BANK OF ENGLAND

MEETINGS OF THE MONETARY POLICY COMMITTEE
January 2016

A meeting of the Monetary Policy Committee was held on Thursday 7 January 2016. The following members of the Committee were present:

Mark Carney, Governor
Ben Broadbent, Deputy Governor, Monetary Policy
Jon Cunliffe, Deputy Governor, Financial Stability
Nemat Shafik, Deputy Governor, Markets and Banking
Kristin Forbes, External Member
Andrew Haldane, Chief Economist
Ian McCafferty, External Member
Gertjan Vlieghe, External Member
Martin Weale, External Member

Dave Ramsden was present as the Treasury representative

Anthony Habgood was present as an observer in his role as a member of the Oversight Committee of Court

The following members of staff were present:

Gareth Ramsay, Director, Monetary Analysis
James Bell, MPC Secretariat
Chris Young, MPC Secretariat
Sarah John, MPC Secretariat
Melissa Davey, Editor of Inflation Report

Transcript of the Monetary Policy Committee Meeting on

Thursday 7 January 2016

Governor Carney. Good afternoon everyone. Why don't we just start off. I've got one piece of data which I'll update on and then I'm going to ask Andy to say a word about what's come out publicly. But just before that, given we had some notable moves earlier in the day, we'll just ask Minouche to say a word or two, if you'd like.

> **Nemat Shafik.** As you probably heard Chinese equities breached the 7% downward limit, which meant that trading was suspended for the whole day. This is the second time this happened since this new circuit breaker was introduced on the 1 January. A further move lower in the renminbi fix was said to be the contributing factor to this, causing again the usual concerns about Chinese growth prospects. So that's one bit of news. Second is that oil prices have reached a new further low. Earlier this morning they were trading as low as $32.16, so a new low for oil. Reflecting this sort of "risk-off" sentiment, gilt yields have fallen in recent days, and the lift-off date has now moved out to April 2017, which is where we were actually at the November IR, and sterling has depreciated just a little bit further; it's down 1.7% since the December MPC meeting. So that's it from me.

Governor Carney. Very good. Thank you. In terms of data, this is to be released tomorrow. It's our old favourite, UK trade for November – I feel obliged to tell you what I know. For what it's worth, the downside surprise, goods volumes rose by less than staff had expected on a three month-three month basis in November. Exports rose by 0.6% versus staff expectation of 1.2%. Goods imports rose by 0.5%, which is more than the expectation of 0%. So a rough 1.1 percentage point net deterioration in trade. This is all based on the output side of the accounts, not the expenditure side. Seasonally adjusted deficit on trading goods and services was estimated at £7.7 billion in the 3 months to November, which is down by almost a billion from the 3 months to August. Specifically that was £8.6 billion of deficit, so some improvement. This will all move around I'm sure in the fullness of time. But if you were that way inclined you would say consistent with a picture of weakened performance that we've seen in other data elsewhere.
Andy do you want to….

> **Andrew Haldane.** Thank you. There are one or two bits and pieces. On the international side, we had some of the PMIs for the euro area, which overall were more positive than expected. That continues the pattern I think we've seen over the last few months. Consumer confidence and employment also a bit better than expected. As the flip of that, in the US, the US PMIs were weaker than expected. That too, in large respect, kind of follows the pattern we've seen over the past month or two. And then, turning domestically, we have this morning the GfK consumer confidence index for December, which ticked up. You'll recall it had been coming off a touch from its peak and the latest move takes it back up to above actually its average through the course of last year, with all of the sub-components pretty positive. We had new car registrations for December, which were also above pretty strongly, and year-on-year were up, getting up towards 8% growth there. We had Halifax house prices for December, which rose 1.8%. That's a bouncier series, but that's running at rates somewhat above the Nationwide Index. We thought they were converging but now they appear not to be again. And then finally we had the REC data for December, which continued the pattern we've seen over the past few months. It was a bit softer on the wage expectations side and also a touch softer on the employment side. I think that's all. Thank you.

Governor Carney. Good. So I'll go to Ben.

> **Ben Broadbent.** Thank you. Thank you, Governor. I'll begin in a moment with the usual summary of news about growth in the global economy and end with my view of monetary policy here. But I can be pretty brief with both. As Jon said yesterday, there was little news about global activity over the past month, relative to our expectations. And to pre-empt the policy conclusion, my overall impression of the UK economy isn't much changed either. The revised path for GDP shows an economy moving pretty much sideways through much of last year. Unemployment continues to fall. But it's doing so at a slower rate, and vacancies, growth of unit wages – even, in the past few months, the level of per capita wages – have been flat. So I will take the opportunity to discuss a couple of relevant issues, one in the labour market and one about China.

First, the global growth news, what there was of it. In our closest neighbour, the eurozone, activity seems still to be growing at the annualised rate of 1½% or so we've been expecting. The PMIs ticked down; the European Commission survey measures of industrial and consumer confidence both ticked up. The ECB eased policy only moderately further. This came as a disappointment to financial markets but, for what it's worth – which isn't that much – hadn't been factored into our own forecasts. Estimates of US growth fell a touch. The estimates for Q3 were revised down marginally, although the rounded figure remains at 0.5%; our now-cast for Q4 also fell a bit, to 0.4%. This would mean that growth through the second half of last year was barely any stronger than in the euro area, despite trend growth in the working-age population that's at least ½ a percentage point higher. Growth of productivity, and participation, have declined in the United States. But I continue to find it difficult to reconcile the divergence in monetary policy between the two areas with the respective economic data – the very recent data at least. Official numbers in China still point to growth of around 1.5% in the fourth quarter, There is continued selling pressure on both the currency and domestic equity markets.

With that out of the way, let me just make a couple of points about yesterday's discussion, starting with the labour market.

The first is really to re-iterate something I said last month: recent changes in the composition of employment have been significant, not least in average hours. As in most other countries, average hours worked have tended to decline over time. It's a slow decline – around ¼% a year over the past forty years – but the trend is clear. However, they're also strongly procyclical. Ian has suggested before that there might be income effects operating on labour supply – that people ease up (take more holiday, perhaps, or drop the second job) when wages recover. But average hours normally rise when the economy recovers. Perhaps people who tend to take part-time jobs tend also to be at the fringes of the labour market. More generally, cycles are probably dominated by shifts in the demand for labour – including, for example, the demand for overtime work. Whatever the reason for this pattern, to see average hours fall at an annualised rate of 1½%, which is what happened through the first three quarters of last year, is surprising at a time when the economy – employment as well as output – has been growing at a reasonable rate. That's the sharpest rate of decline since 2002. As MA analysis has shown, this probably represents something of a correction of the very rapid growth in average hours over the previous few years. They rose at a record rate between 2011 and 2014 – over half a percent per year. And indeed, they still look to be a couple of percent above a crude, long-run trend line. So perhaps we can expect the contraction to continue, even if at a more moderate pace, something that – if it's supply-led – will affect our view of potential growth. However, even if aggregate supply growth had disappointed – and as I said yesterday, we really need to see how employment evolves through the early part of this year to know how to interpret the apparent softening in GDP growth – perhaps the particular mix of the surprise should encourage us. As Jon said yesterday, if the improvement in hourly productivity growth persists, but the rate of decline in average hours abates – and I think that's probably what our instinct tells us – then we can expect aggregate supply growth to improve. We shall see.

What this unusual pattern does mean, I think, is that we need to be careful about which concept of wages we use. In the past, the Bank's wage equations ran only off unemployment and, if there was judged to be an "average hours gap", it was counted as part of spare capacity within firms. This at least seems consistent. With the right-hand side using some per capita measure of slack – the number of people out of work relative to the number participating in the labour market – it's appropriate, in estimates of the wage Phillips curve, to use per capita measures of pay like AWE.

But many of our wage suite models now run off a measure of the labour market gap in hours, including any disparity in average hours. And I think on the left-hand side of these versions of the wage Phillips curve, we should be using hourly, not per capita, wages. And they can be pretty different. Craving Martin's indulgence for confounding the two surveys: basic pay per hour rose at an annualised rate of 4% through the first three quarters of last year, compared with 2½% for the per-capita figure. Now this needn't change our impression of the labour-market "gap" or of the role of low inflation in wage setting; historically, the average rate of hourly wage growth, particularly at levels of unemployment this low, has been significantly higher than 4%. But at times it could change that impression. And, depending on our judgements about the various starred variables, which the forthcoming stocktake will address, it might also affect our forecasts.

