MONETARY POLICY REPORT PRESS CONFERENCE

Thursday 7 November 2024

Opening remarks by Andrew Bailey, Governor

Inflation has been close to our 2% target for more than half a year now. Today, we have been able to cut Bank Rate again, by 0.25 percentage points to 4.75%.

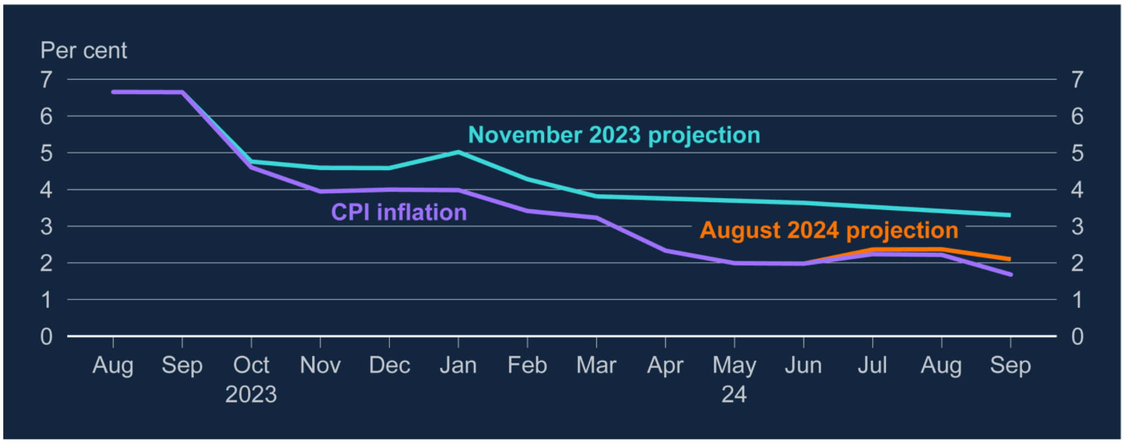
The best and most sustainable contribution monetary policy can make to growth and prosperity is to ensure low and stable inflation.

I will start with recent developments and the near-term outlook for inflation and then turn to our medium-term forecast and its determinant drivers, before concluding on today's monetary policy decision.

Chart 1 shows the evolution of twelve-month consumer price inflation (purple line) over the past year. It has fallen a long way to an average of 2% over the past five months and 1.7% in the latest data for September. This is 0.4 percentage points below our August projection (in orange) and in the order of 1½ percentage points below our projection from a year ago (in blue). The disinflationary process has progressed well, and faster than we had expected.

Chart 1: Inflation has fallen more than expected over the past year

CPI inflation and projections from November 2023 and August 2024



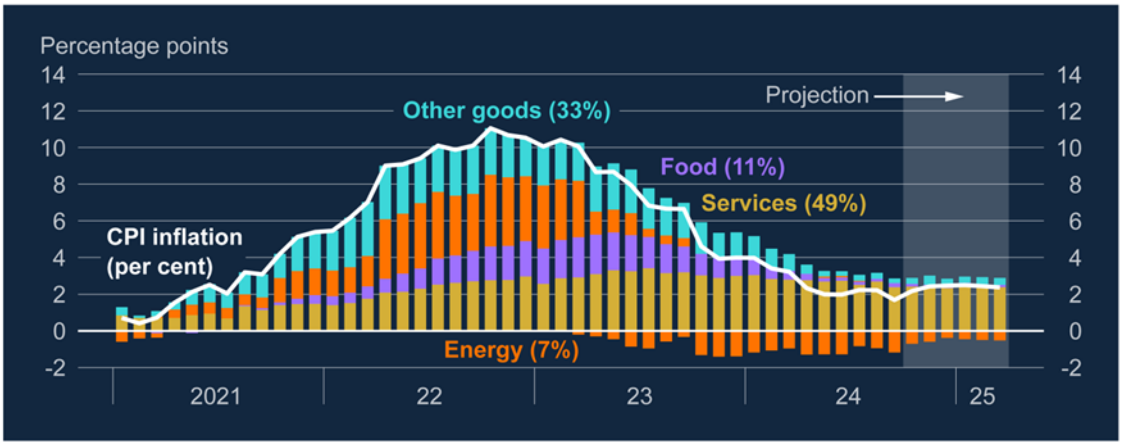
Sources: ONS and Bank calculations

Both oil and gas prices have been significantly lower than market pricing suggested a year ago. But the downside news to inflation over the year has also reflected lower-than-expected food, core goods and services price inflation. Since August, services inflation has fallen quite sharply to 4.9% in September, 0.6 percentage points below our August projection.

