



BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 3 August 2016

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These are the minutes of the Monetary Policy Committee meeting ending on 3 August 2016.

They are available at <http://www.bankofengland.co.uk/publications/Pages/news/2016/008.aspx>

The Bank of England Act 1998 gives the Bank of England operational responsibility for setting monetary policy to meet the Government's inflation target. Operational decisions are taken by the Bank's Monetary Policy Committee. The minutes of the Committee meeting ending on 14 September will be published on 15 September 2016.

Monetary Policy Summary, August 2016

The Bank of England's Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. At its meeting ending 3 August 2016, the MPC voted for a package of measures designed to provide additional support to growth and to achieve a sustainable return of inflation to the target. This package comprises: a 25 basis point cut in Bank Rate to 0.25%; a new Term Funding Scheme to reinforce the pass-through of the cut in Bank Rate; the purchase of up to £10 billion of UK corporate bonds; and an expansion of the asset purchase scheme for UK government bonds of £60 billion, taking the total stock of these asset purchases to £435 billion. The last three elements will be financed by the issuance of central bank reserves.

Following the United Kingdom's vote to leave the European Union, the exchange rate has fallen and the outlook for growth in the short to medium term has weakened markedly. The fall in sterling is likely to push up on CPI inflation in the near term, hastening its return to the 2% target and probably causing it to rise above the target in the latter part of the MPC's forecast period, before the exchange rate effect dissipates thereafter. In the real economy, although the weaker medium-term outlook for activity largely reflects a downward revision to the economy's supply capacity, near-term weakness in demand is likely to open up a margin of spare capacity, including an eventual rise in unemployment. Consistent with this, recent surveys of business activity, confidence and optimism suggest that the United Kingdom is likely to see little growth in GDP in the second half of this year.

These developments present a trade-off for the MPC between delivering inflation at the target and stabilising activity around potential. The MPC's remit requires it to explain how it has balanced that trade-off. Given the extent of the likely weakness in demand relative to supply, the MPC judges it appropriate to provide additional stimulus to the economy, thereby reducing the amount of spare capacity at the cost of a temporary period of above-target inflation. Not only will such action help to eliminate the degree of spare capacity over time, but because a persistent shortfall in aggregate demand would pull down on inflation in the medium term, it should also ensure that inflation does not fall back below the target beyond the forecast horizon. Thus, in tolerating a temporary period of above-target inflation, the Committee expects the eventual return of inflation to the target to be more sustainable.

The MPC's choice of instruments is based on a consideration of their likely impact on the real economy and inflation. The MPC has examined closely the interaction between monetary policy and the financial sector, both with regard to ensuring the effective transmission of monetary policy to households and businesses, and with consideration for the financial stability consequences of its policy actions.

The cut in Bank Rate will lower borrowing costs for households and businesses. However, as interest rates are close to zero, it is likely to be difficult for some banks and building societies to reduce deposit rates much further, which in turn might limit their ability to cut their lending rates. In order to mitigate this, the MPC is launching a Term Funding Scheme (TFS) that will provide funding for banks at interest rates close to Bank Rate. This monetary policy action should help reinforce the transmission of the reduction in Bank Rate to the real economy to ensure that households and firms benefit from the MPC's actions. In addition, the TFS

provides participants with a cost effective source of funding to support additional lending to the real economy, providing insurance against the risk that conditions tighten in bank funding markets.

The expansion of the Bank of England's asset purchase programme for UK government bonds will impart monetary stimulus by lowering the yields on securities that are used to determine the cost of borrowing for households and businesses. It is also likely to trigger portfolio rebalancing into riskier assets by current holders of government bonds, further enhancing the supply of credit to the broader economy.

Purchases of corporate bonds could provide somewhat more stimulus than the same amount of gilt purchases. In particular, given that corporate bonds are higher-yielding instruments than government bonds, investors selling corporate debt to the Bank could be more likely to invest the money received in other corporate assets than those selling gilts. In addition, by increasing demand in secondary markets, purchases by the Bank could reduce liquidity premia; and such purchases could stimulate issuance in sterling corporate bond markets.

