



BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 1 August 2018

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These are the minutes of the Monetary Policy Committee meeting ending on 1 August 2018.

They are available at <https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2018/august-2018>.

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 12 September will be published on 13 September 2018.

Monetary Policy Summary, August 2018

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 1 August 2018, the MPC voted unanimously to increase Bank Rate by 0.25 percentage points, to 0.75%. The Committee voted unanimously to maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £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.

Since the *May Inflation Report*, the near-term outlook has evolved broadly in line with the MPC's expectations. Recent data appear to confirm that the dip in output in the first quarter was temporary, with momentum recovering in the second quarter. The labour market has continued to tighten and unit labour cost growth has firmed.

The MPC's updated projections for inflation and activity are set out in the *August Inflation Report* and are broadly similar to its projections in May.

In the MPC's central forecast, conditioned on the gently rising path of Bank Rate implied by current market yields, GDP is expected to grow by around 1¾% per year on average over the forecast period. Global demand grows above its estimated potential rate and financial conditions remain accommodative, although both are somewhat less supportive of UK activity over the forecast period. Net trade and business investment continue to support UK activity, while consumption grows in line with the subdued pace of real incomes.

Although modest by historical standards, the projected pace of GDP growth over the forecast is slightly faster than the diminished rate of supply growth, which averages around 1½% per year. The MPC continues to judge that the UK economy currently has a very limited degree of slack. Unemployment is low and is projected to fall a little further. In the MPC's central projection, therefore, a small margin of excess demand emerges by late 2019 and builds thereafter, feeding through into higher growth in domestic costs than has been seen over recent years.

CPI inflation was 2.4% in June, pushed above the 2% target by external cost pressures resulting from the effects of sterling's past depreciation and higher energy prices. The contribution of external pressures is projected to ease over the forecast period while the contribution of domestic cost pressures is expected to rise. Taking these influences together, and conditioned on the gently rising path of Bank Rate implied by current market yields, CPI inflation remains slightly above 2% through most of the forecast period, reaching the target in the third year.

The MPC continues to recognise that the economic outlook could be influenced significantly by the response of households, businesses and financial markets to developments related to the process of EU withdrawal.

The Committee judges that an increase in Bank Rate of 0.25 percentage points is warranted at this meeting.

The Committee also judges that, were the economy to continue to develop broadly in line with its *Inflation Report* projections, an ongoing tightening of monetary policy over the forecast period would be appropriate to return inflation sustainably to the 2% target at a conventional horizon. Any future increases in Bank Rate are likely to be at a gradual pace and to a limited extent.

Minutes of the Monetary Policy Committee meeting ending on 1 August 2018

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

Financial markets

2 In the period since the Committee's previous meeting, net changes in asset prices had been relatively small. But that had masked some volatility within the period, associated with a number of economic and political developments.

3 In the United Kingdom, short rates had risen a little since the Committee's June meeting. The three-year instantaneous forward OIS rate had, however, fallen by around 10 basis points relative to the conditioning assumption incorporated in the *May Inflation Report*. Staff analysis using intra-day market movements following economic and geopolitical events had suggested that global trade tensions had pushed down on OIS rates over the period since May, offsetting the upward impetus from domestic news. The market-implied probability of a 0.25 percentage point increase in Bank Rate at the August MPC meeting had increased to around 90%.

4 The sterling effective exchange rate had depreciated slightly since the Committee's previous meeting and was down 2.5% relative to the 15-day average incorporated in the *May Report*. Developments related to the UK's withdrawal from the European Union had continued to influence sterling assets, including the exchange rate. In particular, sterling had been affected by both the Government's statement on the future relationship with the European Union following the Cabinet meeting at Chequers on 6 July and subsequent political developments. Sterling-dollar risk reversals, a measure of the balance of perceived risks, had also declined, consistent with market intelligence that an increase in downside tail risks had exerted downward pressure on sterling. Sterling-dollar implied volatilities at maturities beyond the next few months had picked up somewhat since the *May Report*, implying an expectation that the increase in the level of uncertainty around future sterling moves would persist. But they had remained below their longer-term averages.

5 Rising trade tensions had led to a fall in emerging market equity prices and depreciations against the dollar. In advanced economies, equity markets had been broadly unchanged or had increased slightly since the Committee's previous meeting and the *May Report*. Bank funding costs had risen in recent months in the United Kingdom and particularly in the euro area.

The international economy

6 The near-term outlook for the global economy appeared to be a little softer and somewhat less synchronised across major economies than at the time of the *May Inflation Report*. That reflected a weaker outlook for emerging markets and, to a lesser degree, the euro area, alongside the likelihood of slightly more

negative effects on global growth from the implementation of protectionist measures by the United States and China. Some indicators of world trade – including the export orders components of manufacturing PMIs and advanced economies' capital goods orders – had weakened significantly during the first half of the year. Reflecting in part the escalation in trade tensions, metals prices had fallen by 7% since the MPC's previous meeting. Notwithstanding these developments, world GDP growth was expected to remain above estimates of growth in potential supply.