Second, I thought we had a useful discussion of the recent volatility in Chinese asset prices, and that Jan was right to argue that – so far, at least – the resulting softness in the developed-world risky-asset markets was more to do with what people inferred about the health of the Chinese economy than with a direct expectation of some big, deflationary devaluation by the Chinese. But there's clearly a risk of that. If only for a period, such a devaluation would be good for the terms of trade of trade of households, here and elsewhere, and – I would guess – for consumer spending. Despite fears that low inflation might lead people to defer consumption, or that the fall in oil prices would release "pent-up" saving – an argument I never found that convincing – the saving rate looks to have been flat through the past year or so, not just here but in the US and also in the euro area. Now perhaps saving rates would otherwise have declined. But on the face of it, whatever else has caused the disappointment in global growth, even as oil prices have fallen, it is not because developed-country consumers have failed to spend the proceeds.

For my part, I also think there are downside risks to sterling's exchange rate against developed country currencies over the next couple of years, not just because of the EU referendum – although we can be sure that, were the UK to vote to leave, the currency would take a big hit – but because we're pretty much alone, in the developed world, in continuing to tighten fiscal policy. I noted yesterday that the decline in the exchange rate in December was more significant than that in equity prices. And it fell, I would say, reasonably significantly this morning; it's down 0.8% and is now at an eight-month low.

Nevertheless, if the Renminbi were to fall steeply, something that would probably be matched elsewhere in emerging Asia, this would represent yet another drag on our inflation rate, at least for a period of time.

All that is in the realm of the hypothetical, for the time being. But even without it, I see very little reason to alter my view of the appropriate stance of monetary policy this month, and expect next week to vote again for no change in either Bank Rate or the stock of purchased assets.

Governor Carney. OK, great. Thank you, Ben. So I have Ian and then Kristin please.

Ian McCafferty. Thank you Governor. Good afternoon everyone. At one level, there does not seem to have been any dramatic piece of news this month; at another, though, the cumulation of recent news does pose some serious questions for someone who has been voting since August for a rise in Bank Rate. Has the recent performance of the economy been sufficiently different to that expected in August as to materially change my assessment of both the outlook and the balance of risks around it?

In financial markets, we are again in "risk off" mode, worried by the downside risks to China and other EMEs. However, as we discussed yesterday, the data we have on the Chinese economy suggest that it's proceeding in line with our November expectations, and the argument that the markets have uncovered some new downside seems, to me at least, unconvincing. Even after sharp recent falls, the Shanghai 300 is only 2.8% below its level of a year ago, and is still close to 35% higher than at the start of the bubble in October 2014. We're still in the process of deflating the bubble, such that we may well see further triggers of the circuit breakers in coming weeks, without having to assume a further worsening of the economic situation.

In terms of the rest of the global economy, the staff analysis of the impact of the oil shock does suggests that either the boost to oil consuming economies' GDP has been less than expected, as Ben has just mentioned, or that other headwinds have constrained growth by more than previously thought. Either explanation is of course possible, though the downside surprise appears to vary widely by country, and it may yet be that, with confidence fragile in some countries, the lag between oil price falls and increased growth in some areas may simply be longer than the average. Nevertheless, the recent GDP data and the business surveys suggest that the steady performance of both the US and the eurozone still looks to be intact, such that our projection of a modest pick-up in growth in both areas in 2016 still looks plausible.
The recent data for the UK do give me more pause for thought. Relative to our expectations in August, there have been two key developments:

- First, recent revisions to GDP have slightly accentuated the degree of slowdown in the pace of growth through 2014, and, more importantly, suggest that the bounce back in the quarterly growth rates through 2015 that we had expected earlier last year has been less marked than had been hoped, such that the economy has been running at around 0.5 to 0.6 percentage points[1] a quarter for the past four quarters, rather than rebounding to the 0.7% we had built into our August forecast. Recent surveys suggest that this "less robust" rate of growth will continue into early 2016.

- The second of the big developments for me is the one that Ben's already touched on, that is the dichotomy between labour market quantities and the performance of wages which has become more acute in recent months. In the August to October quarter: quarterly employment growth picked up to more than 200,000, and that's the fastest quarterly rate in over two years; unemployment continued to fall slightly more rapidly than our projections, such that we're now within touching distance of our estimate of long term u*; and vacancy rates remained at relatively high levels, suggesting that, in spite of the slower GDP performance, demand for labour is still relatively strong. Yet AWE wage growth has remained much weaker than all of our expectations and certainly mine, and has fallen back in recent months.

At first sight, therefore, this would appear to be an economy in which the underlying pace of growth is perhaps slightly less, and labour supply slightly greater, than we had estimated.

But it seems to me there are difficulties in the interpretation of the detail of both of these issues. The GDP data revisions stem primarily from financial services, a difficult area to measure, and prone to further revision. The national accounts expenditure data do not look out of line with other related indicators, such as the survey data for consumer confidence and investment intentions, and still suggest an economy in which domestic demand growth is solid, and set to remain so.

In terms of the second, interpreting the labour market, there seem four possible explanations for this disconnect between quantity and values.

First, that labour supply, helped by migration, is increasing more rapidly than thought, such that slack is more persistent. Second, that low inflation has led to a new norm for pay settlements. Third, that the composition effect continues to depress AWE growth. And fourth, that wage growth has recently been held down by the earlier pattern of employment growth, which slowed sharply between spring 2014 and summer 2015, before picking up again late last year.

Of these four explanations, only the first would have medium term implications for the inflation outlook, while the others, I suspect, would prove relatively temporary, such that wage growth would rebound over the course of the forecast horizon. Given the tightness of the labour market, any new pay norm is likely to be reversed as inflation starts to pick up again; the composition effect from rehiring younger less qualified workers will have to unwind at some point, and the recent pick up in employment growth may unwind the recent AWE weakness through 2016.

So while the likely persistence of the recent weakness in the oil price will leave headline inflation a little lower for longer than previously thought, other data signals suggest that inflationary pressures may still build at least in line with our November forecast.

- Ben has focussed on hourly pay growth, and I believe others have looked at the ONS measure of unit wage costs, which picked up sharply in the third quarter, to 2.7% year-on-year. Total unit labour costs are rather lower than that at closer to 2%, but the depressive effect of pension and other social contributions is unlikely to persist.

- There is a further risk to consider, I think this month, given the recent shift in the market mood around sterling, and that risk is how much pass through of previous sterling appreciation will we actually see, if, as seems possible or even likely, sterling weakens further in coming months. At previous inflection points in the sterling exchange rate, businesses have proved sensitive to the change in trend, such that the lagged pass through

[1] MPC Secretariat clarification: speaker meant 'per cent per quarter'

from previous exchange rate moves, those before the inflection point, has been significantly reduced. As such, if sterling continues to weaken on Brexit concerns, the drag to core inflation that we have built in may prove to be lower and shorter-lived than that which we've got in the November forecasts. Staff projections suggest that core inflation will be rising to 1.5% by December, but remain at close to that rate throughout the first half of 2016. If we don't see all of the pass through that we expect I suspect that the balance of risk around that would be to the upside, and that core inflation may be closing on 2% by the end of 2016/early 2017.

To sum up, while the recent flow of data has provided a robust challenge to my recent policy stance, and may well, if it persists, cause me to alter my judgement that the economy is strong enough, and the inflation risks sufficient, to justify a small rise in Bank Rate, I do not find the detail of the recent data sufficiently compelling to alter my stance at this meeting. We will of course compile a new forecast next month, which may provide further insight. But for me the November forecast still looks reasonable, including the rise in inflation later in that forecast to slightly above target. That outlook, combined with my continued wish to provide as gradual a path for Bank Rate as possible, leads me to the conclusion that I am minded this month to vote for a 25 basis point rise in Bank Rate and no change in asset purchases.

Governor Carney. Very good. Thank you, Ian. Then we'll go to Kristin and then Jon please.

Kristin Forbes. Since we last met, one event has dominated headlines - but somehow escaped mention at pre-MPC: *The Force Awakens*. Headlines in Asia showed Stormtroopers lining the Great Wall of China. Headlines in Business sections kept running tallies of record ticket sales and the boost to retail sales from movie-related paraphernalia. Even the *Economist* had an article on intergalactic trading and economics incorporated in the movie. Star Wars even pervaded my drive to a ski resort where road signs cautioned "Believe in The Force, But Buckle Up".

