Kallum Pickering, Senior Economist | Kallum.pickering@berenberg.com | +44 20 3465 2672

UK: BOE CAUTIOUS OF BREXIT RISKS – NEXT MOVE LIKELY UP

Berenberg Macro Flash

The MPC made no policy changes at its May meeting. The nine member committee voted unanimously in favour of keeping the bank rate at 0.5% and maintaining the stock of QE assets at £375 billion.

Looking through the Brexit related noise, the MPC's policy outlook is little changed from February. The tone of the minutes, the modest changes to the inflation forecasts and the statement by the Governor that it is likely 'that the Bank Rate will need to be higher by the end of the forecast period than at present', is consistent with our expectation that the Bank of England (BoE) will hike for the first time in November by 25bps. That is, as long as the UK votes to stay in the EU.

MPC expects the economy to spring back to life after the vote: The MPC noted that current growth momentum is clearly softening, with consumers and businesses temporarily pausing consumption and investment plans ahead of the vote. In line with our recent revisions, the MPC expect economic growth to slow to 0.3% in Q2. Following a vote to stay, the BoE expects uncertainty to diminish sharply and with it, growth to accelerate. The BoE forecasts growth by 2.0% in 2016, implying a fairly strong uptick in growth in the second half of the year after growth of just 0.4% qoq in Q1 and 0.3% qoq in Q2. There were modest downward revisions in the later years, owing to a higher projected rate of unemployment. The BoE's unemployment forecast has been revised heavily in the last few years, suggesting uncertainty at the bank about the supply potential of the economy. The inflation outlook was largely unchanged, weaker sterling and higher oil prices offset the impact of the downgrades to GDP growth. **By keeping the inflation forecast unchanged and overshooting the 2% target some two years down the line, the MPC sent a clear signal that market pricing - which is used in the BoE's forecast - is too dovish.**

Press conference dominated by Brexit, no surprises there: While the BoE have refrained from providing point estimates on the economic impact of a vote to leave the EU, they gave a 'judgement' as well as some insight into the potential policy response. Governor Carney stated that 'Brexit is the key risk to monetary and financial stability in 2016, and could lead to a *material* slowdown in growth'. The minutes noted that a vote to leave the EU would likely lead to a negative short-term demand side shock and a negative long-term supply side shock. In the long-term, this would imply a lower path for GDP growth, but potentially a higher path for inflation, depending on the balance of the demand and supply side factors and exchange rate developments. Commenting on this, the Governor noted that the MPC would face 'a trade-off between stabilising output and stabilising inflation.' That is a clear warning that the optimum policy response would not necessarily be a cut but potentially a hike which would present further risks to growth if domestic demand was already weak.

For once, the BoE is more cautious of domestic risks than what is going on abroad. Since the February inflation report, sentiment in global financial markets has improved, prospects for China and other EM's are brighter, and stronger than expected growth in the Eurozone has offset weaker than expected growth in the US. The key risks lie at home. While the MPC is not overly worried about what they judge to be only a temporary slowdown if the UK votes to stay in the EU, they are clearly concerned about the potential economic implications of the UK leaving the EU. The BoE has responsibility to be clear about the risks. With fiscal policy largely hamstrung by still high deficits, the BoE is the guardian of the UK economy. Chances are, the BoE will be left 'holding the baby' if the UK votes to leave the EU and the economy runs into trouble.

MACRO NEWS

Forecast revisions

GDP	2016	2017	2018
BoE Feb Report	2.2	2.4	2.5
BoE May Report	2.0	2.3	2.3
Berenberg	1.9	2.1	

Unemployment	2016 Q2	2017 Q2	2018 Q2	2019
BoE Feb Report	4.8	4.8	4.7	
BoE May Report	5.1	5.0	4.9	4.8
Berenberg	5.1	4.9		

Inflation	2016 Q2	2017 Q2	2018 Q2	2019 Q1
BoE Feb Report	0.4	1.6	2.1	2.2
BoE May Report	0.4	1.5	2.1	
Berenberg	0.6	1.8		

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7878
www.berenberg.com
Kallum.pickering@berenberg.com