As set out in the August *Inflation Report*, conditional on this package of measures, the MPC expects that by the three-year forecast horizon unemployment will have begun to fall back and that much of the economy's spare capacity will have been re-absorbed, while inflation will be a little above the 2% target. In those projections the cumulative growth in output is still around 2½% less at the end of the forecast period than in the MPC's May projections. Much of this reflects a downward revision to potential supply that monetary policy cannot offset. However, monetary policy can provide support as the economy adjusts. Had it not taken the action announced today, the MPC judges it likely that output would be lower, unemployment higher and slack greater throughout the forecast period, jeopardising a sustainable return of inflation to the target.

This package contains a number of mutually reinforcing elements, all of which have scope for further action. The MPC can act further along each of the dimensions of the package by lowering Bank Rate, by expanding the TFS to reinforce further the monetary transmission mechanism, and by expanding the scale or variety of asset purchases. If the incoming data prove broadly consistent with the August *Inflation Report* forecast, a majority of members expect to support a further cut in Bank Rate to its effective lower bound at one of the MPC's forthcoming meetings during the course of the year. The MPC currently judges this bound to be close to, but a little above, zero.

All members of the Committee agreed that policy stimulus was warranted at this time, and that Bank Rate should be reduced to 0.25% and be supported by a TFS. Eight members supported the introduction of a corporate bond scheme, and six members supported further purchases of UK government bonds.

These measures have been taken against a backdrop of other supportive actions taken by the Bank of England recently. The FPC has reduced the countercyclical capital buffer to support the provision of credit and has announced that it will exclude central bank reserves from the exposure measure in the current UK leverage ratio framework. This latter measure will enhance the effectiveness of the TFS and asset purchases by minimising the potential countervailing effects of regulatory requirements on monetary policy operations. The Bank has previously announced that it will continue to offer indexed long-term repo operations on a weekly basis until the end of September 2016 as a precautionary step to provide additional flexibility in the Bank's provision of liquidity insurance. The PRA will also smooth the transition to Solvency II for insurers.

Minutes of the Monetary Policy Committee meeting ending on 3 August 2016

1 Before turning to its immediate policy decision, and against the backdrop of its latest projections for output and inflation, the Committee discussed financial market developments; the international economy; money, credit, demand and output; and supply, costs and prices.

Financial markets

2 Global financial market sentiment had improved since the Committee's previous meeting. Even so, both sterling and the prices of UK-focused risky assets had remained significantly below their pre-referendum levels. This was consistent with the United Kingdom's vote to leave the European Union being seen by financial market participants primarily as a domestic shock, with relatively limited international spillovers. The Committee discussed the factors behind the general improvement in risk sentiment before turning to market expectations for domestic policy action.

3 Global equity prices had been broadly unchanged on the month and investment grade corporate bond spreads had generally declined. Measures of financial market volatility had also declined: the VIX had fallen back close to its lowest level since the start of the year, and option-implied volatilities through to the end of the year for the FTSE 100 and the major US and euro-area equity indices had decreased, to below their historical averages.

4 These moves had been supported by expectations of looser global monetary policy. In the euro area, market participants expected the ECB's asset purchase programme to be expanded further by September. In the US, although short rates had retraced some of their post-referendum decline, the market-implied path of policy rates remained very flat, and below the published expectations of FOMC members. The FOMC had left rates unchanged at its latest policy meeting, with the next rate increase not priced into financial markets until Q4 2018. The Bank of Japan had announced more stimulus, increasing the size of its exchange-traded fund purchases and doubling the size of its US dollar lending facility.

5 In contrast to the global picture, UK-focused asset prices had continued to imply a weaker outlook for the domestic economy than had been the case prior to the referendum. The sterling trade-weighted effective exchange rate was around 10% lower than the conditioning assumption in the *May Inflation Report*. UK-focused equity prices within the FTSE All-Share Index, including for UK banks, had stabilised on the month, but had remained below their pre-referendum levels. Although sterling high-yield corporate bond spreads had fallen on the month, they remained higher than their pre-referendum levels, in contrast to comparable international indices.

