MONETARY POLICY REPORT PRESS CONFERENCE

Thursday 9 May 2024

Opening remarks by Andrew Bailey, Governor

Today's monetary policy decision

Today, we have held Bank Rate at 5.25%.

The big global shocks that caused inflation to rise have faded. And monetary policy is working to bring inflation back towards the 2% target. Inflation has now fallen to just above 3%. And we expect it to be close to the target in the coming months. That is encouraging.

But we are not yet at a point where we can cut Bank Rate. We will consider the forthcoming data releases as part of our assessment of for how long Bank Rate should be maintained at its current level to be sure that inflation will fall all the way back to the 2% target – and stay there.

The outlook

We have had relatively few UK data surprises since our previous Monetary Policy Report in February.

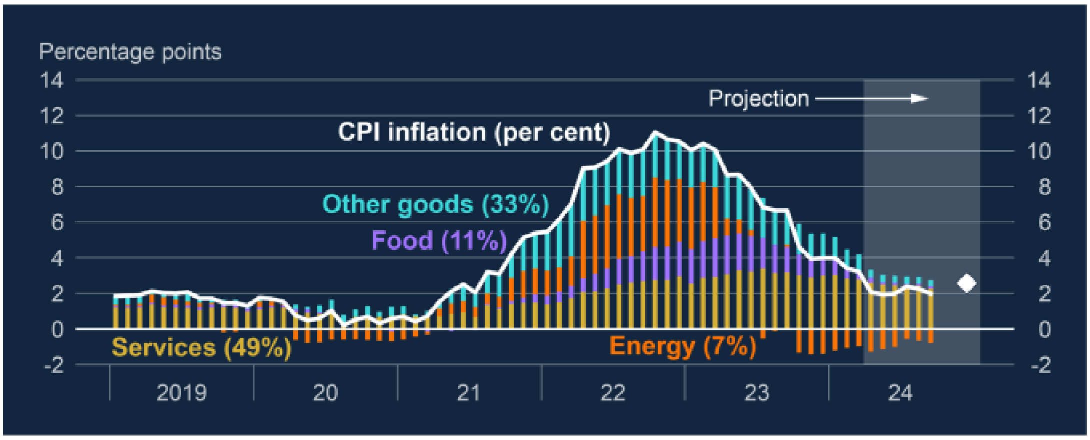
Economic growth was weaker than we expected in the fourth quarter of last year. But we think the first quarter of this year has been a bit stronger, leaving the level of economic activity broadly as expected.

Twelve-month consumer price inflation – shown here in **Chart 1** – fell from 4.0% in December to 3.2% in March, its lowest rate since December 2021, 0.1 percentage points higher than we expected in February. The decline was spread across food, core goods and services. Energy prices have also continued to contribute negatively to the headline inflation rate. And as a lower Ofgem cap on household energy prices has come into effect in April, we expect headline inflation to drop further, to a level very close to target in the next few months. But we then expect it to edge up again in the second half of the year as the negative contributions from energy prices fade.

This absence of data surprises is an indication that we are now getting back to more normal times – at least compared to the highly unusual period we have been living through with a global pandemic and a major war in Europe. Risks to the global economy remain, including from conflict in the Middle East. But so far economies have adjusted to withstand those risks. Global supply chains have held up, and energy prices have moderated.

Chart 1: Inflation is expected to fall close to the 2% target before rising again

