Bank of England

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 10 May 2023

11 May 2023

These are the minutes of the Monetary Policy Committee meeting ending on 10 May 2023.

They are available at **https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2023/may-2023**.

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 21 June will be published on 22 June 2023.

Monetary Policy Summary, May 2023

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 10 May 2023, the MPC voted by a majority of 7–2 to increase Bank Rate by 0.25 percentage points, to 4.5%. Two members preferred to maintain Bank Rate at 4.25%.

The Committee's updated projections for activity and inflation are set out in the accompanying May Monetary Policy Report. They are conditioned on a market-implied path for Bank Rate that peaks at around 4¾% in 2023 Q4 before ending the forecast period at just over 3½%.

There has been upside news to the near-term outlook for global activity, with UK-weighted world GDP now expected to grow at a moderate pace throughout the forecast period. Risks remain but, absent a further shock, there is likely to be only a small impact on GDP from the tightening of credit conditions related to recent global banking sector developments. Headline inflation has been falling in the United States and euro area, although core inflation measures remain elevated.

UK GDP is expected to be flat over the first half of this year, although underlying output, excluding the estimated impact of strikes and an extra bank holiday, is projected to grow modestly. Economic activity has been less weak than expected in February, and the Committee now judges that the path of demand is likely to be materially stronger than expected in the February Report, albeit still subdued by historical standards. The improved outlook reflects stronger global growth, lower energy prices, the fiscal support in the Spring Budget, and the possibility that a tight labour market leads to lower precautionary saving by households.

Although there are indications that the labour market has started to loosen, it is expected to remain tighter than in the February Report in the near term. The unemployment rate is now projected to remain below 4% until the end of 2024, before rising over the second half of the forecast period to around 4½%.

CPI inflation was 10.2% in 2023 Q1, higher than expected at the time of the February and March MPC meetings, with the upside surprise concentrated in core goods and food prices. Although still elevated, nominal private sector wage growth and services CPI inflation have been close to expectations.

CPI inflation is expected to fall sharply from April, in part as large rises in the price level one year ago drop out of the annual comparison. In addition, the extension in the Spring Budget of the Energy Price Guarantee and declines in wholesale energy prices will both lower the

contribution from household energy bills to CPI inflation. However, food price inflation is likely to fall back more slowly than previously expected. Alongside news in other goods prices, this explains why the Committee's modal expectation for CPI inflation now falls back more slowly than in the February Report.

In the MPC's latest modal projection conditioned on market interest rates, CPI inflation declines to a little above 1% at the two and three-year horizons, materially below the 2% target. This reflects the emergence of an increasing degree of economic slack and declining external pressures that are expected to reduce CPI inflation. However, there remain considerable uncertainties around the pace at which CPI inflation will return sustainably to the 2% target. The Committee continues to judge that the risks around the inflation forecast are skewed significantly to the upside, reflecting the possibility that the second-round effects of external cost shocks on inflation in wages and domestic prices may take longer to unwind than they did to emerge. The mean CPI inflation profile, which incorporates this risk, is at or just below the 2% target in the medium term.

The MPC's remit is clear that the inflation target applies at all times, reflecting the primacy of price stability in the UK monetary policy framework. The framework recognises that there will be occasions when inflation will depart from the target as a result of shocks and disturbances. The economy has been subject to a sequence of very large and overlapping shocks. Monetary policy will ensure that, as the adjustment to these shocks continues, CPI inflation will return to the 2% target sustainably in the medium term. Monetary policy is also acting to ensure that longer-term inflation expectations are anchored at the 2% target.

The Committee has voted to increase Bank Rate by 0.25 percentage points, to 4.5%, at this meeting. In doing so the MPC is continuing to address the risk of more persistent strength in domestic price and wage setting, as represented by the upward skew in the projected distribution for CPI inflation.

The pace at which domestic inflationary pressures ease will depend on the evolution of the economy, including the impact of the significant increases in Bank Rate so far. Uncertainties around the global financial and economic outlook remain elevated.

The MPC will continue to monitor closely indications of persistent inflationary pressures, including the tightness of labour market conditions and the behaviour of wage growth and services price inflation. If there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required.

