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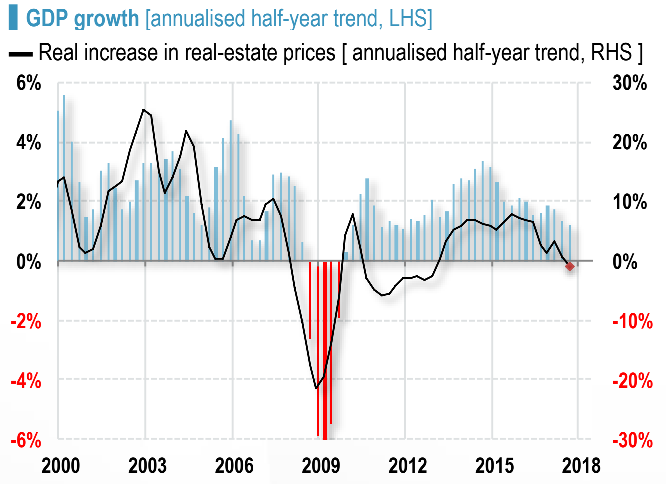
The UK: darker horizons

■ The UK's economic environment is deteriorating ■ Even so, the Bank of England raised its key rate ■ Could it be preparing for a future rate cut?

There are no happy solutions for Brexit. Since 29 March, when the UK triggered the procedure to exit the European Union (EU), the UK economy has not been running very smoothly. Briefly lifted by the drop-off in Sterling and monetary injections, it is now showing increasing signs of weakness. The upturn in inflation is eroding household purchasing power and curbing consumer spending. With little choice but to adopt a wait-and-see attitude, numerous business leaders have been cancelling or postponing investments. In October, the Confederation of British Industry warned that the business climate was deteriorating, in stark contrast with global trends. Migrant flows have come to a virtual standstill due to uncertainty over the situation for expatriates, and as a result construction has stalled, too. Real prices per square metre are falling, which is never good news for an economy that has been traditionally highly dependent on the real-estate cycle (see chart).

UK: GROWTH VS REAL ESTATE PRICES



Sources: Halifax, national accounts

In this case, how should we interpret the Bank of England's key rate increase in early November? The press release issued along with the decision provides no clear explanation. Although the committee reacted in text book fashion to higher inflation figures, monetary policy committee members also explained that Brexit might lower the potential growth rate, i.e. *"the level at which the economy can grow without generating inflation."* The central bank is responding to the shift in the supply curve, even though it is supposed to act on demand. Committee members also pointed out that any further tightening was bound to be *"gradual and limited"*, although they said they were worried by the *"considerable"* downside risks to economic prospects. It looks as though the UK authorities are anticipating difficult times ahead, and are striving rebuild manoeuvring room today to be in a better position to support the economy in the near future.

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