

## Bank of England signals limited enthusiasm for negative rates

The latest decision from the Bank of England keeps the door open to negative rates, though only after a six-month period of industry preparation. But optimistic growth forecasts suggest that a foray into sub-zero rates is increasingly unlikely in the current cycle



Source: Shutterstock

### Limited enthusiasm for negative rates

The standout message from the latest Bank of England decision, is that the MPC as a whole still has limited enthusiasm for negative interest rates.

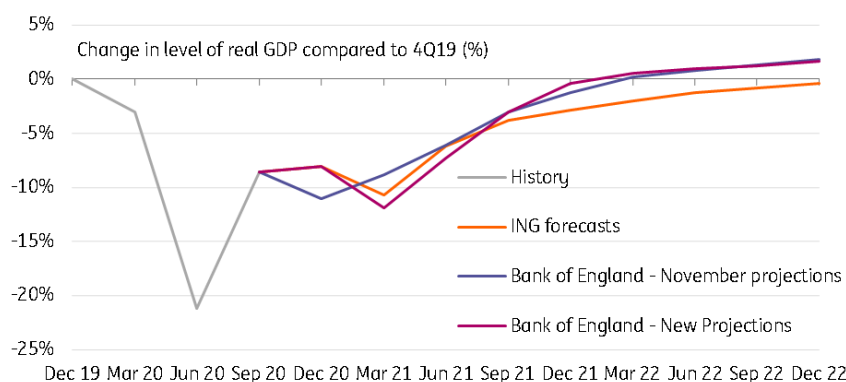
That's become increasingly apparent from comments of various committee members over recent weeks, and is visible again in the findings of the Prudential Regulation Authority's (PRA) review of how negative rates would work in practice. The key conclusion is that it would take at least six months for the industry to reorganise systems and processes to cope with a sub-zero Bank rate - and policymakers will now ask the industry to prepare for a possible implementation beyond that time horizon.

But the meeting minutes contain no less than seven references to the fact that the committee

doesn't want us to interpret this as a signal that negative rates might be on their way. To us, this makes it abundantly clear that - as things stand - negative rates are unlikely to be used this cycle.

Several committee members have previously appeared sceptical of the benefits, and we agree that a further rate cut is unlikely to make a huge amount of economic difference - the cost of borrowing is not the central issue given the wider upheaval caused by Covid. Rate cuts also act with quite a lag.

## The Bank is assuming a full GDP rebound by 4Q this year



Source: Bank of England, ING

## The latest projections are optimistic

Having said that, it's clear the Bank wants the door to be kept ajar to negative rates. Don't forget that the carefully-calibrated messaging the Bank has employed on negative rates has, until recently, helped persuade investors to begin pricing them - in effect achieving some of the benefits of lower rates without actually having to cross the Rubicon.

Nevertheless, the Bank's latest forecasts make it clear policymakers don't see the need for further stimulus. Its projections now assume the economy will regain all lost ground by the fourth quarter, and that unemployment will only be marginally higher at this point next year. Inflation is expected to be a little above target for the next couple of years.

While some of that in our view may turn out to be a little optimistic, the signal implies that neither a rate cut nor a further expansion in quantitative easing beyond this year is likely, if the Covid-19 story goes as hoped.

Importantly though, talk of tightening is clearly some way off - probably a 2023 story at the earliest. And on that note, the comment at the end of the minutes reiterates something that Governor Andrew Bailey talked about last summer - the fact that the Bank is more prepared to begin shrinking its government bond holdings before making significant progress on rate hikes. This underlines the point that the BoE, under Bailey, perceives QE as a much more useful way of adding or removing policy support at the margin, than the Bank rate.

### GBP: Further gains ahead

EUR/GBP broke below the 0.8800 level today. While the committee does not rule out negative rates, this would only be conceivable after a period of six months, as doing so

before then is believed to carry operational risks. This is positive for GBP as (a) negative rates are not imminent and (b) with all eyes on a second quarter economic recovery in the UK, such rate cuts probably wouldn't be necessary in six months (when operational risks fade) from a macro point of view. Hence, we see the market pricing out the odds of negative rates, benefiting GBP.

As we argued in [GBP: Reaping the vaccine dividend](#), we estimate EUR/GBP is currently trading 6-7% above its medium-term BEER fair value. With the risk of a hard Brexit out of the way and the UK set to benefit from faster vaccination vs the eurozone, we expect EUR/GBP to start gradually converging towards its medium-term BEER fair value. Still, a full and fast convergence is unlikely this year, in our view, given the uncertainty stemming from the possible negative headline news around the Scottish independence referendum during the Scottish Parliamentary election campaign (though we don't see a second referendum as imminent) and the ongoing risk of tariffs should the UK government choose to deviate from the EU's level-playing field conditions.

We target EUR/GBP 0.85 level this year and 0.82 in 2022.

## Author

**James Smith**

Developed Markets Economist, UK

[james.smith@ing.com](mailto:james.smith@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit [www.ing.com](http://www.ing.com).