FINANCIAL MARKETS

THE BANK OF ENGLAND: 2018 MONETARY POLICY

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Blackwell Global is a global brokerage, aiming to be the most trusted financial service provider. We are committed to transparency, integrity and service excellence.

Founded in 2010, we now have global presence in over 90 countries, with main offices in the separately regulated markets of Australia, Cyprus, New Zealand and the United Kingdom.

We believe that sound investment and trading decisions begin with a strong grounding in financial education. Our goal is to make this available to everyone - and this free eBook is part of that commitment.

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MONETARY POLICY IN FOCUS

FOREWORD

One monetary policy focus that seems to be dominating traders thinking of late concerns UK interest rates.

Despite the complexities of Brexit, the UK economy has proven resilient, if somewhat unremarkable in recent months.

It's lead the markets to believe that an interest rate hike could soon be on the cards for the Bank of England. The purpose of this eBook is to analyse when an interest rate hike could happen.

Patrick Latchford
CEO, Blackwell Global Investments (UK) Limited

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INTEREST RATES MATTER

THE BASICS OF MONETARY POLICY

Before we explore the Bank of England's future monetary moves, it's important to understand why they matter to Forex traders.

Most traders agree that decisions taken by entities called 'central banks' have a significant influence on currency price.

Every major developed country (or economic region) has its own central bank which prints money. Typically independent of government, these institutions are responsible for controlling the money supply within its jurisdiction.

Money supply simply means the 'flow of capital' within an economy.

It's vital that a central bank keeps the flow of capital at an optimum level to encourage economic growth and job creation. The thinking behind this is simple: if people and businesses have more money to spend, there'll be an uplift in economic activity and growth.

However, central banks also have to ensure that there isn't too much capital available in an economy. When this phenomenon occurs, there is often an increase in the cost of goods and services, as businesses can justify increasing prices, while needing to offer more competitive wages for their workforce. This is known as inflation - and keeping it at a sustainable rate is one of the major priorities of a central bank.

So how does a central bank control the flow of capital? The answer lies in something called monetary policy, which includes interest rates.

THE IMPACT ON CURRENCY PRICE

A central bank has an array of monetary policy tools at its disposal.

One of those is interest rates, which is effectively the cost it charges commercial banks for borrowing capital.

Higher interest rates act to tighten the flow of capital within the economy, as they make it more expensive for commercial banks to lend capital and offer loans to the population. Due to the laws of supply and demand, this often results in the central bank's currency appreciating in value. Higher interest rates can also attract Foreign Direct Investment, as large investors look to move their capital to regions with better commercial bank interest rates.

Lower interest rates have the opposite effect. They act to loosen the flow of capital in an economy, often in the hope of encouraging an increase in economic activity. By making it cheaper for commercial banks to lend capital, central banks usually anticipate an increase in easily accessible loans for both consumers and businesses, which can then spark job creation. Again, due to the laws of supply and demand, lower interest rates can devalue the native currency.

Other monetary policy tools available to central banks include quantitative easing (QE). Widely referred to as 'printing money', this tool has been employed widely over the past decade to restart the global economy after the financial crisis of 2008. Using QE, central banks essentially inject capital into the economy by purchasing commercial bank bonds. This monetary policy tool acts to devalue the native currency.

THE ROLE OF THE ECONOMIC CALENDAR

If traders can predict changes in a central bank's monetary policy direction, then they can also predict where the price of its currency is likely to move.

That's why many Forex traders monitor economic data releases from major economies. They essentially give clues as to how a central bank might act in the near future. You can track major economic data releases by using Blackwell Global's economic calendar.

UK INTEREST RATES

WHY RATE HIKE IS UNLIKELY IN MAY

In March 2018, speculation was rife amongst investors that an interest rate hike from the Bank of England was likely in May.

In fact, at one point the market judged that there was an 84% chance of an increase in the UK benchmark rate.

This confidence was fuelled by multiple factors.

Firstly, the UK economy grew by an encouraging 0.4% in Q4 of 2017. Secondly, inflation remains above the Bank of England's target of 2%, currently sitting at 2.5% (March 2018). Thirdly, UK unemployment remains at record lows. Plus, back in February 2018, the Bank of England actually said that a May interest rate hike was likely to keep inflation at bay.

However, fast-forward to April 2018 and the picture has significantly changed. This comes on the back of disappointing

GDP data for Q1 of 2018, which printed at 0.1% (expectations were set at 0.3%). In fact, this is the slowest rate at which the UK economy has grown since 2012.

Despite a period of bad weather in the UK, this sluggish growth points to more fundamental problems in the British construction industry, which slipped by 3.3% in the first quarter of 2018.

With the aforementioned data points in mind, the markets are now forecasting the chance of May interest rate hike at 25%.

PROSPECTS FOR 2018

However, there's still a decent chance that we could see at least one interest rate rise this year from the Bank of England.

The governor of the central bank, Mark Carney, recently stated that a rate rise 'was still likely for this year (2018)'.

In our view, how the Bank of England proceeds will be heavily influenced by economic data in the next quarter. Of course, as Brexit negotiations continue, we can expect the central bank to give themselves the flexibility to adjust based on how any UK-EU trade deal progresses.

Traders should closely watch UK inflation and GDP for clues as to when the Bank of England might hike its interest rate.


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WHY BLACKWELL GLOBAL?

We can't pretend that is easy to become a successful trader. But we are here to help and support you as you make your trading journey, providing dedicated resources such as our demo trading accounts and regularly published research materials.

Founded in 2010, Blackwell Global was established to offer brokerage solutions for private and institutional clients. Blackwell Global is a Straight Through Processing or STP broker who provide their clients with superior liquidity and price feeds from top international banks. These are offered alongside 24-hour technical support, market research tools, educational materials, professional partnership programmes and fully integrated trading platforms.

We offer access to multiple asset classes including more than 60 currency pairs, precious metals and other contracts for differences. As a global broker, we are always striving to achieve excellence in our customer service, as well as developing innovative technology to support our customers needs.

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