FORECAST REFERENCE GUIDE
May 2015

UK/International Forecast Teams, CAPD/ID

This chart pack summarises the key features of the May 2015 forecast

Contents

Overview

1. Headlines: very low interest rates push inflation just above target
2. News: weaker supply, but little change to inflation
3. The MPC's key judgements
4. Risks around the key judgements
5. How the forecast compares to externals

Key Judgement 1: Global growth picks up slightly, particularly in the euro area

6. The outlook for the world
7. Slower world potential growth
8. The outlook for the euro area
9. The impact of ECB QE

Key Judgement 2: Robust domestic demand is sustained by the recovery in real incomes

9. Accounting for GDP
10. Real incomes and consumption
11. Investment and exports
12. The headwinds to demand

Key Judgement 3: A recovery in productivity supports supply and real income growth

13. Accounting for potential GDP
14. Taking stock of supply
15. The outlook for potential hours
16. Estimates of domestic slack

Key Judgement 4: Wage growth picks up so that inflation returns to the 2% target as the price level effects associated with lower energy, food and import prices dissipate

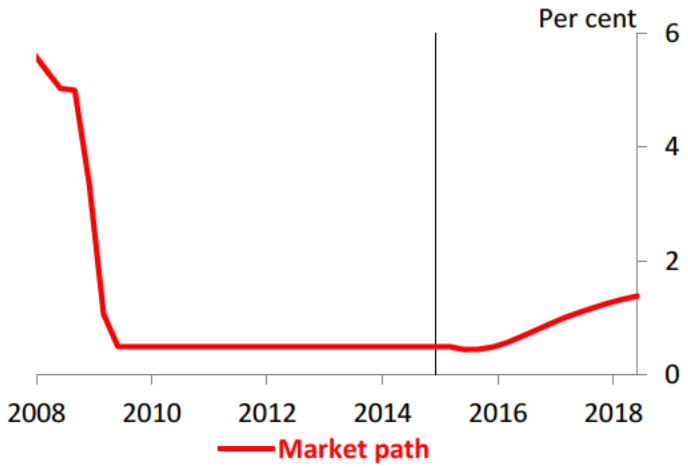
17. The outlook for wages
18. Commodities
19. The outlook for costs
20. Accounting for inflation

Monetary policy in the forecast

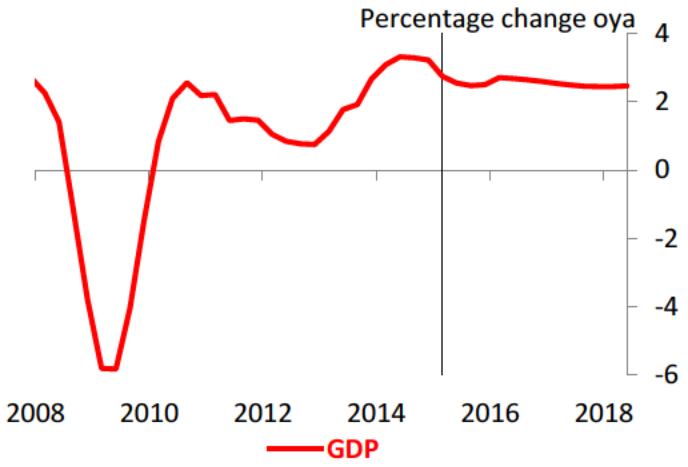
22. The path for Bank Rate

Overview

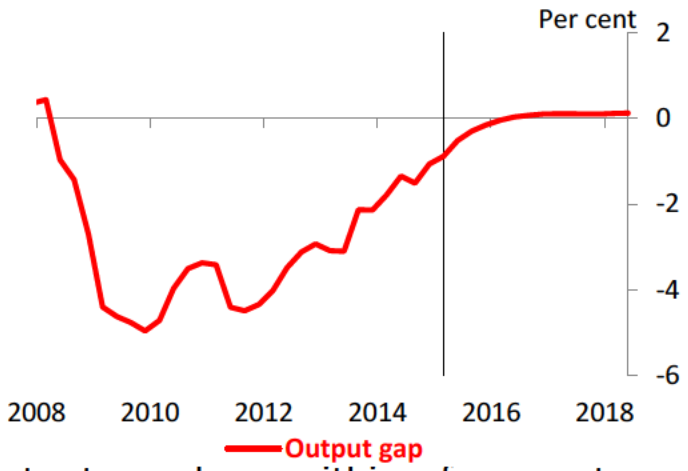
1. Headlines: very low interest rates push inflation just above target



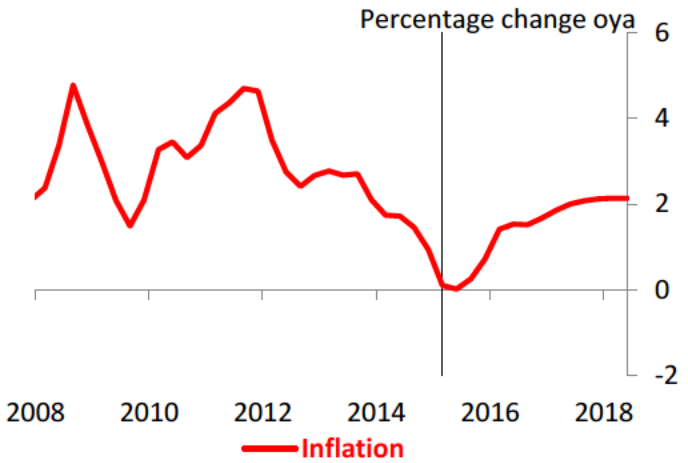
With a very flat market path for rates, which reaches just 1.3% by Year 3 …



… GDP grows around trend over the forecast …

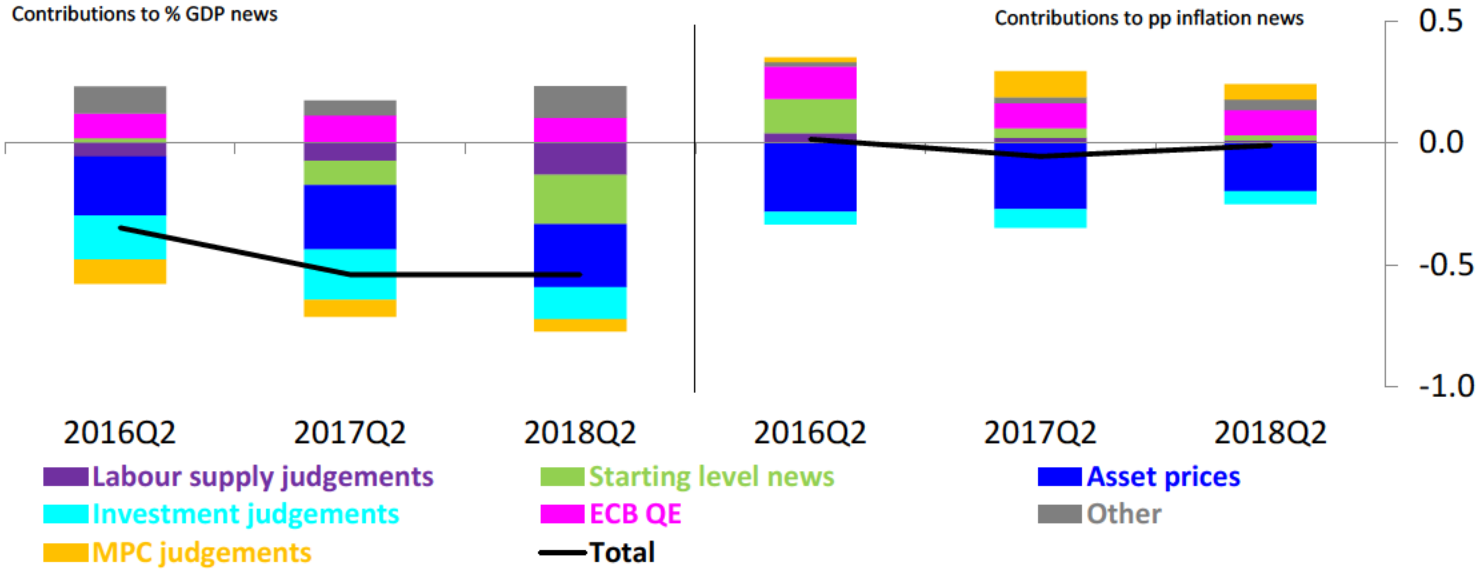


… the output gap closes within a few quarters …



… and inflation bounces back from 0% to end just above target at 2.1%: just like in the February *IR*.

2. News: weaker supply, but little change to inflation



- Potential output ends the forecast around 0.8% lower than in the February *IR*. That reflects: some downside news in the **starting level of productivity** feeding through to lower output; a small net contribution from **labour supply** related judgements (**Slide 15**); and the net effect of **MPC judgements** on productivity growth, partly reflecting the changing composition of the labour force (**Slide 18**), and partly a decision to aim below the capacity utilisation surveys.
- In addition, news in **asset prices** has weighed on the forecasts for GDP and inflation: the market profile is 8bps higher on average than in February, and the exchange rate has appreciated by around 2%. We have revised down our profile for **housing investment**, reflecting persistent weakness in housing starts data, though this is partly offset to an upward revision to **extraction investment** in response to tax measures announced in the Budget. We have incorporated an effect from **ECB QE** via the portfolio rebalancing channel (**Slide 9**), which further supports demand across the forecast. And a further **MPC judgement** boosts the level of demand at the end of the forecast, pushing up on the output gap and inflation.
- The net effect of the demand and supply news leaves GDP 0.6% lower at Y3 (**LHS**) and the output gap 0.2pp higher. But the boost to inflation from the higher output gap is offset by the drag from the exchange rate, leaving inflation virtually unchanged (**RHS**).

