BANK OF ENGLAND

**MEETINGS OF THE MONETARY POLICY COMMITTEE**
**November 2016**

A meeting of the Monetary Policy Committee was held on Monday 31 October 2016. The following members of the Committee were present:

Mark Carney, Governor
Ben Broadbent, Deputy Governor, Monetary Policy
Jon Cunliffe, Deputy Governor, Financial Stability[1]
Nemat Shafik, Deputy Governor, Markets and Banking
Kristin Forbes, External Member
Andrew Haldane, Chief Economist
Ian McCafferty, External Member
Michael Saunders, External Member
Gertjan Vlieghe, External Member

Dave Ramsden was present as the Treasury representative

Anthony Habgood and Dave Prentis were present as observers in their 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
Simon Hayes, MPC Secretariat
Sarah John, MPC Secretariat
Melissa Davey, Editor of Inflation Report

[1] Jon Cunliffe, Deputy Governor, Financial Stability was unexpectedly and unavoidably unable to attend this session of the MPC meeting in person. His indicative vote was communicated to, and read by, the Governor. The Committee agreed he should therefore be treated as present at the meeting as set out in the Bank of England Act 1998, Schedule 3.

**Transcript of the Monetary Policy Committee Meeting on**

**Monday 31 October 2016**

**Governor Carney.** Morning everyone. I'll begin by asking Andy to give us an update on recent data please.

**Andrew Haldane.** Thank you Governor. Four small pieces of domestic data for October. For all of them, the key message is that they are a little bit stronger. So we had the Lloyds Bank Business Barometer for October this morning. That was a touch stronger, to a post referendum high and slightly above its historical average. We had the RICS survey of residential housing market activity for October. That too, across most of the balances, was slightly stronger – for example on new buyer enquiries and on price expectations. We had the REC employment survey for October. That too was a touch stronger across pretty much everything – wages, labour demand, etc. And then finally, we had the UK PMI for October. Both the output and the expectation balances up a touch. We had the decomposition of that on Tuesday, Wednesday and Thursday of this week. Finally, just on the international front, you will have seen we had US GDP data for the third quarter. That came out at 0.7%, which is in line with our expectation. The story there, again in line with what we'd expected, was a reversal of the inventory de-accumulation we had seen in the earlier part of the year. We have Q3 euro area GDP later this morning. That's all, thank you.

**Governor Carney.** So, we'll start with Ben and then go to Ian please.

**Ben Broadbent.** Thank you Governor. I'll begin with a round-up of the international news. I'll be pretty brief again because, as has been the case for a while, the most noteworthy developments have been here at home.

Our global forecasts, over the medium term, are somewhat weaker than those of the IMF. We continue to take the view, supported by falling unemployment rates in most parts of the world, that slow growth is mostly structural, and therefore expect that weakness of productivity growth to persist for a while. Nevertheless, the news on near-term activity in our main trading partners has, at the margin, been slightly positive. US growth was revised up in the second quarter and, as Andy said, the preliminary estimate for Q3 was 0.7% in line with our own expectations but slightly ahead of consensus. In the euro area, industrial activity has been strong and we've revised up our forecasts for GDP growth to 0.4% in each of Q3 and Q4, which is comfortably ahead of most estimates of trend. That said, we continue to believe that further monetary stimulus from the ECB will be necessary for inflation to return to 2% over the medium term.

Turning to the domestic economy, the principle news has been the continued robustness of activity relative to our expectations and, in spite of that, the further leg down in the currency.

Regarding the first, the strength of demand appears driven – if anything, is more than accounted for – by robust consumer spending. We don't get the first estimates of the expenditure components of GDP until later this month. But surveys of investment intentions, which fell after the referendum, have failed to recover. On the output side, those sectors more sensitive to investment – manufacturing and construction – look to have contracted in the third quarter, while those more dependent on consumption have expanded pretty strongly. Distribution, hotels and restaurants grew by over 1%, transport and communication by more than 2%.

One minor miss relative to our forecasts, I note, is the very rapid expansion of oil output. Up 20% in the past two years, and over 5% in the past quarter alone, growth in North Sea extraction added 0.1% to GDP in Q3. Given the large fixed costs in this industry, swings like this don't add much to the demand for resources or, therefore, to domestic inflationary pressure. The marginal cost curve is pretty flat. So that 0.1% should, for our purposes, count as a surprise in potential as well as in actual output.

Nevertheless the miss relative to the August forecast is bigger than that and it's largely a story of strong consumer demand. My guess is that the rate of saving, at least out of disposable income, has declined since the middle of this year.

I don't think it was ever reasonable to expect consumption to respond as strongly to higher uncertainty as capital spending. Nor was that the case in our forecasts, even in August. Uncertainty effects are most acute for durable decisions that are costly to reverse, and consumption spending doesn't fall into that category. And in the data, the saving rate is less well correlated with our measure of uncertainty than is the investment share of GDP.

We did discuss, ahead of the referendum, the possibility that consumers would fail to adjust to the possibility or likelihood of lower income at some point in the future. But even that would only mean a flat saving rate, not a decline. It's also worth pointing out that real interest rates fell last quarter – particularly if people do anticipate the coming rise in import prices. The policy package had a significant impact on mortgage interest rates. And if you're going to buy an imported durable, there's every reason to get on and do it before prices go up. Whether overall pass-through is as rapid as we now expect remains to be seen. Certainly sharp hikes in the prices of Apple computers, Microsoft software and – most alarmingly of all – a jar of Marmite have been well publicised. However, it looks as though it was spending on services, not consumer durables, that was particularly strong. And when you work out the numbers, the income effect of a future price rise should generally dominate the shorter-term substitution effect.