6 Consistent with a weaker outlook for the UK economy, and given the guidance in the MPC's July Minutes, market contacts expected some easing in monetary policy at the August meeting. Meeting-to-meeting OIS swaps showed that a 25 basis point Bank Rate cut had been priced in for August, with a further 10 basis point cut expected later in the year. This was consistent with the latest Reuters poll, in which 42 of the 50

respondents expected a 25 basis point cut in Bank Rate in August. The same poll had also reported that 50% of respondents who had expressed a view expected the MPC's asset purchase programme to be expanded this month. More broadly, there had been discussions among market contacts about the potential for a wider range of measures to be launched, including in some case the possibility of corporate bond and bank funding schemes. There had generally been much less of a consensus view around the use of these tools among contacts.

7 The asset price movements observed following the referendum suggested that market participants viewed the effects as likely to be contained locally. There was also evidence that investors placed some weight on eventual changes to UK trading arrangements being minimal. For example, in a recent poll of international fund managers, over half of those surveyed had said they expected the United Kingdom to retain access to the EU Single Market. The precise parameters of the United Kingdom's future relationship with the European Union remained highly uncertain, and it seemed likely that asset prices would remain sensitive to perceived developments in this outlook in the months ahead.

The international economy

8 The Committee discussed how its assessment of the global spillovers from the referendum result had evolved over the month. Prior to the referendum, the MPC had identified three main channels through which existing vulnerabilities in the global economy could be affected: first, through the effect of sharp moves in financial market prices, including exchange rates; second, by the crystallisation of financial stability risks; and third, by the emergence of widespread risk aversion. Adverse reactions had not occurred to a significant extent: financial market sentiment had improved and there was little evidence of the financial stability and risk channels at work, partly reflecting the significant steps taken by regulators in recent years to enhance the resilience of the financial system. It therefore appeared that, although further shifts in sentiment could not be ruled out, some of the major downside economic risks to the global economy had abated.

9 There was little evidence, so far, in timely economic and financial indicators of any sizeable adverse economic impact of the referendum result on the global economy. In the euro area, consumer confidence indicators had fallen a little in July, while the composite PMI output indicator had been little changed. The forward-looking element of the PMI survey had shown a sharper deterioration in expectations, but was nevertheless consistent with modest growth in Q3. The ECB Bank Lending Survey indicated that credit conditions had continued to improve across the euro area and were expected to ease further. Elsewhere, portfolio flows to emerging market economies had strengthened further following the referendum result, suggesting little contagion. In the United States, the first estimate of GDP growth in 2016 Q2 had been weaker than the consensus expectation, although a significant proportion reflected weaker stockbuilding. Consumption growth had picked up and continued labour market normalisation was expected to support strengthening domestic demand. As a consequence, the global growth outlook incorporated in the August *Inflation Report* projection was only a little weaker than in May, driven by slighter weaker euro area activity. This revised outlook was consistent with the IMF's July 2016 World Economic Outlook, which pointed to global growth of 3.1% in 2016 and 3.4% in 2017 as a central case.

10 Nevertheless, there was considerable uncertainty about the global outlook and a number of areas of fragility remained. Sharp falls in the equity prices of some European banks since the referendum had highlighted vulnerabilities in the system. The results of the European Banking Association stress tests had reinforced perceptions of the location of vulnerabilities, with a particular focus on Italian banks, reflecting their high level of non-performing loans and lower capital ratios than the European average. Outside Europe, financial risk remained significant in China, where economic expansion had been associated with an increase in the growth of credit from already rapid rates, and in EMEs where a material proportion of debt was denominated in foreign currency. These and other factors had the potential to weaken the economic outlook, raise political risks and reignite concerns about debt sustainability.

Money, credit, demand and output

11 UK GDP had been estimated to have grown by 0.6% in 2016 Q2, stronger than the 0.4% growth registered in Q1 and 0.3 percentage points higher than had been incorporated in the *May Inflation Report* projections. Of particular note had been the contribution of industrial production, which had grown by 2.1% on the quarter, and particularly sharply in April. Construction output had fallen slightly for the second quarter in succession.

