MONETARY POLICY REPORT PRESS CONFERENCE

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Opening Remarks by Andrew Bailey, Governor

Hello. I'm delighted that we can host this presentation of the November Monetary Policy Report at the Bank today.

Developments since August

The UK and global economy continue to face challenges as we recover from the pandemic. Both global and UK GDP increased in Q3 this year, although at a slower pace than projected in the August *Report*. Growth has been restrained by disruption in supply chains. Alongside the rapid pace at which global demand for goods has risen, this has led to supply bottlenecks in certain sectors. There have also been some signs of weaker UK consumer spending. While supply bottlenecks will continue to restrain growth somewhat in the near term, global and UK GDP are nonetheless expected to recover further from the effects of Covid-19. UK GDP is projected to get back to its 2019 Q4 level in Q1 next year.

In the labour market, the UK unemployment rate fell to 4.5% in the three months to August, while HMRC payroll data have continued to rise strongly. Just over a million jobs are likely to have been furloughed immediately before the Coronavirus Job Retention Scheme closed at end-September, significantly more than expected in the August *Report*. Nonetheless, there remain few signs of increases in redundancies and the stock of vacancies has increased further, as have indicators of recruitment difficulties. Unemployment has been lower than expected in the August *Report* and is projected to remain low in the near term. While the unemployment rate is projected to pick up in Q4 as the furlough scheme ends, the rise is only small as most employees on the scheme are assumed to return to work. Underlying pay growth has remained above pre-pandemic rates, although we expect it to fall back from its current rate.

Twelve-month inflation was 3.1% in September, broadly as expected in the August *Report*. Inflation is expected to rise to just under 4% in October, predominantly due to the impact on utility bills of past strength in wholesale gas prices. Inflation is then expected to rise to 4½% in November and remain around that level through the winter, accounted for by further increases in core goods and food price inflation.

Developments in energy prices, especially the wholesale price of gas in the UK, are expected to account for a significant proportion of the projected pickup in inflation in the near term, and its subsequent decline. In the run-up to the November *Report*, wholesale oil and gas prices were around 80% and 400% higher respectively than they were in 2020 Q4, and wholesale electricity prices were around 300% higher. Wholesale gas prices in particular have risen sharply in recent months, rising by around 130% since the August *Report*. These rises in energy prices reflect the recovery in global demand as the impact of the pandemic has faded, as well as some disruptions to supply. Taking account of this, CPI inflation is now expected to peak at around 5% in April next year, materially higher than expected in the August *Report*.

Monetary policy can do little to affect inflation in the near term. So the implications of short-term movements in CPI inflation for monetary policy depend on their impacts further ahead. That, in turn, depends on how they affect households' and businesses' expectations of future inflation. Over the past few months, indicators of short-term inflation expectations have risen, as inflation outturns have picked up and given recent developments in energy and other prices which are likely to affect the near-term outlook. Measures of inflation expectations two to three years ahead and some longer-term measures derived from household surveys and financial markets, have also increased in recent months, but by less than short-term measures. The distribution of household inflation expectations has been fairly stable and professional forecasters expect inflation to be close to the 2% target in the medium-term. Making an overall assessment of medium-term inflation expectations using all these different indicators is difficult. Nonetheless, the MPC continues to judge that medium-term inflation expectations remain well anchored, and will continue to monitor indicators of expectations, and their impact, closely.

The influence of energy prices on the outlook

The upward pressure on CPI inflation is expected to dissipate over time, as supply disruption eases, global demand rebalances, and energy prices stop rising. As a result, CPI inflation is projected to fall back materially from the second half of next year.

The path of energy prices will continue to have a significant bearing on inflation. In the central forecast, in line with the current convention, it is assumed that wholesale energy prices follow their respective futures curves for the first six months of the projection and are then flat beyond that point. So although they stop rising, the level of gas prices in the central forecast is still very high by historical standards. On this assumption, and conditioning too on the market-implied path for Bank Rate, CPI inflation is projected to be a little above the 2% target in two years' time. However, because of the depressive effect on incomes and spending of high energy prices, and also the higher level of Bank Rate and less supportive fiscal policy, a degree of spare capacity opens up in the economy during the second half of the forecast. Inflation therefore falls just below 2% by the end of the forecast period and would probably continue to decline thereafter.