Which leads to the question - when will UK inflation awaken? When will it gain enough force to justify increasing interest rates? Moving from Jakku to Planet Earth, what have we learned over the last month to inform today's policy discussion? Since we discussed recent data at length yesterday - I'll only quickly summarise what I found most informative for the inflation outlook. Then I will discuss three bigger picture points.

ONS revisions indicate that UK GDP growth slowed earlier after its post-crisis bounce and has less momentum, but the underlying story of softening-but-still-solid domestic growth continues. Continued stability in DGI measures, and gradual upward momentum in core inflation, suggest that cost pressures are slowly filling in. But once again, underlying trends are partially masked and buffeted by external shocks. Oil prices fell yet again, lowering our inflation forecast by about 0.2 percentage points over the next year. But sterling's 1.3% depreciation since the November IR could more than offset that over a longer horizon - with our baseline case of 60% pass-through to import prices predicting a boost to inflation of about 0.23 percentage points - albeit this boost will be more lagged and much not occur within the same year.

The labour market continues to show unexpected strength in some indicators and weakness in others - but alternating where the strength and weakness lies. The three months through October was the second release showing stronger than expected employment and lower than expected AWE wage growth. This is in contrast to the spring's stronger wage growth but weaker employment growth than expected. Weakness in wage growth is now apparent in enough indicators, and for enough time, that it is probably more than data volatility. Taken by itself, this might suggest wages are not firming quickly enough to meet our inflation target soon. But the strength in wages per hour and unit wage costs suggests that the reduction in hours worked and weak productivity requires lower headline wage growth to be consistent with our inflation target.

Perhaps the main economic news was rather the lack of news from the other great awakening in December - the US Federal Reserve Board's "lift-off". The first increase in interest rates in nine years in the world's largest economy and largest financial market generated a muted reaction in financial markets. Granted, the move had been well telegraphed, but nonetheless the moderate positive response - such as a reduction in the VIX and increase in global equity markets - should provide some confidence for us on the MPC. A well communicated case for liftoff, based on a solid recovery, even in the absence of imminent inflationary pressures, can be a positive signal that boosts confidence. If well telegraphed, it may not even generate additional currency appreciation. While recent news has done little to affect my outlook for UK inflation, last month did provide some time to catch up on reading - including on three broad economic issues.

First, “what is normal”? Several times I’ve been struck with how different members of the MPC could sound either optimistic or pessimistic - but still share fairly similar views on the specific forecast. Some of our differences in language and inherent optimism or pessimism may stem from different priors on what is “normal”. Some of us who sound more optimistic on a specific issue may have just started with more pessimistic priors, and vice-versa. An example of this has been discussions of the outlook for emerging markets. Growth has clearly slowed. Many describe this in sharply negative terms and focus on the risks, while others are more sanguine and focus on aspects of normalisation and rebalancing. If you believe the growth rate from 2003 to 2008 of 7.1% was normal, then EM growth has been quite disappointing. If you believe that the mid-2000s were fuelled by one-off circumstances (commodity cycle, unsustainable global credit growth, integration of China, demographics, etc), then slower growth today is less surprising. EM growth from 2010 through 2015 has actually been almost 1 percentage point above the average from 1990 through 2008. Average growth for 2014 and 2015, which has garnered such widespread disappointment, is only 0.2 percentage points below this longer-term pre-crisis average. What period one uses to define “normal” is therefore critical in interpreting how disappointing the recent EM slowdown has been and what it implies for the UK.

Moving past the issue of what is “normal”, a second theme of my reading was why growth has slowed in emerging markets. A new World Bank paper which breaks down EM growth by expenditure components is insightful. I’ll focus on comparisons to historic averages from 1990 to 2008. Investment growth is still significantly stronger than its historic average in emerging markets, government spending slightly stronger, and consumption growth only very slightly weaker. Where growth has slowed sharply is exports. This is not surprising given slower growth in advanced economies, lower commodity prices, and the general slowdown in global trade. But export growth was the component of EM growth which was unsustainable and contributed to the global imbalances behind the crisis. The fact that this is the main area where growth has slowed sharply, while domestic sources of demand are around long-term averages, is a positive sign that needed transition is occurring. Lower headline growth resulting from this healthy rebalancing is less of a concern - although obviously substantive risks still remain.

A final area I reflected on this month was recent volatility in asset prices and how to incorporate asset price movements into our forecast. The adjustments to our treatment of asset prices in the November IR were less than satisfying. There also seems to be an asymmetry in how we discuss asset price movements - especially equity markets. Sharp downward movements are often seen as indicating deep problems, while sharp upward movements are quietly accepted. The sharp falls in China’s equity market last summer and this week have prompted panicked reaction and dominated the headlines. But China’s equity market actually ended 2015 up by 5.5%; after incorporating the declines even this year - including today - the market is still up around 35% since the rally began in October 2014. Why was there much less attention to the sharp upward move? As we discuss how to interpret asset price movements in the future, we will need to be wary; they can quickly reverse, effects may (or may not) be symmetric, and we are at risk of falling prey to confirmation bias, i.e. interpreting them to justify our priors.

To conclude, my stance on monetary policy is unchanged from last month. Recent falls in oil prices and weaker wage growth suggest there is still not enough forward momentum in cost pressures to act this month. But the slowdown in emerging markets may also not be as dark for the global economy as previously interpreted. The force of the solid UK recovery, and continued signs of a gradual awakening in inflation, will likely still require increasing UK interest rates in the not-too-distant future. At least before the next Star Wars movie.

Governor Carney. Very good. Which is also a UK export since it was largely filmed here as you may know.

Ben Broadbent. And the actors.

Governor Carney. Yes, and the actors.

Kristin Forbes. I wonder if that has a meaningful effect on our exports?

Governor Carney. And this could help – it's not yet shown up in the trade data.

Andrew Haldane. It was shot at Pinewood.

Ben Broadbent. All the CGI as well.

Dave Ramsden. And quite a bit in the Lake District.

Governor Carney. And quite a bit in the Lakes, yes. There you go.

Dave Ramsden. Those scenes of…

Ben Broadbent. …wet weather.

Dave Ramsden. Not the desert scenes [Laughter]

Governor Carney. Climate change should take care of that. Ok. Very good. Anyone else, any other movie comments? OK. Jon Cunliffe and then Martin please.

Jon Cunliffe. Thank you very much. Look, it's always difficult going after Kristin, and I was ready to talk about the lack of snow, which has been quite material across Europe. Not sure I have much to say on Star Wars. I think there was a Krugman piece on the economics of intergalactic trade about 25 to 30 years ago, which is really actually quite interesting but I can't remember.

Ben Broadbent. The world runs a trade deficit with Mars.

Jon Cunliffe. No, but this is about when you can move faster than the speed of light it changes time, and that changes the economics of the intergalactic economy, but I'll have to look it out again.

Governor Carney. You have about 700 words left! [Laughter]

Jon Cunliffe. I'm going to go over this month! Alright. I think there has been substantial news on the month on both the international and domestic fronts. But it hasn't changed my big picture view of the economy. But it hasn't been altogether reassuring either.

Internationally, there were two key developments for me. First, the sharp fall in the oil price, down around 20% since the November IR. I think this bundles together both supply and demand developments. On the supply side, it is taking longer than expected for the high-cost producers to be squeezed out by lower prices. As an aside, I note that Pioneer, a major US shale-oil producer, recently announced that it had raised $1.4 billion in equity and raised its 2016 production forecast. And at the same time that high-cost production has proved more resilient than might have been expected, oil supply prospects have been boosted by the possibility of the sanctions on Iran being lifted.

The demand side explanation looks to me primarily related to the slowdown in China and the knock on effect on other commodity exporting countries and the way that has weighed on advanced economies. And that interaction is consistent with developments in financial markets. All major equity market indices have fallen since the IR. And the MSCI emerging market index is at its lowest level since July 2009. I don't think there's much actual 'new' news this month on the demand side of the oil price, or in the Chinese slowdown more generally – it is largely as we'd expected. But the risk to China and to global growth prospects, for me, remain to the downside and I remain content to have a downside skew on the international economy in the forecast.