12 The United Kingdom's vote to leave the European Union had led to a pronounced shift in the outlook for activity, and the Committee considered what the recent indicators implied about near-term growth prospects. Official activity data pertaining to Q3 had not yet become available. Business surveys conducted after the referendum had generally suggested that activity had slowed sharply. The Markit/CIPS PMIs for services, manufacturing and construction for July had all been consistent with falling output. Services output and expectations indices had seen their sharpest falls since the survey began in 1996, taking both to their lowest levels since 2009. However, although a composite output indicator derived from these surveys had historically been a relatively reliable early indicator of GDP growth, in advance of official data, there had been occasions when it had over-reacted to specific events. In that light, it was noteworthy that the Lloyds measure of business confidence had improved markedly in July after a sharp fall immediately after the referendum, and the CBI Quarterly Industrial Trends Survey had indicated that manufacturing output had held up in the three months to July. Although expectations of output growth over the next three months measured by the CBI survey had declined, this had been only to around their historical averages. That said, the same survey had reported that investment intentions had fallen, and there had been the largest decline in business optimism since 1974. Moreover, the CBI composite activity indicator for July, which included the service sector, had reported a sharp fall in the balance relating to expected output over the next three months. The latest survey by the RICS had reported a further, and pronounced, weakening in commercial real estate investment enquiries, in line with other market intelligence provided to the Committee. Overall, indicators pointed to a material slowing in GDP growth in Q3.

13 The Bank's macroeconomic uncertainty indicator had risen further in July, to around two standard deviations above its historical average. The primary driver had been an increase in the dispersion of external economists' growth forecasts, while media citations of uncertainty and option-implied exchange rate volatility,

which had driven much of the pre-referendum rise in measured uncertainty, had both declined slightly. It was possible that there might be some abatement in near-term uncertainty following the formation of a new government. However, intelligence from the Bank's Agents had indicated that many businesses had yet to make strategic decisions about their future plans in light of the vote to leave the European Union.

14 Consumer indicators and other market intelligence provided to the Committee had generally suggested that household demand had held up more firmly than overall economic activity. The GfK/EC consumer confidence balance for July had shown a material fall, but only back to a level close to its long-run average, and other consumer confidence indicators had displayed similar moves. The Bank's Agents' scores for consumer services turnover had also been relatively upbeat. By contrast, the CBI Distributive Trades Survey had reported a marked drop in sales in July and in expected sales in August. It was possible that any detrimental effect on households of the weaker activity outlook would emerge only when it became evident in employment and pay.

15 In sum, the recent indicators had painted a picture of relative firmness in consumer demand but with some early warning signs of weakness, and possibly contraction, in certain business sectors. This was not atypical of the early stages of a slowdown, with weakness in investment foreshadowing weakness in household incomes and spending. Taking all of the evidence together, and recognising that the uncertainty surrounding any such assessment was greater than usual, the Committee's central expectation was that the United Kingdom was likely to see little growth in GDP during the second half of the year. This would mark a pronounced slowdown from the annualised growth of around 2% that had been seen in the first half of 2016.

Supply, costs and prices

16 Twelve-month CPI inflation had risen by 0.2 percentage points to 0.5% in June, with the increase driven by fuel and recreational goods prices. Core inflation – the inflation rate of CPI excluding energy, food and tobacco – had also risen by 0.2 percentage points, to 1.4%. These increases were in line with expectations made at the time of the *May Inflation Report*. At that time, CPI inflation had been expected to pick up gradually over the remainder of 2016 as core inflation remained steady and the drags from past declines in energy, food and some other goods' prices began to fade.

17 The near-term outlook for CPI inflation had changed markedly on account of the depreciation of sterling that had followed the referendum. The fall in the currency was likely to lead to a fairly rapid pick up in CPI inflation over the remainder of 2016, as additional import price pressure supplemented the increase in inflation that had already been expected. CPI inflation was now expected to rise to around its 2% target in the first half of 2017.

18 Domestic labour cost pressures had been subdued in the first half of the year, despite the fall in the headline rate of unemployment to 4.9% in the three months to May. Whole economy regular pay growth, which had been picking up, had been slightly weaker than expected at 2.2% in the three months to May, compared to the same three months a year earlier. On a national accounts basis, whole economy unit labour costs had risen by 1.5% in the year to Q1, partly driven by a pickup in non-wage costs which tended to be volatile from quarter to quarter. Recent pay and estimated productivity trends had been consistent with annual growth in unit wage

costs of around only 0.2% in Q2. A range of measures of domestically generated inflation had also remained contained.