So there is, as we discussed, a clear discrepancy between the reaction of consumption and that of the foreign exchange market. And in fact, as far as our inflation target is concerned, it's the latter that matters more. Much of the attention - much of the political attention, certainly - will be on the strength of near-term output growth and the forecast error this represents. I am at least as guilty as anyone else in that respect. This looks, so far, much less like the sort of conflagration signaled by early surveys, and much more like Ian's slow burn.

But, at least in this latest forecast, it is the further fall in the value of the currency, which occurred – if you put it slightly coyly in the Inflation Report – around the end of September, that has the more material impact on inflation. And it's one that's been accompanied by a marked widening of breakeven spreads, not just in the near term but further out as well. We are told that the rise takes these spreads only back to historically more normal levels and that it's more about the inflation risk premium than about central expectations of future inflation in markets. And of course, to the extent this is just a removal of deflation risk, which might help to explain the parallel shift in the inflation curve, it should be welcomed.

But we are also responsible for the risk premium, to some degree. I'm not so confident in either of these things – either what constitutes a normal level, or our ability to distinguish risk premium from central expectations – to be entirely sanguine about a rise as rapid as this one. So we are right to use the word "watchful" and to signal our lack of indifference, as we do in this Inflation Report.

And we'd also be right to conclude that, for both these reasons – both the strength of consumption and the 6% decline in sterling – that the economy has not turned out "broadly in line" with our expectations in August. I therefore expect to vote for no change in policy, either rates or asset purchases, later this week.

**Governor Carney.** Thank you Ben. So Ian and – sorry, can I apologise here – it should have been Minouche and then Ian. And I can see Minouche still writing…

**Nemat Shafik.** I'm ready to go.

**Governor Carney.** Alright – it's perfect Minouche! So if can get Minouche then Ian.

**Nemat Shafik.** Perfect, OK. So I've been very preoccupied with the difficulty of forecasting in the current situation during this round. And my comments today will reflect that concern. Our models tend to assume that in the wake of a shock, the economy will return to some sort of equilibrium. Even at the best of times, this is made difficult by the infinite number of paths that variables could follow to get there. But the problem is even more intractable for us at the moment because we don't know what that new equilibrium will look like, or when it can reasonably be expected to be reached. Now, let me reassure you that I am not about to denounce all modern macroeconomic models as Paul Romer recently did. His main critique was that the vast majority of the variations in output in

Real Business Cycle and Dynamic Stochastic General Equilibrium models are attributed to random technology shocks which are otherwise unidentifiable. He disparagingly refers to these identified shocks as "phlogiston" after a substance that was once thought by chemists to be the source of all combustion, but later was proven not to exist. The situation we find ourselves in is quite different: we can easily identify the shock to technology in the form of the decision to withdraw from the EU, but we have little on which to base our assessment of how it will play out.

This is evidenced by the two important changes in the few months since we last produced a forecast: the outlook for activity and the depreciation of the exchange rate, which Ben has just referred to. I'll discuss each of those, before turning to the trade-off induced by the referendum shock.

So on activity, at precisely the same time that medium term prospects have deteriorated on account of the increasing likelihood of a so-called hard Brexit, the near term outlook has surprised us on the upside. It seems that the business community on which we rely so much for survey responses is considerably more downbeat than the Great British consumer who ensured that growth continued at a quite respectable pace in Q3 and will likely only slow a little in Q4. However, I remain firmly of the view that the withdrawal from the EU represents a sizeable economic shock to the UK economy, and I fully expect it to be reflected in lower supply and demand growth over the coming years. But the time, path and magnitude of that shock is almost impossible to predict at this juncture.

As for the exchange rate - well the fall in the exchange rate is entirely consistent with a weaker medium term outlook. But, as we discussed on Thursday, this wasn't the only potential explanation for a falling currency. Having published a forecast for inflation in August which was further above target than any of its predecessors, and given the commentary surrounding the MPC's political independence, it was right that we took the time to consider other potential explanations.

And I took comfort from the fact that the move higher in market-implied measures of inflation expectations has been consistent with the MPC's past behaviour, suggesting a 1% rise in the price level for a 5% depreciation. This is reassuring evidence that market participants' perception of both our political independence and our tolerance for above-target inflation have not changed dramatically.

However, that does not mean that the move in the currency is irrelevant to our policy decision. Although we are uncertain about the timing and extent of pass through, the experience of 2008/09 does suggest it will be sufficiently drawn out to affect inflation at the policy-relevant horizon. Put another way, it is not necessarily the case that we should look through inflation caused by changes in the exchange rate in all circumstances. Instead we should only do so after carefully considering the trade-off between the output gap and inflation. And that's what I'll turn to next.

So, I am not an inflation nutter. My lambda is definitely higher than the zero implied by some of the academic models that Romer so dislikes. And having a non-zero lambda means that I was comfortable with the policy package in August, and of the opinion at the time that should the data evolve in line with the forecast, further stimulus would be required. I was made all the more comfortable with that view by the persistent weakness of wage growth and inflation in the period running up to the referendum, and by the risk management arguments of stimulating when in the proximity of the lower bound.

But nor am I indifferent to inflation. To borrow Ben's phrase from our deliberation meeting, I don't have a lambda of infinity either. Indeed the current forecast - in which inflation is as likely to reach 3.6% as it is to be at the target in the second year - is approaching the limit of my tolerance. Were the projection to rise much further than this, I would begin to worry that domestic price setting behaviour and inflation expectations might be affected. And that would be costly to reverse.

