

## Three thoughts on the Bank of England's November decision

The Bank of England has taken markets by surprise, with two members voting for an immediate cut. But aspects of the Bank's new forecasts are not as dovish as we might have expected. While a lot depends on Brexit, we suspect it's too early to be pencilling in policy easing just yet



Source: Bank of England

### 1 At face value, the Bank's decision is dovish

At face value, the Bank of England's latest monetary policy decision is more dovish than expected.

In a surprise move, two committee members voted for an immediate 25bp rate cut. Policymakers have also for the first time hinted at easing in their statement, suggesting that monetary policy may need to "reinforce" growth should Brexit uncertainty persist.

That suggests (in case there was any doubt) that the Bank is very unlikely to follow through with its signalled rate hikes (should Brexit go smoothly) any time soon.

## The Bank's Brexit assumption could easily change again

But dig a little deeper, and the Bank's latest report isn't quite as downbeat as the overarching guidance implies.

One surprising feature of the latest Bank of England projections is its decision to effectively assume that PM Johnson's Brexit deal will be ratified - taking the UK to a free-trade agreement in the longer-term.

While this reflects the Bank's long-standing policy of basing forecasts on government policy, this will all depend on December's election. And while the polls suggest the Conservatives will gain a majority - giving PM Johnson the scope to get the deal ratified in Parliament - there is still a potential for big surprises when the UK goes to the polls next month.

We wouldn't rule out another hung Parliament, which could either prolong the Brexit uncertainty, or alternatively see a Labour-led minority government begin organising a second Brexit referendum.

In other words, it's not inconceivable that we see another sizable change to the Bank's projections early next year, depending on who prevails at next month's election.

### 3 The Bank's investment rebound may not materialise

The Bank has, as expected, downgraded its growth profile over the next three years, although this is largely accounted for by weaker global growth and a steeper yield curve.

But on investment, the Bank is a little more optimistic about 2020, assuming the deal is ratified. Policymakers now expect investment to return to very modest growth in 2020, compared to the fairly sizable fall policymakers had predicted back in August. In reality, a lot will depend on the length of the transition period. This standstill phase, that is due to last until December next year, will almost certainly need to be extended to allow time for a new trading relationship to be agreed.

However this will require the government to sign up to EU budget payments by June, to unlock a two-year extension until 2022. That will be a tough price for PM Johnson to pay, and negotiations over this will undoubtedly be noisy. While we ultimately suspect a longer transition is inevitable, until we know for sure, we suspect firms will continue to tread carefully, faced with a possible risk of the UK (ex. NI) leaving the EU's single market and customs union abruptly at the end of next year.

While we expect 2020 to be another uncertain year for the UK economy, we still think it is probably still a little too early to be pencilling in rate cuts. While the Bank is now hinting more directly at possible easing, we think the fact that they are still formally projecting excess demand in their forecasts and keeping the door open to rate hikes in their statement, suggests policymakers are reluctant to follow the Fed and ECB into rate cuts just yet.

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