BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 15 March 2017

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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 10 May will be published on 11 May 2017.

Monetary Policy Summary, March 2017

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 15 March 2017, the Committee voted by a majority of 8-1 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, financed by the issuance of central bank reserves, totalling up to £10 billion. The Committee also voted unanimously to maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435 billion.

As the MPC had observed at the time of the UK's referendum on EU membership, the appropriate path for monetary policy depends on the evolution of demand, potential supply, the exchange rate, and therefore inflation. The Committee expects a slowdown in aggregate demand over the course of this year, as household demand growth declines in reaction to lower real income growth. Official estimates of retail sales have weakened notably, consistent with this expectation, although other indicators of consumer demand such as consumer confidence have been steadier. Measures of overall activity growth have been resilient, with official estimates indicating a fairly steady pace of expansion around historical average rates and business surveys suggesting little change in the near term. It is possible that slowing consumption may be offset to some degree by other components of demand, such as a more supportive net trade position following last year's fall in sterling and the recent pickup in global momentum.

Consistent with prospects for stronger global growth, equity prices have generally risen internationally, and short and long-term interest rates have increased in some economies. The evolution of asset prices has been different in the United Kingdom, however, where market interest rates have fallen and the equity prices of companies with significant domestic exposure – most notably to consumers – have underperformed. Those developments seem somewhat difficult to reconcile with the ongoing resilience of most macroeconomic indicators. In addition, for some time, financial markets and households appear to have had different perspectives on UK economic prospects. This difference cannot persist indefinitely, and the nature and timing of its resolution are likely to be key factors in the MPC's policy assessment.

CPI inflation increased to 1.8% in January, and the MPC expects it to rise above the 2% target over the next few months, before peaking at around 2¾% in early 2018 and drifting gradually back down towards the target thereafter. The projected overshoot entirely reflects the expected effects of the drop in sterling. Pay growth has remained subdued, while measures of inflation expectations remain at levels broadly consistent with the achievement of the inflation target.

Monetary policy cannot prevent either the real adjustment that is necessary as the UK moves towards its new international trading arrangements or the weaker real income growth that is likely to accompany it over the next few years. Attempting to offset fully the effect of weaker sterling on inflation would be achievable only at the cost of higher unemployment and, in all likelihood, even weaker income growth. For this reason, the MPC's remit specifies that, in such exceptional circumstances, the Committee must balance the trade-off between the speed with which it intends to return inflation to the target and the support that monetary policy provides to jobs and activity. At its March meeting, the MPC continued to judge that it remained appropriate to seek to return inflation to the target over a somewhat longer period than usual. Eight members thought that the current stance of monetary policy remained appropriate to balance the demands of the Committee's remit. Kristin Forbes considered it appropriate to increase Bank Rate by 25 basis points.

As the Committee has previously noted, there are limits to the extent that above-target inflation can be tolerated. The continuing suitability of the current policy stance depends on the trade-off between above-target inflation and slack in the economy. The projections described in the February *Inflation Report* depend in good part on three main judgements: that the lower level of sterling continues to boost consumer prices broadly as expected, and without adverse consequences for expectations of inflation further ahead; that regular pay growth does indeed remain modest, consistent with the Committee's updated assessment of the remaining degree of slack in the labour market; and that the hitherto resilient rates of household spending growth slow as real income gains weaken, without a sufficient offset by other components of demand.

In judging the appropriate policy stance, the Committee will be monitoring closely the incoming evidence regarding these and other factors. At present, the Committee's best collective view is that the central judgements underpinning the February projections remain broadly on track, and so the conditioning assumption underpinning the February projections – that there will be some modest withdrawal of monetary stimulus over the course of the forecast period – remains appropriate. There are risks in both directions. For example, if aggregate demand growth remains resilient, monetary policy may need to be tightened sooner and to a greater degree than that implied path. A more marked slowdown in activity than currently anticipated by the Committee, by contrast, could warrant additional policy support relative to that implied path. Monetary policy can respond, in either direction, to changes to the economic outlook as they unfold to ensure a sustainable return of inflation to the 2% target.