Contributions to consumer price inflation

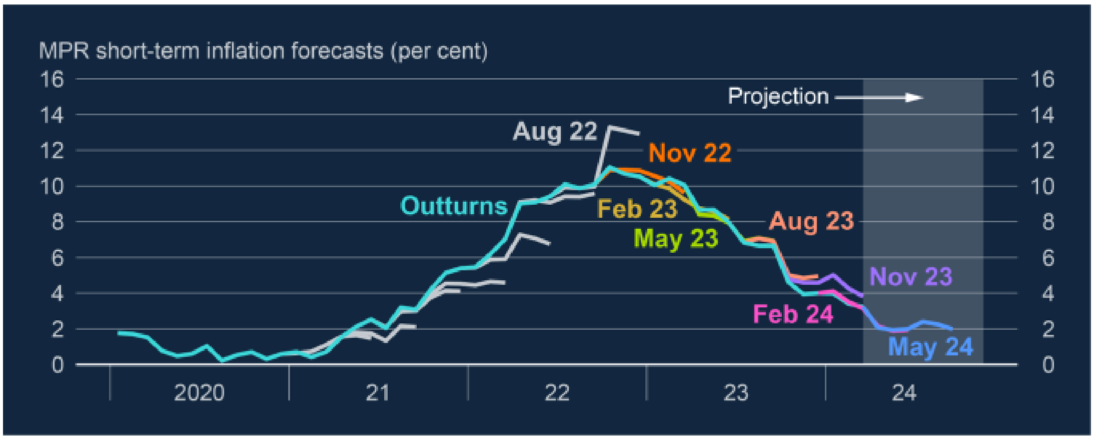


Sources: Bloomberg Finance L.P., Department for Energy Security and Net Zero, ONS and Bank calculation

Chart 2 provides one illustration of how the outlook has become more predictable, at least in the near term. It shows the evolution of our six-month ahead inflation projections (the 'stalks') and compares it with the outturns in the data (the blue line). For some time now, inflation outturns have again come in close to the near-term projections.

Chart 2: Headline inflation has been broadly in line with forecasts this year

Projections from successive Monetary Policy Reports and data outturns



Sources: ONS and Bank calculation

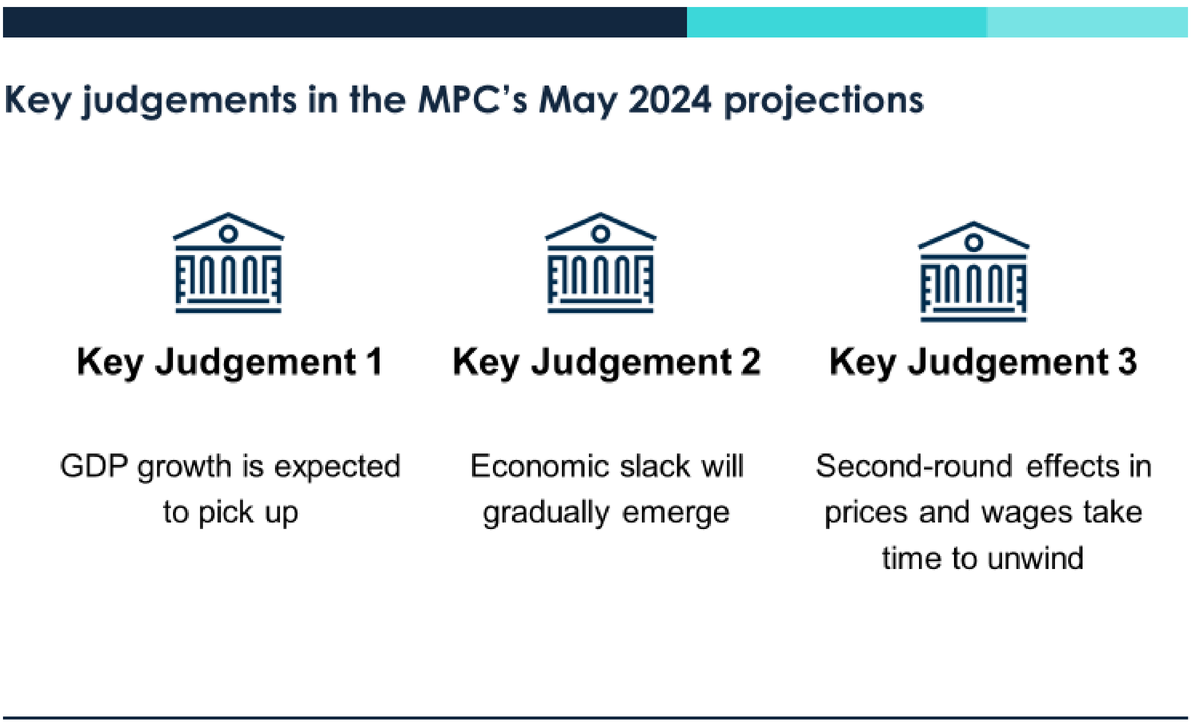
Turning to indicators of inflation persistence, the picture is much the same. Services price inflation and wage growth have both been a little higher than we expected in February. That should give us pause for thought. But we should not over-interpret these surprises either. There will always be some ups and downs in the data, and the news we have had recently has been within the volatility we should expect in normal times. In summary on the data of late, there have been relatively few surprises, with a little more strength on inflation persistence than expected, though this is well within normal margins of variance.

