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Andrew Wroblewski

Chief Economist, Eurozone and UK

London

+44 20 7959 3244

awroblewski@decisioneconomicsinc.com

UK: BoE Worries on Supply Side More Evident?

But Eurozone Concerns Still Dominate

The latest (May) BoE Inflation Report provided some rationale for the MPC decision this month not to extend its asset purchases. Admittedly, the Report seemingly leaves open scope for a further increase in asset purchases at some juncture, especially *as the projections cannot fully incorporate the risks stemming from what could be disorderly developments in the Eurozone*, at least over and beyond those already evident in funding costs and confidence.

Balanced Inflation Risks

However, while the Report still sees a continued undershoot of the 2% target, and at least as sizeable as that seen in the February Report, it is notable that *the BoE still considers that the risks to the inflation projections at the forecast horizon to be balanced rather than skewed to the downside as was the case through 2011*.

Cannot Quantify Eurozone Risks Fully

The former is the case despite a weaker growth outlook, albeit with the BoE more open that this partly stems from what it describes as an unusually slow rise in the supply side of the economy, and with the balance of risks suggesting a return to trend growth by the end of the forecast horizon. As for risks, the Report is again quite candid that the greatest of these continue to come from the Eurozone. However, and very notably, the MPC still sees no meaningful way to quantify all such risks and therefore many are excluded from its updated fan charts, as was the case in the last three Reports. In other words, *the downside risks may be greater than embodied in the fan chart projections*.

MPC Divisions Still Probable

Regardless, the clear worries and uncertainty regarding the supply side of the economy implies that some MPC members may not yet be convinced enough of the disinflationary pressures implicit in this outlook. Indeed, there *may have been clear divisions in the vote this month not to extend asset purchases*; a fuller picture of central bank thinking may come from the minutes to the May MPC meeting due next Wednesday, possibly revealing whether some members are wary that asset purchases may actually have become counter-productive. However, BoE worries about the supply side still pale into insignificance compared to the (impossible to calculate) risks it perceives still emanate from the Eurozone.