3. The MPC's Key Judgements

The MPC's forecast is underpinned by 4 key judgements, which are shown below along with what they imply for key variables.

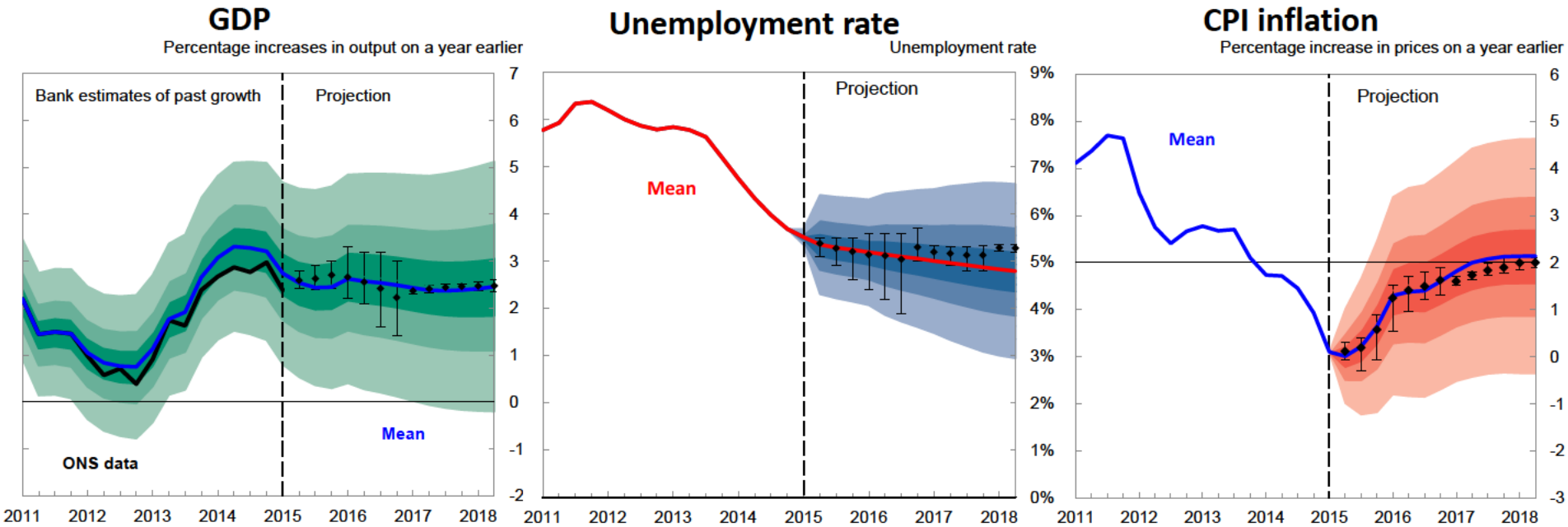
KJ1: Global growth picks up slightly, particularly in the euro area				
	Average 1998-2007	2015	2016	2017
World GDP (UK-weighted)	3	2 ¼ (2 ½)	2 ¾ (2 ¾)	2 ¾ (2 ¾)
World GDP (PPP-weighted)	4	3 ¼ (3 ½)	3 ¾ (3 ¾)	3 ¾ (3 ¾)
Euro-area GDP	2 ¼	1 ½ (1 ¼)	2 (2)	2 (1 ¾)
US GDP	3	2 ½ (3)	2 ½ (2 ¾)	2 ¼ (2 ½)
Dollar oil prices	39	68 (58)	71 (65)	73 (69)
KJ2: Robust domestic demand is sustained by the recovery in real incomes				
	Average 1998-2007	2015	2016	2017
Credit spreads	¾	2 (2)	2 (2)	2 (2)
Household saving ratio	8 ¾	6 ¼ (6 ½)	6 (6 ¼)	5 ½ (6)
Business investment to GDP ratio	10	10 ½ (11)	11 (11 ½)	11 ¾ (12 ¼)
KJ3: A revival in productivity supports supply and real income growth				
	Average 1998-2007	2015	2016	2017
Productivity	2 ¼	¼ (¾)	1 ¼ (1 ½)	1 ¾ (1 ¾)
Participation rate	63	63 ½ (63 ½)	63 ½ (63 ¾)	63 ½ (63 ¾)
Average hours	32 ¼	32 ¼ (32 ½)	32 ½ (32 ½)	32 ¼ (32 ¼)
KJ4: Wage growth picks up so that inflation returns to the 2% target as the price level effects associated with lower energy, food and import prices dissipate				
	Average 1998-2007	2015	2016	2017
UK import prices	¼	-4 ¾ (-3 ¼)	1 ¼ (¾)	¾ (½)
Unit labour costs	2 ¾	1 ½ (2)	3 (2 ¾)	2 ¾ (2 ¾)

4. Risks around the Key Judgements

This table, which was presented to the MPC at Draft 1, sets out a range of risks to the Key Judgements, together with an assessment of the net size and direction of the risks to GDP and inflation. The MPC judged that the risks around the final forecast were to the downside for GDP to reflect the economic uncertainty around the risk that Greece could leave the euro area.

	GDP	*Inflation*
Skews in February *IR* (Y1,Y2,Y3)	*(0,0,0)*	*(-0.15,0,0)*
Skews in May IR (Y1,Y2,Y3)	*(-0.1,-0.1,0)*	*(-0.15,0,0)*
KJ1: Global growth picks up slightly, particularly in the euro area	↓	↓
Euro area policy actions insufficient to prevent low inflation becoming entrenched	↓	↓
Greece exits Euro with contagion limited by policy response	↓	↓
Global risk sentiment worsens due to Euro area weakness and/or FED tightening	↓	↓
Severe slowdown in China	↓	↓
KJ2: Robust domestic demand is sustained by the recovery in real incomes	↓	↓
Demand headwinds unwind more quickly/boost from monetary policy more persistent	↑	↑
Firms are unwilling/unable to invest as much as in the central projection	↓	↓
UK export performance weaker than projected	↓	↓
KJ3: A revival in productivity supports supply and real income growth	↓	↑
Productivity growth fails to pick up	↓	↑
Labour supply could be stronger over the forecast	↑	↓
KJ4: Wage growth picks up so that inflation returns to the 2% target as the price level effects associated with lower energy, food and import prices dissipate	↔	↔
Less of the effect of the appreciation on import prices is left to come, so import prices are higher	↓	↑
Quicker pass-through of the appreciation to CPI	↔	↑
Inexplicable weakness in wages contain more signal about underlying disinflation	↔	↓
Inflation expectations become less well anchored, given the weak near-term inflation outlook	↔	↓

5. How the forecast compares to externals



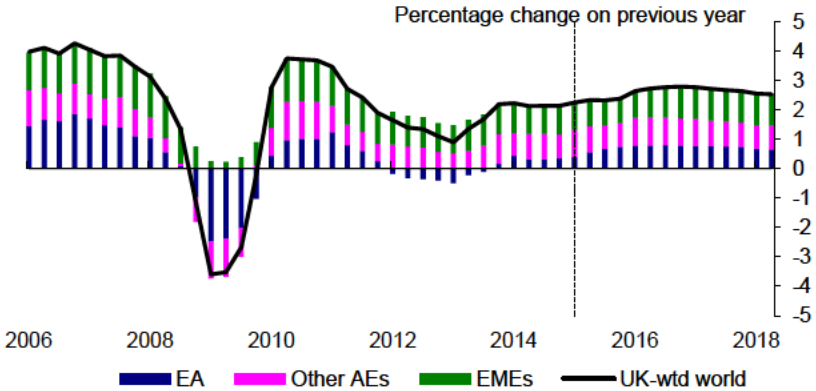
Diamonds represent the average external forecast, bars represent the range

- The mean GDP growth projection is at the bottom of the range of external forecasters in the near term, before moving broadly in line with the average external over the rest of the forecast horizon (**LHS**). Excluding the effect of the backcast, calendar year growth is projected at 2.2% in 2015 and 2.7% in 2016 (average external = 2.6% and 2.5%). The difference in 2015 is mainly accounted for by the MPC's forecast for investment and net trade being weaker than the average external over the forecast.
- The unemployment rate is in line with the average external over 2015 and 2016, though the range of views among external forecasters is wide(**centre**). From 2017 onwards, when the more outlying externals have dropped out of the sample, the MPC's forecast is at the bottom of the range of externals, ending the forecast at 4.8%.
- The mean inflation forecast is in line with the average external over the first half of the forecast (**RHS**). The MPC's forecast rises back to the target more quickly than externals, however. It reaches 2% in 2017Q2, while the average external does not expect inflation to be back at target until 2018Q1.

