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United Kingdom

Bank of England loses appetite for stimulus as economy picks up speed

- **No MPC members vote for more stimulus in September**
- **No 'knockouts' deemed to invalidate forward guidance**

The minutes from the September meeting of the Bank of England's Monetary Policy Committee showed waning support for more stimulus amid signs of the economic recovery gathering momentum.

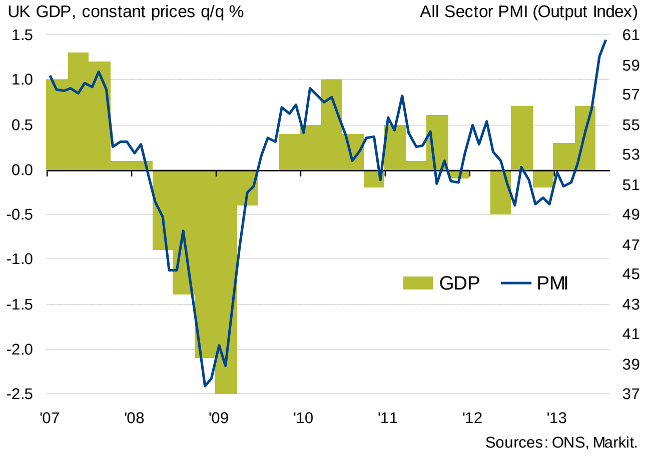
Earlier in the year, two MPC members (Miles and Fisher) had voted for more stimulus. Since then, the economic data flow has improved dramatically. Economic growth was revised up to 0.7% in the second quarter, and business surveys such as the PMIs suggest that a further acceleration, possibly beyond 1.0%, is likely in the third quarter. (The minutes show the Bank is expecting a 0.7% rise, up from its August prediction of 0.5%). Although the minutes noted that more stimulus could be sanctioned if the recovery faded, "no member judged that further stimulus was appropriate at present".

Economic data hit new record highs

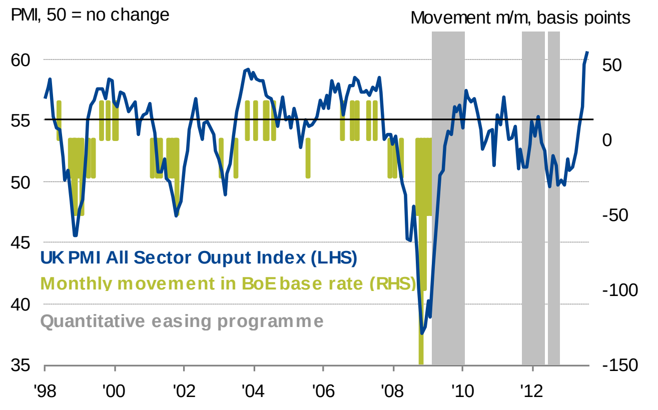
The lack of appetite for more stimulus comes as no surprise. The UK economy has moved up a gear in recent months, buoyed by numerous factors, including a revival in its main trading partner, the eurozone. The single currency area saw its economy pull out of recession in the second quarter, with GDP expanding 0.3%. Meanwhile, at home, consumer confidence has risen to post-crisis highs, fuelled in part by a housing market upturn, and businesses are showing signs of booming.

The all-sector PMI struck record highs in both July and August, moving into territory which in the past would have spooked policymakers into tightening monetary policy through fears of rising inflation. However, with the Bank now focussing on not raising rates until unemployment falls below 7.0%, there is clearly some way to go before rates rise. That said, this perhaps will not be as long as the Bank's guidance of 2016 if the economic data continue to signal such robust growth.

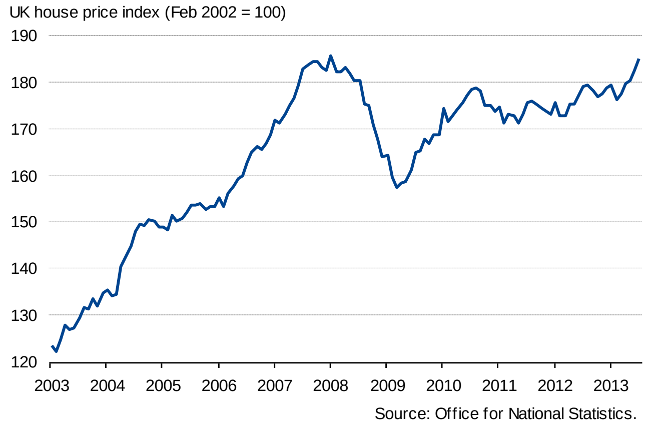
GDP and the PMI business surveys



Bank of England policy decisions and the PMI



House prices



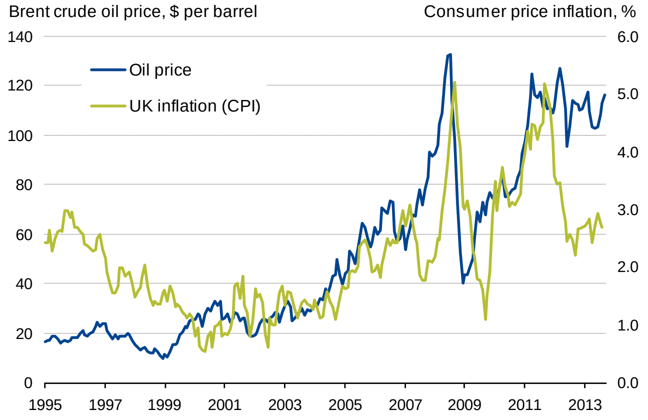
No knockouts

At the moment, the Bank sees none of its three 'knockouts' invalidating its forward guidance.

As far as inflation goes, "the appreciation of sterling meant that CPI inflation was marginally less likely than a month ago to be above 2.5% in 18-24 months' time", and inflation expectations were considered to still be "well anchored". The Bank of England's Financial Policy Committee has also not had the opportunity to judge on potential instability since forward guidance had been announced.

One of the main concerns about the MPC's forward guidance is that leaving rates at historical lows while parts of the economy boom will lead to bubbles, notably in the housing market. House prices in England have now surpassed their pre-crisis peak to reach a new record, according to the Office for National Statistics. The potential for financial instability due to a housing market bubble is clearly something which the FPC is likely to set high on its agenda when it meets today. As far as the MPC is concerned, however, it merely noted that "property market developments would become more of a concern if a period of rapid real house price increases appeared in prospect".

Inflation and oil prices



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