

United Kingdom – No Surprises from the Bank of England

The Bank of England's decision to hold its key lending rate unchanged at 0.5% and maintain its programme of asset purchases totalling 200 billion pounds was widely anticipated. The Bank, in its statement, said that it expects the programme will "take another two months to complete and that "the scale of the programme will be kept under review". The minutes of its latest two-day meeting will be published on December 23.

The nine-member monetary policy committee (MPC) unveiled its decisions following a two-day meeting; and one day after the British government admitted that the country's recession was deeper than it had thought. Finance minister Alistair Darling announced that the British economy was set to shrink 4.75% this year compared with a previous official estimate of 3.50%. Darling added that government borrowing would reach a bigger-than-expected 178 billion pounds in 2009/10, higher than his previous estimate that the state's public deficit would reach 175 billion pounds during the current fiscal year.

This was the same day that Britain announced a one-off tax on bankers' bonuses, slapping a 50% tax rate on bonuses above 25,000 pounds to recoup cash spent saving the sector. The public finances have been severely stretched by costly banking bailouts, while the recession has ravaged taxation revenues for the Treasury. It was also announced, on Wednesday, that the rate of tax levied on income that is used to help fund pensions would be raised, and that pay increases for public sector workers would be capped. Darling also confirmed the government would stick by plans to reverse last year's tax cut on goods and services. The government had cut VAT (value added tax) to 15.0% in December 2008 to help boost consumer spending but will now return as planned to the pre-recession level of 17.5% in January. Relief on property tax (where Britons are currently exempt from paying a tax on property purchases, known as stamp duty, for houses and flats costing less than 175,000 pounds) would also expire at the end of the year.

Unlike the Eurozone, Japan and the US (which have shown signs of positive growth), the UK is still stuck in a recession. Real GDP fell by 0.6% in the second quarter from a contraction of 2.5% in 1Q. Final 3Q GDP numbers which will be rolled out on December 22, is expected to show the economy contracting by 0.3%.

The BoE had slashed its key lending rate to 0.50% in March this year in an attempt to tackle Britain's sharp downturn; and at the same time, had begun its extraordinary policy of pumping billions of pounds worth of newly-created money into the economy. Since then, it has increased the programme thrice – in May, August and November. These, along with the constant trail of comments about the QE program, have caused a substantial amount of pressure and volatility in the GBP. Nevertheless, the decision by the BoE yesterday was in line with expectations and post-BoE did little to impact the GBP/USD, which moved back and forth in trades before ending the overnight session at 1.6281. And there seems to be nothing so far, to alter our expectations that rates will remain on hold until the latter part of 2010. Even if the BoE, at some point, would begin to undertake a less aggressive accommodative policy, it is likely to withdraw the liquidity supplies first before it actually starts hiking rates.