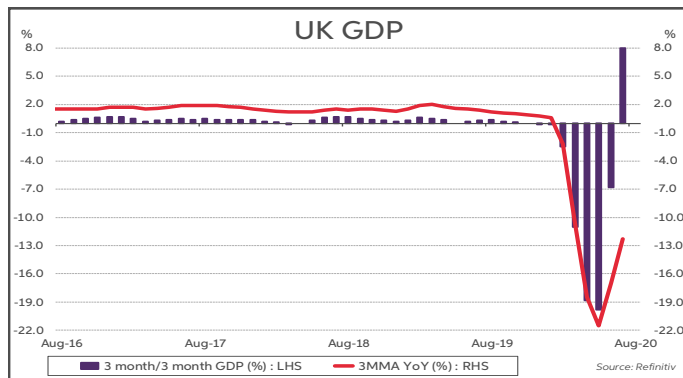


## BoE expands its QE and retains bias to do more

The November meeting of Bank of England's Monetary Policy Committee (MPC) meeting concluded as expected with the Bank Rate being maintained at 0.1%. However, the Bank did expand its asset purchase programme.

It announced a £150bn increase of its target stock of UK government bond purchases, which will see its total stock of all purchases rise to £895bn. This was higher than the £100bn expansion that was forecast by most analysts. Both the decision to leave rates unchanged and expand its QE programme were unanimous. It expects to complete these additional asset purchases around the end of 2021.

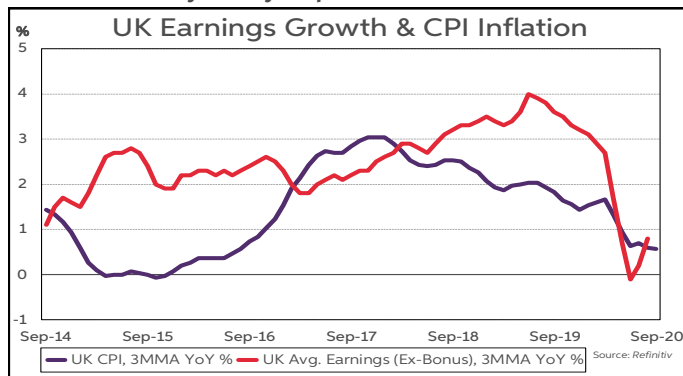


In the meeting statement and minutes, the BoE outlined its rationale for providing further stimulus to the economy. It noted that the outlook remained “unusually uncertain” in the context of the evolution of the pandemic and associated measures to contain it. This is on top of the risks to the economy from the transition to a new trading arrangement with the EU. Not surprisingly, it was of the view that the risks to the outlook for activity were “skewed to the downside”, while the inflation risks were assessed to be “balanced”. It also referenced the likelihood that recent Covid related developments (i.e. new restrictions) were likely to have a further dampening effect on activity.

Therefore, it decided following this assessment of the risks to the economy that “policy should lean strongly against the downside risks to the outlook”. All MPC members were in agreement that a further easing of monetary policy was warranted now to support the economy and help ensure that the “unavoidable near term slowdown” was not made worse by a tightening in monetary conditions.

This more cautious near-term view on the economic outlook was also reflected in the BoE's latest economic forecasts which were released today as part of the November edition of its Monetary Policy Report. The Bank's more downbeat

assessment of the outlook compared to its last update in August, including its expectation that the economy will return to contraction in Q4 (-2% q/q versus previous forecast for +3.5%), saw it revise downwards its full year expectation for GDP in 2020. It is now forecasting a contraction of 11% for this year as a whole versus its August forecast for a 9.5% contraction. It also lowered its GDP growth projections for 2021 from 9% to 7.25%. However, for 2022, it is now pencilling in much stronger growth of 6.25% (+3.5% in August). These forecasts indicate that the BoE expects the UK economy will only get back to its pre-Covid levels in the first half of 2022. Once again the above projections were based on the assumption of the UK-EU FTA being in place at the start of 2021.



The BoE continues to be of the view that CPI inflation will remain below 1% until early 2021. Thereafter, it envisages it rising “quite sharply” and is projected to be at 2% in two years time. Meanwhile, it revised higher and pushed out the timing of its estimate for where/when the unemployment rate will peak, from 7.5% (Q4'20) to 7.75% (Q2'21)

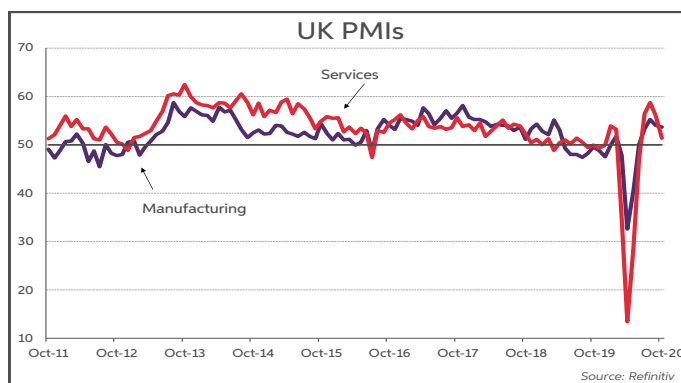
Overall, it is clear from the dovish tones contained in the various updates today from the BoE, including detailed discussion of downside risks and downward revision to forecasts, that the BoE retains a bias to ease policy further if required. However, in this context there was no mention in the minutes of any discussion that took place in relation to a negative interest rate policy.