19 The Committee discussed some of the near-term risks to the outlook for pay growth and the extent to which it would be influenced by a more rapid pickup in CPI inflation than had previously been expected. The central case set out in the *Inflation Report* was that wage growth would pick up gradually in the near term before softening in 2017, given increased slack in the labour market. An upside risk to that outlook was that employees might seek greater pay rises to maintain growth in their purchasing power as inflation rose. Other upside risks to the wage outlook were the effects of the National Living Wage, which had been introduced in April, and the possibility that employers would more readily concede higher wage claims because of concerns about losing migrant workers that might not be easy to replace. Against that, one of the features of the UK economy since the financial crisis had been the apparent flexibility of real wages, possibly driven by the cumulated effect of labour market reform over a number of years. This suggested that pay was likely to be less affected by a pickup in inflation than it had been in earlier decades.

20 Domestic inflationary pressure would also be affected by developments in inflation expectations. Measures of inflation expectations had been, on average, subdued relative to their pre-crisis averages, in part reflecting the low inflation environment. Measures of inflation compensation in financial markets were an indicator of financial market participants' inflation expectations and could provide a timely signal of how inflation expectations had changed since the referendum. Shorter-term inflation compensation measures had picked up a little, consistent with an expectation that the depreciation in sterling would push up on prices in the near term. By contrast, inflation compensation five-to-ten years ahead had fallen a little. A similar pattern had been apparent in households' inflation expectations: the monthly YouGov/Citi measure of household inflation expectations one year ahead had risen by 0.3 percentage points to 1.8% in July, while the equivalent measure of expectations five-to-ten years ahead had fallen by 0.1 percentage points to 2.4%, its lowest level since the survey began in 2005.

The immediate policy decision

21 The Committee set monetary policy to meet the 2% inflation target, and in a way that helped sustain growth and employment. The vote to leave the European Union was likely to have significant implications for the UK economic outlook, and it would take time for those implications to become clear. The Committee's prior belief had been that this outcome could lead to a materially lower path for growth and a notably higher path for inflation than in the projections set out in the *May Inflation Report*. The early indications had been broadly consistent with this assessment, and this had been reflected in the *August Inflation Report* projections.

22 It had been encouraging that the apparent spillovers from the referendum result to the global economy had so far been limited. Global equity prices had been broadly unchanged on the month and investment grade corporate bond spreads had generally declined, as had measures of expected asset price volatility; some of these moves were likely to reflect expectations of looser global monetary policy. Outside the United Kingdom, the euro area was likely to be the most directly affected by the UK vote. Most timely activity indicators there had

declined somewhat, but were nevertheless consistent with modest growth in Q3, although long-standing financial vulnerabilities remained. It was likely, however, that the lower level of sterling and slower growth in UK demand would weigh on euro area exports, and the MPC had lowered slightly its projection for GDP growth in the currency bloc. There had been little material news regarding the other major advanced or emerging economies since the *May Report*.

23 In contrast, the referendum outcome had had a pronounced effect on the domestic outlook, affecting the paths of demand, supply and the exchange rate. Demand was expected to be markedly weaker, and unemployment higher, than in May. This was the result of a number of forces, including the protracted period of heightened uncertainty that was now in prospect, an expected weakening in the housing market, and a higher cost of capital for UK-focused firms, given notable falls in their equity prices. These factors were projected to weigh particularly on business and housing investment in the near term and, with time, consumer spending. Together, these implied a lower path for private domestic demand. Set against that, the fall in sterling should provide some support for exports. Alongside lower real incomes in the United Kingdom, which would weigh on imports, this was projected to imply that net trade would provide some support to demand, albeit one that was insufficient to prevent a substantial fall in GDP growth.

24 Although it would be some time until any such effects were reflected in official data releases, some had begun to manifest in surveys of investment intentions, business activity, and the housing market. The MPC was mindful of the fact that survey indicators might react excessively to events in their immediate aftermath, and so sharp movements should be treated with some caution. Although the quantitative read-across from the surveys to activity was uncertain, the evidence that some degree of a slowdown was in train had been clear, and the best collective judgement of the Committee was that the economy was likely to see little growth in the second half of this year.