1. Global growth picks up slightly, particularly in the euro area

6. The outlook for the world

Contributions to world GDP growth



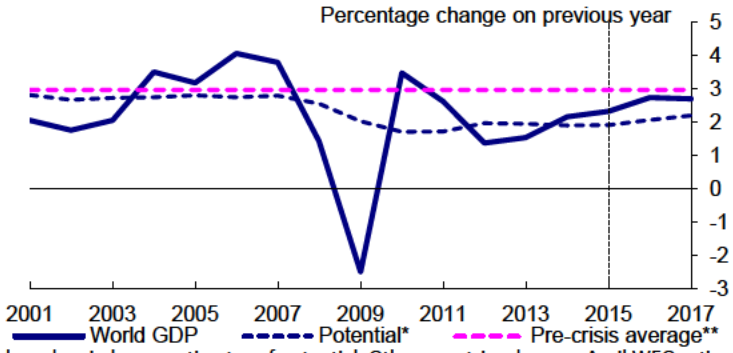
GDP growth by region

		Calendar-year growth rates (%)		
		2015	2016	2017
UK-weighted world GDP growth	May IR	2.3	2.7	2.7
	Consensus	2.3	2.7	n/a
	WEO	2.4	2.6	2.6
PPP-weighted world GDP growth	May IR	3.3	3.7	3.7
	Consensus	3.3	3.9	n/a
	WEO	3.5	3.8	3.8
Euro-area GDP growth	May IR	1.5	2.0	1.9
	Consensus	1.5	1.8	n/a
	WEO	1.5	1.7	1.6
US GDP growth	May IR	2.4	2.6	2.3
	Consensus	2.9	2.8	n/a
	WEO	3.1	3.1	2.7
China GDP growth	May IR	6.8	6.5	6.3
	Consensus	6.9	6.8	n/a
	WEO	6.8	6.3	6.0

- World activity growth is subdued and we expect only a modest recovery over 2015 (**LHS**), despite the fall in oil prices since last summer (**Slide 19**).
- Euro-area growth began to improve in the second half of 2014 and a further acceleration is expected in 2015 (**RHS**). Over the forecast growth is supported by the ECB's asset purchase programme, lower oil prices and improving business and consumer confidence. The boost from these factors wanes later in the forecast, leading growth to fall back a little from late 2016 (**Slide 8**).
- In the US, GDP growth slowed significantly in Q1, falling 0.5pp to 0.1% oqa. That weakness is likely to reflect, in part, temporary factors such as the bad weather, with a bounceback in Q2 expected. But some of the weakness is expected to persist. For example, very weak investment in energy related sectors is likely to continue into Q2.
- EME GDP growth is expected to weaken further through 2015, largely due to the crisis in Russia, a further slowing in Chinese GDP and weaker growth of commodity exporters. Further out, growth is expected to pick up a little as activity stabilises in Russia and some improvement is seen in commodity producing countries. But growth remains significantly weaker than pre-crisis average throughout.

7. Slower world potential growth

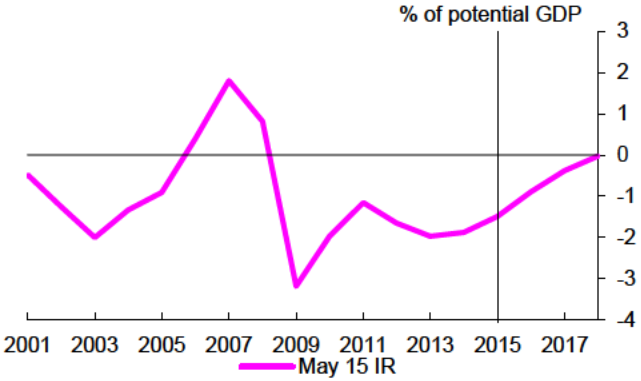
UK-weighted world GDP growth



* US and €A based on in house estimates of potential. Other countries draw on April WEO estimates.

** Pre-crisis average calculated between 1993 and 2007.

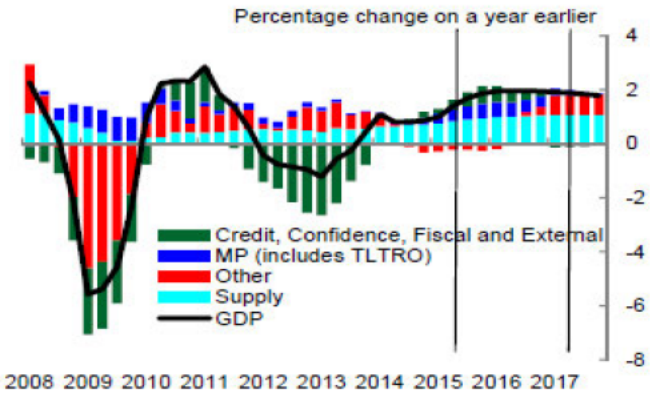
UK-weighted world output gap



- A key judgment behind the international forecast is that potential output growth globally will be weaker than pre-crisis. This means that most of the weakness in world GDP relative to pre-crisis trends reflects weak supply, rather than more transitory demand factors (**LHS**).
- That is particularly the case for the euro area, where we estimate that potential has grown at less than one third of its pre-crisis rate over the past six years. But a marked slowing has also been seen in the US and across EMEs.
- In the euro area and US, the decline in potential growth largely reflects slower growth of capital and weak labour supply. Whereas in EMEs, the slowdown is in large part due to weaker productivity growth. But weaker investment growth, slower population growth and aging populations are also expected to weigh on potential.
- Given the fall in potential, global growth is likely to remain below pre-crisis average rates throughout the forecast, even while output gaps are closing. And we expect the output gaps to close across regions such that the world output gap is closed by the end of the forecast (**RHS**).

8. The euro-area outlook

Contributions to euro-area growth



Possible Greek scenarios

Scenario	Impact on UK	IR consistent scenario	Higher prob of contagion	Higher risk of exit, lower prob of contagion
Deal is reached	Zero / limited	70%	70%	50%
Grexit no contagion	Zero / limited	≈20%	≈5%	≈25%
Grexit - contained contagion	Material	≈5%	≈20%	≈20%
Grexit - uncontained contagion	Severe	≈5%	≈5%	≈5%
Grexit probability		*30%*	*30%*	*50%*
Implied skew on UK GDP fan chart (years 1 and 2)		**≈-0.1pp**	**-0.2pp**	**-0.2pp**

- Euro-area GDP growth is expected to recover from 0.9% in 2012 Q4 to almost 2% in early 2016 (**LHS**).
- It is possible that the fall in oil prices and the range of supportive policy measures that have been implemented in recent months could have a larger-than-anticipated impact on growth. For example, more evidence of coordination across policies could boost confidence sufficiently to unlock pent up investment demand. That would be expected to have significant positive spillovers to the UK.
- Set against that, there is high degree of uncertainty about Greece, which is currently struggling to meet its debt obligations. The forecast assumes an agreement will be reached, but that is not certain.
- In the event of 'Grexit', we believe the most likely outcome would be a period of disruption without significant contagion to other countries (**RHS**). A scenario that leads to further deafults/exits is considered a low probability event. The possibility of 'Grexit' has been reflected in the GDP fancharts with the committee adding a -0.1pp skew to the UK GDP fan in the first two years to account for the increased risk. That is broadly consistent with the probabilities in the first column of the table above. If more weight were placed on Grexit probability or greater contagion that would require a larger downside skew.

9. The impact of ECB QE

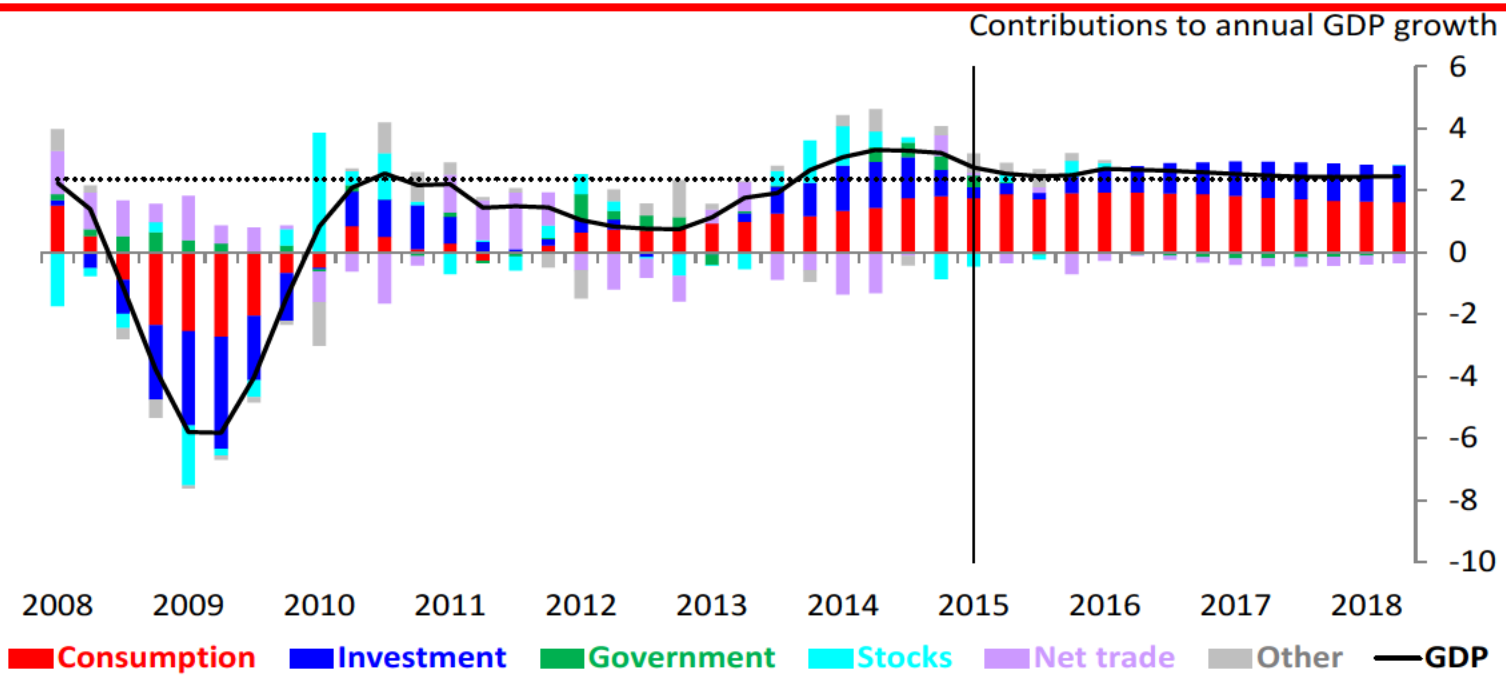
Estimated impact on of ECB QE at Y3

Channel	Euro area	World GDP (UK-weighted)	UK GDP
ERs	0.6		-0.2
Asset prices and credit spreads	0.4		0.4
External trade	0.0		0.1
Confidence	-	-	-
Total	**1.0**	**0.4**	**0.3**

