MPC MEMBERS

COPIES OF THE JUNE 2015 PRE-MPC MEETING PRESENTATIONS

In advance of the MPC meeting, please find attached copies of all presentations given at the June 2015 Pre-MPC meeting.

Monetary Policy COO Division (TS-02)
26 May 2015

1: Financial Markets

Financial Markets

June 2015 Pre-MPC
SMD, MFAD & FED

Plan

- Short rates and MI views on the UK curve
- Rise in long-rates and spillover to risky asset prices
- Inflation breakevens
- Sterling

UK election summary slide

Variable		4pm 7 May	10am 8 May	Change
1Y1Y OIS	UK	0.97	0.94	- 2 bps
	US	1.07	1.05	- 2 bps
	Euro area	-0.08	-0.09	0 bps
10Y government bond yields	UK	1.93	1.86	- 7 bps
	US	2.21	2.16	- 5 bps
	Germany	0.58	0.59	0 bps
FX	GBP/USD	1.52	1.55	+ 1.8 %
	GBP/EUR	1.35	1.38	+ 2.1 %
Equities	FTSE 100	6889.20	6989.61	+ 1.5 %

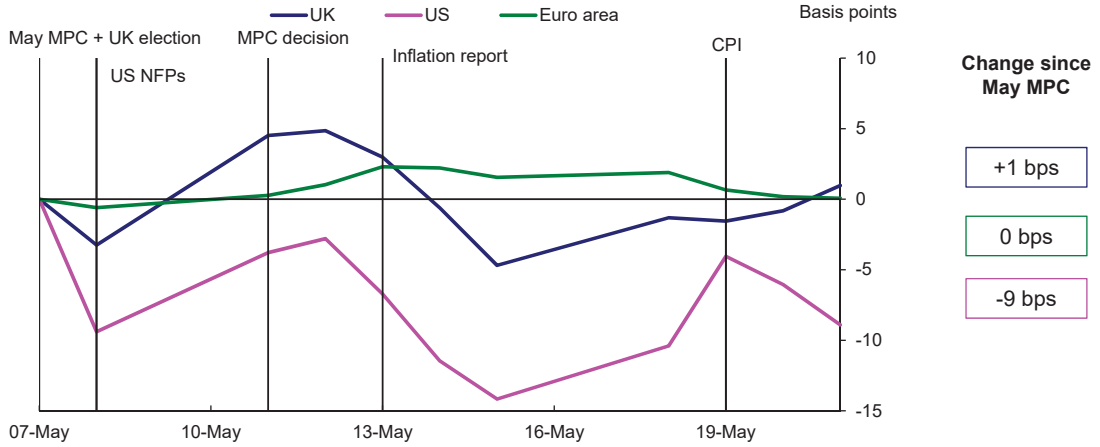
- Se (8th May)

Short rates and MI views on the UK curve

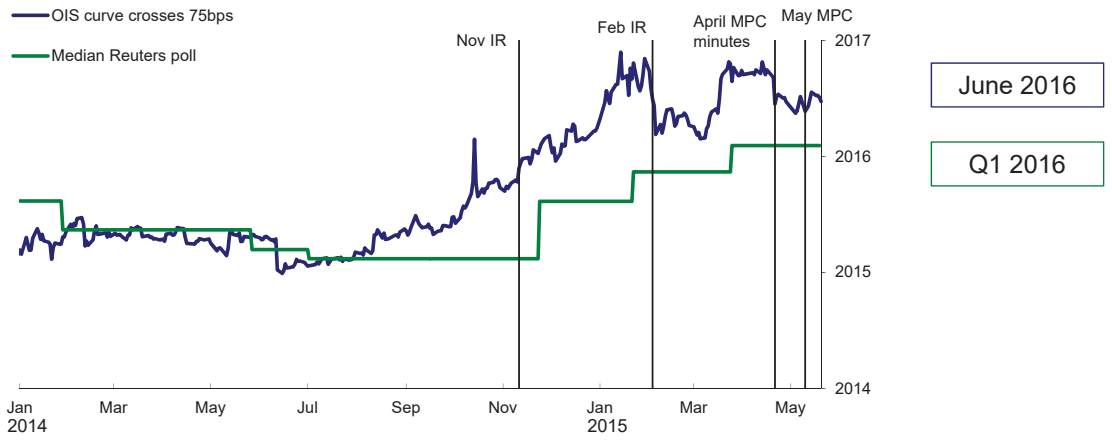
Inflation Report reaction - MI

- Central expectations were for a broadly neutral tone, little changed from February and the April minutes.
- Initial Bloomberg headlines focussed on cut in growth forecasts for 2015-2017, consistent with a slight fall in rates.
- At the margin, some contacts felt that the *Report* was dovish – because it validated a slightly lower curve (despite CPI being a touch above target at year 3).
- Only limited attention to view that the 'terminal rate' was likely to rise as the effects of the crisis faded.
- Overall, the brokers' narrative was very balanced; IR seen as "straight down the middle".

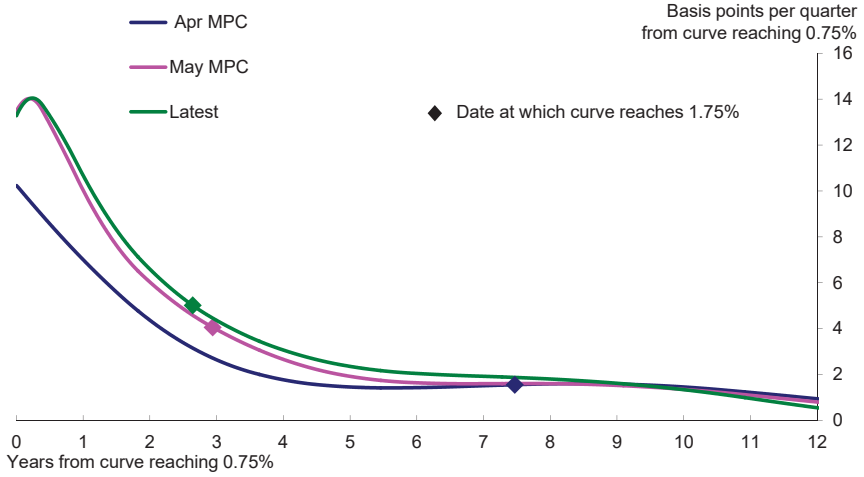
UK, US and euro area 1-year, 1-year OIS rate



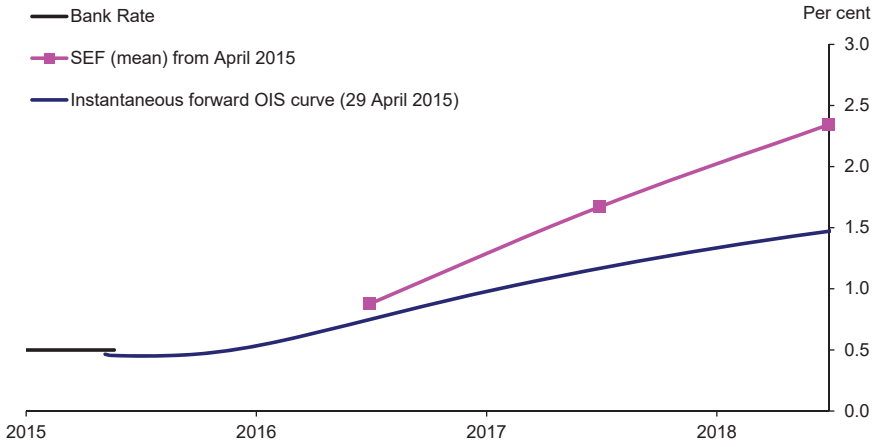
Point at which forward OIS curve crosses 0.75%



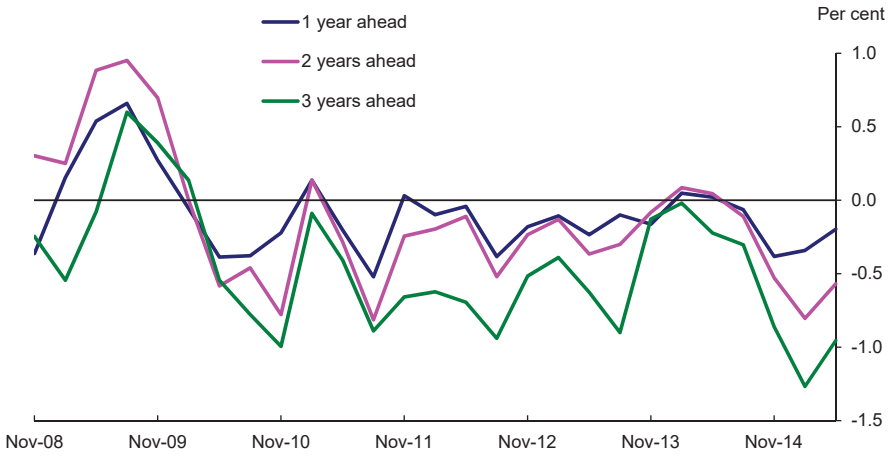
Pace of tightening



Bank Rate forecasts

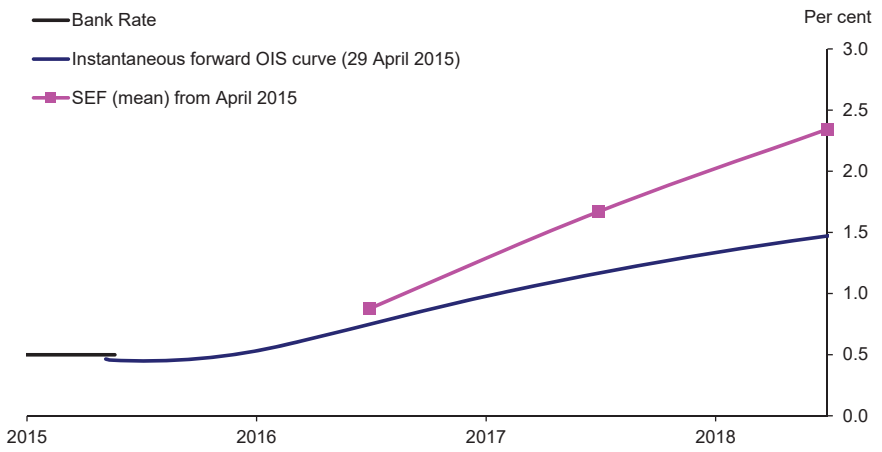


Market vs Economists estimates

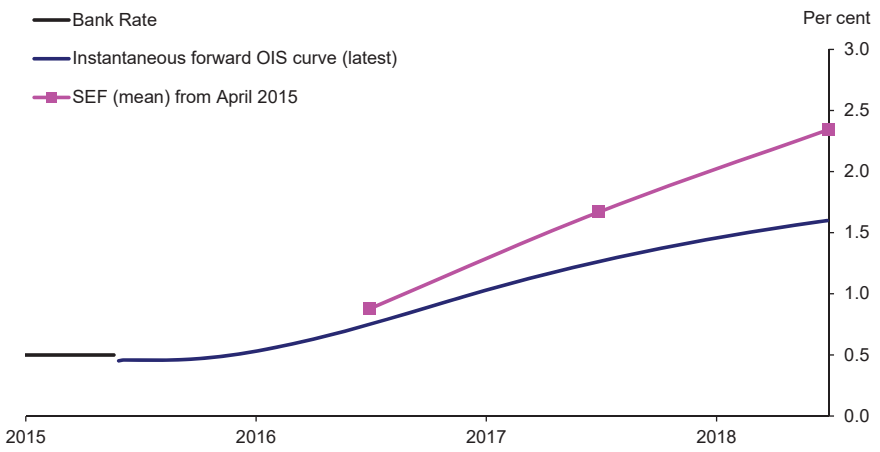


- Size of gap between economists and OIS widened since late 2014 – particularly at 3Y point.

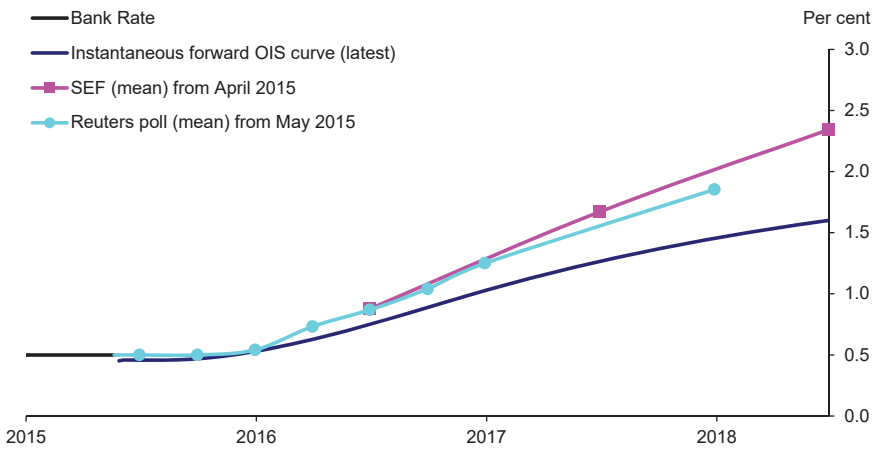
Bank Rate forecasts



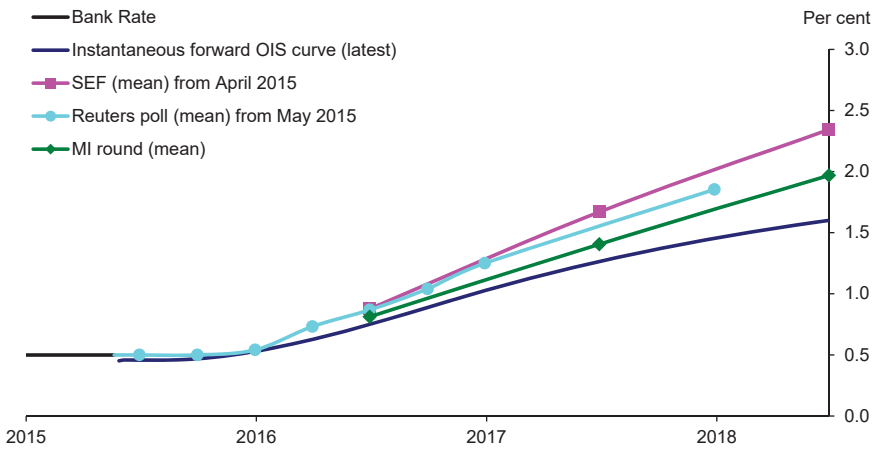
Bank Rate forecasts



Bank Rate forecasts



Bank Rate forecasts



MI round – why are contacts' expectations above the curve

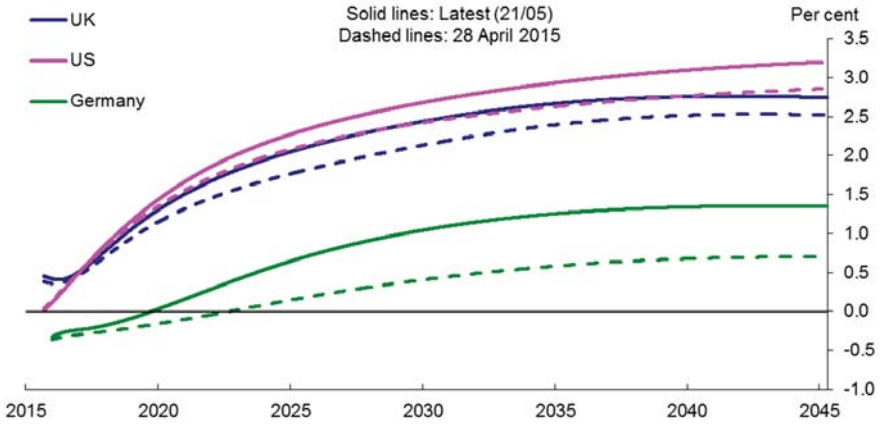
- Greater uncertainty - big downside risks (e.g. Greek exit, renewed global slowdown); the level of the terminal rates; and bigger shocks hitting markets
- Lower focus on short sterling until get to key 'milestones' – e.g. votes for UK hikes; FOMC getting ready to move
- Structurally lower willingness to take positions given absence of bank prop desks
- Spill-overs from ECB QE, as negative yields in Europe encourage reallocation to £ and $ markets.

Summary

- Gap between contacts' expectations and the market curve has narrowed over the past month; curve steepening dependent on UK wages, hike votes or FOMC

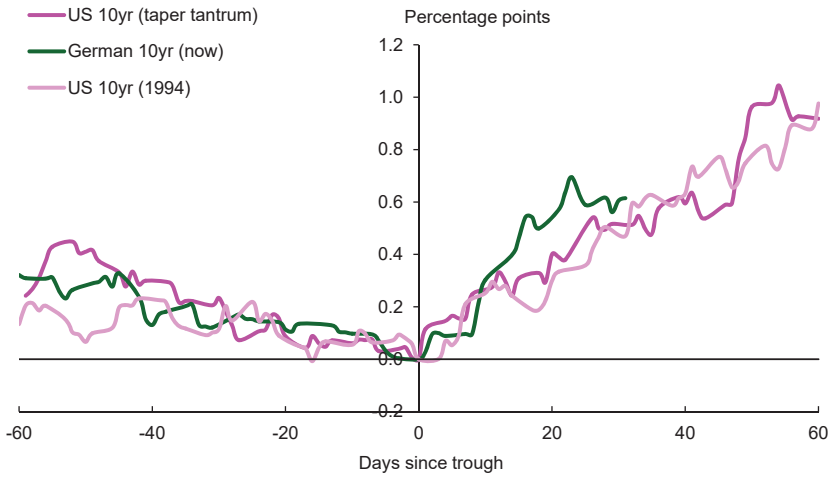
Rise in long-rates and spillover to risky asset prices

International spot yield curves



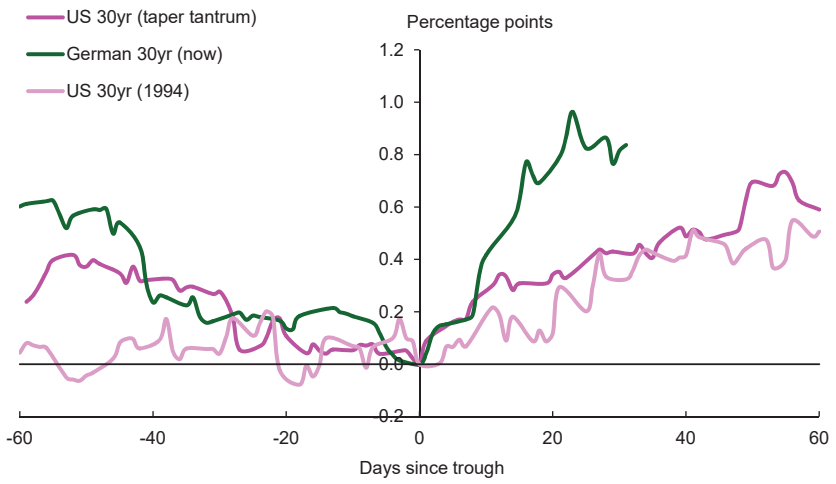
- Large moves in yields across gilts, bunds and treasuries

Putting pace of bund sell-off in context



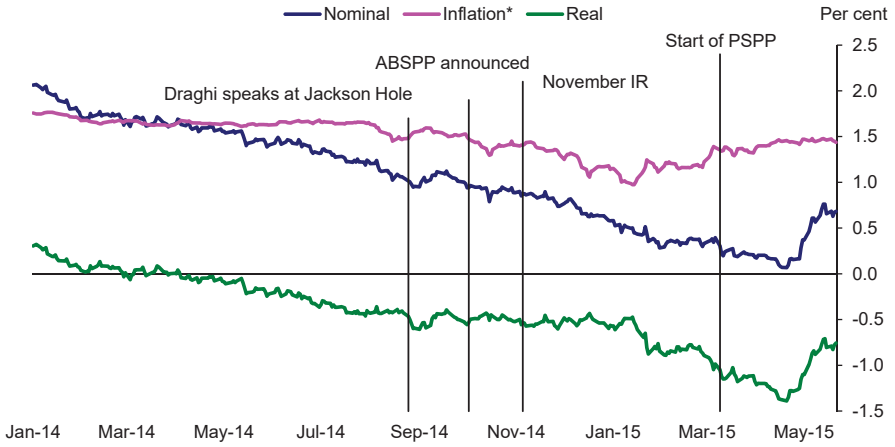
- The move in bunds has been both large and rapid…

Putting pace of bund sell-off in context



- …especially in the 30-year bond

Nominal, real and breakeven 10Y spot Bund decomposition



Change since May MPC

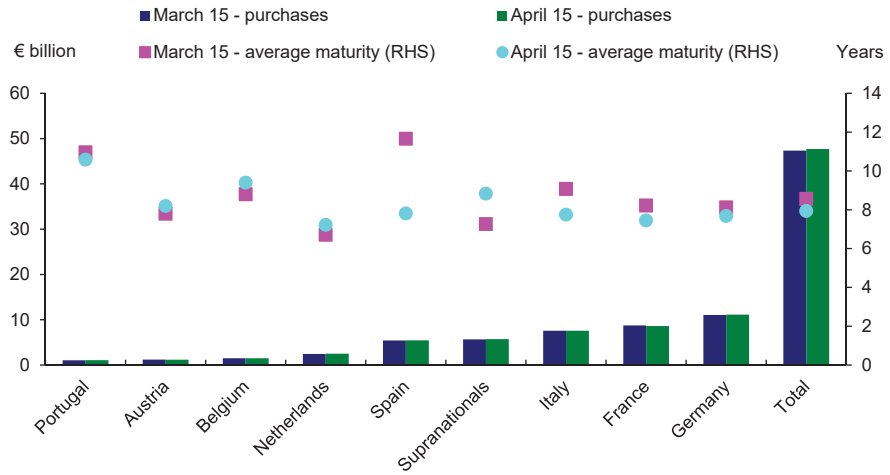
-1 bps

+7 bps

+8 bps

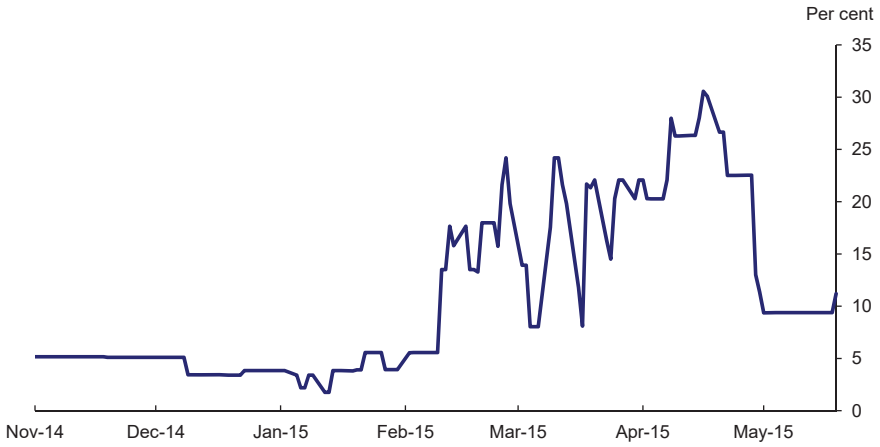
*10-year inflation swap rates for the Euro Area

ECB PSPP update

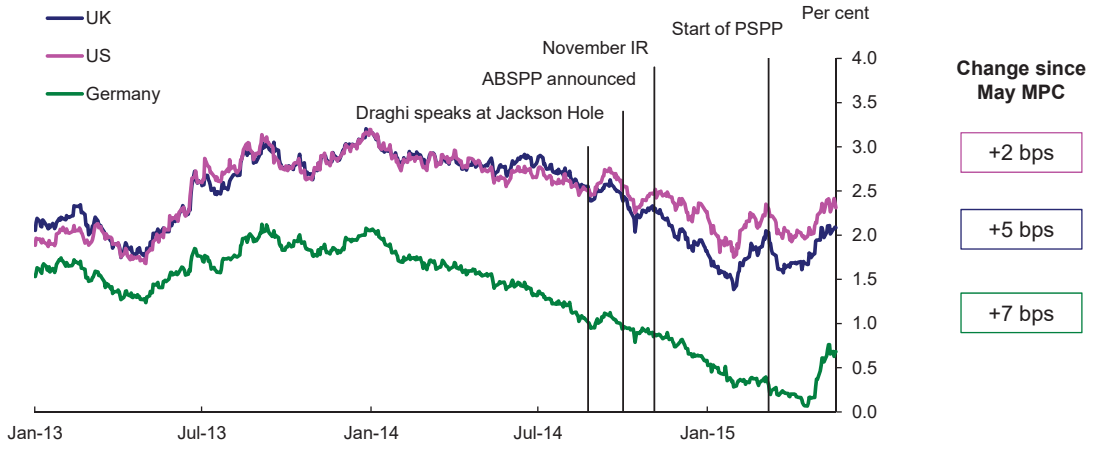


- Weighted average maturity of German purchases a touch down in April

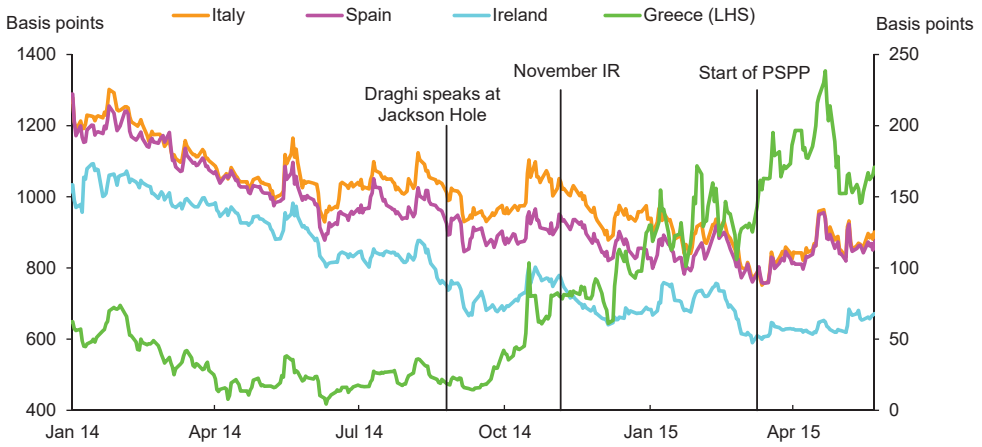
Share of Bunds with yields less than deposit rate of -0.20%



International 10-year nominal government bond yields



10-year euro area periphery spreads to bunds

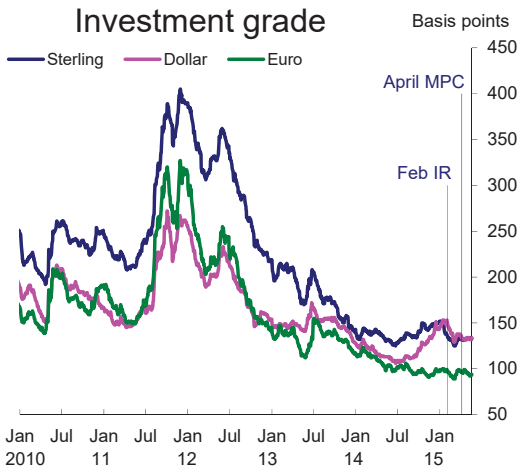


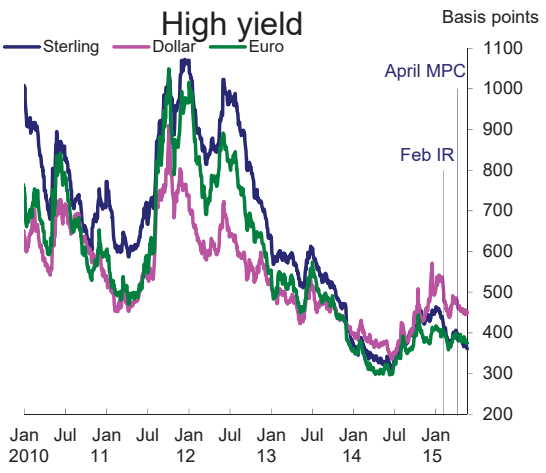
- Peripheral spreads little changed on the month – except for Greece…

Greece Update

12-May	Greece repays **€768mn** to the IMF, including **€650mn** of SDRs held at the Fund
21-May	ECB increases ELA funding ceiling to €80.2bn
27-May	Civil service salaries and pensions- **€2.5bn**
05-Jun	IMF repayment- **€312mn**
12-Jun	IMF repayment- **€351mn** T-Bill redemption- **€2.0bn** & **€1.6bn**
16-Jun	IMF repayment- **€584mn**
18-Jun	Eurogroup meeting
19-Jun	IMF repayment- **€350mn**, ECB bond coupon payment- **€85mn**, T-Bill redemption- **€1.6bn**
25-Jun	European Council meeting
27-Jun	Civil service salaries and pensions- **€2.5bn**
End-June	Current loan agreement extension expires
4-Jul	ECB to decide whether to extend ELA access for Greek banks
10-Jul	T-Bill redemption- **€2bn**
20 July	Principle bond repayment to the ECB – **€3.5bn**
20-Aug	Principle bond repayment to the ECB – **€3.2bn**

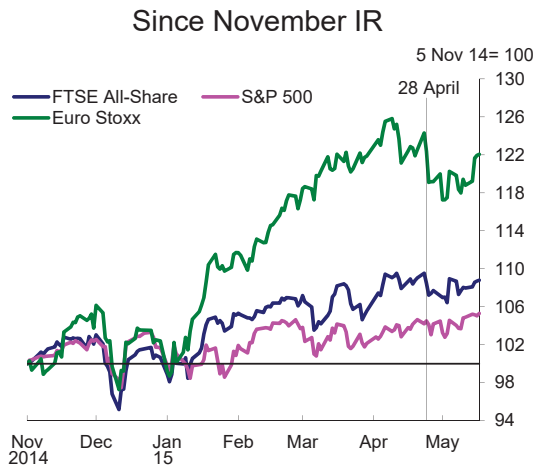
Corporate bond spreads

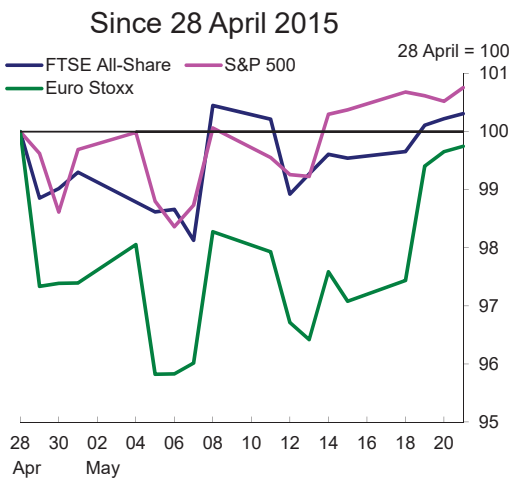




- Corporate bond spreads little changed. European issuance falls sharply during market volatility
- US corporate issuance continues apace – IG issuance at YTD record (c$370bn)

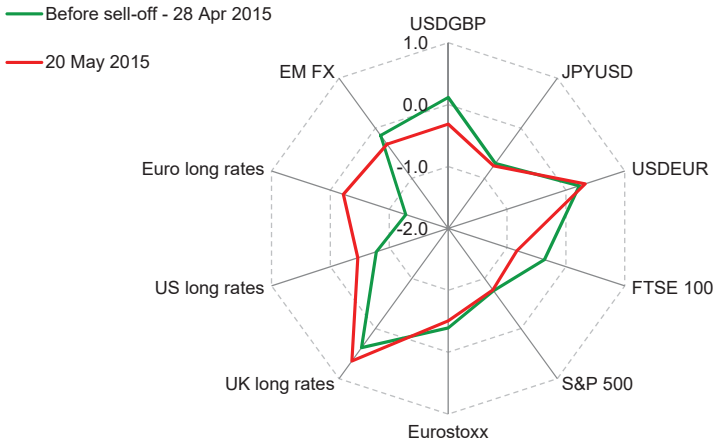
Equity market indices





- European equities recover following the bund sell off; US and UK equities remain strong
- Chinese equities up 8.5% in the last week; over 40% year-to-date

Limited spill over to other asset classes



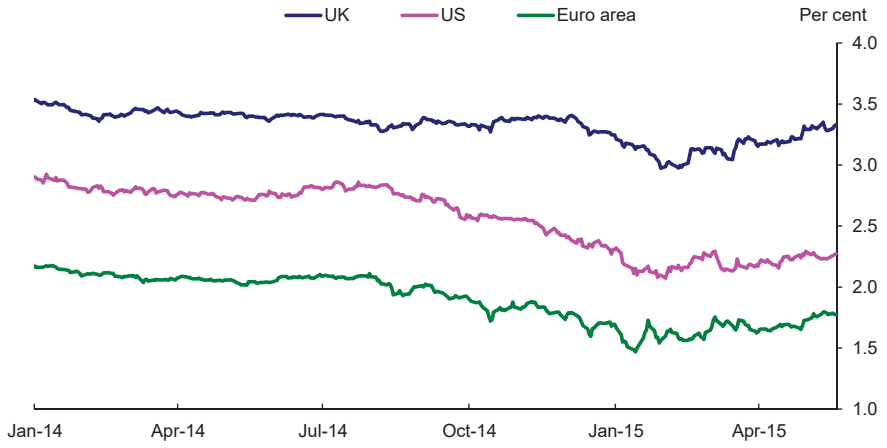
Summary

- Gap between contacts' expectations and the market curve has narrowed over the past month; curve steepening dependent on UK wages, hike votes or FOMC

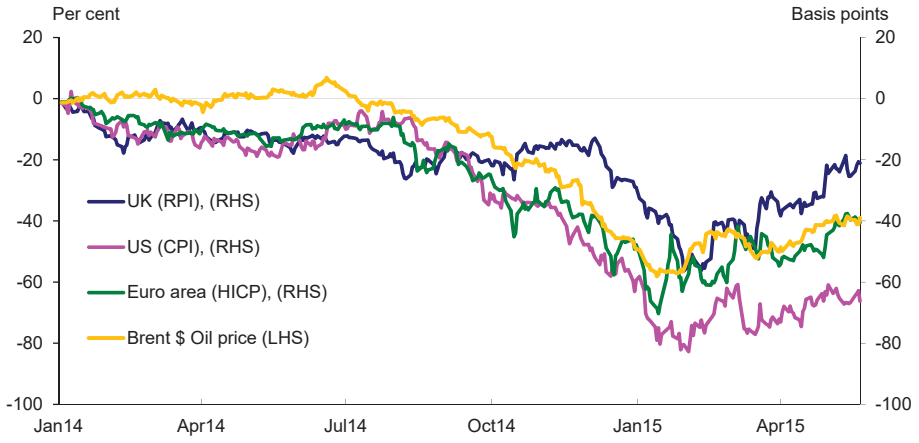
- Large bund sell off spills over to other core fixed income markets; but limited spillover to corporate credit, equities and volatilities. Market ascribes much of move to unwinding of exuberance in light of design of ECB operations

Inflation breakevens

5-year, 5-year inflation swap rates



Changes in oil prices and 5-year, 5-year inflation expectations

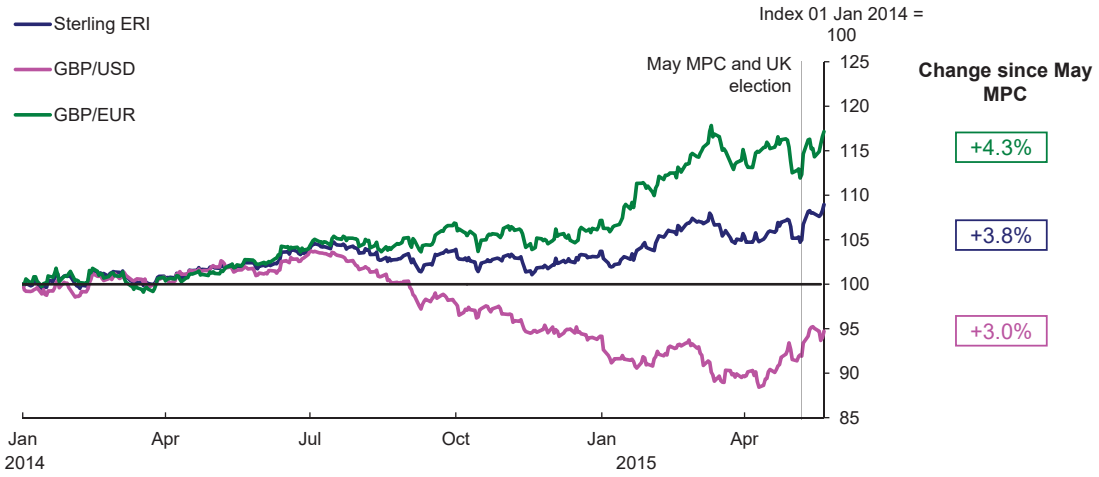


Summary

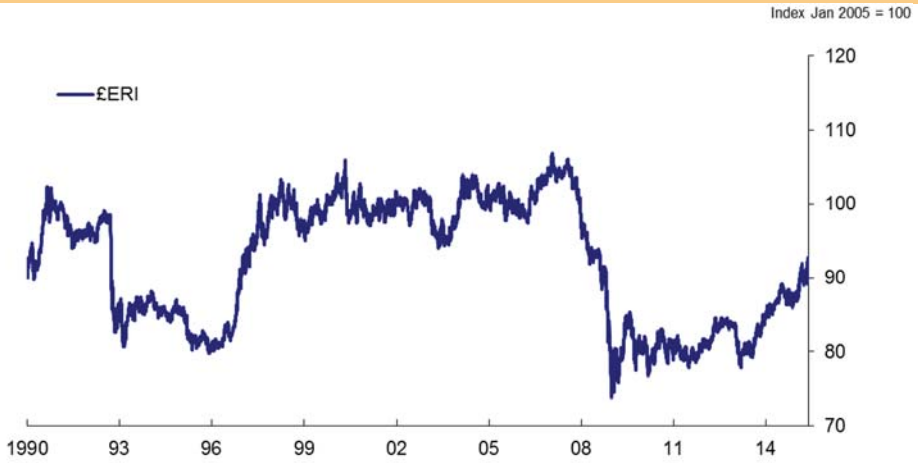
- Gap between contacts' expectations and the market curve has narrowed over the past month; curve steepening dependent on UK wages, hike votes or FOMC
- Large bund sell off spills over to other core fixed income markets; but limited spillover to corporate credit, equities and volatilities. Market ascribes much of move to unwinding of exuberance in light of design of ECB operations
- UK breakevens higher through 2015 – back to levels around the middle of last year. Oil plays a part, along with other market technical factors

Sterling

Sterling ERI and main bilaterals since 2014



Sterling Effective ERI



- ERI up 20% since the recent trough in 2013. Now close to August 2008 levels.

