

## Three takeaways from the Bank of England's August meeting

Despite an upgrade to growth and inflation forecasts, the Bank of England's latest announcement makes it fairly clear that rates are likely to remain on hold for the foreseeable future



The Bank of England's  
Mark Carney

There's little doubt the August meeting was an awkward one for Bank of England policymakers. The sharp fall in market rate expectations has translated into higher growth and inflation forecasts in 2-3 years time. In normal times, this might be interpreted as a hawkish signal to markets - an overheating economy theoretically needs a greater degree of tightening.

But as the Bank is at pains to point out, policymakers are assuming a smooth Brexit path - whereas markets (and their expectations for interest rates) increasingly are not. With Brexit uncertainty set to intensify, we think it is very unlikely the Bank will embark on the tightening that it is still loosely signalling in its statement. Equally though, we think it's too early to be pencilling in rate cuts, given the likelihood that wage growth will continue to perform solidly over coming months.

## 1 A flatter yield curve boosts growth and inflation

The significant flattening in the UK interest rate swaps curve – a gauge of market expectations for future interest rates – since May has given both Bank's growth and inflation a modest boost in 2021/22. That's helped along by the fact that wage growth is expected to strengthen further from here. Skill shortages in the jobs market have already seen wage pressures build, and the BoE expects total pay to increase at a rate of 4% year-on-year by 2021.

## 2 Inconsistent Brexit assumptions mean the forecasts aren't as hawkish as they sound

In times gone by, that might have seen policymakers vocally push back against current market pricing, and warn that markets are too relaxed about the possibility of tightening. Unsurprisingly though, the Bank has opted against sending such a signal this time.

The BoE's forecasts are premised on Brexit going smoothly – something that looks [increasingly questionable](#). Policymakers have devoted an entire paragraph to explain the “inconsistency” that exists within their forecasts, which essentially boils down to: our models assume that Brexit will go smoothly, whereas the market's expectations for the future path of interest rates do not.

## 3 Business investment forecast slashed

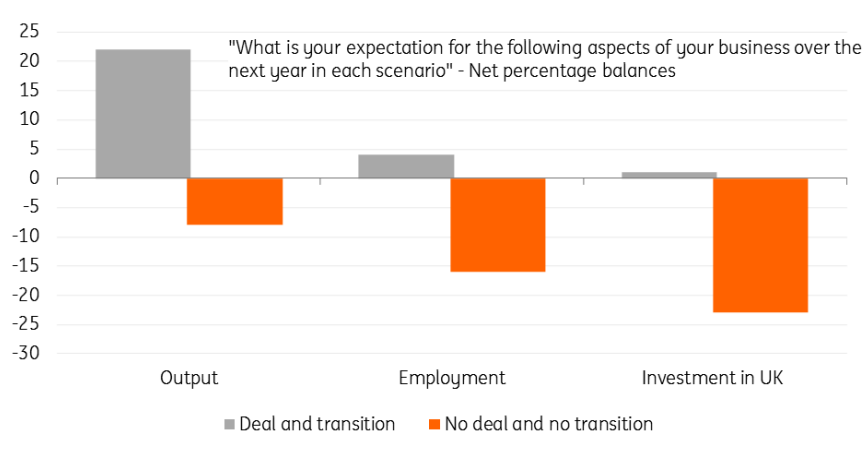
All of the above shouldn't come as too much of a surprise to markets - the challenge for the Bank today was always going to be marrying together the more hawkish forecasts, and the more cautious short-term outlook, without stepping into the political arena.

What is a little more surprising is the extent to which the Bank has cut back its business investment forecast for 2020. Having previously expected capital spending to grow by 3% next year, it now expects it to fall by 1.5% - a pretty substantial change. This follows a new survey of businesses by Bank Agents, which found that even in the case of a deal being struck, on balance firms did not expect to increase investment.

To us, this suggests that interest rates are likely to remain on hold for the foreseeable future. While the Bank's forward guidance notionally points to further tightening, we think the mounting uncertainty related to Brexit - even in the case Article 50 is extended further, or where a deal is agreed - means this is unlikely to materialise.

# Business don't expect investment to increase, even if there's a deal

## Net balances of firms



Source: Bank of England

## Author

**James Smith**

Developed Markets Economist

[james.smith@ing.com](mailto:james.smith@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.