

## Bank of England 'forward guidance' boosting business investment

- **Markit survey suggests companies feel more confident about prospects for UK economy due to introduction of 'forward guidance'**
- **Investment plans have been boosted by changes in Bank policy**
- **Three-quarters of all companies surveyed expect the Bank to raise interest rates within the next two years**

The information contained in this note is based on a survey by Markit of 231 UK manufacturing, service sector and construction companies between 1st – 8th November 2013, and first published today in the Bank of England's Inflation Report<sup>1</sup>.

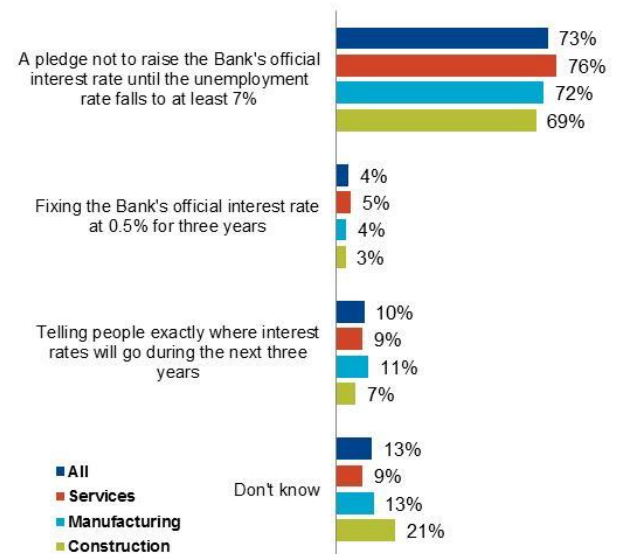
The Bank of England's policy of 'forward guidance' and its related policy communications have made the majority of companies feel more confident about the near-term prospects for the UK economy, according to a survey conducted by Markit. The Bank's new approach has also made companies more likely, on average, to make investments and bring forward capital expenditure. However, almost three-quarters of companies also expect interest rates to start rising within the next two years.

### Clear understanding of 'forward guidance'

The Bank's policy of 'forward guidance' was generally found to have been well understood by the business community, with 73% of companies identifying the main thrust of the policy to be a pledge not to raise the Bank's official interest rate until the unemployment rate falls to at least 7%. However, 13% of companies did not know what the new policy was, rising to 21% in construction, and 14% had misunderstood the message as being either fixing rates at 0.5% for three years or telling people exactly where interest will go over the course of the next three years.

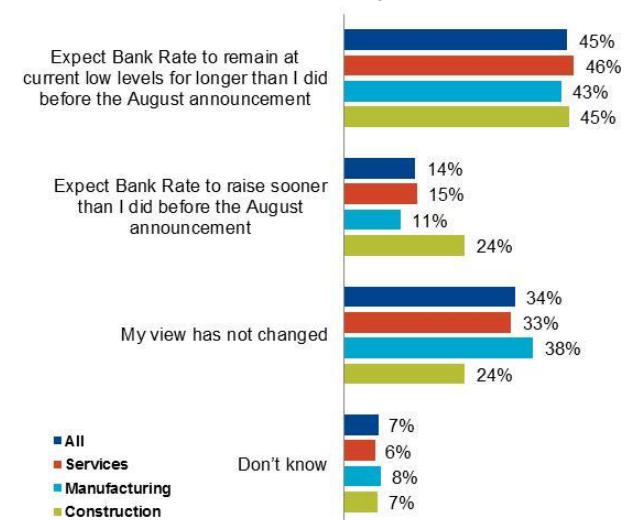
### Companies' understanding of 'forward guidance'

The Bank of England announced a new policy known generally as 'forward guidance' in August. Which of the following do you feel best describes the central message of that policy:



### How 'forward guidance' has changed companies' views on interest rates

Which of the following best describes how the Bank's policy guidance has changed your view of when the Bank Rate (the official interest rate) will next change?



Source: Markit

<sup>1</sup> Bank of England Inflation Report, February 2014. <http://www.bankofengland.co.uk/publications/Documents/inflationreport/2014/ir14feb.pdf>

### Expectations of first rate rise pushed back

The change in policy approach clearly had an impact. Some 45% of respondents indicated that they expected the Bank Rate to remain at its current historic low for longer than they did before the August announcement. By comparison, 34% reported that 'forward guidance' had not changed their view on changes in interest rates and 14% considered it was more likely that rates would rise sooner than under the previous 2% inflation targeting framework.

