



**BANK OF ENGLAND**

# Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 14 September 2016

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These are the minutes of the Monetary Policy Committee meeting ending on 14 September 2016.

They are available at <http://www.bankofengland.co.uk/publications/Pages/news/2016/009.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 2 November will be published on 3 November 2016.

## Monetary Policy Summary, September 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 on 14 September 2016, the MPC voted unanimously to maintain Bank Rate at 0.25%. The Committee voted unanimously to continue with the programme of sterling non-financial investment-grade corporate bond purchases totalling up to £10 billion, financed by the issuance of central bank reserves. The Committee also voted unanimously to continue with the programme of £60 billion of UK government bond purchases to take the total stock of these purchases to £435 billion, financed by the issuance of central bank reserves.

The package of measures announced by the Committee at its August meeting led to a greater than anticipated boost to UK asset prices. Short and long-term market interest rates fell notably following the announcement; corporate bond spreads narrowed, and issuance was strong; and equity prices rose. Since then, some of the falls in yields have reversed, driven by somewhat stronger-than-expected UK data and a generalised rise in global yields.

Many banks announced cuts in Standard Variable Rate and Tracker mortgage rates in line with the cut in Bank Rate. Deposit rates fell in August, although on average these falls were slightly smaller than the cut in Bank Rate. Fixed rates on new mortgage lending also fell.

Overall, while the evidence on the initial impact of the policy package is encouraging, the Committee will monitor closely changes in asset prices and in interest rates facing households and firms and their effect on economic activity.

The MPC set out its most recent detailed assessment of the economic outlook in the *August Inflation Report*. Based on the data available at that time, the Committee judged that the UK economy was likely to see little growth in the second half of 2016. In light of the tendency for survey indicators to overreact to unexpected events, the Committee expected some bounce-back in surveys of business and consumer sentiment following the sharp falls in the immediate aftermath of the vote to leave the European Union. Nevertheless, since the *August Inflation Report*, a number of indicators of near-term economic activity have been somewhat stronger than expected. The Committee now expect less of a slowing in UK GDP growth in the second half of 2016.

It was more difficult to draw a strong inference from these data about the Committee's projections for 2017 and beyond. Moreover, there had been no new information since the *August Inflation Report* relevant for longer-term prospects for the UK economy.

In the *August Inflation Report*, the Committee judged that some parts of the economy would be more sensitive than others to heightened uncertainty. Business and housing investment were expected to decline in the second half of 2016, while consumption growth was expected to slow more gradually, alongside households'

real disposable incomes. While most business investment intentions surveys weakened further since the August *Inflation Report*, the near-term outlook for the housing market is less negative than expected and the indicators of consumption have been a little stronger than expected. Overall, these data remain consistent with the Committee's judgement in the August *Inflation Report* that business spending would slow more sharply than consumer spending in response to the uncertainty associated with the United Kingdom's vote to leave the European Union.

Data on global economic activity have generally been in line with the Committee's August *Inflation Report* projections, with growth in the United Kingdom's major trading partners expected to continue at a modest pace over the next three years.

Twelve-month CPI inflation remained at 0.6% in August, lower than projected at the time of the August *Inflation Report*, and well below the 2% inflation target. As the unusually large drags from energy and food prices attenuate, CPI inflation is expected to rise to around its 2% target in the first half of 2017, consistent with the August *Inflation Report*, albeit with the projection a little lower over the remainder of 2016 than had been anticipated in August.

The Committee's view of the contours of the economic outlook following the EU referendum had not changed. News on the near-term momentum of the UK economy had, however, been slightly to the upside relative to the August *Inflation Report* projections. The Committee will assess that news, along with other forthcoming indicators, during its November forecast round. If, in light of that full updated assessment, the outlook at that time is judged to be broadly consistent with the August *Inflation Report* projections, 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 this year. The MPC currently judges this bound to be close to, but a little above, zero.

Against that backdrop, at its meeting ending on 14 September, MPC members judged it appropriate to leave the stance of monetary policy unchanged.