Summary

- Gap between contacts' expectations and the market curve has narrowed over the past month; curve steepening dependent on UK wages, hike votes or FOMC
- Large bund sell off spills over to other core fixed income markets; but limited spillover to corporate credit, equities and volatilities. Market ascribes much of move to unwinding of exuberance in light of design of ECB operations
- UK breakevens higher through 2015 – back to levels around the middle of last year. Oil and global monetary policy plays a part, along with other market technical factors
- £ ERI up on the month – driven in part by election. Now close to August 2008 levels.

2: Money, Credit and Nominal Trends

MONEY, CREDIT AND NOMINAL TRENDS June 2015

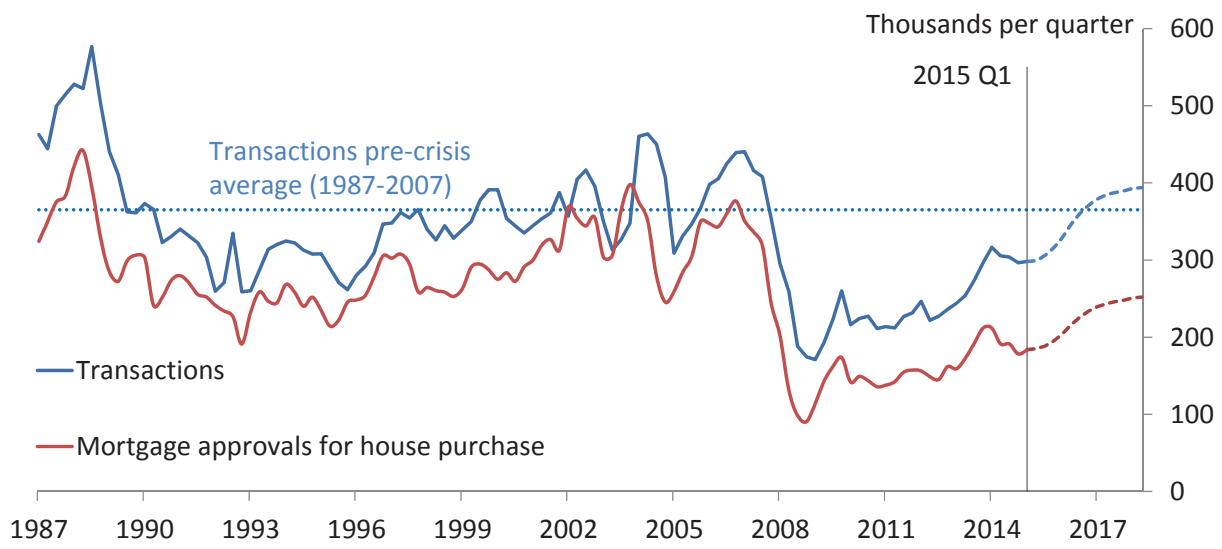
Plan for today

- What factors might affect the level of housing transactions in the medium term?
- What should we make of the recent strength of consumer credit growth?
- Latest on inflation expectations.

Plan for today

- **What factors might affect the level of housing transactions in the medium term?**
- **What should we make of the recent strength of consumer credit growth?**
- **Latest on inflation expectations.**

Housing market activity rises steadily over the forecast

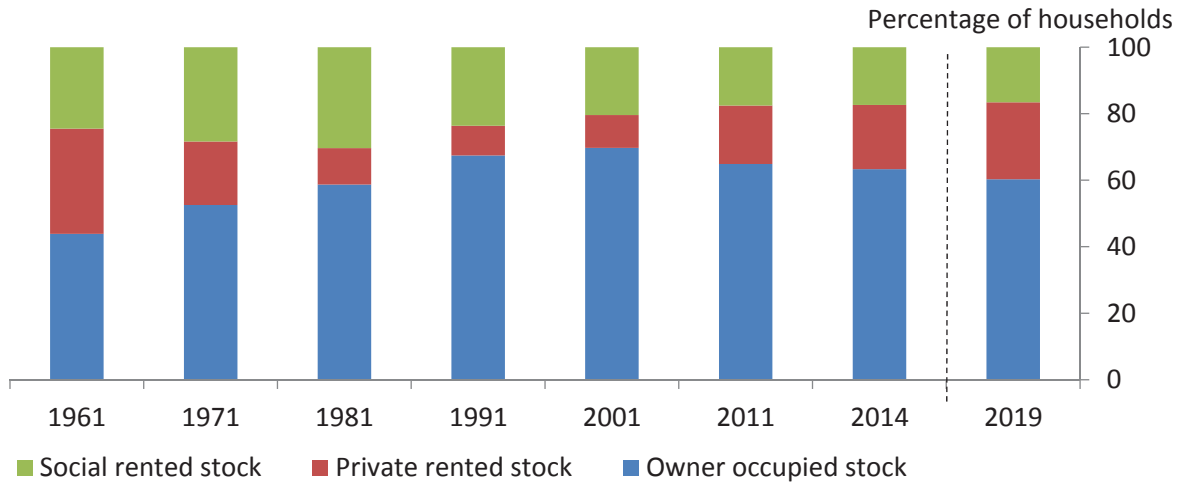


Factors with persistent effects on housing transactions

Factor	Possible effect on medium-term transactions, relative to early 2000s
Tenure – a shift from owner occupation to the private rental sector	
Demographics – an ageing population	
Changes in **stamp duty**	
Persistent effects operating through the **mortgage market**	

The renaissance of the private rental sector may weigh persistently on transactions...

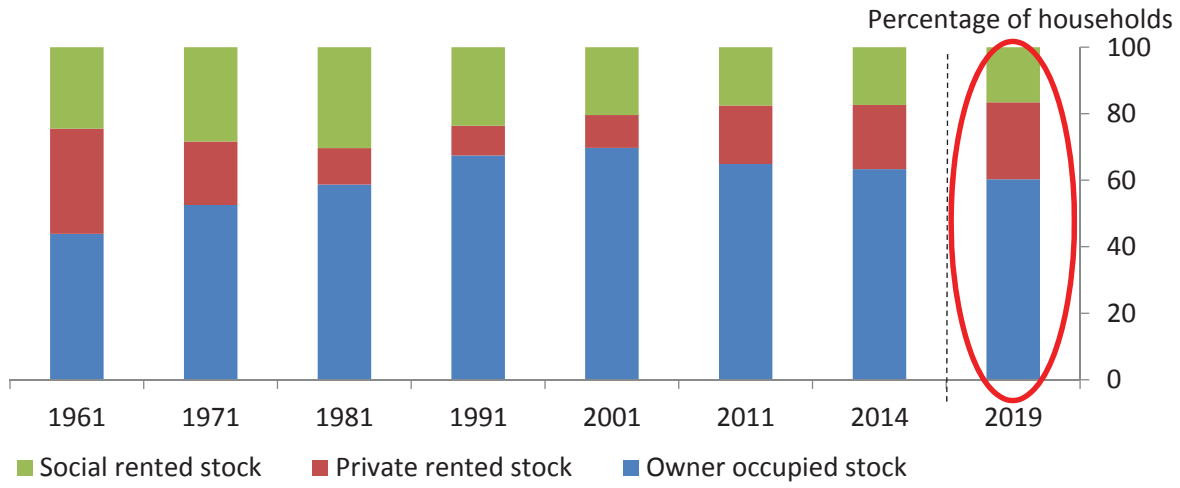
Households' tenure distribution



Sources: Housing stock data from DCLG; 2019 projection from Savills

The renaissance of the private rental sector may weigh persistently on transactions...

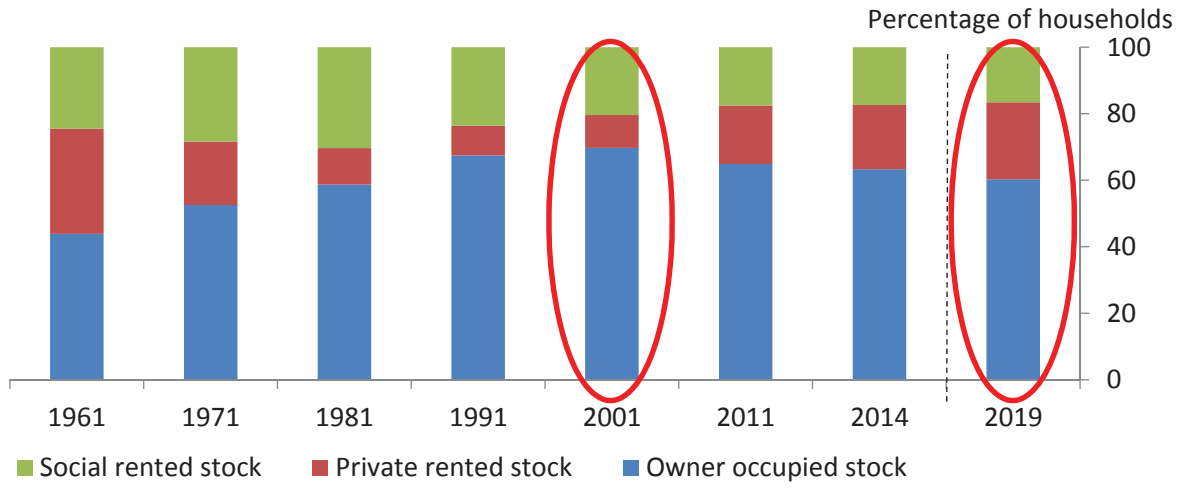
Households' tenure distribution



Sources: Housing stock data from DCLG; 2019 projection from Savills

The renaissance of the private rental sector may weigh persistently on transactions...

Households' tenure distribution

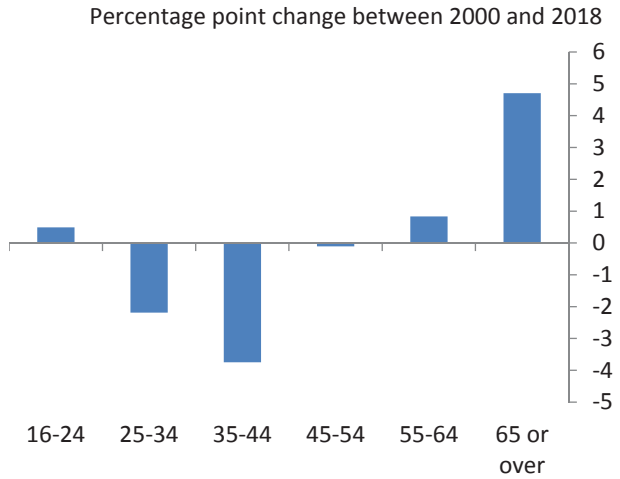


Sources: Housing stock data from DCLG; 2019 projection from Savills

- Change in housing tenure mix since early 2000s could weigh on transactions by up to 4% at MPC's forecast horizon

...as might an ageing population

Age distribution of the population



Source: ONS population projections

Owner occupiers' time in current home

Age	Length of Residence	
	Mean	Median category
25 to 34	5.1yrs	3-4yrs
35 to 44	8.6yrs	5-9yrs
45 to 54	14.0yrs	10-19yrs
55 to 64	18.6yrs	10-19yrs

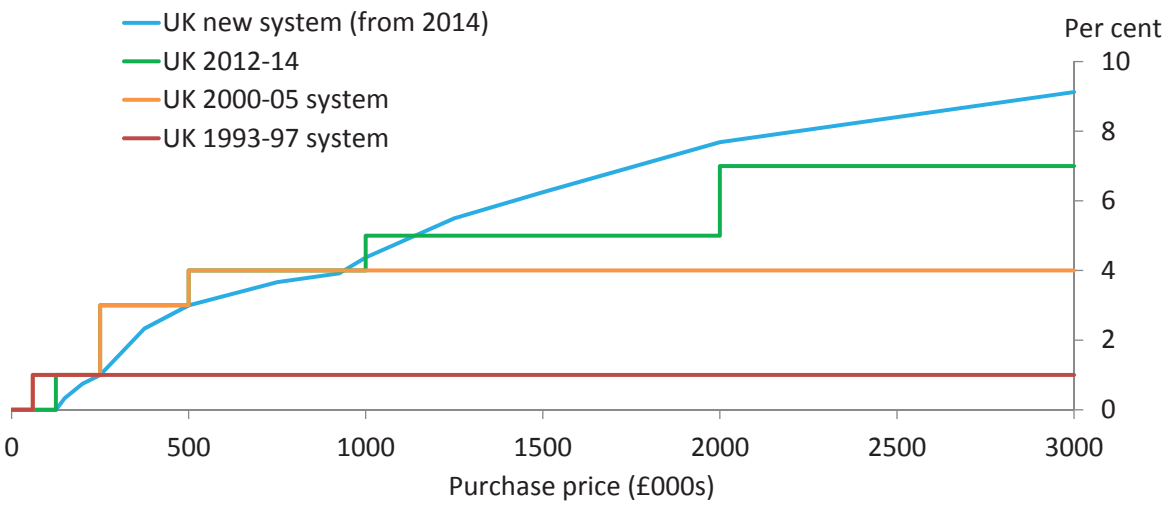
Source: English Housing Survey 2012-13

- Ageing of population since early 2000s cold also weigh on transactions by up to 4% at MPC's forecast horizon.

Factors with persistent effects on housing transactions

Factor	Possible effect on medium-term transactions, relative to early 2000s
Tenure – a shift from owner occupation to the private rental sector	Material and ongoing
Demographics – an ageing population	Material and ongoing
Changes in **stamp duty**	
Persistent effects operating through the **mortgage market**	

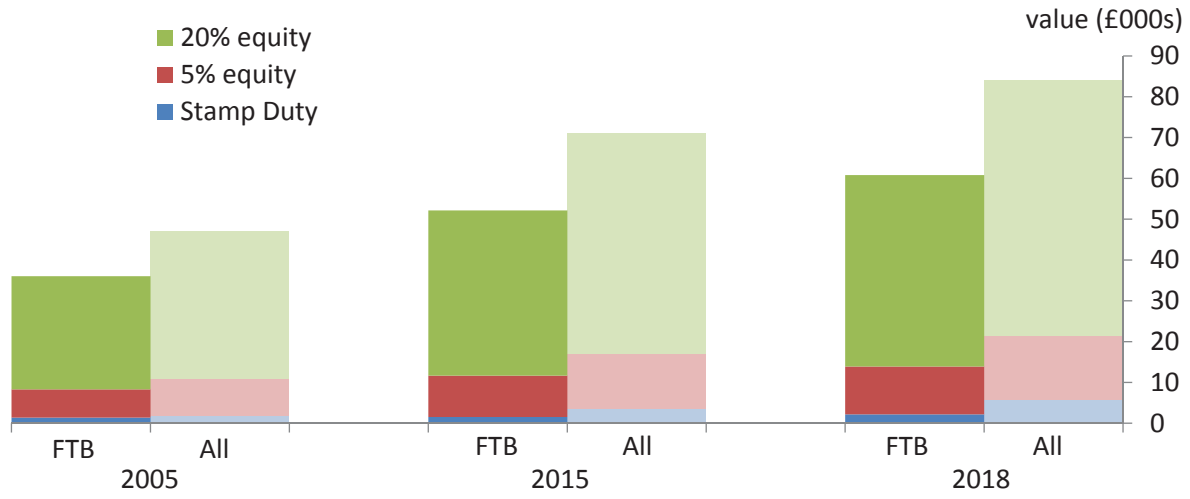
Effective stamp duty rates



Excludes stamp duty holidays

- Effective rates have only increased since 2000 for sales over £1.25m, accounting for around 1% of transactions.

Stamp duty relative to possible deposits

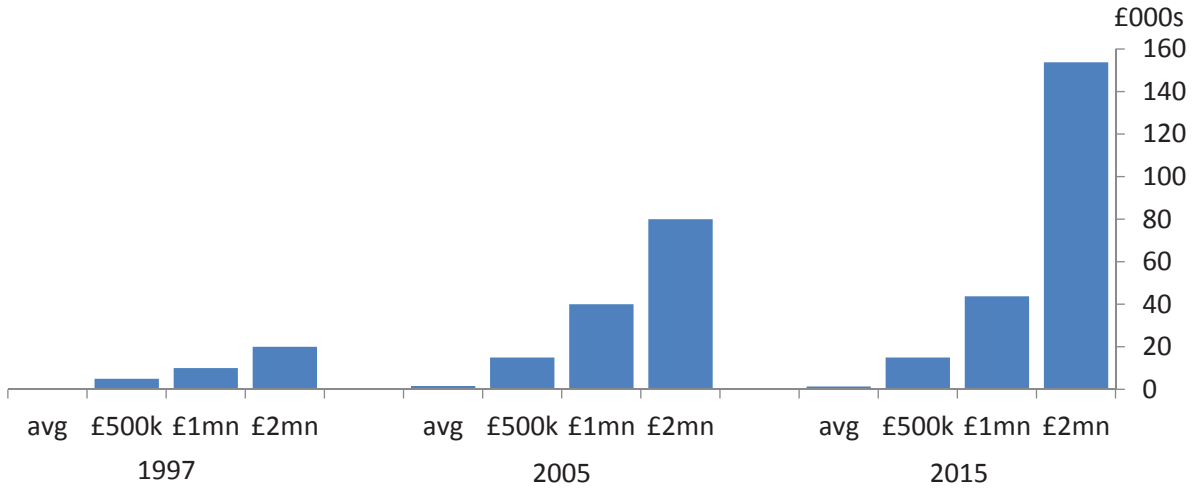


Based on ONS average house prices

- Stamp duty obligations have not increased much at the lower end of the housing market, and remain small relative to deposit requirements.

Stamp duty obligations

Stamp duty costs of buying a house at different values



- In 2013, around 5% of transactions were for houses above £500k, with 1% above £1mn and only 0.4% above £2mn

Persistent changes in the mortgage market

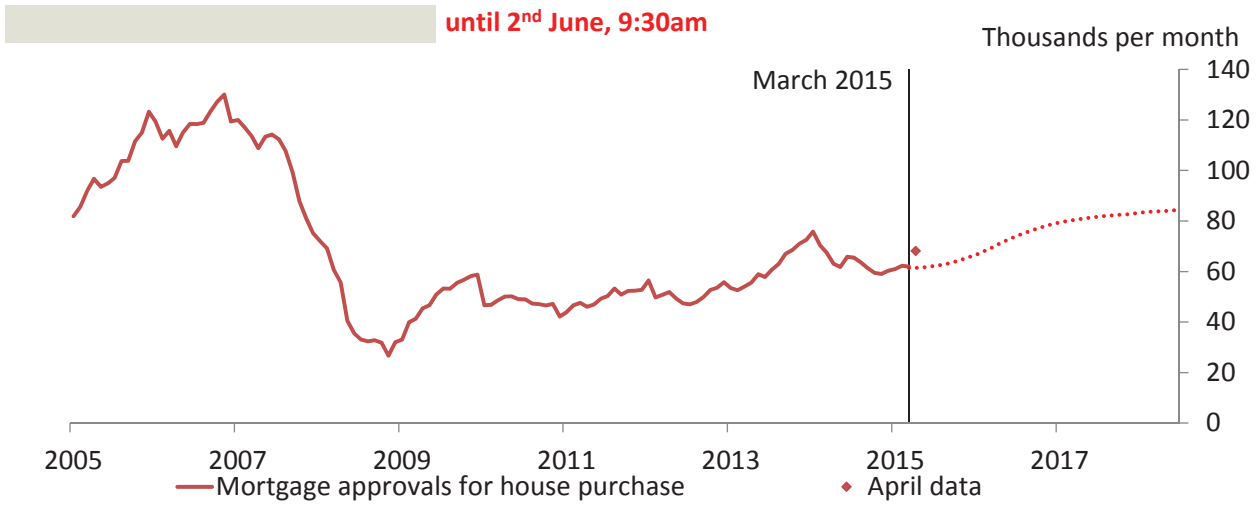
Relative to early 2000s, transactions may be lower due to:

- **LTV tiering**: banks price discriminating more across LTVs
- **Trapped mortgagors**: up to a quarter of mortgagors may not be able to refinance
- **Self restrained:** up to a quarter of mortgagors currently paying rates below 2.5%

Factors with persistent effects on housing transactions

Factor	Possible effect on medium-term transactions, relative to early 2000s
Tenure – a shift from owner occupation to the private rental sector	Material and ongoing
Demographics – an ageing population	Material and ongoing
Changes in **stamp duty**	Small proportion of sales directly affected, but possible spillovers
Persistent effects operating through the **mortgage market**	Likely to be material over forecast period

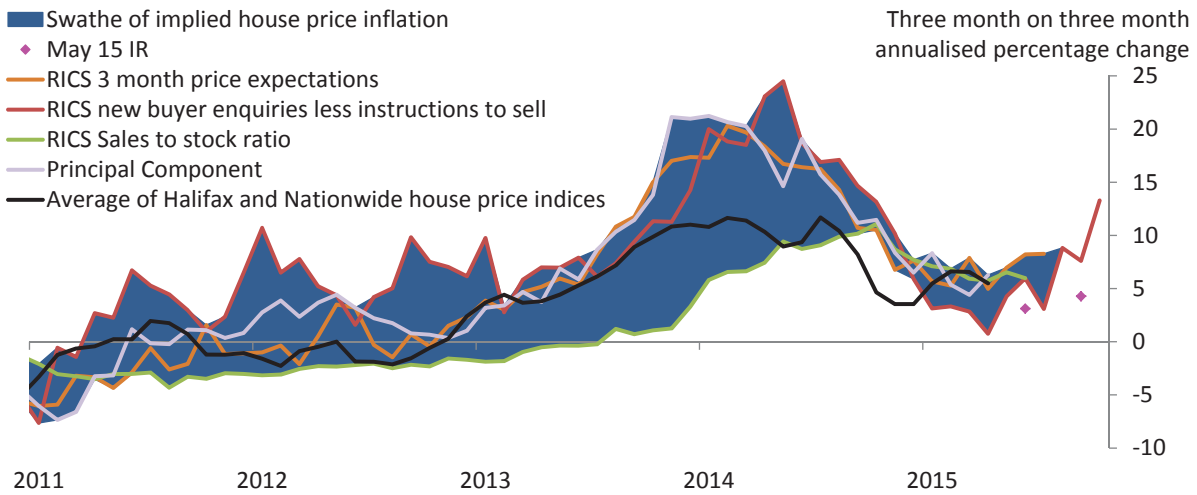
Upside risks to activity from latest approvals data



- May IR Monitoring Judgement: mortgage approvals will pick up to average 65,000 a month in Q4. April: 68,000.

Upside risks to the near-term forecast for house prices

Swathe* of leading indicators of UK house price inflation

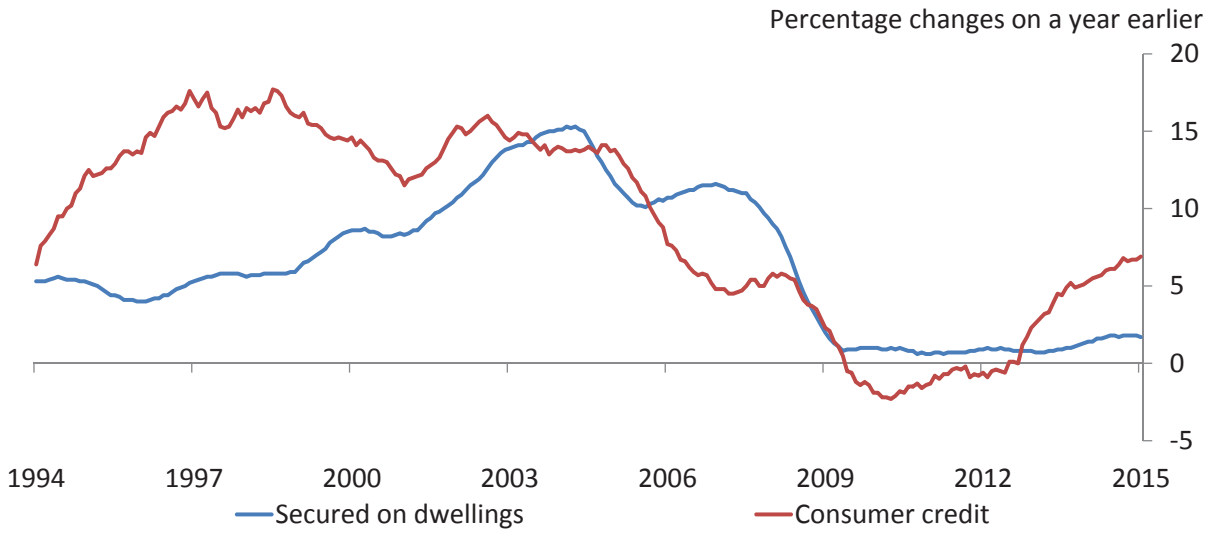


*Swathe includes: RICS new buyer enquiries less instructions to sell (lagged 6 months); RICS three month ahead price expectations (lagged 3 months); RICS sales to stock ratio (lagged 3 months); and a principal component of house prices.

Plan for today

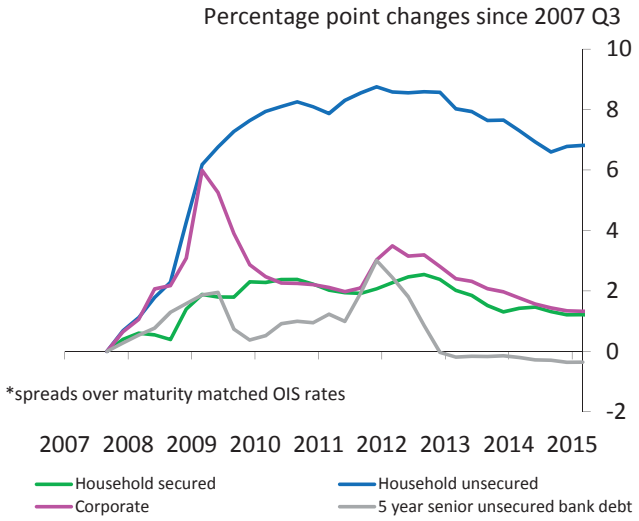
- What factors might affect the level of housing transactions in the medium term?
- **What should we make of the recent strength of consumer credit growth?**
- Latest on inflation expectations.

Household borrowing

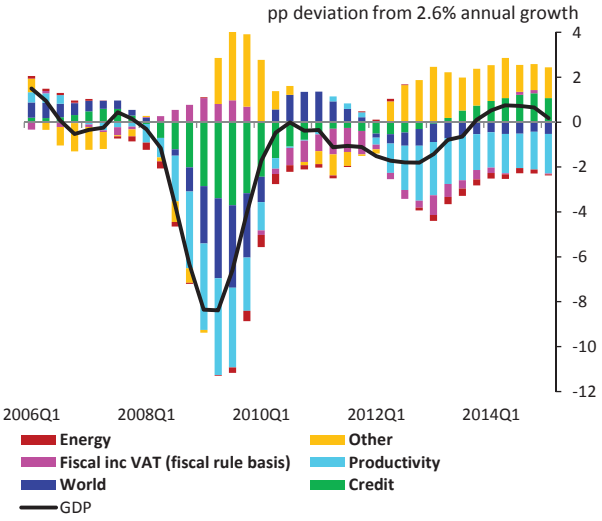


Unsecured lending conditions can have a sizeable impact on GDP

Credit spreads by sector and bank funding spreads*



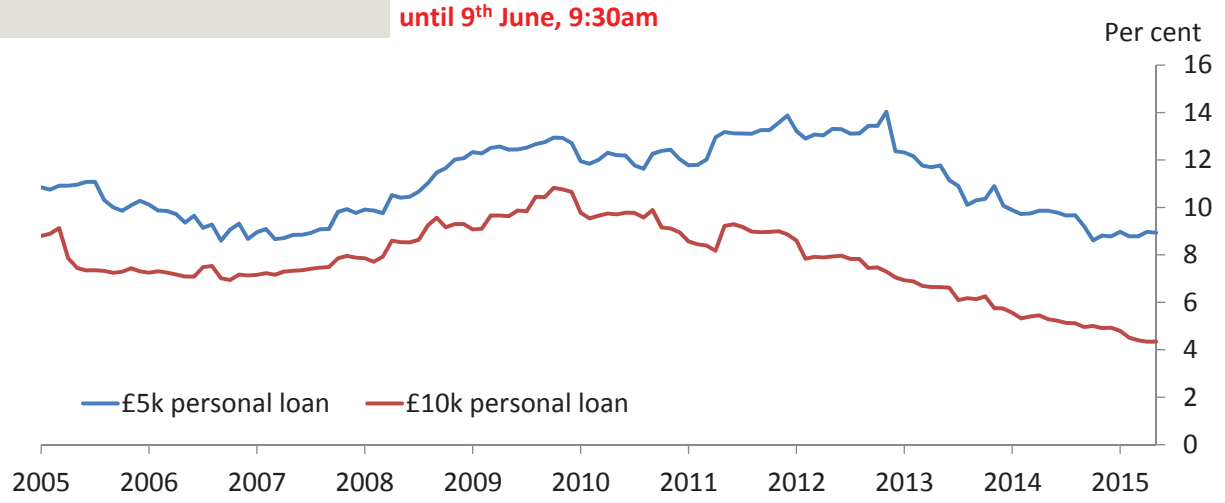
Decomposition of GDP growth



Changes to nature and intensity of competition easing supply conditions in consumer credit markets

Quoted rates on unsecured personal loans

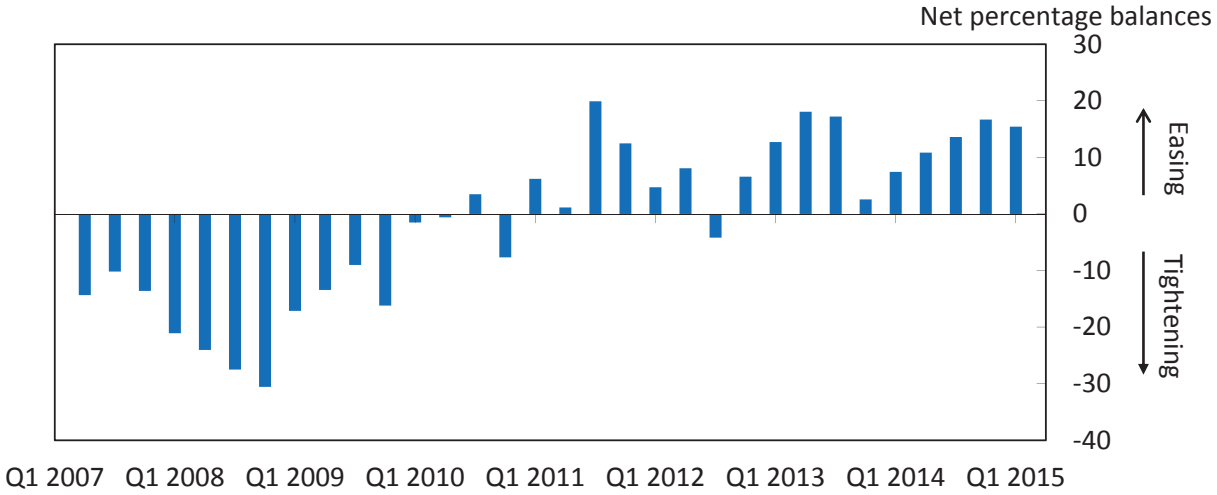
until 9th June, 9:30am



- Personal loan rates have fallen sharply, to historically very low levels

Changes to nature and intensity of competition easing supply conditions in consumer credit markets

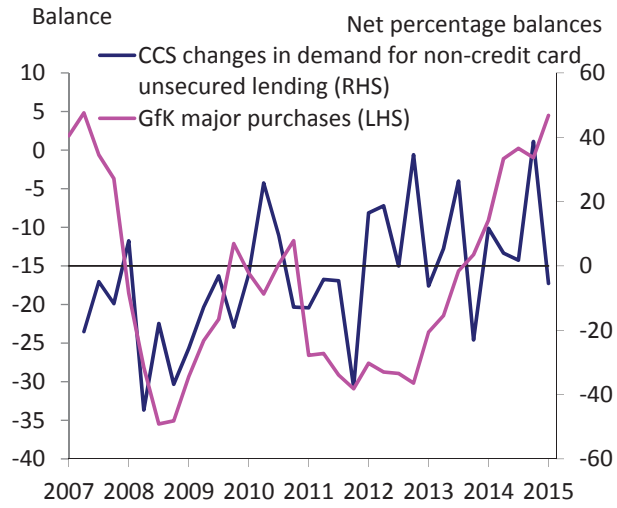
Unsecured credit availability, *Credit Conditions Survey* 2015 Q1



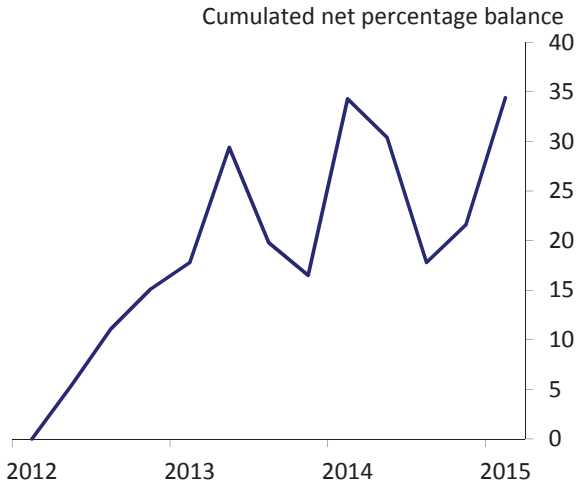
For intelligence from the major lenders, by Bank Lending Monitoring Team