When the oil price fell sharply in the second half of 2014 I have to say I didn't seriously consider the prospect that it would fall even further. With that experience of last year partly in mind, I do now think there is a near-term downside risk, maybe not the majority risk but certainly a risk, around oil prices that could prolong the disinflationary impact even further. The Saudi willingness to keep prices low, even if it means budget cuts, shows they are willing to endure a degree of political pain. And there are geo-political forces, I think, driving that as well. Of course, at $35 per barrel there's a limit to how much further prices can fall. But the upside risk to oil prices, barring some sort of a political blow up in the Gulf, looks to me much less significant

As we discussed yesterday, I don't think the net positive boost to global output from a fall in oil prices that we have assumed in the past has gone away. The fall in oil prices since June 2014 I think has boosted activity relative to the counterfactual of no fall even though the outlook for aggregate activity globally has worsened over that period. But I found myself less cheered by the supply driven element of recent oil price falls than perhaps I would have been last year for two reasons. First, the greater-than-expected impact on oil producers that we've seen. And second, the recent oil price falls will keep inflation lower for longer, and that may have a further dragging effect on variables that we need to pick up for inflation to return to the target, like pay.

One bright spot for me in the international picture was the market reaction to the Fed rate hike. This I think is a material development and a reduction in risk around US monetary policy that we have been discussing for some time, though of course there remains the risk of the US tightening cycle getting out of line with market expectations further along the line.

Domestically, there was continued softness in growth. The Quarterly National Accounts contained small downward revisions to growth going back to 2014. Annual growth in Q3 is now estimated to have been 2.1%, down from 2.3%. These revisions in part reflected lower construction output during 2014 and in part lower financial services output over the second quarter and third quarter of 2015. Both are a bit puzzling to be honest, but staff have locked in this news in the backcast.

And staff have also lowered their GDP now-casts for both Q4 and Q1 by 0.1 percentage points to 0.5% in part due to the Quarterly National Account revisions, but also due to the weakness in the surveys. The Markit/CIPS composite activity index fell a bit this month and the Markit/CIPS UK services expectation index fell to its lowest since February 2013. Weakness in pay could also corroborate a view that the near-term outlook will be weaker. So I agree that downgrading near-term growth is the right thing to do.

The overall message I take from all of this is that growth has been a bit weaker than we thought recently and will bit a bit weaker in the near-term. And when you add up the 'bits' and compare the latest provisional forecast for 2016 with the forecast for 2016 in the February 2014 inflation report, the effect is not insubstantial. In the February 2014 forecast, we were expecting quarterly growth of 0.7 to 0.8% in 2016, now we are provisionally expecting something nearer to 0.5%, maybe 0.6% over that period.

And in the same way, the other notable development domestic was pay growth, which was weaker than expected again. Whole economy pay growth was 2.4% in the three months to October, 0.1% lower than expected and down 0.6% on the month.

And there is also a risk, in my view, from the impact on housing transactions from the Government's changes to stamp duty and to tax deductibility on second homes and buy-to-let properties. I think this does pose a downside risk to housing transactions and associated expenditure.

However, while there has been downside news, I am still able to stay within the broad picture outlined in the November forecast. I think that the conditions for robust growth in consumption and private investment – which are the main motors of growth in that forecast - remain broadly in place. Consumption growth should be underpinned, in part, by high consumer confidence, which increased in December and remains well above its historic average, and strong employment and real pay growth. And surveys of investment intentions remain strong.

In addition, credit conditions continue to ease. Between June and November, two-year fixed mortgage rates fell by 46 basis points for 90% loan to value products and 26 basis points for 95% loan to value products. Secured and unsecured lending growth continued to pick up, as did net lending to UK private non-financial corporations. For SMEs, the 12 month lending growth rate was positive for the third consecutive month.

And on pay and productivity I do take some comfort from the per hour readings, which are stronger than those metrics for heads. It may be that workers are now a bit more confident given real pay growth and the boost from oil, and because a tighter labour market has given them more job security. And as result they may be going back to taking what you might think of as a more normal amount of holiday. On a recent Agency visit – so it has to be true – the Finance Director of a large holiday company told me that there had been a strong pick up in second holiday bookings over the Christmas period. It is only one anecdote but it's also consistent with improved consumer and worker confidence. And maybe with the passage of time, we should get a better handle on whether recent trends in pay growth are short or long lived and whether signs of improved worker confidence then spills over into pay settlements.

There are of course less benign explanations for weak pay growth. As Ben said yesterday, employment quantities may not yet have caught up with weaker demand. And another explanation, as mentioned last month, is that low inflation is dragging down pay demands and company's pricing power. Most surveys of pay growth expectations sit within around 1.8% to 3.0% which is consistent with a continuation of moderate pay growth.

I take a little comfort from the expected pick up in ONS core CPI inflation to 1.5% in December but less comfort from the fact that we expect it to stay around that level at least for the first half of 2016. And this again to me demonstrates the need for a pick-up in domestic cost pressures.

So, putting it all together, overall my big picture has not shifted. But the strength of the economy following the end of that 2013 boost from pent up demand has been noticeably weaker than we thought. I'm not sure that robust remains the right description for growth. Solid is probably a better description. At the same time, external disinflation is set to persist for longer than we had expected. I'm not ready to abandon my slow post-crisis healing thesis and the broad picture set out in the November IR. For the moment, my view is the process is just taking a bit longer than I'd originally anticipated. But I certainly don't see the build-up of inflationary pressure that could justify taking action now to reduce the risk of inflation overshooting when externally generated disinflationary pressures recede.

So with that my provisional view and my vote for this month is no change in Bank Rate and no change in the stock of purchased assets.

Governor Carney. OK. Very good. Martin and then Jan please.

Martin Weale. Thank you Governor. I too have been affected by contagion from Kristin so let me start by saying that over the Christmas holiday I took the opportunity to visit the church at Greensted. Since my first visit in the 1970s its date of construction has been revised from 845 to 1060.

Ben Broadbent. Sorry, which church is this one?

Martin Weale. The church at Greensted.

Governor Carney. That's a big revision! [laughter and mumbles]

Martin Weale. Yes, the point I wanted to make was the national accounts too, have been revised in ways which, if less dramatic, are nevertheless material. But before discussing these I would like to say something about the international picture.

The general feature of 2015 was relatively good growth in the advanced economies with growth in developing countries weaker than it had been previously. The picture we were presented with on China seemed broadly consistent with that of a month earlier - a shift towards consumption is supporting overall growth reasonably well. The weak Caixin PMI for services, contrasting with the strong NBS PMI for services earlier in the week, casts some doubt on this but the move isn't enough to change our nowcast for Q4.

The December increase of a ¼ percentage point in the target range for the federal funds rate came as no surprise to anyone; indeed a failure to raise the rate might have been taken as a bearish signal. Whatever the long-term implications of the move, though, the increase did demonstrate that it is possible to change the target rate without leading to chaos in financial markets. Perhaps that is just as well, since few would doubt that the rate had to change at some time. Nevertheless, the

FOMC having accomplished the change, I think we can all be a bit more confident that the timing of the first increase here need not be excessively influenced by fears of what might happen rather than what is most likely. Overall, for me at least, the outcome points to a slightly reduced risk of an early change relative to a late change in Bank Rate.

I think the main international development has been the renewed decline in the oil price, falling to below $33 today. This will prolong the period of very low inflation throughout the world. Nevertheless, as a proportion of the oil price in the summer of 2014, the recent decline is much smaller than it was in late 2014. On the upside, there's been the 1.7% decline of the exchange rate since our last meeting. Exchange rate movements are not, on their own, a reason for concern about China exporting disinflation to us – at least so far. At around 9.6 yuan to the pound, the currency is close to a six-month high. The concerns we hear about are the effects of dollar strength rather than renminbi weakness. Since the start of the year we have, nevertheless, seen renewed weakness in Chinese share prices, with markets being very sensitive to indicators that are probably noisy. In the short term at least this has affected share prices in the advanced economies. Overall, it does seem to me that there are clear risks to spending decisions in the advanced economies, at least if things continue like this. Staff analysis suggests that supply more than demand effects have been influencing oil, at least until this week, but given stock market movements, perhaps the most recent fall is a response to expectations of near-term demand rather than supply.

Returning to the national accounts, the Q3 GDP figure was revised down by 0.1 percentage point, albeit a movement accentuated by rounding, and the Q2 figure by 0.2 percentage points. I doubt that we can have a useful discussion over the factors which made growth weaker than we had thought. There are plenty of candidates - eg, electoral uncertainty in Q2, Greece or China in Q3, changes to measurement error - and no obvious way of distinguishing them. More pertinently, it now seems that growth slowed materially in 2014, and the latest survey data fed into our models are pointing to growth in the final estimate of GDP of 0.5% in 2015 Q4 and 2016 Q1; an important issue for the forecast will be assessing when things are likely to improve, and that will depend on how far the issue is one of weak supply as much as weak demand. That said, Ben reminded us that the final figures may be some way off these early estimates.

