Bank of England stays cautious ahead of an uncertain 2020

In the aftermath of last week's UK general election, the Bank of England is sticking to its cautious stance. But despite two committee members voting for a rate cut, we think it would take a sharper deterioration in the jobs market for the Bank to act

Mark Carney, Governor of the Bank of England

What will the Bank of England do in 2020? This is a question that is dividing economists at the moment. Some see cuts in the first half of the year, and others expect rate hikes in the second.

We are yet to be convinced about either, and that is largely backed up by the latest BoE statement. Policymakers stuck to a cautious stance while keeping interest rates on hold at their final meeting of 2019.

Admittedly two rate-setters again voted for a rate cut this time, and it's not inconceivable that another member joins them at subsequent meetings. But the statement suggests the broader committee is happy to stay in "wait-and-see" mode, and for now, doesn't buy into the 'insurance rate cut' argument being promoted by BoE doves.

But it's fair to say the economic outlook for 2020 is fluid, and in our view, Bank of England policy next year will hinge on two main things.

1 For the Bank to cut rates, the jobs market needs to deteriorate further

A decision to cut rates in the early stages of 2020 would require the jobs market to weaken further. A persistent lack of investment, and the resulting fall in new orders, has reduced firms appetite to hire, and recent PMIs and the decline in vacancies suggest that some firms are not replacing departing staff. But so far this has not been fully reflected in the official jobs data, and for now, the latest BoE statement states that the jobs market is “tight”.

For that reason, we aren’t currently expecting policy easing next year. But the risk is that the ongoing weakness in investment hits hiring demand further, and if it does, our view on the Bank of England could change.

2 To hike rates later in 2020, investment needs to stage a turnaround

So what about rate hikes? This question could come back into focus later in 2020, assuming the jobs market doesn't deteriorate further.

The answer really hinges on whether the removal of the 31 January ‘no deal’ risk translates into an increase in investment. It is abundantly clear from the latest set of BoE minutes that policymakers are keeping their cards close to their chest on this one. The Bank noted that it was “too early to judge how material” the election result would be for the economic outlook.

But after January, pretty quickly focus among firms will switch to the 31 December end-date for the standstill transition period. And the reality is that the government’s decision to enshrine that date into UK law presents a multitude of uncertainties for firms.

Can the transition period still be extended before the EU’s end-of-June deadline? That currently looks unlikely. And if not, will the UK be able to negotiate a bare-bones free trade agreement by the end of 2020?

Trade experts believe the answer is “just about”, but it will require the government to quickly concede to the EU's demands on level-playing field commitments and state aid, among other things. If the government judges this a step too far, then the possibility of an abrupt exit from the EU single market and customs union (with the exception of Northern Ireland) at the end of 2020 can’t be totally ruled out.

Whatever happens, we may not know the answer to many of these questions until much later into 2020. And in turn, that suggests that investment and therefore growth, will remain subdued. For now, we think this will steer policymakers away from hiking interest rates later into next year.

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