Improving economic situation has altered the level and mix of demand

GfK and CCS demand indicators



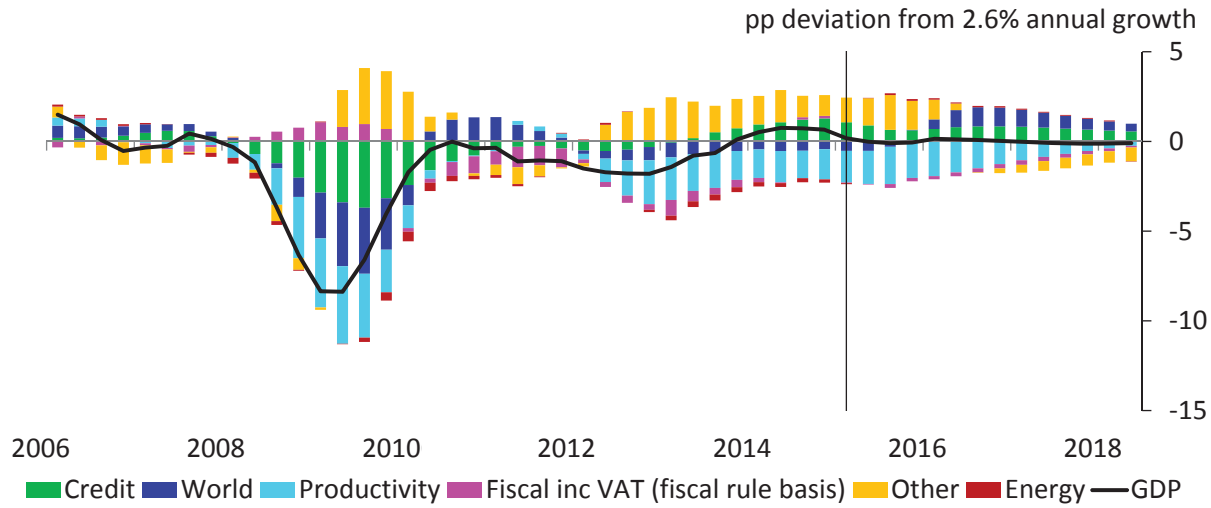
CCS average credit quality of new lending*



*Increase in balance represents an increase in credit quality

Conditions in unsecured credit markets continue to support GDP

Decomposition of GDP forecast



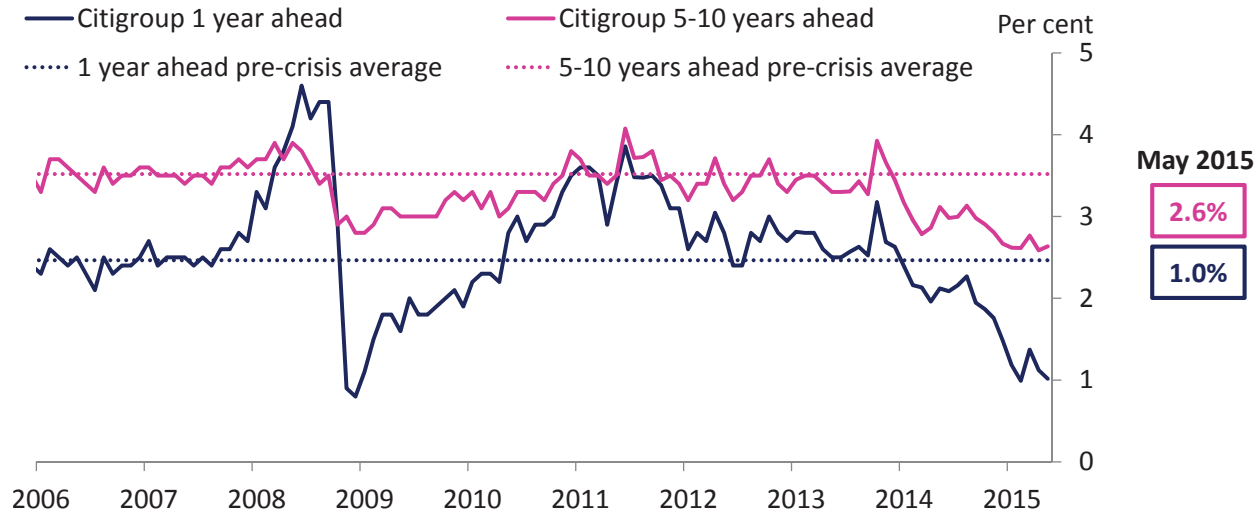
For more detail on consumer credit,

Plan for today

- What factors might affect the level of housing transactions in the medium term?
- What should we make of the recent strength of consumer credit growth?
- **Latest on inflation expectations.**

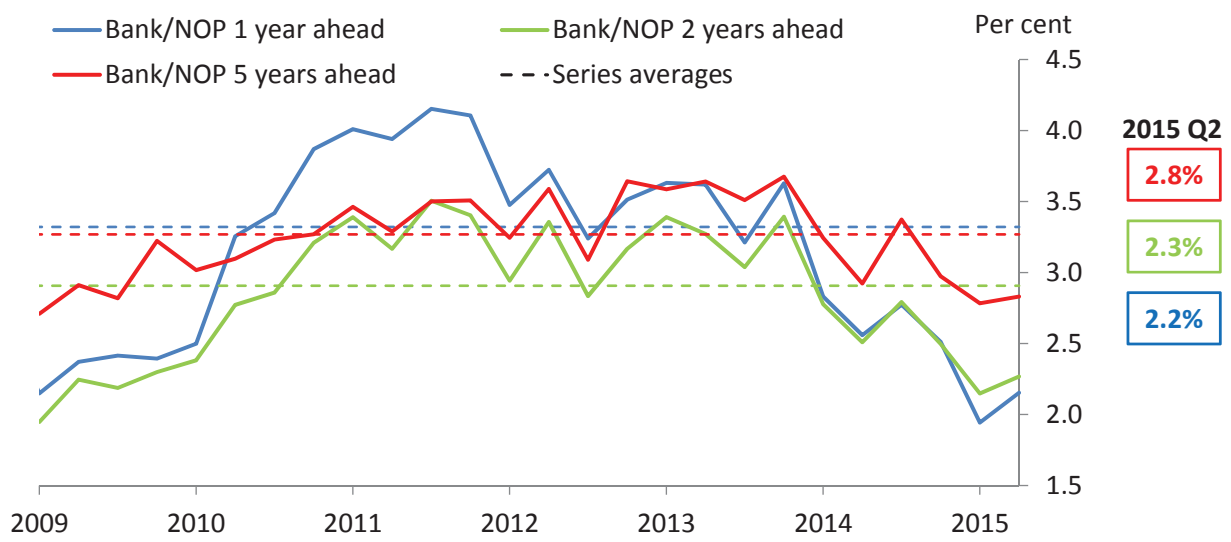
Citigroup inflation expectations broadly unchanged

Citigroup survey of household inflation expectations*



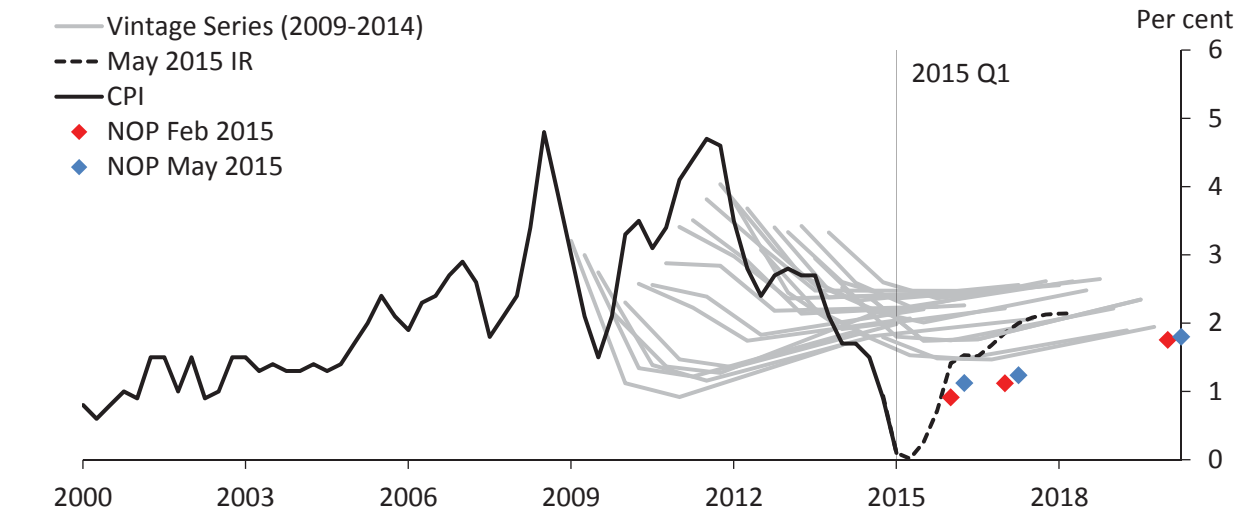
* Survey question: *"How do you expect consumer prices of goods and services will develop over the next one and five to ten years respectively?"*

Bank/NOP inflation expectations ticked up on the quarter



Term structure of Bank/NOP broadly unchanged

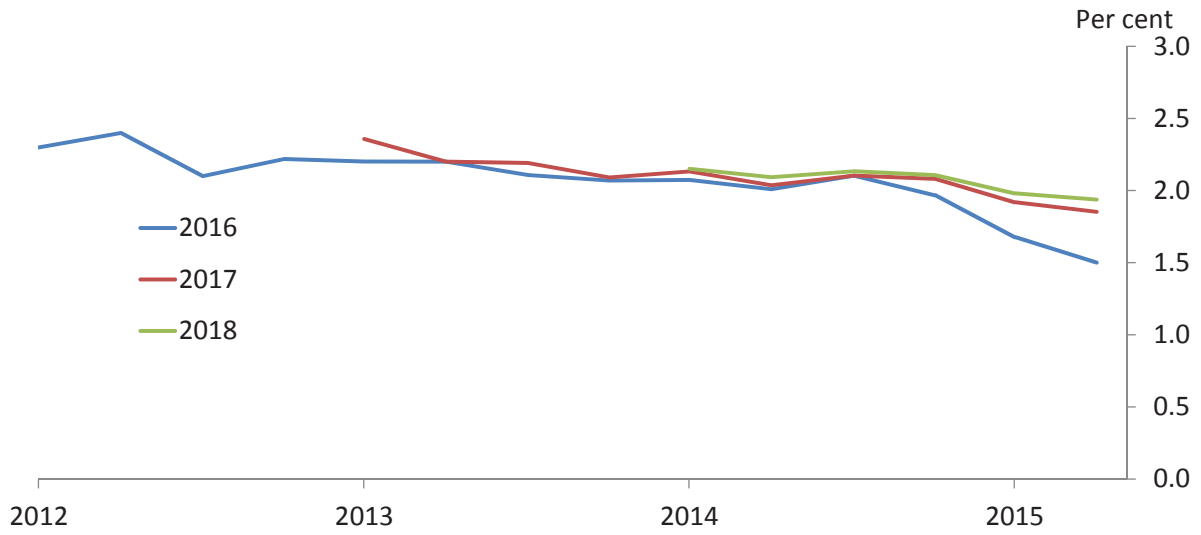
Bank/NOP inflation expectations*



* Bank/NOP series adjusted for **average** wedge between perceptions & CPI outturn

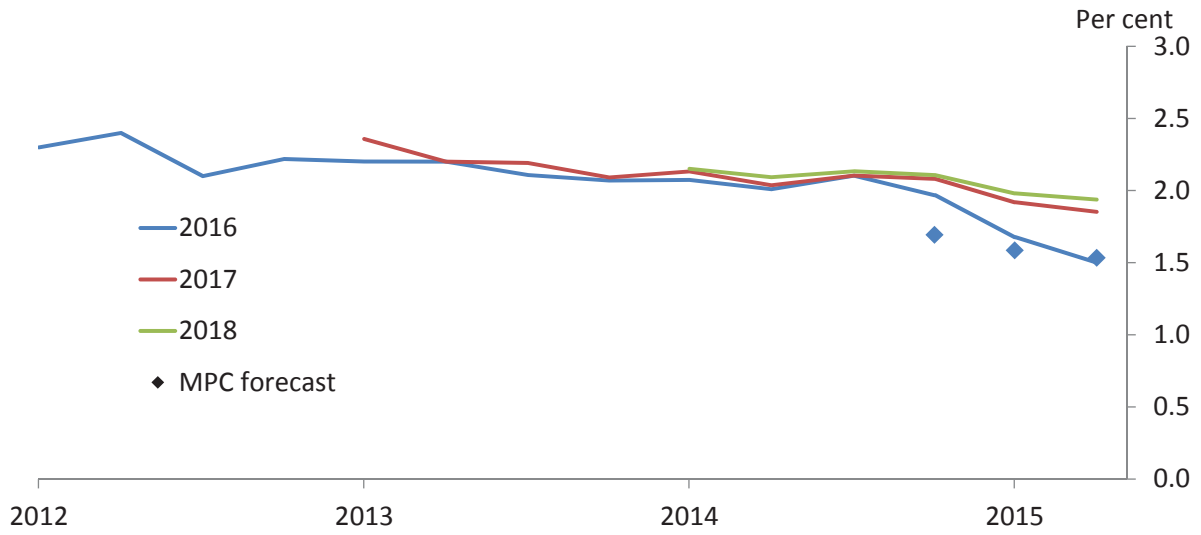
HMT sample of professional forecasters' expectations ticked down at all horizons

HMT sample and MPC inflation forecasts, averages of inflation rates within each calendar year

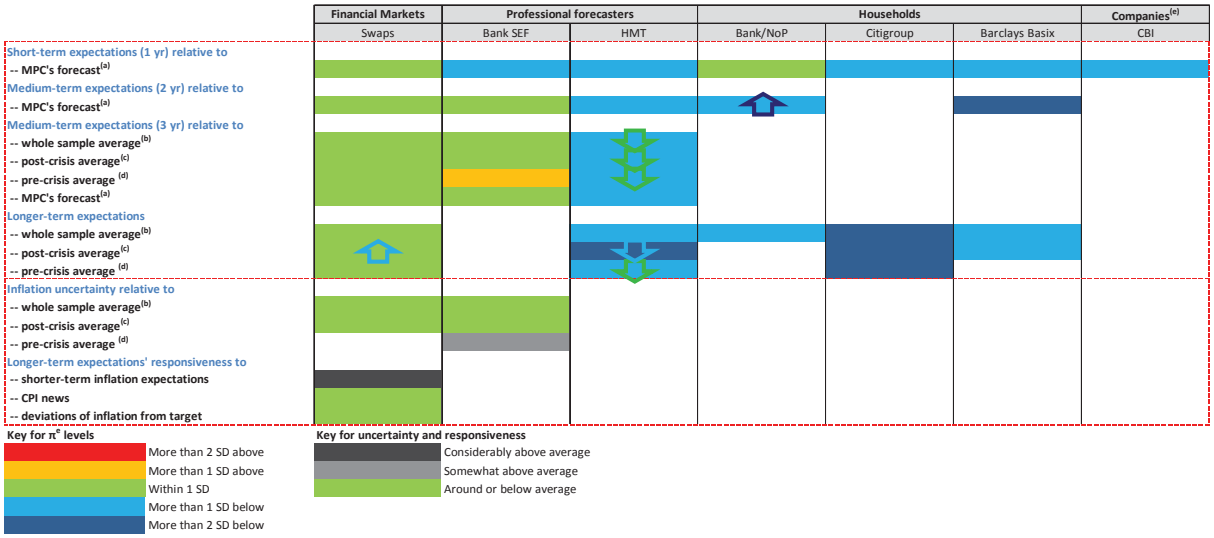


HMT sample of professional forecasters' expectations ticked down at all horizons

HMT sample and MPC inflation forecasts, averages of inflation rates within each calendar year



Updated inflation expectations heatmap



See forthcoming *Quarterly Bulletin* article "Do inflation expectations currently pose a risk to inflation?"

Main messages

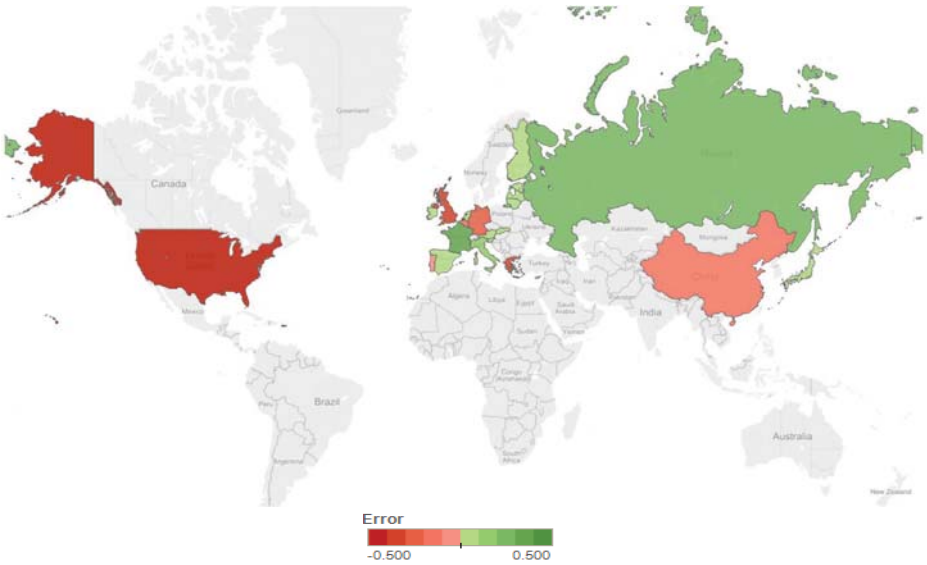
- Some possible downside risks to outlook for housing market activity in the medium term
- But latest data suggest upside risks to housing market forecasts in the near term
- Easing of supply conditions in consumer credit markets will continue to support growth
- Little news on inflation expectations

3: Global Environment

Bank of England
International Directorate

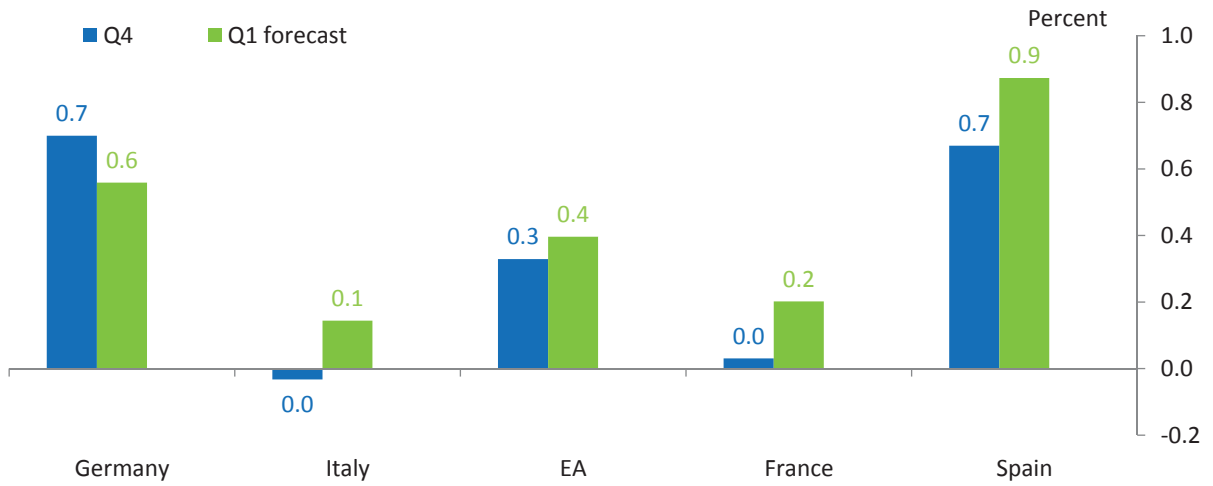
Global Environment
Pre-MPC June 2015

World GDP news: 2015 Q1



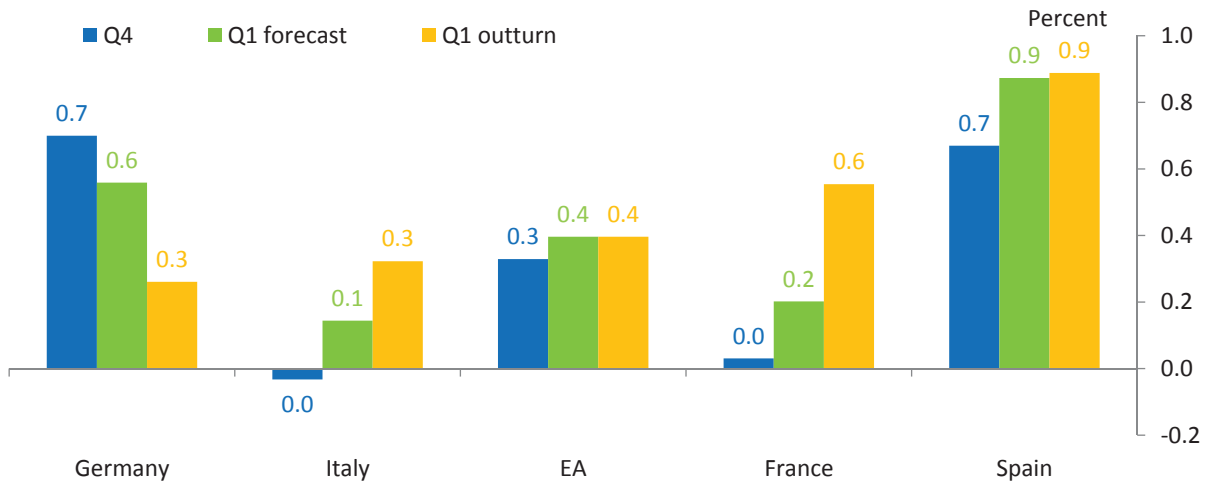
Euro area

Euro-area country split



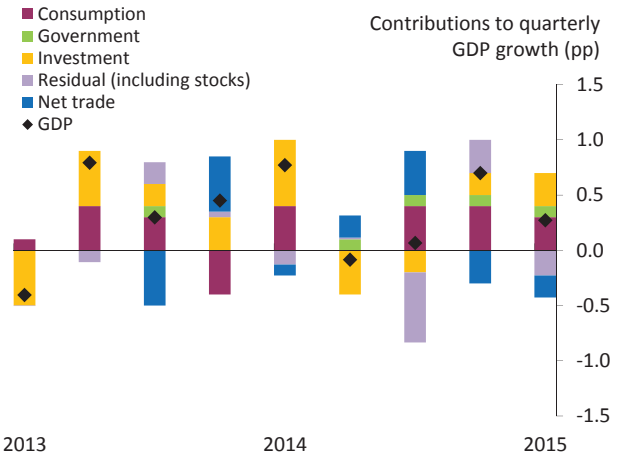
- Last Pre-MPC expected Q1 euro-area growth of 0.4

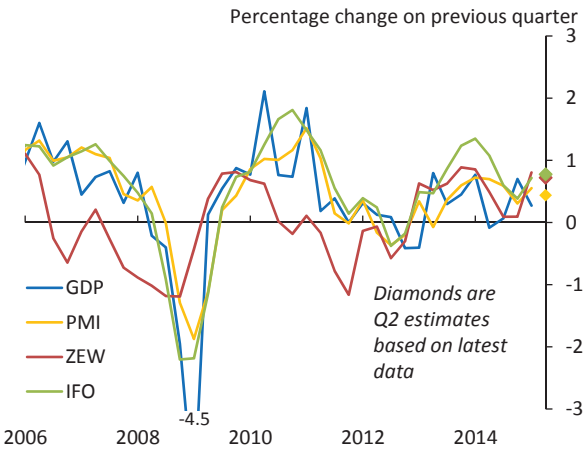
Euro-area country split



- Q1 GDP 0.4% - as expected. Italy and France stronger than expected. Germany weaker.

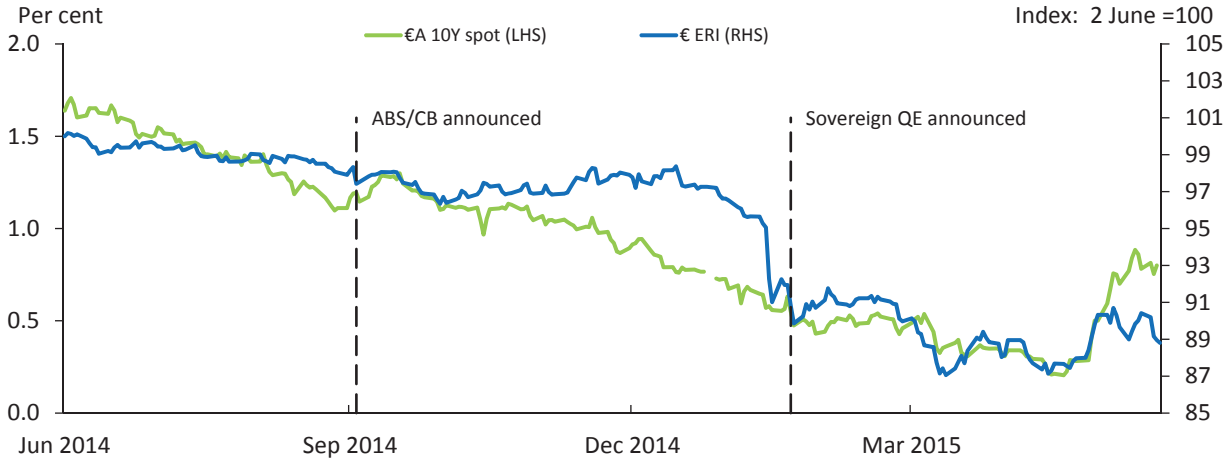
Outlook for Germany





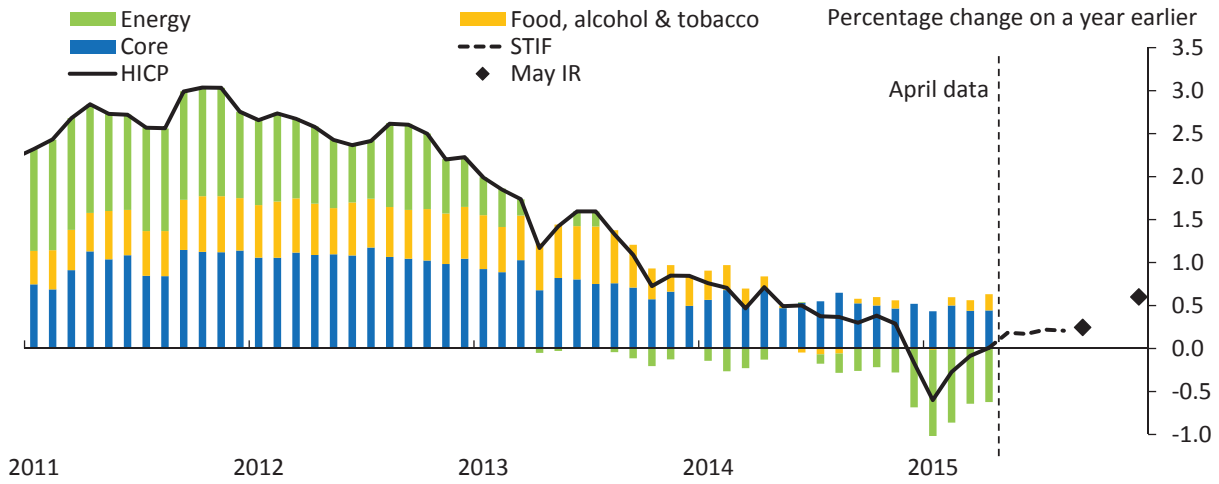
- Q1 driven by consumption and investment, plus reversal in Q4 stocks. Average Q1 and Q4 gives 0.5%.
- For Germany in Q2, survey indicators range from 0.4% to 0.8%.
- Euro-area Q2 nowcast is 0.5%. But downside risks from PMIs.

Asset price moves and our estimates of QE



- We have not revised our view of the impact of ECB QE in light of recent moves in rates.
- Rates remain below the levels seen in 2014 H2 and the exchange rate, which we see as a key transmission channel, has not moved that much recently.

Euro area HICP



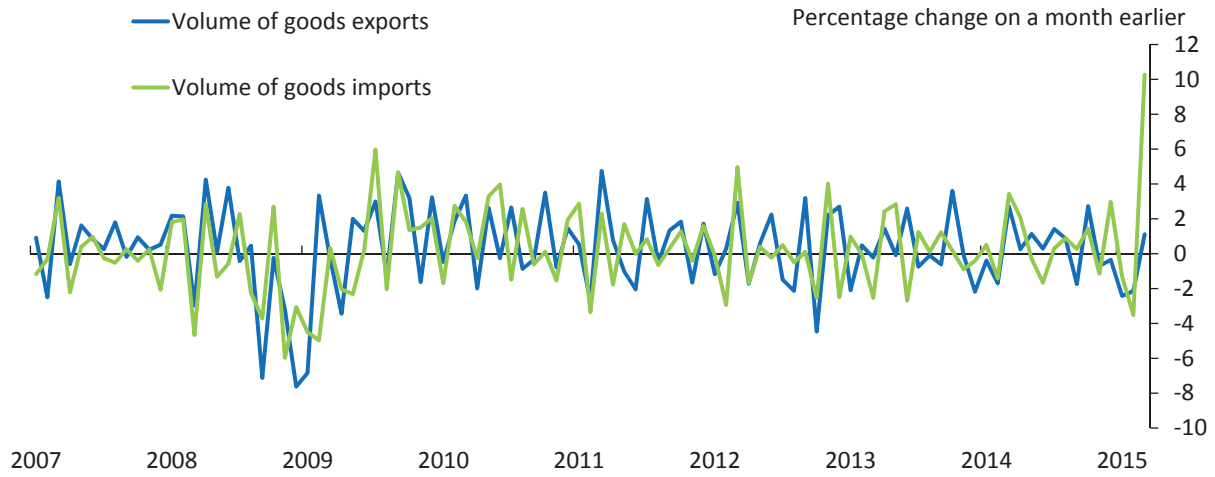
- Euro area HICP was 0.0% in April, 0.1pp below our expectations. Now we expect 0.2% in May and a stronger pick up further out, reaching 0.6% at the end of the year.

Euro area

- Q1 GDP: 0.4 as expected. France and Italy stronger than expected. Germany weaker.
- Expect Q2 GDP at 0.5 – but downside risks.
- Inflation weak but picking up.

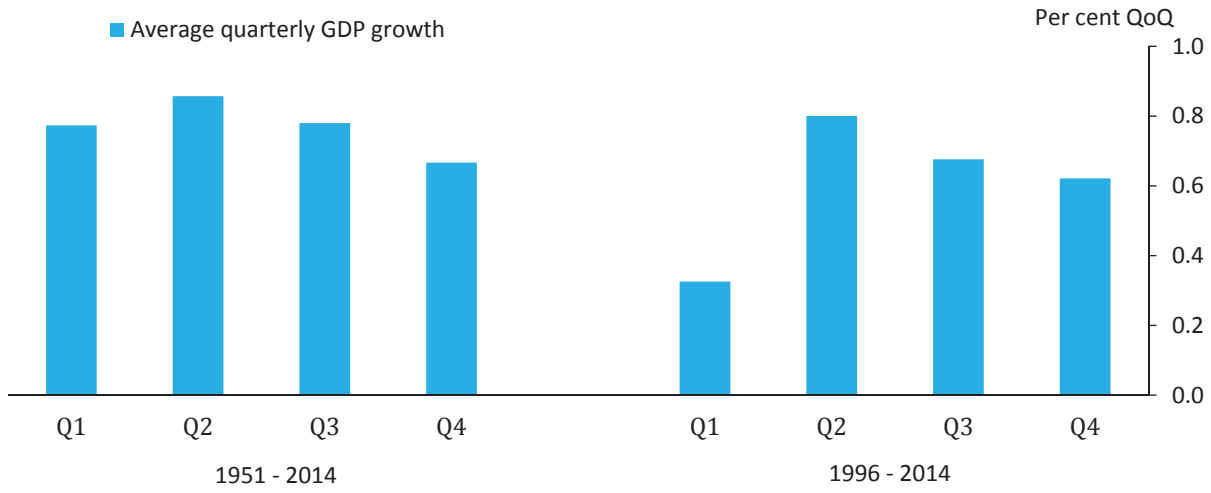
US

US Trade



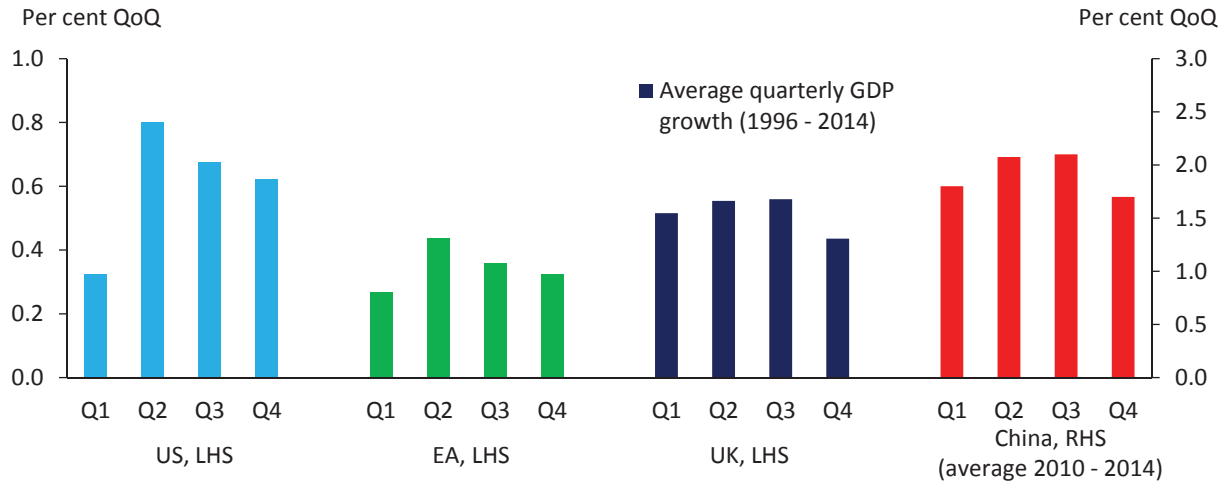
- The nominal trade balance widened by $15bn in March.
- This was led by a surge in real goods imports which increased by 10.3% on the month.

Seasonality



- GDP growth in Q1 has consistently been weaker than other quarters.

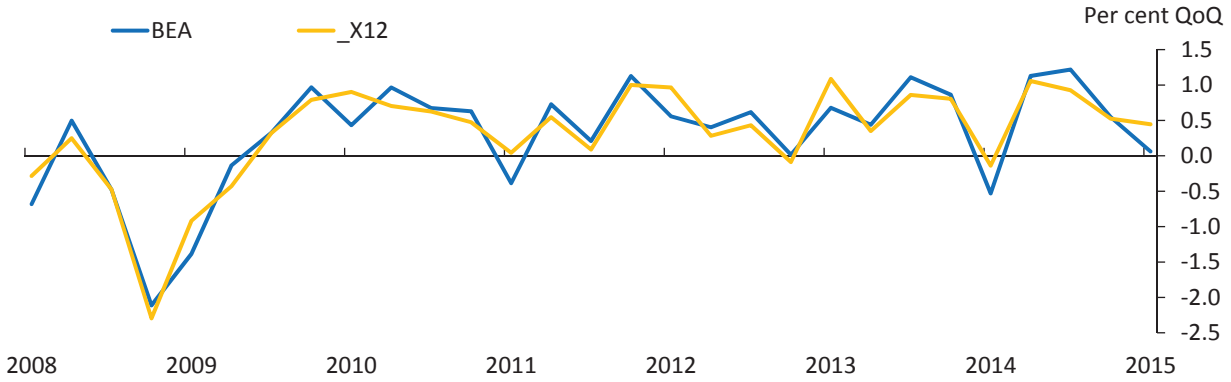
Seasonality across countries



- And this looks to be a unique US problem.