So, let me pull this all together for what it means on my view on the likely appropriate path for policy, and for forward guidance. And that's in two important ways.

- First, and for the benefit of the record, the data since the August Inflation Report have been sufficiently different that I would no longer think it responsible to cut Bank Rate to its effective lower bound at the current juncture, so I intend to vote for "no change" to policy this month. Indeed, my view on the likely direction of the next move in policy has become more neutral.

- And second, chastened by the difference that three months has made to the outlook, my view of the range of possible policy outcomes has widened. And we will need to continue to assess the trade-off between output and inflation at each meeting over the coming months. But I hope we can convey that message in our Monetary Policy Summary and in the Inflation Report.

I'll stop there.

**Governor Carney.** Thank you. And now Ian and then Michael please.

**Ian McCafferty.** Last month I talked of a dance of the seven veils, with the true nature of the underlying economy only slowly being revealed. The two main veils to fall this month were the further sharp fall in sterling and the strength of the near term activity data, both in the surveys and preliminary Q3 GDP. At first glance, they each tell a very different story, such that the true picture is still obscured and will only emerge in the fullness of time.

The further fall in the exchange rate appears to be predominantly a real adjustment, as the foreign exchange market tries to anticipate the implications for the openness of the economy of an increasing likelihood of a hard Brexit. Minouche suggested that such arguments could account for some 80% of the depreciation since the referendum and, although I would not wish to be over precise, that does not look implausible.

However, I do not think we should overlook the other 20%, as I do worry about what it may be saying about our credibility. First, I suspect the market is misreading our collective lambda, and overestimates our willingness to tolerate ever more above-target inflation in order to minimise the output gap - that is potentially more of a departure from our primary mandate than I, for one, would be happy to sanction.

On the surface, the second of this month's veils tells a different story. Not only were the preliminary Q3 GDP data stronger than we, and the markets, expected, but both the CBI and CIPS surveys suggest that that momentum is expected to persist into the fourth quarter.

But within the survey data lies a more nuanced story. The detail of the CIPS survey is not yet available, but the detailed message from the CBI ITS was less upbeat than the headline implied. Business sentiment remains fragile, and both investment and employment intentions are weakening. Moreover, given the magnitude of the fall in the currency, the export related responses to that survey improved by less than on previous similar episodes, suggesting that manufacturing exporters believe that, this time, other factors will limit the extent to which they will be able to take advantage of the weaker currency.

So while consumers, and by extension consumer services, remain robust, driving growth in the near term, the broader picture from the surveys is much more in line with our narrative of an economy in which Brexit effects gradually erode both demand and supply over the course of the forecast. Both, as I have argued in previous months, are likely to take place in relatively slow motion, but feed through they will.

So the two veils may not be as inconsistent as they at first appear. The foreign exchange market is more likely to be forward-looking and rational, whereas both consumers and businesses will take longer and require more real time evidence before they make the required adjustments. Indeed, a recent regional visit has convinced me that we may be seeing a perverse reaction to the current uncertainty - it is so elevated that for many businesses, the only possible response is "business as usual" - at least for now.

The CBI survey also contained some early warning lights with regard to inflation, which makes me slightly concerned about upside risks to our inflation forecast. Not only have input costs risen sharply, but shortages of skilled labour are also emerging as a serious constraint to both output and investment, posing some upside risks to DGI over the course of the forecast, over and above the pick-up in nominal wages already built in.

A further potential upside risk to our forecast comes from a spate of news items this month. You could call it either the Marmite or the Microsoft effect. There have been recent attempts to drive the prices of both of these products sharply higher, even though neither is, strictly speaking, imported. Both are distributed by UK firms that ultimately remit profits to their parent in foreign currency, and are therefore subject to pressure to maintain margin in foreign currency terms. These are inflation pressures linked to the fall in the currency, but not to import price movements themselves. Their impact on inflation is not, as far as I can discover, covered by our treatment of pass through, which is constrained by the import share, and may help explain the "unexplained" component of the decomposition of inflation at times of currency movement. They also appear to be quite immediate, offsetting some of the slower pass through that we are observing elsewhere. Such inflationary pressure from foreign currency margin protection is unlikely to be huge, but, given the rising foreign ownership of UK firms, is likely to be greater than 15 or 20 years ago, and as such could represent an upside risk to our inflation forecast.

In summary, while I am happy to approve the November forecast on a best collective estimate basis, I am keen to ensure that we do not appear to underestimate the acceleration in inflation over the forecast period. The underestimation of inflation was a shortcoming in our forecasts identified in the Stockton report, and though we have made significant improvements to our models and techniques since then, I am concerned that a second episode, similar to that of 2010-2012, in which the committee repeatedly under-forecast the pace and persistence of inflation following a sharp move in the currency would be damaging to our credibility.

Turning to policy issues, the latest data make it easy for me to conclude that the economy has not evolved in line with the August forecast, such that there is no justification at present for a further rate cut. Nor, in spite of my concerns about upside risks to the inflation forecast, and having a lambda that is probably slightly lower than the average of the Committee, do I yet see sufficient argument for anything other than rate stability, given the current uncertainties. More difficult, from my perspective, is this month's decision on asset purchases, and whether to continue the programme already underway, or whether the change in the trade-off justifies halting it now.

As long as today's - that is Monday 31 October - gilt operation is fully covered, the stock of gilts purchased will be £404.9 billion by tonight, leaving a further £30 billion to be purchased over the next three months under the purchase schedule announced in August. On the normal multipliers, that is equivalent to a reduction in Bank Rate of just over a quarter point, a not insignificant stimulus still in the pipeline. Now. if such a stimulus were to be proposed in isolation today, I would not support it, for similar reasons to my vote against the initial QE stimulus in August. However, given that the purchase programme is already underway, there are potential costs of reversing it, which also need to be considered.