25 A key judgement was the extent to which this lower path for demand was likely to be matched by a lower path for supply. Here, too, there were numerous forces at work. The weakness in demand would itself weigh on supply growth as a period of low investment restrained growth in the capital stock and productivity. There could also be more direct implications for supply from the vote to leave the European Union. The UK's trading relationships with its major trading partners were likely to be different, but precisely how would be unclear for some time. If companies were uncertain about the future impact of this on their businesses, they could delay decisions about building supply capacity or entering new markets. In anticipation of the UK's new trading arrangements, a period of resource reallocation could be necessary as some sectors expanded and others contracted. Finally – and although it had only small implications for average wages, productivity, and so inflation – the path for net migration, and therefore labour supply, was particularly uncertain in light of the vote to leave the European Union. As a result of these factors, the MPC expected supply growth to remain well below past average rates throughout the forecast period.

26 On balance, demand was likely to fall relative to supply, so that a margin of spare capacity was expected to open up and the unemployment rate was expected to rise from its current level of 4.9% over the course of the next year or so. All else equal, this would be expected to weigh on consumer price inflation as firms found it more difficult to raise prices given that lower demand and higher unemployment were expected to mean that

wage growth remained below pre-crisis rates. Acting against that, the fall in the sterling exchange rate was expected to push up on import prices and consumer prices notably over the next three years. This was likely to hasten the return of CPI inflation to the 2% target, and probably cause it to rise above the target in the latter part of the forecast period, before the exchange rate effect dissipated thereafter.

27 In the absence of any monetary policy response, these shifts in the outlooks for activity and domestically-driven inflation were expected to endure. An extended period of uncertainty was likely to widen the margin of spare capacity in the economy for some time. Equally, the pass-through of higher import costs to consumer prices was likely to be incomplete even at the end of the MPC's forecast period as, for example, past experience suggested that it took time for retailers of imported goods to reflect fully their higher costs in the prices they charged. The MPC expected inflation to return to the target within two years. Given the persistence of these effects, however, it expected thereafter to balance a period of above-target inflation in the second and third years of the forecast, owing primarily to imported price pressures, with a period over which the economy operated below full capacity, which would bear down on domestic costs.

28 Fully offsetting the persistent effects of sterling's depreciation would require exerting further downward pressure on domestic costs. This would involve lost output and higher unemployment. In the Committee's judgement, such outcomes would be undesirable and, moreover, would be unlikely to generate a sustainable return of inflation to the target beyond the three-year forecast horizon. In line with its remit, the MPC therefore judged it appropriate to set policy so that inflation settled at its target over a slightly longer period than the usual 18-24 months in order to mitigate some of the adverse effects on growth.

29 The MPC was unanimous in the view that some policy easing was needed to reduce the amount of spare capacity and thus ensure that inflation returned sustainably to the target. The Committee had a range of tools at its disposal to support the economy, and its choice of instruments would follow from a consideration of their likely impact on the real economy – including how they supported UK households and businesses – and inflation. The MPC also discussed the interaction between monetary policy and the financial sector, with regard both to ensuring the effective transmission of monetary policy to the real economy, and to maintaining the stability of the financial system.

30 A cut in Bank Rate would lower borrowing costs for companies and households. However, as interest rates were close to zero it was likely to be difficult for some banks and building societies to reduce deposit rates much further, which in turn might limit their ability to cut their lending rates. Analysis by staff across the Bank had suggested that a reduction in Bank Rate towards zero from 0.5% could, by itself, lower banks' net interest margins a little, which could in turn lead to upward pressure on margins on new lending. In such circumstances, the transmission of monetary policy would be less effective than usual.

31 To avoid the risk that reductions in Bank Rate did not feed through fully to the rates faced by households and businesses, the MPC considered the establishment of a Term Funding Scheme (TFS) that would provide funding for banks at interest rates close to Bank Rate, and was calibrated so that any reduction in Bank Rate had a broadly neutral impact on building societies' and banks' margins in aggregate. This monetary policy

measure should help reinforce the transmission of the reduction in Bank Rate to the real economy so that households and firms benefitted from the MPC's actions.

