

BoE increases its QE programme

The Bank of England's Monetary Policy Committee (MPC) meeting for June concluded as expected with no changes to its interest rate policy. The central bank did, though, as anticipated increase the size of its QE programme by £100bn to £745bn. The increase was in line with market forecasts. The central bank was on course to exhaust the previously announced £200bn expansion in July. The decision to leave rates unchanged was unanimous, while one member of the MPC (Haldane) voted against the proposition to increase its QE stock of government bonds by £100bn. The meeting statement and minutes emphasised that the central bank stands ready to do more to support the economy, if necessary. However, there was no specific reference in the minutes to negative interest rates, despite Governor Bailey recently stating that this was under active review.

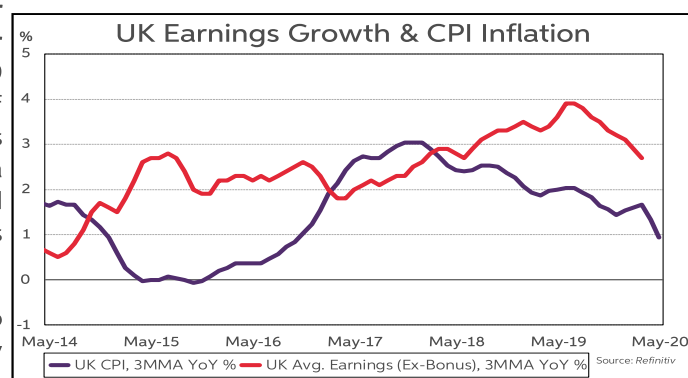
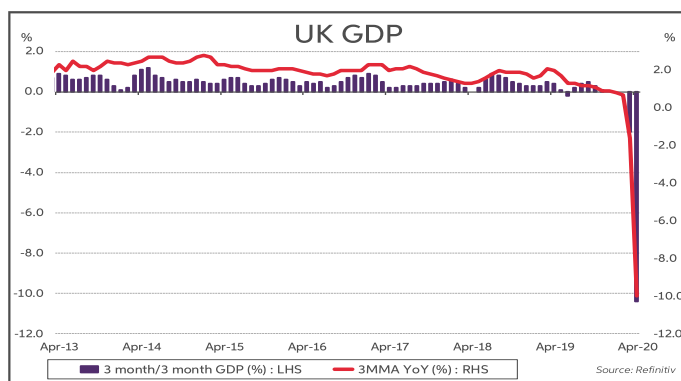
Since the onset of the Covid-19 crisis, the central bank has acted aggressively. This has included cutting the Bank Rate by a total of 65bps, leaving it at a record low of 0.1%. As referenced above it had also implemented another round of QE, adding a further £200bn assets to its holdings, thereby increasing its portfolio to £645bn. As well as this, the central bank agreed to expand the government's overdraft facility, in effect allowing for temporary monetary financing. On the liquidity side, the central bank moved to support businesses by introducing a corporate financing facility and a SME term funding scheme.

The meeting statement and minutes continued to espouse a very cautious tone. However, the description of the economy was somewhat more upbeat compared to May. It noted that recent high frequency data indicated that the decline in consumer spending could have bottomed out and started to recover in May and June. The BoE also acknowledged that "there were also signs of a pick-up in activity elsewhere in the economy". As a result, the central bank was of the view that given this "emerging evidence" the expected sharp contraction in Q2 GDP might be "less severe" than the 25% fall it had envisaged in its May forecasts.

However, at the same time, the BoE stated that "other indicators suggested greater risks around the potential for longer lasting damage to the economy" due to the Covid-19 pandemic. It pointed to the likelihood that a degree of "precautionary behaviour" on the part of both households and businesses was likely to persist, thereby acting as a headwind. This would mean that both economic activity and the labour market would take some time to recover towards their previous path.

As referenced earlier, the BoE's most recent macro projections were contained in the May Monetary Policy Report. It discussed what it termed an "illustrative scenario", which assumed the lockdown remaining in place until early June and a gradual removal of restrictions in Q3. The BoE projected a decline of 14% in GDP this year. This was to be followed by growth of 15% in 2021. However, in the minutes of the June meeting, BoE Chief Economist Haldane, noted that demand and output were recovering sooner and at a materially faster pace than previously anticipated, presenting upside risks to the MPC's GDP and inflation forecasts.