Minutes of the Monetary Policy Committee meeting ending on 15 March 2017

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 Since the Committee's previous meeting, both short-term and long-term sterling interest rates had fallen notably. The three-year instantaneous forward OIS rate had fallen by 15 basis points and ten-year gilt yields by 25 basis points, the latter largely associated with a decrease in the inflation compensation component. These moves appeared to be driven mainly by market participants placing weight on weaker-than-expected economic data in the United Kingdom, in particular retail sales data, and their potential implications for both the economic outlook and the monetary policy stance.

3 In contrast, US Treasury yields had increased slightly over the period as market participants had continued to respond to news on the new administration's policies, improving prospects for US activity, and the anticipated tightening of US monetary policy. A further increase in the Federal Funds Rate was widely expected at the March FOMC meeting, and had been reflected in US short-term rates.

4 The Committee discussed the divergence between UK gilt and US Treasury yields in a longer-term context. Having moved broadly in line for much of 2015 and the first half of 2016, there had been a marked divergence following the UK referendum on EU membership, which had only partially unwound following stronger-than-expected UK data in the autumn. The divergence had then increased further since the US presidential election, driven by a rise in US Treasury yields, as markets priced in expectations of US fiscal stimulus and a boost to US activity. Following the recent fall in gilt yields, the spread to Treasuries had reached its widest since the middle of the 1980s.

5 Short-term euro-area interest rates had risen slightly since the Committee's previous meeting. The ECB had left policy unchanged but some market participants had noted the upward revisions to near-term growth and inflation forecasts. Political risk had been a key theme in long-term euro rates markets, with a widening of the spread between French and German government bond yields. Foreign exchange markets had also appeared to respond to polling news, and option implied volatility had picked up around the date of the second round of the French presidential election.

6 The sterling ERI had fallen a little since the Committee's previous meeting. The FTSE All-Share Index had risen further, along with US and European indices. The share prices of UK-focused firms within the All-Share Index had, however, underperformed, with a weak contribution from consumer-facing sectors in particular. Sterling investment grade corporate bond spreads had been broadly unchanged over the period, although high-yield spreads had fallen a little.

The international economy

7 Financial market investors appeared to have become more optimistic about global growth prospects following the US presidential election: equity indices in the United States, euro area and Japan had risen by over 10% since that event. The Committee discussed the extent to which the available indicators had been consistent with an improved activity outlook.

8 On a UK export-weighted basis, global growth in H2 had been only a touch above the H1 reading, and in line with the MPC's recent forecasts. The US had seen faster growth in the second half of 2016, owing in particular to a strong outturn in Q3. Euro-area growth in H2 had been broadly unchanged from that in H1.

9 Survey data had been more positive, rising in the early autumn and accelerating following the US election. Global PMIs had reached their highest level in around two years in January, although the US Markit PMI had fallen back a little in February. Indicators of consumer and business confidence had also improved in the United States and the euro area, with economic indicators generally having surprised to the upside. Although the staff nowcast of UK export-weighted world GDP growth had remained at 0.6% for 2017 Q1, survey data suggested that the risks to this estimate lay more to the upside.

10 In the United States, investors and businesses expected an expansion in fiscal policy and possibly some additional upward impetus from tax reform and deregulation across a number of industries. There had also been some expectation of more supportive fiscal policy in the euro area. Elsewhere, most emerging economies were viewed as being less vulnerable than in the past to a strengthening US dollar.

11 Although the central outlook for global activity appeared stronger, there remained a number of important uncertainties. The precise nature, size and timing of any fiscal measures in the United States remained unclear, as did the outlook for regulatory and trade policy. Rising global inflation might lead to tighter monetary policy than was currently expected. And forthcoming elections in the euro area had the potential to increase asset price volatility. In sum, although near-term prospects for global growth had improved, whether this momentum would be sustained remained an open question.

