

The Aerial View

Morning Briefing

Sep 16, 2020

BoE Flying Half-Blind into Q4

- **Risks are to the downside ahead of BoE September Meeting**
- **Budget delay means BoE may need to fly half-blind for a while**
- **Burden of adjustment for GBP should now be on growth**



Geoff Yu
Senior EMEA Market Strategist

[Email >](#)

The Bank of England is not expected to make changes in this week's policy decision but we do expect the Monetary Policy Committee to conclude that risks to the economy are to the downside.

The impositions of new restrictions on social activity in itself is enough to inject renewed uncertainty into forecasts (especially for the services sector), but now the MPC will have renewed Brexit and fiscal uncertainty to contend with. Sterling's recent weakness is certainly warranted, but the market probably needs to start shifting towards non-Brexit drivers to determine future price action.

We have previously highlighted the impending labor market pressures and so far the government has not expressed any willingness to extend the furlough program, even on a targeted basis. Furthermore, the BoE also differs from peers in not expressing a stronger view to maintain employment protection programs.

Chief Economist Andy Haldane said recently that it was not an efficient use of fiscal resources to support the businesses which "will probably not make it through" and the jobs which "may well not be coming back." In essence, if labor market (and wider economic) scarring is going to happen, it is best to let it happen immediately and let industrial policy direct government spending towards economic restructuring.

Tuesday's ILO jobs data are pointing to serious challenges as total payrolls and hours worked continue to decline, but we still believe the figures do not fully reflect the

dependency on the furlough scheme (there is a 4-4.5 million gap between ONS and government estimates of furloughed workers).

Elsewhere, the BoE's Agents Reports also point to near unprecedented slack in the labor market in the form of collapsing difficulties in recruitment and more worryingly, employment intentions (see chart below). The agents are based across the country and inform the BoE's decisions. Given the low total score provided by the agents, the economic adjustment which appears to be "hollowing out" cities is clearly not just a London phenomenon.

Employment Scores - BoE Agents' Report



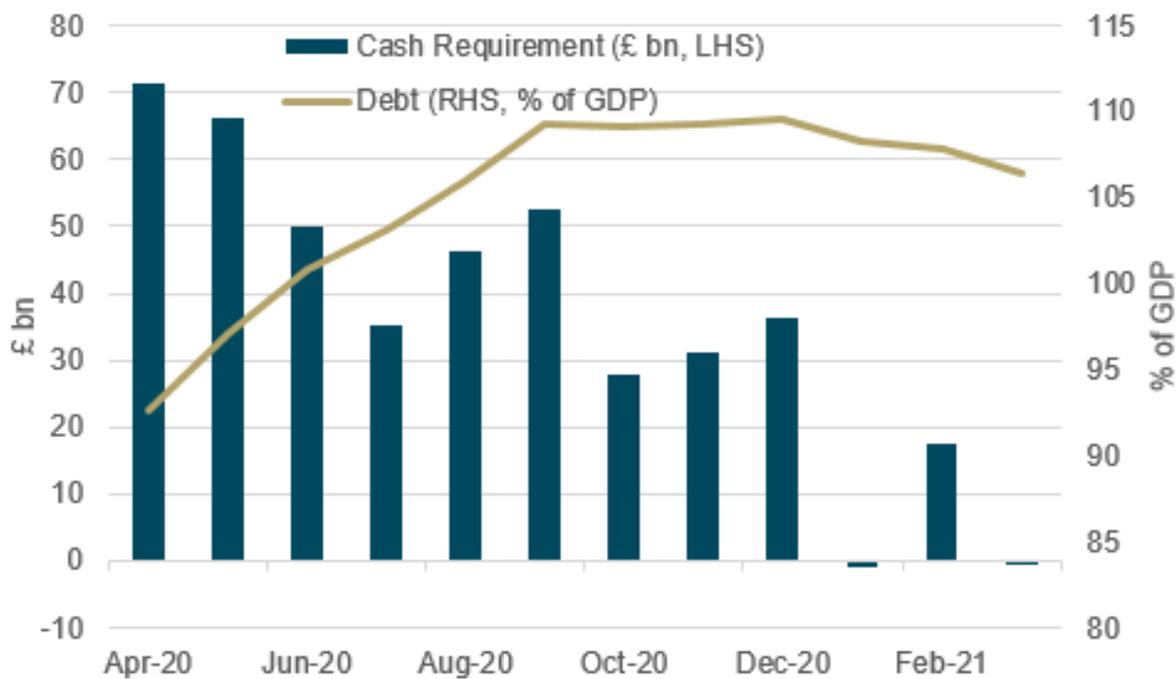
Source: Bloomberg, BNY Mellon

Even if the BoE wants to take the long view and not stand in the way of inevitable economic vicissitudes, we still question whether such a stance is consistent with their price stability mandate. For example, Haldane also noted that the BoE's job is to "make that process of adjustment as seamless and painless" as possible. From a policy perspective, this means using measures such as quantitative easing to amplify government firepower.

