AIB Group Treasury
Economic Services Unit

On Hold for Now

The Bank of England holds its monetary policy meeting on Wednesday and Thursday of this week. Rates were unexpectedly cut by 0.25% at the August meeting, reducing the base rate to 5.00%. The minutes of that meeting clearly show that it was not an easy decision, with the committee voting 6-3 in favour of the rate cut. However, the final vote masks the level of discussion and dissent. Not only did three members vote against a rate cut, but at least two others considered voting in favour of a more aggressive 0.50% cut.

UK economic activity slowed considerably in the three months to June. GDP increased by 0.3% to give a year-on-year growth rate of 2.1%. This constitutes the weakest growth rate for two and a half years. The slowdown in the economy was driven by a sharp downturn in industrial production, mainly due to a collapse in technology output. If the economy continues to lose momentum then the Bank of England will surely cut interest rates again. However, data released over the last month indicate that economic imbalances persist and we expect rates to remain on hold for now. If those arguing in favour of a rate cut last month feel that further easing is required, they will have an even tougher fight on their hands this time round.

The MPC sees the main risks to the economy as being threefold; a deeper or more prolonged down in the global economy, in particular the US, a rise in the savings ratio as consumers respond to lower net financial wealth and a more pronounced downturn in company spending plans. With the US economy still weak, the eurozone economy lethargic, and UK business investment being scaled back drastically there is potential for further weakness going forward. However, alongside a buoyant housing market, wage growth, the labour market and retail sales data all continue to trend upwards. Data show that UK consumer confidence is waning with growing pessimism about the state of the economy undermining sentiment. The Gfk consumer confidence index fell to 0 in August from +4 in July. This is under the average of +1 seen over the past year but still well above the 19-year average of -7.

Supported by the current interest rate environment, consumer credit and house lending recorded another sharp rise in July. Net mortgage lending (total mortgage loans less repayments) stood at its highest level since the series began in April 1993. The latest UK banking association's report suggests that the housing market will moderate in coming months (as labour market conditions becomes less favourable) but the BoE figures also showed another sharp rise in loan approvals. We expect rates to remain steady at 5.0% for now, with a move to 4.75% only likely if we see a correction in consumption and the labour market.

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