
Canadian to take helm at Bank

The man with the plan?

"In the wake of the UK losing its AAA status, does the Bank of England governor elect have what it takes to get the UK economy moving quickly?

The arrival in the UK of ex-Bank of Canada Governor, Mark Carney, has stoked a flurry of excitement from economists and the media ahead of his appointment as Governor of the Bank of England this coming June. While Sir Mervyn King keeps his seat warm until then, Mr. Carney has been doing the rounds and giving some hints as to what role he believes the Bank should be playing in the midst of a fragile economy and what policy changes he might be making as a result.

His first important appointment was the most daunting; a grilling from the UK's Treasury Select Committee – something that could have put him off UK press conferences for life. The session did begin with some rather awkward questions about his salary from a sceptical panel of MPs with a point to make, but his deft handling of the discussion limited further "banker bashing" and his confident yet respectful performance appeared to win over MPs from the left and right; offering to adopt a more open dialogue with MPs about internal Bank of England discussions – all part of a "new look". Furthermore, inflation

targeting will be more flexible in the future and, whilst he stopped short of making firm predictions about the UK's growth potential, it was clear that stimulating the UK economy will be higher up the agenda. It was, in short, a polished performance in front of intense media scrutiny hanging on every word.

The word which got picked up was "flexible". Mr. Carney repeatedly spoke of a flexible inflation-targeting framework and high-level discussions with George Osborne about changing the Bank's remit. All of which leads the market to speculate that, behind the scenes away from the rating agencies, both Prime Minister Cameron and Chancellor Osborne have decided to go all out for economic growth and desperately need the Bank of England to get stuck into getting the economy moving, pronto, in contrast to Sir Mervyn's rather more stoic approach and commitment to controlling inflation.

This is an interesting development because it appears to partly confirm what was already suspected; namely that the 2% inflation target is no longer the main objective for the Bank of England. Given that his incumbent Sir Mervyn King has already had to write 14 letters to the Chancellor in 5 years to explain why UK inflation has been above target for 37 straight months, this should surprise no one; and certainly not anyone familiar with the Bank of England "fan charts" of inflationary predictions.

Even Sir Mervyn is now using the word flexible to explain why the Bank is unlikely to get inflation down to 2% for a least 2 more years – the longest "miss" ever and a task not made easier with the UK losing its AAA rating which could undermine Sterling further. Elsewhere, 2% inflation is the target rate for the US Federal Reserve, the Bank of Japan and the ECB. In the UK, however, it now seems to be more of an aspiration than a firm target. As the markets have been waking up to what this really means – base rates stuck at 0.5% for years but with the prospect of inflation off the leash, the pound has been on the slide against all major currencies, down over 6% against the US dollar in February. To compound Sterling weakness further, even before Moody's downgrade, Sir Mervyn has also been talking down the pound which will, in turn, be generally inflationary as it pushes up the cost of imports. Gilts have also been on the slide with the 10 year yield rising to as much as 2.23%. The UK yield curve is steepening.

Mr. Carney has already dismissed talk of a dual-mandate and growth is clearly now the name of the game in this new cooperative approach with the Government, and with their eyes on an election in 2015. It may take the form of some GDP targeting although it's unlikely that anyone will admit as much in the months ahead in order to downplay any sense of major upheaval. Nevertheless, Gilts are starting to struggle in the wake of this new reality and, whilst we do not expect them to entirely lose their relative attraction as a safe haven during periods of volatility, we have no intention changing this stance as TAM portfolios enjoy a strong start to the year.

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