First, although we have an explicit vote on QE every month, such that any lengthy purchase programme is in fact conditional, there is also an implicit contract in announcing a total figure for assets to be purchased, and there is no precedent for the MPC halting a purchase programme before completion. Highlighting that conditionality would risk reducing the effectiveness of QE as a policy tool in future, if the market refused to take on trust the degree of stimulus announced at the outset. Given the medium term uncertainties around the post-Brexit economy, we may need to redeploy QE at some point in the future, and I would not wish to have reduced its effectiveness as a policy tool.

Second, while the markets have taken on board the reduced probability of a further rate cut, an end to the QE stimulus would come I think as a significant shock, potentially causing a sharp market reaction, which would be unwelcome. In particular, given that I view most of the recent sterling depreciation as a real shock, I would be reluctant to encourage sterling to strengthen sharply from current rates.

So the risks to the economic outlook of continuing the asset purchase programme are relatively low, but the potential costs of reversal at this stage are rather higher, leading me to continue to support the programmes already underway, as I did last month.

In terms of a communications strategy, that leaves me in the "on hold upside" camp. Beyond that, my inclination would be to avoid over-precise guidance about the direction of the next move in policy, or about the state contingencies that would trigger any policy change, given the myriad uncertainties about the economic outlook that we face.

So to sum up, this month I am minded to vote for no change in Bank Rate and no change to our announced policy of increasing the stock of asset purchases to £435 billion, or the programme for corporate bonds.

**Governor Carney.** Thank you Ian. Michael Saunders and then Jan please.

**Michael Saunders.** Thank you. I am inclined to vote for unchanged policy this month.

I would like to discuss three issues: the economic outlook, the policy choice and communication.

I broadly share the Committee's central view that the coming year is likely to see slower growth and higher inflation, and that the central paths for both growth and inflation over the next few quarters should be above the August IR forecasts.

But I do want to highlight some risks around that forecast. First, even after the sizeable upgrades in this IR, I suspect that growth in the next few quarters is more likely to surprise on the upside than the downside. Growth in Q2 and Q3 combined was probably slightly above potential and I doubt that growth in coming quarters will be clearly below potential on average.

The adverse effects of Brexit-related uncertainty on investment are clear in business surveys. However, there is also ongoing support for activity from loose financial conditions plus the gradual reduction in worries over income prospects and job security as the 2007-09 crisis recedes. There has been a clear pickup in money and credit growth. Surveys continue to suggest that greater uncertainty over the economy has not, so far, translated into greater pessimism for peoples' own financial position or into expectations of higher unemployment.

I am not that worried by the quarterly drop in manufacturing output in Q3. It was exacerbated by marked weakness in pharmaceuticals output, a highly volatile sector for which quarter to quarter growth tends to show negative serial correlation.

Moreover, business surveys suggest that export orders in manufacturing have gained markedly in recent months, and to me it looks like they're responding in the usual way, to sterling's recent major depreciation. The potential adverse effects on inward investment from Brexit may be cushioned in some sectors by sterling's depreciation, which has now made the UK a relatively low-cost country. Using Eurostat data, I estimate that the average level of hourly labour costs (including non-wage costs) in the UK is now slightly below the level in Spain and roughly 35% below the average for Germany, France, Italy and the Netherlands. Even with risks that Brexit uncertainties hit some sectors, I suspect that our forecasts understate export growth in the next year.

Hence, I continue to doubt that the jobless rate will rise much, if at all, over the next year or two, especially in the context of the considerable financial pressures that people face to work in some form, even if low-paid and insecure, rather than remain in unemployment. Of course, all this probably tells us very little about the long-run effects of Brexit.

Second, I continue to suspect that the economy currently has more slack than assumed in our forecast, with a lower equilibrium jobless rate. Hence, I expect that pay growth will pick up less than in our forecast - even with the more stable jobless path that I expect and especially if the jobless rate rises in line with the IR forecast. To be sure, the availability of foreign workers may well decline. But other factors behind the change in the labour market probably remain intact – namely reforms to the tax and benefit system, slack in the form of under-employment, and the rising participation rate among the over 50s. Indeed, the prospective rise in inflation may well put some upward pressure on labour supply, via the participation rate or desired hours, as people seek to limit the erosion of household real income.

Third, I see two-sided risks on pass-through from import prices to consumer prices. Historically, the Bank has tended to understate pass-through. It may well be that the total pass-through from sterling weakness to consumer prices exceeds the CPI import share, because of price hikes among firms that compete with imports - reversing the squeeze on margins and prices seen during sterling's appreciation of 2013-15. Moreover, at current exchange rates, the level of UK food prices is extremely low versus other Western European countries, pointing to considerable upward pressure even with competitive pressures in this sector. Against that, prices of tradable non-food consumer goods and services did not fully adjust downwards to sterling's previous appreciation in 2013-15, and hence upward pressure on consumer prices in these sectors might be less than would normally be expected given sterling's recent depreciation.

These first two issues roughly cancel out in terms of the prospective output gap: upside risks to growth may prevent slack rising, but would leave intact the current degree of slack from a lower U*. And I would not be surprised if pass-through causes inflation to rise roughly in line with the MPC base case even if wage growth picks up less than expected.

On policy, I vote for no move in Bank Rate. I believe the guidance from August and September has expired with the economy's recent resilience and the extra upward inflation pressures from sterling's recent depreciation. We face a significant inflation overshoot two to three years ahead - the greatest the MPC has ever forecast - amidst a modest amount of slack. Our remit encourages us to consider the appropriate trade-off in such circumstances. I am slightly uncomfortable with the trade-off shown in the MPC's forecasts and hence I would not want to fully endorse the market path used for those forecasts, which is below the current policy rate.

