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UK: BOE MAINTAINS GUIDANCE FOR A FURTHER RATE CUT IN 2016

Berenberg Macro Flash

This month's Monetary Policy Committee meeting follows on from the August Inflation Report where the BoE sharply downgraded its forecast for GDP growth and announced a broad expansion of monetary policy. To recap, in response to the Brexit shock the MPC voted last month in favour of a 25bp rate cut, a £60bn increase in quantitative easing (QE), £10bn of corporate bond purchases and a new Term Funding Scheme to aid the transmission of rate cuts to the real economy.

Just a month into the new stimulus, unsurprisingly, the MPC voted unanimously in favour of keeping all policy measures unchanged.

To keep things simple, we focus on three points in the September minutes: (1) the BoE's assessment of current economic conditions and any changes to the outlook, (2) views on the impact of the August stimulus (3) changes to guidance on future policy.

Current conditions and outlook: In August, the MPC stated that they expected to see 'little growth' in the second half of the year. Today this assessment was upgraded on the back of stronger than expected data since the Brexit-vote, 'the Committee now expect less of a slowing in UK GDP growth in the second half of the 2016'. In line with our assessment, the BoE expects Q3 GDP to grow by c0.2% qoq. Given the still limited data available and time passed since the June 23 vote, the MPC made no change to their assessment of the outlook. In August the BoE forecast growth of 0.8% in 2017. If the economy outperforms the bank's August expectations in Q3, it should lead to a modest upward revision to the BoE's outlook for next year at the next Inflation Report in November.

Assessment of the August stimulus: The minutes describe the short-term impact of the August package as 'encouraging', noting that the measures had caused asset prices to rise by more than expected. In financial markets, short and long-term market rates have fallen since the package of measures was announced. In the real economy, mortgage rates had fallen broadly in line with the 25bps cut in the bank rate. Given that lending to the real economy was growing at healthy rates before the referendum, the effectiveness of this package will probably be judged by how limited the contraction in lending is, rather than by how much it improves.

What is next for policy: Monetary policy works with a lag and is therefore set with respect to expected rather than current conditions. Today the MPC maintained the guidance given in the August Monetary Policy Committee minutes with a slight alteration in order to allow for further easing even if the economic outlook is revised up in light of better than expected current conditions. The minutes noted that "If, in light of that full updated assessment, the outlook at that time is **judged to be broadly consistent** with the August Inflation Report projections, a majority of members expect to support a further cut in Bank Rate to its effective lower bound at one of the MPC's forthcoming meetings during the course of this year'.

Unless the stronger than expected current conditions lead to a material upward revision to next year's GDP growth forecast, to say, above our own forecast of 1.3%, which looks unlikely, more likely than not, the ultra-dovish MPC will vote to cut the bank rate by a further 15bps to 0.1% before the end of year.

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