September 19, 2019

BoE: Steady as Brexit Remains in Flux

- **The MPC voted 9–0 to maintain the Bank Rate at 0.75%, as literally every submission in the consensus forecasts expected, with no changes to the balance sheet.**
- **On Brexit, the MPC reiterated its view that a smooth Brexit would likely prompt rate hikes, while the response to a no-deal scenario remained uncertain and dependent on subsequent macroeconomic developments.**

The Bank of England's (BoE) Monetary Policy Committee (MPC) met expectations with a unanimous decision to hold its key Bank Rate unchanged at 0.75% (chart 1) along with no changes to the Bank's balance sheet. Following so soon on the heels of the August 1 *Inflation Report*, in the midst of near-daily changes in the prospects for Brexit, and in the absence of a significant body of new macro data, it was rightly anticipated that this meeting would simply bide time ahead of the October 19 deadline to avoid an extension to Article 50 and a possible early election this autumn. Scotiabank Economics expects the BoE to remain on hold through end-2020 (chart 1, again).

The characterization of macroeconomic developments in the *Summary and Minutes* was marginally more dovish than in August. The UK's real GDP fell by 0.2% in Q2 compared with a flat expectation in the *Inflation Report.* On the basis of the BoE's Nowcast model, the UK's Q3 growth projection was lowered 10 bps from the 0.3% projection in August to 0.2%, largely owing to auto-plant shutdowns. The MPC noted that the "global growth outlook has weakened" since August even as "monetary policy has been loosened in many major economies". Committee members viewed the direct impact of ongoing trade tensions as "relatively small" even though it is "having a material negative impact on global business investment growth." Brexit-related developments are making UK economic data even "more volatile", and slowing growth has opened up "a degree of excess supply," reversing a fall in the degree of slack in the UK economy since the 2016 EU referendum. Labour markets do not "appear to be tightening further." On the upside, the MPC noted that UK consumers remain resilient with Q2 growth stronger than expected in the August *Report*, and that the UK government's plans to increase spending over 2020–21 "could raise GDP by around 0.4% over the MPC's forecast period, all else equal."

On setting monetary policy with respect to Brexit, the MPC's views remained largely unchanged, but were laid out in greater granularity. In August, the MPC noted that the monetary policy response to Brexit, "whatever form it takes, will not be automatic, and could be in either direction." Now, this data-dependent guidance is focused on the possibility of a no-deal Brexit where the Committee would likely have to balance upward pressure on inflation from exchange-rate pass-through with downward pressure on domestic demand. In the event of a smooth Brexit, the Committee continued to expect that a significant margin of excess demand would be likely to build in the medium term and that gradual and limited increases in interest rates would be appropriate to return inflation sustainably to the 2% target.

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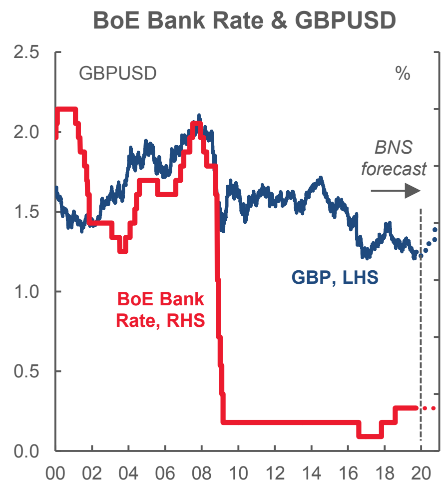
Chart 1



Sources: Scotiabank Economics, Bloomberg.

The decision marked the first time that the MPC has provided guidance on the possibility of a protracted period of Brexit uncertainty, clearly reflecting political developments since the Committee's last statement on August 1. The MPC advised that the longer such uncertainty persists, the more likely growth would remain below potential, excess supply would increase, and domestic price pressures would remain reduced—which would imply that interest rates would remain low for even longer than previously envisaged before either a smooth Brexit or no-deal scenario becomes clear.

The particular circumstances of Brexit imply that slowing global growth and the recent wave of easing by major central banks may play less of a role in the Bank of England's decision making than for other central banks. With the Norges Bank hiking today, and the Riksbank and Bank of Canada remaining on hold—for now—the Bank of England is in a shrinking club of major monetary institutions that haven't begun easing conditions. Extended Brexit uncertainty, the ambiguous monetary policy implications of a possible no-deal Brexit, and the possibility of a further delay in naming Governor Carney's successor look set to keep the UK in this small club even as its membership is set to fall further with Sweden and Canada likely to join the easing crowd.