



BOE Meeting

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Key Highlights —

- ◆ BOE increases interest rates for the first time in a decade in order to curb high inflation.
- ◆ Base rate lifted from a record low of 0.25% to 0.5%.
- ◆ BOE last hiked interest rates in July 2007
- ◆ BOE expects the inflation rate to have peaked at 3.2% in October and will be at 3% for the year as a whole

The Bank of England (BOE) has raised interest rates for the first time in more than 10 years to head off rising inflation. The Central Bank's Monetary Policy Committee voted 7-2 in favour of increasing the base rate from 0.25% to 0.5%. The minutes from the MPC's meeting indicated that the Central Bank is in no hurry to raise interest rates again and that further increases will be limited.

Governor Mark Carney said: "It isn't so much where inflation is now but where it is going that concerns us." Carney stressed that rates would "gently" rise as inflation eases in the foreseeable future. The Central Bank expects the inflation rate to have peaked at 3.2% in October and will be at 3% for the year as a whole. The Bank had previously said that inflation would be 2.8% for 2017.

Meantime, the BOE forecasted relatively gloomy growth outlook. Mr Carney said: "The pace at which the economy can grow without generating inflationary pressures has fallen relative to pre-crisis norms. This reflects persistent weakness in productivity growth since the crisis and, more recently, the more limited availability of labour." This has also been exacerbated by the Brexit vote, he believes. "Uncertainties associated with Brexit are weighing on domestic activity, which has slowed even as global growth has risen significantly," he said. The BOE now estimated that the U.K. economy would grow by 1.6% in 2018 and by 1.7% the year after, unchanged from projections it made in August.

Despite some concern about the validity of a rate hike as the growth is slowing down and much uncertainty from Brexit, we think rate hike is a positive step. The reason is that if the rate left at its current low level, it will encourage rampant borrowing which will store up a dangerously large pile of debt for the future, which households and businesses will not be able to service when interest rates start rising again. In short, the BOE needs to raise rates to end an era of cheap borrowing. If the interest rate remained unchanged, households are set to borrow more than they can afford and save less than they will need for the future.

In addition, Brexit fears have reduced the supply of workers since many EU nationals are returning home or not coming, whilst the weaker Pound is less of an incentive for migrant workers. This, in turn, is leading to supply constraints which could increase wages and combined with excess demand is further propelling inflation higher. Without higher interest rates, continued excess demand growth will cause domestic inflation to remain well above the BOE's target level of 2%.

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Stock Recommendation	Expected absolute returns (%) over 12 months
Strong Buy	>20%
Buy	between 10% and 20%
Hold	between 0% and 10%
Sell	0 to <-10%
Neutral	No Rating

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