Weekly Market Summary

February 8th, 2019

The Sands Seems To be Shifting in the Land of Fish & Chips!!

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The Bank of England has retreated from plans for multiple interest rate rises as it sharply downgraded its economic outlook amid mounting Brexit uncertainty and slowing global growth. The Bank kept its rates on hold at 0.75%, as expected, in a unanimous decision despite rumours of a hawkish dissenter. With the March 29 deadline to leave the EU and no Brexit deal yet concluded which has depressed spending and confidence, the BOE said that “uncertainty had intensified,” and now forecasts 1.2% growth this year, down from 1.7% predicted three months ago, the biggest downgrade since the 2016 referendum according to Bloomberg. "Growth appears to have slowed at the end of 2018 and is expected to remain subdued in the near term," it said.

In case anyone missed the reference to low-lying clouds, Bank of England Mark Carney warned that the “fog of Brexit” is creating “a series of tensions” in the British economy. Although many companies have stepped up preparations for the possibility that Britain might crash out of the European Union on March 29 without a deal, Carney said the economy as a whole “is still not yet prepared for no deal, no transition exit.” He said half the business survey by the Bank of England are “not ready for such a possibility” and that “on balance respondents expect U.K. output, employment, and investment to contract substantially if it were to occur.” The BoE expects business investment to drop 2.75 per cent this year, having previously expected growth.

On the inflation front, the Committee’s forecasts showed little concern about rising inflation even if it kept rates on hold for the next three years. They illustrated that policymakers thought there was only a 56% probability that inflation would exceed the BoE’s 2% target after two years if it left rates unchanged with a weaker inflation profile than in the November forecasts.

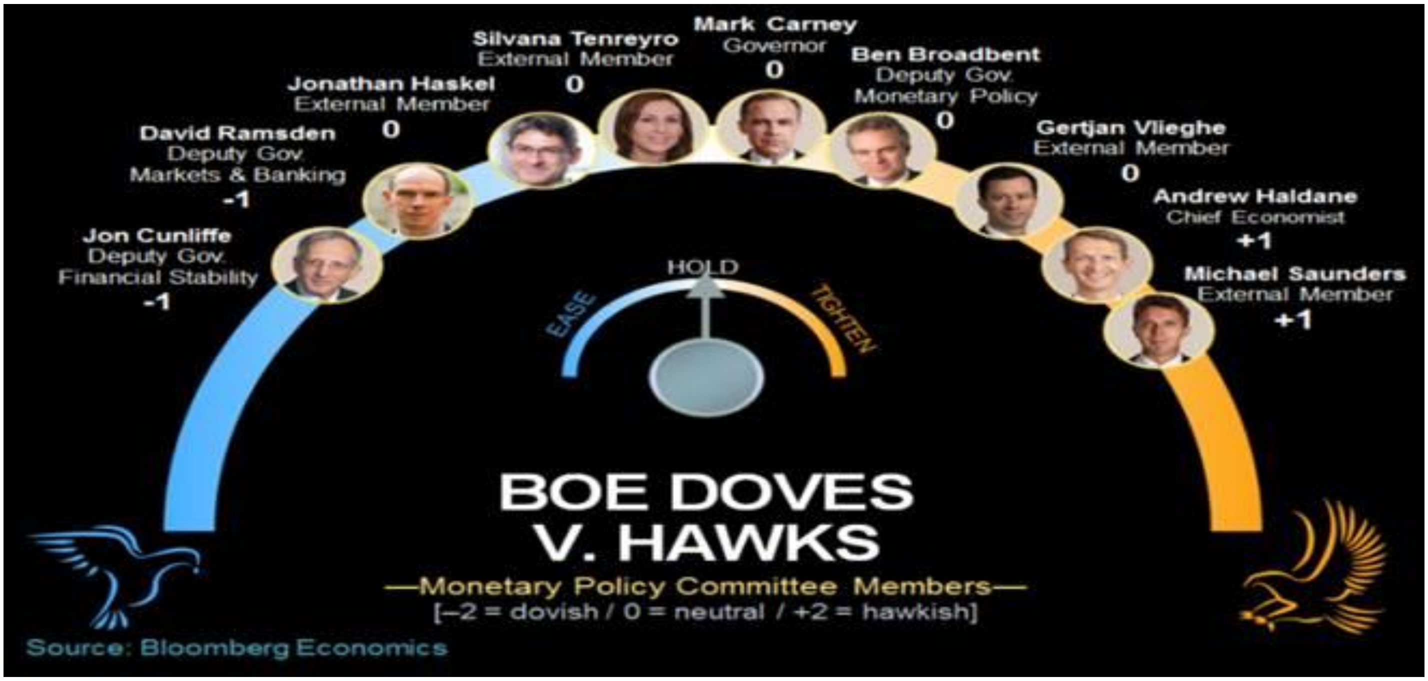
The pound declined after the report was published. The messaging was clearly negative, even as potential growth offsets the debate around slack in the economy, meaning less growth is required for inflation; Whilst the report was not unequivocally dovish, Sterling tumbled on the release, though the pound soon erased its losses. 10Y gilt yields moved down to 1.1650. In the press conference, Carney stuck to his line that more rate increases will probably still be necessary. He said that markets should not prepare for a scenario without rate hikes. Sterling climbed 0.3% to $1.2975, having touched $1.2854, the lowest level since January 21st. Traders in money markets are now only pricing a 65 percent chance of a rate hike by June 2020, versus 75 percent Wednesday, and 35% by year end vs 44% on Wednesday.

The Bank said the forecasts will need to be updated "once greater clarity emerged about the nature of EU withdrawal" and actually ran an analysis showing that less uncertainty would lead to much stronger growth - 1.6 percent this year and 2.2 percent in 2020. Here are a few points in the forecasts summarized:

- 2019 growth downgrade due to a slower global economy and Brexit. Net trade to contribute less to the economy than previously thought
- Productivity growth outlook cut again. Hourly productivity growth has underperformed relative to most of the G7.
- Supply growth lowered to a little below 1.5%. It was previously at 1.5%
- Slower GDP growth in the near term means we get little excess capacity in early 2020, though that unwinds and there’s 0.75% excess demand by 1Q 2021.
- BOE notes Brexit means a lot of noise in the data so it’s not clear how much it’s telling us about the medium term.

The Bank of England is stuck between rock and a hard place. When asked about whether he wakes in the morning regretting his position as governor during Brexit, Carney responded: “*I don’t wake up in the morning any more, I wake up in the middle of the night!*”

Below was the most recent spectrometer prior to the decision, a guide to the Doves and Hawks published by Bloomberg Economics:



**BE's Spectrometer ranks policy makers along a spectrum from -2 (dovish) to +2 (hawkish). A zero rating means a member is neutral. Half of the weighting is based on past votes, as well as any clear dissent in the minutes. The other half is a subjective assessment based on public statements.*

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