The revisions mean that the productivity picture is not as favourable as I had previously thought. What looked like 0.9% growth in Q2 has fallen to 0.8%, while the figure for Q3 is 0.5%. These data, on their own, are perfectly respectable growth rates, but perhaps rather less so when seen with the early indicators for Q4. Total hours grew by 0.6% in the three months to October relative to the previous three months. Given the likely underlying growth rates of GDP that, although a weak indicator for Q4, points to productivity having stagnated again, or perhaps having fallen. It's worth noting that, even with zero productivity growth in Q4, however, productivity over the four hours to Q4 would be 1.4%, still broadly consistent with the idea that productivity growth is improving, after nearly two years of stagnation. A swallow in each of Q2 and Q3, however, does not on its own make a summer.

Wage growth remains weak. The growth rate over the last year has fallen to 2.4% and, more pertinently, over the six months to October, the average weekly wage has grown by only 0.2%. With the benefit of hindsight, perhaps I should not be too surprised by that. Using a fat tails time series model I find an underlying rate of wage growth also of 2.4%. So perhaps there's a strong element of noise in the recent data. Looking at figures over the last year one might focus on the growth in real weekly wages, also 2.4%, but of course the real rate of growth over the last six months has also been close to zero.

On the issue of Phillips curves in hours or jobs, my preference is for the latter. Looking at the labour force survey I do not find those people who want to increase their working hours accepting relatively low wage growth. At the same time of course that's hardly the last word on the matter.

The ONS productivity release shows that unit wage costs grew by 2.7% in the four quarters to 2015 Q3 and unit labour costs grew by 1.9%. These figures may well be revised down if growth is revised up. For the time being it seems weak inflation is not being translated into weaker cost growth.

Despite this, a striking feature of the STIF is that, for the twelve months starting in December, the monthly inflation rate reaches a rate consistent with the 2% target in only two of those months. After the most recent oil price movements, the STIF suggests that inflation will reach 0.5% in January and then stagnate for some months. My own work on oil last summer suggested that perhaps inflation would stay low for a bit longer than our analysis at that time had indicated but then pick up fairly sharply. So I wouldn't be surprised if, over the next year perhaps, inflation runs a bit lower than the STIF projects , but that shouldn't on its on imply that oil price movements continue to affect inflation materially for more than two years.

Seen from the perspective of the initial estimates, Ben pointed out that, except for current inflation, circumstances are not very different from those at which previous interest rate tightening cycles began. I continue to believe that the factors holding down inflation are temporary. Nevertheless, given what we have learned about their likely duration and also about the most likely time-path of the response of inflation to interest rate changes, I expect to vote for no change to interest rates and no change to our holdings of assets.

Governor Carney. Very good, thank you Martin. So Jan and then Andy please.

Jan Vlieghe. Thank you. Despite recent volatility, I actually do not think that there is that much new to say on financial markets. Most equity indices and government bonds yields have moved in a range since last summer, swinging between bouts of optimism and pessimism about growth and inflation. In the past week or so, most have fallen back near the bottom of that range. Credit spreads have widened back to September levels. All in all, aside from oil, "more of the same" in financial markets.

Even the substantial depreciation in the UK's trade-weighted exchange rate just takes us back to the level seen in October. The one interesting aspect of the move in sterling has been that it has not been accompanied by a commensurate move in relative interest rates. So it has probably not been driven by relative growth or inflation data, which would have changed relative expectations for monetary policy. A possible explanation is that it is due to a referendum risk premium, a view also supported by the large spike in risk reversals, which is the difference in the cost of insuring against downside vs upside risk in FX option markets. This cost difference has risen sharply over the past few weeks, to levels close to those seen ahead of the Scottish referendum. If it only represents uncertainty by foreign investors, while UK businesses and households carry on as normal, this FX depreciation is a stimulus for the UK. But if the uncertainty by foreign investors is matched by increased uncertainty of UK businesses and households, there is no boost to growth, though still a direct effect on the inflation profile.

Moving away from financial markets to the economy, this month I thought I would revisit my comments since I joined the Committee in September, and provide a brief assessment of how the story - as I have seen it in real time - has evolved. This is a discipline I imposed on myself when I worked in financial markets, and I have found it useful in two respects. First, it keeps me honest by refreshing my own memory about what I said and thought at the time. Second, it helps me hone in on the most important things that I have changed my mind about, which is a version of "identifying the shock".

Concerning the global outlook, I have been arguing that global growth would remain subdued, and that any expectations of an acceleration would be met with disappointment. I noted the sharp run-up in indebtedness in emerging markets since the financial crisis, which was likely to weigh on emerging markets growth in the coming years.

Domestically, my assessment had been that we were seeing a modest loss of momentum in demand growth since the early 2014 peak, but that supply growth was improving somewhat.

I thought that the negative of renewed fiscal drag would be broadly offset by the positive of an improving housing market, which, along with improving productivity and real wage growth, would underpin solid consumption growth. On balance, I thought there would be no further loss of domestic growth momentum, but I saw the risks to the downside. Last month, I became more concerned about the outlook for the housing market, given the fiscal policy changes that will affect buy-to-let investors. I noted some tentative signs of slowing activity growth in the housing market, especially in the RICS survey.

On the inflation front, I have been encouraged by some signs of bottoming out in core inflation, but have been worried about the lack of broad-based upward momentum in cost pressures. Initially, that assessment was based on the fact that survey measures of pay did not show an upward trajectory, and that AWE pay data - which had shown improvement earlier last year - lacked further upward momentum. More recently, we have seen that AWE pay data itself has been losing momentum.

So what have been the most interesting changes or surprises?

My overall assessment of global growth has been little changed throughout this period. I have been somewhat surprised on the upside by the improvement in eurozone growth, while disappointment in EM growth has probably been a little greater than my baseline was. This change in the global growth mix is favourable for the UK at the margin, given the importance of the eurozone to the UK. But EM risks remain firmly to the downside.

My reading of the domestic growth data is still that we are likely to see a stabilisation in growth after the slowdown since early 2014, but that stabilisation looks to be taking place at a growth pace closer to 2% rather than 2½%, slightly weaker than what I had in mind. More importantly, the balance of my forward-looking ledger of positive and negative factors for growth has changed. The negative of fiscal drag remains, but what I earlier saw as a positive - improving housing and productivity - has been undermined.

The fact that housing might be less supportive of overall growth than I had hoped earlier is an unambiguous downside risk to demand growth. The signs of a slowdown in housing activity are still tentative, and we are due to see substantial noise as transactions could spike ahead of the stamp duty change in April. We may not be able to assess whether this downside risk is materialising until the early summer.

The productivity and wage disappointment are simultaneous news on demand and supply. As I mentioned last month, a weaker wage profile combined with a downside risk to housing is likely to imply a lower consumption forecast. But weaker consumption alongside weaker productivity growth does not necessarily have near term monetary policy implications.

On the other hand, the fact that wage growth continues to disappoint relative to our assessment of slack does, in my view, have a monetary policy implication. There may not be that much news in unit wage costs relative to productivity, but there is some, and as we keep pointing out, unit labour cost growth remains too low. To be confident in a forecast of rising cost pressures that brings inflation back to target, I need to see evidence of broad-based improvement in indicators relating to pay. I have nothing new to offer relative to last month on why wage pressures remain low: the plausible candidate explanations remain that (1) inflation expectations are too low, (2) slack is bigger than our central estimate, and (3) immigration is putting more downward pressure on wages than we think.

All this leaves me with an outlook of stable, unspectacular growth after the slowdown over the past 18 months. Growth risks remain to the downside, and signs of inflationary pressure remain largely absent. That is not an environment where I feel a rate rise is required. I am therefore minded to continue to vote for no change in interest rates and the stock of assets purchased.

Governor Carney. Thank you. Andy and then Minouche please.

Andrew Haldane. Thank you. Internationally, the macro-economic news over the month has done little to alter the picture painted in the November Inflation Report. UK-weighted world growth in 2015 is likely to be in line with 2014, at a quarterly average rate of ½% – ½% of course being the "Broadbent Constant" to which all macro-series converge over time. In other words, it will have been another year of slight under-achievement on global growth. The most significant piece of international news since the November IR has probably been the further fall in oil prices, down around a further 25%. And with the balance of factors driving prices appearing, latterly, to have shifted back towards supply, that ought to provide some fillip to global growth this year and next on conventional ready-reckoners, by perhaps 0.2%.

