

QE2 on the slipway

- *MPC should announce more QE straight away*
- *But it may hold off until November*
- *Either way, the next bout is unlikely to be the last*

With the news on the UK and global economies continuing to deteriorate, it is now a question of *when*, rather than *if*, the Monetary Policy Committee will restart its quantitative easing (QE) programme. While we would advocate immediate action, the Committee may decide to hang on for a month until November's *pre-Inflation Report* meeting. Either way, though, QE2 is on the slipway and ready to set sail.

Posen still alone in September

Expectations that the MPC might have taken a visible step towards more QE at September's policy meeting were disappointed by the minutes showing arch-dove Adam Posen still alone in voting for an immediate expansion of the asset purchase programme. (Table 2 later on shows MPC members' voting records on interest rates.)

Still, after a year out on a limb, it looks like Posen will finally have company very soon. September's minutes recorded that "for most members, the decision of whether to embark on further monetary easing at this meeting was finely balanced since the weakness and stresses of the past month had significantly strengthened the case for an immediate resumption of asset purchases". What's more, "for some members, a continuation of the conditions seen over the last month would probably be sufficient to justify an expansion of the asset purchase programme at a subsequent meeting".

Bad news has continued

This poses two questions. First, have those conditions continued? And second, when will that

subsequent meeting be? As far as the first is concerned, the answer would appear to be a fairly unequivocal yes.

Table 1 compares the latest outturn of the major UK data releases with those ahead of the September meeting. (The arrows loosely indicate the influence on policy.) By and large the activity data have continued to weaken, with the annual growth rates of both retail sales and manufacturing slowing further and claimant count unemployment registering another (albeit smaller) monthly rise. Meanwhile, market conditions have also deteriorated, with the FTSE 100 losing around 6% over the month and gilt yields falling further.

TABLE 1: DATA BACKGROUND TO MEETING

Indicator	At previous meeting	Latest	Influence on policy*
CPI inflation (%)	4.4	5.0	↑
GDP (%q/q)	0.2	0.2	→
Retail sales (%y/y)	+0.2	+0.0	↓
Unemployment (m/m)	+34k	+20k	↓
Av. earnings (%3m y/y)	2.7	2.8	→
Man. output (%y/y)	2.2	1.9	↓
NW house price (%y/y)	-0.4	-0.4	→
M4 (%y/y)	-1.1	-0.6	→
FTSE 100	5340	5040	↓
10 yr yields (%)	2.55	2.35	→
£ TWI	79.0	79.8	→
Brent Oil (\$pb)	111.0	103.0	→

* An upward arrow indicates an upward influence on monetary policy.

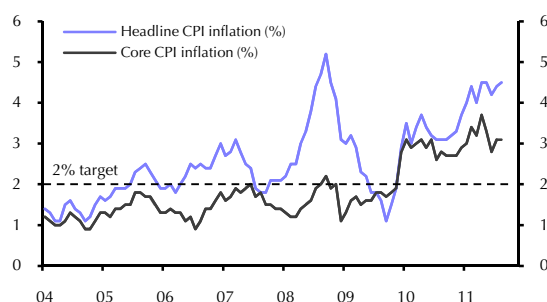
Source – Thomson Datastream, various

The outlier is still inflation. The headline rate of CPI inflation rose from 4.4% to 4.5% in August. Quite what the MPC will make of this is unclear.

On the one hand, the Committee has been expecting headline inflation to rise to 5% or so. In that sense, the numbers perhaps provided little in the way of “news”.

But on the other, the fact that core (ex. food and energy) inflation remained stubbornly high at 3.1% - held up by rising clothing inflation - might fuel concerns amongst some members that spare capacity in the economy is not going to bring inflation down in the way that the Committee has been envisaging.

CHART 1: CONSUMER PRICE INFLATION



Source – Citigroup/YouGov

Overall, though, with oil prices having fallen back further over the month and measures of inflation expectations still contained, we doubt that the MPC will have altered its view that inflation will fall back sharply over the next 18 months or so – a view which we share. **As such, the weaker news on activity is likely to have been the dominant influence on most members’ thinking since the last meeting.**

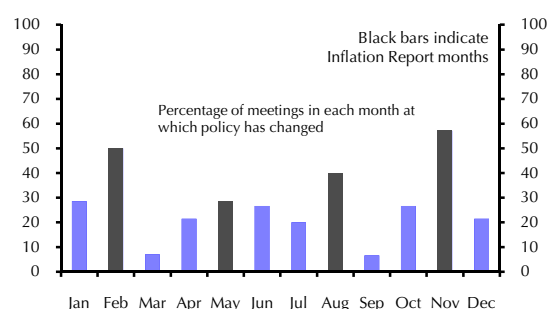
When will it happen?