During a reflation phase, such support can certainly strengthen price trends, but the UK is not in that phase. Arguably with the new restrictions coming through, the risk is that the disinflation phase will become extended and as things stand, neither the BoE nor the government have announced measures to offset. Fears of persistently elevated debt levels have clearly affected the government's decision making, but barring a renewed full lockdown of the economy, the bulk of fiscal stress has likely passed.

The latest Office of Budget Responsibility (OBR) forecasts published in August sees a stabilization in the debt outlook and the public sector net cash requirement will likely fall into surplus towards Q1 next year. This still leaves the debt/GDP ratio peaking at close to 110% (see chart below) but at least within G10, the market is hardly looking at debt sustainability issues while COVID-19 continues to damage economies.

OBR Debt Projections (Aug 2020)



Source: OBR, BNY Mellon

More immediately, the news that the Autumn Budget may be delayed represents a new challenge for the BoE as they will need to decide on policy with limited visibility on future fiscal policy. After all, these are the very policies which should intend to – to quote Dr Haldane – "adjust" the economy and replace the jobs which are not coming back.

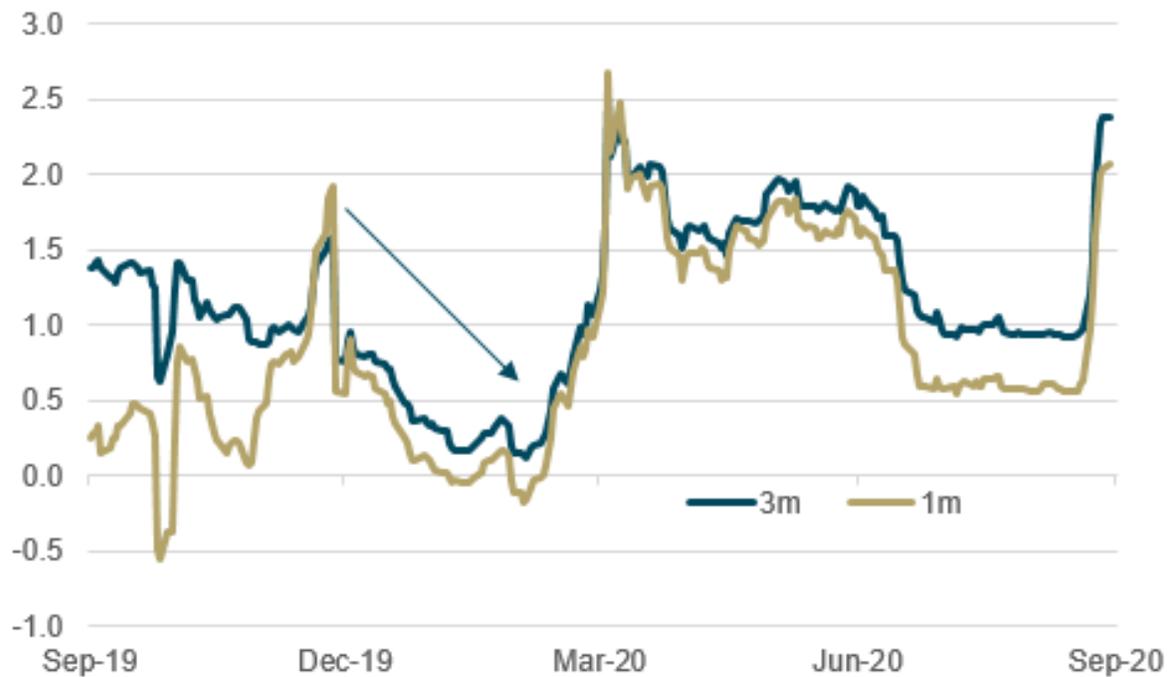
In normal times monetary policy would act in a complementary manner, but the BoE may now have to wait a bit longer. Constitutionally, the UK is required at the bare minimum to pass a budget resolution before the end of the financial year in April 2021. It is highly unlikely that the government will leave it so late but on top of economic challenges and the Brexit impasse, the additional uncertainty is hardly welcome.

