Payden&Rygel

Economic Update

THOUGHTS FROM OUR ECONOMICS TEAM

SEPTEMBER 11, 2015

The Bank of England: Doing The Fed's Work

The policy statement and minutes released Thursday after the September meeting of the Bank of England's Monetary Policy Committee (MPC) may serve as a useful template for US policymakers when they meet next week. As expected, the MPC kept their key policy rate unchanged at 0.5%. More importantly, the British central bank stuck to its benign economic outlook despite global financial market developments since the August MPC meeting.

Why look to the Bank of England (BoE) for Fed cues? The US and UK economies share certain attributes that have no doubt caught the eyes of policymakers: a strengthening currency, downside risks from a global "slowdown", and below-target inflation despite a rapid decline in the unemployment rate. To address the elephant, or dragon, in the room, BoE Governor Mark Carney stated at the end of last month that "developments in China are unlikely to change the process of rate increases from limited and gradual to infinitesimal and inert." The BoE minutes reiterated that statement by pointing out that "it was premature to assume that the effects of developments [in China] to date would have a material effect on this UK outlook." In fact, while eight MPC members voted to keep rates unchanged, one member was ready for a rate increase for the second month in a row. Ian McCafferty believed the strength of the domestic economy, growing at an impressive 2.7% annual rate in the second quarter, was reason enough to hike.

The Bank of England meeting minutes are probably a fairly accurate representation of what the Fed will discuss next week. If anything the Fed should be even less concerned with recent global economic turmoil. After all, while UK exports represent 28% of GDP and UK banks' exposure to emerging market (EM) debt is 30% of GDP, US exports are only 14% of GDP and US banks' exposure to EM debt is only 3.2% of GDP. If the Bank of England is not changing course, why should the Fed?

If the Fed does defer in September (as we've said elsewhere we think September is "on the table" and the case for staying at zero is wearing thin), we expect at least one dissenter, just like at the MPC. Jeffrey Lacker, the President of the Richmond Fed and a voter on the Federal Open Market Committee (FOMC) delivered a speech last Friday titled, "The Case Against Further Delay." To paraphrase Lacker, we do not argue that the US or UK economy is perfect, but neither economy is "on the ropes." It's time to align overnight interest rates with the significant progress that's been made.

We'll find out more next Thursday.

LOS ANGELES | BOSTON | LONDON | PARIS

333 South Grand Avenue, Los Angeles, CA 90071 | payden.com