The MPC will adjust Bank Rate as necessary to return inflation to the 2% target sustainably in the medium term, in line with its remit.

Minutes of the Monetary Policy Committee meeting ending on 10 May 2023

1. Before turning to its immediate policy decision, the Committee discussed: the international economy; monetary and financial conditions; demand and output; and supply, costs and prices. The latest data on these topics were set out in the accompanying May 2023 Monetary Policy Report, available at **https://www.bankofengland.co.uk/monetary-policy-report/2023/may-2023**.

2. The latest international economic data suggested GDP growth had been stronger than the February 2023 Monetary Policy Report forecast across the United Kingdom's main trading partners. The Committee noted that this had reflected different factors across regions. For instance, activity in China, particularly in the service sector, had surprised to the upside following the end of its zero-Covid policy. The euro-area economy had been more resilient than expected to the previous sharp rise in energy prices, while exports had been supported by stronger growth in China. In the United States, a robust labour market and higher post-tax income, following an increase in income tax thresholds that had come into effect from January, had been reflected in stronger-than-expected household consumption. In absolute terms, global output growth was nevertheless expected to remain somewhat weaker than its pre-pandemic average. The Committee also noted that headline inflation, while remaining elevated, had been falling in the United States and euro area, but core inflation measures had been flatter at high rates.

3. In addition to the latest developments in monetary and financial conditions, the Committee discussed the divergence in movements in UK and US market interest rates since the failure of Silicon Valley Bank (SVB). While short-term interest rates in the United Kingdom had risen back to similar levels to those seen before the failure of SVB, those in the United States had remained at around the lower levels reached at the time of SVB's failure. Market contacts had noted that this could, in part, be attributed to both UK-specific factors, such as CPI inflation having been higher than expected, and US-specific factors, where US credit conditions were expected to be somewhat tighter given stresses experienced by medium-sized US banks.

4. Following further signs of improvement in official estimates of UK activity and business surveys, Bank staff had increased their estimate of underlying quarterly GDP growth to around 0.2% during the first half of the year. The Committee discussed the potential factors behind the recent upside news in demand. While high energy and other tradable goods prices had depressed activity, these external shocks were beginning to abate and to a greater degree than assumed in previous forecasts that had been conditioned on higher

prevailing commodities futures prices. Businesses and households also appeared to have been more resilient to the shocks that had crystallised, supported by fiscal policy. For households, spending had been further supported by the strength of the labour market and continuing employment growth, which had boosted incomes and may have reduced the extent of precautionary saving.

5. The Committee discussed how domestic inflationary pressures were evolving. Indicators of tightness, such as the vacancies-to-unemployment ratio and reported recruitment difficulties, continued to point to a loosening in the labour market, albeit they remained high by historical standards. Annual private sector regular pay growth had been close to expectations in recent months, consistent with an easing in higher-frequency pay growth data. But there continued to be a risk that pay growth could plateau at rates above those consistent with meeting the 2% inflation target sustainably in the medium term, if the labour market were to remain tight while households' real incomes were still weak and short-term inflation expectations were elevated. Similarly, businesses might rebuild, and perhaps expand, their margins if demand were to remain firm.

6. Twelve-month CPI inflation had remained just above 10% in March, higher than expected in preceding forecasts. Although services CPI inflation had been in line with expectations, there had been material upside news within food and core goods prices. Food price inflation had reached a new historical high of close to 20%, and this component of the CPI basket was particularly salient for households and hence potentially for their inflation expectations more broadly. Contacts of the Bank's Agents were expecting an easing in cost pressures associated with lower commodity prices and broader improvements in supply conditions to be passed on to consumer goods prices, but this would take some time to work through supply chains. The Committee judged that that process would be slower for food prices than had previously been anticipated.