More data will help us to extract the signal from the noise and help us to judge whether or not we are on track to bring inflation back to the 2% target sustainably. And more data will help us assess if we are sufficiently confident in that process that we can start to withdraw some of the restrictiveness in the monetary policy stance.

Before our next meeting in June, we will have two full sets of data – for inflation, activity and the labour market – that will help us in making that judgement afresh. But, let me be clear, a change in Bank Rate in June is neither ruled out nor a fait accompli.

The key forecast judgements

In our current assessment of the medium-term outlook, the Monetary Policy Committee has been guided by three **Key Forecast Judgements**. These judgements, and the risks around them, are described in detail in today's Report.



The first key judgement is that GDP growth is expected to pick up during the forecast period, following modest weakness last year. The second is that demand will gradually fall short of supply, leading to a margin of economic slack. The third is that second-round effects in domestic prices and wages will take longer to unwind than they did to emerge.

Let me briefly address each of these key judgements in turn.

First, on growth, we think that the stance of monetary policy will weigh less on economic growth over the next three years. We also expect economic growth to be supported by an increase in the population and by some pick-up in productivity. Fiscal policy will have some effect too. And the continued unwind of global shocks to energy and imported goods prices will boost real incomes.

Second, on demand and supply, we think that the current balance between them will gradually turn into excess supply. Despite picking up during the forecast period, demand growth is expected to remain weaker than supply growth, in part reflecting the restrictive stance of monetary policy. This also means that we expect unemployment to rise somewhat over the next couple of years, but by less than we have been expecting previously.

Third, on wages and prices, we think that headline consumer price inflation will edge up again in the second half of this year. The negative contributions from energy prices will fade while domestic inflation pressures are likely to persist for longer. That illustrates why we monitor indicators of domestic inflationary pressures very carefully.

We have made two important adjustments to our inflation judgements.

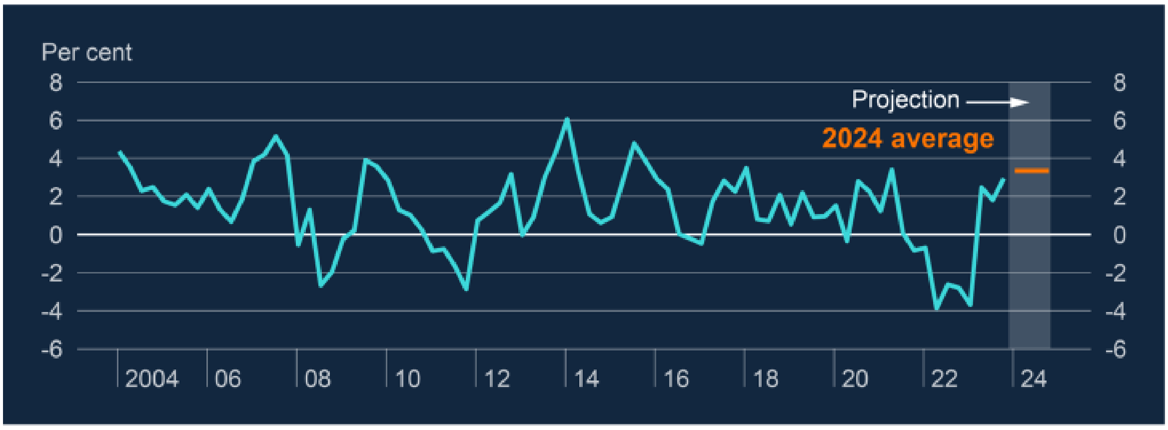
First, we now judge that a greater proportion of the effect of past increases in import prices has already passed through to consumer prices. This is not least because the rise in import prices was associated with acute shortages of many products. What this means is both that the past rise inflation is easier to explain and that external pressures are likely to be somewhat weaker over the first half of the forecast period.

Second, it is now the MPC's best collective judgement that second-round effects on domestic prices and wages will fade slightly faster than we have previously assumed. There remains considerable uncertainty around this judgement, however, and I should note that MPC members hold a range of views about it.