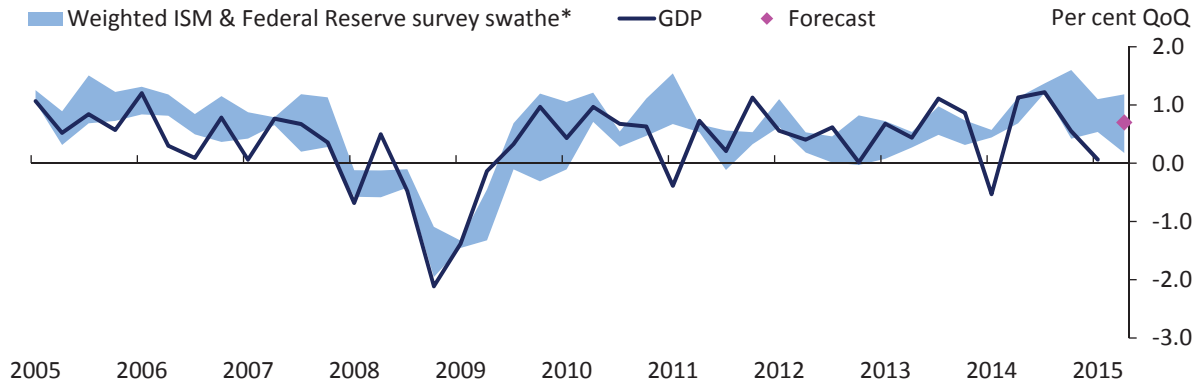
Seasonality

Seasonal adjustment



- A re-seasonal adjustment would leave the advance estimate of growth in Q1 at 0.4%.
- April FOMC minutes: "A pattern observed in previous years of the current expansion was that the first quarter of the year tended to have weaker seasonally adjusted readings on economic growth than did the subsequent quarters."

Survey swathe

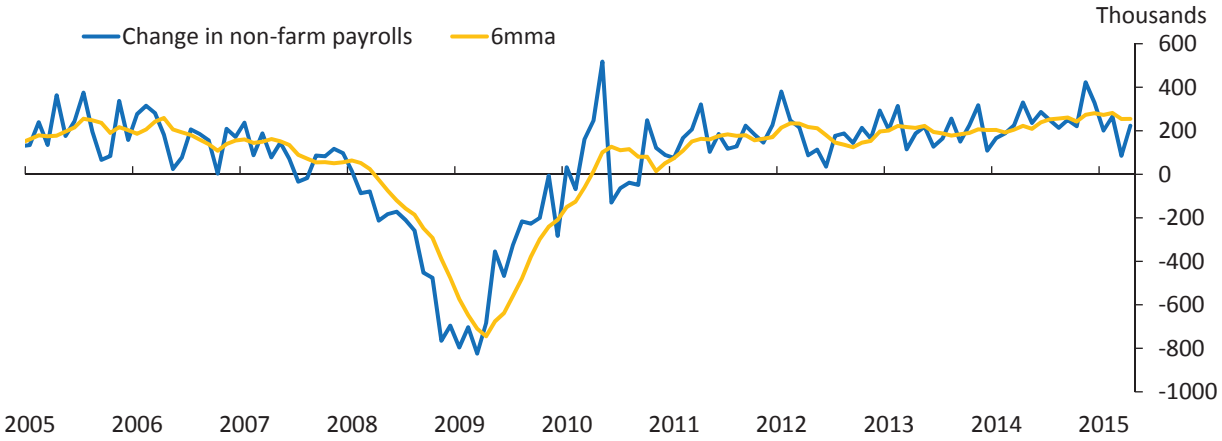


*Federal Reserve surveys: New York Empire State Manufacturing, Philadelphia Fed Business Outlook survey, Weighted Richmond Fed Manufacturing & Services surveys, Weighted ISM. Data up to April.

- In April, the ISM manufacturing production (56, +2.2) and non-manufacturing activity (61.6, +4.1) indices rebounded.
- We expect Q2 to be 0.7%. Externals expect between 0.5 and 0.6.

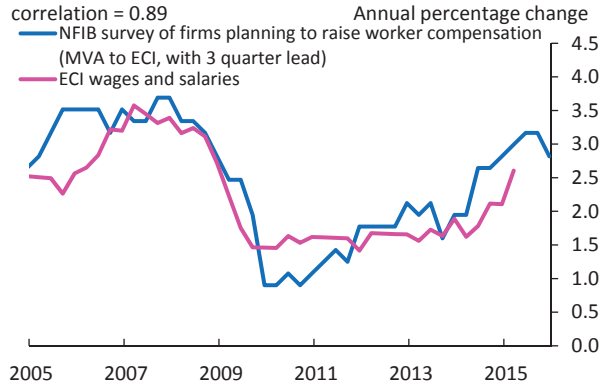
US labour market

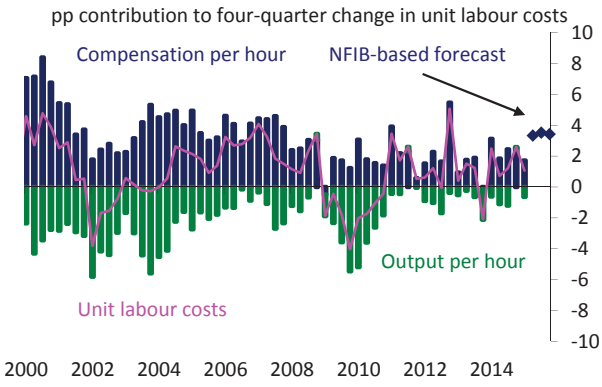
Non-farm payrolls



- In April, NFPs grew by 223k, with March numbers revised down to 85k (-41k).
- The unemployment rate ticked down to 5.4%.

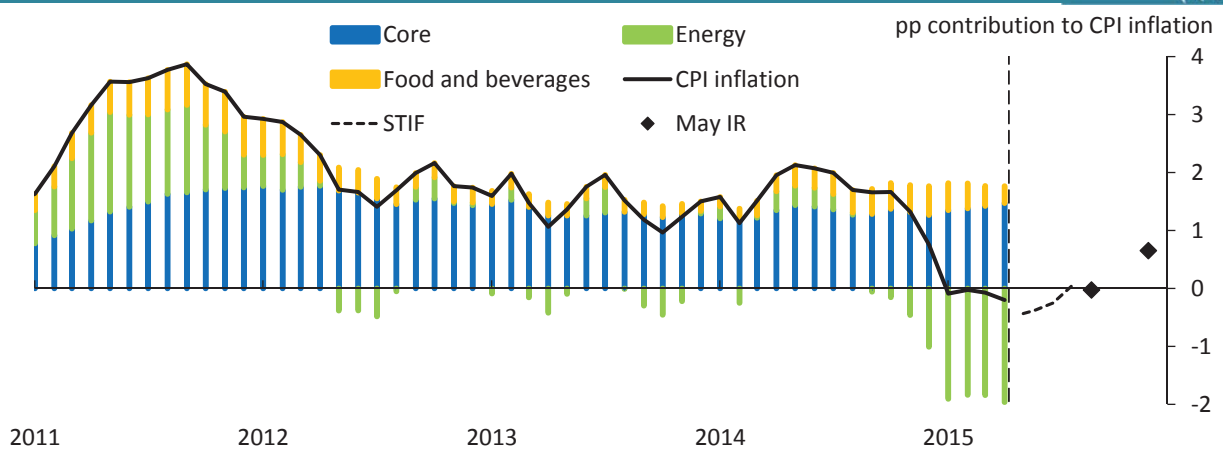
Wages and ULCs





- In Q1, NFIB survey of firms' intent to increase worker compensation fell to 13% (15% in Q4). But level consistent with further increase in wage growth.
- Absent material pick up in productivity, ULCs likely to pick up going forward.

Inflation



- Annual headline inflation fell by less than expected to -0.2% in April.
- Core inflation remained at 1.8%.
- Inflation is expected to remain weak through Q2 and Q3 before picking up sharply.

FOMC Minutes

- "The medium-term projection for real GDP growth was revised up modestly, as monetary policy was assumed to be a little more accommodative in this projection and the projected path for the foreign exchange value of the dollar was a little lower."

- "The medium-term forecast for inflation was little changed, with inflation in 2016 and 2017 projected to move closer tot, but remain below, the Committee's longer-run objective"

- "Participants expressed a range of views about when economic conditions were likely to warrant an increase in the target range for the federal funds rate."

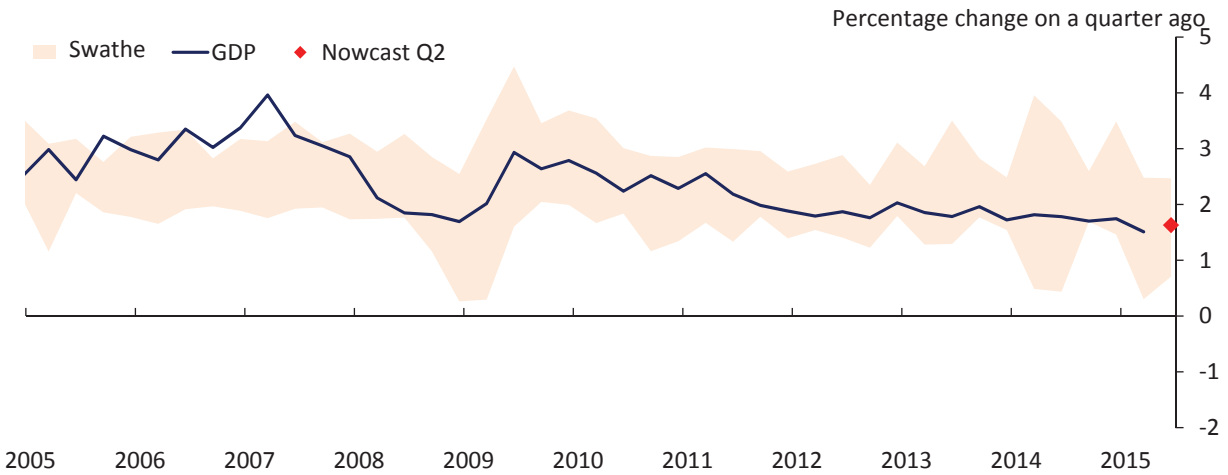
- "A *few* [*several* in March] anticipated that the information that would accrue by the time of the June meeting would likely indicate sufficient improvement in the economic outlook to lead the Committee to judge that its conditions for beginning policy firming had been met."

US

- Q1 GDP was genuinely weak, but residual seasonality exaggerated weakness.
- Expect growth to recover in Q2 to 0.7.
- Labour market remains robust, cost pressures picking up.
- But inflation set to remain weak until the end of the year
- FOMC tightening in June less likely

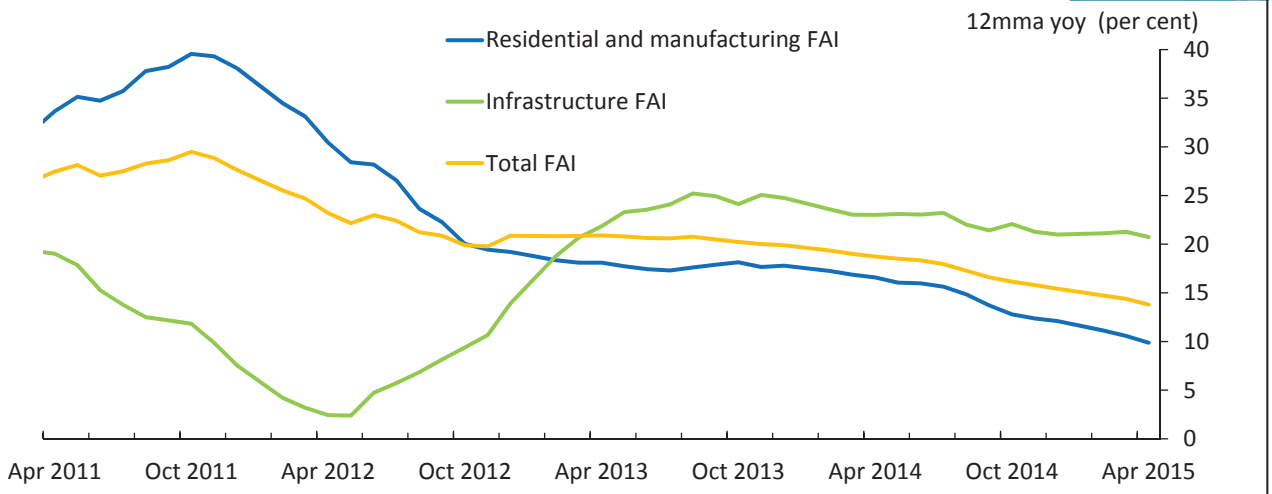
China

China expected to tick up in Q2



- IP edged up to 5.9% (+0.3 pp). Fixed asset investment and retail sales weakened.
- Nowcast for Q2 to pick up slightly to 1.6% oqa.

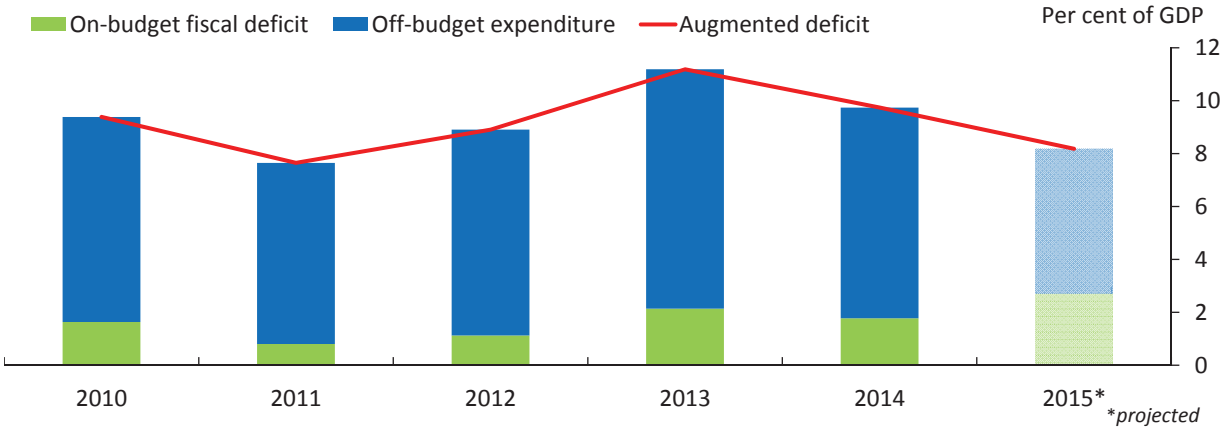
Fixed asset investment breakdown



- Local government led infrastructure investment has been supporting FAI as residential and manufacturing FAI has fallen back.

Policy constraints going forward

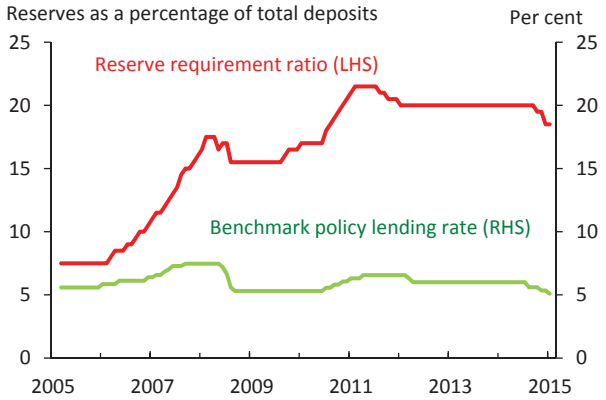
'Augmented' fiscal deficit and off-budget financing



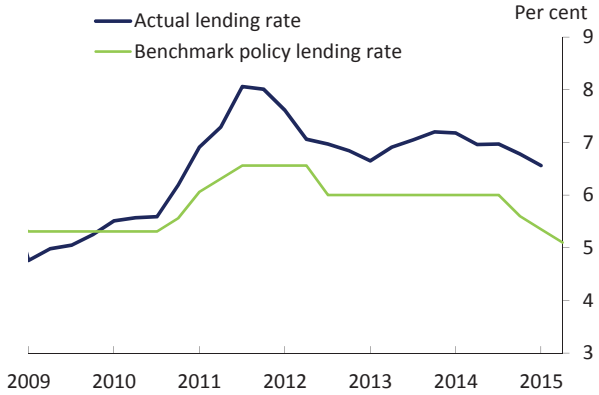
- The shift from Local Government Financing Vehicles to municipal bonds could act as a fiscal drag on growth.

Policy support

Monetary policy move – cut in rates and RRR



Borrowing cost



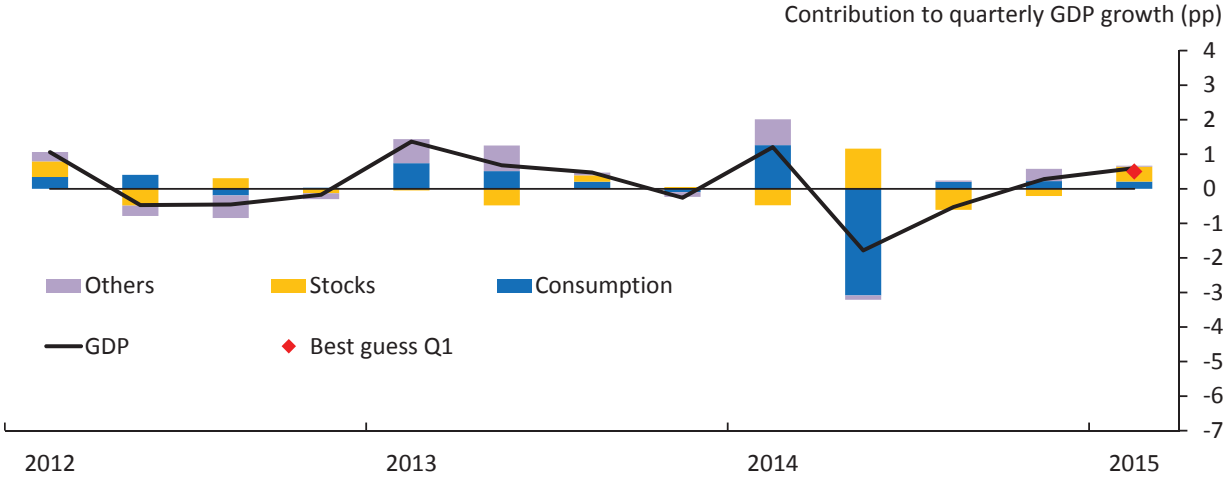
- Since Feb, the PBoC has cut rates twice and lowered the RRR twice. On 19th April the benchmark lending and deposit rates were both cut by 0.25pp.
- Actual borrowing costs have fallen by less (so far).

China

- Expect growth to pick up to 1.6% in Q2.
- Local government fiscal reform poses downside risks to growth.
- Monetary policy has eased – but has not yet passed through fully. Additional policy loosening required.

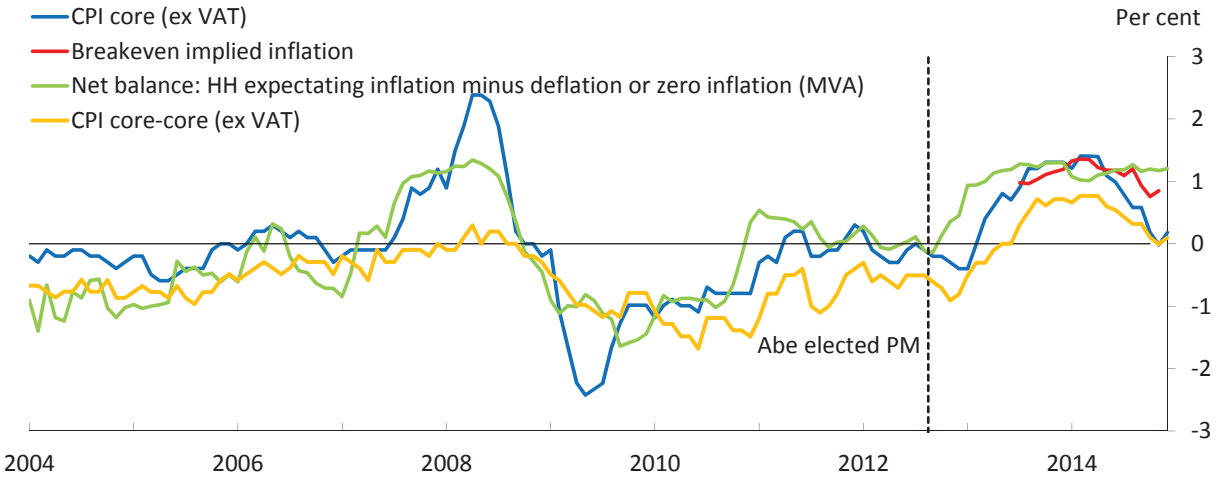
Japan

Japan - GDP



- Q1 GDP growth of 0.6%, slightly stronger than expected.

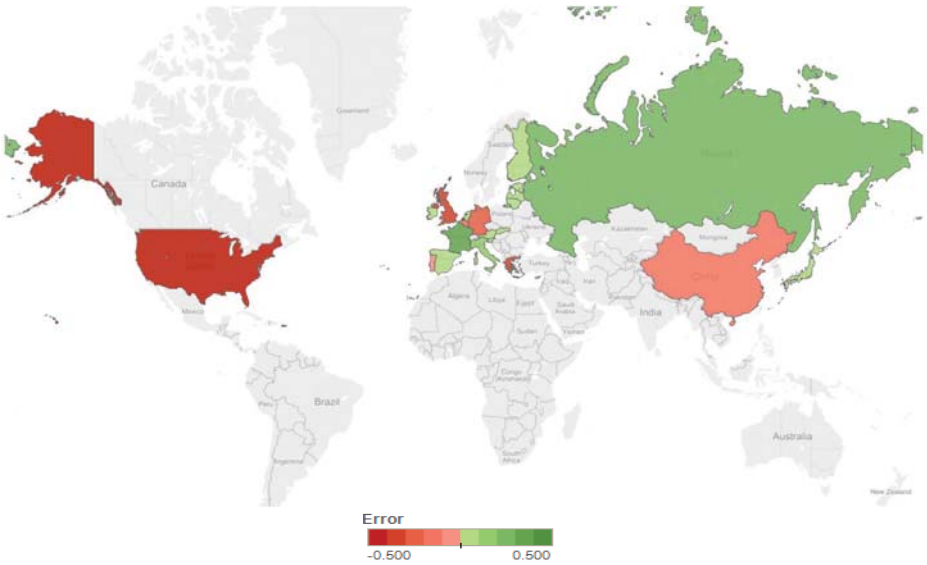
Japan: inflation remains subdued



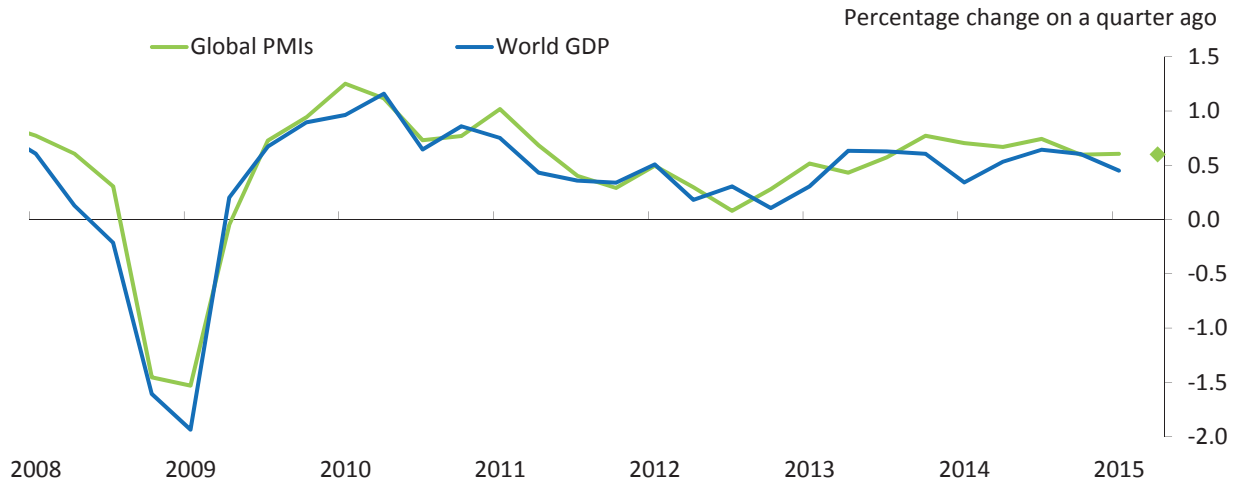
- Core-core CPI inflation (ex VAT) ticked up to 0.1% in March (+0.1pp), but remains very weak. Inflation expectations remain well below the 2% target.
- Despite some progress in raising inflation and inflation expectations there is further to go.

World

World GDP news: 2015 Q1



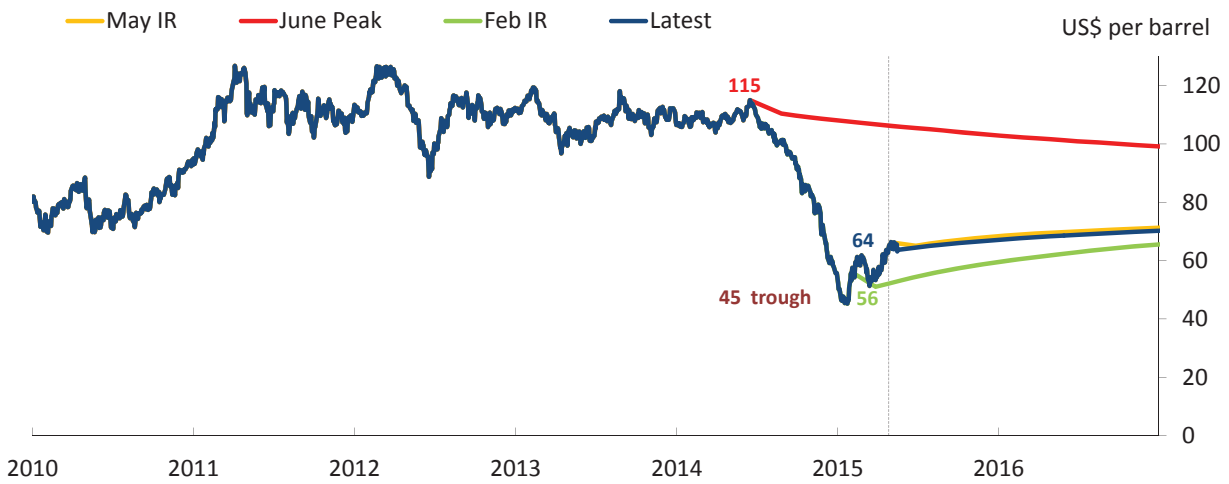
PMI mapped to global activity (UK-wtd)



- World GDP growth fell slightly to 0.5% in Q1. Global PMI's suggest growth of 0.6% in Q2.

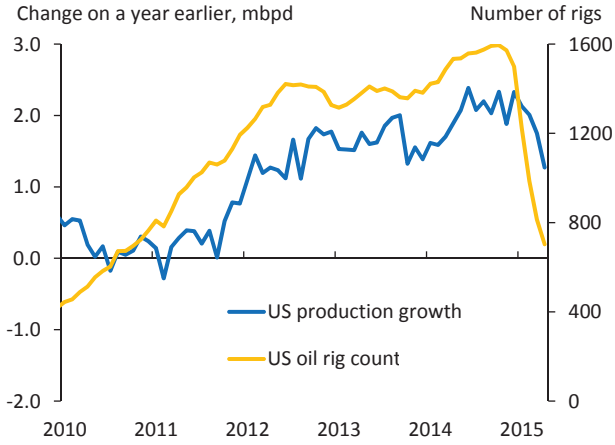
Oil

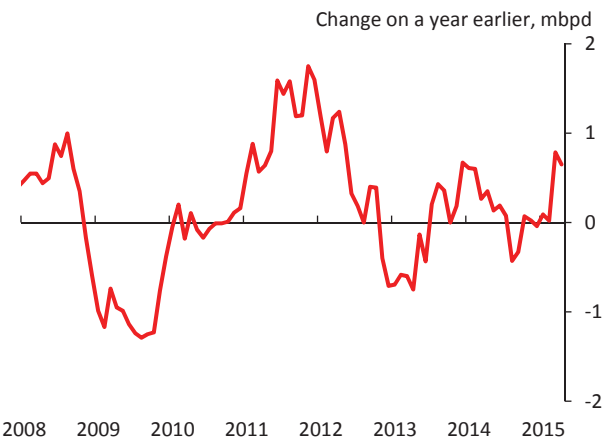
Oil futures curve



- Spot oil prices have fallen 4% since the May *IR,* and 1% across the futures curve due to strong global oil supply.

Oil production





- US oil production growth slowed sharply in April. But Saudi Arabia production grew strongly.
- US production growth is likely to fall further and Saudi production unlikely to rise to offset this.

Summary

- Steady euro-area recovery still on track. But downside risks to Q2. Inflation rising from very low levels.
- US growth to recover in Q2. Wage growth rising. Inflation remains very low.
- China GDP to pick up slightly in Q2 but substantial policy challenges ahead.
- Japanese GDP stronger than expected at 0.6 in Q1. Inflation and inflation expectations well below target.
- World activity slowed slightly in Q1 but should pick up in Q2.

End

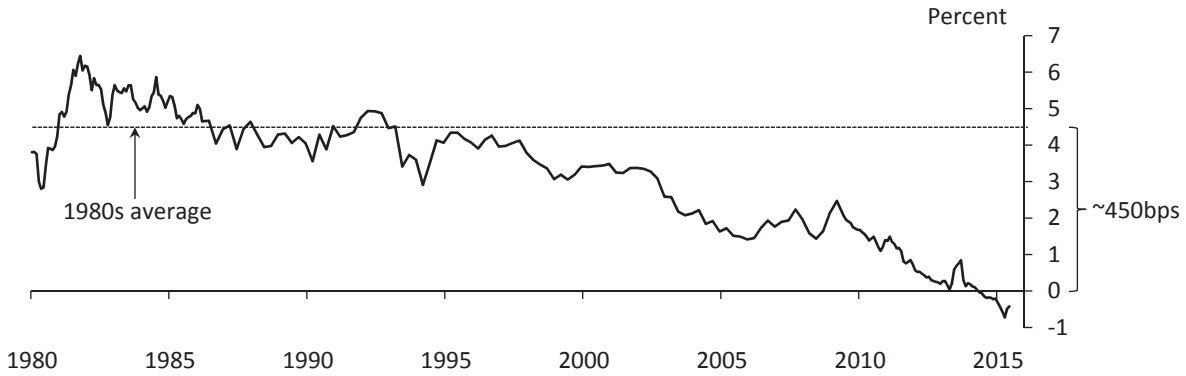
4: Factors Driving Global Real Rates

Bank of England
International Directorate

Secular drivers of global real interest rates

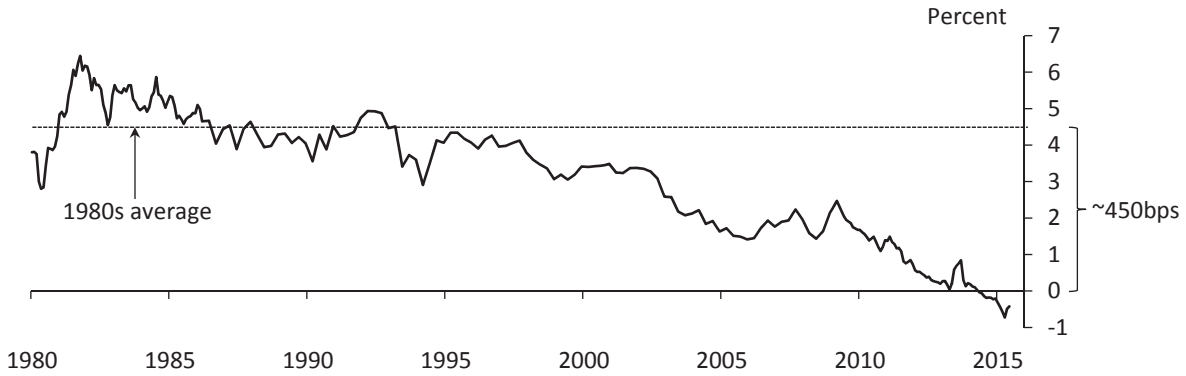
Pre-MPC June 2015

Global real interest rates



Note: The black line is taken from King and Low (2014) and is based on the average 10-year spot yield on inflation-linked bonds in the G7 (ex. Italy). Updated by Bank staff.

Global real interest rates



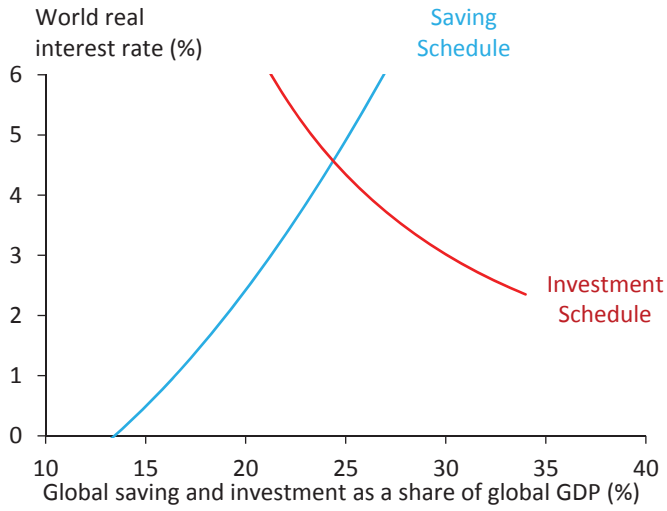
Note: The black line is taken from King and Low (2014) and is based on the average 10-year spot yield on inflation-linked bonds in the G7 (ex. Italy). Updated by Bank staff.

More details in the June IEM

Key messages:

- **We can account for most of the fall – perhaps 400bps or so – with secular macro factors.**
- **The drivers are persistent, so long-term global rate likely to stay low – around 1% over the next 5 years**

The saving-investment framework

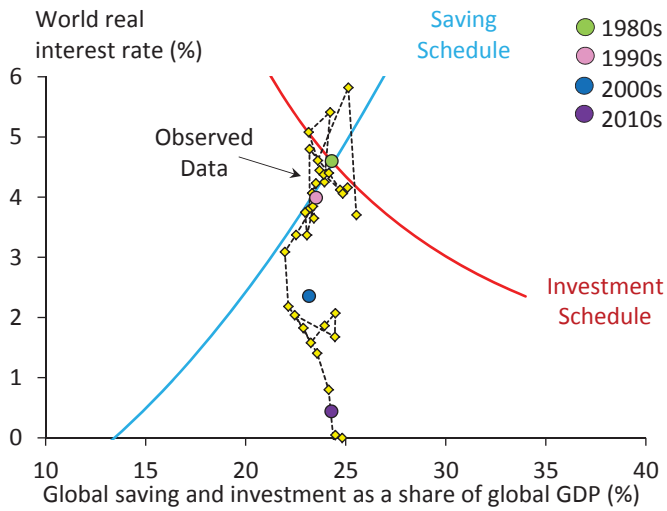


POINTS TO NOTE:

- Conceptually, we can plot upward sloping desired saving; and downward sloping desired investment schedules.
- We follow empirical estimates in the literature to calibrate the slopes.
- We actually only observe the intersections of the two schedules…

Note: Studies we use to calibrate the slopes include: Kashyap et al (2001), Gilchrist & Zakrajsek (2007), Ellis and Price (2007). Doehr (2014) provides a literature review, including a list of past studies and their estimates.

