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Markit Economic Research

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United Kingdom

Bank of England holds policy amid uncertain outlook

- **Bank of England leaves policy unchanged at July meeting amid 'Grexit' fears and low inflation**
- **Signs of post-election economic upturn and wage growth revival add to scope for rate rise later this year**

There were no surprises at the Bank of England as the Monetary Policy Committee left interest rates at their record low of 0.5% after their July gathering.

No statement was made but, with inflation at just 0.1%, the Bank's inflation target of 2.0% is clearly still a long way off and, with 'Grexit' concerns casting a dark cloud of instability over the economic outlook, now is clearly not the time for central banks to be causing further uncertainty.

However, policymakers will most likely continue to lay the ground for rates to start rising later in the year if we see a positive resolution to the Greek crisis and the UK economy continues its recent impressive performance in coming months.

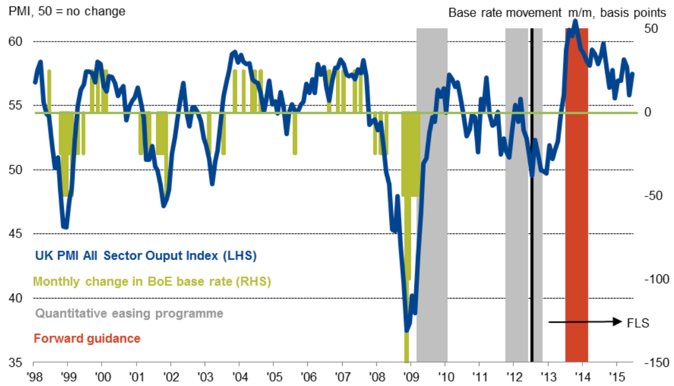
A post-election pick up in the [Markit/CIPS PMI surveys] indicates the economy looks to have grown 0.5% in the second quarter, up from 0.4% in the first three months of the year. While by no means tear-away growth, the solid first half of the year puts the economy on course to grow by just less than 2.5% in 2015, which is at the top end of estimates of the country's long-term trend rate. Employment meanwhile continues to rise, pushing unemployment down to a seven-year low, and wage growth has picked up to its highest since 2009.

Much of the current weakness of inflation is also due to the drop in oil prices and appreciation of sterling, effects which we should see start to reverse in the second half of the year and early next year.

Clearly, however, uncertainty surrounding the Greek debt crisis and the unknown impact that 'Grexit' might have on the economy will deter the Bank from tightening policy until there is a viable long-term solution in place. Policymakers will also cite worries about the impact of the strong pound, which is showing signs of having severely hampered the performance of the manufacturing sector via falling exports, as well as slowing global economic growth amid a renewed downturn in the emerging markets. There are also doubts that wage growth will continue to build, as low inflation looks set to restrain annual wage negotiations.

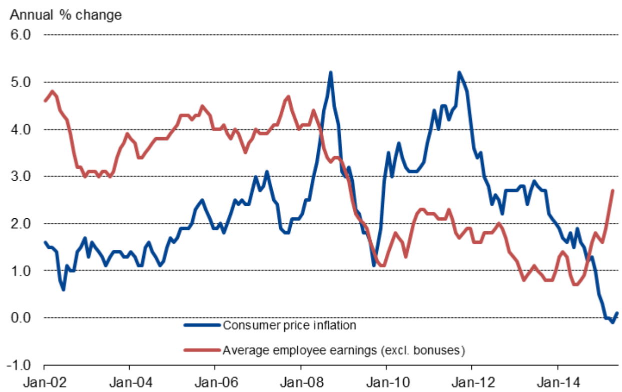
The uncertainty over the outlook means that, even if we see a swift resolution to Greece's problems, the decision on whether to hike interest rates looks set to remain finely balanced for some time to come, and could easily be pushed into next year.

Bank of England policy decisions and the PMI



Source: Markit.

Inflation and wages



Sources: Markit, Office for National Statistics

Chris Williamson

Chief Economist, Markit

Tel: +44 207 260 2329

Email: chris.williamson@markit.com

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