Yet as the analysis at pre-MPC illustrated, historical ready-reckoners might at present overstate somewhat these benefits. The fall in revenue streams for commodity exporters has coincided with a reversal of capital flows and a rise in dollar borrowing costs. And that triple whammy appears to have materially tightened financing constraints in some countries, generating a larger-than-usual contraction in domestic absorption.

The further commodity price falls we have seen over the past quarter will have further tightened these financing constraints, potentially generating another, potentially more pronounced, contractionary response. On the other side, there must at least be a question-mark about the extent of the demand offset that will be provided by commodity importers. In a number of them, at present, households and companies are facing uncertainties – whether political, economic or social – about future prospects. And recent events in China, the Middle East and elsewhere are likely to have added to those uncertainties, making somewhat more likely a precautionary saving response to their recent terms of trade windfall. For all those reasons, I think it might be optimistic to believe the further recent fall in oil prices will deliver a significant net stimulus to world growth.

Turning to the domestic economy, the latest revisions to GDP data brought into sharper focus a puzzle about the UK growth story which I have harboured for some time. Some parts of the growth story make perfect sense. For example, the rebound in output in 2013 due to the dissipation of euro-area uncertainty makes sense, and so too does the fact that some of that boost proved temporary. But the combined effects of diminishing fiscal drag, a significant loosening of credit conditions and rising profits and real wages would probably have been expected to add impetus to UK growth after 2013, probably maintaining it at above-trend rates. And indeed, that was what the MPC itself was expecting. As Jon mentioned, in its 2014 Inflation Report, quarterly growth rates were expected to continue averaging 0.7% during 2015, before rising towards 0.8% in 2016.

What we've seen instead over that period is quarterly growth rates falling. Indeed, excluding oil and gas, they've halved comparing the start of 2014 with 2015. There are several possible explanatory factors of course, including a slightly weaker world picture and a stronger exchange rate, but it is unclear these fully account for this loss of growth momentum. Put differently, this growth pattern is hard to reconcile with r* having risen much over the period or with r minus r* having been significantly negative. If that were the case, I would have expected to see growth on a rising path, perhaps above trend, rather than a falling one to around trend. And if anything, the surveys suggest growth could be set to slow a little further, not just in manufacturing but services too.

Based on its usual determinants – confidence, incomes and credit, all of which have been positive – this growth pattern is not so easy to explain. Perhaps there is something simpler, and structural, at work. If we look at growth over the whole period 2010 to 2015, we find it has averaged ½% per quarter – that "Broadbent Constant" again. Perhaps what we have seen is no more than an undershoot of that trend during the euro-crisis, a slight catch-up overshoot in its immediate aftermath with then a subsequent reversion to mean.

Whatever the explanation, this leaves me feeling less certain that the degree of momentum in the economy is, or is likely, to build in the way that our forecast suggests is needed to return inflation to target. And that reflationary momentum, or lack of it, is also apparent to some extent when we look at the nominal side.

CPI continues to surprise a little to the downside, albeit largely for energy-related reasons. Core CPI may be about to nudge-up, but pretty gradually and, with a full percentage point to travel back to target, there is plenty of scope for a slip between cup and lip.

Looking across the wage swathe, growth now looks becalmed in the 2-point-something zone. Over the period 2010 to 2015, wage growth per quarter has averaged 0.4%, just under the "Broadbent Constant". It appears to be reverting back to close to those levels at least for now. And mirroring wages and prices, inflation expectations among at least households and companies remain weak, with a majority expecting inflation will undershoot its target at the two year horizon. Overall, there remains a lack of clear evidence of nominal momentum building and that is being complemented by some signs of slightly stalling momentum on the real side.

Earlier this week, I met the Chief Executive of one of the Big Four accounting firms. Based on his conversations with businesses, he had coined the expression the "looking for excuses" recovery.

That reflected the fact that, although many of the businesses he dealt with were doing pretty well, when it came to making big investment decisions they were tending to “look for excuses” not to do so. Recently, these excuses had ranged from the Scottish referendum, to the election, to Greece and China. And this year they will likely include China again, the Middle East and Brexit.

The latest CFO survey suggests these worries, and their likely impact on investment intentions, may have intensified somewhat over the past quarter. This look-before-you-leap psychology is not that surprising or indeed irrational. And the slightly rocky start to the New Year, at least in financial markets, may have caused a further thumbing of the worry beads. These sentiments may be shared by households as well as companies, although seemingly to lesser extent if today’s buoyant consumer confidence figures are any guide.

Either way, according to our surveys a prospective rise in UK interest rates is also on the worry list of households and companies. That is no surprise, given the MPC’s messaging last year and in the light of the US’s recent move. But against a backdrop of slightly drooping momentum in activity, and still-weak momentum in prices, I think it is important monetary policy does not add unduly to this worry list. Re-emphasizing the flexibility of the monetary regime in dealing with shocks, whether positive or negative, would be one way of doing so. Making clear that the path of monetary policy is not pre-ordained, but will move with the fortunes of the economy, would be another. Neither would break new ground, but either could provide a more supportive tone.

Either way, I am minded this month to continue to vote to leave unchanged Bank Rate and the stock of purchased assets, with no bias on either’s future direction. Thank you.

Governor Carney. OK, thank you Andy. Minouche, please.

Nemat Shafik. At the start of the year, every commentator ventures to predict what the year ahead will bring. Rarely does anyone return to these predictions to assess their accuracy, so the practice continues. The global forecasts for 2016 produced by various commentators over the past few weeks have a familiar feel to them: they all say the recent drop in oil prices is the last before we will see a modest increase; the return of inflation to above 1% is just around the next corner; sluggish global growth will improve only moderately reflecting the now accepted fact that global supply is not what it used to be; and monetary policies will continue to diverge as the FOMC and the MPC tighten, while the ECB and the BoJ engage in more easing; and China will struggle to manage a depreciation and deleveraging but will ultimately succeed.

As we begin the process of updating our own forecasts for the UK, we are faced with a set of questions that also have an air of familiarity. Will private final demand remain strong enough to sustain growth? And will domestically generated inflation pick up enough to ensure that inflation will return to target in the medium term? Let me take those two questions in turn, before saying a few words about other things that will influences 2016.

I’ll start with the question around growth and demand. News that quarterly and annual GDP growth had been revised down to 0.4% and 2.1% respectively in Q3, has provided further confirmation that activity is slowing. Now, whether this represents a relatively benign maturing of the recovery or whether it represents the beginning of a more pernicious slowdown will depend crucially on the behaviour of final domestic demand.

Thus far private final demand has held up very well, maintaining growth rates of around 3% despite the slowing in aggregate growth. But there is a concern that this has been driven by a temporary boon to real wage growth from falling energy and import prices, and that once this fades some underlying weakness in demand will be exposed.

I don’t consider such a scenario the most likely outcome – I am not a secular stagnation-ist. While the reduction in energy prices did provide a welcome impetus to real incomes, the recovery should now be able to continue under its own steam: the strength of consumer and business surveys suggest that domestic confidence is robust, and that will no doubt be bolstered by the wider availability of credit. What is true, however, is that for the recovery to be sustainable we will need to see a more consistent resumption of productivity growth, which has thus far shown only stuttering improvement.

Let me turn to inflation and the prospects there. I said last month that before voting for an increase in Bank Rate, I would like more certainty that wage growth will return to levels consistent with inflation returning to target – by which I mean wage growth consistently growing 2 - 3% more quickly than productivity.

When will that certainty come? The November Inflation Report projected that in the second quarter of this year wages would grow by 2.1% more quickly than productivity, and that that wedge would continue to increase thereafter. But the news since then has been clearly to the downside: whole economy total pay growth has fallen back to 2.4%, with regular pay even weaker at 2%. Some of this weakness has been matched by disappointing revisions to productivity per head, but the net result will still be that unit wage cost growth looks set to be a little weaker in the near term than we had expected at the time of the previous forecast.

Nevertheless, I do still think that the most likely outcome is that this pre-condition for lift off will be met in 2016. The ratio of vacancies to unemployment is at its highest since 2005, firms continue to report recruitment difficulties and skills shortages to the agents, and it seems inevitable that this tightening of the labour market will ultimately feed through to higher labour costs. But I would like to wait and see evidence of this happening before voting for a rate rise.

