

United Kingdom

Bank of England holds fire on extra stimulus despite bleak outlook

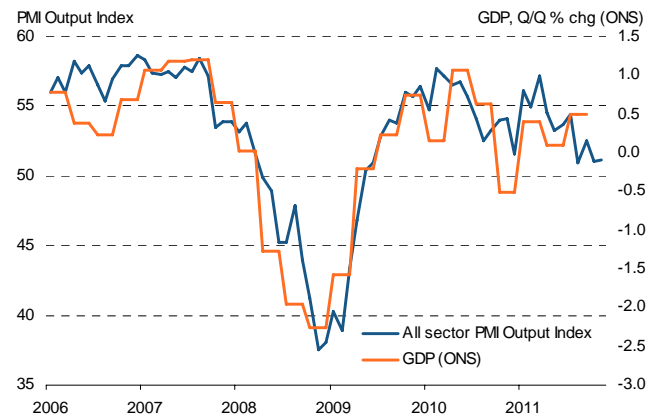
The Bank of England left policy unchanged at its December meeting. The lack of action was in line with expectations. The data flow has changed little over the last month. Although manufacturing is contracting at a steep pace, services continue to expand at a modest rate, leaving a picture of overall economic stagnation, which is in line with the Bank's forecasts. Inflationary pressures are meanwhile showing signs of cooling, with a strong reduction in the inflation rate next year growing increasingly likely.

However, we have become confused by the Bank of England's actions in recent weeks. While the data flow have not surprised over the last month, the outlook remains extremely worrying.

The Bank projects inflation to fall well below its 2% target based on current interest rates and asset purchases, and notes the extraordinary degree of uncertainty that the euro zone crisis has created. This would normally indicate that further stimulus is required to revitalise the flagging UK economic recovery.

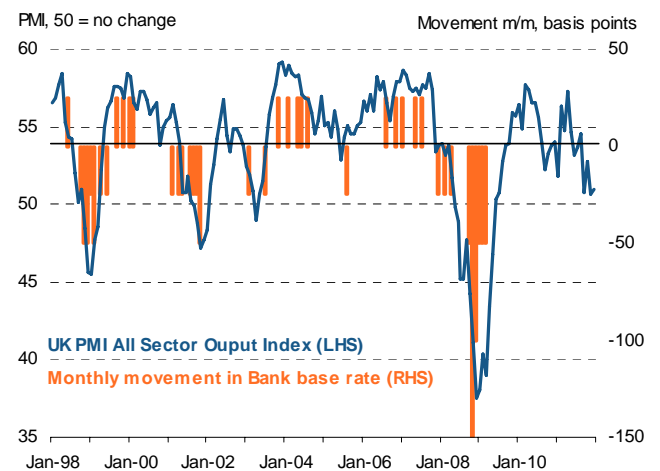
However, the Bank appears to be sticking to its plan to sit on its hands until at least February. This is because the Bank believes February is the earliest the bond market will be able to cope with more asset purchases via quantitative easing, following October's £75bn addition to the initial £200bn programme. But the promise of more QE beyond February, or perhaps the purchasing of different assets other than government bonds, could be announced if the Bank really believed additional stimulus was necessary. By doing nothing, the lack of action raises concerns that the Bank is either worried about the effectiveness of QE as a stimulus tool or perhaps is suffering a lack of confidence in its forecasting ability.

Ailing economy stalls



Source: Markit, CIPS, ONS.

More medicine needed?



Sources: Markit, CIPS, BoE.

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