

Friday, 06 November 2009

# Flash Notes

## United Kingdom

### BoE Increases Size of Asset Purchase Programme by 25 Billion Pounds; Leaves Repo Rate Unchanged at 0.50%

Continuing its unprecedented scheme to revive Britain's recession-hit economy, the Bank of England expanded its quantitative easing (QE) program by 25 billion pounds to 200 billion pounds on Thursday, saying that the bond-buying would take another three months to complete. The BoE also left interest rates unchanged at a record low of 0.50%, as widely expected.

In its statement, the BoE noted that "a number of indicators of spending and confidence have suggested that a pickup in economic activity may soon be evident". But it still believed the prospect was for "a slow recovery in the level of economic activity".

The decision followed a report on October 23, showing that the UK economy unexpectedly contracted 0.4% in the third quarter, extending the slump to six quarters. Unlike the US and Eurozone's largest economy, Germany – where the economies have already started growing again – growth prospects are much dimmer for the British economy which has been mired in the recession since early 2008.

Still, following the increases in May and August, some had expected a bigger expansion of the QE program, which was launched in March this year. We feel that the increase in 25 billion pounds, instead of 50 billion pounds, could be part of the BoE's interests in preparing markets for a gradual tapering off in QE. And besides being slightly more confident about the economy, the BoE has also highlighted that the "past depreciation of the sterling" could lead to higher prices, indicating that "inflation is likely to rise sharply to above the 2% target in the near term".

Furthermore, recent economic indicators have also shown improvements. An index of UK service industries based on a survey of purchasing managers rose to 56.9 last month; while a gauge of manufacturing expanded at the fastest pace in two years, the Chartered Institute of Purchasing and Supply and Markit Economics said this week.

All of these imply that the BoE, at some point, would begin to undertake a less aggressive accommodative policy approach, though it is likely to withdraw the liquidity supplies first before it actually starts hiking rates. There is nothing so far, though, to alter our expectations that rates will remain on hold until the latter part of 2010.

	End 4Q09	End 1Q10	End 2Q10
Repo Rate	0.50	0.50	0.50
GBP/USD	1.655	1.670	1.685
Source: UOB			

Nevertheless, the expansion by “only” 25 billion pounds coupled with a more upbeat statement, were seen boosting the sterling. GBP/USD soared to highs of 1.6637 in the London-NY session following the announcement. And so far in Asian trades today, the pair has been supported above the 1.660-levels.

Going forward, we expect that, barring any further negative surprises to the British economy, GBP/USD should comfortably trade above the 1.680-levels by the middle of next year. We are looking at real GDP to recover from a full-year decline of 4.2% for 2009 to a growth of 1.1% in 2010. And since the decision yesterday was based on revised forecasts, November 11 would be a look-forward to event, when the central bank publishes its quarterly Inflation Report. The minutes of the meeting yesterday will be released on November 18.

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