Let me finally turn to the unknown unknowns for 2016. We can predict with some confidence that the most important factors that will affect the outlook in 2016 are things that are unpredictable. History teaches us that economies tend to grow unless they are hit by war, exogenous shocks such as to commodity prices, or financial crises. But there are nascent risks of all those three in the year ahead:

- In the first week of this year, we have seen escalating tensions in the Middle East and weapon testing by North Korea. If that's anything to go by, geopolitical concerns could begin to impact on uncertainty.

- Second, financial markets will also generate uncertainty: will wobbles in risky asset prices turn into something more serious? Will Chinese instability spillover to other financial markets? Will sterling give back some of the appreciation seen since the beginning of 2013? Will the yield curve remain as flat as it currently is?

- And then finally of course we can't ignore the EU referendum, which now seems likely to take place in June or the Autumn. A period of uncertainty is inevitable. The question for us will be how much of an impact that will have on the economy, particularly on investment, wages and the current account.

And so finally to conclude, so although the questions with which we start the year are pretty familiar, that shouldn't be mistaken for meaning that 2016 will be boring or predictable. This month, however, I will be utterly predictable and given the continued absence of steady and sustained domestic cost pressure I intend to vote for no change in Bank Rate and no change in the stock of purchased assets.

Governor Carney. OK. Very good. Well, I don't have a clever narrative or a brutal and frank self-assessment, but I'll just go through a couple of considerations. I'll start with the observation that what we've seen over the last month or so has broadly been an intensification of previously identified trends, and intensification in some respects may be too strong. I'd start with the European recovery, which has continued to extend and broaden. The PMIs today I would take as consistent with that – the consumer confidence measures mentioned by Ben. I mean, I think there is a real prospect of European growth moving consistent with our forecast up towards the upper ends of 1%, you know 1¾%, maybe potentially stronger – obviously material for us. Set against that have been these increased strains in emerging markets: notably, but not exclusively, China; Latin America hard hit by falls in commodity prices; the Brazilian morass is deepening – Brazil is a lot more important than it used to be, maybe not to us but from global and from a spillover perspective.

You see manifestations of some of the economic strains in the revolving door. The finance ministry in South Africa and, I'd argue a bit, some of these tensions in the Middle East, are reflective of that as well. China does bear a special consideration and certainly it was enough to merit our downside skew on growth and inflation last time. I think recent events just confirmed that the currency adjustment's likely to extend. It's probably come a little sooner than we might have expected. They do retain the ability and the resources to manage it, and I would argue that they do have a more coherent approach than hoping for the best, which was the previous strategy. But domestic stock market pressures and possible rising domestic political tensions – and I wouldn't under-estimate the strains that are going on in the Chinese system right now, given the anti-corruption drive and the manifest lack of delivery on economic objectives. Both of those have the potential to accelerate capital flight and make that job of managing the exchange rate that much harder.

It's been, in my one bit of confirmation by a self-selecting look back – what did I expect to happen that actually turned out to be true – I've had long held view that China was facing a big adjustment that had been slowing for longer than had been apparent. And I would underscore that there has been no progress, no progress, in addressing the major challenge they have, which is this massive debt overhang of quasi-municipal debt. And in fact all of these challenges, from what I can tell in some of my conversations, is if anything delaying that adjustment. So problems are building but the core issue is not yet being addressed. And this is just shaping up the possibility of potentially a sharper adjustment down the road. But it makes it that much more likely that China is going to be slow for long, I think that, you know, the sum of all these.

The oil price drop, I thought the analysis and the discussion was persuasive in terms of the balance of this being a supply shock and that net positive for the UK and net positive for the global economy. Exact orders of magnitudes and lags *et cetera* of course subject to some debate, but is positive.

On balance, domestic wage pressures – this is another trend that we have been seeing, and I would say – are more muted than labour market economists might have suggested, possibly reflecting some combination of compositional effects, contemporaneous inflation and migration is the way I would look at it. I do take Ian's caution on the temporary aspect of most of those, and of course this sets up a risk of an acceleration once they come off, particularly the contemporaneous inflation effect. I'll come back to that.

Housing market activity is still modest, somewhat to our surprise, and I think we're not really going to be able to tell… Unless it remains modest; there will be real news if it remains modest in the coming months given what Andy drew our attention to yesterday, on just the attractiveness of credit conditions. I mean mortgage credit is wide open, except at the highest levels, and it's very attractively priced. And obviously also the incentive to pull forward some transactions because of stamp duty changes. It may be possible, and there is a bit of a puzzle given undoubtedly the British consumer, as far as we can tell, is confident. You know, consumer confidence as measured is near, and from time to time at, decade highs – certainly very strong – and they are confident enough to borrow and reduce savings. We see that most markedly in the auto market. But that may be the limit of major purchases. I mean major purchases may be more limited to hire purchases I guess the way I might put it. And taking the step into the housing market, as I tried to argue yesterday, may be a bit too strong. But we should expect that, well I do expect at least, that consumer consumption growth will remain what I would term strong in this case, continuing to drive the economy forward.

There are a couple of new developments that merit tracking and I'll mention three. First, and I won't go over it because we'll have a chance in the forecast, but a bit less growth momentum in the economy than previously thought. These quarterly averages of about ½% net out oil and gas extraction, which had a sort of notable bump last year. It's less than ½%. I wouldn't expect the oil and gas contribution to be that material going forward. But it's a broad picture of probably consistent growth at that level going forward. Obviously, I'll come back to what it means for inflation in a moment.

Secondly, I think it is material that we now have referendum risk, at least in the short term. In sterling, it means that sterling is firmly in risk-off camp, and that's helping to drive. And that also reduces an upside risk that we could have sterling get away from us on the upside.

And then thirdly – and I'm glad that transcripts come out in eight years' time – I would say the risk of pro-cyclical fiscal policy is increased. You know, we'll see what happens on the revenue side, but the chance of a revenue shortfall certainly has gone up. Nominal GDP has not performed as expectations were there, and I think if you listen carefully to what the Chancellor was saying today, he was setting out the need for tough decisions. It wasn't just political positioning, the need for tough decisions. And tough decisions are more likely to involve expenditure reductions. There is not a massive amount of untapped revenue opportunity out there and so we already have the prospect of material fiscal drag. So I think we may lose some of that fiscal boost that we thought we got in November – that's the only thing I'll mention there – and I do think that, in the end, drew attention to this. It still makes a reasonable impression on me this scale of deepening fiscal consolidation, this process that we are headed into. It will undoubtedly weigh on growth. The question is only of degree.

I'm glad we are doing our supply stocktake in February as opposed to May because we've got some important issues. Particularly, how much of the weakness of demand is matched by supply? And one way into this is to try to determine what explains that constellation of moderating growth: falling unemployment; softening wages; average hours falling and productivity growth flattening. That's the big question. You could take a more supply-type perspective which, and it is possible that u*, that there have been a series of adjustments which one can point to on the micro side that it made the cost of hiring and, I would say, utilising labour more cheap; zero hour contracts, other aspects that mean there's more flexibility in the use of labour. But at least on the hiring side that u* may be lower than we thought, which would suggest more supply. Alternatively the moderation of productivity growth could explain the slowing in output growth, but still falling unemployment. Now that should, of course, boost inflationary pressures over time. And also should moderate consumption, which, as I say, has been growing quite strongly. Neither has happened and, of course, it may just be a case of timing. Neither has happened yet and that may still be to come.

Ben stressed yesterday another reason. This is just another reason to watch labour markets developments closely. I won't belabour average hours because we are going to go through that in some detail. That was always the intent. I think I will just add, gratuitously, the sort of comment that, when we do this sort of bottom up "output-gappery" if you will – is that a word, well it's a word now – I think it's useful still to step back and look at what the top down filters say. It was helpful that, in terms of the adjustment, I think, in retrospect it was helpful in the adjustments we've made in the last couple of Inflation Reports. And it will be interesting to see what the filters make of co-movements of weaker wage growth, lower unemployment and moderating wages.

Another big topic for us to, I think, drill down a little more, are questions around inflation persistence. It's certainly an empirical regularity – Martin has drawn our attention to this in the past – particularly in core inflation. A number of us have raised the question, and Kristin and others, whether we are seeing some of this through the wage channel, with a mutual reinforcement between lower inflation and lower wage growth. We may be seeing, may – and that's obviously the big question – whether we are seeing more of this through an expectations channel. It's going to be very hard to identify that. Obviously the core of the Lucas Phillips curve was in expectations we make. We should at least ask the question. I guess if David Miles were here he would remind us that individuals' expectations of inflation are formed by contemporaneous inflation so we will probably get it virtually indistinguishable. So maybe I've answered my own question right there.

