Market Bulletin

February 7, 2019

Bank of England still constrained by Brexit uncertainty

The Bank of England (BoE) Monetary Policy Committee (MPC) today voted unanimously to keep interest rates at 0.75%. This was in-line with market expectations and as such there was a muted market reaction to the announcement.

For now, Brexit uncertainty continues to constrain the BoE from significantly altering its direction of monetary policy. As a result, the normalisation of interest rates for the BoE has been gradual to say the least, with rates only 50 basis points higher than where they were following the post-referendum interest rate cut. The BoE will be hoping that when they meet at the next inflation report meeting in May, there will be some clarity on the direction of travel.

On the Bank's latest forecasts for growth (**Exhibit 1**), real GDP growth for 2019 and 2020 was downgraded to 1.2% year-over-year (y/y) and 1.5% y/y respectively. The BoE Governor Mark Carney cited slower estimates for global growth, and an assumption of a longer period of Brexit-related uncertainty than it had previously anticipated, as the primary drivers of the changes. For 2021 the growth forecast was revised up to 1.9% y/y.

Exhibit 1: Bank of England forecasts

	GDP (y/y)				CPI inflation (y/y)			
Meeting	2018	2019	2020	2021	2018	2019	2020	2021
Nov-18	1.3%	1.7%	1.7%	1.7%	2.5%	2.1%	2.1%	2.0%
Feb-19	1.4%	1.2%	1.5%	1.9%	2.3%	2.0%	2.1%	2.1%
Change	+0.1%	-0.5%	-0.2%	+0.2%	-0.2%	-0.1%	-	+0.1%

Source: Bank of England, J.P. Morgan Asset Management. y/y is year-over-year. Data as of 7 February 2019.

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Governor Carney also highlighted that the labor market continues to tighten and that underlying domestic inflationary pressure is building. With employment growth still strong, wages now rising at the fastest rate since 2008, and the employment rate at its highest level since comparable estimates began in 1971, the labor market continues to show signs of limited excess capacity.

The question therefore for the BoE at future meetings will be whether the current low levels of interest rates are still appropriate for such a strong labor market. It is worth remembering that before the Brexit debate began in 2015, the BoE was slated to be the first major developed central bank to normalise monetary policy, ahead of the Federal Reserve. Had the referendum not occurred, it seems likely that interest rates would be higher than their current level.

We expect that if Brexit uncertainty is at least partially resolved, and a risk of no-deal is taken off the table, then the Bank would like to see rates higher than their current low levels. This point is reiterated by the BoE's latest forecast, which still sees inflation above its 2% target in the medium term.

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