28.10.2015

MPC MEMBERS

Copies to: Markets – SMD PAL Team

From:

PRE-MPC FOLLOW-UP,

Question
- Ben Broadbent asked if recent large moves in short rates and sterling coincided with UK and US data surprises.

Main message
- The fall in UK short rates since the last IR mirrors that in analogous US rates, and predominantly reflects international rather than domestic news. Of this, data is not a significant driver, with the largest falls in both UK short rates and sterling occurring in the period of equity market volatility in late August and in the days following the September FOMC meeting.

1. Since the release of the August IR, the largest falls in short UK OIS rates occurred around the same time as global equity prices fell: in the period following the changes to the Renminbi fix methodology and again following the September FOMC meeting. See for more detail on what has driven the fall in short rates since the August *Report*. Similarly, the fall in sterling since August has been primarily against the euro and occurred largely during the period of equity market volatility in late August, and following the FOMC meeting in September.

2. That said, a recent MI update by colleagues in SMD found a number of contacts thought recent UK data releases did have a role to play. In particular, wage growth had levelled off (having increased sharply earlier this year) and the spot CPI figure fell (unexpectedly) to -0.1%. A number of contacts also placed weight on weakening forward looking measures of activity as grounds for concern about the outlook for growth. For example, services PMI data published at the beginning of October fell short of the market expectation.

3. These surprises are captured by the UK economic surprise index (ESI). This is plotted in **Chart 1** alongside its US and euro area counterparts. This suggests that data surprises have been only modestly disappointing relative to expectations in the UK.

4. **Chart 2** shows the cumulative change in 1-year instantaneous UK OIS rates and sterling ERI plotted against the cumulative economic surprises indices for the UK and US, along with stalks for significant UK and US data surprises. From the chart it does not appear that the data surprises correspond with particularly large moves in either short-term interest rates or sterling. Broadly, the cumulative surprise in the data over the period shown is only slightly negative in the UK (and positive in the US), while rates have fallen around 25bps. Of course, intraday moves might have been larger than the daily data suggests, so there may have been more volatility following data releases than is captured here.