But, given the repeated undershoots in pay growth - which suggests to me that slack currently exceeds the MPC's estimate - I would be more or less content for now to endorse the current market path which is roughly flat at the current policy rate near-term. I would be reluctant to signal a tightening bias for the year ahead given the signs that the economy still has slack and that inflation expectations are not uncomfortably high.

My preference to continue the current QE program is really just based on the potential costs of stopping the program partway. If the program had been launched as £30 billion over three months and we were now considering whether to implement a further £30 billion over three months, I would probably (all else being equal) not vote to extend it. However, given that the current QE program was launched with a commitment to do £60 billion over six months, a decision now to stop it half way could cause an abrupt market adjustment and - via reducing the credibility of MPC commitments - could reduce the effectiveness of future policy announcements. A vote to suspend QE now would probably only be warranted if there was evidence that inflation expectations were clearly too high to be consistent with the inflation target – and that is not currently the case.

The final issue is what we aim to communicate over the interest rate outlook. I would be surprised if a majority of us wish to signal the next move is likely to be tightening or loosening. Hence I doubt we can continue with guidance in the form of a bias statement as in August and September. I believe our emphasis should be on our willingness and ability to respond to developments either way, as needed, consistent with our remit and in particular the need to consider the appropriate trade-offs.

I also believe that there is some value in emphasising that, with a low r*, we still expect that policy rates in the next few years are likely to stay relatively low compared to the historic norm of roughly 5%, even without any guidance either way on the near term policy outlook. One of the benefits of the "limited and gradual" guidance was that when expectations of policy tightening flared up in 2014-15, they were not so unbounded as to derail the expansion. And I would like to try and ensure that interest rate uncertainty again does not escalate to a counter-productive level in coming months.

[redacted]

**Governor Carney.** Thank you, Michael. I originally had Jon here. I'll have Jan and then Andy please. Battlefield promotion [*laughter*]

**Gertjan Vlieghe.** We have made two consecutive and sizeable forecast errors for growth in Q2 and Q3. On both occasions, I was at the pessimistic end of the spectrum, so my forecast errors were larger than those of others.

What happened?

I over-estimated the short-term impact of both pre- and post-referendum uncertainty on demand. I possibly also over-estimated either the extent to which households and businesses would revise down their estimates of their medium-term growth prospects, or the extent to which they would respond in the near-term to changes in prospects further out.

While the headline GDP part of the forecast has clearly been too pessimistic so far, other aspects of the forecast, and of our discussions about risks in the past few months, have been closer to the mark. Judging by the survey evidence, the idea that business investment would respond by more, and sooner, than consumer spending seems to have come to pass. [redacted]

Looking ahead, I continue to think that Brexit-related uncertainty is unlikely to allow the economy to continue with "business as usual" in the next few years, in the face of the possible loss of future immigration, the possible loss of financial passporting, and the risk of a reintroduction of tariffs, as well as non-tariff barriers to trade. So, despite several quarters of stable growth averaging 0.6%, I do not think a continuation of recent growth rates is the best forecast. I feel comfortable with our updated November forecast, which has changed from a sharp near-term slowing to a "slow-motion slowdown".

My sense that business as usual cannot continue for long seems to be shared by the FX market. Trade-weighted sterling is now down 21% from its November 2015 peak, which in turn, in poetic symmetry, was up 21% from its 2013 trough. It's difficult to overstate the scale of this move. If sterling remains near current levels, it will be the lowest it has been at any point in the post-war period and possibly even longer, when measured in real annual average terms against the US dollar and the euro (previously Deutsche Mark). Clearly, the foreign exchange market does not believe in "business as usual". Neither does the equity market, for that matter. In common currency terms, the FTSE-250 has underperformed the S&P by 17% since the referendum, and has underperformed the Eurostoxx by 15%.

This tension between the assessment by financial markets and the apparent assessment by households and businesses of the UK's medium-term prospects cannot last. Either it will turn out that Brexit really does not make much difference to medium-term prospects, in which case the exchange rate should recover a substantial part of its losses. Or it turns out that Brexit does make a difference, in which case the economy will slow further from its the current pace.

The further fall in the exchange rate has, for now, worsened the trade-off we face between the expected output gap and expected inflation. The output gap is now expected to be less negative, but inflation is expected to be further above the target. But in terms of our loss function, the gains in the output gap are smaller than the losses due to higher inflation, so the total loss is worse than in August.

At the same time, as we have seen the exchange rate weaken further, we have also seen inflation expectations rise. The rise in near-term inflation expectations just reflects exchange rate pass-through, and the magnitude of the move is in line with our own revisions to our inflation forecast. But inflation expectations further out, for example as measured by the five year five year break-even rate, has risen as well, and this deserves close scrutiny.

A negative correlation between the exchange rate and longer-term inflation expectations is not the usual state of affairs. Most of the time, the correlation is positive: faced with a demand shock, the

[redacted]

exchange rate and inflation expectations move in the same direction. [redacted]

For now, my interpretation is that the further weakening of the exchange rate has been largely driven by a further re-assessment of the UK's medium-term prospects, as the government started to reveal its negotiating priorities. Via a pass-through channel, this has led to an upward revision in inflation expectations in the next few years. In turn, this has led to a reduction in the perceived risk of being trapped in a too-low inflation environment, pushing up long-term inflation expectations as well, from excessively low levels. So far, this is a benign situation, where we have moved from downside risks to inflation expectations to symmetric risks. But I will be keeping a close eye on the level, rather than the change, of longer-term inflation expectations, to make sure we do not progress from symmetric risks to upside risks.

