# 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

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## Limited enthusiasm for negative rates

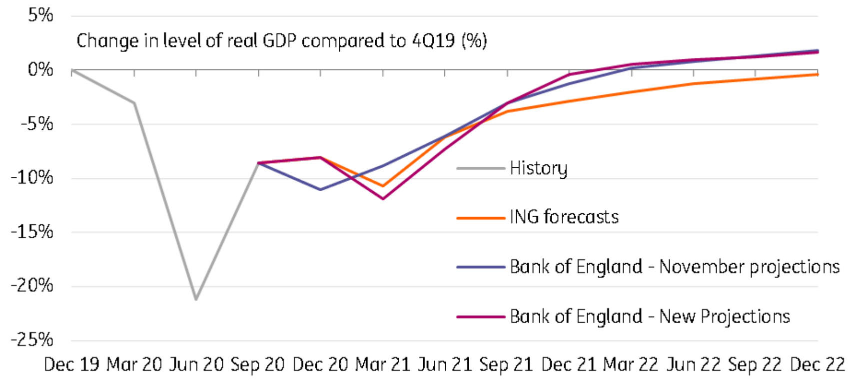
The standout message from the latest Bank of England decision, is that the MPC as a whole still has limited enthusiasm for negative interest rates.

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.

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