United Kingdom | Economics

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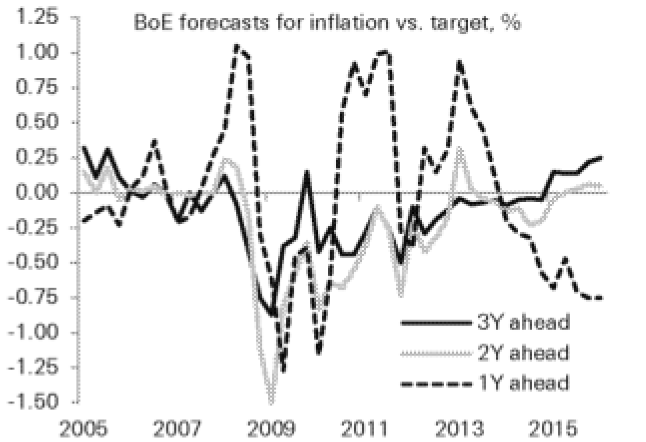
UK: Markets still see rate-cut risk

- The BoE revised down its forecasts for near-term inflation, though they remain slightly above 2% at the end of the forecast horizon. Despite this, and generally positive comments on the real economy from Governor Carney, markets continue to see the risk of a rate cut later this year.

Near-term revisions, similar end-horizon forecasts

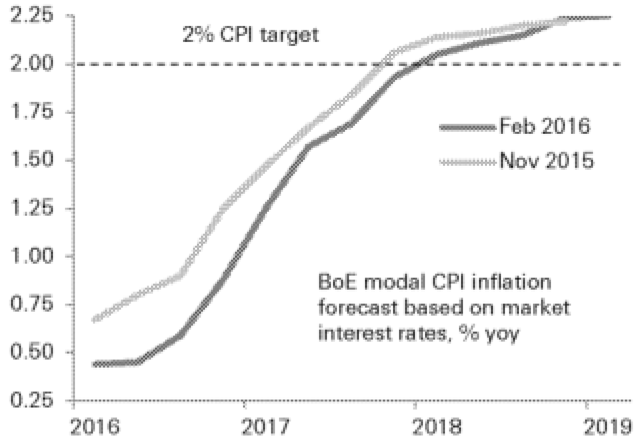
The Bank of England this week published revised forecasts in its quarterly *Inflation Report*. Not only were the Bank's end-period projections little changed for both growth and inflation relative to the November forecast round, but it is fair to say that the Governor sounded a note of economic optimism in his remarks at the press conference, despite the recent escalation of global economic and financial market concerns. Still, near-term forecasts for growth and inflation were revised down by up to 40bps each.

Figure 1: Inflation remains above target in 2/3 years



Source: Deutsche Bank, Bank of England

Figure 2: CPI forecasts down in the near-term due to oil



Source: Deutsche Bank, Bank of England

First, consider Figure 1 which shows the evolution of the Bank's forecasts for 1Y, 2Y and 3Y-ahead CPI inflation. Near-term forecasts for inflation in particular were revised lower, as Figure 2 shows, thanks in no small part to further falls in oil prices. But at the 2Y and 3Y horizons inflation was seen as being broadly similar to what was expected in November (in fact the 3Y forecast was modestly higher) and – importantly – remained above the 2% target. Moreover, it was pointed out that core inflation had risen, which illustrated the point that much of the fall in inflation had been down to volatile external factors.

Growth was revised down (Figure 3) to a similar degree to inflation in the near-term (i.e. up to 40bps) as a result of recent global economic and financial market developments. The Governor remained relatively optimistic about UK economic growth describing the outlook as a "continued solid expansion". A weaker external picture, with net exports expected to drag on growth, would be partially offset according to the Bank by lower sterling (down 6% trade-weighted relative to its peak in mid-November), a lowering of the yield curve