We still question whether [the BoE's stance] is consistent with their price stability mandate

Sterling has moved materially lower from summer highs but almost exclusively on the back of Brexit developments.

The recent jump in EURGBP risk-reversals is similar to the cross' pathway as the UK negotiated its outright EU exit towards the end of last year. The Internal Markets Bill – the center of contention with the EU – will be moving its way through the House of Commons this week and it remains to be seen whether any amendments to the EU's satisfaction can be realized by month-end.

EURGBP 25d Risk Reversals



Source: Bloomberg, BNY Mellon

Sterling price action will lean much more on domestic economic and fiscal matters over the coming months

A lack of a trade deal after the Brexit transition period is complete will certainly change the BoE's conditional assumptions on monetary policy. However, the November meeting is probably the first in which there is any prospect of a corresponding change and the BoE will be trading carefully on this matter so as to not preempt the government on a political issue.

As a result, sterling price action will lean much more on domestic economic and fiscal matters over the coming months. If so, even if a UK-Brussels deal is struck after a (virtual) walk in the woods between key leaders, we would not expect any let up in the currency's volatility as growth risks come to the fore.

Please direct questions or comments to:

AerialView@BNYMellon.com

Disclaimer

bnymellon.com

BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation and may be used as a generic term to reference the corporation as a whole and/or its various subsidiaries generally. This material and any products and services may be issued or provided under various brand names in various countries by duly authorized and regulated subsidiaries, affiliates, and joint ventures of BNY Mellon, which may include any of the following. The Bank of New York Mellon, at 225 Liberty St, NY, NY USA, 10286, a banking corporation organized pursuant to the laws of the State of New York, and operating in England through its branch at One Canada Square, London E14 5AL, UK, registered in England and Wales with numbers FC005522 and BR000818. The Bank of New York Mellon is supervised and regulated by the New York State Department of Financial Services and the US Federal Reserve and authorized by the Prudential Regulation Authority. The Bank of New York Mellon, London Branch is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. The Bank of New York Mellon SA/NV, a Belgian public limited liability company, with company number 0806.743.159, whose registered office is at 46 Rue Montoyerstraat, B-1000 Brussels, Belgium, authorized and regulated as a significant credit institution by the European Central Bank (ECB), under the prudential supervision of the National Bank of Belgium (NBB) and under the supervision of the Belgian Financial Services and Markets Authority (FSMA) for conduct of business rules, and a subsidiary of The Bank of New York Mellon. The Bank of New York Mellon SA/NV operates in England through its branch at 160 Queen Victoria Street, London EC4V 4LA, UK, registered in England and Wales with numbers FC029379 and BR014361. The Bank of New York Mellon SA/NV (London Branch) is authorized by the ECB and subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority. Details about the extent of our regulation by the Financial Conduct Authority and Prudential Regulation Authority are available from us on request. The Bank of New York Mellon SA/NV operating in Ireland through its branch at 4th Floor Hanover Building, Windmill Lane, Dublin 2, Ireland trading as The Bank of New York Mellon SA/NV, Dublin Branch, is authorised by the ECB and is registered with the Companies Registration Office in Ireland No. 907126 & with VAT No. IE 9578054E. The Bank of New York Mellon, Singapore Branch, subject to regulation by the Monetary Authority of Singapore. The Bank of New York Mellon, Hong Kong Branch, subject to regulation by the Hong Kong Monetary Authority and the Securities & Futures Commission of Hong Kong. If this material is distributed in Japan, it is distributed by The Bank of New York Mellon Securities Company Japan Ltd, as intermediary for The Bank of New York Mellon. If this material is distributed in, or from, the Dubai International Financial Centre ("DIFC"), it is communicated by The Bank of New York Mellon, DIFC Branch, regulated by the DFSA and located at DIFC, The Exchange Building 5 North, Level 6, Room 601, P.O. Box 506723, Dubai, UAE, on behalf of The Bank of New York Mellon, which is a wholly-owned subsidiary of The Bank of New York Mellon Corporation. This material is intended for Professional Clients only and no other person should act upon it. Not all products and services are offered in all countries.

The information contained in this material is intended for use by wholesale/professional clients or the equivalent only and is not intended for use by retail clients. If distributed in the UK, this material is a financial promotion.

