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# Economic News

## UK MONETARY POLICY

### Bank of England sparks rate cut speculation

The Bank of England's Inflation Report has sparked rate cut speculation by market participants. According to the baseline scenario underlying the updated forecasts, growth is projected to weaken further in the coming quarters. However, the salient point was that, according to the inflation projections, the inflation rate is expected to drop below the BoE's 2% target in two years amid constant policy rates. We are sticking to our view that the central bank will lower rates next year at the very earliest. On the one hand, inflation is expected to climb temporarily to 5% according to the projections, forcing the Bank of England to further justify its measures to the Chancellor of the Exchequer. On the other hand, the BoE's inflation projections show that risks are pointing upwards.

- The increased risks to growth are reflected in the Bank of England's latest economic prognosis, which suggests the possibility of a technical recession, i.e. two successive quarters of negative quarterly GDP growth. Today's published data show that the downturn is increasingly impacting the labour market, as the harmonised unemployment rate rose from 5.2% to 5.4% in June. The downturn in the real estate market currently shows no sign of flagging. Real estate prices have declined significantly according to a number of price indicators. The Bank of England should favour lowering rates to boost growth – the question is when.
- Following the publication of the Inflation Report, market participants believe there is an 80% likelihood of a rate cut by the end of the year. This is a remarkable shift in expectations, considering that several weeks ago the markets were expecting a string of rate hikes due to high inflation.
- However, we continue to believe that a first downward rate move will not occur before the beginning of next year. Firstly, inflation will rise significantly in the short term due to gas price increases, with the BoE itself expecting inflation to reach up to 5%. This implies that Mervyn King will have to issue several written statements to the Chancellor of the Exchequer to account for overshooting the target. Secondly, the Bank of England sees the risks to its inflation outlook as pointing upwards. We believe that rates will only be cut when it is relatively certain that inflation can be reined in to below the 2% target on a two-year horizon.
- Nevertheless, we expect a significant rate cut from 5% to 4% starting next year due to the recessionary tendencies in the UK.

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