In terms of market expectations, futures contracts indicate that the market is anticipating that the BoE will cut interest rates by at least 10bps in the coming year. This would take the Bank Rate down to zero, and the market is even discounting the possibility that rates could go slightly negative. Rates in the UK are not seen rising above their current levels until H2 2024.

## Lockdown likely to cause GDP to contract in Q4

The UK economy contracted by 19.8% in the second quarter of 2020, leaving the annual growth at -21.5%. The decline was the largest on record for the UK, with the economy being one of the worst impacted by the Covid-19 recession. This largely reflected the long duration of the UK restrictions. Activity staged a slight recovery in May (+2.4%), before a more pronounced rebound in June (+8.7%).

The PMIs for Q3 were consistent with a continued economic recovery. While the services and manufacturing PMIs both slipped back in September, they remained expansionary. Overall, the manufacturing PMI averaged 54.2 in Q3, with the services index at 57.1. On the demand side, the Gfk consumer confidence measure also improved, although the index remains at a very subdued level.

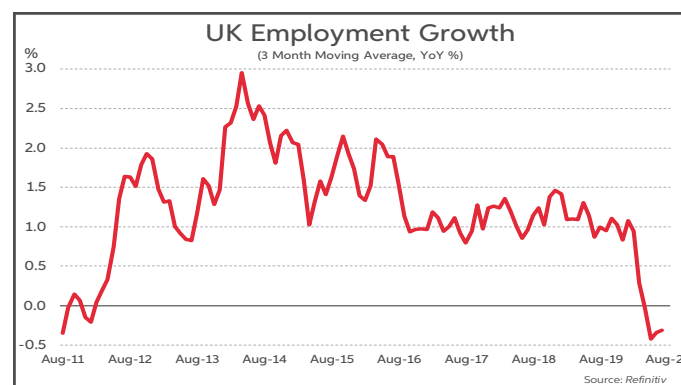


The available 'hard' data backs up the view that the UK economy rebounded strongly in Q3. Retail sales increased, albeit at a slowing monthly pace throughout the quarter. Retail sales were 3.9% above their pre-Covid levels in value terms, and 5.5% higher in volume terms, in September. The monthly GDP estimates, which are calculated by the output method, show a continued expansion in July and August of 6.6% and 2.1% m/m, respectively. Although, this leaves GDP 9.2% below its February levels. Despite a strong rebound in Q3, the new lockdown in November is likely to see GDP contract again in Q4.

For now, the labour market continues to be sheltered by the Government's furloughing scheme. Nonetheless, the unemployment rate edged up to 4.5% from 4.3% in August, as the number of people employed fell by 153,000. The national furlough scheme has been extended until the end of March 2021, as the UK deals with its winter lockdown. The self-employed income support grant has also been increased to support sole traders. However, the outlook for the labour market remains much less benign next year, with the unemployment rate likely to rise in 2021 once the furlough scheme is wound down.

In relation to inflationary developments, the headline CPI rate remains rose from 0.2% in August to 0.5% in September. A rise in transport costs and the end of the "Eat Out to Help Out" scheme contributed to the upward move. However, with new restrictions introduced throughout October, and with the UK re-entering lockdown in November, inflation is not expected to rise anywhere near to 2% anytime soon.

Despite a strong rebound in Q3, near term downside risks continue to weigh on the UK economy. While the October PMIs suggest the recovery continued at the start of Q4, the national lockdown imposed in November is likely to cause output to contract in Q4. There is also the possibility that the lockdown may need to stay in place beyond November which would inflict further damage to the economy.



However, the contraction in GDP will not be as severe as in the Spring. This is because the current lockdown is not as restrictive. Manufacturing and construction remain open, while other businesses are better prepared, and able to offer services such as click-and-collect. The government's continued fiscal support and the BoE's monetary policy stimulus are also providing support to the economy. However, the latest GDP forecast from the BoE have been revised downwards. The central bank now expects GDP to contract by 11% in 2020, before rebounding by 7.25% in 2021, and 6.25% in 2022. This would mean output would not regain its pre-Covid levels until H1 2022. The IMF's current projections are for UK GDP to fall by 9.8% in 2020 before recovering by 5.9% in 2021 and 3.2% in 2022. This would mean that GDP would not regain its 2019 level until 2023. Both of these forecasts assume the UK and EU agree on a trade deal and thus, a disruptive no-deal outcome is avoided.

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