Money, credit, demand and output

12 The official data and the major business surveys had continued to indicate a steady pace of expansion in real activity. The estimate of GDP growth in 2016 Q4 had been revised up by 0.1 percentage points to 0.7%. The Markit/CIPS composite output and expectations indices had been close to their historical averages in January and February, while the CBI balances had been above their means. Bank staff's GDP nowcast was for growth of 0.6% in 2017 Q1, 0.1 percentage points higher than at the time of the February *Inflation Report*. Although it was too early to make a confident prediction of growth in Q2, there had been relatively little evidence so far from the output indicators of a slowdown.

13 A slowing in household demand had been a central feature of the MPC's February projections. Household consumption was estimated to have grown by around 3% in 2016, the highest rate since 2004, but

this was projected in the February *Report* to fall to around 2% in 2017 in response to a marked weakening in real income growth. Several indicators had been consistent with such a slowdown. Retail sales were estimated to have fallen for three months in succession, a weakening that had been corroborated by data from the British Retail Consortium. The components of retail spending that had fallen furthest – including food, drink and fuel – tended to be those for which price inflation had risen most. The Bank's Agents' contacts in the retail goods sector had said they expected a pronounced slowing in demand in the year ahead; and it had been noteworthy that the equity prices of consumer-facing companies had under-performed the overall market this year. Moreover, external forecasters were generally predicting substantially weaker growth in consumption and aggregate demand than was the MPC.

14 The evidence of a broader consumption slowdown had been more mixed, however. Although the retail sales data fed into the early official estimates of consumption, over time the latter were refined, drawing on more comprehensive evidence on household spending, loosening the link between the two. In fact, the correlation between retail sales growth and mature estimates of consumption growth had not been especially high in the past. Indicators that had, historically, been more reliable had remained relatively steady. Consumer confidence indices had been broadly flat since November, and close to their historical averages. This had included the index relating to consumers' willingness to make major purchases, which had the best predictive power for spending. Consumer credit growth had remained in double digits in annual terms, despite a slight softening in the most recent data. In addition, housing market indicators, such as house prices, mortgage approvals, housing transactions and the price and activity indicators in the RICS survey, had not pointed to any pronounced weakening in housing demand.

15 As had been the case at the time of the February *Inflation Report*, the Committee was of the view that a moderate slowing in consumption was the most likely outcome, with signs that this was already beginning to come through in some components of spending. This slowing, however, needed to be viewed in the context of the other indicators. Recent activity and expenditure indicators had raised the possibility that overall aggregate demand growth might hold up even as consumption slowed, perhaps on account of a more supportive net trade position following last year's drop in sterling. The evolution of the aggregate demand and activity data would remain of central interest to the Committee's policy assessment.

16 The Committee noted the measures announced in the government's Spring Budget and the corresponding projections from the Office for Budget Responsibility. The OBR's projections for GDP growth had been in line with the central projections in the February *Inflation Report*. The measures announced in the Budget had amounted to a small short-term fiscal loosening, followed by a small tightening.

Supply, costs and prices

17 Twelve-month CPI inflation had been 1.8% in January, fractionally below Bank staff's expectation at the time of the February *Inflation Report*, in part owing to weaker clothing and footwear prices, which were typically volatile. Since the time of the previous *Report*, a number of domestic utility providers had announced increases in gas and electricity prices that were somewhat in excess of the baseline assumptions factored into the

February forecast. The net result of the news in the January CPI outturn, recent utility price announcements, and the decline in the sterling oil price was to leave the staff's expectation for CPI inflation broadly similar to the February projection. CPI inflation was expected to rise to around the 2% target over the next month or so, and, given the impact of sterling's depreciation, to exceed the target materially by the summer.