### Positive impact on economy

The survey data also indicated that the Bank's policies and communications had positively affected companies' confidence about the near-term prospects for the UK economy.

Some 58% of respondents were more confident about the UK's prospects over the course of the next one to two years, though only 7% of those were 'much more' confident. Only 3% reported that they had lost confidence compared to before the Bank's recent policy change and related communications.

Manufacturing saw the biggest improvement in sentiment about the economy, while services saw optimism improve to the least extent.

### Companies set to increase spending

The survey data suggested the Bank's recent policies and guidance had a positive net effect on companies' plans to bring forward existing capital spending, increase their investment spending, and purchase other assets such as property and financial assets.

Some 14% of companies were more likely to bring forward their existing capex plans than prior to the introduction of 'forward guidance', while just 4% were less likely. Some 17% meanwhile reported that the new policy framework had encouraged them to increase their overall investment spending while just 4% were less likely to boost investment.

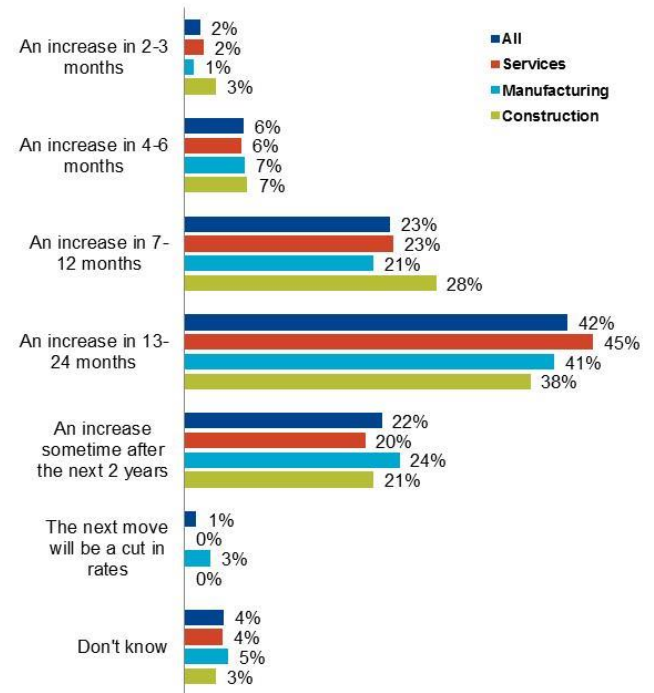
Similarly, 17% said they were now more likely to purchase assets such as property or financial assets against just 7% that were less likely.

However, with interest rates expected to rise, companies were less likely to take on more debt. Just 9% of companies reported that the Bank's current policies and guidance are likely to result in them taking on more debt (either via banks or capital markets) while 14% were less likely to increase their debt levels.

Moreover, only 5% were encouraged to raise their cash holdings while 9% were less likely.

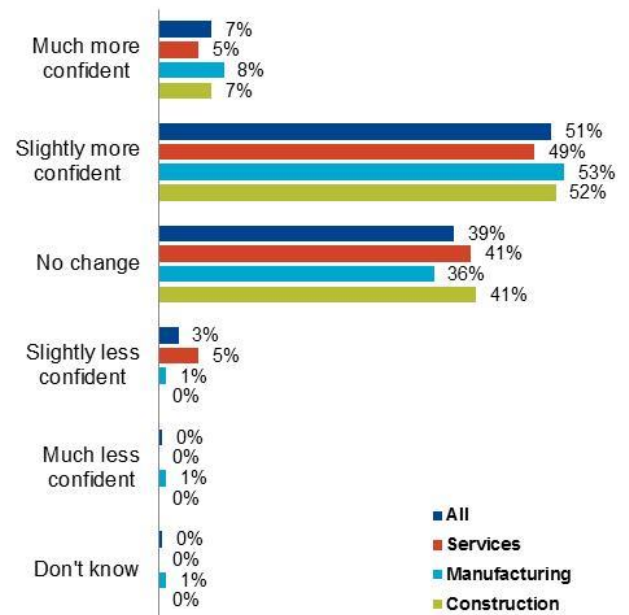
### Companies' views on interest rates

The interest rate set by the Bank of England is currently 0.5%. Please let us know when and how you think the Bank will next change interest rates by choosing one of the options below:



### How companies' confidence about prospects for UK economy has been affected by policy change

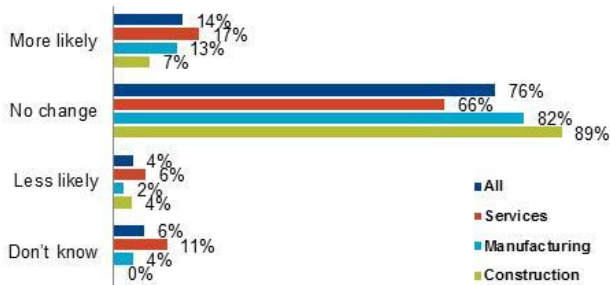
How have the Bank's recent policies and communications affected your confidence about the near-term (1-2 year) prospects for the UK economy as a whole?



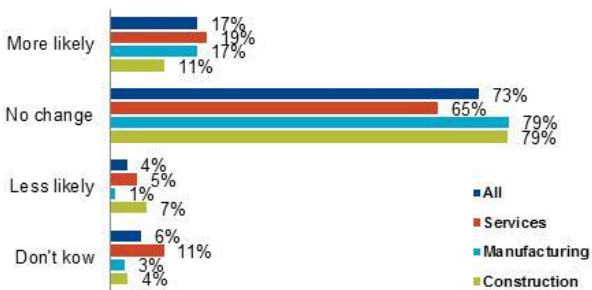
**Behavioral changes due to ‘forward guidance’**

*How have the Bank’s recent policies and guidance influenced your company’s decisions in relation to....?*

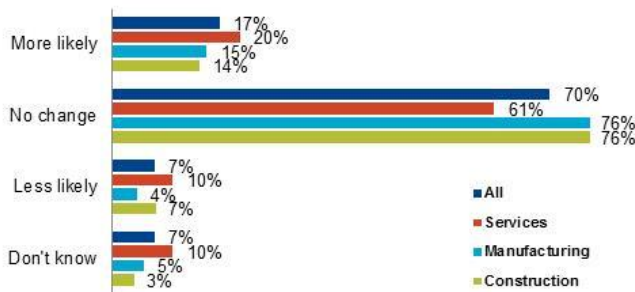
**Bring forward existing capital spending plans**



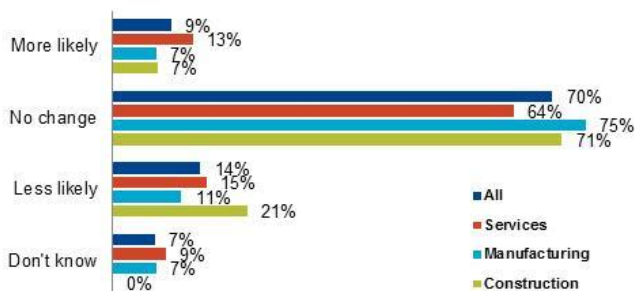
**Increase investment spending**



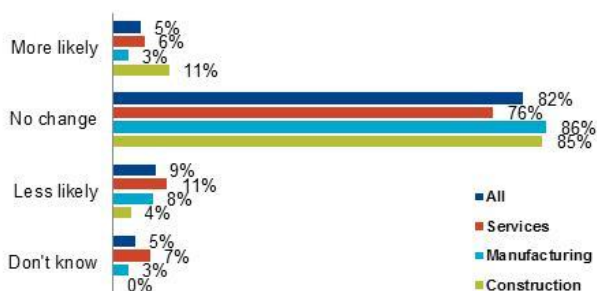
**Purchase other assets, e.g. property, financial investments**



**Take on more debt (from banks or capital markets)**



**Reduce cash positions/holdings**



**Chris Williamson**

**Chief Economist**

Markit

Tel: +44 207 260 2329

Email: [chris.williamson@markit.com](mailto:chris.williamson@markit.com)

[Click here](#) for more PMI and economic commentary.

For further information, please visit [www.markit.com](http://www.markit.com)