Looking further ahead to the next six months as in the shaded area of **Chart 2**, we expect consumer price inflation to rise somewhat as the drag from lower energy bills wanes (orange bars) and the contribution of services price inflation comes to dominate (yellow bars). It is encouraging that we can now move forward from a lower starting point. But services price inflation remains elevated, and recent downside news has tended to be driven by more volatile components such as airfares and accommodation. We still need to see services price inflation come down more broadly to keep headline consumer price inflation at the 2% target.

Chart 2: Inflation fell to 1.7% in September but is expected to rise somewhat

Contributions to consumer price inflation



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

Monetary policy has been guided by the need to squeeze remaining inflationary pressures out of the economy to achieve the 2% target sustainably. We have needed restrictive monetary policy to lean against domestic second-round effects from global inflationary shocks.

We now face the question of whether the remaining domestic inflationary pressure – for instance manifest in services price inflation and pay growth – will dissipate naturally now that the global shocks initially driving up inflation have unwound; or whether achieving this disinflation will require a period of economic slack in the UK economy. Alternatively, are we experiencing sustained changes in the structure of the economy with longer-lasting effects on inflationary pressures?

These have become important cases in the Monetary Policy Committee's deliberations. As policymakers, we can think that all three cases are of relevance, albeit to different degrees.

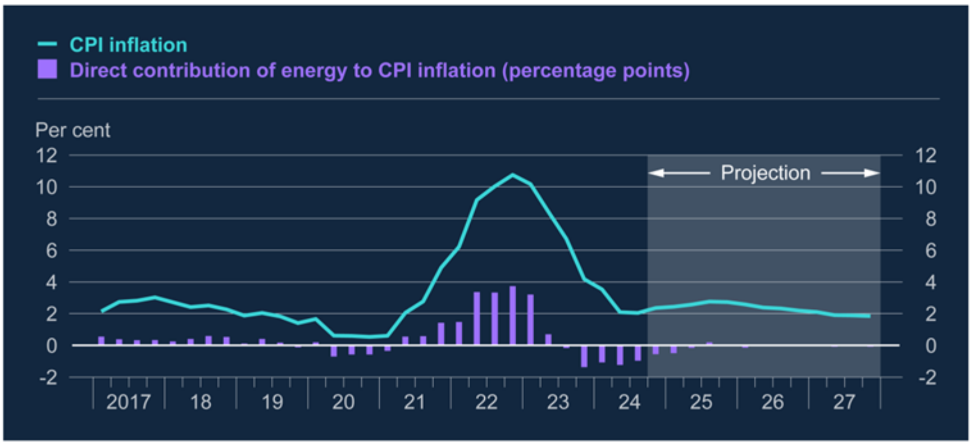
The forecast we publish in the Monetary Policy Report today is based on the second case.

In the projection, second-round effects on domestic prices and wages are expected to take somewhat longer to unwind then they did to emerge. But a margin of slack emerging over the forecast period is sufficient to ensure that consumer price inflation falls back to the 2% target in the medium term.

This is shown here in **Chart 3.** The blue line is the projection for consumer price inflation, conditional on the 15-day average of the market-implied path for interest rates to 29 October – our usual convention. Headline inflation increases to around 2¾% by the second half of 2025, before falling back to around the 2% target over the medium term.

