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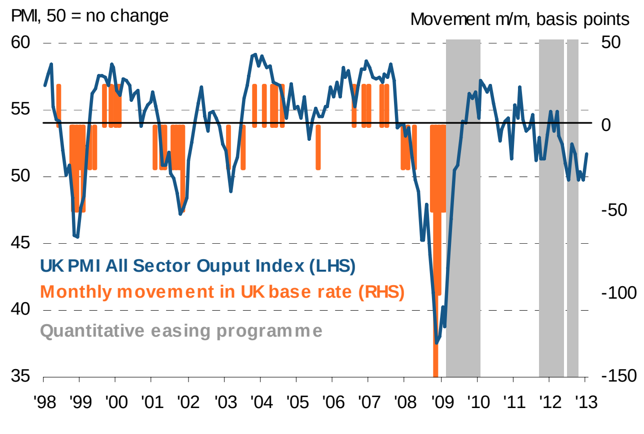
# United Kingdom

## Gloomier Bank of England sees monetary policy alone as insufficient to generate robust growth

- **Forecasts of growth revised down and inflation up**
- **Bank seems ready for more stimulus if economic data worsen**
- **Recovery also dependent on supply side improvements and overseas demand**

The Bank of England revised down its growth projections in its latest quarterly Inflation Report and hiked its expectations for inflation. However, it is clear that the Bank's decisions on monetary policy will not be determined by the rate of inflation for the foreseeable future, and instead be guided by the pace of economic recovery and people's expectations of inflation, which currently remain fairly well-anchored. There is therefore plenty of scope for further monetary policy stimulus if the indicators of economic activity wane after an initial good start to the year.

**Bank policy and the PMI**




The concern is that monetary policy will not be sufficient on its own to generate a satisfactory economic recovery. While dispelling concerns that quantitative easing has become an ineffective policy tool, Bank Governor Sir Mervyn King stressed that monetary policy needs to be accompanied by more targeted measures to boost the supply capacity of the economy and help improve overseas demand for UK-produced goods and services.

### Higher inflation, weaker growth

Three months ago, the Bank expected inflation to fall to 1.8% in two years' time. Now, the two-year horizon will see a rate of 2.3%, and that it will take until the first quarter of 2016 until inflation drops below the 2% target.

As for economic growth, it will be another two years until GDP reaches its pre-crisis peak, representing a "lost" seven years, but that the economy appears to be on a steady recovery path.

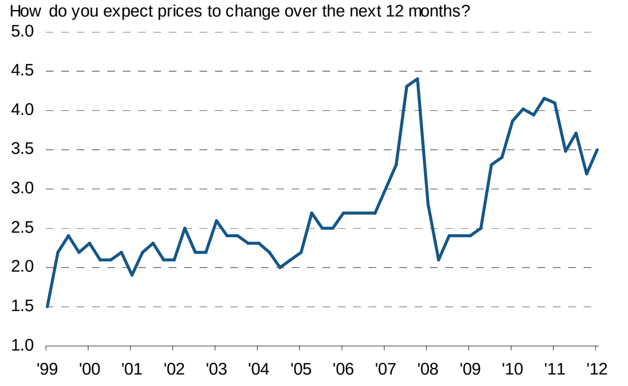
Normally, an above target inflation outlook would be a prescription for tighter policy. However, the Bank is rightly pointing out (see yesterday's note on inflation), that the main reasons for inflation running above target is due to higher administered and regulated prices. These include higher tuition fees and increased prices for oil and gas, which are in part related to the industry seeking to pay for future investments. The Bank will therefore "look through" these price pressures and instead focus on domestic cost growth, which is currently very weak.

### More needed besides monetary policy

A key feature of the press conference was Sir Mervyn King's emphasis that monetary policy can merely bring forward future spending and cannot raise the total amount of spending in the economy over time. Supply side boosts are needed to help raise the total potential level of spending in the economy, which needs to be accompanied by increased overseas trade. The latter is of course largely dependent on the pace of global economic growth, but can also be influenced by the exchange rate and competitiveness.

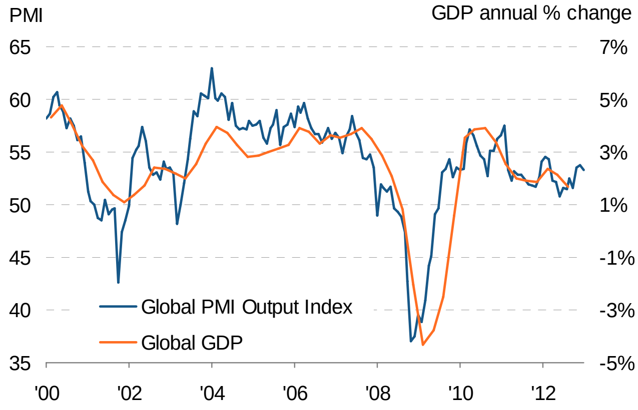
While plenty of work clearly still needs to be done in relation to supply side improvements, the Funding for Lending Scheme is starting to have a noticeable effect on raising credit availability, and global economic growth has picked up. At the same time, the domestic economy saw a far better-than-expected start to the year, with the PMI surveys – a key guide to Bank policy – signalling a return to growth and allaying fears of a "triple-dip" recession. All of these factors suggest that policy will remain on hold unless the domestic economy weakens again, but many will come away from today's press conference believing that the Bank will not hesitate to boost its stimulus further at the first sign of disappointment.

**Inflation expectations**




Source: Bank of England/NOP

**Global economic growth**

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