FOREX TRADING

WILL THE BOE HIKE INTEREST RATES?

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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 CHANGE?

FOREWORD

Nothing quite excites the markets like an unexpected move from a central bank. We've had a recent example of this from the Bank of England.

Specifically, the governor of the Bank of England, Mark Carney, hinted that they could increase UK interest rates as early as November 2017.

These comments have surprised the markets. So is the Bank of England set to embark on a cycle of hiking interest rates? This is what we'll explore in this eBook.

Patrick Latchford
CEO, Blackwell Global Investments (UK) Limited

WHY DO INTEREST RATES MATTER?

COVERING THE BASICS

Before we explore the specific actions of the Bank of England, it's important that you understand why interest rates matter.

It's actually quite simple. High interest rates tend to increase the value of a currency; while low interest rates do the opposite. It's why Forex traders pay a lot of attention to central banks that hint at changing their interest rate in the near future. These changes indicate how the value of a currency might move.

So why do interest rates have this effect? Let's explore this in detail.

Firstly, a central bank's benchmark interest rate is effectively the cost charged to private banks for borrowing capital. These interest rates are then passed on to consumers and businesses through various financial products from private banks. Examples of these products are bank accounts, mortgages and loans.

Higher interest rates make it more expensive to borrow capital. They also encourage foreign investors, businesses and consumers to deposit money with private banks - as they receive an increased return for doing so. This increase in demand is why high interest rates often act to strengthen the native currency.

Adjusting interest rates is a common monetary policy tool for central banks. We'll explain why interest rates are changed in the paragraphs below.

AN AGE OF HISTORICALLY LOW INTEREST RATES

Since the global financial crisis of 2008, every major central bank has adopted historically low interest rates as part of its monetary policy.

Low interest rates were set in order to kickstart economies that had entered a recession. These economies typically had high unemployment rates and negative GDP growth. In an effort to remedy these problems, central banks enacted policies that encouraged an increase in the flow of capital within their economies.

This included setting low interest rates. By making it cheap for investors, businesses and consumers to borrow money - policymakers hoped economic growth would pick up.

Fast-forward to 2017 and we're still in an age of historically low interest rates. In fact, the Federal Reserve is the only major central bank actively in a hiking cycle (their rate is currently between 1% -

1.25%).

However, there is a general sense that other major central banks could soon follow the Federal Reserve in entering a hiking cycle.

One such central bank is the Bank of England. In the next section, we'll explore the reasons behind this potential hike - and rate the likelihood of it happening in the near future.

LOOKING AT THE UNITED KINGDOM

WHY HIKE INTEREST RATES?

Interest rates are typically increased when an economy has a track record of steady growth and low employment, along with an increasing inflation rate.

Central banks are particularly concerned with inflation. This is the rate at which the cost of goods and services increase. The major central banks all have a target inflation rate of approximately 2% - a level which has been deemed sustainable. Should inflation consistently overshoot this level, goods and services can become expensive too quickly. This phenomenon is usually a symptom of a growing economy with loose monetary policy (an approach which encourages the flow of capital).

By tightening monetary policy (which involves hiking interest rates), central banks can taper the rate of inflation back to a sustainable level.

LOOKING AT THE UK

Since the EU referendum in 2016, the UK has experienced an increase in inflation. This has been driven by the sharp fall in the pound, which has made importing goods from abroad more expensive.

What's more, the UK economy has proved resilient in terms of economic growth and low unemployment. This is despite many economists and market analysts predicting that Brexit would have an adverse effect on these metrics. Interestingly, the fall in the pound has made UK exports cheaper to buy - which has helped the UK manufacturing sector.

Despite this, UK wage growth remains sluggish. It's why Mark Carney, governor of the Bank of England recently hinted that the bank could increase its benchmark interest rate as early as November 2017. By doing so, the central bank would tighten its monetary policy in an attempt to slow the rate of inflation.

EFFECTS OF BREXIT?

A future rate hike from the Bank of England has been touted throughout 2017. However, the markets didn't expect Mark Carney to suggest that an increase could happen as soon as November 2017.

One reason for that is the ongoing Brexit negotiations. Above anything else, Brexit continues to be the major issue that causes volatility for the pound.

So far, progress in the negotiations has been slow. At the time of writing (October 2017), there is speculation that a 'No Deal' scenario could unfold. Such an outcome could have serious consequences for UK businesses that are reliant on trade with the EU. As with most Brexit issues, it's difficult to predict what will happen.

Furthermore, the political uncertainty around British Prime Minister Theresa May is continuing to cast doubt over what form Brexit will eventually take. Her authority in the Conservative party has been diminished after this year's UK general election - and many political pundits believe she could be replaced before 2018.

WHEN WILL A HIKE HAPPEN?

We anticipate a rate hike of 0.25% to 0.5% from the Bank of England in November 2017. Recent economic data has done little to change the picture that operating and living costs are increasing for UK businesses and households. Traders should closely monitor UK economic data releases ahead of November.


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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.

Today, the Blackwell Global group of companies has a presence in over 90 countries, with its main offices situated in the individually regulated markets of Australia, Cyprus, New Zealand and the United Kingdom.

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