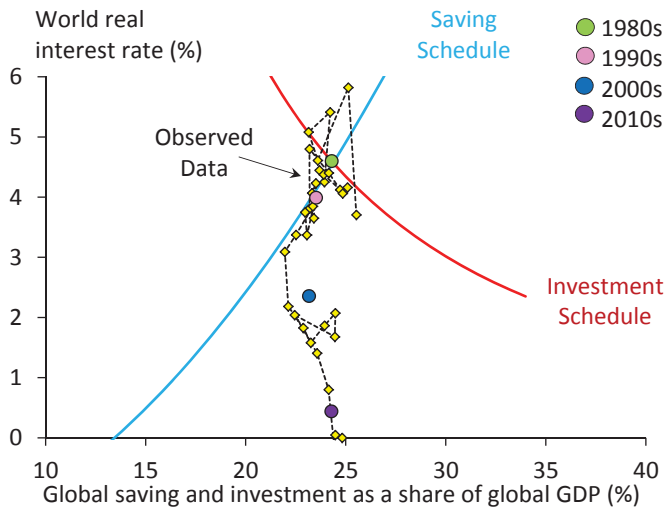
The saving-investment framework



POINTS TO NOTE:

- At the global level, *actual* saving and investment ratios have been remarkably stable.
- If we assume the slopes follow empirical estimates in the literature, the vertical pattern suggests that *both curves have shifted.*

The saving-investment framework



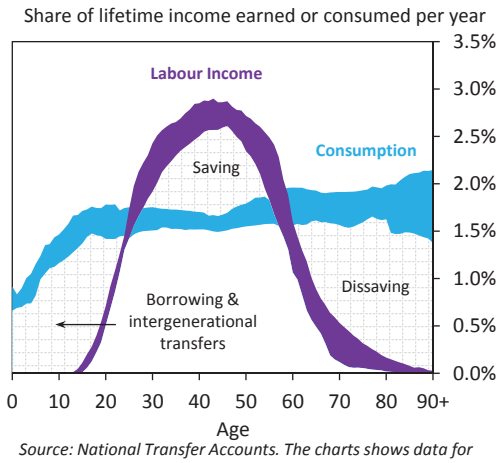
SHIFTS IN DESIRED SAVING

1. Demographics
2. Rising Inequality
3. Global Savings Glut

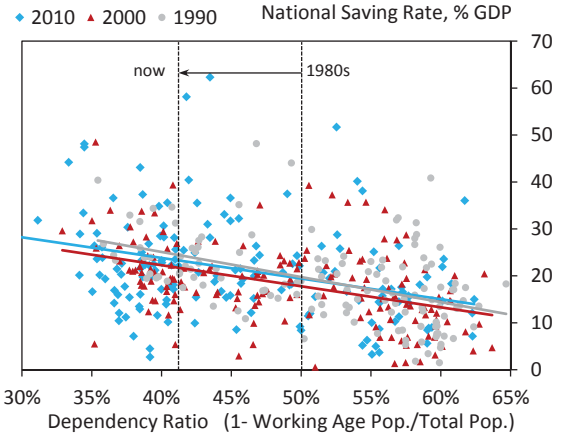
SHIFTS IN DESIRED INVESTMENT

4. Price of capital
5. Public investment
6. Rise in spreads
7. Global trend growth expectations

① Global demographic shift



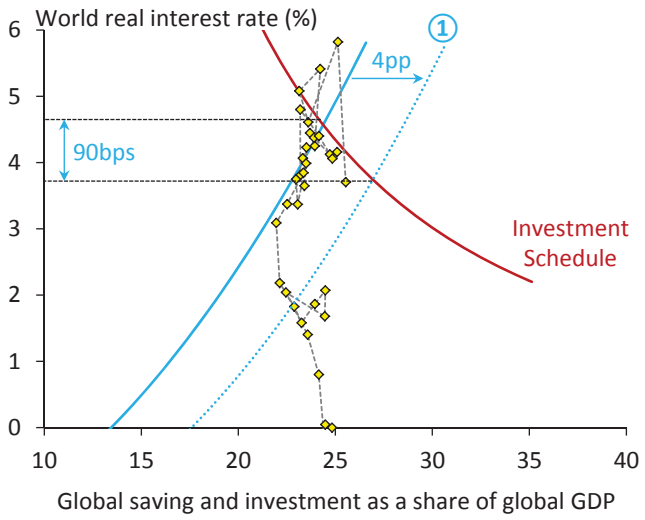
Source: National Transfer Accounts. The charts shows data for 23 advanced and emerging economies. See Goodhart (2014), for example.



Source: IMF, UN and Bank Calculations.

- The fall in dependency ratio globally pushed up on desired savings by around 4% of WGDP for a given interest rate

① Global demographic shift



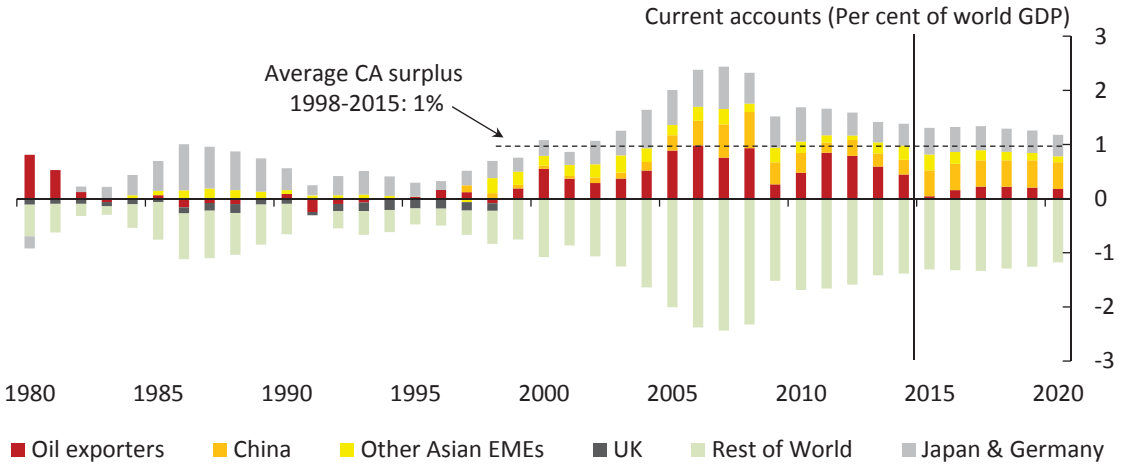
SHIFTS OF DESIRED SAVINGS
① **Demographics: 90bps**

② Inequality

Source: Dynan et al (2004) and US Census Bureau. Note: Data are for the US

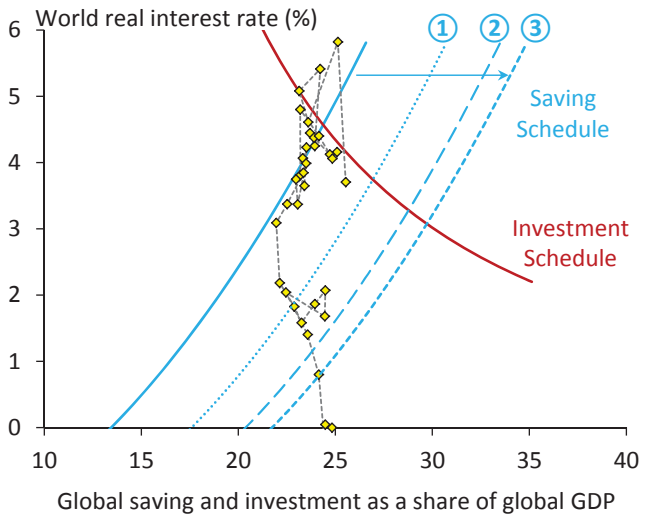
- Rich people save more, so a rise in inequality leads to an increase in desired aggregate savings
- Rise in inequality has raised desired savings by 2pp, and lowered real rates by around 45bps

③ Global savings glut



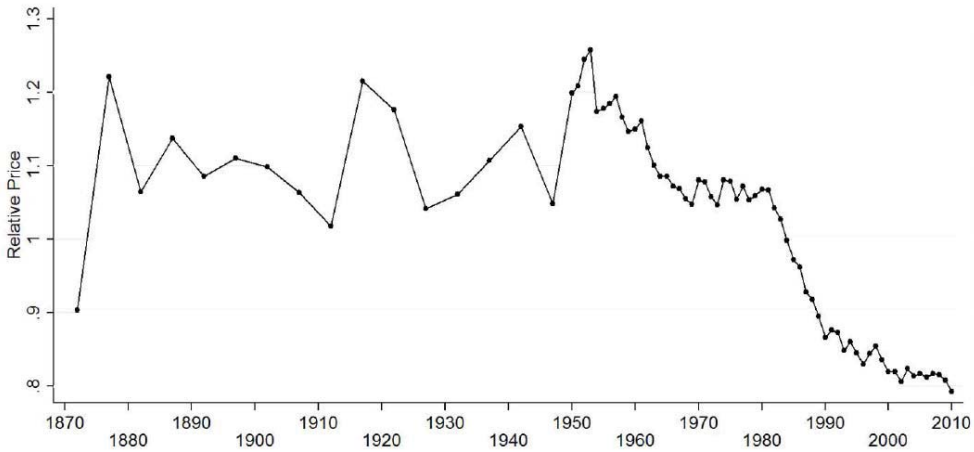
- Exogenous preference shift towards higher saving across some EMs. See Bernanke (2005) and (2015)
- Average net supply of savings around 1% of WGDP since 1998, compared to zero before then

Saving shifts: summary



SHIFTS IN DESIRED SAVING
① Demographics: 90bps
② Rising Inequality: 45bps
③ Global Savings Glut: 25bps

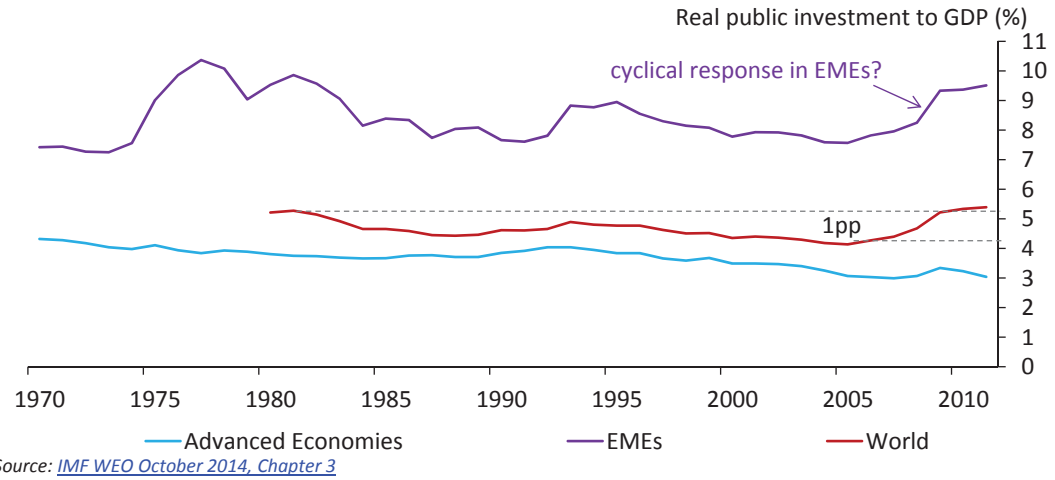
④ Relative price of capital goods



Source: Eichengreen (2015). Note: based on a sample of 11 now-advanced countries from Collins and Williamson (2001).

- Capital is 30% cheaper today than in the 1980s. We calibrate the effect using model in Thwaites (2015)
- Desired investment expenditure falls by a little more than 1pp, lowering real rates by around 50bps

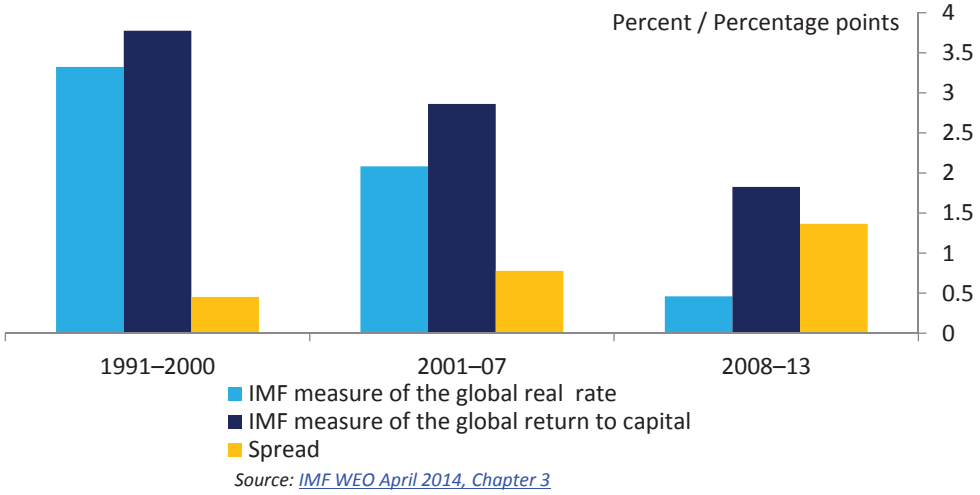
⑤ Public investment



Source: IMF WEO October 2014, Chapter 3

- Public investment fell by around 1% of global GDP from the 80s until pre-crisis, lowering rates by ~20bps
- China's response to the crisis pulls this back up more recently – we treat it as cyclical

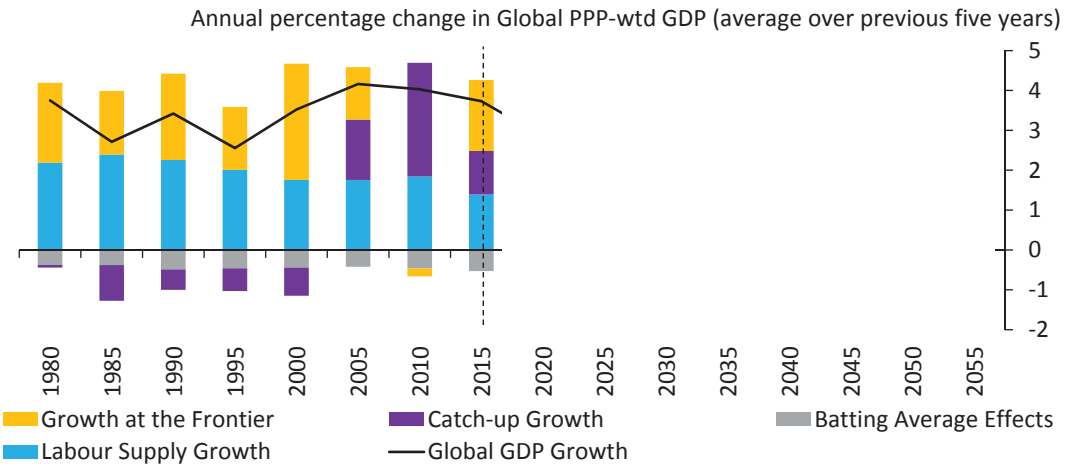
⑥ Credit spreads



Source: IMF WEO April 2014, Chapter 3

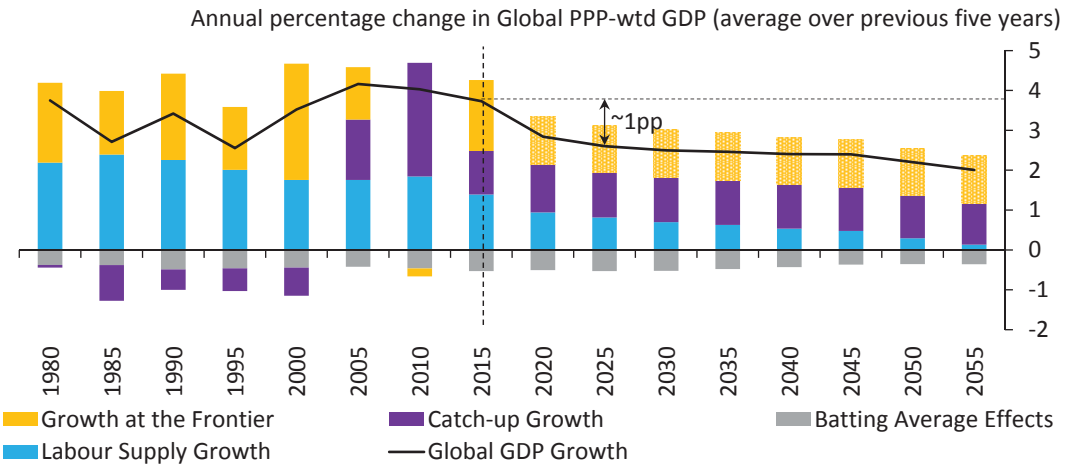
- Our best guess is that spreads may have increased by around 100bps internationally

⑦ Global growth: drivers



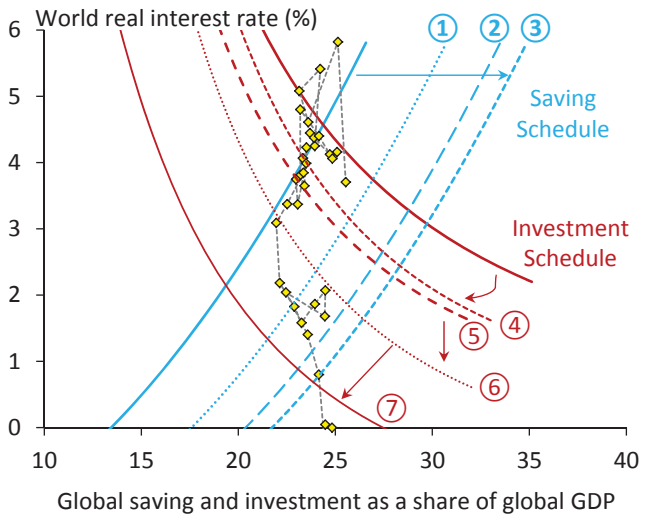
- Given global growth has been stable until recently, so we don't think growth can account for much of the historic fall in rates before the crisis

⑦ Global growth: prospects



- But it is possible that, prompted by the crisis, people revised their expectations (see Gordon (2014)), and this may be an important driver of the recent fall in rates (perhaps accounting for around 100bps)

Investment shifts: summary



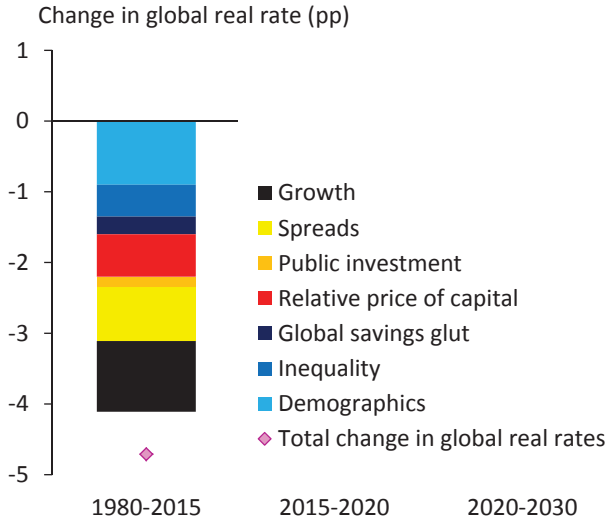
SHIFTS IN DESIRED SAVING

1. **Demographics: 90bps**
2. **Rising Inequality: 45bps**
3. **Global Savings Glut: 25bps**

SHIFTS IN DESIRED INVESTMENT

4. **Price of capital: 50bps**
5. **Public investment: 20bps**
6. **Rise in spreads: 70bps**
7. **Global trend growth expectations: 100bps**

Summary



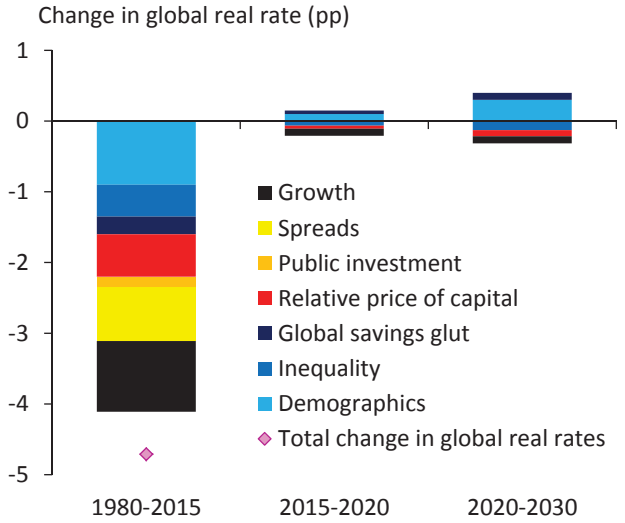
SHIFTS IN DESIRED SAVING

1. **Demographics: 90bps**
2. **Rising Inequality: 45bps**
3. **Global Savings Glut: 25bps**

SHIFTS IN DESIRED INVESTMENT

4. **Price of capital: 50bps**
5. **Public investment: 20bps**
6. **Rise in spreads: 70bps**
7. **Global trend growth expectations: 100bps**

Summary: going forward



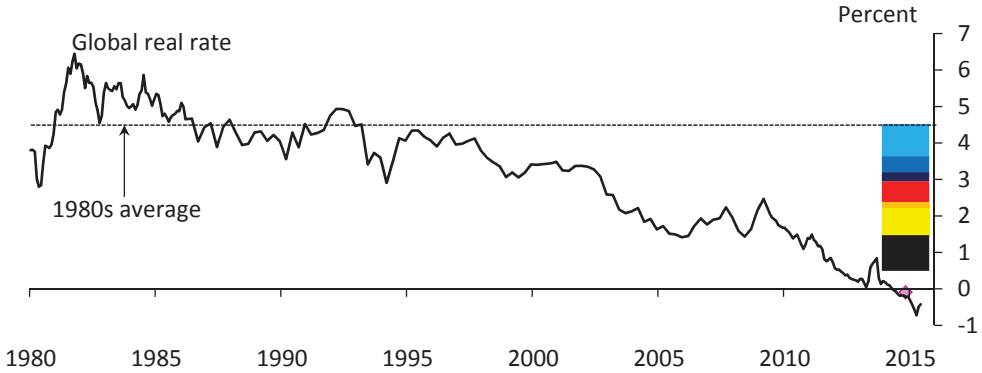
SHIFTS IN DESIRED SAVING

1. **Demographics: 90bps – stable, then reverses**
2. **Rising Inequality: 45bps – may build**
3. **Global Savings Glut: 25bps – reverses slowly**

SHIFTS IN DESIRED INVESTMENT

4. **Price of capital: 50bps – builds, but more slowly**
5. **Public investment: 20bps – policy dependent**
6. **Rise in spreads: 70bps – stable**
7. **Global trend growth expectations: 100bps – may build slowly**

Key messages



Note: The black line is taken from King and Low (2014) and is based on the average 10-year spot yield on inflation-linked bonds in the G7 (ex. Italy). Updated by Bank staff.

Key messages:

- **We can account for most of the fall – perhaps 400bps or so – with secular macro factors.**
- **The drivers are persistent, so long-term global rates likely to stay low – around 1% over the next 5 years**

5: Demand and Output

Demand and Output

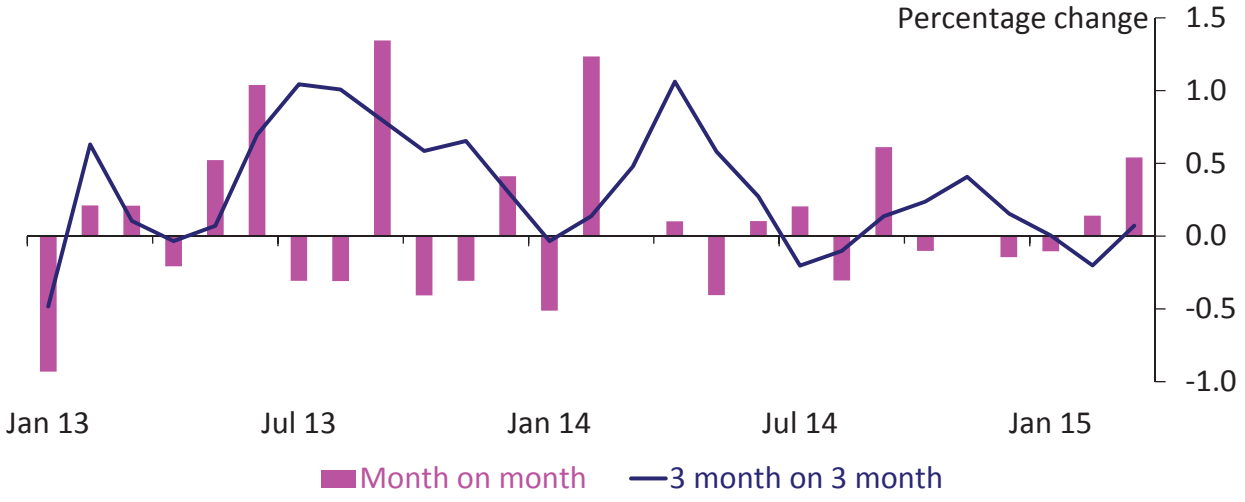
June 2015

DSI and UK Teams

Outline

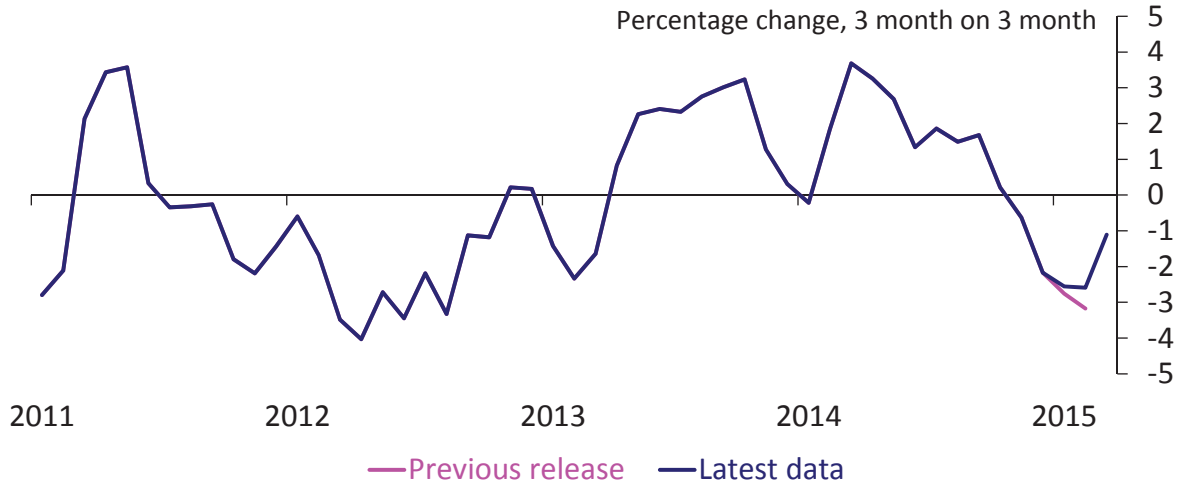
- **Activity indicators: Q1/Q2 update**
- **Household consumption**
  - —A look at the fundamentals
  - —Updated impact of pension changes
  - —The risk from fiscal consolidation

Industrial production



- Positive momentum going into Q2

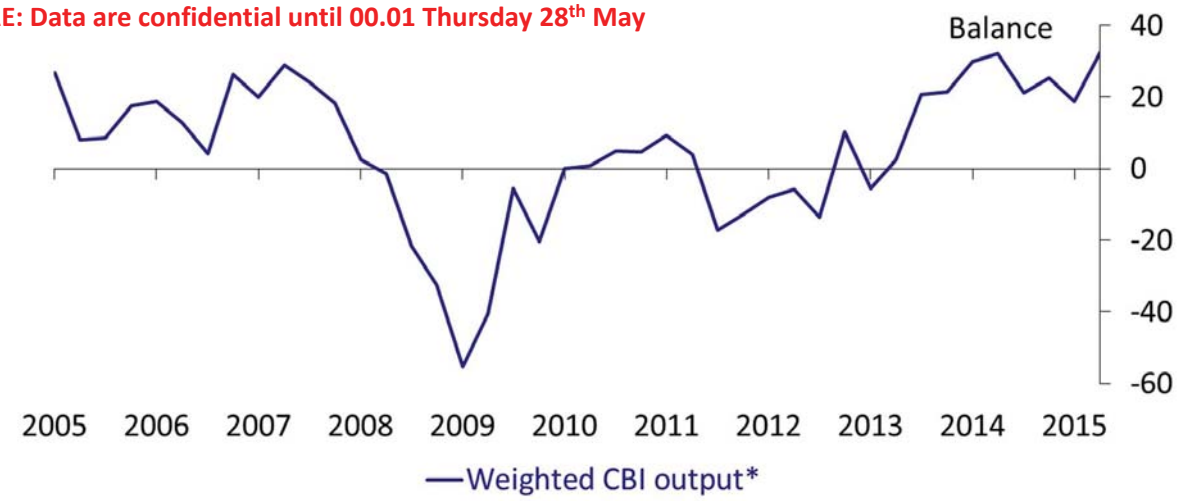
Construction output



- Construction output may have passed a turning point

CBI in-house weighted composite

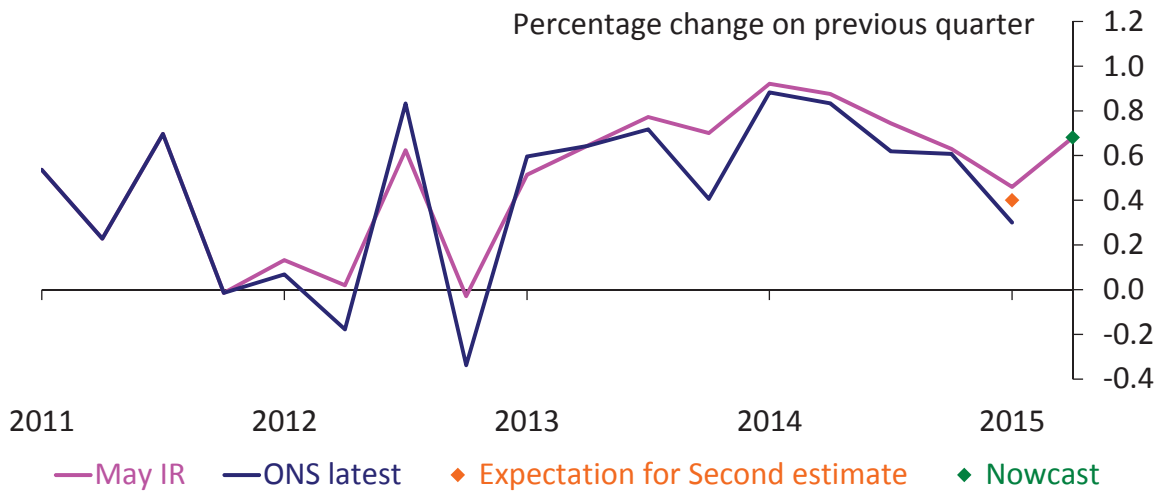
CARE: Data are confidential until 00.01 Thursday 28th May



*In-house weighted composite of Service Sector, Distributive Trades and Monthly Trends surveys

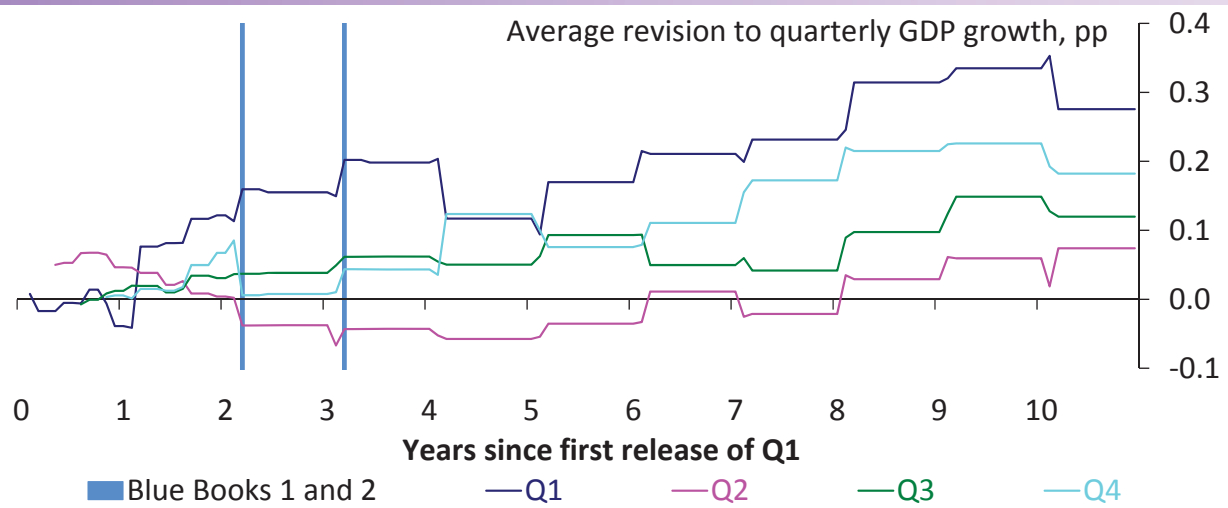
- The CBI surveys now suggest GDP growth of 1% in Q2

Near-term GDP outlook



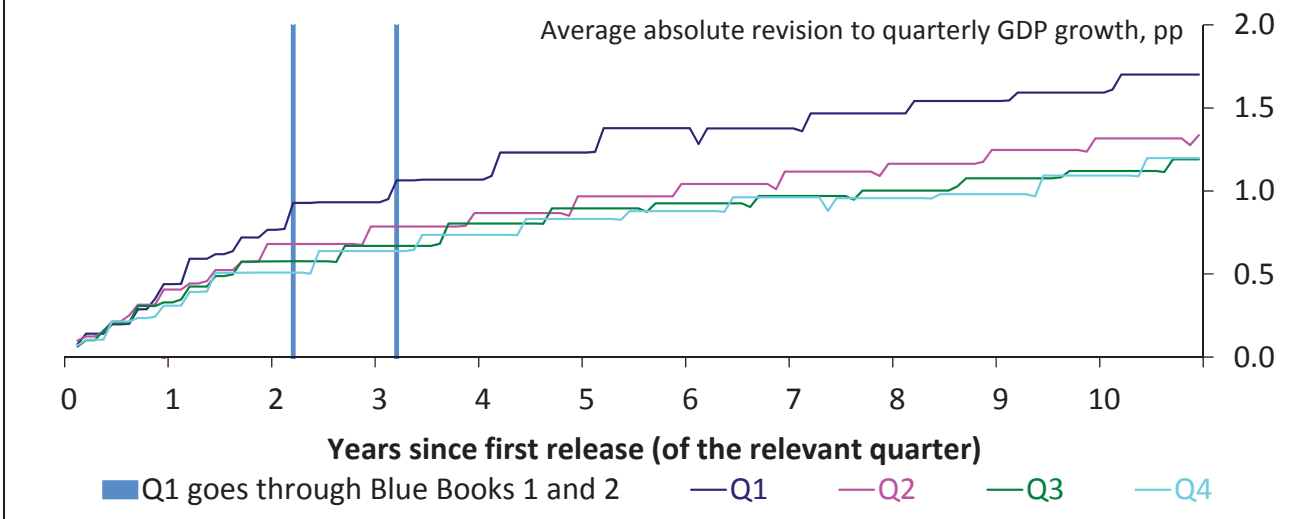
- We expect Q1 growth to be revised up to 0.4%

Average revisions by quarter



- Q1s are revised up by more than other quarters. See for more details.

