the downside due to persisting virus-related risks and, in the UK, uncertainties linked to outcome of the UK-EU talks on their future relationship, we still see a good chance the BoE is forced to ease further in H2 as the UK economic recovery disappoints.

Some positive signs: Parsing through the minutes, the MPC seems less concerned than before about the downside risks to growth and inflation and notes some evidence that economic conditions could be improving faster than anticipated as '*recent data outturns suggest that the fall in global GDP in 2020 Q2 will be less severe than expected at the time of the May Monetary Policy*

Report.' The minutes noted '*signs of consumer spending and services output picking up, following the easing of Covid-related restrictions on economic activity'* which '*in part reflected an earlier end to lockdowns than had been assumed.*' The MPC's decision to further expand its asset purchases seems to be partly based on the fact that it sees '*risks around the outlook for the labour market appeared to be tilted to the downside*' in addition to worries about '*greater risks around the potential for longer lasting damage to the economy from the pan*demic'. This justifies further action to try to return the economy to full employment as soon as possible.

Risk assessment favours aggressive action

Risk to inflation and growth risks are still tilted to the downside, in our view. As a result, the potential costs of an economic policy error are asymmetric. The risks associated with providing too much stimulus are much lower than the risks associated with providing too little. It is better to risk doing too much now and pull back if and when the economy rebounds faster than expected than do too little and potentially allow the economy to suffer a dangerous bout of deflation or fall into liquidity trap. The outlook does not justify the planned significant slowdown in the pace of asset purchases yet, in our view.

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