The immediate policy decision

7. The MPC sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment.

8. Recent UK and global economic developments reinforced the MPC's view at the time of its March meeting that economic activity had been more resilient than expected at the time of the February Report. Bank staff now expected underlying UK GDP to grow by around 0.2% in both 2023 Q1 and Q2, compared to expectations in the February Report of negative growth. There were indications that the labour market had started to loosen. The vacancies-to-unemployment ratio had continued to fall, contacts of the Bank's Agents had reported that recruitment difficulties had eased and staff availability had increased in the latest KPMG/REC UK Report on Jobs. Nonetheless, the labour market was tighter than had been expected in February. Employment growth had been 0.5% in the three months to February, and was

expected to be around 0.2% in 2023 Q2, both stronger than projected in the February Report. The unemployment rate was projected to be flat at 3.8% in Q2, compared to a projection of 4.1% in February.

9. Twelve-month CPI inflation had been higher than expected in 2023 Q1, at 10.2%, reflecting upside news in food and other goods price inflation, while services CPI inflation had been in line with expectations. Annual private sector regular pay growth had been 6.9% in the three months to February, close to the February Report forecast. The KPMG/REC permanent staff salaries index, which had tended to lead the ONS measure of private sector pay growth, had flattened in recent months, following a marked fall since last summer. Indicators of household and business UK inflation expectations had fallen back slightly, but most were still at elevated levels.

10. As set out in the accompanying May Monetary Policy Report, the MPC's updated projections showed that CPI inflation was expected to fall sharply from April, in part as large price rises one year ago dropped out of the annual comparison. In addition, the extension in the Spring Budget of the Energy Price Guarantee and declines in wholesale energy prices would both lower the contribution from household energy bills to CPI inflation. However, updated staff analysis and reports from the Agents' contacts suggested that food price inflation was likely to fall back more slowly than previously expected. Alongside news in other goods prices, this explained why the Committee's modal expectation for CPI inflation now fell back more slowly than in the February Report.

11. Economic activity had been less weak than expected in February, and the Committee now judged that the path of demand was likely to be materially stronger than in the February Report, albeit still subdued by historical standards. The improved outlook reflected stronger global growth, lower energy prices, the fiscal support in the Spring Budget, and the possibility that a tight labour market would lead to lower precautionary saving by households. Given the lags in monetary policy transmission, the increases in Bank Rate since December 2021 were expected to have an increasing impact on the economy in the coming quarters. The unemployment rate was now projected to remain below 4% until the end of 2024, before rising over the second half of the forecast period to around 4½%.

12. In the MPC's latest modal projection conditioned on market interest rates, CPI inflation declined to a little above 1% at the two and three-year horizons, materially below the 2% target. This reflected the emergence of an increasing degree of economic slack and declining external pressures that were expected to reduce CPI inflation.

13. However, there were considerable uncertainties around the pace at which CPI inflation would return sustainably to the 2% target. The Committee continued to judge that the risks to the inflation forecast were skewed significantly to the upside. Staff analysis had explored a range of channels that could be associated with more persistence in wage or price setting in

the current environment. The Committee discussed the possibility that the second-round effects of external cost shocks on inflation in wages and domestic prices could take longer to unwind than they had to emerge. These risks were inherently difficult to quantify precisely, which had motivated the Committee's choice to include them in the skew rather than the modal projection. The mean CPI inflation profile, which incorporated this risk, was at or just below the 2% target in the medium term.

14. The Bank of England's Financial Policy Committee (FPC) had continued to brief the MPC about recent banking sector developments. The FPC continued to judge that the UK banking system was resilient, maintaining robust capital and strong liquidity positions. It was resilient to the current economic outlook, and had the capacity to support the economy in a period of higher interest rates even if economic conditions were worse than forecast. The FPC was monitoring developments in other jurisdictions closely in light of the risk that indirect spillovers from overseas banks impacted the wider UK financial system.

15. The impact of recent global banking sector developments on domestic credit conditions and hence UK GDP was expected to be small. The MPC would continue to monitor closely any effects on the credit conditions faced by households and businesses.

16. The MPC's remit was clear that the inflation target applied at all times, reflecting the primacy of price stability in the UK monetary policy framework. The framework recognised that there would be occasions when inflation would depart from the target as a result of shocks and disturbances. The economy had been subject to a sequence of very large and overlapping shocks. Monetary policy would ensure that, as the adjustment to these shocks continued, CPI inflation returned to the 2% target sustainably in the medium term. Monetary policy was also acting to ensure that longer-term inflation expectations were anchored at the 2% target.