Given our updated output gap and inflation forecast, the policy stance that I consider appropriate has changed. In August, I thought it was highly likely that further stimulus would be required. Not just the additional rate cut towards the effective lower bound, but probably more asset purchases in the Spring as well. Now, I do not think that anymore. Given my own loss function, I think the trade-off between the output gap and inflation conditional on current asset prices is just about acceptable, but it's close to my limit. There is little scope for further upside surprises to the inflation outlook, unless these are also matched by adverse revisions to the outlook for economic slack.

Moreover, while I previously had several risk management considerations to reinforce my "bias to ease", now I have fewer. A weak current level of inflation pressure is less of a concern, given some uptick in our DGI measures and the rapid expected near-term rise in headline inflation. Though wage growth remains subdued, weak medium-term inflation expectations is also not an additional argument anymore. The only risk management consideration that remains is the asymmetry of monetary policy tools. The fact that we have less room to ease than to tighten is still a factor that I put significant weight on. And it leads me to want to be more patient, for any given median outlook, before considering monetary policy tightening moves.

Meanwhile, I favour continuing with the gilt purchase programme. Stopping it prematurely risks sending completely the wrong message on rates, ie, signalling that we are considering a much earlier tightening than I think would be appropriate. That would be counterproductive. Stopping it prematurely also risks causing undesirable volatility in the gilt market, and undermining the power of future asset purchases should we need them again. It might also raise the risk of future disorderly markets when we sell gilts, if the market believes we might take stock decisions at high frequency and reverse them easily. Concerning the corporate bond programme, I believe we should also continue for now. But I feel less committed to complete the programme, given its longer horizons and smaller scale. We can revisit this in the coming quarters.

I am therefore minded to vote for no change in Bank Rate, and to continue with the asset purchase programme as announced in August.

**Governor Carney.** Thank you Jan. So Andy and then Kristin please.

**Andrew Haldane.** Thank you Governor. Fathom Consulting recently issued a circular on the UK economy with the title "The Penny Drops". I wish I'd thought of that. It certainly captures a sense of the scale of sterling's fall - now down around 20% from its post-crisis peak in November last year. But it also conveys a sense of its source - the dawning realisation, among market participants at least, that the UK's future trading arrangements, and hence income-earning capacity, might be materially worse in future. Even with those falls, the skew in options prices suggests financial markets still believe the balance of risks to sterling lie to the downside.

At the same time, as recent data releases have made clear, this same penny has yet to drop for the average consumer. Among households, there is no evidence so far of fearfulness about their future income prospects. The Bank's latest NMG survey suggested consumers' perceptions of income and jobs prospects have been largely unaffected by Brexit, a message largely echoed in surveys of consumer sentiment.

The key driver behind the above-expectation increase in third quarter UK GDP growth was the continuing strength of services in the consumer-facing sectors. Spending on visits to hotels, restaurants, shopping centres and cinemas appear to have carried on much as normal since the referendum. The average consumer has interpreted Brexit, thus far at least, as a Big Friendly Giant – and have watched the movie, bought the T-shirt and consumed the popcorn to prove it.

The company sector, meanwhile, appears to be occupying something of a halfway house between consumers and financial markets. According to the Bank's new Decision Maker Panel survey, around 54% of firms anticipate no effect of Brexit on investment over the coming year. Perhaps not coincidentally, that is roughly the same as the number of people who voted for Brexit. The other half of firms do anticipate some impact, consistent with surveys from the CBI, BCC and others of stalling investment intentions.

So this is a story of, on the one hand, sluggish consumers, together with perhaps half of all businesses, continuing to spend as normal. And, on the other, a story of skittish investors, together with the other half of businesses, trimming their investment. As Jan noted, the gap between these perceptions needs eventually to close, though quite when, and quite how, is at present unclear. In the meantime, I would say there are good grounds for aiming off somewhat from the signal provided by either when gauging the appropriate stance of monetary policy.

For the exchange rate, and asset prices generally, recent movements appear to be acutely - perhaps excessively – sensitive to news about the future shape of the UK's trading arrangements. This excess-sensitivity is set to persist for months, perhaps years, to come. It provides good statistical grounds for lowering somewhat the weight we might otherwise attach to such asset price movements. This is a somewhat different justification for "looking through" exchange rate movements than the normal one, but I think it's not unreasonable. Put differently, we would not want excess volatility in sterling, through perceptions of our own reaction function response to the exchange rate, to get transmitted into the yield curve.

As for consumers, I think there are good economic grounds for believing it is a question of when, rather than whether, the penny will drop for them. Certainly, it now seems pretty certain their pound will stretch far less far in the shops and cinemas next year than this, with a knock-on effect to spending. This pinch on purchasing power is embodied in the November IR forecasts for consumption which slow markedly, and plausibly, next year.

Notwithstanding the need to aim off somewhat from recent movements in financial markets, it is clear the fall in sterling has worsened significantly the output/inflation trade-off we face today.

This is brought home pretty starkly in the inflation and output forecasts we are about to publish. The cumulative deviation of inflation from target and the output gap, at the year two and three horizons, is 2.5 percentage points in the November IR. In the August report, itself a fairly stark trade-off, that cumulative deviation was 2 percentage points. Since 2003, we have never published an inflation forecast which is higher, nor a GDP growth projection which is lower, than in the November IR. This is of course no more than recognition of the fact that the UK has faced a significant supply shock.