7 Euro-area GDP growth had weakened slightly further, from 0.4% in 2018 Q1 to 0.3% in the preliminary estimate for Q2. This was 0.3 percentage points weaker than had been expected by Bank staff at the time of the *May Report* and well below the 0.7% quarterly growth rates recorded throughout 2017. Survey indicators, such as PMIs, were consistent with stronger activity growth and Bank staff expected GDP to grow by around 0.5% per quarter during the second half of the year.

8 According to the advance estimate, US GDP growth had risen to 1.0% in 2018 Q2 from 0.5% in Q1, 0.2 percentage points higher than had been expected at the time of the *May Report*. Even if some of the second-quarter strength was likely to be temporary, underlying growth had appeared to be holding up. Indicators of US business and consumer confidence had remained robust since the MPC's previous meeting. Non-farm payrolls had increased strongly in June, although the unemployment rate had also risen slightly, reflecting a sharp pickup in female labour force participation. The latest estimate from Bank staff was that GDP growth would slow to 0.7% in the third quarter.

9 Chinese GDP had increased by 1.8% in 2018 Q2, up from 1.4% in Q1 and broadly in line with expectations at the time of the *May Report*. A weighted PMI measure had remained flat during Q2 at the weaker levels recorded during the first quarter, although a range of industrial indicators had been robust. Total social financing growth had fallen back towards the pace of nominal GDP growth in recent months, with non-bank lending growth declining significantly, although levels of corporate debt relative to GDP had built materially over recent years. The PBoC had cut the Reserve Requirement Ratio for some banks by 50 basis points, while the State Council had announced a slight loosening of fiscal policy. Looking ahead, Bank staff expected a gradual easing in economic growth during the second half of the year. The sharp declines in Chinese asset prices, in part reflecting increasing trade tensions, had highlighted downside risks to the economic outlook.

10 In other emerging market economies, for which Q2 GDP data were mostly not yet available, indicators of growth such as PMIs had generally fallen during the second quarter. The recent tightening in financial conditions was also expected to weigh on growth further ahead.

11 The Brent oil futures curve had increased by 3% in dollar terms since the MPC's previous meeting and by 9% since the *May Report*, largely reflecting weaker prospects for supply. Headline measures of consumer price inflation in both the euro area and the United States had risen in recent months, reflecting developments in energy prices. In the euro area, annual HICP inflation excluding energy, food, alcohol and tobacco had risen to 1.1% in July. In the United States, core CPI inflation had increased to 2.3% in June, its highest level since early 2012, as the downward impact of transitory factors previously depressing inflation had waned and healthcare costs had risen. US annual core PCE inflation was 1.9% in June, unchanged from May.

Money, credit, demand and output

12 The ONS had introduced a new monthly GDP estimate, and discontinued the preliminary estimate of quarterly GDP. These changes had not materially altered the extent of the information available to the MPC at its policy meeting.

13 GDP was reported to have grown by 0.2% in the three months to May compared with the three months to February, in line with the MPC's expectation. This had represented an improvement on the zero growth recorded in the three months to April, although it had still been weighed down by weak activity in March, in part as a result of weather-related disruption. The improvement had been driven by both consumer and business facing services, while construction output had seen its largest monthly increase for more than two years. Production had remained weak, however, reflecting weakness in manufacturing output. For Q2 as a whole, the MPC continued to expect a pickup in growth to 0.4%. The limited business surveys available for the quarter had pointed to a similar pace of growth in Q3.

14 Further evidence of a recovery in demand from a weak Q1 had been provided by the retail sales data. Although sales volumes had fallen by 0.5% in June, the Q2 increase of 2.1% had been the highest for more than three years. Weather effects – both the snow-related disruption in February and March, and the unseasonably warm weather and long sunshine hours in May and June – seemed to have accounted for around half of the Q2 rise, but that still suggested some recovery in underlying demand during the quarter. The trend in retail sales over the past year had weakened notably, however, so any strength in the high-frequency data needed to be seen against that backdrop.

15 One feature of the MPC's recent forecasts had been the expectation that the rotation in demand away from household consumption and towards net trade and business investment would continue. Some data for the first half of the year had run counter to that view. Recent official data suggested that net trade had subtracted from growth in the first half of the year and that business investment had fallen in Q1. However, surveys of UK export orders had remained buoyant. Although uncertainty about Brexit was weighing on business investment, surveys were consistent with modest growth.

