



# The Bank of England unleashes QE2.1

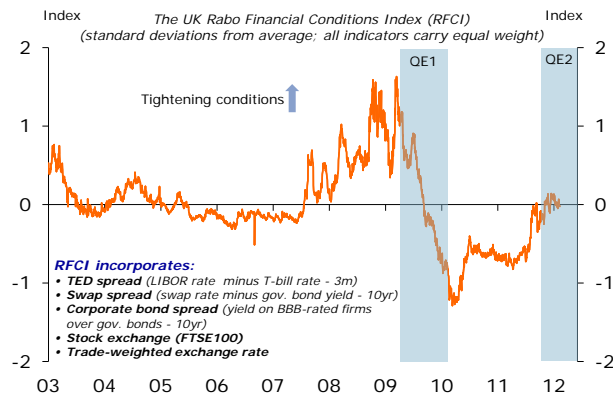
*The Bank of England extended QE2, in line with our expectation. This may mark the end of the Bank's easing cycle unless the economy weakens substantially going forward.*

The Bank of England's decision to keep the policy rate unchanged (at 0.5%) and extend the second round of quantitative easing (QE2) by another GBP 50bn was bang in line with our expectations. This will take the total stock of asset purchased to GBP 323bn (accounting for almost one-third of total public debt outstanding). The question now is whether this will mark the end of the BoE's easing cycle? The odds have certainly increased over the past few months.

For one, a number of UK macro data releases have been better than expected. Most obviously, the forward looking January PMI releases for both the manufacturing and services sectors showed a marked improvement. These surveys are pointing to a moderate but accelerating pace of expansion in January. In fact, we now expect the UK to avoid a technical recession altogether. What is also important to realise is that inflation will be on a declining trend this year owing to falling commodity prices and statistical 'base effects' (due to the January 2011 VAT hike). This will provide a welcome boost to real disposable incomes and may lead to stronger growth in household spending (accounting for roughly 60% of total demand). The final reason why the BoE may decide to not extend QE2 any further is due to the programmes' lack of success in materially transforming the economic outlook. As figure 1 illustrates, the first round of QE was indeed successful to substantially loosen financial conditions in the country. However, since the inception of QE2, financial conditions have not been easing, as one would have expected. This might be partly due to the stress in the financial markets arising from the eurozone debt crisis. Yet the fact that gilt rates are already hovering at record-low levels (see figure 2) suggest that the BoE is merely "pushing on a string" with its QE2 programme. The BoE's decision to purchase government bonds probably serves as a 'signaling function' that the monetary authorities are doing everything in their power to jump-start the economy.

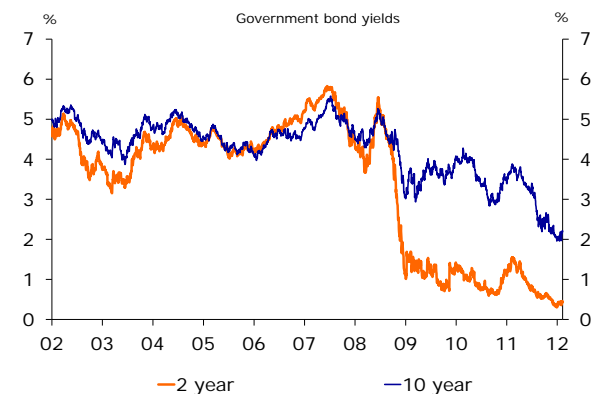
The upshot is that the better economic data and the underwhelming effect of QE2 on UK's financial conditions have lowered the chances of QE2 being extended any further still. Of course, a renewed escalation of the euro crisis may force the hands of the Monetary Policy Committee (MPC) to do more. In any case, the Inflation Report (due on February 15) and the MPC minutes (due on February 22) will hopefully give us a better clue on whether the hawks are once again taking the upper hand in the MPC.

Figure 1: Financial conditions in the UK



Source: Reuters EcoWin, Rabobank

Figure 2: Interest rates



Source: Reuters EcoWin

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