- Prospects for the euro area are supported by the ECB's QE programme, via the exchange rate, lower long rates and lower credit spreads. In total we expect it to boost euro area GDP by around 1% after three years. In UK weighted space this equates to about a 0.4% to world GDP.
- The impacts of the programme spill over to the UK via a number of channels. The boost to world GDP adds around 0.1% to UK GDP via stronger export demand. Offsetting that, we think QE accounts for around 5% of sterling's appreciation; that lowers GDP by 0.2%. Finally, we estimate that it has raised UK asset prices by roughly the same amount as £65bn of UK QE – we have included an explicit judgement in the forecast to capture this, which adds 0.4% to UK GDP.
- The effects of these channels broadly net out in inflation space. In the near term the exchange rate effect dominates, so that ECB QE drags on inflation. But by Y3 this is offset by the increase in demand, giving zero net impact on Y3 inflation.

2. Robust domestic demand is sustained by the recovery in real incomes

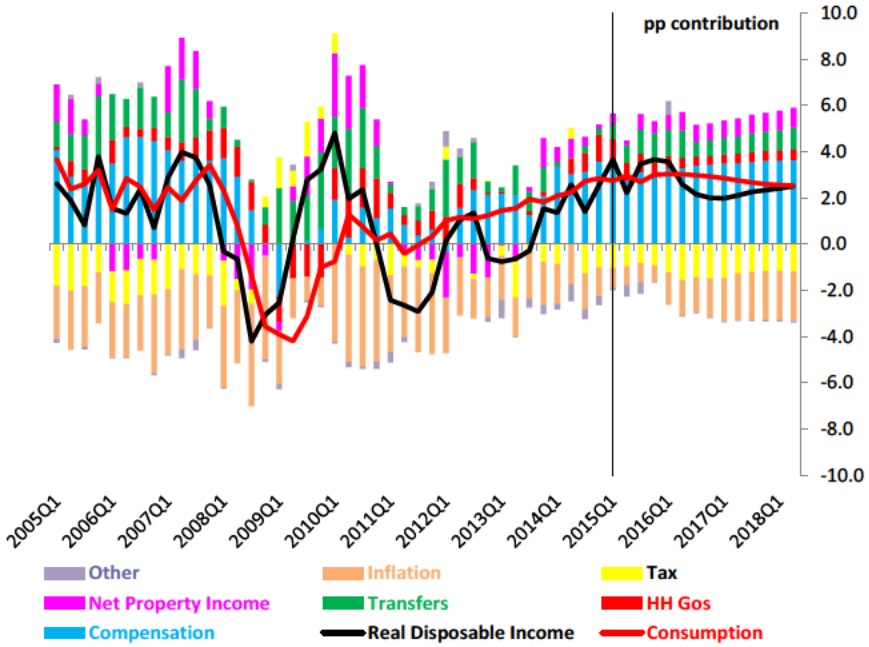
10. Accounting for GDP



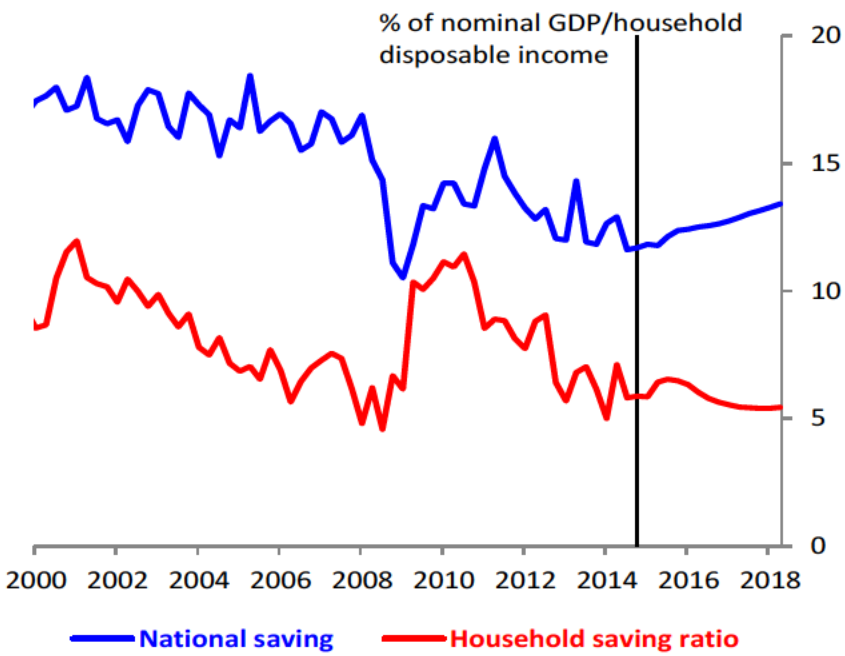
- Across the forecast demand is concentrated in domestic components. **Consumption** grows robustly throughout, reflecting robust growth in real income (**Slide 11**). And **investment's** contribution picks up over the forecast, recovering from its recent softness to reach 9% annual growth by Y3 (**Slide 12**).
- External demand, meanwhile, remains weak. We forecast **net trade** to drag on GDP growth over the medium term, as growth in the UK outstrips UK-weighted world GDP over the next few quarters and relative price effects from the appreciation of sterling take hold (**Slide 12**). And **government expenditure** is basically flat, as the fiscal consolidation continues.
- In a sense these two facts are two sides of the same coin: policy fills the gap left by weak external demand by generating domestic demand to replace it. A key question for the forecast is whether we have correctly judged the extent to which these external headwinds will drag on demand (**Slide 22**).

11. Real incomes and consumption

Contributions to real household incomes



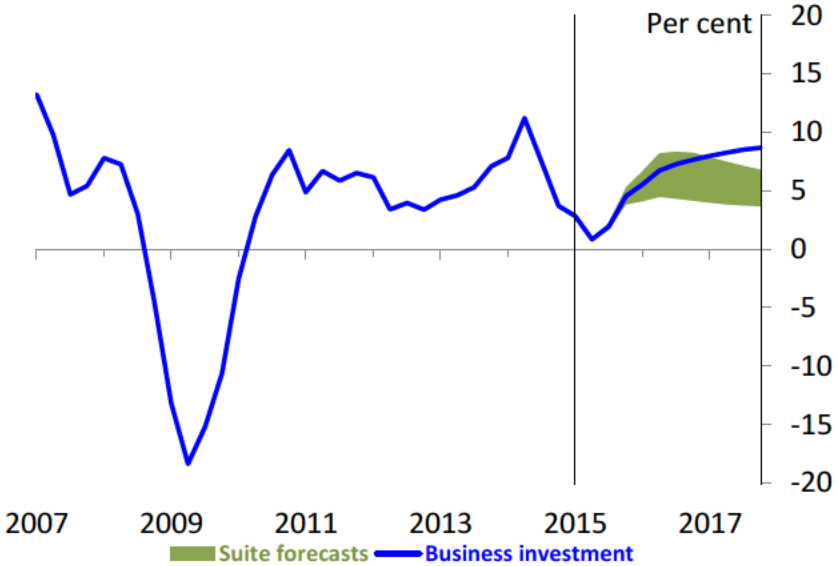
Household and national saving



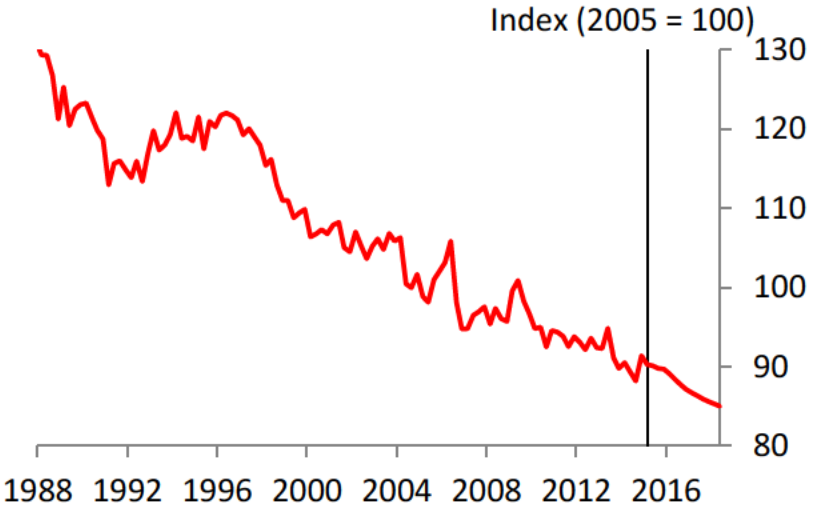
- At the beginning of forecast **real household income** (**LHS**) grows robustly before slowing in the second year of the forecast. Near term strength is largely accounted for by the recent external price shocks and subsequent weakness in **inflation** (**Slide 21**). The strength in income growth then falls back as inflation recovers; a rise in effective **tax rates** also drags.
- The strength in real income growth is mirrored in **consumption**, which maintains its recent growth rates of around 3% per year (**LHS**). Households smooth through some of the windfall from weak inflation, but this process is complete by the end of the forecast, leaving the **saving ratio** broadly flat overall (**RHS**). But although household saving remains at its current low level, the continued fiscal consolidation means that the **national saving rate** actually picks up across the forecast (**RHS**).

