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BOE IN 'WAIT AND SEE' MODE UNTIL BREXIT RISKS PASS

Berenberg Macro Flash

With a little over two months to go before the EU referendum (23 June), minutes from the April meeting show that Britain's MPC is firmly in 'wait and see' mode until the outcome of the vote is clear. Expectedly, the MPC voted unanimously in favour of keeping the policy rate on hold at 0.5% and in favour of maintaining the stock of QE assets at £375 billion.

Minutes caution on impact of a Brexit. The impact of a Brexit probably featured more heavily in discussions around the table than the minutes let on. This follows accusations from several 'out' campaigners in parliament that the Bank of England and Governor Mark Carney have been subjective with their analysis on the potential effects of a Brexit in favour of the 'remain' vote. Nevertheless, in today's minutes they reiterate their view that a Brexit would hurt the UK economy. They argue it would create an extended 'period of uncertainty', weigh on demand in the short run and have 'significant' implications for the exchange rate.

Referendum uncertainty beginning to weigh on demand: The minutes attribute the 10% drop in trade weighted sterling since last November to Brexit uncertainty. It is worthwhile noting that, while the value of sterling is clearly reflecting Brexit uncertainty, the prices of other UK assets have thus far largely been unaffected. Gilt yields and UK stock indices have progressed broadly in line with those in the US and Europe. The minutes also note that there are signs that uncertainty relating to the referendum is starting to weigh on demand. They point to evidence that capital expenditures and commercial property transactions are being postponed pending the vote.

Although uncertainty had risen, domestic data had improved during the past month: Inflation continued to trend upward (0.5% in March), though it remained well below the 2% target. Wages had accelerated (2.2% yoy) and consumer confidence remained elevated relative to pre-crisis levels, despite overhanging uncertainties. Combined with cheap oil and robust consumer credit growth, data for retail sales was consistent with stable gains in consumption since Q4 when the economy expanded by 0.6% qoq. The minutes show, however, that the MPC's collective view is for GDP growth to slow to 0.4% qoq in Q4. Financial market volatility and weak global demand in Q1 led to declines in the export-oriented industrial sector. Although this sector accounts for just 15% of GDP, the falls will be enough to shave around 0.1-0.2 ppt from the first quarter growth rate. The minutes also drew attention to the sharp fall in the savings rate and record 7% current account deficit in the final quarter of last year. But the MPC offered no immediate implications beyond explaining the causes and that such data is often subject to large revisions.

Upside risk to inflation outlook: Inflation rose by more than expected in the past month, increasing by 0.2 ppt mom to 0.5% in March. The same data showed that core prices, which remove volatile components like food and energy, increased by 1.5%. In part, this was due to the early Easter pushing up airfares more than expected. However, there was evidence of an increase in inflation across a range of components. The headline rate has been below the 2% target since December 2013. With low unemployment beginning to drive faster wage growth, domestic cost pressures are likely to underpin an acceleration in inflation over the medium-term. In the February inflation report, the committee forecast that headline inflation would increase to 1.0% by the end of the year. However, the impact of the recent falls in sterling will probably cause a quicker than expected pick-up in import prices. Similarly, the price of oil is likely to rise modestly in the coming months. As a result, we expect an upward revision to the BoE's inflation forecast in the next quarterly inflation report.

Brexit clouds make it difficult to see past June 23: It is likely that referendum uncertainty will cloud the outlook until the vote has passed. This will make economic data hard to interpret. We therefore expect the Bank's communications to be decidedly neutral until after the vote. Still, the MPC state that it is 'more likely than not' they will need to raise the policy rate over the forecast period. As long as the UK votes to stay in the EU, we expect the MPC to introduce more hawkish language after the vote in preparation for a 25 bps hike in November.

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