Bank of England slashes forecasts amid Brexit uncertainty

There's plenty of short-term negativity in the Bank of England's latest predictions, but there is still the subtlest of hints that they'd still like to tighten policy further if they can. That says to us that a 2019 rate hike shouldn't be ruled out just yet, although as ever it all depends on Brexit

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A big cut to 2019 growth forecasts

With just 50 days left until Brexit, it shouldn't come as much of a surprise that the Bank of England has taken a more dovish stance amid all the uncertainty. Policymakers unanimously opted to keep rates unchanged, and the statement is littered with references to intensified uncertainty.

That said, the extent of the downgrade to 2019 growth – from 1.7% to 1.2% – is much sharper than we had expected. The Bank now looks for just 0.2% in both the first and second quarter of 2019 and only a marginal improvement in the third.

This partly reflects the weaker global backdrop, but we suspect it may also reflect the growing risk that the Brexit deadline could need to be extended, prolonging the uncertainty well beyond March. We agree that there is a real risk that business investment stays subdued for some time, as firms remain awake to the 'no deal' risk.

A hike still seems some way off, but it's too early to rule it out this year

The upshot is that the Bank is highly unlikely to tighten policy again through the first half of this year, and indeed the chances of a rate hike at all in 2019 have receded – although we think it's too early to write one off completely.

Despite all the caution in the February report, we still get the sense that the Bank has a preference to tighten policy at some point if it can. Wage growth has been particularly strong recently and the Bank continues to see this rising at a rate close to 4% in 2021. This has been central to the Bank's previous rationale for hiking rates, and policymakers gave the subtlest of hints again that It thinks rates may eventually need to rise further than markets expect.

A lot depends on Brexit

Of course, all of that relies heavily on Brexit. Most paths now lead to an extension of the article 50 negotiating period, but if (and it's still a big if) the government can secure a cross-party consensus for a particular deal – for instance one that commits to a permanent customs union – then this may well be followed up with a Bank of England rate hike relatively swiftly.

A lot depends on the global outlook too, and some are questioning whether the Bank of England would still opt to hike rates at a time where the Fed is easing off and the ECB is moving only very gradually. However, it's important to remember that the Bank of England is much further away from a neutral stance than the Fed. So with the economy running close to full capacity, policymakers may still conclude that some catch up is required.

Author

James Smith
Developed Markets Economist
james.smith@ing.com