Bank of England takes stock as economy enters uncertain phase

The recovery is likely to be slower than the Bank of England's illustrative scenario, and that means quantitative easing is likely to be boosted over coming months

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An opportunity to take stock

Having thrown the kitchen sink at the economic recovery - and been unafraid of acting in between meetings - it's not too surprising that the Bank of England has opted against making any major new changes this week. After all, financial markets are calmer - money market conditions have improved to a certain degree.

But the key message from the Bank of England today is that the economic hit has been large. Policymakers estimate the economy will be 30% smaller by the end of the second quarter - a larger hit than most forecasters, ourselves included, had been pencilling in (ultimately it depends a lot on when, and how quickly, the lockdown has been unwound by the end of June).

But more importantly, the Bank's stylised scenario loosely assumes both GDP and unemployment returns to pre-virus levels/trends at some point in 2021.

We expect a much slower recovery

Of course there is plenty of uncertainty about what will happen later this year and beyond, but we suspect the true path of the recovery will be more gradual. We don't expect the economy to recover its lost ground until at least 2022, and perhaps later.

Despite the government's best efforts, we suspect a portion of the unemployment created by the virus will be longer-lasting, given a number of firms are unfortunately unlikely to come out the other side in the same shape. And with the risk of further lockdowns likely to linger until a vaccine is able to be rolled out, the uncertainty is likely to lift savings rates and keep investment low.

The Bank of England acknowledges both of these factors, and other risks, as ways in which the recovery could be slower than in its main scenario.

Expect QE to be beefed up

With that in mind, the Bank of England's overall stimulus package is probably going to have to be stepped up again over coming weeks and months. And with policymakers clearly wary about lowering interest rates any further below the current 0.1% level, quantitative easing is the most obvious candidate for changes.

For the time being, the Bank has a reasonable amount of room to continue making purchases before hitting its £200bn target for additional gilt/corporate bond buying.

But this target is going to have to increase by the summer. Our Rates Strategy Team estimates that the Bank has another couple of months before reaching the ceiling if purchases continue at the current pace. Don't forget the Debt Management Office (DMO) is looking to issue £180bn worth of gilts in the three months to July.

An additional round of QE therefore looks likely, and interestingly two committee members voted for a £100bn extension at this meeting.

Government measures back in the spotlight

Still, the overarching theme is that monetary policy is probably doing about all it can to support the recovery for the time being. That means the government's response will come under increasing focus again - and in particular how the likes of the Job Retention Scheme can be tweaked to help facilitate a return to normality that is likely to be exceptionally gradual.

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