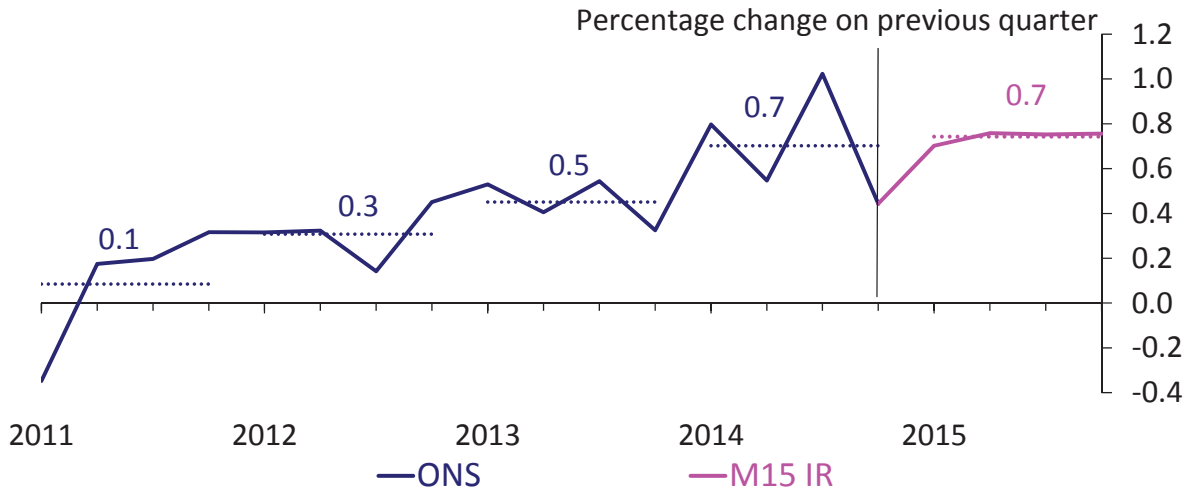
Average absolute revisions by quarter



- Q1s are revised by more (in either direction) than other quarters

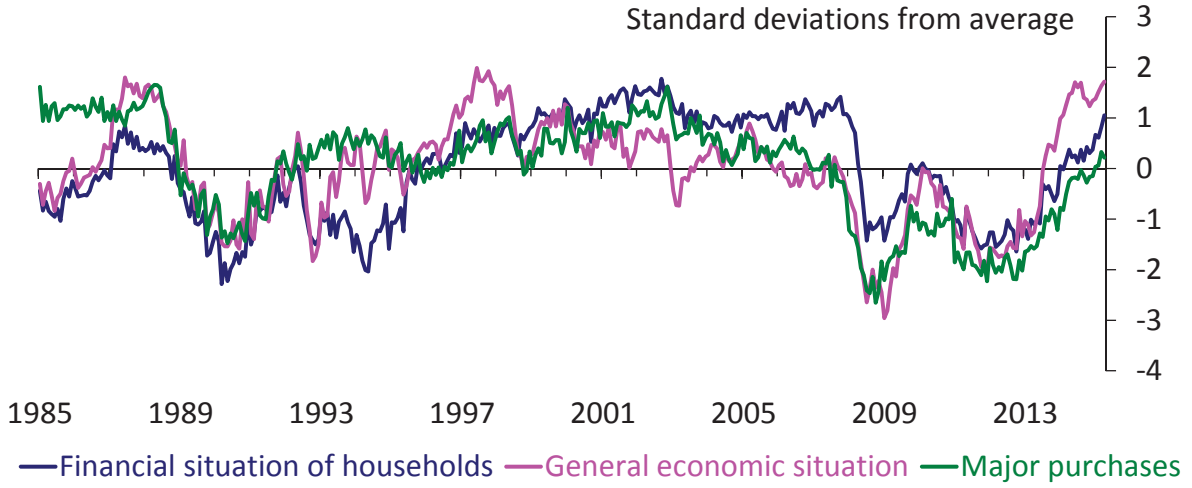
Consumption

Quarterly consumption growth



- We expect last year's pace of growth to be maintained

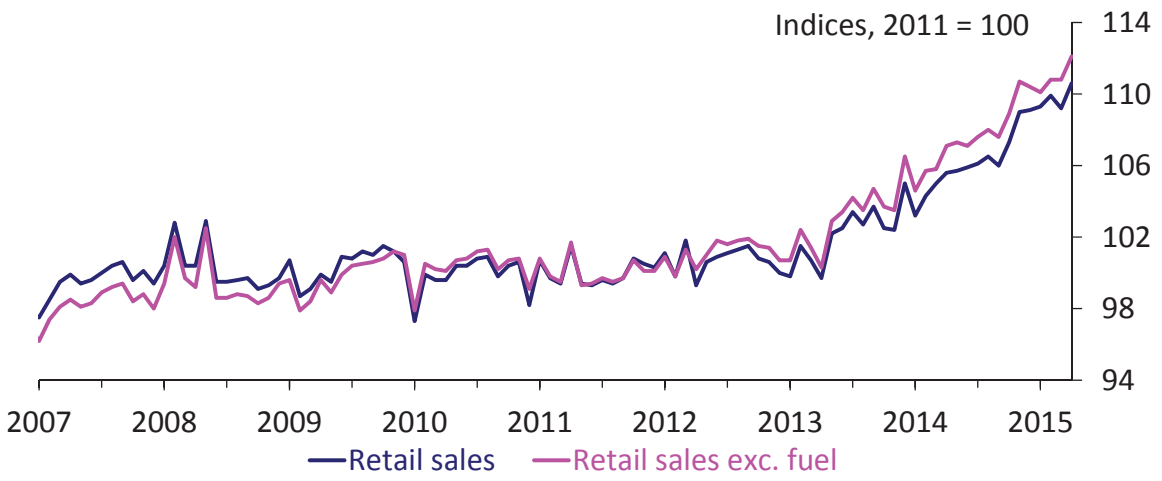
GfK/EC consumer confidence



Series are an average of forward and backward looking balances. Sample average: January 1985 to April 2015

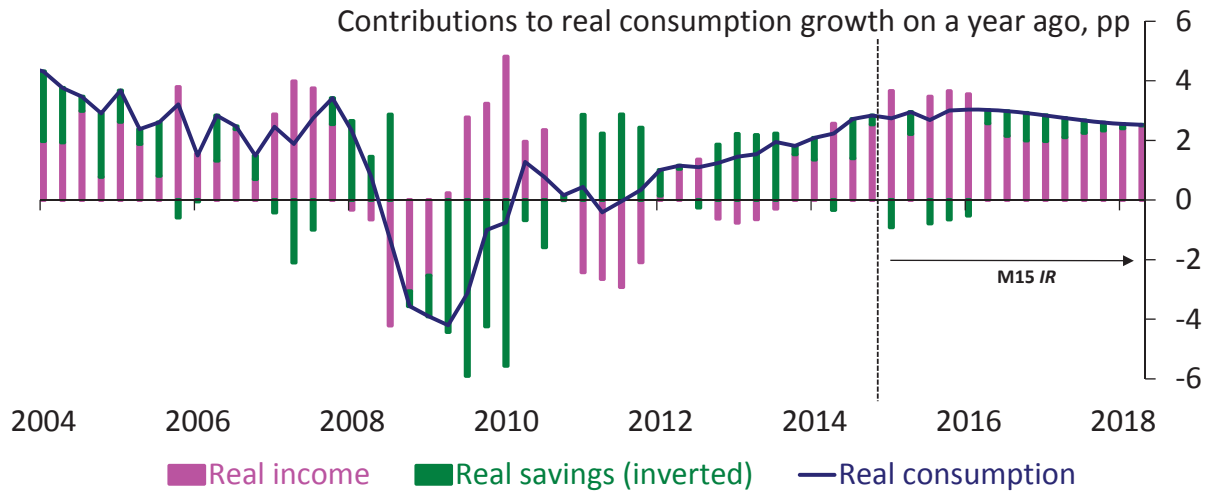
- Consumer confidence remains around historically high levels

Retail sales



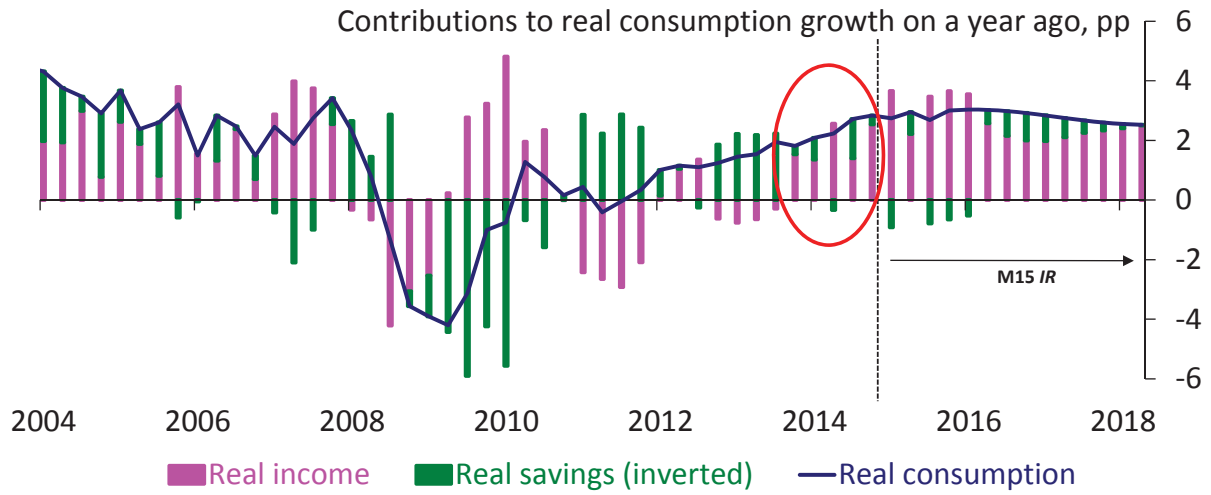
- Retail sales (both incl. & excl. fuel) rose by 1.2% on the month in April

Real consumption growth



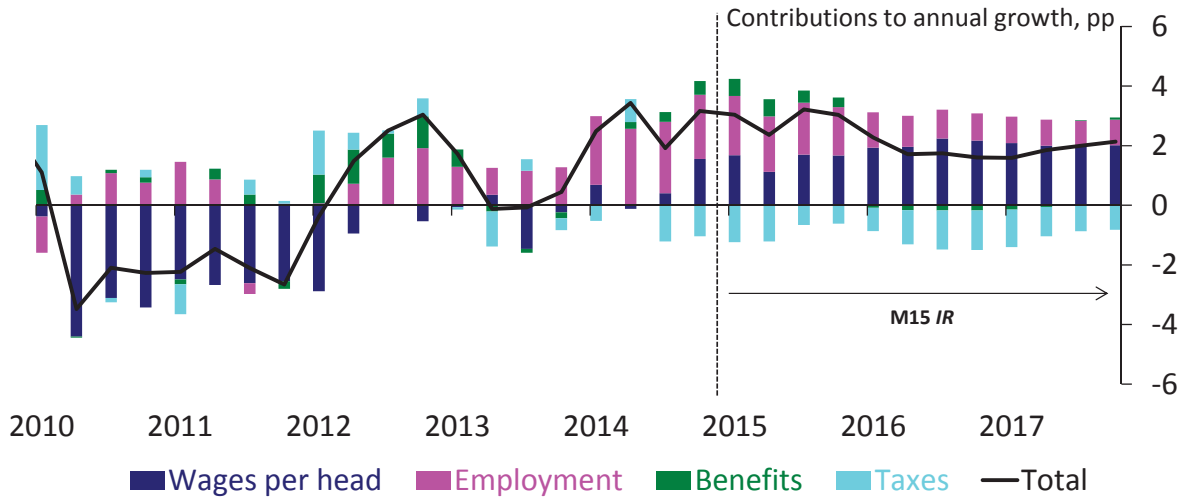
- The May15 *IR* forecast predicts that consumption growth will continue to be underpinned by real income growth

Real consumption growth



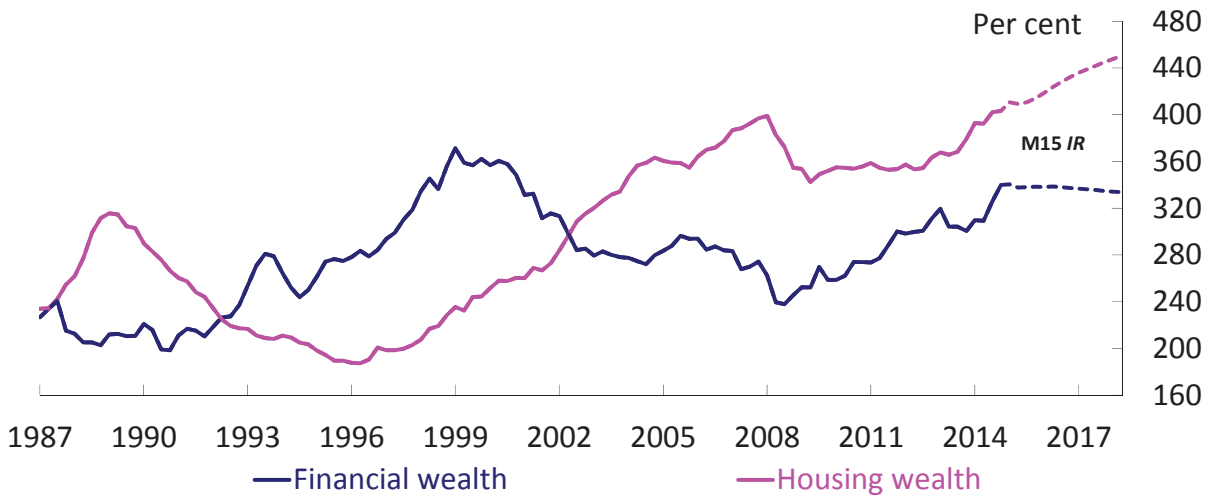
- The May15 *IR* forecast predicts that consumption growth will continue to be underpinned by real income growth

Contributions to real labour income growth



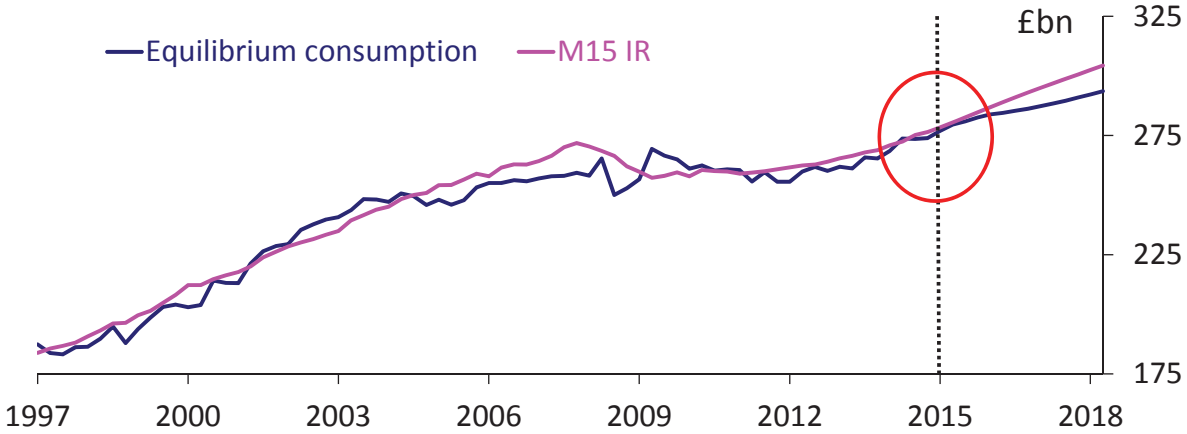
- The composition of real labour income growth is expected to shift from employment to wages per head over the forecast

Household wealth to income ratios



- We do not expect planned wealth accumulation to weigh on consumption

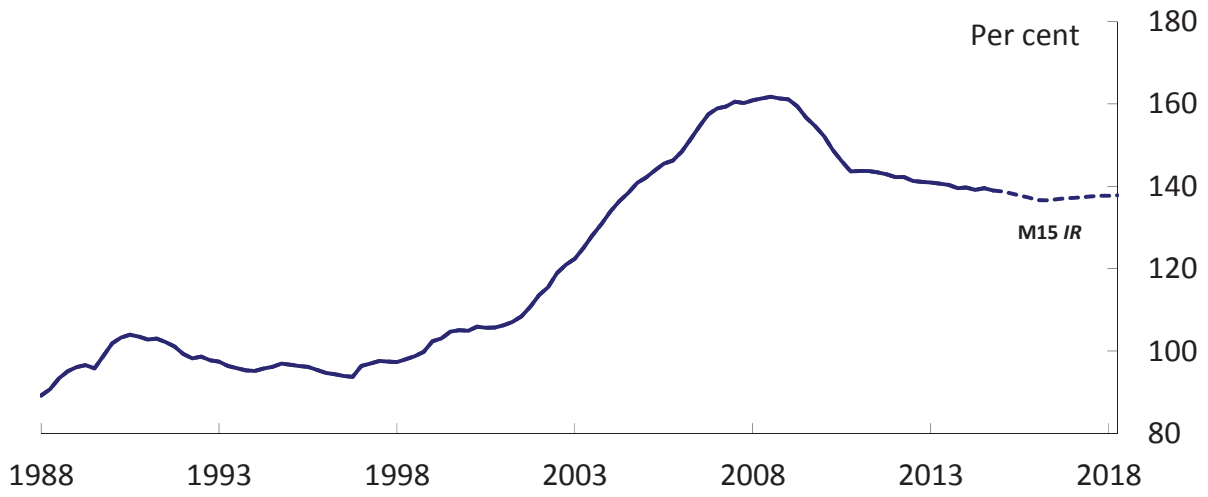
Consumption level relative to equilibrium



Note: The ECM includes total real wealth, real labour income and the real rate of interest in the long-run term.

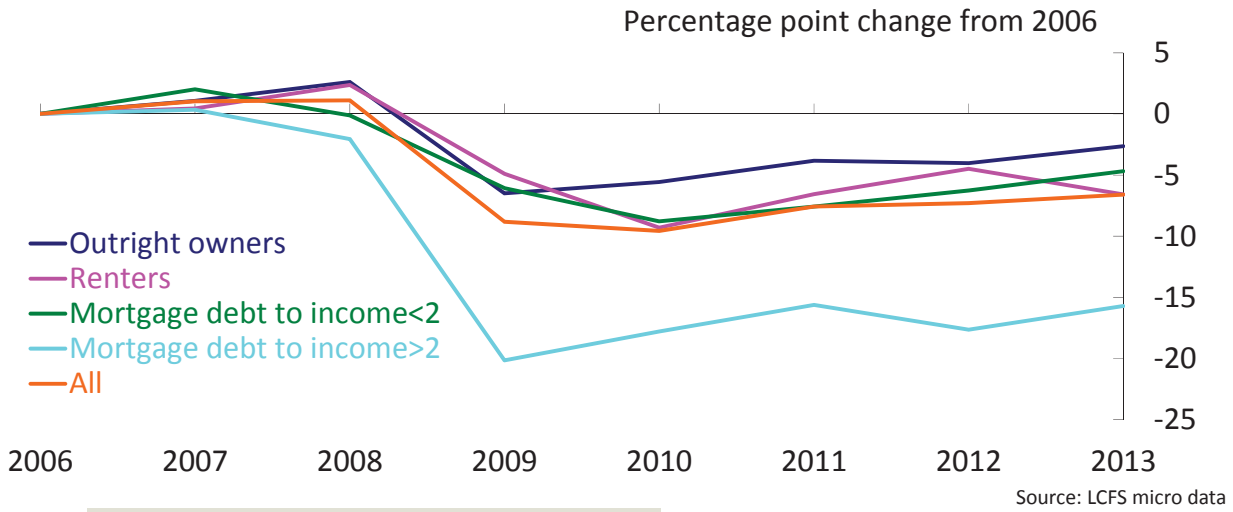
- Consumption remains in line with its equilibrium level over the first year of the M15 *IR* forecast

Household debt to income ratio



- We do not expect de-leveraging to hold back household demand

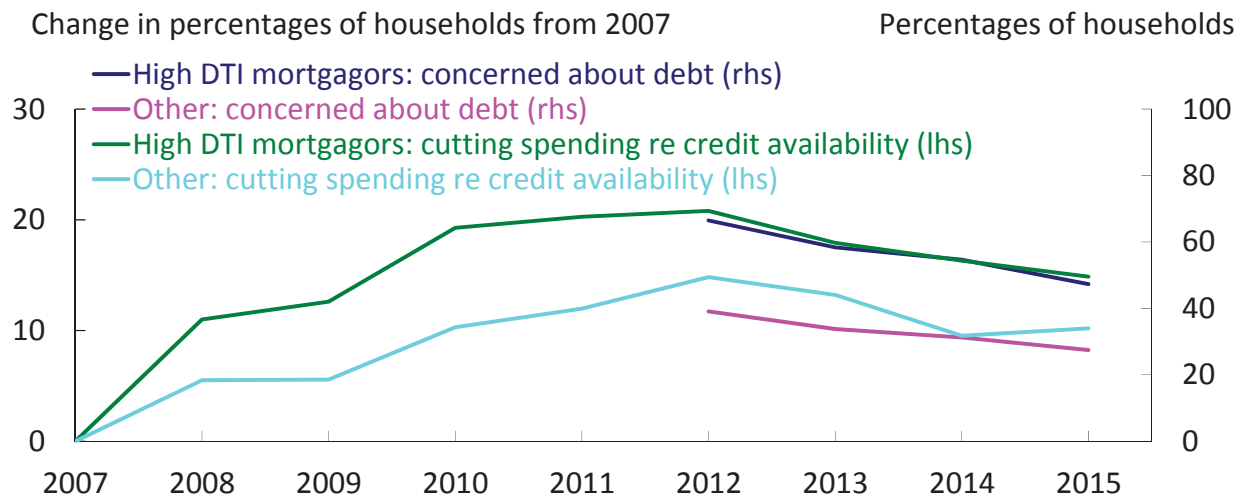
Changes in spending relative to income



Source: LCFS micro data

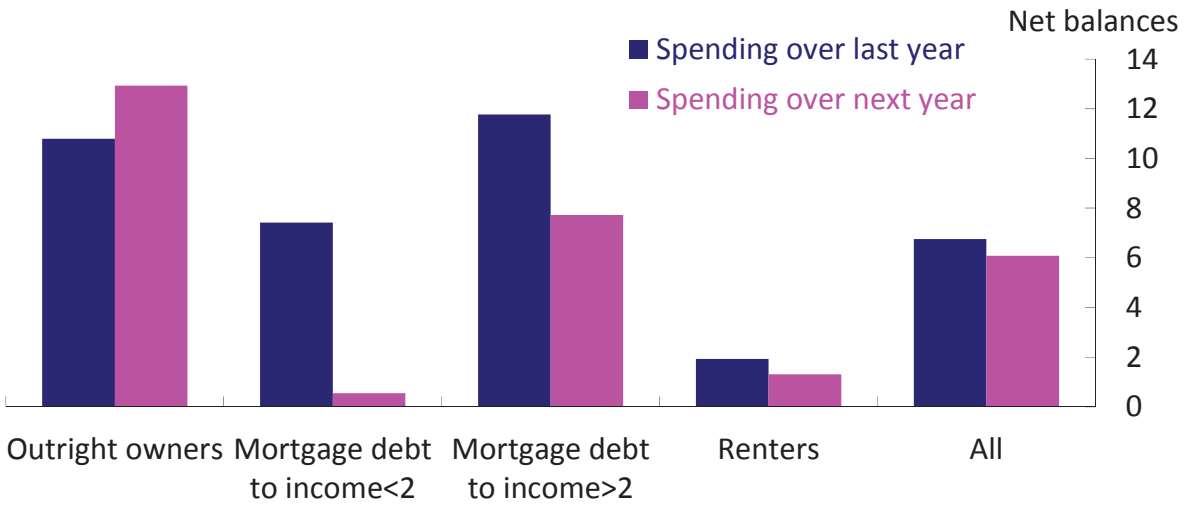
- See for more disaggregated analysis

NMG: concerns about debt and credit availability



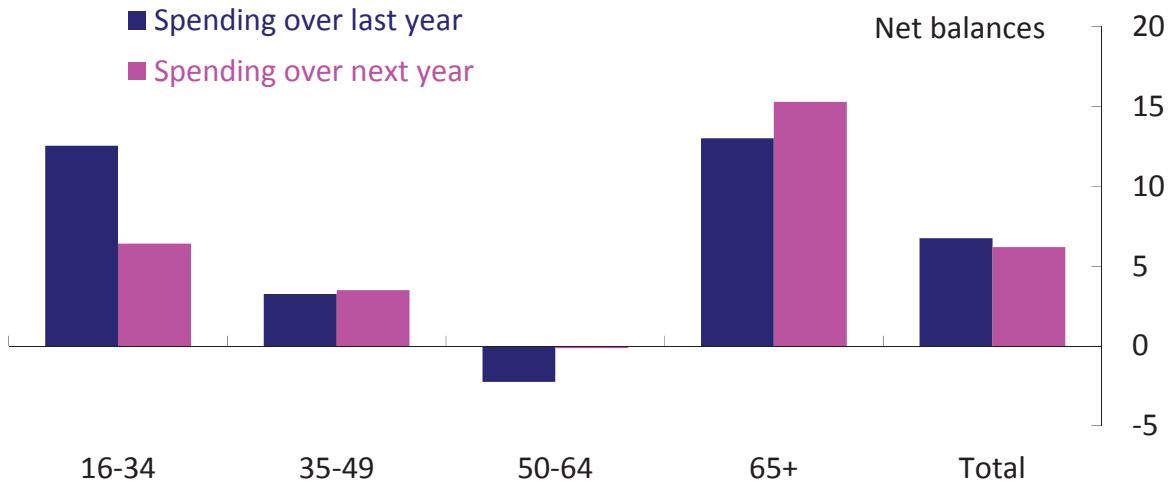
- Concerns about debt have eased a little

NMG: spending by tenure



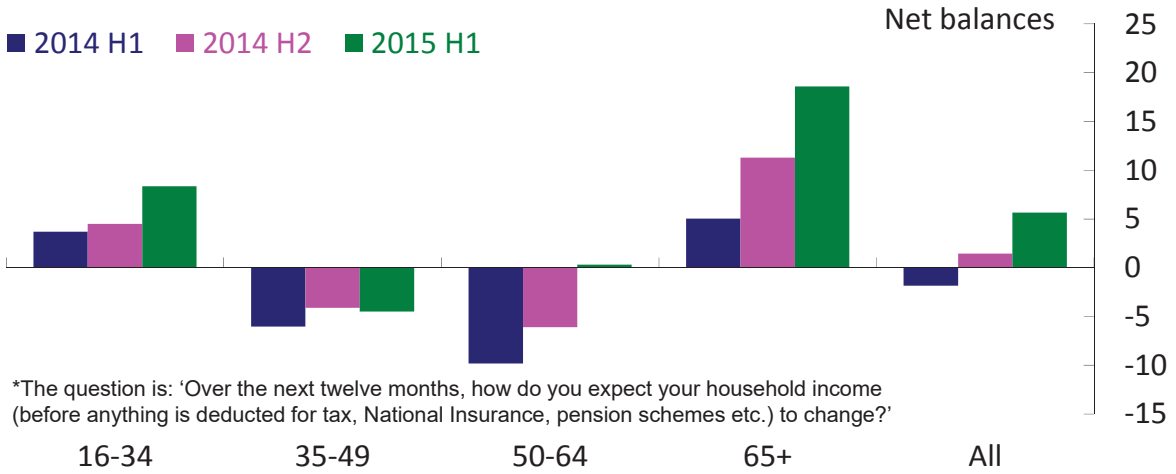
- More indebted mortgagors have reported relatively strong actual and planned spending growth

NMG: spending by age



- The reported increase in spending was largest among the youngest and oldest groups

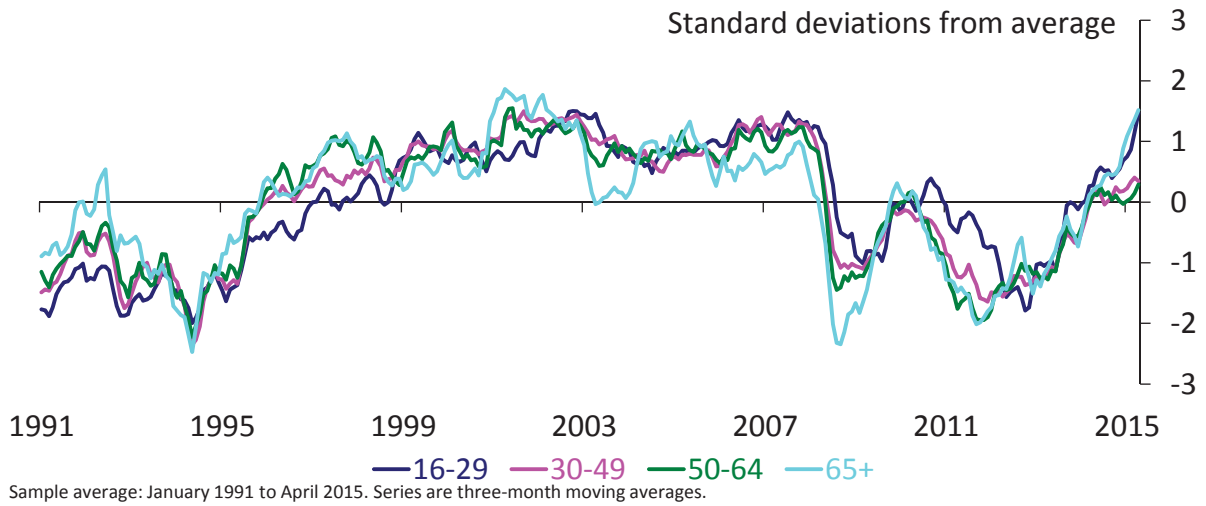
NMG: year ahead income expectations* by age



*The question is: 'Over the next twelve months, how do you expect your household income (before anything is deducted for tax, National Insurance, pension schemes etc.) to change?'

- The more positive income outlook is driven by the youngest and oldest cohorts

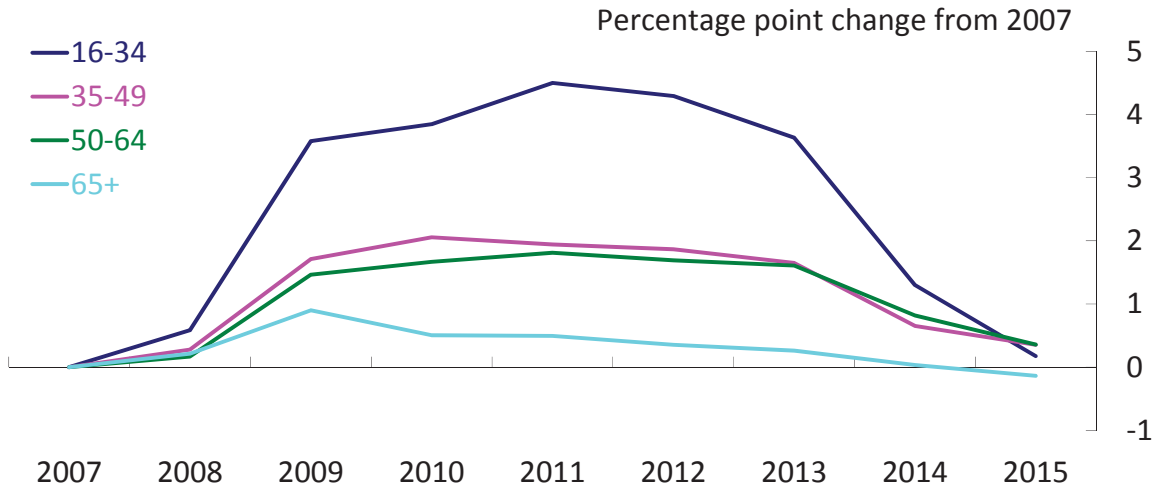
GfK/EC household financial situation by age



Sample average: January 1991 to April 2015. Series are three-month moving averages.