## Minutes of the Monetary Policy Committee meeting ending on 14 September 2016

1 Before turning to its immediate policy decision, the Committee discussed financial market developments; the international economy; money, credit, demand and output; and supply, costs and prices.

### Financial markets

2 There had been substantial asset price moves in response to the package of measures announced by the Committee at its previous meeting. The Committee discussed the immediate market reaction to the package, as well as the market response to subsequent data releases and the global market context.

3 A 25bp cut in Bank Rate had been priced in by financial markets ahead of the MPC announcement on 4 August. There had therefore been little reaction to the announcement at the very short end of the sterling OIS curve. Further out, the curve had initially fallen, possibly as markets took a signal that Bank Rate could be cut to its effective lower bound before the end of the year. Partly following a series of somewhat stronger-than-expected UK data releases, the OIS curve had subsequently risen and at the three-year point was up around 10 basis points since the Committee's previous meeting.

4 On the day of the MPC announcement, gilt yields had fallen by 10-20 basis points across maturities, with the largest falls in the five to fifteen year sector. Swap rates had also fallen across maturities, although by less than the gilt curve, possibly indicating that the inclusion of £60 billion of gilt purchases in the policy package had not been fully anticipated by the market. Using surveys to estimate market expectations ahead of the announcement, the response of gilt yields looked to be more consistent with the size of the effects seen at the launch of the Committee's gilt purchase programme in 2009, rather than the smaller effects during subsequent phases. UK long-term interest rates had initially continued to decline, but had then risen following better UK data and the rise in global yields. These movements had left gilt yields little changed at maturities up to ten years, and yields at longer maturities down around 10 basis points, since the Committee's previous meeting.

5 The announcement of the Corporate Bond Purchase Scheme had been less anticipated by financial market participants. Consistent with this, in the period immediately following the announcement, spreads relative to government bond yields on sterling investment grade and high yield non-financial corporate bonds had fallen sharply. Corporate bond issuance by UK-domiciled firms had also picked up sharply in August, relative to previous years.

6 The long-term wholesale funding spreads of major UK banks had fallen by around 20 basis points following the announcement of the Term Funding Scheme, broadly in line with the Committee's expectations over the period since the *August Inflation Report*. UK banks' issuance in these markets, including of AT1 debt, had been strong since the announcement compared with the same month in previous years.

7 Equity prices had risen following the MPC announcement. On the day, the FTSE 100, 250, and All-Share indices rose around 1.5%, with the UK-focused equity index up 1.2%.

8 Sterling had depreciated immediately following the announcement of the August package, with the sterling ERI falling 1.3% on the day, and by more than could be explained by interest rate differentials alone. Over the period since the Committee's previous meeting, the sterling ERI had also depreciated slightly.

9 Announcements by central banks and expectations of their policies appeared to have been important factors behind movements in global bond yields since the Committee's previous meeting. In particular, the ECB's decision not to change policy at its September meeting, and market participants' interpretation of the accompanying communications, had been followed by widespread increases in global government bond yields, including in the United States. There had also been a steepening in the Japanese yield curve, possibly related to market expectations of a change in the composition of the Bank of Japan's policy stimulus.

10 In summary, the immediate impact of the UK policy package on asset prices had been greater than expected, and the Committee would monitor closely the extent to which those asset price movements would be transmitted through to the broader economy. More recently, some of those asset price movements had been reversed, driven by somewhat stronger-than-expected UK data and a change in market perceptions of the monetary policy stance of other central banks.

### **The international economy**

11 Recent data releases on global economic activity had been consistent with the Committee's projections for modest world GDP growth contained in the August *Inflation Report*. The Committee reviewed the latest data before discussing the drivers of, and the prospects for, global equilibrium real interest rates.

