(BN) BOE Raises Rates as Carney Unites Panel to Curb Inflation R isks

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BOE Raises Rates as Carney Unites Panel to Curb Inflation Risks

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By David Goodman and Lucy Meakin

(Bloomberg) -- The Bank of England raised its benchmark interest rate to the highest level since 2009 as Mark Carney suggested that inflation is a more imminent concern for the economy than the risk of a disorderly Brexit.

"With domestically generated inflation building and the prospect of excess demand emerging, a modest tightening of monetary policy is now appropriate," the BOE governor told reporters in London on Thursday. "The Bank is well-prepared for whatever path the economy takes, including a wide range of potential Brexit outcomes."

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While the rate increase was widely anticipated, few economists had predicted the Monetary Policy Committee would be unanimous on the move with Britain's divorce from the European Union on the horizon. The 9-0 vote to lift the rate to 0.75 percent was the second quarter-point increase since November, and the bank's forecasts suggest it doesn't see the need for another hike before the U.K. leaves in March.

The action follows on from Carney's view in May -- when the BOE held off from tightening -- that a slump in growth in the first quarter would prove temporary.

Still, increased uncertainty about Britain's future relationship with the EU and ongoing global trade tensions could mean that further hikes prove risky. The pound dropped as investors focused on Carney's more-cautious comments, including that Brexit talks are entering a "critical period" and that the BOE is prepared for all scenarios. The pound was down 0.8 percent at $1.3024 as of 1:04 p.m. London time.

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What Our Economists Say"The problem is so much hangs on the outcome of Brexit negotiations. All options remain on the table but if, as we expect, the U.K. manages to secure a deal, another hike is likely in May next year."-- Dan Hanson and Jamie Murray, Bloomberg Economics. See their U.K. REACT *T

In the Inflation Report accompanying the decision, the BOE cut its forecast for global growth, though its predictions for Britain were broadly unchanged. While the U.K. expansion is expected to be just 1.4 percent this year, it'll average about
1.75 percent a year through 2020, slightly above the 1.5 percent long-term potential.

If the economy grows as expected, "an ongoing tightening of monetary policy over the forecast period would be appropriate to return inflation sustainably to the 2 percent target at a conventional horizon," the central bank said. It repeated its phrase that rate hikes will be limited and gradual.

New Forecasts

Similar to the last forecasts in May, the bank's update on Thursday suggests that about one interest-rate increase a year will be enough. Carney will elaborate on the outlook at a press conference at 12:30 p.m. in London.

The forecasts see inflation slipping to 2.2 percent in 2019 from an average of 2.3 percent this year before settling at the goal in 2020.

The BOE is following the U.S. Federal Reserve in slowly raising borrowing costs from levels that are still at emergency lows a decade after the financial crisis. The European Central Bank is set to end its bond-buying program later this year. At the same time as the BOE announced its decision, the Czech central bank also raised its rate by 25 basis points -- the fifth hike there in a year.

The MPC said that while the Brexit-induced depreciation of the pound has helped exports, the uncertainty about future trade is damping investment. The two effects largely cancel each other out, and prospects for overall growth haven't weakened.

For the first time, officials also published their estimate of the equilibrium interest rate -- known as r* -- the long-term trend rate plus short-term factors. While the long-term trend rate has fallen by more than 2 points since 1990, short-term factors are currently pulling the equilibrium rate even lower.

Over the next few years, the bank expects the equilibrium rate to re-converge with the long-term trend rate. It didn't put a number on what it estimates r* is now.

--With assistance from Harumi Ichikura.

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