32 In addition to its primary monetary policy objective, the TFS would provide participants with a cost effective source of funding in the form of central bank reserves to support additional lending to the real economy. Banks would be able to access another pound of funding for every pound their net lending expanded. Although bank funding markets had been resilient in the face of the worsening outlook for the real economy, there remained a risk that funding conditions could tighten. The TFS would provide an alternative source of finance, and, in addition to its direct effect on funding costs, it could lower market rates.

33 The MPC also considered an expansion of its asset purchase programme for UK government bonds, financed by the issuance of central bank reserves. This would trigger portfolio rebalancing into riskier assets, lowering the real cost of borrowing for households and companies. The Committee was mindful of the fact that an expansion of its asset purchase programme would be within the context of an already low interest rate environment. Long-term interest rates had fallen over recent years, reflecting a range of factors including the outlook for long-term supply and the balance between global saving and planned global investment. Lower yields posed potential risks to some aspects of the functioning of the financial system, for example by increasing the deficits of many pension funds and through their effects on the business models of insurers. At present, however, those effects appeared to be relatively limited. Many companies that saw increased pension deficits were able to extend the period over which they brought them back to balance, maintaining the existing level of contributions. Indeed, the overall size of contributions to defined benefit schemes had been broadly stable over the past decade¹ despite fluctuations in the size of the deficit.

34 The MPC also discussed the merits of purchasing private sector assets, financed by the issuance of central bank reserves. Given that corporate bonds were higher-yielding instruments than government bonds, investors selling corporate debt to the Bank could be more likely to invest the money received in corporate assets than those selling gilts. In addition, by increasing demand in secondary markets, purchases by the Bank could reduce liquidity premia. The Asset Purchase Facility had been used to ease conditions in corporate debt markets during intense financial market stress in 2009; only small quantities of private sector assets had been purchased but the Bank's purchases played a role in reducing liquidity premia from elevated levels. Moreover, such purchases could stimulate issuance in sterling corporate bond markets. It was therefore likely that purchases of corporate bonds would provide a greater boost to activity, pound for pound, than purchases of government bonds. In addition, such purchases were judged likely to have fewer implications for the financial system than additional gilt purchases.

35 The MPC would look to purchase a portfolio of sterling non-financial investment-grade bonds representative of issuance by firms making a material contribution to the UK economy, in order to impart broad economic stimulus. The likely size of the market that would be eligible for the purchase scheme was around £150bn. The purchases would probably increase the prices and lower the rates on eligible bonds and the programme could stimulate issuance of bonds that would be eligible for the scheme. Although corporate bonds were typically issued by larger companies, any shift towards debt issuance would reduce their demand for bank

¹ The version of these Minutes originally published erroneously stated "...over the past two decades...".

lending, potentially freeing up the amount of bank capital that was available to fund lending to smaller businesses.

36 These policy deliberations took place against a backdrop of other supportive actions taken by the Bank of England recently. The Bank had previously announced that it would continue to offer indexed long-term repo operations on a weekly basis until the end of September 2016 as a precautionary step to provide additional flexibility in the Bank's provision of liquidity insurance. The PRA would also smooth the transition to Solvency II for insurers.

37 The MPC also viewed the domestic banking system as being much better placed to face the challenging outlook than during earlier periods of stress. Over recent years, regulators in the United Kingdom and internationally had required banks to strengthen their balance sheets so that the financial system had become more resilient. The Financial Policy Committee (FPC) expected that capital and liquidity buffers would be drawn upon as needed to support the supply of credit and in support of market functioning, and had recently reduced the countercyclical capital buffer rate from 0.5% to zero. This had reduced regulatory capital buffers by £5.7 billion, raising banks' capacity for lending to UK households and businesses by up to £150 billion.

38 In addition, the MPC had been informed that the FPC would announce the exclusion of central bank reserves from the exposure measure in the current UK leverage ratio framework with immediate effect. In so doing, the FPC's aim was to ensure that the leverage ratio did not act as a barrier to the effective implementation of policy measures that led to an increase in central bank reserves.

