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TD Economics

International Commentary: **Bank of England leaves policy rate unchanged (at 25 basis points), maintains current pace of asset purchases, but drops guidance on the next bank rate decision**

- The Monetary Policy Committee (MPC) for the Bank of England (BoE) voted unanimously to leave monetary policy unchanged this morning, keeping the bank rate at 0.25% and maintained its current pace of asset purchases. Most notable was the removal of MPC guidance put in place at its September meeting concerning the likely downward trajectory of the next bank rate decision.

- The outlook for the UK economy was broadly revised up since this past August. The latest modal projections from the November Inflation Report anticipate growth in real GDP of 2.2% in 2016 (+0.2 ppts), 1.4% in 2017 (+0.6 ppts), and 1.5% in 2018 (-0.3 ppts). While some of the near-term revisions reflect better than expected growth in 16Q3 (+2.0% q/q annualized), the firmer growth outlook generally reflects stronger spending by households, smaller declines in business investment, and slightly better growth in exports due to a weaker pound. As a result, the level of GDP is now about 0.5 percentage points stronger than forecast back in August through 2018.
- The supply side outlook remains broadly unchanged, with the only exception of marginally better productivity growth owing to the smaller expected decline in business investment this year and next. The outlook for inflation was revised up, peaking at 2.8% on average at the end of 2017 before falling off modestly thereafter.

Key implications

- While the UK economy appears to be holding up better than expected immediately post-Brexit, the process of leaving the EU is highly fluid and it is still early days. The rapid and significant depreciation in the pound – a feature of the monetary stimulus package announced this past August – is facilitating the complex adjustment of the UK economy to a post-EU world.

- It remains to be seen whether the current level of household spending will continue to hold in the future, particularly due to the high degree of uncertainty clouding the future of business in the UK. During the press conference, Governor Carney noted that about 50% of UK businesses have considered the implications that Brexit will have on their investment decisions. A lack of investment, and therefore business capacity in the UK could result in slower employment and labour income growth. When combined with weaker real income growth due to higher inflation, household consumption growth is on track to slow over the next several years.
- Adding to the uncertainty is the ruling this morning from a UK High Court that stated that the UK government but must seek parliamentary approval of beginning the Article 50 process. The court ruling is likely to be appealed by the government to the Supreme Court, which could delay plans to begin the Article 50 process as early as the end of March 2017. The combination of the upgraded outlook for the UK economy from the BoE and the High Court ruling has moved markets to push up the USDGBP and recoup much of the depreciation incurred over the past month.

- While a rosier economic outlook may be in the cards for the UK economy, the long-term costs of Brexit to the UK economy have not disappeared. Slow labour force growth due to decreased migration to the UK, and weaker labour productivity growth from weaker business investment will work to slow trend output growth. Nevertheless, better than expected economic growth in the third quarter of this year is likely to drive up our near-term forecasts for UK economic growth (TD Economics September 22, 2016: 1.7% and 0.8% in 2016 and 2017, respectively).

- With the BoE now likely on hold for the foreseeable future, all attention now turns to the fall statement by the UK government on November 23rd which could detail a package of fiscal stimulus measures to help the UK's complex adjustment to a post-EU world.

Fotios Raptis, Senior Economist
416-982-2556

@TD_Economics