Chart 3: Inflation is projected to revert to the 2% target over the medium term

Projections conditional on market-implied path for interest rates



Sources: Bloomberg Finance L.P., ONS and Bank calculations

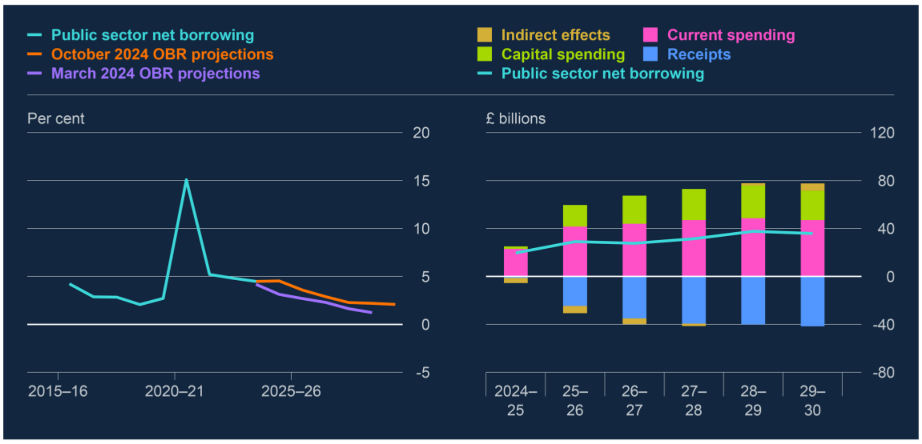
Alongside this forecast, the Committee has also considered the two alternative cases for how the persistence of inflationary pressures may evolve. In these cases, inflationary pressures may prove to be either less persistent or more persistent than in the projection. This is set out in more detail in a Box in the Report.

I will now add some reflections on the key judgements we have made on the outlook for inflation.

Our November projection is conditioned on Government policies as announced in the Autumn Budget. **Chart 4** shows public sector net borrowing and how it is projected to change relative to the previous March projection by the Office for Budget Responsibility. In the Autumn Budget, the path for public sector net borrowing is higher than it was in March. But the chart on the left also shows that the difference is more pronounced in the first than in future years. Public sector net borrowing is still projected to fall significantly over the forecast period.

Chart 4: Public sector net borrowing is expected to fall albeit by less

PSNB, % of nominal GDP and changes since OBR March projection (£ billion)

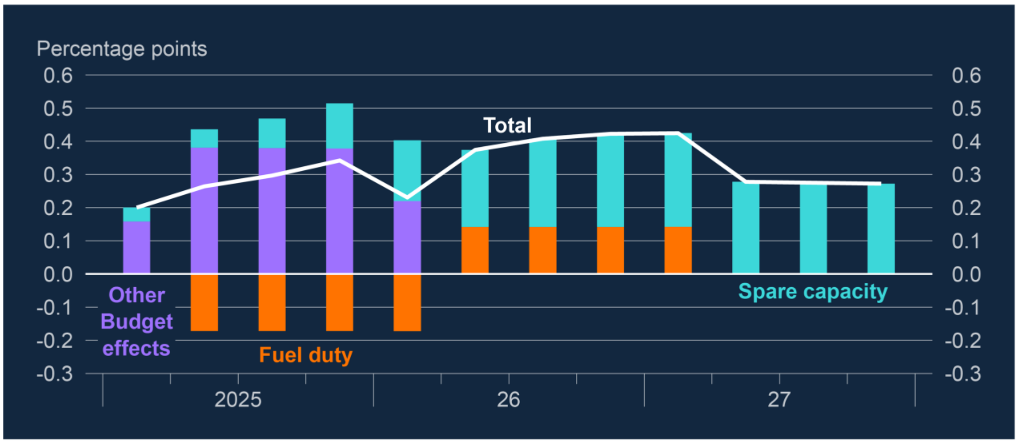


Sources: OBR, ONS and Bank calculations

We provisionally expect the measures announced in the Autumn Budget to boost the level of GDP by around ¾% at their peak in a year's time. This reflects the stronger, and relatively front-loaded, paths for government consumption and investment more than offsetting the impact on growth of higher taxes. Overall, fiscal policy is still expected to tighten over the forecast. But all else equal, the changes announced in the Budget are expected to reduce the margin of spare capacity in the economy over the forecast period.

Chart 5: Policies included in the Budget are expected to raise inflation

Marginal impact of measures in the Autumn Budget on CPI inflaiton



Sources: OBR and Bank calculations

The marginal effects on our inflation projections from the Autumn Budget are shown in **Chart 5.** Combined, measures push up on inflation by just under ½ percentage point at their peak (white line). The extended freeze on fuel duty pushes down on inflation over the next fiscal year (orange bars). But as it is assumed to rise thereafter in line with announced Government policy, fuel duty then pushes up on inflation from the second quarter of 2026. Other measures directly push up on inflation over the first fiscal year (purple bars).