16 Despite a significant fall in mortgage interest rates in recent years, the housing market had remained subdued. Annual inflation in the UK House Price Index published by HM Land Registry had fallen to 3.0% in May from 3.6% in April and was six percentage points lower than in late 2014. The number of residential property transactions had dropped by nearly 6% in the year to June and remained more than 20% below the average in the decade prior to the financial crisis. Slow growth in real per capita incomes was likely to be part of the explanation, but the contrasting performance of London and the rest of the UK had also been striking.

17 The decline in both house price inflation and housing activity had been particularly marked in London. Several factors set London apart and might account for this divergence in behaviour. Measures of affordability, such as house prices relative to household incomes, were especially elevated in London. The recent weakness in London house prices might therefore mark an adjustment to more sustainable levels. Given its relatively high

level of house prices, London was also likely to have been disproportionately affected by regulatory and tax changes since 2014.

18 The MPC judged that weakness in the London housing market was unlikely to have significant spill-overs. Nonetheless, the MPC expected only a modest housing market recovery, with annual house price inflation settling at around 3% and the number of transactions rising only gradually.

Supply, costs and prices

19 Annual CPI inflation had been unchanged at 2.4% in June. Although this had been weaker than the staff forecast, the downside news had been concentrated in a small number of volatile components and the implications for the broader inflation outlook had appeared limited. Indeed, rises in sterling energy prices and the lower level of sterling had meant that the short-term inflation outlook was a little stronger than it had been at the time of the *May Inflation Report*. Energy prices were expected to push CPI inflation a little higher in July, after which a forecast softening in this component contributed to a gradual decline in CPI inflation towards the 2% target.

20 The labour market had continued to be strong. Employment had risen by 137,000 in the three months to May, taking the 16+ employment rate to 61.1%, the highest since the early 1970s. Vacancies had also risen, to another record high, and the Bank's Agents' score of recruitment difficulties had continued to track upwards. The unemployment rate had been steady, at 4.2%, close to the MPC's estimate of the natural rate, while the claimant count data had pointed to a continued downward unemployment trend.

21 The participation rate had been little changed in the latest data, but it had risen further above the MPC's estimate of equilibrium since the *May Report*. In contrast, average hours worked had fallen further below equilibrium. The MPC judged that the remaining very limited amount of slack in the economy could be largely accounted for by the shortfall in average hours.

22 Pay growth, excluding the volatile bonus component, had been in line with the *May Report*. At the whole economy level, regular AWE growth had declined slightly in the three months to May, with annual growth falling to 2.7%, but up from 2.0% a year earlier. Annual private sector regular earnings growth had held steady at 2.9%, also significantly higher than last year. The more volatile three month on three month annualised measure of whole economy regular pay growth had remained above 2½% for 13 months, the longest such run since mid-2008.

23 As the labour market had tightened since the financial crisis, a gradual firming in underlying wage pressures was clearly evident. Whole economy regular pay had grown by around 1¾% per year during the 2010-2015 period. Growth had picked up to 2½% in 2016, and was expected to have risen a little further, to 2¾% around the middle of this year.

24 A number of proximate indicators supported the view that the pay environment was strengthening further. Having been steady at around 2.0% for the past three years, the median pay settlement had risen to around

2.5%, according to the Bank's settlements database. The rise in settlements had been particularly pronounced in the public sector, following the removal of the 1% pay cap, and the possibility that this might have significant spill-overs to private sector pay presented an upside risk to the MPC's forecast for whole economy earnings growth. A special survey by the Agents had indicated that labour market tightness had spurred employers to increase pay to key existing staff. For both permanent and temporary employees, the REC pay indices had remained well above their historical averages.

25 Measures of domestically generated inflation based on unit labour costs had also been stronger in recent data, and were at levels broadly consistent with meeting the inflation target in the medium term. This had marked a continuation of the gradual acceleration seen since the crisis, similar to the trends observed in wage growth. Whole economy growth in unit labour costs had averaged ½% per year during the 2010-2015 period and had risen to 1¾% in 2016. Recently, unit labour cost growth had picked up further, although it had been boosted by temporarily weak growth in output per head, in part reflecting a temporary dip in GDP growth in 2018 Q1 that had not been mirrored in the employment data. Prospects for unit labour costs would also depend on how pay developed relative to productivity. The MPC's projections assumed that both would pick up over the forecast period, and that unit labour cost growth would be sustained at higher levels than in previous years.

26 Surveys of household and corporate inflation expectations had been stable.

The immediate policy decision

27 The MPC sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. In pursuing that objective, the main challenges for the Committee had continued to be to assess the economic implications of the United Kingdom withdrawing from the European Union and to identify the appropriate policy response to that changing outlook. During the negotiation period, those economic implications would be influenced significantly by the expectations of households, firms and financial markets about the United Kingdom's eventual economic relationships with the European Union and other countries, and the transition to them.

28 The Committee considered how the economic outlook had changed since its June meeting and the May *Inflation Report*. The updated August projections and the main factors shaping them were broadly similar to the forecasts made by the MPC three months ago.

