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Central Bank Outlook

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February 1, 2013

UK: BoE Debate Intensifies, Both Present and Future

by Andrew Wroblewski

The BoE comes back into the spotlight this week, both in terms of current policy and also how future policy may be shaped. Current policy will obviously be addressed at the MPC meeting which gives its usual monthly verdict on Thursday, albeit possibly more primed than in other months to consider further stimulus given the in-depth assessment it will have made in drafting the Inflation Report (the latter due for publication on February 13).

Maturing Gilts. An added complication is that some of the gilts the BoE owns start to mature in coming months, with it likely that the MPC will decide at this meeting to reinvest the proceeds so as to maintain an outstanding stock of £ 375 bln, at least for the time being. If so, the question is whether any such decision will be revealed this Thursday or instead left to another time, such as the publication of the meeting minutes.

Clear Reasons for No Further Stimulus. Regardless, against the backdrop of a fresh and surprisingly large drop in Q4 GDP, the case for a resumption of asset purchases over and beyond the £ 375 bln could seemingly be made. However, especially with diminution of financial market strains and better signs from abroad, the weakness in those GDP numbers will create no reverberations within the BoE save to make the central bank realize that perhaps further headwind faces the economy, namely the trend decline in oil output, this being the main factor that caused that Q4 drop.

FLS Increasingly Influential? Instead, the BoE will be impressed by the signs that the Funding for Lending Scheme (FLS) is having some impact in boosting the housing market, a development that, in turn, may act to bolster consumer spending. In this regard, several MPC members may already be regarding the FLS as a substitute for further stimulus via asset purchases, also taking the view that the fall back in the trade-weighed pound in the last month has also provided some stimulus and/or caused more upside inflation risks.

Inflation Still Above-Target. Inflation risks will also clearly be discussed by the MPC, these clearly being evident of late. Indeed, aside from the hawks on the committee who have been overtly worried about (weak) productivity, *a growing theme of late within the BoE is the worry that persistent above-target inflation will not only damage central bank credibility but may soon affect wage-setting behavior*. In this regard, some on the MPC will be pointing to the fact that CPI inflation is not only still above target, but is also running (possibly increasingly) above BoE projections, at least those laid out in the November Inflation Report. NB: The MPC meeting will be given a draft of the January CPI data which may show a fresh rise!

Policy Reservations? Finally, at least some on the MPC seem to be of the view that the asset purchases have become less effective, especially in regard to the impact on demand. Indeed, Governor King used a keynote speech two weeks ago to highlight his reservations about what monetary policy can do, particularly in the current atypical business cycle. His reservations about any further policy stimulus at this juncture may be all the greater given hints he has provided about risky investment re-emerging. In another recent set of comments, Governor King stressed his concern about markets searching for yields amidst a weak economic backdrop.

Carney Blarney! The reservations Governor King has regarding what monetary policy can do seemingly contrast with those hinted by the man who will succeed him at the helm of the BoE in June. Indeed, Mark Carney has used several high-profile speeches of late to underscore his view that he thinks monetary policy has more to offer, the question being the extent to which current central bank remits would have to be changed or made more flexible in order to do so. Specifically, Carney has underlined that monetary policy should try and push any economy towards what has been termed an escape-velocity, this possibly necessitating inflation being above any explicit target for an extended period.

Flexible Inflation Target? In this regard, Carney was seen even hinting that he may even prefer a shift to targeting nominal GDP rather than inflation, an area of debate highly divisive with the economic fraternity. More recently, however, he seems to be embracing a more flexible inflation target, possibly a result of pressure from the UK Government which is wary of altering any BoE mandate too significantly particularly during a period when inflation is above target. Instead, Dr Carney could be contemplating a change in the inflation measure or either more specific or conditional guidance on what will commit the central bank to any particular policy stance.

Carney Testifies! All of which makes the appearance by Dr Carney before a UK parliamentary committee on Thursday of added interest, this being the first and possibly only such time he will have appear under such auspices before he takes up his new role. He will surely be sounded out in regard to the issues discussed above. However, perhaps several other areas may deserve equal attention, one area that markets have overlooked being the extent to which he echoes or not the current attempt by some on the MPC to talk down sterling.

DE View: For a start, while it is unclear what kind of pace of growth represents escape-velocity, if the economy is growing a moderate pace by mid-year (as DE expects) would this preclude, or at least defer, the need to alter the policy framework. Secondly, Dr Carney must suggest to what extent he would be willing to override any opposition in the rest of the MPC in changing the MPC remit to any degree. It is already the case that the MPC is spilt into three camps, with even the more dovish element having questioned the need for any material change from the current status quo. Notably, while a change in the mandate may make some of the MPC feel able to go along with a change to their remit, some members may not wish to work under any other framework: MPC resignations would be very messy for any new Governor!