There are different ways in which the increase in employer National Insurance Contributions could play out in the economy. It represents an increase in the cost of employment. There are at least four margins of adjustment. Firms could pass on higher costs to consumer prices, or firms could absorb the increase through lower margins or higher productivity; firms could increase wages by less, or firms could respond by reducing employment.

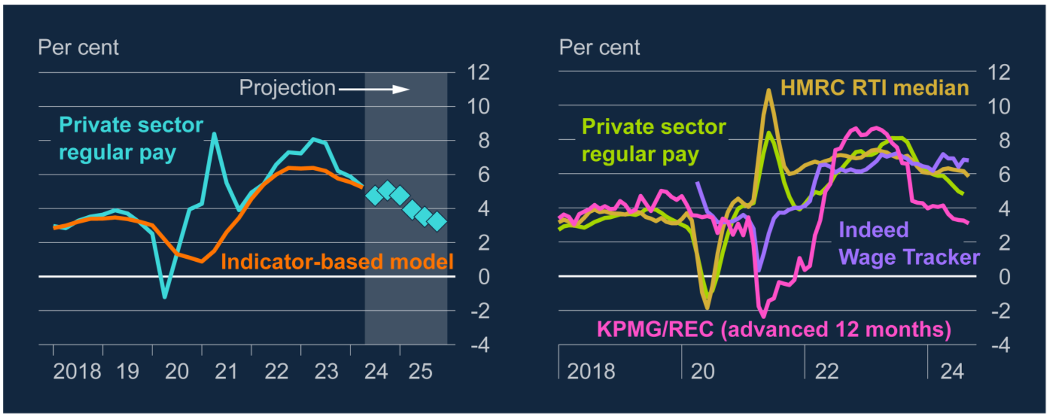
Let me be clear, public policy measures of this kind serve other objectives and it is not for us to opine one way or the other. What we must do is respond to any consequences for inflation in order to meet our 2% target over the medium term. We will get information on how the consequences for inflation evolve over time.

A gradual approach to removing monetary policy restraint will help us to observe how this plays out, along with other risks to the inflation outlook.

Developments in the UK labour market continue to be very important for assessing developments in inflationary pressures. There are mixed signals from the data.

Chart 6: Most indicators of wage growth have moderated in recent quarters

Measures of annual private sector wage growth



Sources: HMRC, Indeed, KPMG/REC UK Report on Jobs, ONS and Bank calculations

Wage growth remains strong relative to our models, perhaps reflecting some continuing real wage catch-up in a still relatively tight labour market. As **Chart 6** shows, annual growth in private sector regular pay (in blue on the left-hand side) has eased to 4.8% in the three months to August, down from a peak of just above 8% in mid-2023 and in line with our expectations in August. A normalisation in inflation expectations and easing in labour market tightness have supported that moderation in pay growth. Consistent with the slowing in the official measure, a Bank staff indicator model of underlying pay growth has also declined in recent quarters, pointing to underlying wage growth of around 4.8% (orange line). Along with some but not all outside surveys and measures (seen here on the right), this points to a gradual but progressive move down in wage growth towards levels consistent with the 2% inflation target.

The Bank's Agents also suggest that wage settlements could continue to come down, perhaps to around 2-4% in 2025 compared with 6-6.5% in 2023. This is the story I have heard consistently when I have joined them recently on visits to businesses in different parts of the country.

But two further observations should give us cause to reflect. First, one year-ahead expectations for wage growth of firms in the Bank's Decision Maker Panel seems to have stabilised at a higher level of around 4% in recent months. Second, the evidence – such as it is – points to the quantity side of the labour market remaining relatively tight while showing some loosening. Both of these observations could point to lingering persistence in wage pressures beyond what we are assuming in our projection.

Let me conclude.

There has been continued progress in disinflation, particularly as previous external shocks have abated.

So, at this meeting, the Committee voted to reduce Bank Rate to 4.75%.

Based on the evolving evidence, a gradual approach to removing policy restraint remains appropriate. Monetary policy will need to continue to remain restrictive for sufficiently long until the risks to inflation returning sustainably to the 2% target in the medium term have dissipated further. The Committee continues to monitor closely the risks of inflation persistence and will decide the appropriate degree of monetary policy restrictiveness at each meeting.

And with that, Clare, Dave and I will be happy to take your questions.