12. Investment and exports

Business investment growth

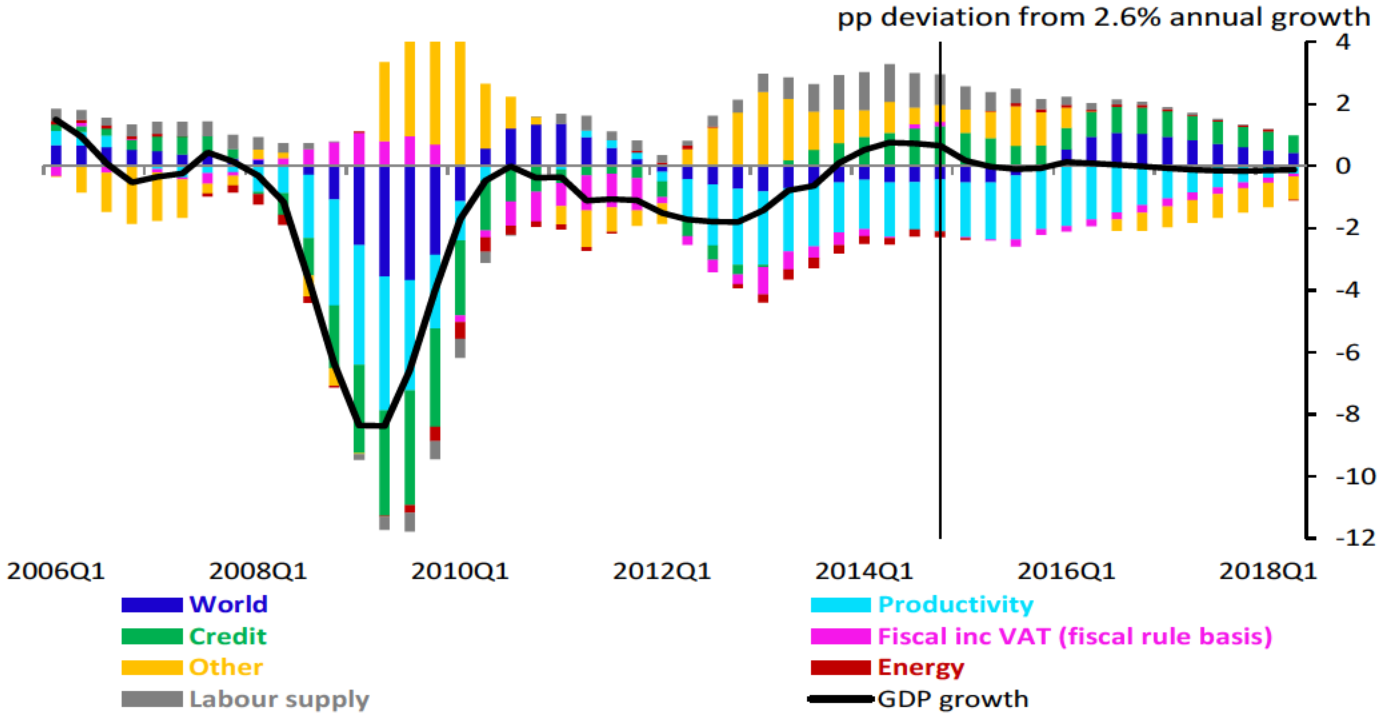


The export share



- **Business investment growth** recovers from its recent low rates, reaching robust annual growth of 8-9% in the second half of the forecast (**LHS**). That's close to the Special Project Team's proposal from last year. But it is now above the **swathe of conditional forecasts** from our empirical models, suggesting the risks lie a little to the downside.
- We also think the risks to our net trade projection lie to the downside. One reason for that is that while the **export share** (the ratio of UK exports to UK-weighted world trade) falls broadly broadly in line with its long run trend over the forecast, it implies quite strong growth in financial services .

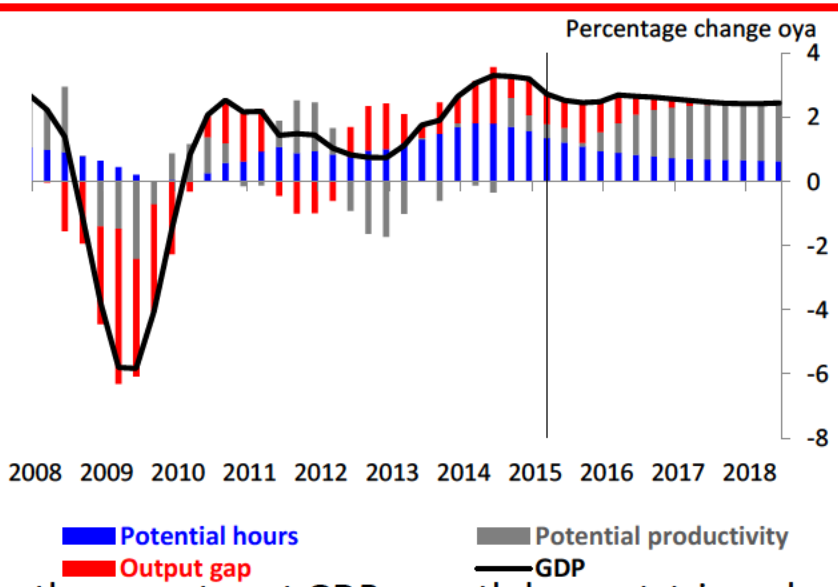
13. The headwinds to demand

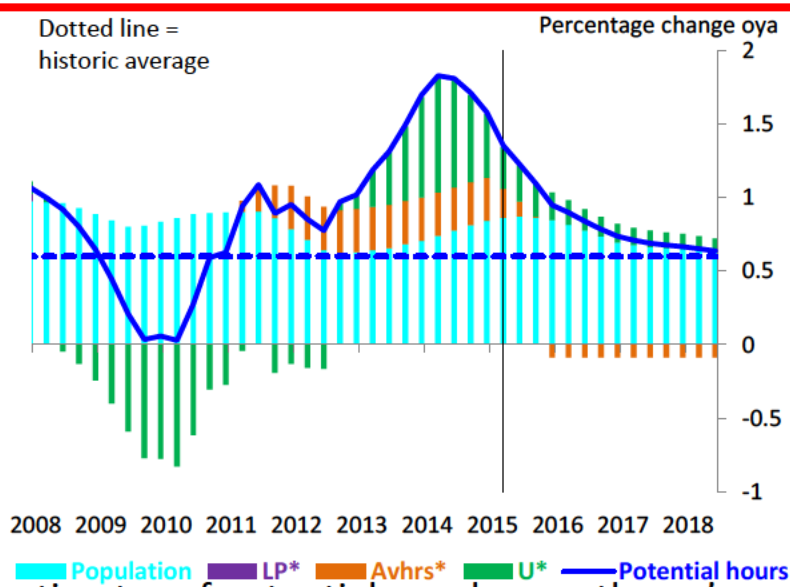


- We think the weakness of demand in recent years reflects a number of fundamental headwinds: weak productivity, fiscal consolidation and **global economic conditions** have all weighed on growth. More recently these have been offset by other factors, including confidence and reduced uncertainty as well as the effects of monetary policy, the recent strong growth in labour supply, and the unwinding of the shock to **credit conditions**.
- Throughout the forecast **credit** continues to support growth. Initially GDP growth is also boosted by labour supply; its positive contribution slows in later years, but this is more than offset by the recovery in productivity growth (**Slide 14**). The fiscal consolidation continues to drag over the forecast. But in the later years, **world demand** pushes up on growth as global headwinds dissipate and world trade growth picks up, though it continues to drag on the level throughout the forecast.

