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United Kingdom

Bank of England keeps monetary policy unchanged

- **Interest rates held at 0.5% and QE unchanged at £375bn**
- **Above-target inflation and service sector growth likely to have deterred further easing**
- **Concerns over policy effectiveness suggest outlook is for weak economic growth at best**

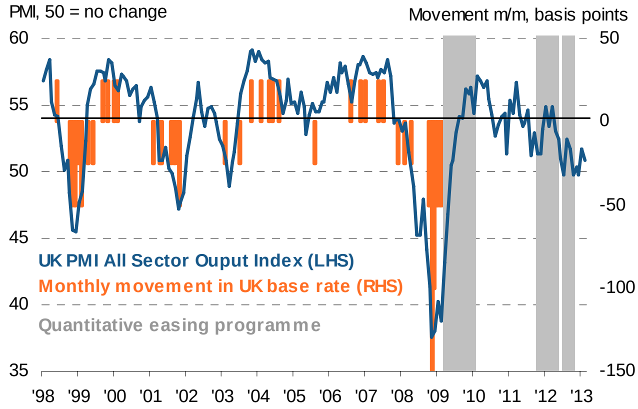
The Bank of England's Monetary Policy Committee voted to keep policy unchanged at its March meeting. Signs of better growth in the service sector alongside above-target inflation is likely to have convinced some members that further stimulus was not appropriate at the moment. However, the concern is that monetary policy alone is proving ineffective in stimulating a meaningful recovery and, given the absence of government initiatives to remove the obstacles still impeding the economic recovery, the outlook is one of further stagnation or modest growth at best.

The lack of action comes as only a minor surprise: although three of the nine MPC members had already voted for further QE in February, including Bank Governor Mervyn King, the recent economic data leave the overall impression of an economy that is showing some signs of pulling out of the downturn seen late last year.

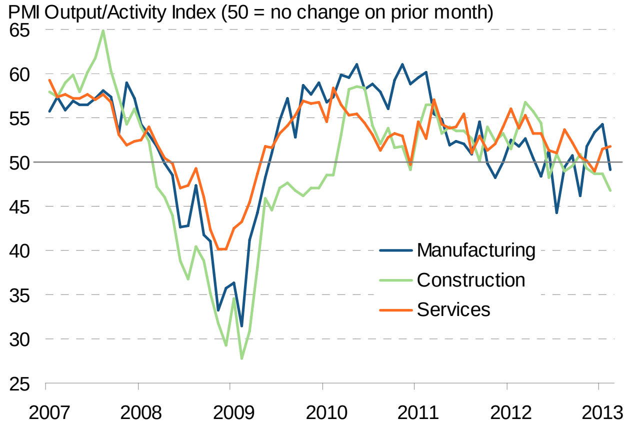
Manufacturing and construction PMI surveys showed worrying falls in activity in February, but these declines could be in part attributable to business being disrupted by bad weather. The disappointments were also countered by a better than expected increase in the services PMI, as well as signs of further growth of retail sales and house prices. Taken together, the various indicators suggest that the UK is on course to muster a 0.1% increase in GDP in the first quarter, which is hardly a cause for complacency or celebration, but at least means the country is on course to avoid a "triple-dip" recession and is showing some signs of gaining momentum.

The lack of action today does not rule out future easing. Importantly, despite the rise in the services PMI in February, the PMIs remain at a level that is historically consistent with the Bank easing monetary policy.

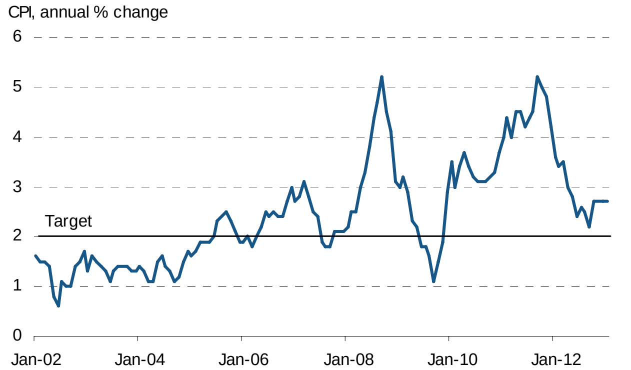
PMI surveys and monetary policy



Services growth offsets manufacturing and construction weakness



Above-target inflation



Source: Office for National Statistics (via Ecowin).

Policy effectiveness

The concern is that, with QE now totalling £375bn – a far greater a proportion of GDP than the US, for example – and interest rates at a record low of 0.5%, monetary policy on its own is clearly insufficient to generate anything like meaningful growth in an economy that is sill facing major constraints.

Despite the Funding for Lending Scheme, bank lending fell in the final quarter of last year, highlighting the still dysfunctional banking sector, real wages are falling and austerity is sapping demand both at home and in many traditionally important export markets.

The current limitations of monetary policy have been recognised by Sir Mervyn King, as well as by other central banks around the world - including the ECB and the Bank of Japan. In the absence of any new government policies to address these constraints, the outlook for the UK is therefore one of very modest growth at best for the foreseeable future.

Analysts will therefore be looking at possible changes to the Bank of England's remit on the appointment of Mark Carney as new governor in July, an in particular to see if new tools become available to the Bank of England to help revive the fragile economy.

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