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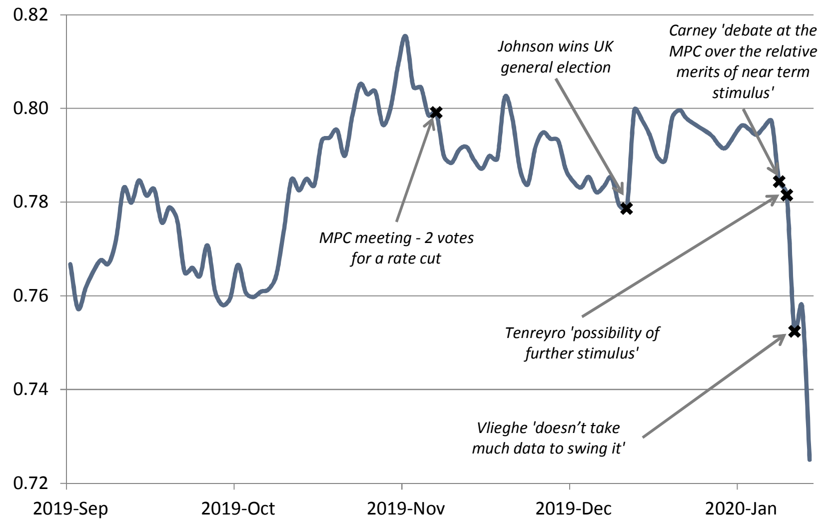
17 January 2020

BoE: near-term "insurance" rate cut possible

Three-month London interbank offered rate based on £ (%)



Daily data. Source: Intercontinental Exchange

- **Rate cut ahead?** Recent comments by Bank of England (BoE) policymakers point to a possible rate cut as soon as the next policy meeting on 30 January. Two of the nine members of the Monetary Policy Committee (MPC) – Michael Saunders and Jonathan Haskel – already voted for a 25bp rate cut to 0.5% in November and December last year. Last week, BoE governor Mark Carney referred to a debate at the MPC about the "relative merits of a near-term stimulus", while two additional MPC members (Gertjan Vlieghe and Silvana Tenreyro) added that they could vote to cut rates, too, unless economic data improved soon – see chart.
- **Noisy politics hurts:** Economic activity in the UK, much like in core Europe, was very subdued in 2019. The Brexit mess and other political risks, as well as noisy US-China trade negotiations, sapped business and household confidence. Consumption growth sagged, business investment stagnated and production contracted. Real GDP in November 2019 was broadly flat from February 2019. The first of Q4 2019 real GDP – out on 11 February – will likely show that the economy expanded by 1.2% for the year overall – well below its potential rate of c1.6-1.7%.
- **The case for a cut:** In a low interest rate environment, central banks should err on the side of caution when downside risks emerge. With more power to lower inflation than to raise it, monetary policymakers might be inclined to overreact with too much stimulus and, if needed, hike rates later to correct course.
- **The case for holding rates:** The big win for Boris Johnson and the Conservative Party on 12 December and the recent "phase one" US-China trade deal have drastically reduced uncertainty and the downside risks to the outlook. Key surveys taken after the election, such as the Deloitte CFO survey and the RICS residential market survey, show a sharp bounce in confidence and expected economic activity.
- **Key data ahead:** The decision by the MPC about whether to ease policy or to stay on hold could depend on the data released between now and Governor Carney's final policy meeting on 30 January. The CBI Industrial Trends survey (22 January), the preliminary PMI estimates (24 January), the CBI Distributive Trades survey (28 January) plus the BoE's own surveys could tilt the balance of votes towards either an insurance rate cut or for rates to remain unchanged if the data signal a solid post-election rebound in confidence and momentum.
- **Positive outlook:** Given the post-election upturn in some surveys and the strength of the fiscal stimulus to come, our base case remains that the BoE will remain on hold. The market currently sees a c63% chance of a rate cut at the January MPC meeting (up from c5% on 8 January – the day before Carney's dovish comments). As we expect forthcoming data to show a material post-election bounce, we only put a 40% chance on a cut.

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