ACCORDING TO THE BANK OF ENGLAND (BoE)

- The Bank of England’s Monetary Policy Committee today voted to maintain the official Bank Rate paid on commercial bank reserves at 0.5%.
- The Committee also voted with its programme of asset purchases totalling £200B (US$320B) financed by the issuance of central bank reserves.
- The Committee expects the announced programme to take another month to complete. The scale of the programme will be kept under review.

COMMENTS

This morning’s decision by the BoE did not surprise anyone. Britain’s key rate is expected to stay at its 0.5% floor for several more months or even quarters. The BoE will opt to wait until its asset purchase program is completed before making a decision on whether it needs to expand its quantitative action again. Purchases of financial securities, mainly gilts, are going well, with transactions totalling more than £190B (US$304B) complete at the end of last month.

As usual when it does not make any changes to its monetary policy, the BoE was quite terse this morning. However, the minutes of the December 2009 meeting and other analytical documents that the BoE has released recently give us a fairly clear glimpse of Bank leaders’ views.

Overall, British economic statistics show that the situation has improved somewhat. In particular, the employment market seems to be stabilizing more quickly than expected, while activity indexes have risen to levels that clearly point to growth in the manufacturing and service sectors. The harsh recession that hit Britain’s economy should thus have concluded in the last quarter of 2009. Britain’s economy will be operating below potential for a long time, however, which will substantially limit inflation pressures. At 1.9% last November, Britain’s inflation rate was already fairly high and could climb higher in the near term, driven by increases in oil prices and the sales tax. For the BoE, however, the main medium-range risk is that inflation will slip too far below its 2% target.

The BoE has numerous concerns in addition to the economy. In its bi-annual Financial Stability Report, it said that British banks will have to keep bolstering their balance sheets and that they remain vulnerable to a number of substantial risks. The BoE is also disappointed with the money supply’s feeble response to its quantitative policy. Lastly, the disastrous situation of Britain’s public finances, which made it impossible to postpone raising the consumption tax beyond the beginning of the year, is certainly a worry for the BoE.

Implications: The BoE will seriously consider expanding its quantitative policy again in February, when its new quarterly Inflation Report comes out. If it does not raise its inflation outlook substantially, the asset purchase program could very well be extended again.

Mathieu D’Anjou
Senior Economist
EXCERPT FROM THE BANK OF ENGLAND PRESS RELEASE

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