18 The unemployment rate had continued its steady decline, falling to 4.7% in the three months to January, lower than had been expected in the February forecast. A sharp increase in the average number of hours worked per week meant that the total number of hours worked in the economy was estimated to have risen by 1.5% in the three months to January. In contrast to the strength of the labour quantities, annual regular pay growth in the private sector had declined to 2.6% in the three months to January, compared with its recent peak of 3.0% near the end of 2016. In the economy as a whole, annual regular pay growth had dropped back to 2.3% over the same period. Both of these figures were notably weaker than had been expected at the time of the February *Inflation Report*. Bonus payments had also been weaker than expected, and reports on the size of bonus payments in the financial sector indicated that they were likely to make little contribution to overall pay growth over the first few months of 2017.

19 The evolution of wages, labour costs and measures of domestically focused inflation more broadly, remained a critical influence on the Committee's assessment of inflationary pressure in the medium term and therefore the appropriate policy stance. Pay growth was expected to pick up gradually during 2017, reflecting the past tightening of the labour market and the impact that increased headline inflation might have on pay claims. It remained to be seen how significant the impact on wages of the pickup in headline inflation would be for a given level of unemployment. The experience of the labour market adjustment following the large depreciation of sterling accompanying the financial crisis, and subsequent increase in the rate of VAT, was that real wages had been remarkably flexible. Employees had, in aggregate, accepted the erosion of their purchasing power without a significant pickup in nominal pay growth. This flexibility in real wages had helped to ensure that the increase in unemployment after the recession, while substantial, had been more limited and short-lived than would have been expected on the basis of the experience of previous decades.

20 The Committee's central expectation was that pay growth would remain fairly restrained following the recent depreciation. Indeed, it was possible that firms might seek to limit pay awards to offset partially the impact of higher imported costs and some increases in non-wage labour costs – for example, those associated with increased pension contributions or the introduction of the Apprenticeship Levy. In assessing the outlook for inflation in the medium term, the Committee would be monitoring closely the development of regular pay, non-wage costs and other domestically focused measures of inflation.

21 There had been no new information regarding businesses' expectations of inflation since the previous MPC meeting. Measures of households' expectations of inflation in the medium term had generally edged up, though remained broadly in line with historical averages. Measures of inflation compensation derived from financial instruments had declined since the time of the Committee's previous meeting.

The immediate policy decision

22 The MPC set monetary policy to meet the 2% inflation target, and in a way that helped sustain growth and employment. The Committee noted the Chancellor's letter to the Governor of 8 March which, as required annually by the Bank of England Act (1998), described the MPC's remit and the government's economic policy objectives. The remit for monetary policy had been unchanged. It continued to stress the primacy of the 2% inflation target, as measured by the Consumer Prices Index, and also to specify that, in exceptional circumstances, the Committee must seek to balance the trade-off between the speed with which it intended to return inflation to the target and the support that monetary policy provided to jobs and activity. In the exceptional circumstances since the United Kingdom's decision to withdraw from the EU, the main challenges for the Committee had remained assessing how the economic outlook had changed, and identifying the appropriate policy response to that changed outlook, including to the substantial depreciation of sterling that was expected to push CPI inflation well above the 2% target for a period.

23 The MPC's February projections had been for a protracted period of above-target inflation coupled with only a modest degree of slack, and recent data had done little to change that assessment. The MPC continued to expect CPI inflation to rise above the 2% target over the next few months, peaking at around 2¾%, before falling back gradually towards the target. The unemployment rate, at 4.7%, was only a little above the Committee's central estimate of the equilibrium rate of 4.5%.

24 The Committee had previously noted that there were limits to the extent that above-target inflation could be tolerated. The continuing suitability of the current policy stance depended on the trade-off between above-target inflation and slack in the economy. The MPC's central outlook for the economy, as described in the February *Inflation Report*, had depended in good part on three main judgements: that the lower level of sterling continued to boost consumer prices broadly as expected, and without adverse consequences for expectations of inflation further ahead; that regular pay growth did indeed remain modest, consistent with the Committee's assessment of the remaining degree of slack in the labour market; and that the hitherto resilient rates of household spending growth slowed as real income gains weakened, without a sufficient offset by other components of demand. The Committee considered the latest evidence on these judgements.