12 In the United States, despite some modest downward revisions, GDP growth in the second quarter had remained at 0.3%. Non-farm payrolls had risen by 151,000 in August, below market expectations but above the level thought to be consistent with continued falls in unemployment, and there had been broadly offsetting revisions to the data for June and July. The US unemployment rate had remained at 4.9%. Based on the available official and survey data, Bank staff had revised up their forecast for US GDP growth in the third quarter by 0.1 percentage points, to 0.7%, though an unusually persistent inventory correction was clouding the assessment of underlying demand momentum. Euro-area GDP growth in Q2 had been unrevised at 0.3%. Although the euro-area composite Purchasing Managers' Index had fallen slightly in August, measures of economic uncertainty had fallen back and Bank staff had continued to expect that rate of GDP growth to be maintained in Q3.

13 Chinese GDP growth in Q3 was still expected to be 1.7%, with indicators suggesting robust consumption growth in particular. Q2 output growth had been weaker than expected in some major emerging market economies including Brazil, India and Nigeria. But forward-looking indicators for emerging markets had

strengthened, portfolio capital inflows had increased and the pace of tightening of credit standards had eased. Dollar oil prices had risen by around 3% since the August *Inflation Report*.

14 At its August meeting, the MPC had discussed the possible global spillovers from the EU referendum result. Overall, there had been little news since then and, in particular, no signs of a significant adverse impact.

15 The Committee had discussed again the low levels of global long-term interest rates. Very long-term structural factors, such as trends in productivity growth and demography, appeared to have had a depressing impact on long-term real interest rates over an extended period. It was difficult to believe that these factors had changed sufficiently to explain the further fall in yields since the start of the year. It was possible that long-term equilibrium real interest rates had been further depressed by persistent cyclical influences, such as heightened uncertainty and the weakness of growth since the financial crisis. Such factors would tend to lead to a fall in investment, or a rise in desired savings, both of which could depress long-term bond yields. It was unclear, however, how long these factors would persist. In addition, structural reforms or more expansionary fiscal policy in major economies could act to push up equilibrium interest rates, and therefore long-term bond yields, in the future.

### **Money, credit, demand and output**

16 At the time of the August *Inflation Report*, the best collective judgement of the Committee was that the UK economy was likely to see little growth in the second half of 2016. The focus of the Committee's discussion was therefore on whether the latest data had been in line with their expectations in the August *Inflation Report* and the impact so far of the package of measures announced by the Committee at its August meeting.

17 UK GDP was estimated to have grown by 0.6% on the quarter in Q2, unchanged from the initial estimate. There had been relatively little news in the output split in the second estimate with the production and service-sector data unrevised and a slight downward revision to construction output, although the construction data had been revised up again in a subsequent ONS data release. On the expenditure side, the data had been consistent with greater-than-expected momentum in domestic demand – with a larger-than-expected increase in both consumption and business investment and a smaller-than-expected fall in housing investment on the quarter – and a correspondingly weaker contribution to GDP growth from net trade.

18 Turning to indicators of activity for the second half of the year, both the Markit/CIPS composite output and expectations indices had risen sharply in August, following large declines in July, although both remained below their historical average. The CBI composite survey measures of output and expectations had also picked up a little in August and were slightly above, and slightly below, their historical averages respectively. While the Bank's Agents' scores for business services, domestic manufacturing and construction output had been consistent with positive annual rates of output growth for these sectors in Q3, they had weakened on the month. In addition, industrial production had risen by 0.1% in July, a little less than expected; manufacturing output had fallen for the third month in a row. Overall, these data were consistent with somewhat less of a slowing in

near-term UK GDP growth than envisaged in the August *Inflation Report*, although that change in the outlook was well within the range of uncertainty associated with near-term activity projections at this early stage of the data cycle. The staff's latest projections were for quarterly growth in Q3 of 0.3% in the mature data and for 0.2% in the preliminary release from the ONS. That compared with 0.1% and 0% respectively at the time of the August *Inflation Report*.

19 In the August *Inflation Report*, the Committee had judged that different sectors of the economy would slow at different speeds. In those projections, business and housing investment had been expected to fall in the second half of 2016 as heightened uncertainty weighed on spending decisions that would be costly to reverse. In contrast, the Committee had expected consumption growth to slow alongside the growth of households' real disposable income.