3. A revival in productivity supports supply and real income growth

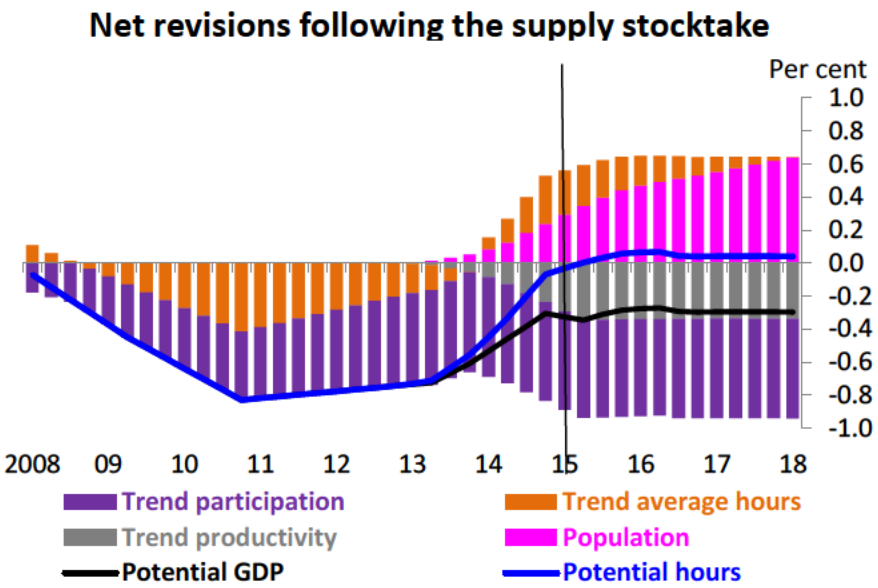
14. Accounting for potential GDP





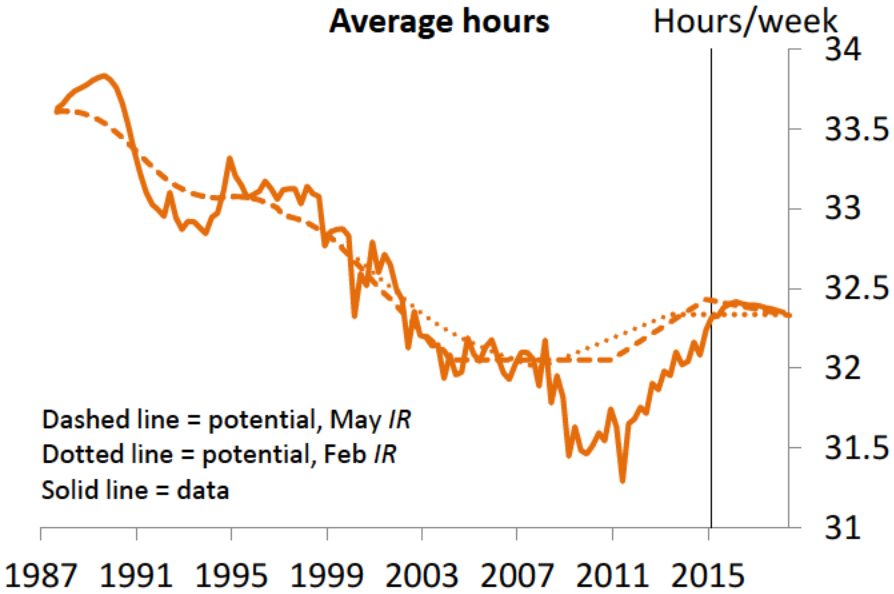
- In the recent past GDP growth has outstripped our estimates of potential supply growth: we've seen a sharp closing of the **output gap** (**Slide 15**). In particular, we've seen above trend growth in **potential hours** **(LHS)**; productivity growth has remained unusually weak. Over the forecast that changes: the output gap is closed by 2016 and remains close to zero, and growth is accounted for by potential GDP growth, in particular by a recovery in **potential productivity** growth towards its historic average rates.
- The recent strength in **potential hours** has reflected two things (**RHS**). First, in line with the rapid decline in actual unemployment, our estimate of medium-term equilibrium unemployment (**U***) has fallen back. And we think various structural and cyclical factors have boosted labour supply, reflected in above-average contributions from **population** and **desired average hours**.
- Over the forecast the rate at which U* falls declines, as unemployment approaches our estimate of the natural rate; the somewhat higher contribution of migration to population growth eases; and our estimate of desired average hours declines slightly. So potential hours growth falls back towards its historic average rate.

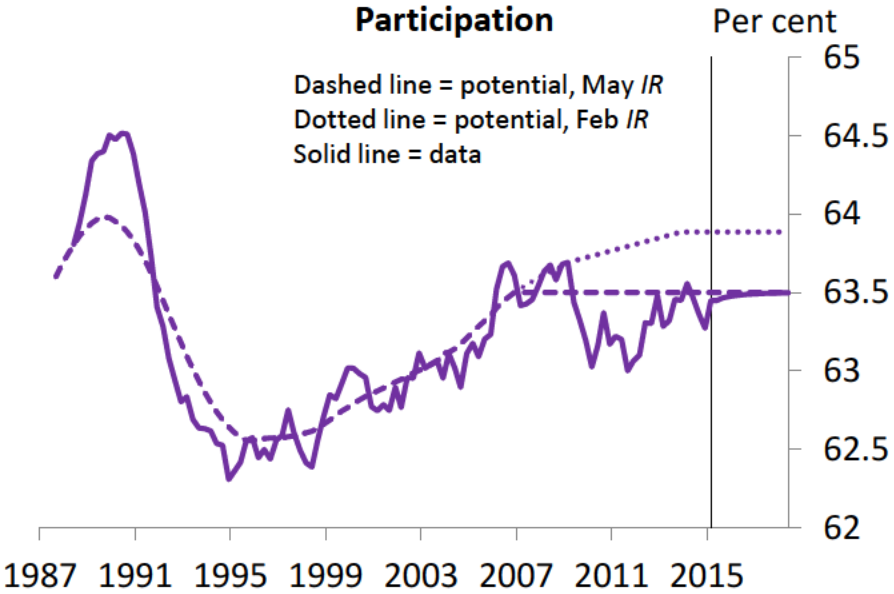
15. Taking stock of supply



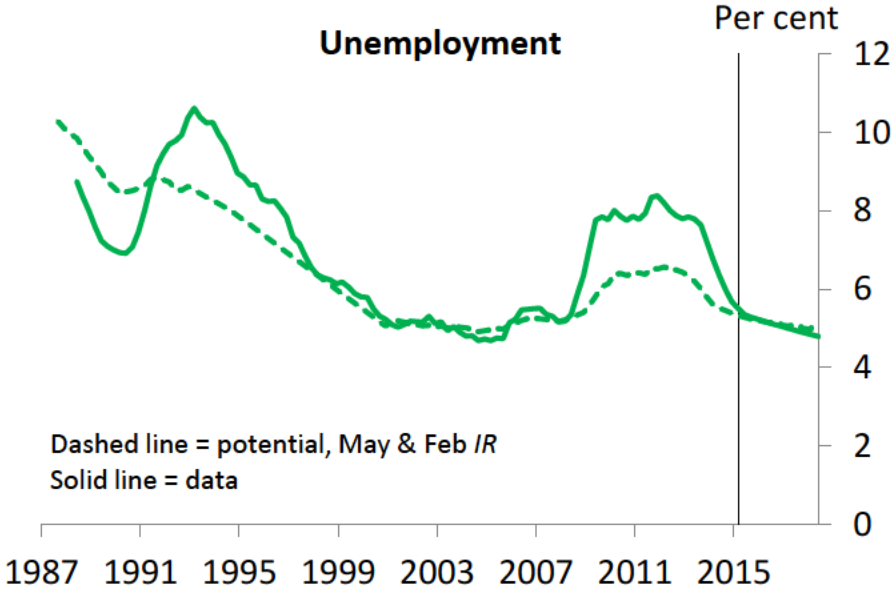
- Following the supply stocktake requested by the MPC in February we have incorporated a number of adjustments to our view of labour supply. But these broadly net out, leaving the forecast for labour supply little changed (**LHS**).
- We have revised up our **population** assumption, reflecting a view that recent strong migration inflows will continue in the near term. Population growth now peaks at 0.9% later this year before falling back to a more normal 0.6%. The revision would, all else equal, raise GDP by around 0.3% at the start of the forecast. But since GDP was what it was, this is instead offset in weaker **potential productivity**.
- **Equilibrium average hours** have also been revised up by 0.2%, but that is more than offset by an 0.6% downward revision to **trend participation**, leaving potential hours very little changed lower at the start. And over the forecast, downward-sloping trend average hours (relative to the flat trend we had in February) are offset by slightly stronger population growth, leaving potential hours little changed, and potential output about 0.3% lower, at the end.
- In a bigger picture sense, the supply stocktake highlighted that there's now little labour market slack left to support growth in the absence of a recovery in productivity: this is one reason why we think the recent weakness of wages is likely to reflect some other factor than more slack (**Slide 18**).
- In addition to these judgements, the combination of data news and MPC judgements on capacity utilisation and productivity growth means that potential productivity actually starts the forecast 0.1% higher than last time, and ends it 0.8% lower (**Slide 2**).

16. The outlook for potential hours



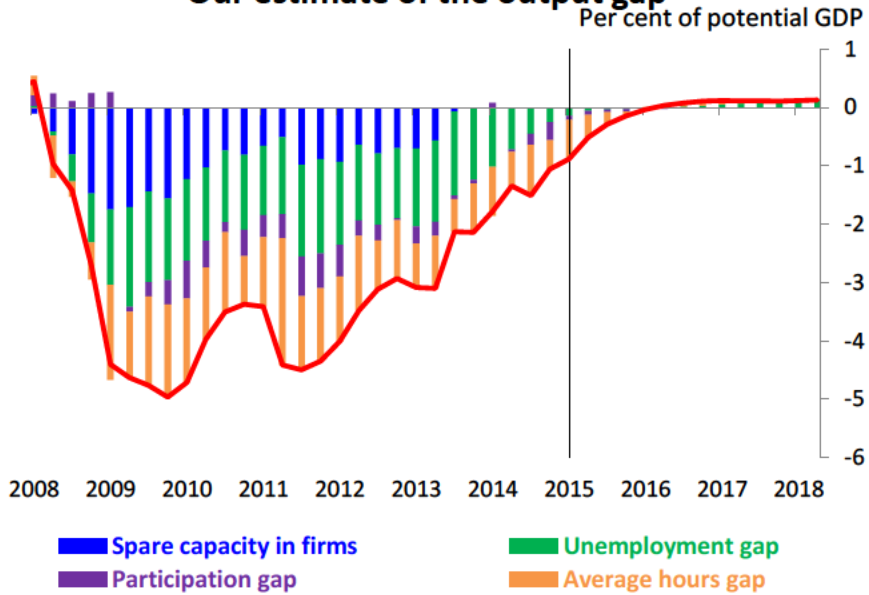


- These three charts show the revisions to potential hours made as a result of the supply stocktake (**Slide 15**). **Potential average hours** (top left) have been revised up a little at the start of the forecast but grow a little more slowly; **potential participation** is now flat over the forecast.
- We did not revise our view of **U*** or the natural rate. U* ends the forecast at 4.9%, just below our estimate of the natural rate, reflecting continued declines in medium and long term unemployment over the forecast.



