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## **BOE HOLDS FOR NOW – SIGNALS EASING IN AUGUST**

### Berenberg Macro Flash

The jump in sterling and gilt yields immediately after the BoE published its decision to keep policy unchanged in July gives the impression that the MPC minutes were hawkish. This is not the case. The minutes send a clear signal that the BoE will ease monetary policy in August.

So that you don't miss it, the first paragraph in the minutes notes 'most members of the Committee expect monetary policy to be loosened in August'. The negative assessment of near-term demand and the reference to a 'package' of measures sets the stage for more easing next month when Governor Mark Carney will give a press conference and the BoE will publish its revised forecasts.

### **Current economic conditions and the outlook – The Brexit impact**

There is no official published data to assess the economy since the June 23 vote though early confidence indicators point to sharp falls in sentiment. The minutes note that early indications from the bank's surveys show that businesses are delaying investment decisions and postponing further hiring. There has also been a notable drop in housing market activity. The limited data so far is in line with the consensus expectation of a material slowdown in UK growth in the near-term.

Inflation has been close to zero in the UK for over a year. This should soon change, 'the sharp fall in the exchange rate will, in the short-run, put upward pressure on inflation.' Considering the changes in the determinants of output and inflation as a result of the vote, a weaker near-term growth outlook combined with higher inflation is the most likely medium-term scenario. This represents a sharply negative revision compared to the BoE's May Inflation Report forecasts of low inflation and relatively strong growth.

### **Other developments**

Markets have continued to function well during the past month despite sharp and widespread falls in the immediate period after the vote. But assets linked to UK growth expectations have weakened significantly. The falls in gilt yields and weaker sterling were consistent with a 'weaker UK growth outlook'. The MPC notes that market participants see the balance of risks to sterling 'to the downside'. On a positive note, the minutes noted that asset prices had not showed signs of being distorted by impaired market functioning and that there had been no discernible response in UK gilt yields to the downward revision to the UK's credit rating.

### **Why didn't the BoE cut today?**

We wrote earlier in the week that we wouldn't be surprised if the MPC voted to keep rates on hold for just three weeks longer until the August Inflation Report. Here's why:

- (1) By next month, the MPC will have more data to assess the performance of the economy since the June 23 vote. The scale of scope of the easing will be directly related to the expected size of the negative shock.
- (2) Like other central banks, the BoE uses its forecasts as a form of forward guidance. Publishing forecasts at the same time as policy changes gives markets more insight into the BoE's reaction function.



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### Policy expectations

The minutes reference a discussion of possible ‘packages’ of stimulus measures that could be employed to tackle the negative shock, and that most members expect policy to be ‘loosened’ in August. We therefore look for a rate cut in August and see a 60% chance that the BoE restarts its asset purchase programme (“quantitative easing”, QE). The BoE purchased GBP200bn of assets in 2009 during the financial crisis and GBP175bn in 2011-12 during the euro-crisis. As a start, we expect the BoE to purchase around GBP100bn of gilts.

The combination of a lower bank rate plus more QE should mean that 10 year gilt yields and trade-weighted sterling will remain at or even below current levels until the end of the year before rising modestly in 2017 as the economy begins to regain some momentum.

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