Bank of England expands bond purchases as lockdown begins

The Bank of England has added a hefty dose of QE but importantly has offered no new hints on negative rates. While the Bank has signalled the policy is in the toolkit, we think the jury's still out on whether it will be used in 2021. It'll depend on how the economic outlook pans out, but also on whether policymakers think lower rates would be effective

Bank of England, in the City of London

Source: Shutterstock

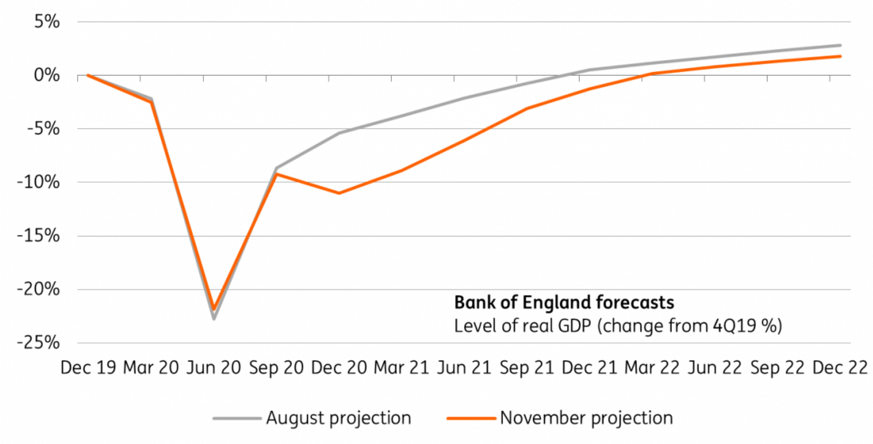
Larger-than-anticipated QE surprise

The Bank of England has taken markets by a little by surprise this morning by announcing a larger-than-anticipated expansion to its quantitative easing programme. Policymakers have vowed to increase the stock of bond purchases by £150bn, which will reportedly allow it to continue making purchases throughout 2021. Policymakers noted that 'risk management' considerations pushed for a strong early reaction, with the economy faced by a myriad of downside risks stemming from both lockdowns and Brexit.

The real question that markets want answered is whether there will be a shift to negative interest rates in 2021

But what the markets really want to know is whether there will be a shift to negative interest rates in 2021 - and for the time being, the Bank is offering no fresh hints. That's not particularly surprising perhaps, given that there is still roughly a week to go for commercial banks to respond to the central bank's survey and feedback on how negative rates might affect their operations.

The Bank of England expects GDP to return to pre-virus levels in early 2022



Source: Bank of England, ING

The jury's still out on negative rates

Whether the policy materialises next year will, in part, depend on whether the economic outlook worsens relative to the Bank's latest forecasts. In our opinion, this is probably likely. While the Bank's projection for Q4 GDP (-2% QoQ) is similar to our own, the forecasts assume that the economy will still recover its pandemic losses by the start of 2022, which we think is a little optimistic.

There is also a latent risk that the unemployment rate rises further than the Bank's 7.7% forecasts for the first quarter of next year

There is also a latent risk that the unemployment rate rises further than the Bank's 7.7% forecasts for the first quarter of next year, although this really depends on how/when government wage support is removed through 2021. We'd also note that the BoE expects inflation to remain a touch below 2% in two years time (even when based on interest rates at -0.1 as markets are pricing), which in theory could also signal that policymakers think more stimulus may be needed.

In other words, there is scope for further easing in 2021, particularly if the switch to new UK-EU trading terms proves to be messier than expected (more likely in the event of there being no agreement).

But will this involve a rate cut? We think the jury is still out. There still appears to be a lack of consensus among MPC members that the policy would be effective, and we'd note that Governor Andrew Bailey's comments over the summer suggested he thinks QE is a much more useful marginal policy tool than interest rates.

For the time being, asset purchases are likely to remain the tool of choice

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