Caution creeps in at Bank of England as 'no deal' fears resurface

The fact that Bank of England policymakers are flagging that the perceived risk of a 'no deal' Brexit is rising suggests that interest rates are unlikely to rise this year, despite recent signals that markets may be underestimating future tightening

Source: Bank of England

Policymakers decided against offering an explicit signal

While the Bank of England unanimously opted to keep rates on hold, all things considered, the latest statement is slightly more dovish than might have been expected.

Back in May, Governor Mark Carney warned investors that, with just one rate hike priced in over the next two years, they may be underestimating the pace of future tightening. Since then, the revaluation of global monetary policy in light of the escalation in trade tensions has seen investors lower their expectations even further. In fact, markets now think UK interest rates are more likely to fall over the next couple of years.

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We had wondered if this would lead the Bank to hint more explicitly that market rate expectations are too low. In the event, however, they chose not to and interestingly have made reference to the fact that the perceived risk of a 'no deal' Brexit is rising. This is perhaps a subtle nod to the fact that risks to growth could lie to the downside over the summer months if uncertainty continues to rachet up.

We tend to agree - while the recent growth numbers are being thrown around by sharp changes in inventories, we think underlying economic momentum will remain slightly weaker in the near-term as businesses ramp up preparations for an October 'no deal' Brexit.

We don't expect a rate hike this year

We wouldn't totally rule out a rate hike from the Bank of England later this year if wage growth continues to perform solidly and the immediate threat from Brexit recedes – either through another Article 50 extension or less likely, a deal being ratified by parliament ahead of the October deadline.

In reality though, we think it is unlikely the Bank will hike rates this year. Domestically, uncertainty is likely to remain elevated – particularly given that we see an increasing probability of a general election later in the year. Globally, our team expects trade tensions to get worse before they get better, and this will act as another reason to proceed cautiously when it comes to possible future tightening.

Author

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

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