Chart 1: Cumulative economic data surprises since the August IR

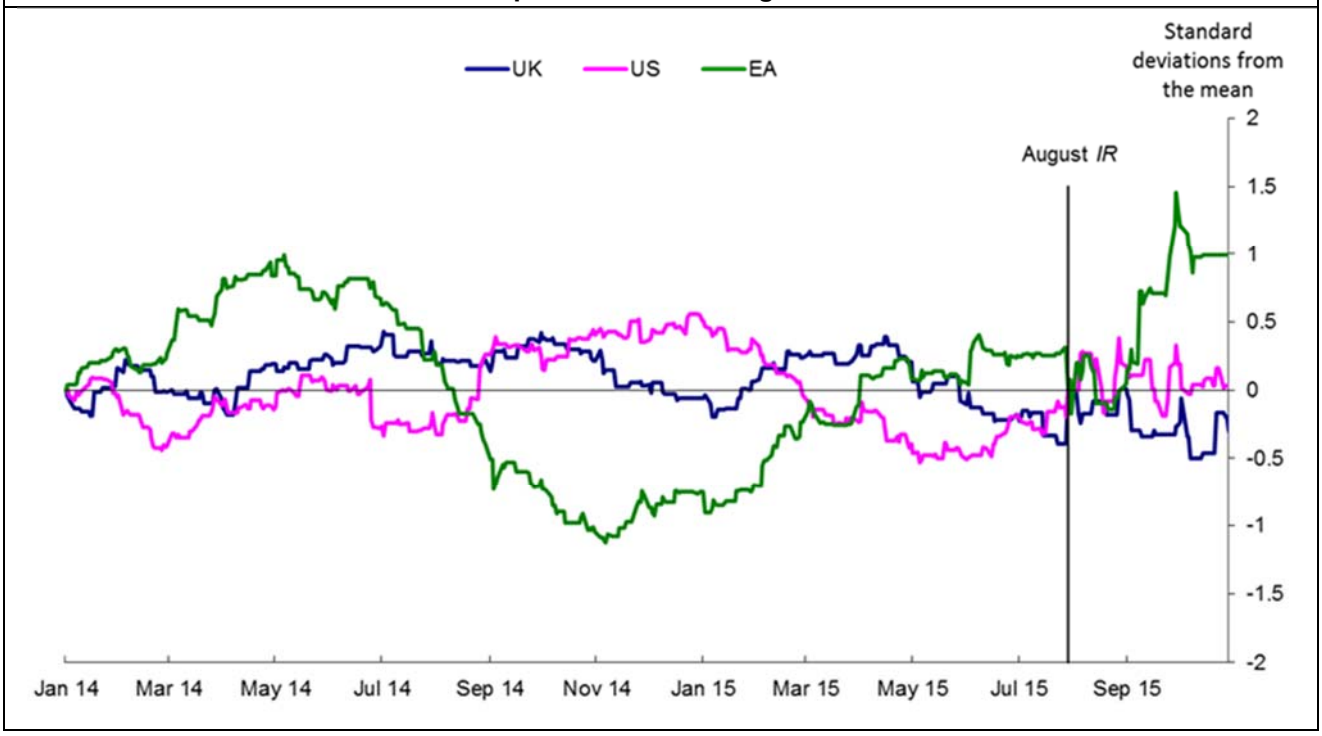
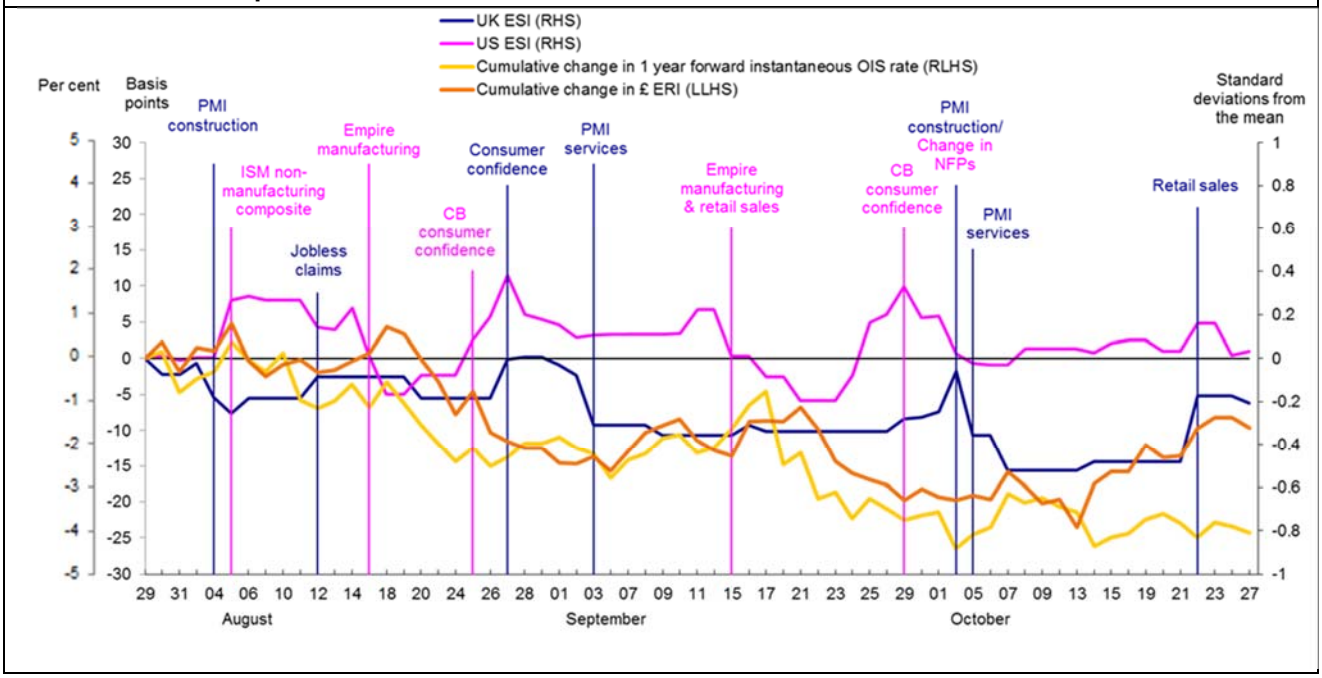


Chart 2: Cumulative changes in UK 1-year instantaneous OIS rates, sterling ERI and UK & US economic data surprises



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