The excellent staff analysis of this trade-off presented at our meeting last week helped me clarify my own thinking on what this might mean for policy paths. At our July meeting, I defined my own preferences for lambda as lying in the range 0.5 to one. Given that, my preferred policy package in August was at least as large, and ideally somewhat larger, than the one we announced. Using the same level of lambda, but facing today's trade-off, the policy implication is that the current, rather flat, yield curve is now roughly in the right place.

In other words, in managing the trade-off, there are no strong grounds for requiring either a monetary loosening or tightening in the immediate period ahead.

One reason you might wish to deviate from that path is if there were highly asymmetric risks to the trade-off. In August the risks for me were still skewed to the downside, not least due to the potentially lower effectiveness of our tools close to the zero bound. Indeed, staff have now put some numbers to that ZLB risk using stochastic simulations. That analysis puts this risk in the range of 15-40%, which is at least as high, if not higher, than my own subjective probability. It strikes me as good grounds for being cautious about not providing too much upwards impetus to the yield curve in the current environment.

Equally, on the other side, the fall in sterling has had a quite pronounced and, more importantly, persistent impact on financial markets', and to less extent consumer, measures of inflation expectations. Of course, there may be technical reasons why these measures are providing a false signal. And even the upwards shifts of the inflation swap curve only takes it back to levels prevailing around the start of the year.

Nonetheless, a further shift up in expectations from current levels would, I think, be unwelcome, especially if it were accompanied by a continuation of the heightened sensitivity of long-term inflation expectations to short-term movements. That being the case, I think there is value in the MPC making clear its tolerance, or rather intolerance, for any further material upward shift or drift in longer-term inflation expectations.

Taken together, for me this leaves the risks to our inflation and output objectives larger even than in August, but now more broadly balanced.

So where does this leave policy? Our August guidance has clearly expired, with the economy not "broadly consistent" with the August IR projections. So I am minded this month to leave unchanged Bank Rate and our programme of asset purchases.

But I was also convinced by the argument that some clarity about how we intend managing this now-sharper trade-off might be useful - if you like, some sense of our collective lambda. If so, my inclination is to keep this guidance fairly neutral and minimalist, to avoid creating any future hostages to fortune and given the yield curve has been doing a decent job so far of digesting macroeconomic news.

Guidance which said we were neutral on the future direction of rates, with risks broadly balanced either side, could I think suffice. This would not be an especially exciting statement but, in the current environment, monetary policy probably does not need to add to the excitement. Thank you.

**Governor Carney.** Thank you, Andy. Kristin, please.

**Kristin Forbes.** "Be careful what you wish for." Some claim the phrase originated with Goethe, or in ancient China, or St Teresa. I prefer the attributions to Aesop, whose fables show how a wish, once granted, can have unexpected consequences.

The MPC has now gotten one of its wishes; inflation is definitively picking up and will reach 2%, without a deflationary spiral. But, as in Aesop's fables, the wish is not playing out as expected. Inflation is not going to stop at 2%, but accelerate higher - potentially overshooting by so much that our reprieve from writing letters to the Chancellor will be brief. Even more uncomfortable, inflation could remain meaningfully above target for an extended period and within the horizon for monetary policy to react.

Since these inflation dynamics are key for our decision today, my comments will focus on them - for the global economy and then the UK.

Outside much of Europe and Japan, concerns about low inflation are fading. UK-weighted global inflation is expected to pick up from 0.4% in 2015 and 0.8% in 2016 to 1.9% in 2017. This inflationary impulse will loosen financial conditions in many countries and provide greater pricing power for many companies. It will weigh on real incomes and consumption over time, but the risks around low inflation have fallen in much of the world.

This turnaround in global inflation is a reminder of the potency of energy prices and currency movements. In June, oil was down 22% relative to the previous year; if oil prices remain at Thursday's levels, they will be up 36% at year-end relative to the previous year. A number of major emerging markets whose currencies have recently depreciated now have inflation well above target.

In the UK, inflation will be higher due to substantive news on the exchange rate, supply, and demand. Sterling has continued to depreciate; the multilateral index is down 21% from its November peak. Exchange rate movements have been less correlated with economic news and more with politics. For supply, although there are not yet significant changes, the increased probability of a "hard" Brexit and corresponding reduction in trade access and disruption to financial services suggests that negative effects will be larger than expected. Demand has been substantially stronger than in our forecast - albeit in line with the alternate scenario I presented in August, which assumed consumption growth remained at last year's levels.

All three of these developments will generate higher inflation. This will be aggravated by recent developments in oil prices and the turnaround in global inflation. These forces are worth unpacking. So first, past falls in energy prices are rolling off the annual price comparison. This increases inflation by about 0.3 percentage points at the start of next year. The fact that energy prices started falling sharply in Fall 2014 and the effects are rolling off now, however, is a timely reminder that these shocks are often correlated and effects prolonged more than 12 months.

Second, energy prices have recently increased. We traditionally look through this, a treatment reinforced by the fact that recent increases partially reflect an OPEC agreement that may unwind. Since oil price increases are occurring at the same time as other inflationary forces, and the effects may take longer to fade than a year, however, this could aggravate inflation dynamics. It should therefore be part of the discussion.

Third, and more important for medium-term inflation dynamics, is pass-through from sterling's depreciation. I went through some numbers Thursday - but here are the key conclusions using my estimates for pass-through. The shocks behind sterling's initial 6.6% depreciation prior to the referendum should generate less pass-through. The shocks behind sterling's sharp 10% depreciation from the referendum through mid-September, and the 6% depreciation since, are expected to boost the CPI by more and faster. Cross-country evidence also suggests that larger depreciations usually correspond to larger and faster pass-through. For all of these reasons, there is a risk that inflation is boosted by even more than the already hefty boost in our forecast. But on a brighter note, faster pass-through should also be shorter-lived and easier to look through, if we are confident it does not feed through into domestic inflation.

