Market Bulletin

7 November 2019

New Bank of England Governor to be greeted by a change in the fiscal wind

Today the Bank of England's (BoE) Monetary Policy Committee met, and voted by a majority of 7-2 to keep the policy interest rate at 0.75%.

The outlook for UK interest rates remains highly dependent on the outcome of the 12 December general election. The only certainty for the Bank of England at this stage is that whoever wins the election is planning to loosen the purse strings. The fiscal headwind the Bank of England has faced for much of this expansion is about to become a tailwind.

Of course whether the election serves to resolve Brexit uncertainty remains to be seen. The polls currently point towards a Conservative majority government, but there is also a significant possibility that the election results in a hung parliament. A Conservative majority might provide the most near-term clarity as it would be highly likely that the UK would leave the EU on 31 January 2020 with Boris Johnson's negotiated deal. However, the Brexit reprieve may prove short-lived if the period of transition is not lengthened, given the final partnership still needs to be thrashed out. The negotiated backstop has much of the UK leaving the customs union, which will still require a lot of re-routing of supply chains. This may limit the extent of a post-deal economic bounce.

By contrast, a hung parliament may not deliver decisive near-term Brexit progress but could ultimately lead to a compromised solution. This would most likely be a softer Brexit than that delivered by the Conservative party alone. For a detailed analysis of the upcoming election and implications for markets please see *"On the Minds of Investors – Will a general election in the UK solve the Brexit impasse?"*

Regardless of the election outcome, a knee-jerk policy response from the Bank looks unlikely. Both because of a need to remain apolitical immediately after an election, and because sterling will likely do much of the Bank of England's work. An appreciation in sterling on the back of a market-friendly outcome would dampen imported inflation, while a depreciation in a less market-favourable scenario could boost UK inflation and limit the need for an immediate policy response.

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The Bank assess that the UK economy remains on solid footing, but that Brexit uncertainty and slowing global growth have weighed heavily on the economy this year. The Bank expects that Brexit uncertainty for households and businesses will have been reduced by the recent agreement of a new deal between the EU and the UK, as the perceived chance of a no-deal exit has fallen. It therefore forecasts that based on more supportive fiscal policy, improving domestic dynamics from reduced uncertainty, and a recovery in global growth, that growth should improve markedly in the coming year.

And on inflation the Bank forecast that inflation will still be above target by the end of the forecast horizon. As these forecasts are now based on the assumption of a deep free trade agreement between the UK and the EU, and a modest easing in monetary policy over the forecast period, we would expect that the Bank is unlikely to cut interest rates next year if a deal is implemented shortly after the election.

Bank of England Governor Mark Carney is due to step down at the end of this January, and we will have to wait until after the election to find out who his successor will be. The incoming governor is likely to inherit a similarly uncertain economic outlook. The Bank is likely to remain paralysed—with rates on hold—until both Brexit and global fogs have cleared.