25 CPI inflation in January[1], at 1.8%, had been only a touch weaker than expected, and overall there had been little news about the near-term inflation outlook. The expected imported price pressures stemming from the drop in sterling were clearly evident in the official data and in businesses' responses to surveys. Indicators of inflation expectations from financial markets had generally fallen since February while those from households had edged up, but the general picture that they seemed consistent with inflation close to the target had remained intact. Wage growth had been notably softer than expected, despite a further fall in the unemployment rate.

26 The news on aggregate demand had been mixed. Official estimates of retail sales had weakened notably, although other indicators of consumer demand, such as consumer confidence, had been steadier. Moreover, survey measures of overall activity had so far shown little signs of a slowing. It was possible that moderating

[1] The version of these minutes that was originally published erroneously stated that this figure was for February.

consumption growth was being offset to some degree by an improving net trade position as exporters benefitted from both the lower level of sterling and relatively solid overseas demand. An upbeat outlook for exports might also act as a support to business investment. Reflecting the mixed indicators, the expectation that activity would slow in line with the February forecast over the next few quarters was held with differing degrees of confidence across the Committee.

27 Developments in the international economy had been supportive of UK activity, with business surveys internationally being consistent with sustained demand growth in the near term. Equity prices had generally risen globally, and short and long-term interest rates had increased in some economies. The evolution of asset prices had been different in the United Kingdom, however, where market interest rates had fallen and the equity prices of companies with significant domestic exposure – most notably to consumers – had underperformed. Those developments seemed somewhat difficult to reconcile with the ongoing resilience of most macroeconomic indicators. In addition, for some time financial markets and households appeared to have had different perspectives on UK economic prospects. This difference could not persist indefinitely, and the nature and timing of its resolution were likely to be key factors in the MPC's policy assessment.

28 Eight members considered the current policy stance still to be appropriate. Pay growth had remained subdued, consistent with the Committee's view that some slack remained in the labour market, and there had been some signs that the squeeze in households' real income growth was feeding through into spending, as expected. In this context, the conditioning assumption that had underpinned the February projections – that there would be some modest withdrawal of monetary stimulus over the course of the forecast period – remained appropriate. The potential for uncertainty over future trading arrangements to affect materially economic decision making remained, posing a downside risk to the activity outlook, to which the Committee could respond if necessary. On the other hand, with inflation rising sharply, and only mixed evidence on slowing activity domestically, some members noted that it would take relatively little further upside news on the prospects for activity or inflation for them to consider that a more immediate reduction in policy support might be warranted.

29 For one member, the monetary policy trade-off had evolved to justify an immediate increase in Bank Rate. Inflation was rising quickly and was likely to remain above target for at least three years. Measures of domestically generated inflation had also increased notably and, combined with global reflation and minimal labour market slack, posed upside risks to inflation. On the other side of the trade-off, the weakness in activity expected since the referendum had not materialised. Unemployment showed no signs of increasing. Although consumer spending appeared to be softening, as expected, growth was likely to be supported by other components of demand, such as net exports. Therefore, for this member, there was less justification for tolerating inflation above the target for an extended period, although monetary policy should remain nimble.

30 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 bond purchases totalling up to £10 billion, financed by the issuance of central bank reserves;

The Bank of England maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435 billion.

Regarding Bank Rate, eight members of the Committee (the Governor, Ben Broadbent, Jon Cunliffe, Charlotte Hogg, Andrew Haldane, Ian McCafferty, Michael Saunders and Gertjan Vlieghe) voted in favour of the proposition. Kristin Forbes voted against the proposition, preferring to increase Bank Rate by 25 basis points.

Regarding the stock of purchased assets, the Committee voted unanimously in favour of the second and third propositions.

31 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
Charlotte Hogg, 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.

Jon Cunliffe was present on 9 and 13 March but was unable to attend on 15 March owing to other official business. He communicated his vote to the Governor, and the Committee, in accordance with the provisions of paragraph 12 of Schedule 3 to the Bank of England Act 1998, agreed that he should be treated as present at the meeting for the purposes of sub-paragraph (4) of paragraph 11.