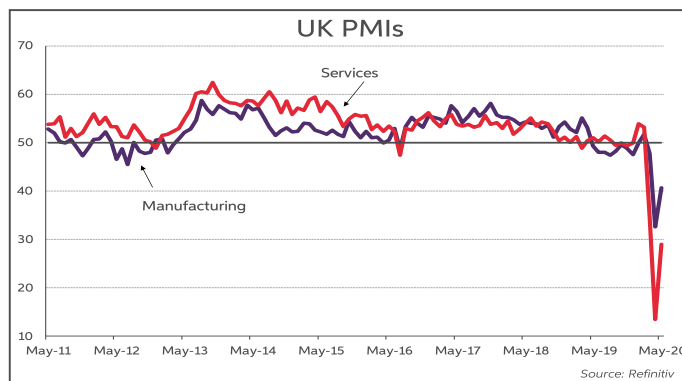
Overall, the BoE reaffirmed its commitment today that it was ready to "take further action if necessary" to support the economy and achieve its inflation target. As part of this, the MPC stated it would keep its QE programme "under review". This indicates that if it is to provide further stimulus this is likely to incorporate an additional increase to its asset purchase programme. The BoE expects its QE purchases to reach its increased target of £745bn around the turn of the year. Meanwhile, futures contracts indicate the market expects a further cut of 10bps in the Bank Rate in the coming year, taking it down to zero.



UK enters deep recession in H1

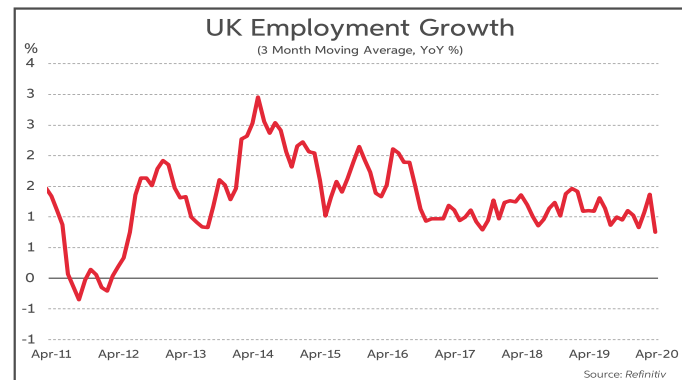
The UK economy contracted by 2% in the opening quarter of 2020, having stagnated in Q4 2019. The decline, the largest since the Financial Crisis, reflected the initial impact of Covid-19 restrictions, with output plummeting by 5.8% in March. In terms of the breakdown, spending by consumers and the government fell by 1.7% and 2.6% in Q1, respectively. At the same time, fixed investment dipped by 1%. Net trade was broadly neutral despite a 6% fall in exports as imports slumped by a more severe 8.1%.

The more timely monthly estimate of GDP for April captures the extent of the more comprehensive restrictions that were in place which resulted in many sectors of the economy essentially shutdown. Output plunged by a record 20.4% in the month and by 10.4% on a 3 month-on-3 month basis. Construction fell by 40% m/m, industrial production declined by 26%, while services output registered a 19% contraction in April.



However, the PMIs for May provide some evidence that the downturn may be bottoming out, reflecting the fact that the government has begun to ease lockdown restrictions. The composite index improved from its worst ever reading of 13.8 in April to 30.0. While this level is still technically consistent with contraction, it may be the case that respondents are giving an indication about how business compares to normal levels. Therefore the rise in the index would suggest that April represents the low point for activity. The rebound in the index, was driven by increases in the PMIs for both service sector (13.4 to 29) and manufacturing (32.6 to 40.7). On the demand side, the GfK measure of consumer sentiment also improved in June.

With regard to the labour market, the government's furloughing scheme, which covers 8.4m individuals or roughly 25% of the total number of workers, has prevented mass lay-offs. Although, it also means that capturing the true level of the rise in unemployment has become more difficult. This is because those 'furloughed' are classified as employed. Another factor is that a good portion of those who are not furloughed but have not job have not been 'actively seeking work' due to the pandemic, resulting in a fall in the size of the labour force. This was evident in the latest data covering the three month period to April. The unemployment rate remained unchanged at 3.9% versus expectations for an increase to 4.7%. However, job losses are likely to increase as some of those furloughed become 'unemployed' and as more people who are out of work come back into the labour force seeking employment. Indeed, the more timely PAYE-based data show a 163k fall in employment in May, which followed a 449k decline in April.



On the inflation front, headline CPI eased to 0.5% in May from 0.8%. This reflected the recent plunge in oil prices, as well as weak demand stemming from the Covid-19 and related restrictions. The latter factor resulted in the core rate of inflation decelerating to 1.2% from 1.4%.

The outlook for the UK economy remains uncertain and challenging arising from the Covid-19 pandemic. This backdrop poses plenty of headwinds for both business expenditure and consumer spending. On top of this, the UK economy looks to be facing a scenario at the start of 2021 where its trading relationship with the EU will be based on either a very basic free trade agreement or on WTO rules.

The action taken by government and the BoE will provide some support to the economy. The former has ramped up fiscal spending, rolled out state guarantees for loans and established income replacement schemes to limit the scale of lay-offs. The latter has provided significant monetary stimulus and put in place liquidity supports for businesses. The OECD latest outlook shows that it is forecasting a decline of 11.5% in UK GDP in 2020, followed by growth of 9% in 2021 on the assumption that the country avoids a second wave of Covid-19.

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