This material, which may be considered advertising, is for general information purposes only and is not intended to provide legal, tax, accounting, investment, financial or other professional advice on any matter. This material does not constitute a recommendation by BNY Mellon of any kind. Use of our products and services is subject to various regulations and regulatory oversight. You should discuss this material with appropriate advisors in the context of your circumstances before acting in any manner on this material or agreeing to use any of the referenced products or services and make your own independent assessment (based on such advice) as to whether the referenced products or services are appropriate or suitable for you. This material may not be comprehensive or up to date and there is no undertaking as to the accuracy, timeliness, completeness or fitness for a particular purpose of information given. BNY Mellon will not be responsible for updating any information contained within this material and opinions and information contained herein are subject to change without notice. BNY Mellon assumes no direct or consequential liability for any errors in or reliance upon this material.

This material may not be distributed or used for the purpose of providing any referenced products or services or making any offers or solicitations in any jurisdiction or in any circumstances in which such products, services, offers or solicitations are unlawful or not authorized, or where there would be, by virtue of such distribution, new or additional registration requirements.

The terms of any products or services provided by BNY Mellon to a client, including without limitation any administrative, valuation, trade execution or other services shall be solely determined by the definitive agreement relating to such products or services. Any products or services provided by BNY Mellon shall not be deemed to have been provided as fiduciary or adviser except as expressly provided in such definitive agreement. BNY Mellon may enter into a foreign exchange transaction, derivative transaction or collateral arrangement as a counterparty to a client, and its rights as counterparty or secured party under the applicable transactional agreement or collateral arrangement shall take precedence over any obligation it may have as fiduciary or adviser or as service provider under any other agreement.

Pursuant to Title VII of The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the applicable rules thereunder, The Bank of New York Mellon is provisionally registered as a swap dealer with the Commodity Futures Trading Commission ("CFTC") and is a swap dealer member of the National Futures Association (NFA ID 0420990).

BNY Mellon (including its broker-dealer affiliates) may have long or short positions in any currency, derivative or instrument discussed herein. BNY Mellon has included data in this material from information generally available to the public from sources believed to be reliable. Any price or other data used for illustrative purposes may not reflect actual current conditions. No representations or warranties are made, and BNY Mellon assumes no liability, as to the suitability of any products and services described herein for any particular purpose or the accuracy or completeness of any information or data contained in this material. Price and other data are subject to change at any time without notice.

Rates: neither BNY Mellon nor any other third party provider shall be liable for any errors in or delays in providing or making available the data (including rates, WM/Reuters Intra-Day Spot Rates and WM/Reuters Intra-Day Forward Rates) contained within this service or for any actions taken in reliance on the same, except to the extent that the same is directly caused by its or its employees' negligence. The WM/Reuters Intra-Day Spot Rates and WM/Reuters Intra-Day Forward Rates are provided by The World Markets Company plc ("WM") in conjunction with Reuters. WM shall not be liable for any errors in or delays in providing or making available the data contained within this service or for any actions taken in reliance on the same, except to the extent that the same is directly caused by its or its employees' negligence.

The products and services described herein may contain or include certain "forecast" statements that may reflect possible future events based on current expectations. Forecast statements are neither historical facts nor assurances of future performance. Forecast statements typically include, and are not limited to, words such as "anticipate", "believe", "estimate", "expect", "future", "intend", "likely", "may", "plan", "project", "should", "will", or other similar terminology and should NOT be relied upon as accurate indications of future performance or events. Because forecast statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. iFlow® is a registered trademark of The Bank of New York Mellon Corporation under the laws of the United States of America and other countries.

This document is intended for private circulation. Persons accessing, or reading, this material are required to inform themselves about and to observe any restrictions that apply to the distribution of this information in their jurisdiction.

Currency Administration is provided under and subject to the terms of a definitive agreement between BNY Mellon and the client. BNY Mellon exercises no investment discretion thereunder, but acts solely pursuant to the instructions in such agreement or otherwise provided by the client. Unless provided by definitive agreement, BNY Mellon is not an agent or fiduciary thereunder, and acts solely as principal in connection with related foreign exchange transactions.

All references to dollars are in US dollars unless specified otherwise.

This material may not be reproduced or disseminated in any form without the prior written permission of BNY Mellon. Trademarks, logos and other intellectual property marks belong to their respective owners.

The Bank of New York Mellon, member FDIC.

© 2020 The Bank of New York Mellon Corporation. All rights reserved.