- Confidence in household finances has improved the most among the youngest and oldest

Changes in unemployment rates since 2007



- The young have been the main beneficiaries of strong employment growth

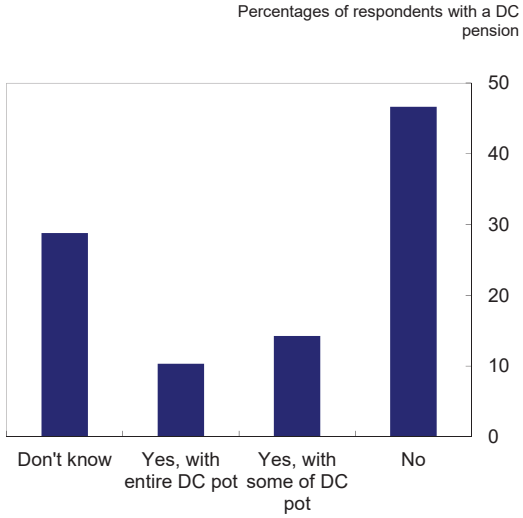
Pension reforms

- April 2015 – those retiring with a defined contributions pension no longer need to buy an annuity
- April 2016 (proposed) – existing annuity holders will be able to sell back

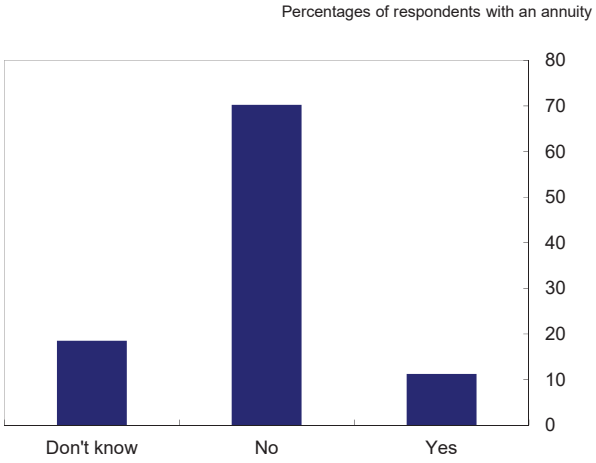
- See for more on the impact of the recent reforms

NMG: pensioners' intentions

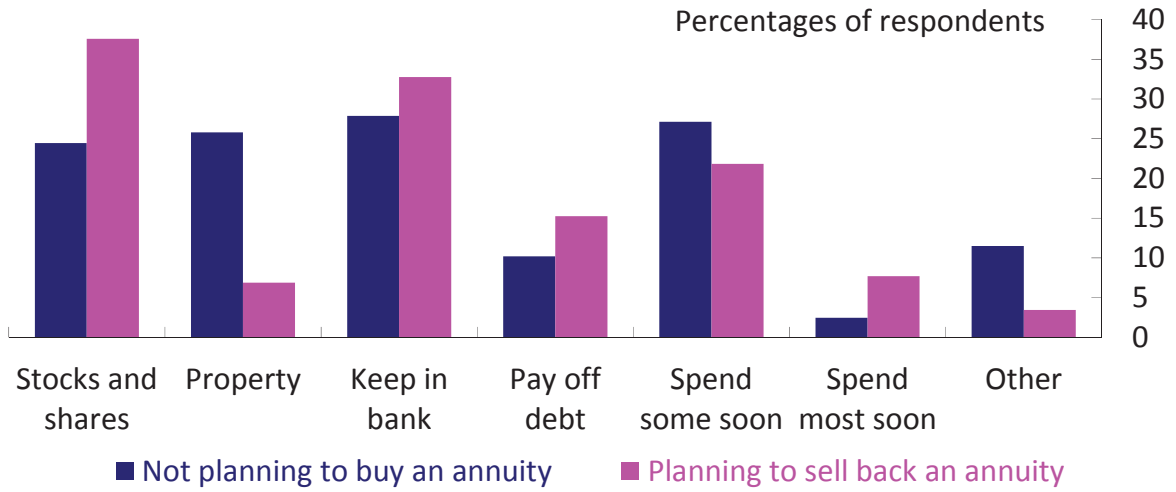
Will buy an annuity



Will sell back an annuity

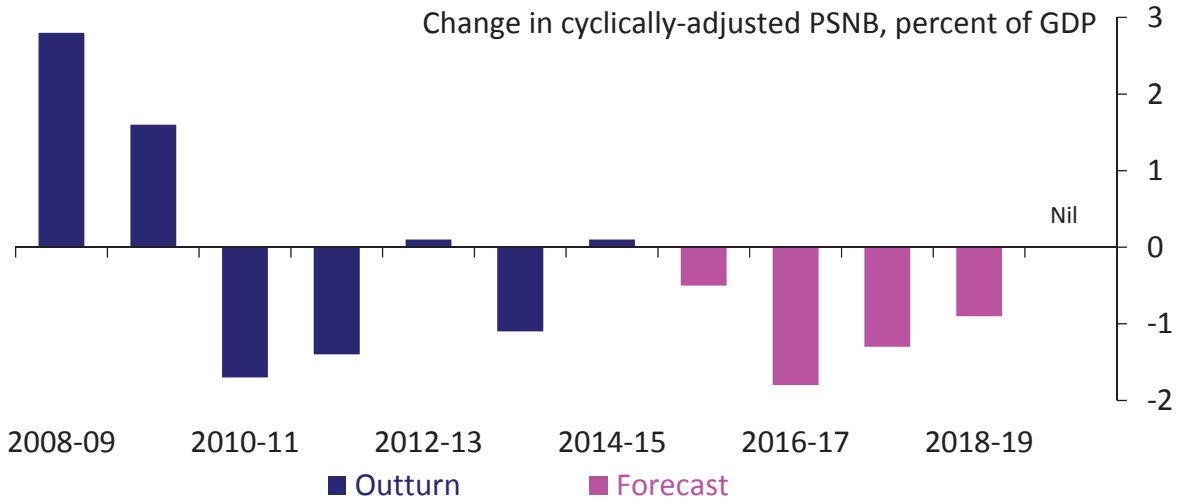


NMG: uses of the liberated pension cash



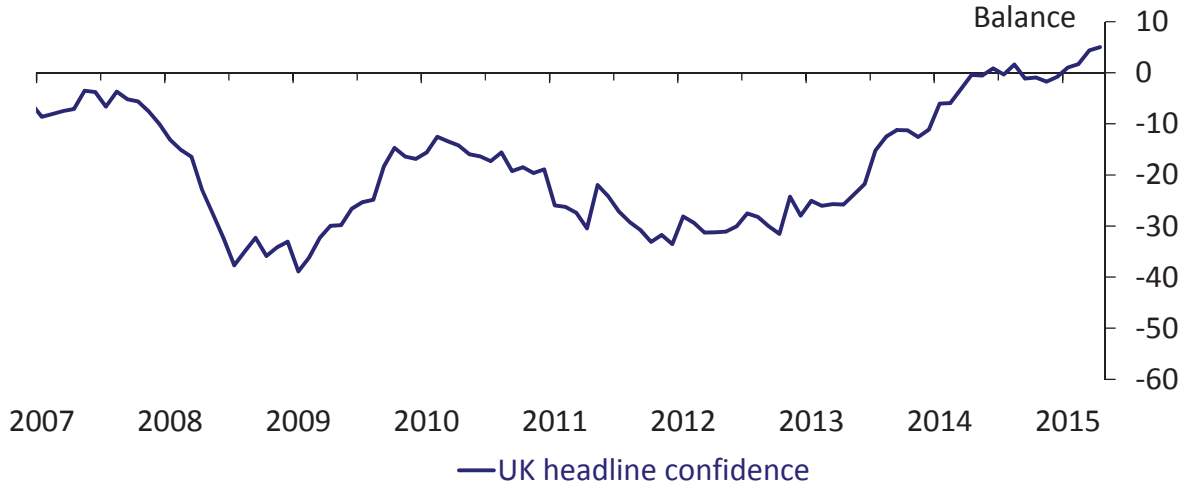
- The <0.1% impact on consumer spending suggested by the NMG results is smaller than we originally thought

Change in cyclically adjusted PSNB



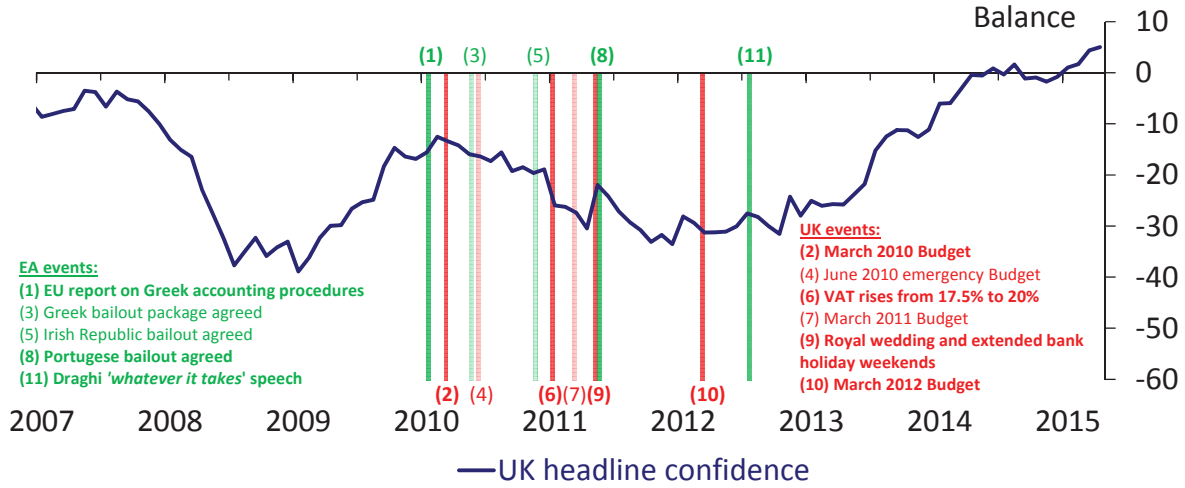
- A cumulative 4.5% of GDP adjustment is factored into the forecast over 2015/16- 2018/19

GfK/EC headline consumer confidence



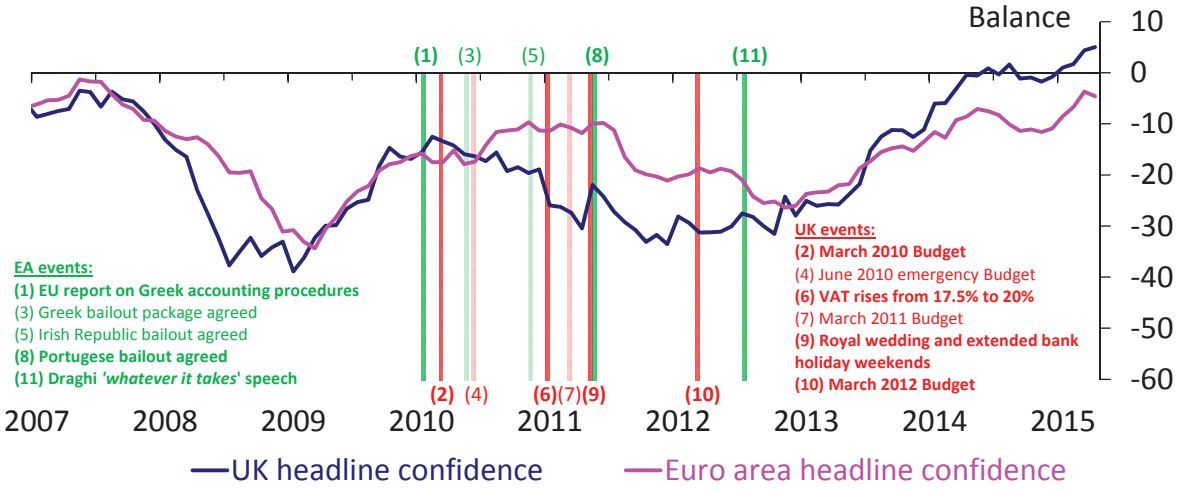
- The post-crisis recovery in consumer confidence went into reverse in 2010

GfK/EC headline consumer confidence



- Looking at specific domestic and euro area events, it is hard to disentangle their effects

GfK/EC headline consumer confidence



- But it is striking that UK confidence was much weaker than EA confidence from mid-2010 to 2012

Key messages

- Modest upside news on near-term activity; Q1 weakness still appears largely erratic
- Household consumption seems well-supported by fundamentals, at least in the near term
- Pension changes are likely to impart a negligible boost to consumption
- There is a risk that fiscal consolidation hits household confidence, but this is hard to quantify

GDP tables (unchanged since May pre-MPC)

Excluding revisions:

Current quarterly GDP growth & initial release projections

	Headline GDP#		GDP**^	
	Now	Feb IR	Now	Feb IR
2013 Q1	0.6	0.6	0.7	0.7
Q2	0.6	0.6	0.5	0.5
Q3	0.4	0.7	0.5	0.5
Q4	0.4	0.4	0.5	0.5
2014 Q1	0.9	0.6	0.7	0.5
Q2	0.8	0.8	0.8	0.8
Q3	0.6	0.7	0.6	0.7
Q4	0.6	0.5	0.8	0.7
2015 Q1	0.3	0.6	0.5	0.6
Q2	0.6	N/A	0.6	N/A
Q3	N/A	N/A	N/A	N/A

Including revisions:

Final quarterly GDP growth estimates & projections

	Headline GDP#		GDP**^	
	Now	Feb IR	Now	Feb IR
2013 Q1	0.5	0.5	0.6	0.6
Q2	0.6	0.6	0.5	0.5
Q3	0.7	0.8	0.8	0.5
Q4	0.7	0.6	0.8	0.7
2014 Q1	0.9	0.8	0.8	0.7
Q2	0.9	0.9	0.9	0.9
Q3	0.7	0.8	0.8	0.9
Q4	0.6	0.6	0.8	0.8
2015 Q1	0.5	0.7	0.7	0.7
Q2	0.7	0.7	0.7	N/A
Q3	N/A	N/A	N/A	N/A

market prices
^ basic prices

END

6: Agents' Special Topics - Exports

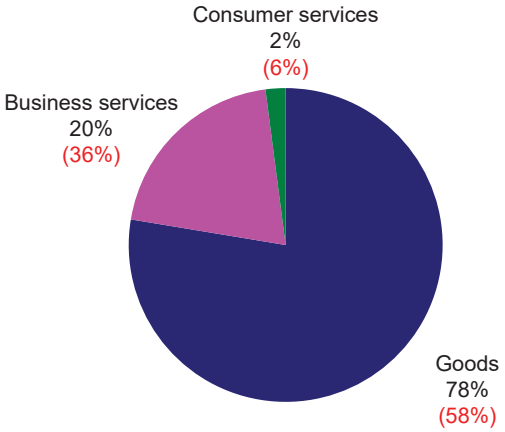
Agents' Exports Survey

26 May 2015

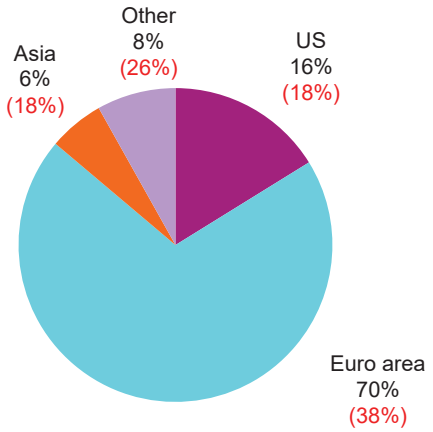
Agency for Greater London
Inflation Report & Agency Intelligence Division

Respondents by sector & main market

Sector



Main market



Aggregate results weighted by export turnover and sector export share
Red denotes official data

Background note by

Questions

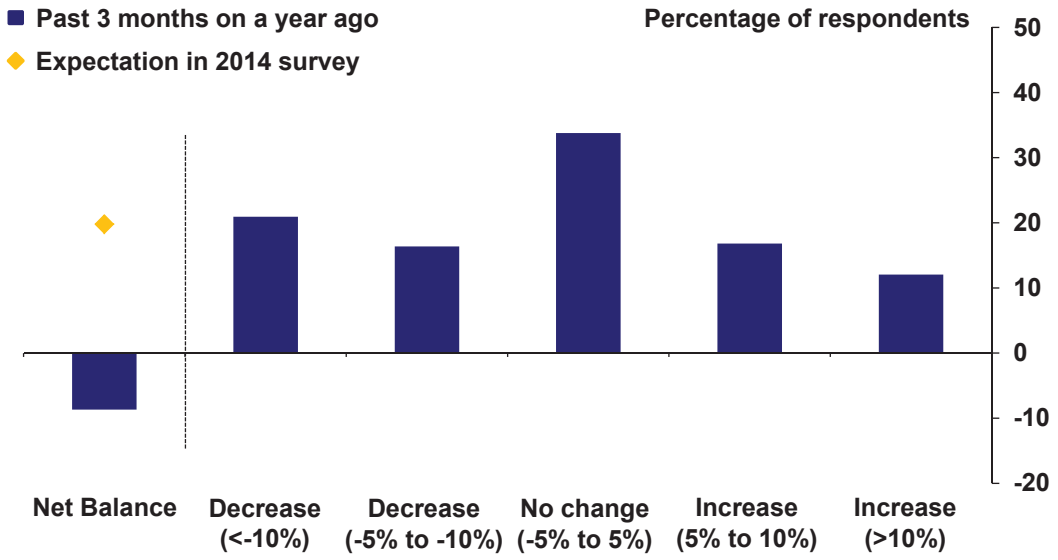
1. Currency in which exports predominantly sold.

2. Change in GBP value of exports over the past 3 months oya, and expectations for the next 12 months.

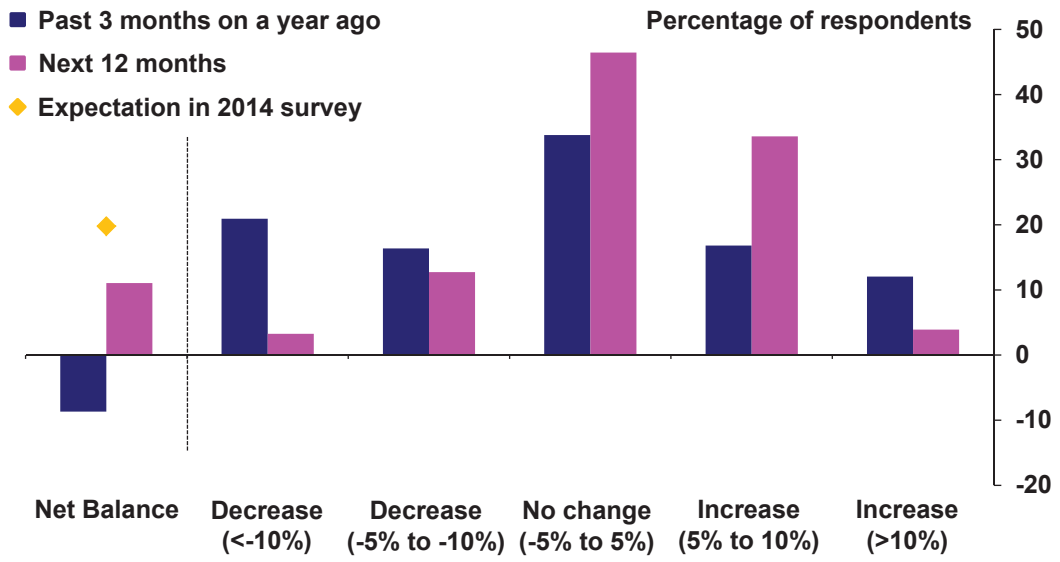
3. Factors affecting GBP value of exports over the next 12 months.

4. Effects on export performance from GBP movements since early 2013.

Exports - sterling value growth

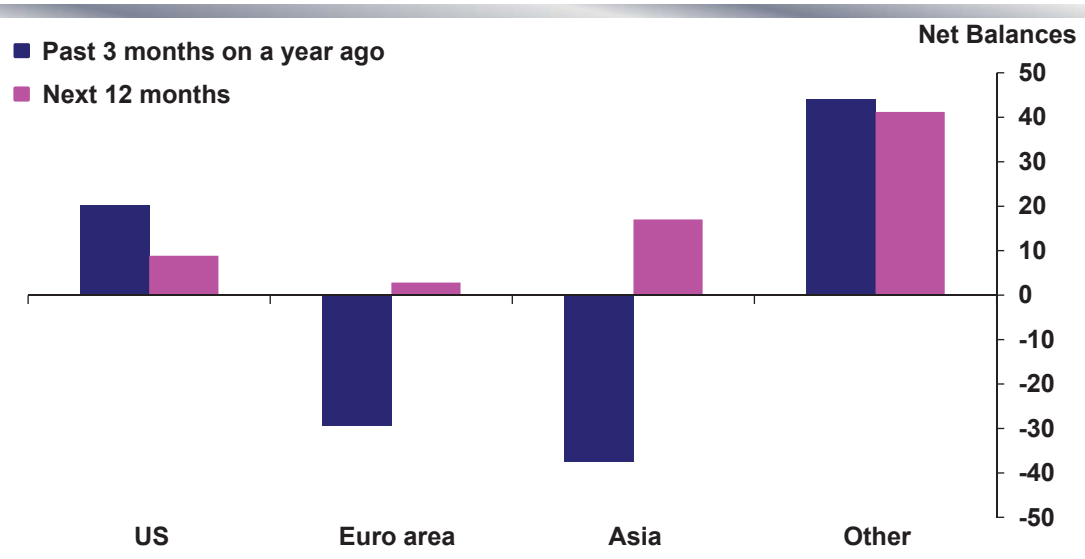


Exports - sterling value growth

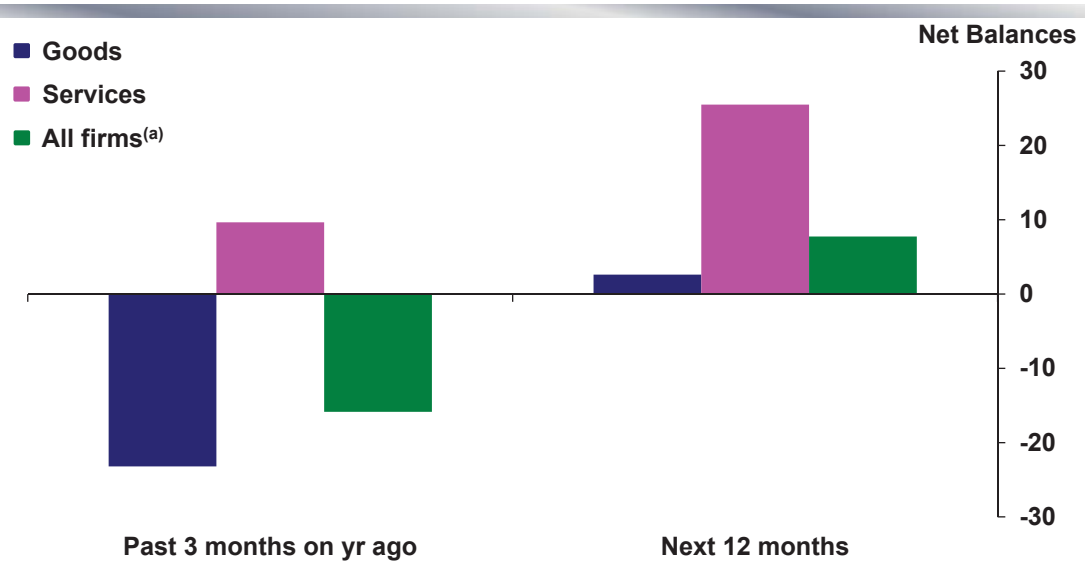


5

Exports - sterling value growth: by main market

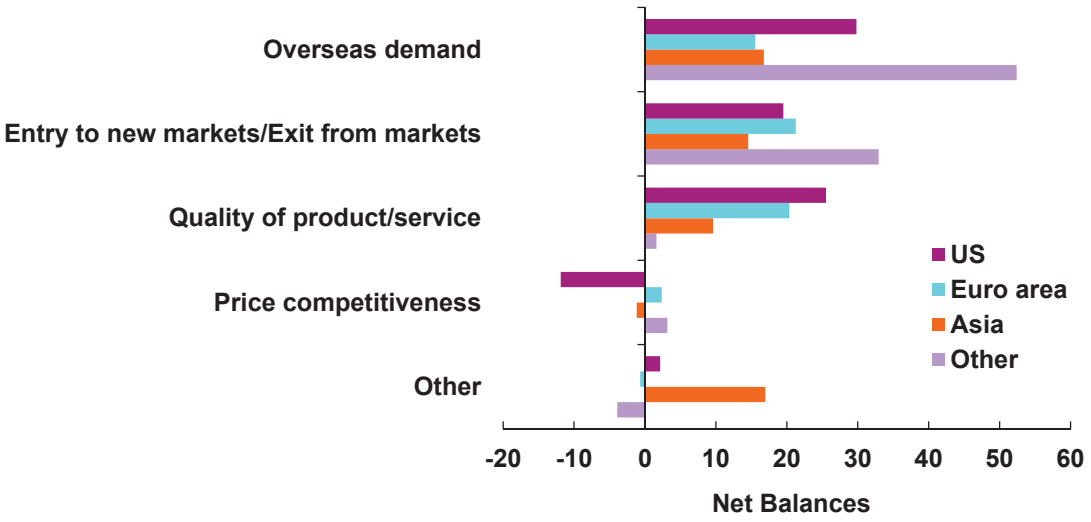


Exports - sterling value growth: by sector

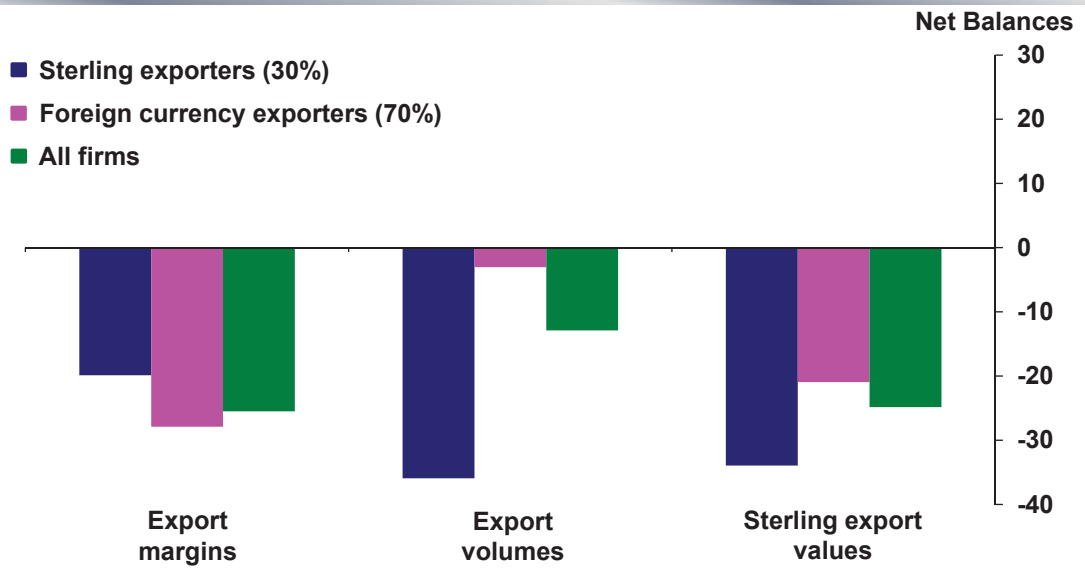


(a) Aggregate bars single weighted in this chart

Factors affecting export growth over the next year



Effect of movements in sterling: by predominant exporting currency



Sterling +18% vs EUR between March 2013 and the start of the survey; little changed against the US dollar; +24% against the yen.)

Impact of exchange rate changes

- Short-term consistent with 70:30 fx:GBP pricing
- Medium-term, some fx prices will rise to improve margin; some GBP prices will fall o/a competitiveness
- Hedging delays the impact for some contacts
- For some contacts, negative impact of rise in GBP on margins offset by lower input costs

Summary

- Softer export performance, especially to Europe and Asia, and especially in goods
- Weak pickup expected, with “other” markets strong; services more positive than goods
- Overseas demand growth expected to be positive in all markets; little net impact from price competitiveness
- Exchange rate changes have so far affected margins more than volumes

END

7: Costs and Prices

Costs and Prices

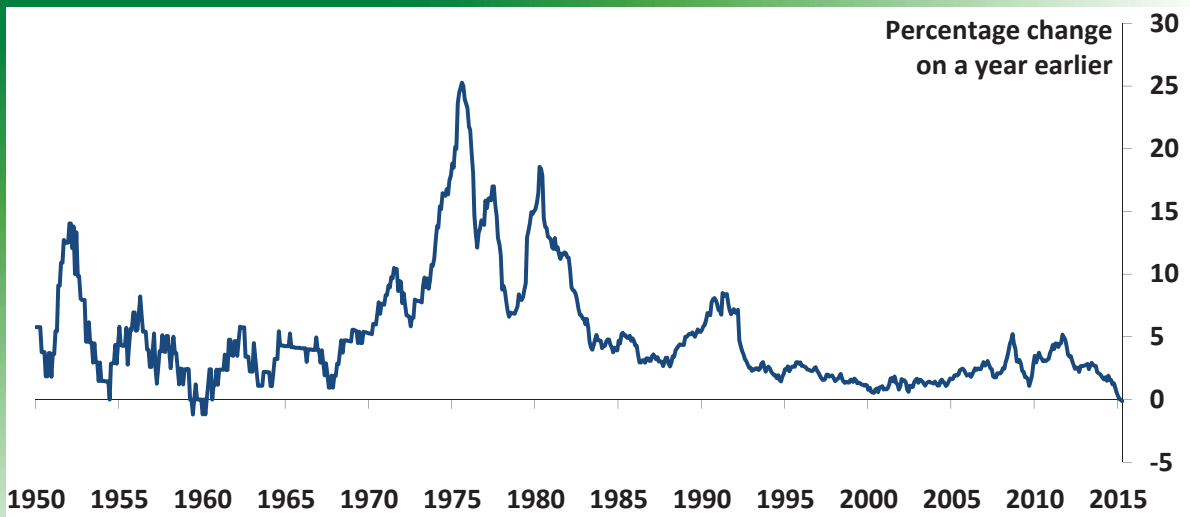
26 May 2015

Structural Economic Analysis Division

Outline

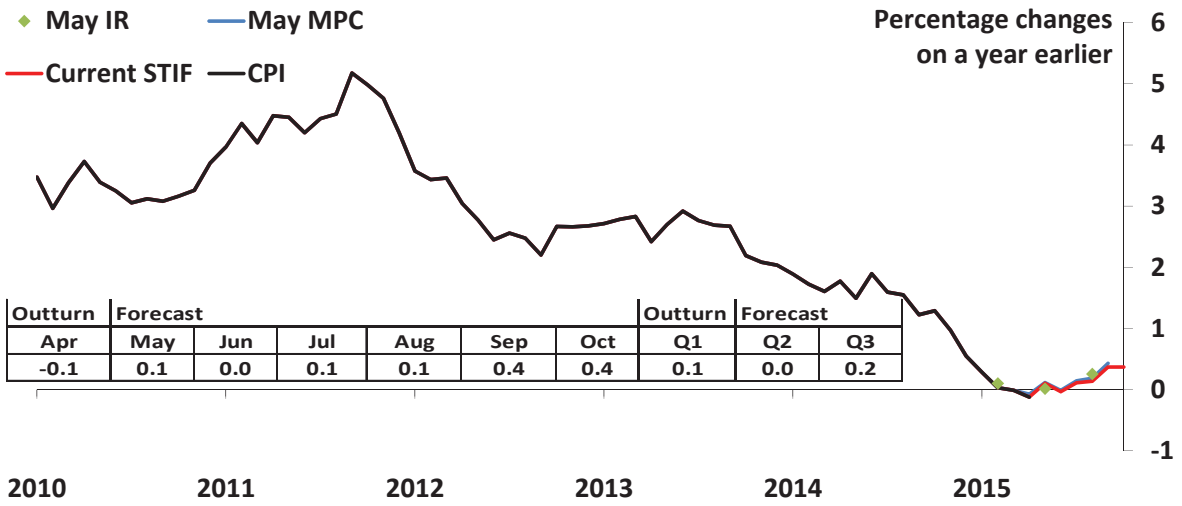
- Short-term inflation forecast
- Latest pay trends
- Migration update
- Labour market quantities including the outlook for unemployment

Long-run inflation



- April saw the first negative inflation outturn since March 1960.

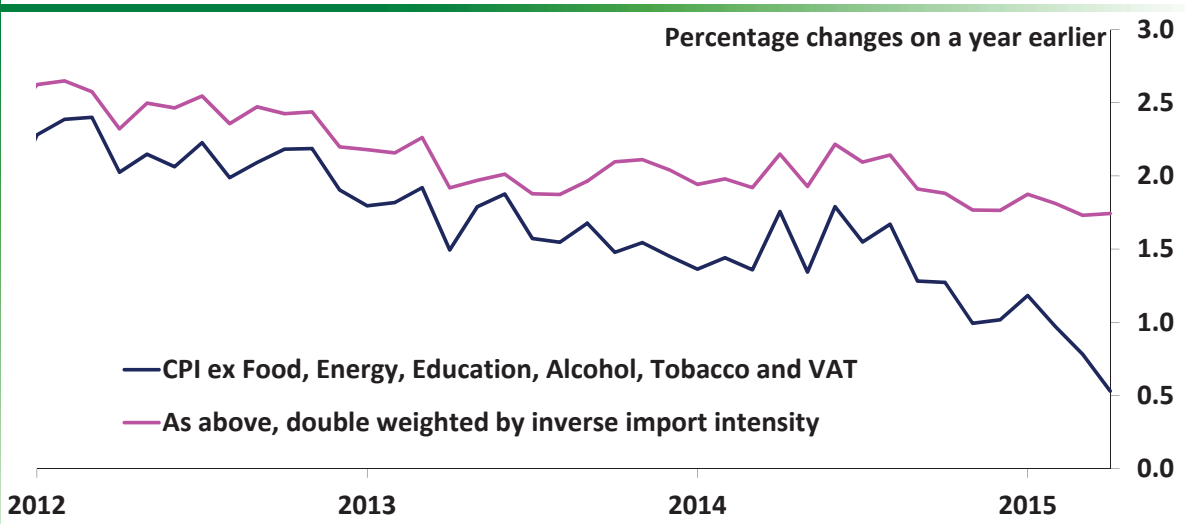
Short-term inflation forecast



Outturn	Forecast						Outturn	Forecast	
Apr	May	Jun	Jul	Aug	Sep	Oct	Q1	Q2	Q3
-0.1	0.1	0.0	0.1	0.1	0.4	0.4	0.1	0.0	0.2

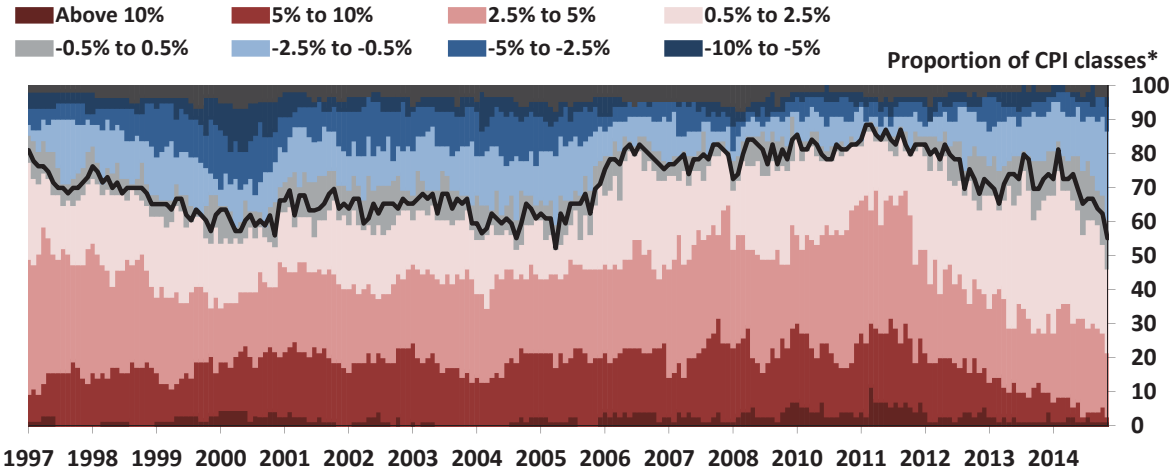
- Inflation -0.1% in April as expected. Positive outturn expected in May.

Core inflation



- **ONS measures of core inflation fell from 1% to 0.8%. Much of the fall in core inflation appears to reflect import prices.**

Diffusion index (annual inflation rates)

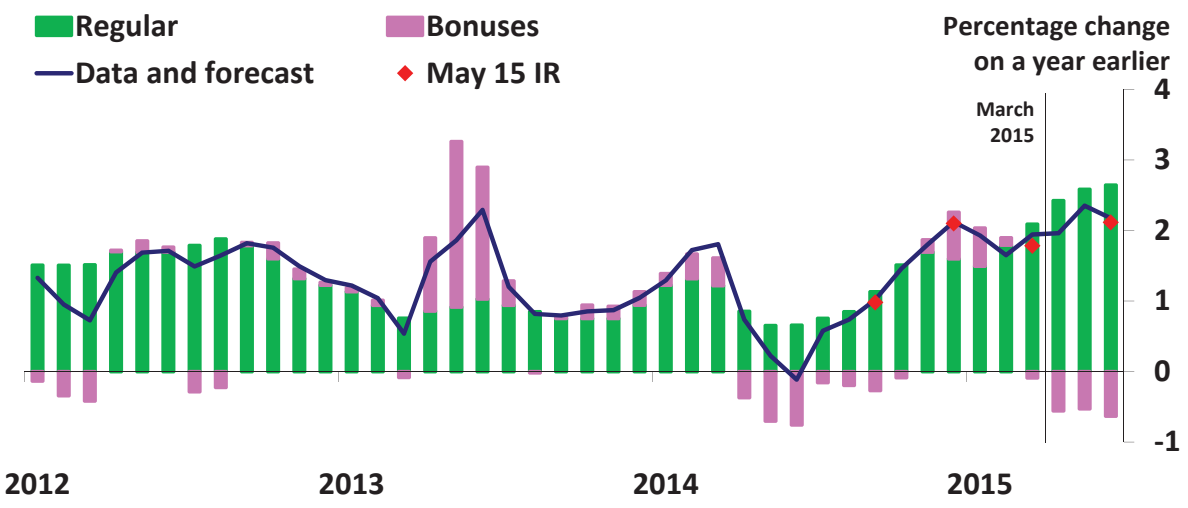


** Excludes food, non-alcoholic beverages and energy*

- **Proportion of items with rising prices fell in April from 62% to 55%, partly reflecting Easter effects.**

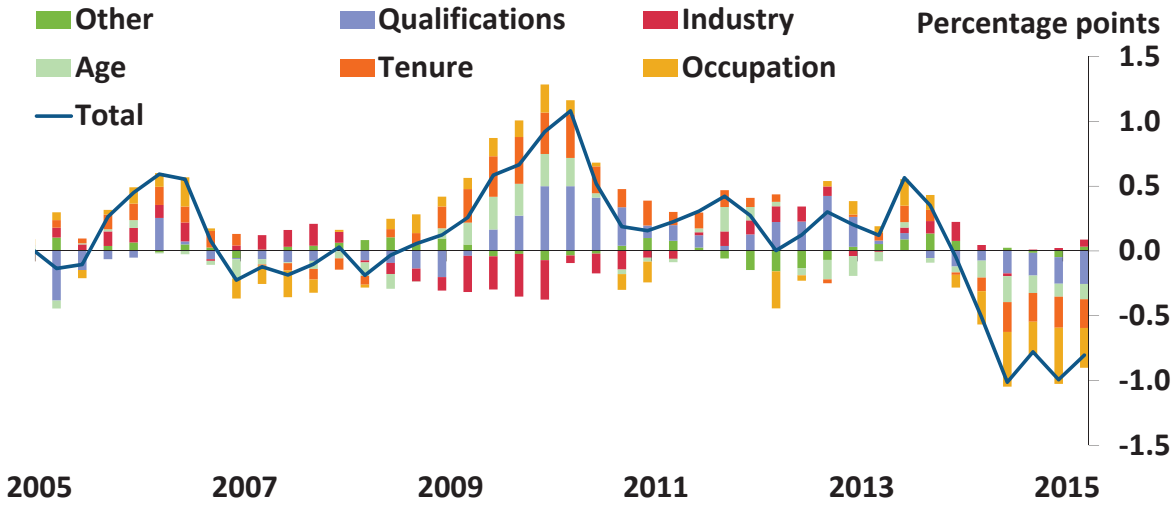
Wages

Whole economy earnings growth



- Pay growth picked up slightly faster than expected to 1.9% in Q1.