So if the news on the economy justifies more QE, when will it happen? Our view is that the MPC *should* announce more QE at the October meeting. **Indeed, we have been virtually the only forecaster predicting throughout the last two years that the next move in monetary policy would be a loosening in the form of more QE, as opposed to a tightening in the form of higher interest rates. With little doubt that the economic**

recovery is going to need more support, there seems little point in delaying.

However, it is possible that some, or even most, members will take a rather more cautious approach and prefer to wait until the November meeting, when the additional analysis prepared for the next *Inflation Report* will be available. **Note from Chart 2 that November has been comfortably the most popular month of the year for policy action since the MPC took control of monetary policy and is around twice as likely to see a change than October.** (Almost 60% of November meetings have seen a policy change compared to less than 30% of October meetings.)

CHART 2: DISTRIBUTION OF POLICY CHANGES UNDER MPC



Sources – Thomson Datastream

Is QE still the best thing to do?

So more QE is on the way, but is it actually the right thing to do? There have, after all, been widespread doubts over the effectiveness of the first bout of asset purchases, given the continued weakness of bank lending and credit growth and the general sluggishness of economic activity.

What’s more, international sentiment appears to have turned somewhat against QE as a policy tool. In particular, the US Federal Reserve has responded to concerns over the undesirable side-effects of more QE by focusing instead on rebalancing its existing portfolio of assets – via the so-called “Operation Twist” – in order to put further downward pressure on long term interest rates. And while the European Central Bank (ECB) is expected soon to start re-loosening policy by

reversing its recent interest rate increases, there is little expectation that it will then engage in QE.

Nonetheless, while the MPC discussed alternative policy options at its September meeting – including changing the maturity of its own assets, cutting Bank Rate further, and providing explicit guidance on the future path of interest rates (to lower long-term market rates) – for now at least, more QE still appears to be very much at the top of the list.

This sentiment was supported by an article in the Bank of England Quarterly Bulletin estimating that the previous £200bn of asset purchases may have boosted the level of GDP by 1.5% to 2% and the rate of inflation by 0.75% to 1.5% - similar to the effects of a cut in official interest rates of 150bps to 300bps. Clearly there are lots of uncertainties surrounding such estimates. **At the very least, though, more QE will send a signal that the MPC recognises the seriousness of the threats facing the economy and is prepared to do something about them.**

More to come next year

To sum up then, while we think that the MPC certainly *should* announce more QE at its October meeting, lingering inflation worries and the normal tendency to change policy in Inflation Report months suggest that a delay until November might just be a shade more likely. But the decision is

clearly very close and may even be influenced at the last minute by Wednesday's CIPS report on services.

Whenever it comes, though, there must be a strong chance that the next extension of the QE programme is not the last. Note, after all, that the last bout was steadily extended three times from £75bn to £200bn. With the fiscal squeeze set to intensify in the coming months, inflation pressures set to ease and the global outlook – in the euro-zone in particular – set to worsen, we suspect that a £50bn extension of the purchases in October or November will be followed by another extension of the same size in January or February.

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TABLE 2: MPC MEMBERS' VOTING RECORD

	King	Bean	Tucker	Dale	Fisher	Miles	Posen	Weale	Broadbent
End of term	Jun-13	Jun-13	Feb-14	May-13	May-14	May-12	Aug-12	Jul-13	May-14
No. of meetings	173	133	112	39	31	28	25	14	4
Votes for rate rise	30	8	13	6	0	0	0	7	0
Votes for rate cuts	23	22	10	6	1	0	0	0	0
Votes against maj.	14	5	7	6	0	0	0	7	0
Av. vote (bps)	-1.3	-5.1	-2.0	-7.7	-1.6	0.0	0.0	12.5	0.0
Av. abs. vote (bps)	10.0	8.1	7.8	15.4	1.6	0.0	0.0	12.5	0.0
Av. deviation ¹ (bps)	2.0	-0.9	1.1	3.8	0.0	0.0	0.0	12.5	0.0
Av. abs. deviation (bps)	2.0	0.9	1.6	3.8	0.0	0.0	0.0	12.5	0.0
Hawk ranking ²	3	9	4	2	5=	5=	5=	1	5=
Activist ranking ³	3	4	5	1	6	7=	7=	2	7=
Maverick ranking ⁴	3	5	4	2	6=	6=	6=	1	6=

¹ From majority. ² From average deviation of vote from majority (1= most hawkish). ³ From average absolute vote (1= most activist). ⁴ From average absolute deviation of vote from majority (1= most maverick).