20 Consistent with those projections, most business investment intentions surveys had weakened further since the August *Inflation Report*. The Bank's macroeconomic uncertainty indicator remained above its long-run average in August, although it had fallen back from its recent peak in July and to a lower level than expected in the August *Inflation Report*. Commercial real estate prices had fallen further in July and transactions had also continued to fall in both July and August.

21 The outlook for the housing market – and therefore dwellings investment – looked somewhat less negative than at the time of the August *Inflation Report*. While housing transactions in July had been in line with the Committee's expectations, mortgage approvals for house purchase had fallen by less than expected on the month. The July and August RICS surveys had continued to suggest a fall in new buyer enquiries, but the pace of decline had slowed since the August *Inflation Report*. House price inflation had also slowed by less than expected, from 4.6% in the three months to June to 3.7% in the three months to August on an annualised basis according to the average of the lenders' series. In addition, house price expectations three months ahead in the RICS survey had turned positive in August.

22 The data on consumer spending released since the August *Inflation Report* had also been a little stronger than expected. Having fallen sharply in the immediate aftermath of the vote to leave the European Union, the GfK/EC consumer confidence indicator had improved slightly in August. Retail sales data from the ONS had increased more strongly than expected, by 1.4% in July following a contraction in June, although the British Retail Consortium's retail sales data for August had suggested that the value of sales had fallen in the year to August. Total new car registrations had increased by 0.3% in the three months to August, turning positive for the first time in four months.

23 It was possible that the Committee's actions to ease monetary policy at its August meeting had contributed to some of the improvement in survey balances and associated sentiment. The prices of UK risky assets had generally increased and the cost of borrowing for households had declined since the August *Inflation Report*. Many banks had announced their intention to reduce Standard Variable Rates and Tracker mortgage rates in line with the cut in Bank Rate. Although some lenders had not yet made public announcements, the information available to the Committee suggested that the vast majority of borrowers with floating rate

mortgages would benefit from this reduction. The announcements made so far suggested that deposit rates had fallen by more, on average, than expected in August although by less than the cut in Bank Rate. Two and five-year fixed mortgage rates – which cover the majority of new mortgage lending – had fallen since May, reflecting the fall in swap rates over that period, which had moved down in anticipation of an easing of monetary policy. Pass-through to new lending rates had historically taken some time and, absent further movements in swap rates, the MPC’s expectations were for mortgage rates to fall a little further over the coming months, to levels lower than expected in the *May Inflation Report*.

## **Supply, costs and prices**

24 Data released since the *August Inflation Report* had contained relatively little news for the Committee’s projections for supply, costs and prices, although the increase in CPI inflation over the rest of 2016 was now likely to be slightly more gradual.

25 Twelve-month CPI inflation had remained at 0.6% in August. That was 0.2 percentage points weaker than expected at the time of the *August Inflation Report*. Although starting from a slightly lower level, CPI inflation was expected to pick up further over the remainder of 2016, reflecting the waning influence of past falls in energy and food prices, the reduced disinflationary impact from sterling’s appreciation between 2013 and 2015 and the initial effects of the depreciation of the exchange rate over the past year. Further ahead, CPI inflation was expected to rise to around its 2% target in the first half of 2017. Core inflation – the inflation rate of CPI excluding energy, food and tobacco – had also remained at 1.3% in August.

26 Domestic labour cost pressures had remained subdued. Total annual pay growth in the whole economy and in the private sector was 2.3% and 2.4% in the three months to July. The headline rate of unemployment had remained at 4.9%. The claimant count rate had been unchanged in July and August. The number of job vacancies had been broadly flat for the past 18 months, increasing fractionally in the three months to August. Surveys of employment intentions from the REC and CIPS had declined immediately following the referendum, but they had recovered in the latest data and were now at levels consistent with fairly flat employment. Intelligence gathered from the Bank’s Agents had suggested a similar picture. Taken together, these data suggested that there had not been a deterioration in labour market conditions following the referendum. But it was too soon to tell how businesses would adjust to the longer-run impact of the vote to leave the European Union and the Committee would continue to monitor closely the prospects for employment and unemployment.