Compositional effects

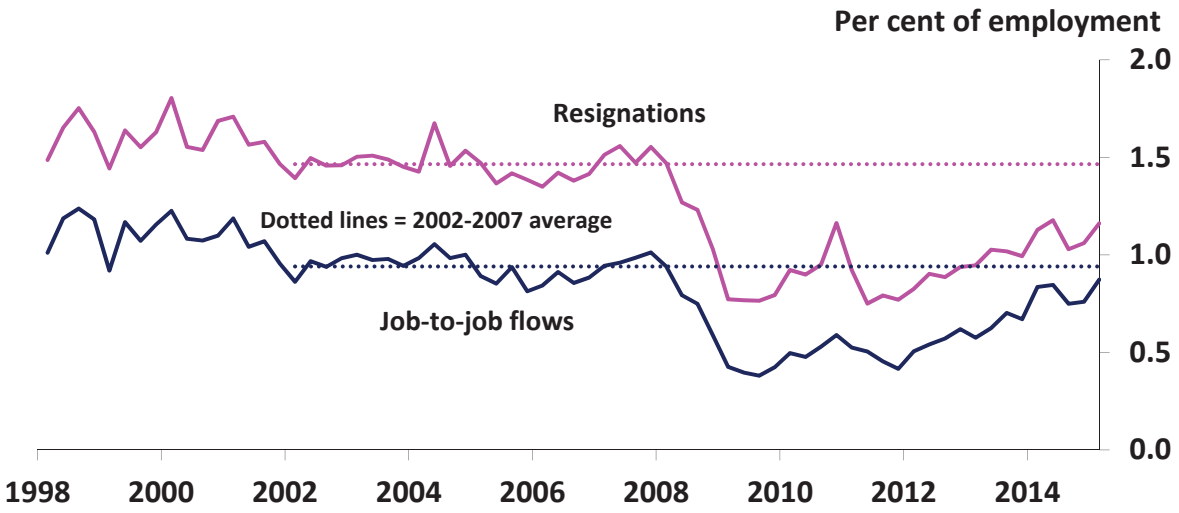


- Compositional effects still dragging on annual pay growth by 0.8pp.

Actual and underlying pay growth

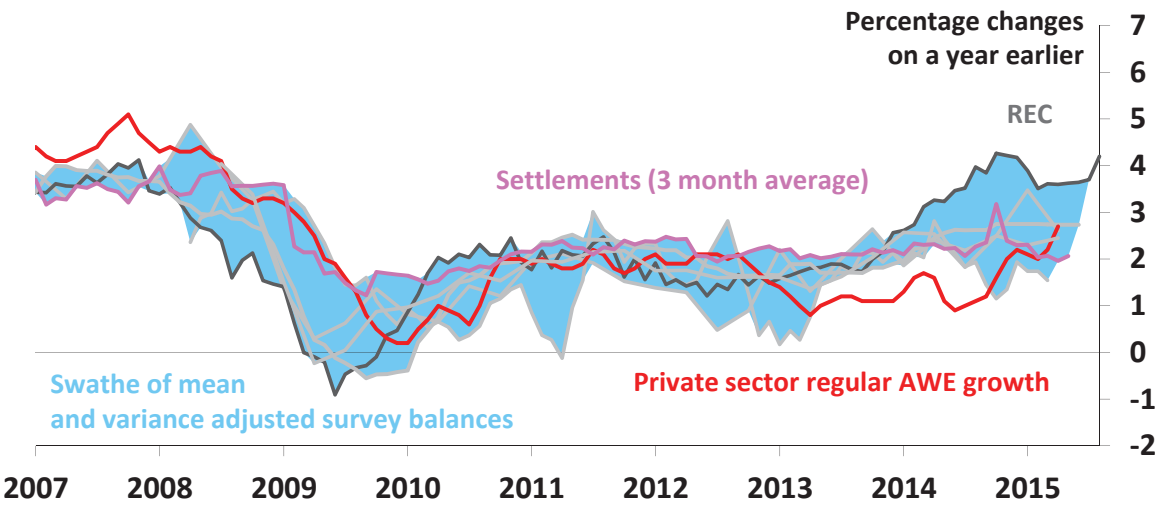
- For more details of compositional effects see .

Voluntary job-to-job flows



- Job-to-job flows are returning to normal.

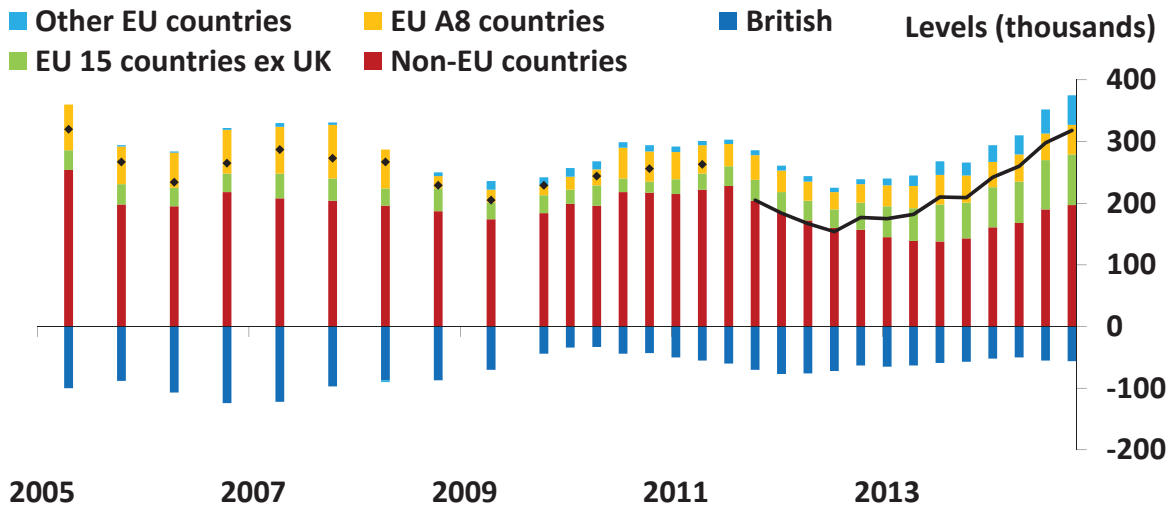
Earnings swathe



- Pay surveys broadly stable, pointing to pay growth around 3%.

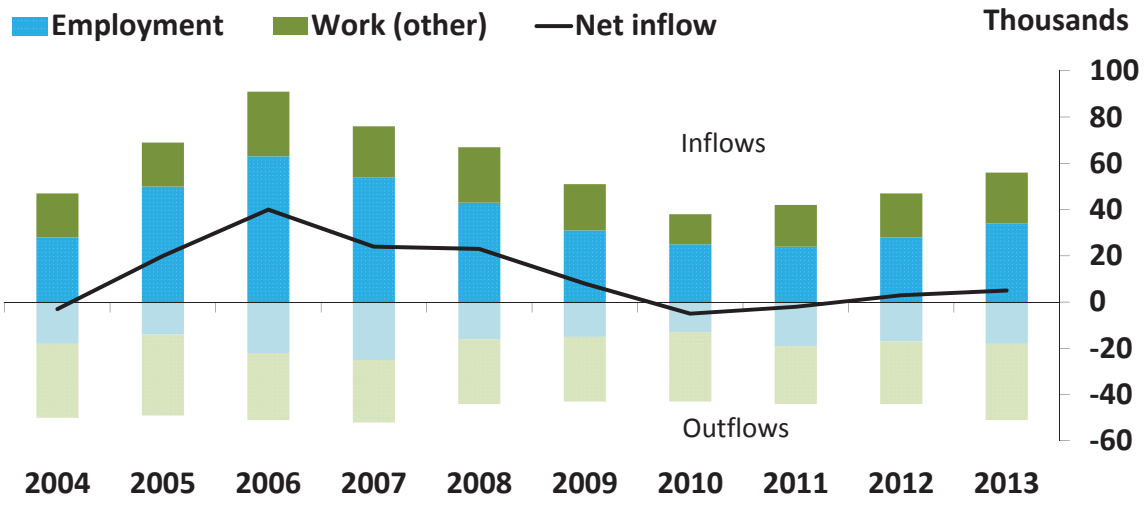
Migration

Net long-term migration



- Net migration in 2014 was 318,000, slightly lower than the mid-2005 peak.

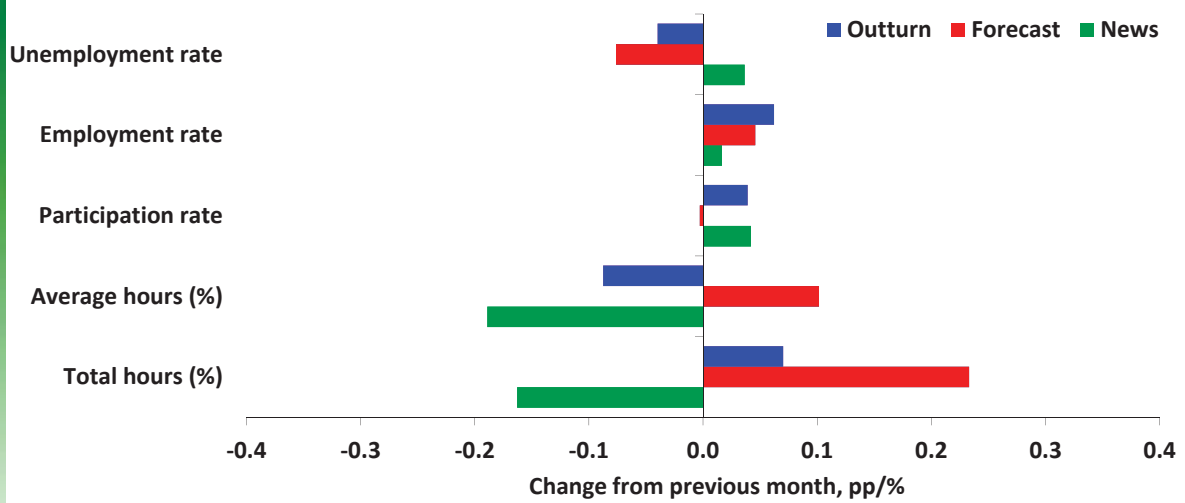
Work-related short-term migration



- For more details on migration, see .

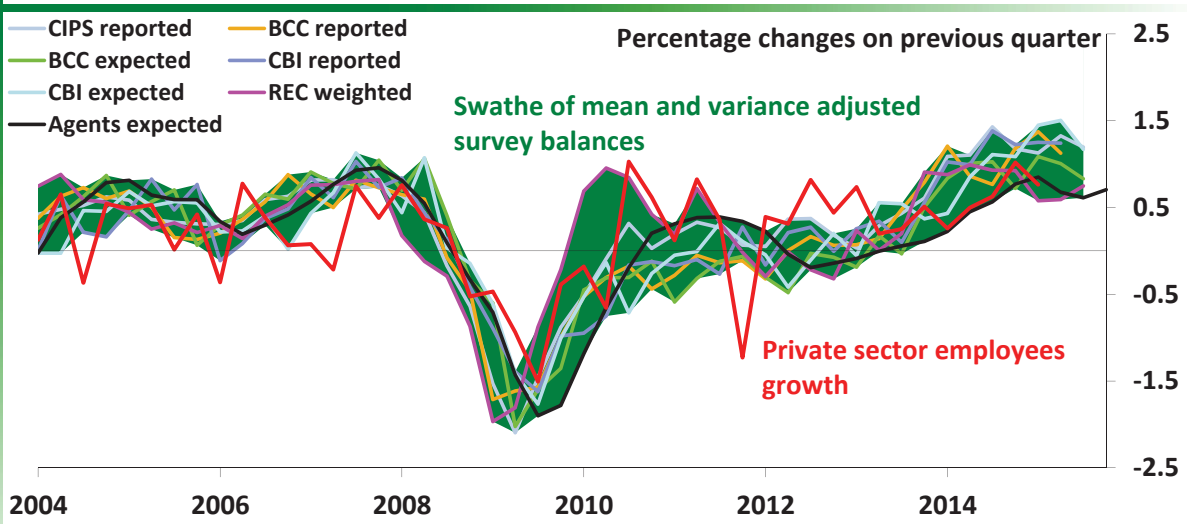
Labour market quantities

News in labour market quantities



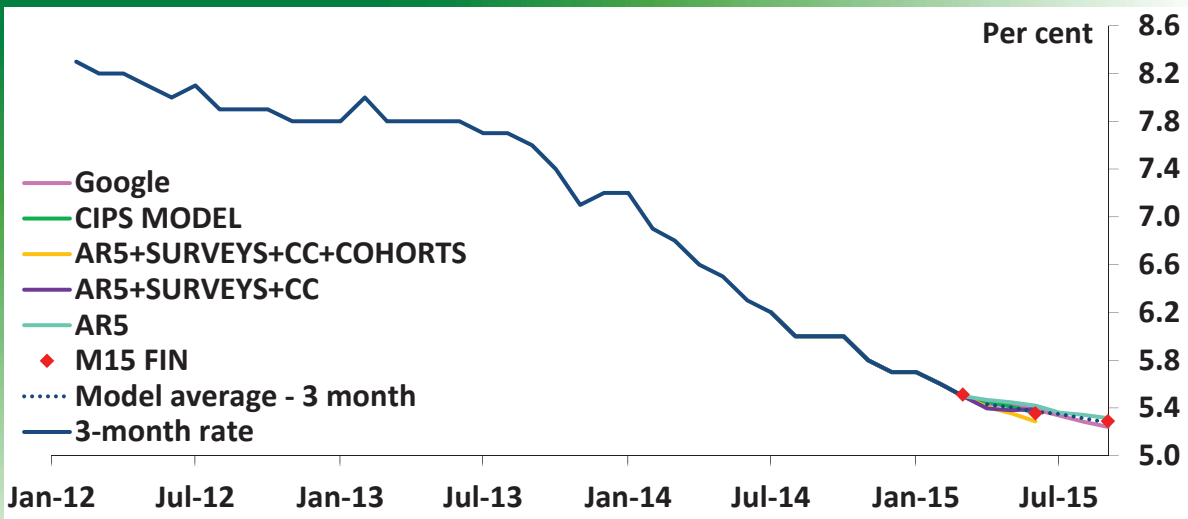
- **Unemployment and employment as expected, total hours slightly weaker than expected.**

Employment swathe



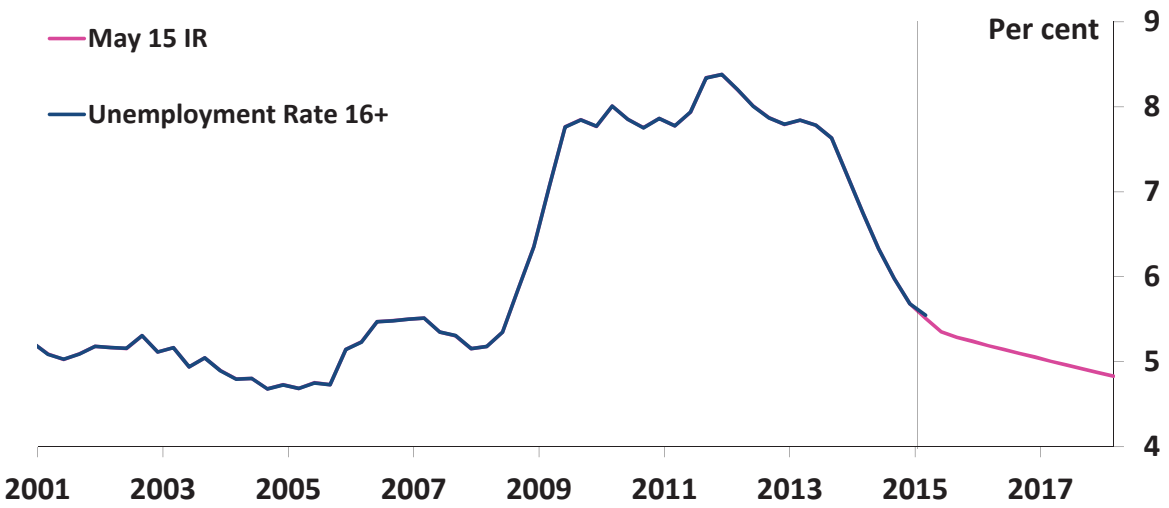
- Employment surveys remain robust.

STUF



- **Unemployment was 5.5% as expected—forecast little changed.**

Unemployment

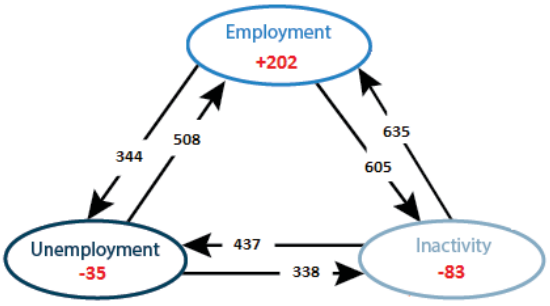


- After falling 2½ pp over the past three years, unemployment is forecast to fall ¾ pp over the next three years.

Gross flows

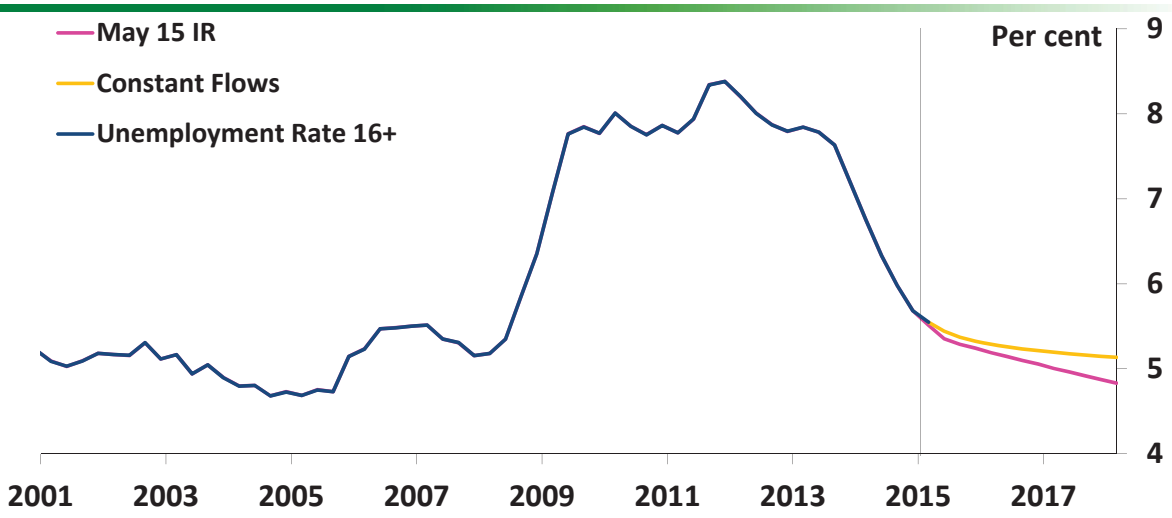
Quarterly flows
UK, seasonally adjusted

Jan-Mar 2015



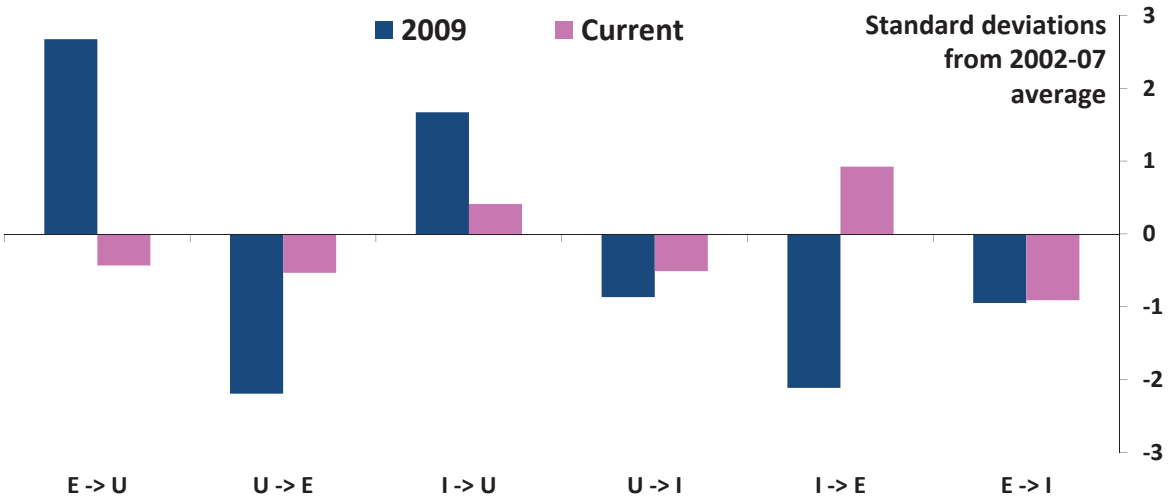
Number of people aged 16+ (thousands)

Unemployment flow scenarios



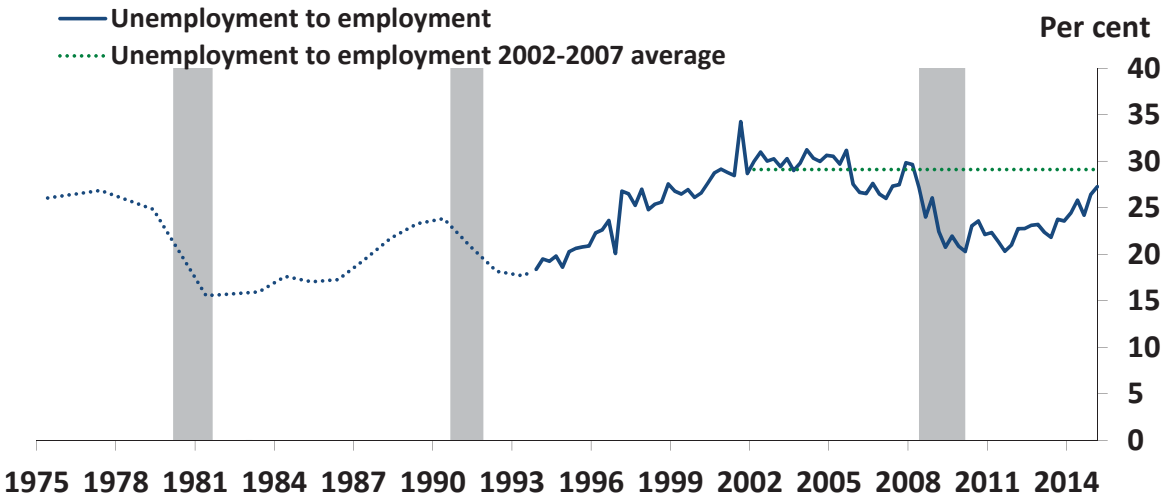
- If labour market flows remain at current rates, unemployment would converge to 5%.

Gross flows are close to pre-crisis averages



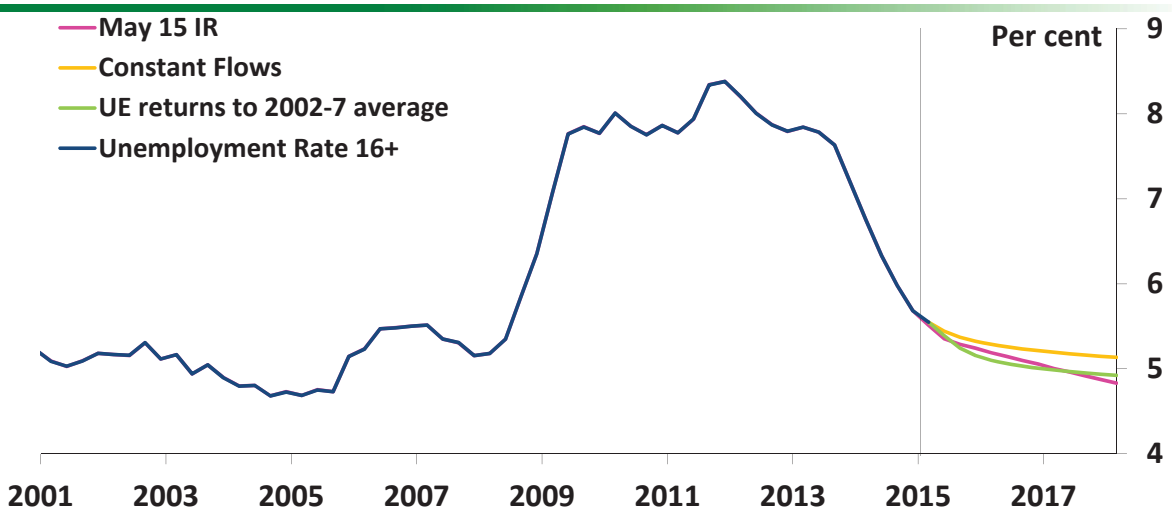
- Most flows are close to their pre-crisis average.

Job finding rate



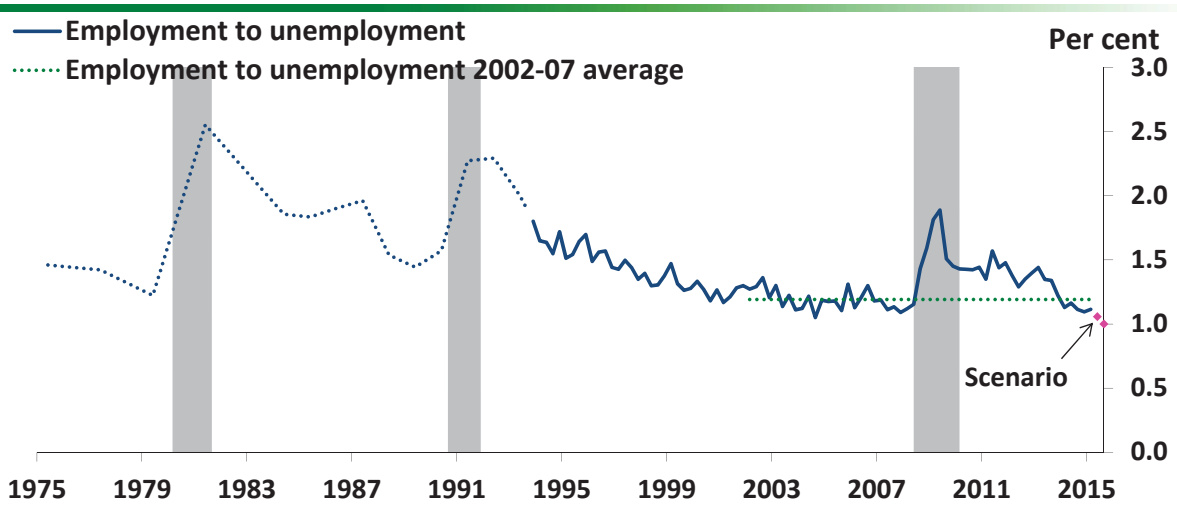
- Job finding rates still slightly below pre-crisis average.

Unemployment flow scenarios



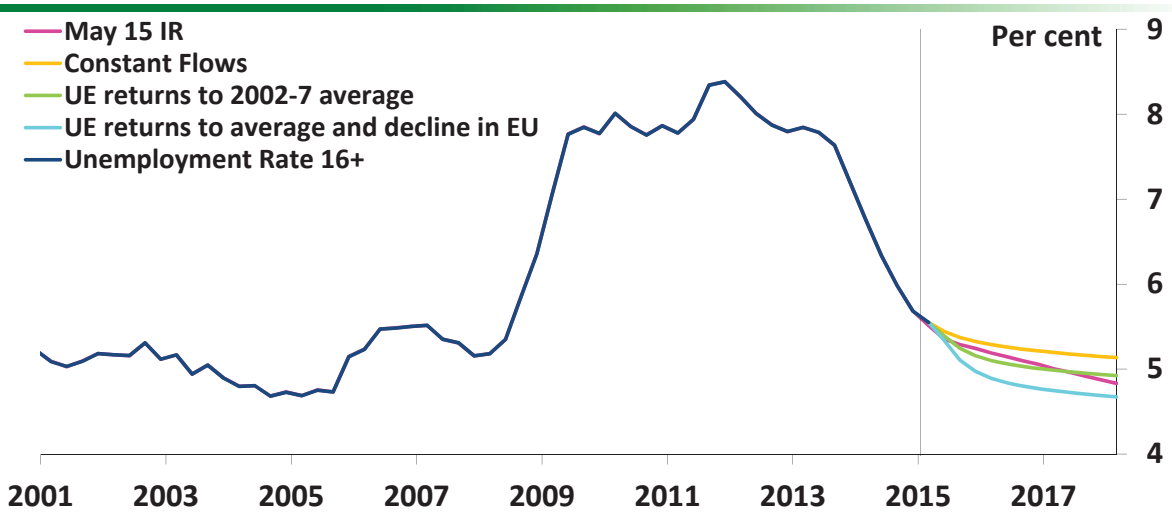
- The May IR implicitly assumes job finding rates return to their pre-crisis average.

Employment to unemployment flows



- A job loss rate of 1% would be a record low...

Unemployment flow scenarios



- …and would imply the unemployment rate falls to around 4.7% in 2018.

Main messages

- Prices fell slightly in the year to April in line with our expectations. We continue to expect inflation to bounce back later this year.
- Wage growth is picking up—broadly in line with expectations.
- Migration remained high in 2014Q4.
- Unemployment continues to fall, but we remain confident that these falls will ease over the next year.

THE END

8: Agents’ Update

Agents' Update

26th May 2015

, Agency for Scotland
Inflation Report & Agency Intelligence Division

Outline

- **Reaction to general election result**
- **Activity**
  - Consumption
  - Business services and manufacturing
  - Construction and housing

General election

- **Little evidence of significant headwinds to activity ahead of vote.**
  - Where there was a negative impact, much of it has unwound.
- **Surprise at clear outcome; effect of this still being digested:**
  - Impact of EU Referendum debate and then vote.
  - 'Pro-business' outlook should support private investment.
  - Concerns about extent and pace of deficit reduction on public sector procurement.

General election: effect on sentiment

Positive effect

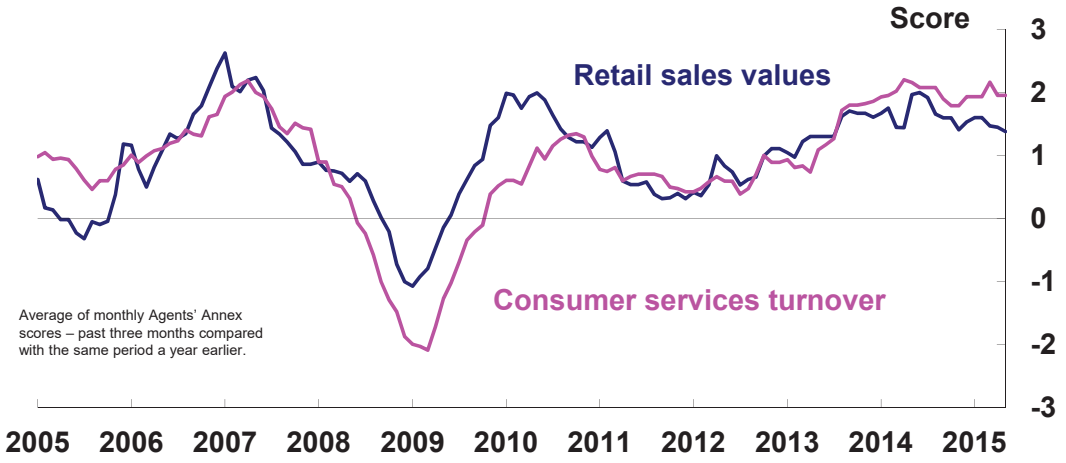
- Investment
  - Energy providers
  - Defence contractors
  - University sector
- Business services
- Construction
- Housing

Negative effect

- Internationally owned companies
- Suppliers to non-ring fenced public spending
  - Care providers
  - Social housing providers
- Process of devolving powers to parts of UK

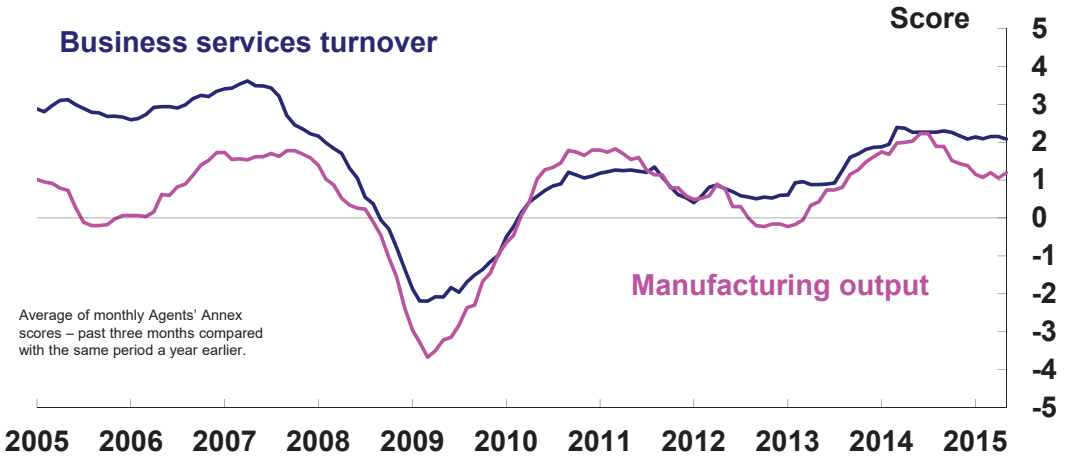
- **Expect some turbulence in next 2 to 3 years from deficit reduction and EU referendum. Medium term outlook more positive.**

Consumer demand



- **Sustained consumer confidence.**
- **Values growth softened by current pricing environment.**

Business Services and Manufacturing



- **Sustained growth, little change in last few weeks.**
- **Contacts generally more optimistic about second half of year.**

Construction output

- **Gradual easing in annual growth.**

Housing

- **New build**
  - Steady growth with outlook improving
- **Established market**
  - Sales and listings slowed through April
  - Expectations for post election recovery in activity and that sales volumes will pick up modestly in second half of 2015
  - BTL demand strengthening
- **Mortgage funding**
  - FPC's LTI limit may influence some lenders' activity this year

Summary

- Limited impact on activity ahead of election; some concerns about EU referendum debate and public sector cuts
- Activity levels sustained across most sectors
- Construction activity positive but slowing
- Housing market expected to pick up in H2/2015