17. Seven members judged that a 0.25 percentage point increase in Bank Rate, to 4.5%, was warranted at this meeting. It was important to continue to address the risk of more persistent strength in domestic price and wage setting, as represented by the upward skew in the projected distribution for CPI inflation. CPI inflation had been stronger than expected, owing to higher food and other goods prices, although services CPI inflation and wage growth, while still elevated, had been close to expectations. There were indications that the labour market had begun to loosen, but the path of unemployment was projected to be lower than in February. GDP growth had also been stronger than expected, and was expected to be higher over much of the forecast period than in February. For these members, there had been repeated surprises about the resilience of demand, while the labour market had remained tight. These were circumstances in which domestic price pressures risked becoming more persistent. In the May Report projections, CPI inflation was projected to take longer to return to the 2% target, conditioned on a higher path for Bank Rate. There remained a risk that the second-round effects of external cost shocks on inflation in wages and

domestic prices could take longer to unwind than they had to emerge. A 0.25 percentage point increase in Bank Rate would better manage the upside risks to the inflation outlook, in the context of a more prolonged return of inflation to target and materially stronger projected demand.

18. Two members preferred to leave Bank Rate unchanged at 4.25% at this meeting. As the effects of the energy price shock and other cost-push shocks unwound, headline CPI inflation should fall sharply over 2023, which would also reduce associated persistence in domestic price setting. At the same time, the lags in the effects of monetary policy meant that sizeable impacts from past rate increases were still to come through. That implied the current setting of Bank Rate would be likely to reduce inflation to well below target in the medium term. As the policy setting had become increasingly restrictive, this would bring forward the point at which recent rate increases would need to be reversed.

19. The pace at which domestic inflationary pressures eased would depend on the evolution of the economy, including the impact of the significant increases in Bank Rate so far. Uncertainties around the global financial and economic outlook remained elevated.

20. The MPC would continue to monitor closely indications of persistent inflationary pressures, including the tightness of labour market conditions and the behaviour of wage growth and services price inflation. If there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required.

21. The MPC would adjust Bank Rate as necessary to return inflation to the 2% target sustainably in the medium term, in line with its remit.

22. The Chair invited the Committee to vote on the proposition that:

> Bank Rate should be increased by 0.25 percentage points, to 4.5%.

23. Seven members (Andrew Bailey, Ben Broadbent, Jon Cunliffe, Jonathan Haskel, Catherine L Mann, Huw Pill and Dave Ramsden) voted in favour of the proposition. Two members (Swati Dhingra and Silvana Tenreyro) voted against the proposition, preferring to maintain Bank Rate at 4.25%.

Operational considerations

24. On 10 May 2023, the total stock of assets held for monetary policy purposes was £816 billion, comprising £813 billion of UK government bond purchases and £2.7 billion of sterling non-financial investment-grade corporate bond purchases.

25. In February 2022, the MPC had voted to unwind fully the stock of sterling non-financial investment-grade corporate bond purchases no earlier than towards the end of 2023. In

December 2022, the Committee had noted that it was content with the initial rate of reduction in the stock which, if sustained, would permit an earlier unwind of the portfolio than originally anticipated.

26. Consistent with those indications, corporate bond sales had continued to progress and had been absorbed smoothly by the market. The sales programme was expected to conclude in coming weeks after which a small number of very short maturity bonds would continue to be held, as announced by the Bank at the outset of the sales programme, maturing fully by 5 April 2024.

27. The following members of the Committee were present:

Andrew Bailey, Chair
Ben Broadbent
Jon Cunliffe
Swati Dhingra
Jonathan Haskel
Catherine L Mann
Huw Pill
Dave Ramsden
Silvana Tenreyro

James Bowler was present as the Treasury representative.

28. As permitted under the Bank of England Act 1998, as amended by the Bank of England and Financial Services Act 2016, David Roberts was also present on 2 and 4 May, as an observer for the purpose of exercising oversight functions in his role as a member of the Bank’s Court of Directors.