

Economic News

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The case for a BoE rate cut on December 6th

The time has come for the Bank of England to forget about moral hazard and inflation issues and to start addressing the mounting downside growth risks facing the UK economy at this stage of the cycle. Indeed, considering the news out over the past couple of sessions and notwithstanding last week's remarks from BoE King (which failed to hint at an imminent rate cut), we believe that the probability to see a BoE rate cut on December 6th has risen to just over 50%.

Of most concern was the latest FSA report providing a worrying warning that UK mortgage holders (up to 1.5m of them) will be facing growing difficulties next year, while the Council of Mortgage Lenders (CML) has highlighted a rising risk to see many financial institutions having to fight for survival next year. The persistently high money market rates also desperately need to be addressed, or this will eventually translate into higher borrowing costs in the economy, at which stage there is a discrepancy between the official repo rate and the rate at which economic agents operate. **At that point, monetary policy becomes ineffective.**

However, bearing in mind the BoE's attachment to moral hazard and given the impression that the MPC was not going to cut interest rates until evidence emerged that the financial market crisis was filtering through onto the real economy, **most recent survey evidence could just tip in favour of a rate cut on December 6th.** A marked weakening in the housing sector has been captured by negative readings in both the Halifax and Nationwide November house price indices, with negative spill-over effects on consumer confidence emerging already (see November consumer confidence recording its largest monthly decline since May 2004). Moreover, **the service sector PMI** (a survey that the MPC pays close attention to) fell to a four year low of +51.9 in November, down from +53.1 previously and a clear sign of a worsening domestic demand. **In fact, it may even be argued that the BoE is behind the curve already.** How worse does it need to get for the BoE to respond? After all, domestic conditions are arguably less worrying in Canada at this stage of the cycle and the BoC opted for a pre-emptive policy action on December 4th. The MPC may feel in a pre-emptive mood too on December 6th.

It is a very close call but considering early December financial and economic news, we believe that the BoE is now left with little choice but easing monetary policy on December 6th. A no-change policy outcome could prove damaging, not only to the markets and to overall economic confidence, but above all, to the BoE's credibility.

Longer-Term CIBC forecasts for BoE rates

	Present	Q407	Q108	Q208	Q308	Q408
Base Rate	5.75	5.50	5.25	5.00	5.00	5.00

Audrey Childe-Freeman, December 5th 2007