27 Measures of long-term inflation compensation in financial markets had risen since the *August Inflation Report*, reversing the falls seen since the EU referendum. Moreover, these moves appeared UK-specific, and stood in contrast to the patterns observed in the United States and euro area. It was possible that some of the rise in measures of inflation compensation, towards levels more consistent with meeting the inflation target, was a response to the Committee’s policy package. However, households’ long-term expectations of inflation had declined a little in Q3.



## The immediate policy decision

28 The Committee set monetary policy to meet the 2% inflation target, and in a way that helped sustain growth and employment. At the time of the August *Inflation Report*, the best collective judgement of the Committee had been that the United Kingdom's vote to leave the European Union would lead, over the forecast horizon, to a materially lower path for growth and a notably higher path for inflation than would otherwise have been the case. The Committee had announced a package of policy measures aimed at reducing the amount of spare capacity in the economy and thus ensuring that inflation returned sustainably to the target over time. As set out in the August *Report*, conditional on this package of measures, the MPC had expected that by the three-year forecast horizon unemployment would have begun to fall back; much of the economy's spare capacity would have been re-absorbed; and that inflation would be a little above the 2% target. In preparing those projections, the Committee had only a limited amount of data to inform its assessment of how the vote to leave the European Union would affect the underlying momentum and medium-term prospects of the UK economy. The focus of the Committee's September discussion had been on the immediate impact of the policy package and whether the latest economic data had been in line with their projections in the August *Inflation Report*.

29 The August MPC announcement had led to a greater-than-anticipated boost to UK asset prices. While a 25bps cut in Bank Rate had already been priced in by financial markets, short-term market interest rates had fallen notably following the announcement. Long-term interest rates had also fallen, with gilt yields falling by more than swap rates, possibly reflecting that the inclusion of £60 billion of gilt purchases, and the overall breadth of the policy package, had not been fully anticipated by the market. Since then, some of those falls in yields had reversed, driven by somewhat stronger-than-expected UK data and a generalised rise in global yields. On the month, the sterling ERI had depreciated slightly.

30 The inclusion of a Corporate Bond Purchase Scheme in the package had been less anticipated by market participants. Consistent with this, corporate bond spreads had narrowed and sterling issuance by UK-domiciled firms had been strong. Equity prices had also risen.

31 The long-term wholesale funding costs of major UK banks had fallen by around 20 basis points following the announcement of the Term Funding Scheme, broadly in line with the Committee's expectations, and August issuance of long-term wholesale debt had been strong. Deposit rates also fell in August, although, on average, these falls had been slightly smaller than the cut in Bank Rate. Many banks had announced their intention to reduce Standard Variable Rates and Tracker mortgage rates in line with the cut in Bank Rate. Fixed rates on new mortgage lending had also fallen a little, although pass-through to new lending rates had historically taken some time and the MPC's expectation was that mortgage rates would fall a little further over the coming months.

32 Overall, while the evidence on the initial impact of the policy package had been encouraging, the Committee would monitor closely changes in asset prices and in interest rates facing households and firms and their effect on economic activity.

33 The Committee's August *Inflation Report* projection had been that the UK economy was likely to see little growth in the second half of 2016. In light of the tendency for survey indicators to overreact to unexpected events, the Committee had expected some bounce-back in surveys of business and consumer sentiment, following the sharp falls seen in the immediate aftermath of the vote to leave the European Union. Nevertheless, since the August *Report*, a number of indicators of near-term economic activity had been somewhat stronger than expected. Albeit to a lesser extent than anticipated in the August *Report*, the Committee still expected a material slowing in UK GDP growth in the second half of 2016.

34 It was difficult to draw any strong inferences from these data about the Committee's projections for 2017 and beyond. Moreover, there had been no new information since the August *Inflation Report* relevant for the longer-term prospects for the UK economy.