29 The near-term outlook for the global economy appeared to be a little softer and somewhat less synchronised across major economies than at the time of the May *Report*, although world GDP growth was expected to remain above estimates of growth in potential supply. There were tentative signs that actual and prospective protectionist policies were starting to have an adverse impact, most notably on indicators of global goods trade. To date, wider measures of business confidence had held up, however.

30 In the MPC's central forecast, conditioned on the gently rising path of Bank Rate implied by current market yields, GDP was expected to grow by around 1¾% per year on average over the forecast period. Along with

accommodative financial conditions, relatively robust global growth was projected to support UK demand, particularly investment and net trade. Uncertainty around the United Kingdom's future trading arrangements continued to weigh on business investment, however. And while the fall in sterling associated with the EU referendum was boosting net trade, it was still having some dampening effects on the growth rates of household real income and consumption.

31 Recent activity data appeared to confirm that the dip in output in 2018 Q1 had been temporary, with momentum recovering in the second quarter. The latest expenditure indicators had, however, thrown up some question marks around the rotation in demand, away from household consumption and towards net trade and business investment, that was expected in the MPC's central forecast. Some household indicators, such as retail sales, had bounced back. Although surveys of UK export orders had remained much stronger than official export data, net trade might be weaker than expected should recent developments in global trade presage a broader slowdown in global growth. Taken in isolation, the 2½% depreciation in sterling since the *May Report* should be expected to provide a further boost to net trade. To the extent that this depreciation had reflected developments related to the UK's withdrawal from the European Union, however, the Committee's judgement was that there could be offsetting negative effects on growth if, for example, higher uncertainty were to lead to weaker business investment. Even if the rotation in demand was now somewhat less marked, prospects for aggregate GDP growth had not appeared to have weakened.

32 Although modest by historical standards, the projected pace of GDP growth over the forecast was slightly faster than the diminished rate of supply growth, which averaged around 1½% per year. The MPC continued to judge that the UK economy currently had a very limited degree of slack and there were a number of signs that the labour market was continuing to tighten. The employment rate and the number of vacancies had risen to record highs, and indicators of recruitment difficulties had increased further. The unemployment rate was low and was projected to fall below the MPC's estimate of the natural rate. In the MPC's central projection, therefore, a small margin of excess demand emerged by late 2019 and built thereafter.

33 Regular pay growth, excluding the volatile bonus component, had been in line with the *May Report*. The underlying trend in the growth of unit labour costs had continued to firm, partly reflecting the ongoing weakness of productivity. The tightening labour market was expected to continue to feed through into faster growth in domestic costs than had been seen over recent years. That was consistent with recent evidence from the Bank's Agents, the REC survey and rising wage settlements, including in the public sector.

34 Annual CPI inflation had been 2.4% in June, weaker than expected. Although it was possible that recent CPI data were signalling slightly weaker inflationary pressures, the judgement was that the news had been largely erratic. Indeed, recent developments in energy prices and the exchange rate meant that the shorter-term inflation outlook was a little stronger than it had been at the time of the *May Report*. The combined contribution of those pressures was projected to ease over the forecast period. Taking external and domestic influences together, and conditioned on the gently rising path of Bank Rate implied by current market yields, CPI inflation remained slightly above 2% throughout most of the forecast period, reaching the target in the third year.

35 The Committee considered the immediate policy decision. Since the *May Report*, the near-term outlook had evolved broadly in line with the MPC's expectations. Although the global outlook was a little softer, recent data appeared to confirm that the dip in UK output in the first quarter had been temporary, with momentum recovering in the second quarter. The labour market had continued to tighten and unit labour cost growth had firmed. Given these developments, a 0.25 percentage point increase in Bank Rate was warranted at this meeting to return inflation sustainably to the target.

36 The Committee judged that, were the economy to continue to develop broadly in line with its *Inflation Report* projections, an ongoing tightening of monetary policy over the forecast period would be appropriate to return inflation sustainably to the 2% target at a conventional horizon. All members agreed that any future increases in Bank Rate were likely to be at a gradual pace and to a limited extent.

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

Bank Rate should be increased by 0.25 percentage points, to 0.75%;

The Bank of England should maintain the stock of sterling non-financial investment-grade corporate bonds, financed by the issuance of central bank reserves, at £10 billion;

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

The Committee voted unanimously in favour of all three propositions.

38 The Governor expressed his and the Committee's appreciation to Ian McCafferty for his contribution as a member of the Committee.

39 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
Dave Ramsden, Deputy Governor responsible for markets and banking
Andrew Haldane
Ian McCafferty
Michael Saunders
Silvana Tenreyro
Gertjan Vlieghe

Clare Lombardelli 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, Diana Noble was also present on 26 July as an observer for the purposes of exercising oversight functions in her role as a member of the Bank's Court of Directors.