# What to expect from the Bank of England this week

We're expecting another large increase in quantitative easing when the Bank of England meets this week. But markets may be more interested in what policymakers have to say on negative rates - a policy which we still suspect is unlikely to materialise in the UK any time soon

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## Expect more stimulus this week

As the Bank of England prepares to announce its latest policy announcement this Thursday, it'll be acutely aware that the economic recovery from coronavirus is still very much in its infancy. Having shrunk by 25% in March and April - an unprecedented decline - the UK economy appears to have recovered only a small portion of this through May and the early stages of June. And while there should be a more pronounced rebound during the third quarter as the lockdown measures are eased further, the economy is still likely to be well below its pre-virus size.

Social distancing rules, while essential to avoid a second-wave, will make it harder for many businesses to operate profitably. Consumer caution, as well as Brexit, also pose further challenges for the recovery phase.

All of that means the pressure is on the Bank of England to continue maintaining a high level of stimulus - and we expect more action this week. Here, we take a quick look at what policymakers have done so far, and what could still be to come.

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## Quantitative easing - £150bn expansion possible this week

The Bank looks poised to expand its QE programme this week, although this will come as little surprise.

Policymakers pledged to add £200bn to the Asset Purchase Facility (APF) back in March, which would take total holdings to £645bn. But we estimate this will be exhausted by early July if purchases continue at the current pace - at the last count, the size of the APF stood at £598bn (including £15bn of corporate bonds).

The question is how far the BoE will expand its QE programme this week. Two policymakers voted to add an additional £100bn to the APF target, and that's the consensus for this week. That would allow purchases to continue until early September, which may well mean policymakers need to top-up again in August. That's not ideal, and we suspect we could see a more sizeable - perhaps £150bn - expansion, allowing purchases to continue until early October.

An alternative option would be to take a leaf out of the Federal Reserve's book, and switch to a monthly purchase target. That would help avoid having to make frequent expansions, but for the time being we suspect the BoE will stick to its existing way of doing things.

## The BoE looks set to hit its £200bn QE target in July


Source: BOE, DMO, ING

## GBP Rates: yield curve steamrolling to continue

Judging from past QE iterations, purchases do not necessarily slow down in the summer, unlike the European Central Bank's. This brings the risk of Gilt yields remaining low and richening relative to swaps over the summer months when purchases gain in importance relative to traded volumes.

We expect Gilt and GBP swap rates to be on just a gradual rising path into next year as a result, with a slow recovery outweighing the QE steamroller. The risks around this trend are daunting, and skewed to the downside. With the BoE resolutely on the front foot when it comes to easing, it would not take much for rates to take another plunge. This is particularly true if the Monetary Policy Committee is indeed considering removing the 0% floor under interest rates. Barring this, we see 10Y GBP swap rates (vs 6m Libor) rising to 0.60% by year-end.

## Negative rates - still looking unlikely

Away from QE, this is very much the hot topic. Policymakers appear to have become more open to negative interest rates - or at least have been keen not to rule them out. We shouldn't expect any changes this week, but it'll be interesting to see what the minutes (which are also released on Thursday) have to say on the topic.

You can understand why the policy may be tempting. Investment has already underperformed since the Brexit referendum, and the Covid-19 crisis is only likely to make matters worse. That implies that productivity growth will remain minimal, and a potential consequence of the crisis is that the so-called neutral rate of interest will fall. In other words, over time the current level of interest rates could become decreasingly stimulative.

Having said that, it's not clear how negative rates would help the recovery. The potential impact on bank profitability is well documented, given the difficulty in pulling retail deposit rates below zero. The results of the policy in Europe and Japan also haven't been spectacular, and we know that the main problem over coming months is likely to be credit demand - or a lack of it. Modest changes in Bank rate are unlikely to change the game for spending and investment.

*It's not clear how negative rates would help the recovery*

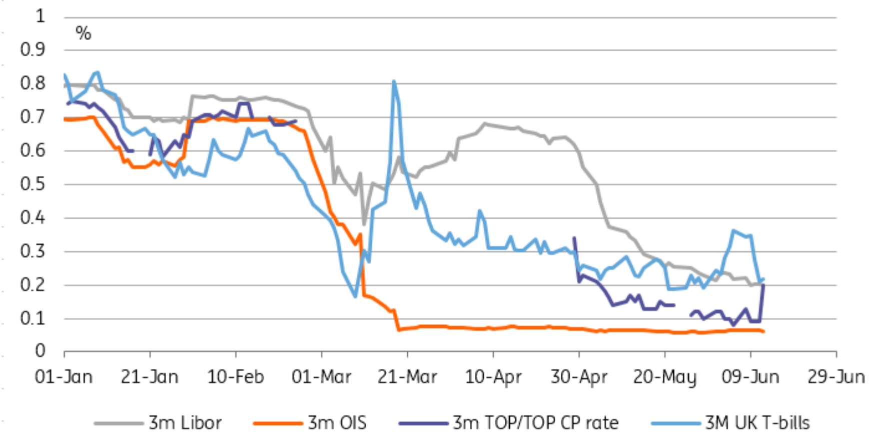
So we suspect negative rates are still fairly down the Bank's list of favoured tools - despite the more open-minded rhetoric of late. But if the Bank did want to do more, one alternative option would be to make changes to the Term Funding Scheme (TFS). That could potentially give lenders access to funding below the Bank rate, assuming they increase lending to businesses (specifically SMEs).

## Commercial paper purchases have helped money market normalisation

Usage of the Commercial Paper Purchase Facility (CCFF) has been muted since the last MPC meeting with purchases now standing at £16.3bn from a £71bn capacity. This is not entirely surprising given signs of normalising money market activity. As usual, CP volumes are hard to come by but the more regular TOP/TOP index publications as well as tightening to OIS are confirmations of this trend. At this stage, we regard the CCFF as more of a comfort blanket helping maintain participants' confidence.

In contrast, the fall in Libor fixings has taken a breather since the end of May and they remain historically wide relative to OIS rates. In a context of activity normalisation, we suspect the relative weights of expert judgement, but also references to markets other than deposits, is decreasing. This would explain the fact that Libor fixings failed to converge more to OIS when CP rates did, and failed to jump with T-bills. Risks remain high and in light of 3m Libor fixings to tighten further to OIS despite the drop in commercial paper rates, we doubt fixings will drop below 0.20%.

## UK money market rates




Source: ING, Bloomberg

## Author

**James Smith**
Developed Markets Economist, UK
james.smith@ing.com

**Antoine Bouvet**
Head of European Rates Strategy
antoine.bouvet@ing.com

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