17. Estimates of domestic slack

Our estimate of the output gap



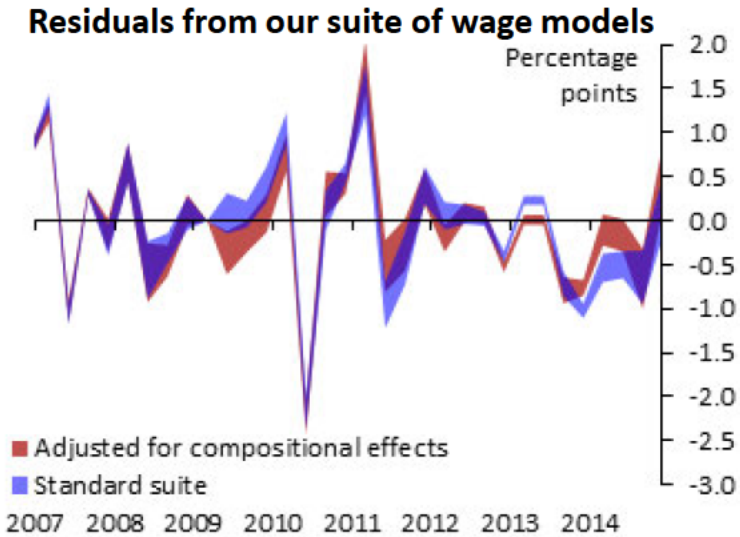
External estimates of the output gap

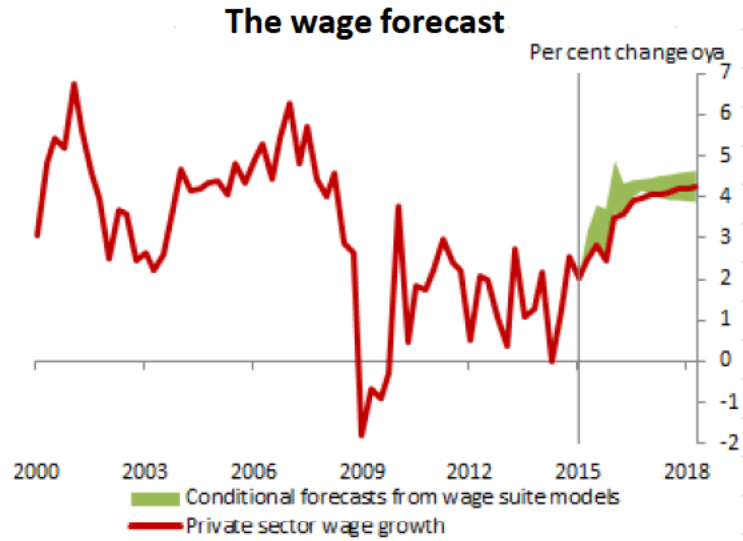
	BoE	IMF	OECD	EC	OBR
2014	-1.4	-1.8	-0.6	-1.1	-1.0
2015	-0.5	-0.9	0.0	-0.1	-0.4
2016	0.0	-0.5	0.2	0.6	-0.2
2017	0.1	-0.2	N/A	N/A	-0.1

- Our estimate of the **output gap** has closed quickly over the last couple of years, so that it now starts the forecast at just 0.5pp (**LHS**), concentrated largely in **average hours**. But the pace at which it contracts slows into the forecast – we are at the turning point of the "dogleg". By 2017 the gap has turned slightly positive and flattened off, and it remains flat for the remainder of the forecast. Similarly **unemployment**, having fallen by more than 2½pp over the past three years, falls only a further 0.6pp over the the forecast: it reaches 4.8% by the end of the forecast, just below our estimate of **U*** (**Slide 18**).
- Given the considerable uncertainty around any estimate of the degree of slack, there is value in considering alternative techniques for estimating the output gap, such as statistical filters, as well as looking at other institutions' estimates as cross-checks (including the OBR, EC, IMF and OECD). External estimates of the output gap are broadly similar to our own for 2014 (**RHS**), but the degree of uncertainty regarding the output gap is high as indicated by the range of estimates and forecasts, and also by ex-post versus real-time analysis

4. Wage growth picks up so that inflation returns to the 2% target as the price level effects associated with lower energy, food and import prices dissipate

18. The outlook for wages

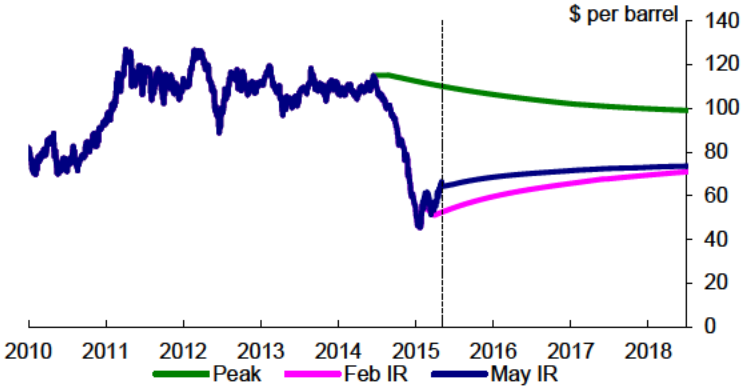




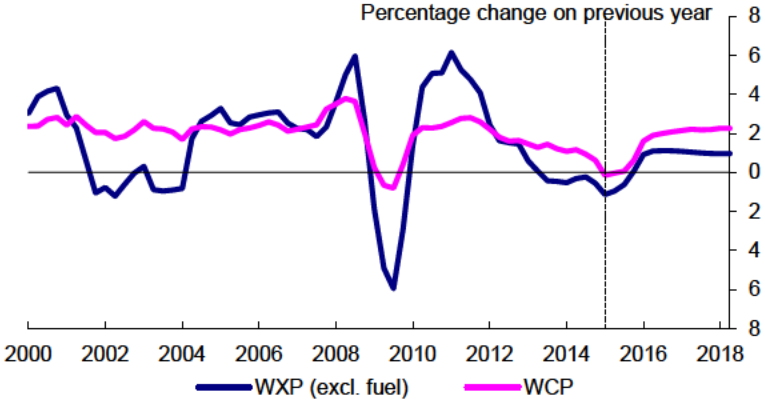
- Wage growth has been weak over the past few quarters, both in an absolute sense and relative to what its past relationship with slack and productivity would suggest: our suite of wage models has produced a string of large **negative residuals** (**LHS**).
- Partly we think the weakness of wages reflects changes in the composition of the labour force, which we estimate pulled down on wage growth by around 1pp in 2014; adjusting the data for these effects produces **residuals that are around 1/3 smaller** (**LHS**). We have assumed this continues to drag on quarterly wage and productivity growth until mid 2016. We think the remaining weakness mostly reflects unusually weak wage growth expectations, either because inflation or productivity growth are expected to stay low, or because households and firms will take time to react to the sharp erosion of slack (**Slide 17**).
- We have therefore assumed wages will remain weak in the near term – **our wage growth forecast** lies below those from the **suite** (**RHS**) (though this is less pronounced once compositional effects are accounted for). But by the end of the forecast growth returns to normal rates, in line with the suite.
- For more discussion of the possible explanations for the weakness of wages, .

