



Interest rate decision: what can we expect and why?

By [Nicholas Paler](#) | 08:30:00 | 08 October 2008

Most investors and economic experts are expecting the Bank of England (BoE) to cut rates by 50 basis points tomorrow to help alleviate the pressures on UK markets.

Beware excessive action

Citywire A-rated fund manager Colin Mclean of SVM, believed there was significant scope for the BoE to cut interest rates as food and commodity prices are expected to fall, reducing the inflationary pressures in the economy.

However, he warned against too excessive action as the era of cheap debt is a major contributor to the credit crisis.

He said: 'Low interest rates have partly created the crisis, so sharp cuts in interest rates are not necessarily the solution.'

'Besides there is no guarantee that it will improve conditions, and banks need to start lending to each other if the consumer is to feel the real benefit of cuts in interest rates.'

Hoping for a big cut

Henderson Global Investors' director of economics and asset allocation Tony Dolphin expected severe action: 'I think they will cut by 0.5% and I certainly hope they do,' he said.

'It's got to a point where it's become a matter of confidence and they need to give people hope that there is light at the end of the tunnel.'

Dolphin noted that there had been increasing calls from a number of quarters – such as manufacturers and real estate agents – for a cut.

He acknowledged that inflation was still too high and likely to come in higher still in the short term, but he was expecting at least a 0.25% cut, if not more.

'It's likely they will cut rates although it is a toss up between 0.25% and 0.5%,' he conceded.

He added that looking further ahead he was factoring in a fall in rates to below 4% one year from now.

The chief investment officer of Mercater Capital Management, David Oakes, added that a 50 basis point cut was widely expected. 'A 0.5% cut is the general view,' he said.

Meanwhile, Blackrock's director and vice chairman Bob Doll, who is also global chief investment officer at the firm, said he expected most countries to opt for a large cut.

He said: 'Now that financial stresses are threatening the flow of credit to the corporate and household sectors, we expect most central banks to cut interest rates by about 50 basis points at some point soon.'

However, it was by no means clear cut about which way the MPC would go, and some, in particular New Star's chief economist Simon Ward, said the smaller cut was likely.

Ward conceded that a number of factors were building to support a 0.5% cut – namely the current highly elevated level of sterling LIBOR (the rate at which banks lend to each other), and the latest inflation data.

However, he argued that overall, while some members of the MPC would want a 0.5% cut, the majority would go for a quarter-point cut, potentially followed-up by more action in November.

He said: 'While several MPC members may vote for a 50 basis points cut, I suspect a majority will prefer a quarter-point cut.'

Effects of a cut

Ward, along with other commentators, was also dubious about the effect any cuts would have now, given that the current crisis battering markets was more to do with severe problems with the actual financial system rather than the cost of money.

He said: 'Current economic risks stem less from the price of money than the complete breakdown in the plumbing of the financial system, a problem better addressed by direct official intervention.'

Oakes agreed, saying: 'It is getting to the point where you have to ask what difference does the rate cut make.'

Dolphin said a plan to help banks get the toxic assets off their balance sheets was needed, especially as there was a growing feeling that rate cuts alone won't solve the crisis.