Let me just make one observation. Second-round effects on wages and prices emerged at least in part in response to falling real incomes as households and businesses understandably sought to resist an erosion of their real income and profits. But real incomes are now growing again. As **Chart 3** shows, aggregate real income growth is about as strong now as at any point over the past decade. That is good news in itself, of course, and higher real incomes should also help such second-round inflationary pressures to ease.

Chart 3: Households' real incomes have picked up

Aggregate real post-tax labour income growth



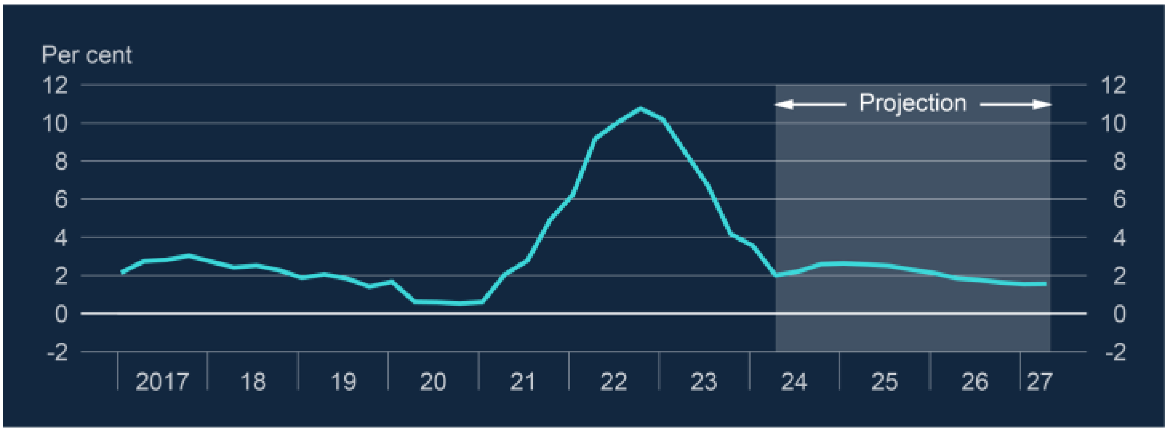
Sources: ONS and Bank calculation

That takes me to the medium-term outlook for inflation.

Chart 4 shows the MPC's modal, or most likely, projection for consumer price inflation, conditional on the market-implied path for Bank Rate. In this projection, inflation increases from around the 2% target in the second quarter of this year to around 2½% by the turn of the year, before falling back to 1.9% in two years' time and to 1.6% in three years.

Chart 4: Inflation is projected to fall below target at the end of the forecast

CPI inflation projection conditional on market-implied path for Bank Rate



Sources: ONS and Bank calculation

This projection reflects our view that we are making very good progress in returning inflation to the 2% target, that the restrictive monetary policy stance is working. In fact – conditional on the market-implied path for Bank Rate – the projection suggests that inflation could fall below the inflation target towards the end of the forecast period.

Monetary policy

So with the progress we have made, to make sure that inflation stays around the 2% target – that inflation will neither be too high nor too low – it is likely that we will need to cut Bank Rate over the coming quarters and make monetary policy somewhat less restrictive over the forecast period, possibly more so than currently priced in market rates. This would be consistent with ensuring that inflation does not fall noticeably below target at the end point of the forecast.

But that is a judgment for the future. It really depends on how the data evolve, and how that evolution affects our assessment that the risks from inflation persistence are receding.

We have no preconceptions about how fast and how far we might cut Bank Rate. Instead, we will continue to look carefully for evidence that the outlook for inflation is consistent with the 2% target given the decisions we have already made. And we will reach a new decision on the appropriate level of Bank Rate, based on that evidence, at each meeting.

Finally, this is Ben's last MPC Press Conference, though not his last meeting – that will be in June. In fact, today is his 40th press conference, his 52nd MPR (his first 12 were as an external committee member) and his one hundred and twenty seventh MPC meeting. Impressive numbers. But the numbers only tell a small part of the story. Ben, you have been an excellent colleague and we will miss you greatly. The fact the Jürgen Klopp has decided to step down just as your term expires is, I am told, entirely coincidental.

With that, Dave, Ben and I will be happy to take your questions.