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United Kingdom

Bank of England holds policy amid signs of economy gaining momentum

- **BoE policy unchanged at £375bn QE and 0.5% interest rate**
- **Signs of economy reviving have added to the case for inaction, but great uncertainty persists**

The Bank of England's Monetary Policy Committee voted to keep policy unchanged at its April meeting. The decision is likely to have been a close call, and there is much uncertainty about whether further stimulus will be sanctioned in future meetings.

While there are signs that the economy is picking up again, the government has clearly put the onus on the central bank to ensure any recovery is robust and counteract austerity-focused fiscal policy.

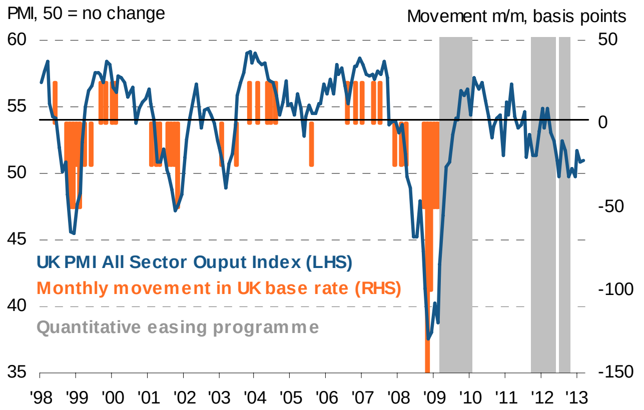
In the absence of surprisingly strong economic indicators in coming months, there is therefore a possibility that we will see far more aggressive policy action on the arrival of new Bank governor Mark Carney in July, matching a similar more aggressive approach announced today in Japan at new Bank of Japan boss Haruhiko Kuroda's first policy meeting.

Signs of renewed life in the economy

There is a strong case for keeping policy unchanged, with clear signs that the economic recovery is gaining momentum again. The March service sector PMI showed the strongest growth in business activity since the Olympics-related upturn last autumn, helping offset downturns in manufacturing and construction. The latter in part reflected weather-related disruptions to business in the first few months of the year, meaning the underlying trend is likely to have been much firmer had the weather been better. With PMI future business confidence indicators also rising in March, prospects look good for a reasonable looking GDP expansion in the second quarter.

It's not just the PMI that are giving out positive signals. The labour market continues to improve, consumer confidence is rising, retail sales rebounded in February and recent tax revenue figures are consistent with a growing economy. There are also signs that the housing market is picking up, both in terms of prices and transactions, buoyed probably by the Funding for Lending Scheme.

Bank of England policy and the PMI



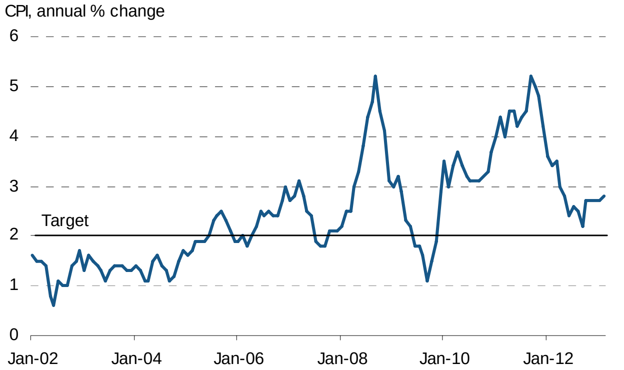
Alongside these positive developments, inflation has risen further above the Bank's 2.0% target, hitting 2.8% in February, although recent changes to the Bank's remit in the March Budget mean these price developments have become less of a concern for policymakers.

The case for further stimulus

The main concern is that the UK's main trading partner – the eurozone – remains firmly mired in recession, with the downturn also showing signs of worsening in March, according to the PMIs. Falling demand in continental Europe will inevitably continue to act as a dampener on the UK economy, irrespective of any competitive advantage the depreciation of sterling might provide. However, growth is picking up in other overseas markets, notably in the US, China and Japan. This should help allay fears of the extent to which weak demand from the Eurozone could impact the UK.

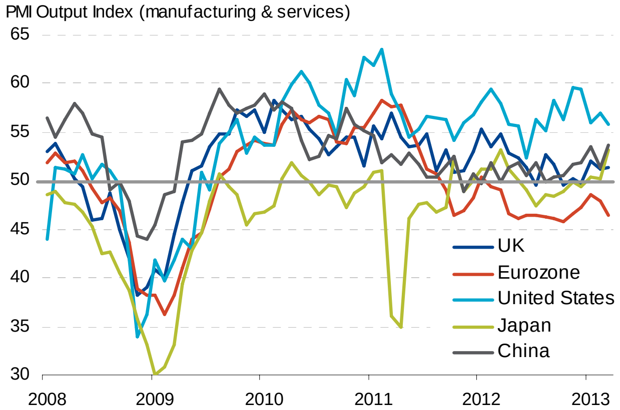
Perhaps the main reason to expect further stimulus is therefore that the new governor, Mark Carney, will want to be seen to be pro-active in generating a more sustainable and robust looking recovery when he takes up his new position in July. After all, although the PMIs have picked up since late last year, the surveys remain consistent with further central bank stimulus, according to the close historical relationship that exists between the surveys and past policy decisions.

Inflation



Source: Office for National Statistics (via Ecowin).

International PMIs compared



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