39 The Committee discussed whether to cut Bank Rate immediately to its effective lower bound, close to but a little above zero, or whether to cut Bank Rate by 25 basis points at this meeting. For a majority of Committee members a case could be made for cutting Bank Rate immediately to the effective lower bound. However, most Committee members also thought there was value in delivering the required stimulus via a broad package of measures and recognised that there would be further opportunities to assess economic prospects at coming meetings in the light of new data.

40 The Governor invited the Committee to vote on the propositions that:

Bank Rate be reduced by 25 basis points to 0.25%;

The Bank of England introduce a Term Funding Scheme, financed by the issuance of central bank reserves, that would reinforce the transmission of the cut in Bank Rate;

The Bank of England purchase a stock of sterling non-financial investment-grade corporate bonds, issued by firms making a material contribution to the UK economy, financed by the issuance of central bank reserves, of up to £10 billion;

The Bank of England increase the stock of purchased UK government bonds, financed by the issuance of central bank reserves, by £60 billion to a total of £435 billion.

The Committee voted unanimously in favour of the propositions on Bank Rate and the Term Funding Scheme. The Committee voted 8-1 in favour of the scheme to purchase corporate bonds. Kristin Forbes voted against the proposition, preferring no purchases of corporate bonds at this time. The Committee voted 6-3 in favour of increasing the stock of purchases of UK government bonds. Kristin Forbes, Ian McCafferty and Martin Weale voted against the proposition, preferring no additional purchases at this time.

41 The three members who voted against purchases of government bonds took the view that the deterioration in recent surveys and confidence measures observed in the aftermath of the referendum may overstate the weakness of the economy. As such, the additional stimulus through immediate purchases of government bonds risked increasing the overshoot of inflation relative to the target. These members felt that any decision to purchase government bonds could be made at future meetings, once more information became available. The member who also voted against the purchase of corporate bonds at this meeting was particularly concerned about excessive stimulus at this stage, the costs of easing monetary policy, and the risks involved in the programme.

42 As set out in the *August Inflation Report*, conditional on this package, the MPC expected that by the three-year forecast horizon unemployment would have begun to fall back and that much of the economy's spare capacity would have been re-absorbed; and that inflation would be a little above the 2% target. In those projections the cumulative growth in output was around 2½% less at the end of the forecast period than in the MPC's May projections. Much of this reflected a downward revision to potential supply that monetary policy could not offset. However, monetary policy could provide support as the economy adjusted. Had the MPC not taken this action, it judged it likely that output would be lower, unemployment higher and slack greater throughout the forecast period, and that this would jeopardise a sustainable return of inflation to the target.

43 This package contained a number of mutually reinforcing elements, all of which had scope for further action. The MPC could act further along each of the dimensions of the package by lowering Bank Rate, by expanding the TFS to reinforce further the monetary transmission mechanism, and by expanding the scale or variety of asset purchases. If the incoming data proved broadly consistent with the *August Inflation Report* forecast, a majority of members expected to support a further cut in Bank Rate to its effective lower bound at one of the MPC's forthcoming meetings during the course of the year. The MPC currently judged this bound to be close to, but a little above, zero.

44 The Committee agreed that the additional purchases of UK government bonds should take place over a six month period. The cash flows associated with the redemptions of gilts owned by the APF that occurred while the APF was undertaking additional gilt purchases would be incorporated into the overall purchase programme. This would be subject to the total stock of purchases not increasing at any point above the target stock. The purchases of sterling non-financial investment grade corporate bonds should take place over an 18 month period. Further details would be set out in Market Notices.

45 Finally, the Governor expressed his appreciation to Martin Weale for his contribution as a member of the Committee.

46 The following members of the Committee were present:

Mark Carney, Governor

Ben Broadbent, Deputy Governor responsible for monetary policy

Jon Cunliffe, Deputy Governor responsible for financial stability

Nemat Shafik, Deputy Governor responsible for markets and banking

Kristin Forbes

Andrew Haldane

Ian McCafferty

Gertjan Vlieghe

Martin Weale

47 Dave Ramsden was present as the Treasury representative.