19. Commodities

Oil futures curves

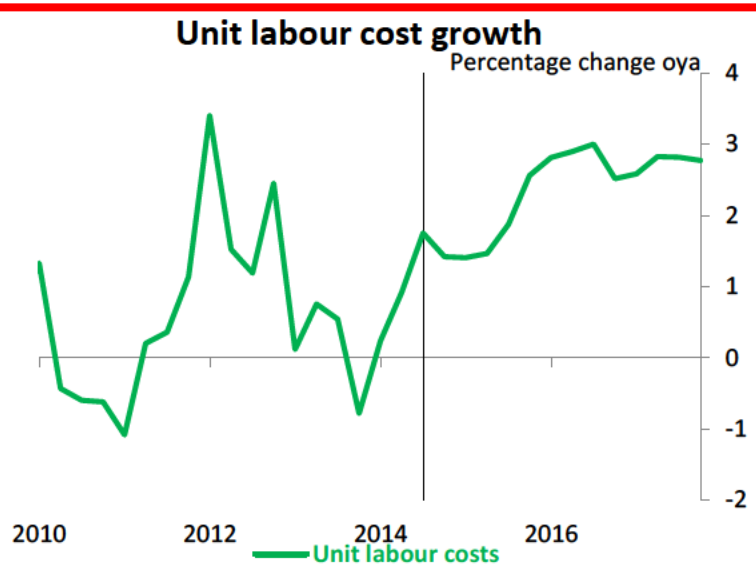


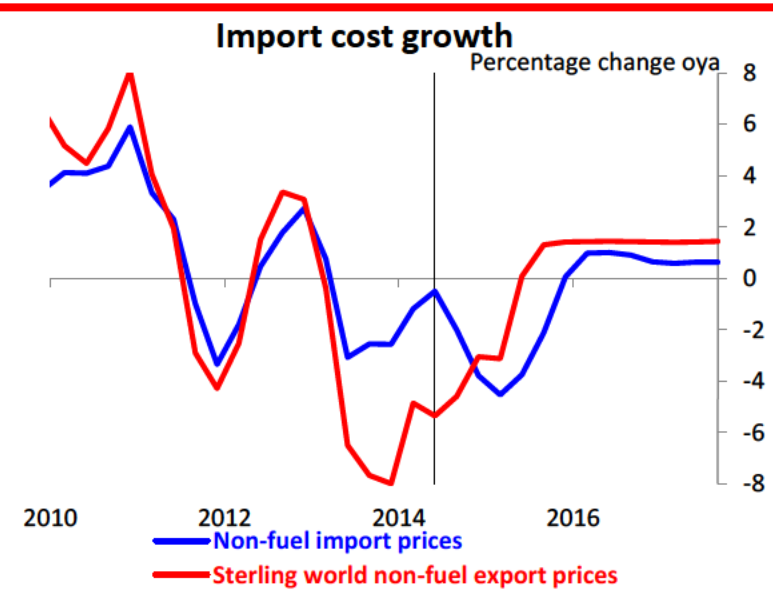
World export and consumer prices



- The price of **Brent crude** has risen by 15% since the May IR and by over 40% since its **trough** in January to $64pb (**LHS**). But the curve has become flatter, such that the news across the curve is 10% and 13%, respectively. That pickup has primarily been driven by signs of a greater-than-expected response of supply to lower prices. But the price remains 45% below its **peak** of $115pb in June 2014, and prices are around 30% lower across the curve. A range of estimates suggest the fall since last summer primarily reflected supply factors, but weaker demand has also played a role.
- Lower oil prices should support growth in the UK and rest of the world. Our best guess is that the fall in oil prices should boost UK GDP by around 0.5% and UK-weighted world GDP by around 0.7% by end-2017.
- Lower oil prices are weighing heavily on world **export** and **consumer** prices (**RHS**). Over the forecast, inflation across countries should pick up as the drag from lower oil prices drops out.
- The futures curve suggests a gradual rise in the oil price to just under $75pb by the end of the forecast. But there is a lot of uncertainty around the path of future prices. In the near term, further rises in inventories could put downward pressure on prices, whereas further out, there is a great deal of uncertainty around the extent to which higher prices will lead oil supply to fall.

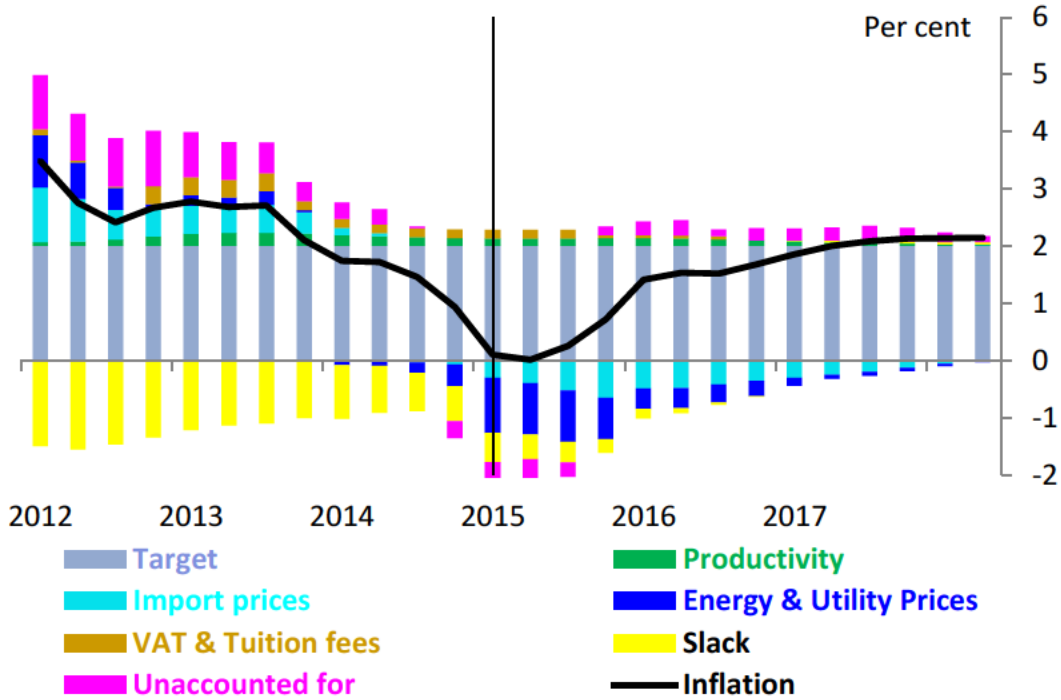
20. The outlook for costs





- The combination of the recovery in wage growth (**Slide 18**), the relatively slow pickup in productivity (**Slide 14**), and some expected increases in non-wage employment costs means that **unit labour cost** growth picks up over the forecast, reaching 2¾% growth by Y3 (**LHS**). And with market sector output prices growing roughly in line with CPI, the labour share also increases gently over the forecast.
- The strength of labour costs, however, is offset in firms' costs by relatively weak growth in import costs. The past appreciation of sterling and, to a lesser extent, the recent weakness in world prices (**Slide 19**) has borne down on **sterling non-fuel world export prices** **(RHS)**. And although these recover to reach 1½% growth by the end of the forecast, our assumptions about passthrough mean that **non-fuel import cost growth** is subdued throughout **(RHS)**; indeed import prices continue to pull down on inflation throughout the forecast (**Slide 19**).
- Finally the gentle upward slope in the oil futures curve (**Slide 19**) means that energy costs grow around their historic average rate of 3% over the forecast.

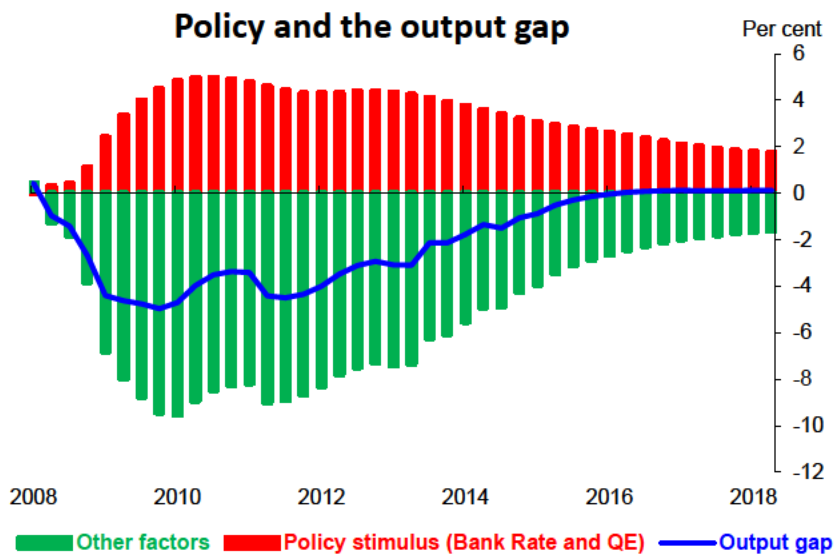
21. Accounting for inflation



- Inflation was 0.1% in 2015Q1, and starts the forecast at 0.0% in 2015Q2. The current weakness of inflation reflects downward pressure from the remaining output gap combined with a drag from import prices and especially **energy prices** (**LHS**). Not all of the current weakness in inflation can, however, be accounted for by the usual factors, with idiosyncratic factors, picked up by **residual** (e.g. lower food price inflation), also at play.
- Import prices have been falling since mid-2013 (**Slide 20**). But slow pass-through to consumer prices means that their contribution to annual CPI inflation is only now turning negative; it remains negative throughout the forecast.
- As oil and food effects drop out of the annual comparison, inflation picks up to 1.4% at the start of 2016, with import price and energy passthrough the only material drags remaining. Then, as the output gap closes and turns slightly positive and the drag from import prices finally dissipates, inflation climbs to back to target at the year 2 point and is 2.1% at year 3.
- But although inflation ends above target, there is little sign of increasing or incipient further inflationary pressure. Although labour costs are growing relatively quickly, that is offset by the weakness of import prices (**Slide 20**), such that our estimates of consumer sector margins are broadly flat over the forecast.

Monetary policy in the forecast

22. The path for Bank Rate



Factors dragging on the output gap

	World trade	Credit	Fiscal policy	Other
2010-12	**-1½**	**-4¼**	**+½**	**-3**
2013-14	**-2¾**	**-2½**	**-½**	**-½**
2018 Q2	**-1¼**	**0**	**-1**	**½**

- This forecast sends a signal that the yield curve is a little too low. Inflation reaches 2.0% within 2 years, and ends the forecast at 2.1% (**Slide 21**). And the **output gap** closes by 2016, ending the forecast very slightly positive (**LHS**).
- With the output gap closing and inflation above target, one might reasonably ask whether it's really plausible that Bank Rate will only have reached 1.4% by Y3, as in the conditioning path. But there are good reasons why Bank Rate should need to stay low over the forecast. We think many of the factors that have dragged on the level of demand in the past (**Slide 13**) are still dragging now (**RHS**). And some of them – in particular weak world trade and the fiscal consolidation – continue to drag over the forecast. The closing of the **output gap** relies on continued **stimulus** from low Bank Rate to offset that **drag** (**LHS**). Whether we have assessed that drag accurately is therefore a key question for policy and the forecast.
- In addition to these headwinds, we think the neutral rate is also likely to be lower now than in the past. The secular decline in global real rates and the higher steady state cost of intermediation would both imply Bank Rate needing to stay below its pre-crisis level in the medium term.