What happens to energy prices is clearly very uncertain and there are material risks around this assumption. Indeed, wholesale gas prices over the past week have been, on average, 18% lower than the 15-day average to 27 October. In an alternative scenario that is conditioned on energy prices following forward curves throughout the forecast period and as set out in a box in the November *Report*, CPI inflation falls back towards the target more rapidly than in the MPC's central projection, and is materially lower, particularly over the second half of the forecast period. In this scenario, inflation falls back to target three quarters earlier than the MPC's central projection.

The policy decision

The inflation target applies at all times, reflecting the primacy of price stability in the UK monetary policy framework. The framework also recognises that there will be occasions when inflation will depart from the target as a result of shocks and disturbances. In the recent unprecedented circumstances, the economy has been subject to very large shocks. Given the lag between changes in monetary policy and their effects on inflation, the Committee, in judging the appropriate policy stance, will as always focus on the medium-term prospects for inflation, including medium-term inflation expectations, rather than factors that are likely to be transient.

At its recent meetings, the Committee has judged that some modest tightening of monetary policy over the forecast period is likely to be necessary to meet the 2% inflation target sustainably in the medium term. The latest developments, set alongside the Committee's updated projections, reinforce this view. Nevertheless, near-term uncertainties remain, especially around the outlook for the labour market and the extent to which domestic cost and price pressures persist into the medium term.

Unemployment in the UK is not projected to rise materially in the near term, consistent with information from a range of high-frequency indicators of the labour market. But there is a high degree of uncertainty around the near-term outlook, particularly reflecting the end of the furlough scheme.

The high use of the furlough scheme, as well as somewhat elevated unemployment relative to pre-Covid, contrasts with other signals of a tight labour market, such as reports of significant recruitment difficulties, elevated levels of vacancies and higher-than-expected wage growth over the pandemic as a whole. It is possible that shifts in the pattern of demand during the pandemic will mean that some of those people who are unemployed or were on furlough may not be matches for the job vacancies available. The MPC judges that some frictions in the matching of workers and jobs have contributed to a rise in the medium-term equilibrium rate of unemployment during the pandemic. That effect is expected to dissipate over the forecast period, as the economy normalises, and given the historical flexibility of the UK labour market.

At this meeting, the Committee concluded that the existing stance of monetary policy remained appropriate.

The Committee judges that, provided the incoming data, particularly on the labour market, are broadly in line with the central projections in the November *Report*, it will be necessary over coming months to increase Bank Rate in order to return CPI inflation sustainably to the 2% target. In observing the market-implied path for Bank Rate, the Committee notes that, in the November *Report* central projections, CPI inflation is projected to be below the 2% target at the end of forecast period, and would probably fall a little further beyond that point, given the margin of spare capacity that is expected to emerge.

Looking beyond the coming months, the Committee will, as always, continue to focus on the medium-term prospects for inflation. The Committee judges that there are two-sided risks around developments in the economy in the medium-term, and will reach its assessment on the balance of these risks in light of the relevant data as they emerge.

To sum up, this period of higher inflation is likely to be temporary, as depicted in the forecast. Moreover, monetary policy cannot tackle the causes of supply problems. But it is likely that for inflation to return to target in a timeframe that should help to keep medium-term inflation expectations anchored will require Bank Rate to rise. That said, I would caution against views on the scale of an increase that would be likely to push inflation below target in future by increasing slack in the economy. The short-term evolution of the labour market will be crucial in determining the scale and pace of the response. We do not yet have the necessary hard evidence on the state of the labour market following the end of the furlough scheme to make a sufficiently clear assessment. Over coming months that is likely to change.

Thank you.