35 In the August *Inflation Report*, the Committee had judged that different sectors of the economy would slow at different rates. A protracted period of heightened uncertainty following the United Kingdom's vote to leave the European Union and an expected weakening in the housing market had been projected to weigh particularly on business and housing investment in the near term, while consumption growth had been expected to slow more gradually alongside households' real disposable incomes. The outlook for business spending, including commercial real estate transactions, seemed consistent with those projections. Indicators of consumption had been a little stronger than expected, and the near-term outlook for the housing market also appeared somewhat less weak than projected in August. Overall, though, the early data had remained consistent with the Committee's judgement that business spending would slow more sharply than consumer spending in response to the uncertainty associated with the vote to leave the European Union.

36 There had been limited news on the labour market. The headline rate of unemployment had remained at 4.9% in July and the early official evidence suggested that the number of vacancies had held up in the period immediately after the referendum. Surveys of employment intentions from the REC and CIPS had recovered in the latest data, following initial post-referendum declines, and were at levels consistent with stable employment. Taken together, these data suggested that there had not been a deterioration in labour market conditions following the referendum. But it had been too soon to tell how businesses would adjust to the longer-run impact of the vote to leave the European Union and the Committee would continue to monitor closely the prospects for employment and unemployment.

37 Data on global economic activity had generally been in line with the Committee's August *Inflation Report* projections, with growth in the United Kingdom's major trading partners expected to continue at a modest pace over the next three years. Oil prices had risen slightly since the August *Inflation Report*, but remained volatile.

38 Twelve-month CPI inflation had remained at 0.6% in August, lower than projected at the time of the August *Inflation Report*, and well below the 2% inflation target. As the unusually large drags from energy and food prices attenuated, CPI inflation was expected to rise to around its 2% target in the first half of 2017, consistent with the August *Inflation Report* projections, albeit a little lower over the remainder of 2016 than had been anticipated in August.

39 The Committee's view of the contours of the economic outlook following the EU referendum had not changed. News on the near-term momentum of the UK economy had, however, been slightly to the upside relative to the August *Inflation Report* projections. The Committee would assess that news, along with other forthcoming indicators, during its November forecast round. If, in light of that full updated assessment, the outlook at that time was judged to be broadly consistent with the August *Inflation Report* projections, 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.

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

Bank Rate be maintained at 0.25%;

The Bank of England continue with the programme of sterling non-financial investment-grade corporate bonds purchases totalling up to £10 billion, financed by the issuance of central bank reserves;

The Bank of England continue with the programme of £60 billion of UK government bond purchases to take the total stock of these purchases to £435 billion, financed by the issuance of central bank reserves.

The Committee voted unanimously in favour of all three propositions. For Kristin Forbes and Ian McCafferty, who had opposed the increase in gilt purchases last month, the current outlook still did not fully warrant the additional stimulus generated by the increase in the size of the gilt purchase programme. However, given the potential costs to the economy of immediately reversing the programme underway, they would not vote against the continuation of that programme for now. For Kristin Forbes, these arguments also applied to the corporate bond purchase programme.

41 As set out in the August *Report*, the Term Funding Scheme (TFS), which had been introduced as part of the policy package in August, would have an initial drawdown period of 18 months. Given the need to provide certainty to participants to allow them to form their initial funding and lending plans, the MPC would not vote on the TFS at each policy meeting. The MPC only expected to adjust the terms and length of the Scheme should macroeconomic conditions warrant it, and would not make the Scheme less generous during the initial 18 month drawdown window.

42 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  
Michael Saunders  
Gertjan Vlieghe

Dave Ramsden was present as the Treasury representative.

As permitted under the Bank of England Act 1998, as amended by the Bank of England and Financial Services Act 2016, Anthony Habgood was also present on 8 September as an observer for the purposes of exercising oversight functions in his role as a member of the Bank's Court of Directors. Tim Frost was also present on both 8 and 9 September as an observer for the purposes of exercising oversight functions in his role as a member of the Bank's Court of Directors.