I'd be interested, and wouldn't mind drilling down a bit more on, what to make of – and of course we have to see persistence in this and it's not that regular a survey – but what to make of CFO's expectations of below target inflation in two years' time. You know, whether this is rational or adaptive. I certainly hope it isn't self-fulfilling. I suspect there's no evidence that it is indeed the case. That's right. Gareth is nodding, so that's not the case, but I do take note of it.

I'll just end by, I guess, reinforcing what I think we all believe – the importance of being as clear as possible about our objectives. In particular, and these are strategic and communication points, the importance of returning inflation to target in around two years, which is what we said last time, and in a sustainable manner. This is what gets to the heart of, to simplify, the building domestic inflationary pressures offsetting persistent foreign disinflation. But at some point that persistent foreign disinflation should roll off. It may have been reinforced by recent events. We'll have to see if they're persistent in terms of exchange rate moves and potential, and I would underscore potential, weakness abroad. There are clear risks in running domestic inflation too fast. I don't think we face those yet, but we have to be quite conscious, and I think hammering home this point that this is a risk we are trying to avoid.

Ben Broadbent. And it hasn't got anywhere nearer home.

Governor Carney. And it hasn't got anywhere nearer home. Exactly. And so I think this is one of the challenges to try to think through. And I think the other thing, and we may not all be – well, we'll talk it though – but the other thing is, you know, just how to avoid our communications being reduced to a simple validation or not – a simple validation of a market-implied view of lift-off date. You know, we've all remarked many times, with a very flat curve, it's very easy for this date to move around quite quickly with modest moves. And I think we know that the – we know certainly, the market doesn't like to acknowledge it, and you gamely tried to make this point – that it's the inter-role of the rate increases that is what's relevant. And the question is whether there is a way to help get this across. It's certainly possible. It's not necessarily advisable, and I don't feel today is the time to do it. But it's possible to go earlier and less steeply than the market expects, and to live with the same effect of tightening. Now, it's marginal in terms of the scale of what's actually likely to be required at this stage. It is marginal, but I do think, unfortunately, we've got into this sort of game of everything – for all the great detail and analysis and hard work and thought that goes into what is produced on a Super Thursday, or whatever it is, it gets reduced to whether or not I validate, which is losing the richness of the reaction function in the communication, I think. And so I don't have an answer to my challenge but I think we should be thinking through that, to the extent possible, in order to ensure that there is the focus on our reaction function and the state contingent nature of policy.

So with that, I am minded, as you can probably can gather, I'm minded to vote for no change in interest rates and no change in asset purchases. Which, by my count, makes eight in favour of no change in interest rates, and everybody in no change in asset purchases. I take your "no bias" comment Andy. I take note of that. And with that, if anyone has any other comments or addendums? And hearing none I will close the meeting for now and we will reconvene – it feels like we should reconvene in about five minutes given the meeting schedule we had – but we will reconvene next Wednesday right? Wednesday.

A meeting of the Monetary Policy Committee was held on Wednesday 13 January 2016. The following members of the Committee were present:

Mark Carney, Governor
Ben Broadbent, Deputy Governor, Monetary Policy
Jon Cunliffe, Deputy Governor, Financial Stability
Nemat Shafik, Deputy Governor, Markets and Banking
Kristin Forbes, External Member
Andrew Haldane, Chief Economist
Ian McCafferty, External Member
David Miles, External Member
Martin Weale, External Member

Gareth Ramsay as Treasury representative for Dave Ramsden

The following members of staff were present:

James Bell, MPC Secretariat
Chris Young, MPC Secretariat
Sarah John, MPC Secretariat
Melissa Davey, Editor of Inflation Report

[redacted]

Transcript of the Monetary Policy Committee Meeting on

Wednesday 13 January 2016

Governor Carney. OK. Good afternoon everyone. Welcome to this Decision meeting. Andy, perhaps you'd like to go through some of the data. I have one or two things to update from Basel weekend, nothing momentous but just to pass on.

> **Andrew Haldane.** OK. Thank you. On the international side, let me mention just three things quickly. First, of course, we've had the payrolls data for the US last Friday, which was a stronger than expected increase of 292,000. This morning, and therefore not in the background note on data that you've had round, we had industrial production data for the euro area in November, which came in well below our expectations, actually a contraction of 0.7%. I think we'd been expecting a contraction of 0.1%. There was some upside revisions however to the October data, so our nowcast is a bit weaker than we'd expected, and that will be an issue we need to take into the forecast round and see if we can make sense of. And finally on the international side, again this morning, we had some trade data for China for December, and there the news, if anything, was to the upside, with both exports and imports decreasing less than I think we'd expected.
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> And then domestically, the one piece of domestic data I thought I'd mention we've had since we last met was Index and Production for November, which I am sure you'll have seen, fell by 0.7%. That was just a touch more than our own in-house expectation, although quite a lot weaker than had been the outside expectation. I think that is all, thank you.

Governor Carney. OK. Very good. Thank you. In terms of Basel, just a couple of things. [redacted]
One of the things that – and I'm going to turn to you, Minouche, in a second to speak markets – but one of the things that people are obviously focussing on is that, well, in theory there is a basket to some extent, but the fix, and the fix is against the dollar, and it's the dollar which is always quoted by Chinese officials. You know, the dollar cross which is always quoted as opposed to managing it more explicitly against that basket. And I think that… Jon, do you have anything else? That was the thrust. Just to give you a sense of the mood music, I mean, it was sombre from the emerging markets. I wouldn't say it was distressed or anything like that, it was just that things are slower. And things are slowing in a variety of emerging markets, which is consistent with our forecast. OK, so Minouche on the markets side.

> **Nemat Shafik.** Since our December meeting there have been further falls in UK short term interest rates, as well as declines in sterling's effective exchange rate. UK market interest rates 3 years forward are now 1.1%, compared to 1.3% at the time we met in December, and the sterling ERI is 3.3% lower. Just following on what the Governor said on China, relative to our December meeting, the dollar/Chinese yuan rate is down 2.4% and the Shanghai composite is down 12.9%. So that's since our December meeting. Since Pre-MPC on the 6th January, global financial markets have continued to be volatile. Global equity prices have fallen further, alongside declines in the oil price, and that's put particular downward pressure on energy stocks. Risk appetite has generally diminished, particularly around concerns around emerging markets, and as in the summer of 2015, the movements in the Chinese equity markets have had knock-on effects on advanced economy financial markets.
>
> In terms of UK specific data since Pre-MPC, the weaker industrial production data that Andy mentioned contributed to further falls in UK short-term interest rates and lower falls in sterling ERI.

Some market contacts are saying that the forthcoming UK referendum on EU membership is a possible explanation for sterling's depreciation as well as for the increase in the price of options that protect against the risk of sterling depreciation relative to the price of protection against an appreciation.

And then finally, recognising that the curve remains very flat, the date of lift-off has been pushed back even further now, a further six months to July 2017. That's it.

Governor Carney. OK. Great. So if nothing further to add of context... Any questions? Good, so why don't we turn to the votes and I'll just try to make sure that I run in the same order as our last discussion. This much I know, it starts with you Ben.

Ben Broadbent. Thank you very much Governor and thanks for the update, none of which is enough to change my vote from no change in either Bank Rate or asset purchases.

Governor Carney. Thank you very much. Ian, please.

Ian McCafferty. A rise of 25 basis points in Bank Rate, no change in asset purchases.

Governor Carney. No change. Kristin.

Kristin Forbes. No change, no change.

Governor Carney. Jon.

Jon Cunliffe. No change, no change.

Governor Carney. Martin.

Martin Weale. No change to Bank Rate, no change to asset holdings.

Governor Carney. Jan, please.

Jan Vlieghe. No change in Bank Rate, no change in asset purchases.

Governor Carney. OK. Andy.

Andrew Haldane. No change, no change.

Governor Carney. And Minouche.

Nemat Shafik. No change, no change.

Governor Carney. OK. And I also vote for no change in Bank Rate and no change in asset purchases, which makes 9-0 for no change in asset purchases, and 8 to 1 for no change in Bank Rate and Ian voting for an immediate 25 basis point increase. OK. Very good. With that I'll terminate this meeting and we can head down to write up the Minutes and the Monetary Policy Summary.