Which leads to a final factor important to inflation dynamics - domestically generated inflation. Although DGI is not our target, it is an important check on underlying inflationary pressures. Other measures are also useful - such as core inflation - but recent analysis I've done suggests that core inflation is significantly more affected by movements in sterling and oil prices than DGI. But the DGI measures are not timely. Of my 10 measures, only three have data through September, and the rest are from Q2. All measures are still well below their pre-crisis averages. But the index is moving up more sharply and will likely surpass 2% once we have Q3 data. The most updated measures indicate the strongest DGI pressures.

Next, our forecast. If sterling does not recover, there is a substantial risk we are underestimating inflation. I will be pleasantly surprised if productivity is as strong as in our forecast. I would not be surprised if demand continues stronger than forecast. In May and August we underestimated Q2 and Q3 growth, respectively, by 0.4 percentage points. These are not small misses. So what are we missing? Are we putting too much weight on survey data - which can be less informative during political events? Are we overestimating the effects of uncertainty - or focusing on the wrong type of uncertainty? Or have major shifts in global savings and investment, or recent increases in global inflation, raised r*? If the hard data continues to be stronger than our forecast, we do need to push ourselves in the next round on what assumptions to recalibrate. If an output gap does not open up as forecast, this will significantly affect the current trade-off for monetary policy.

As for this month, we should clearly remove our easing guidance. The economy has not evolved as in our consensus forecast due to substantially stronger demand and a substantially weaker exchange rate.

We should also accentuate that we care about inflation exceeding our target, such as Ben's proposal of (if I've got this right) "being willing to tolerate a larger output gap to avoid a large inflation overshoot". And forcefully state that we are not indifferent to exchange rate movements - albeit not try to steer the exchange rate, which would probably have little success.

Finally, I hope we will clarify that the next move in Bank Rate could be up or down, and could occur at any time, based on how demand, supply, and the exchange rate evolve. Basically reiterate what we said before the referendum, accentuating the two-sided nature. I would not suggest adjusting Bank Rate or a bias in either direction. Although our highly stylised modelling of personal lambdas and trade-offs suggests tightening, I do not think that is appropriate today, just as I did not think the hyperactive monetary policy these models suggested previously was appropriate in the past.

I will not vote against the QE to which we previously committed, for the same reason as last month and as Ian so eloquently argued. Although I wish we did not commit to this stimulus, this is not the time to reverse a policy announcement, potentially undermining the credibility of future announcements.

The inflation genie is out of the bottle. The difficult trade-off about which we warned is here. I will only tolerate an inflation overshoot that is moderate, temporary (even if not short-lived), and corresponds to a meaningful output gap. Hopefully we can put the inflation-expectation genie back in the bottle, and avoid other unwanted side effects of having our wish for inflation returning to 2% granted.

**Governor Carney.** Very good. OK, unfortunately the Continent is cut off by fog, which means that we don't have Mr Cunliffe here. So you are going to have to hear me twice, but different takes. So I'm just going to read in Jon's speaking note, unless he magically appears in the next few minutes.[2]

**Jon Cunliffe's comments were read by the Governor.** In August we loosened policy along a number of dimensions and included forward guidance for the rest of the year that was conditional on how the economy evolved relative to the August forecast. It is now clear that the economy has performed better than we had expected in August.

The forecast then was for growth of 0.1% in both Q3 and Q4. The preliminary estimate for Q3 came in substantially higher at 0.5%, in line with our forecast of the mature reading and driven by the data-based part of the estimate. On Q4, we now expect growth of 0.4%, 0.3 percentage points higher than in August.

The labour market has also held up better than expected. Vacancies - where you might expect to see weakness show up first - have been stable on the ONS measure, as have online vacancies data which staff look at and the REC vacancies balance on the month to October rose at its fastest pace since May of this year.

The domestic, rather than international, economy continues to dominate my thinking this month, particularly as there has been little news on the month in the international economy. But even for the international economy, we've cut our expected spillovers from Brexit on growth by around half.

So the possible explanations for the stronger economy. There are at least three of them.

First, we got wrong the fundamental mechanism about how the decision to leave the EU will affect the economy. We thought the decision would hit both supply and demand hard and quite quickly in large part due to uncertainty. But actually, although we might see some slowing in business investment due to elevated uncertainty, this will be offset by a boost to exports from the fall in sterling and strong consumption growth - consumers may be putting weight on the argument that a UK freed from the EU will be more prosperous. Under this hypothesis, assuming no actual supply hit, the impact of the decision to leave the EU on the economic outlook is less far reaching over our forecast horizon.

Second, the 'slow motion' hypothesis. In this world, the broad contours of our story – meaning a weakening in business investment, and other lumpy, hard-to-reverse decisions, due to elevated

[2] Jon Cunliffe's flight into the UK was severely delayed due to fog.

uncertainty which then weighs on consumer confidence and consumption, and in my view, the housing market – are still right. But this process is likely to play out over a slower period. This is a reasonable description of the November forecast.

Third, the ‘sudden change of sentiment’ hypothesis. In this world, not much happens for a while. Households keep spending and companies don’t hold back much. Then it happens all at once when agents realise permanent incomes and profits will be lower and that they don’t know what particular trading arrangements with the EU mean in practise. But until negotiations advance, economic agents won’t do very much. This world of a sudden sharp adjustment is probably costly and carries the most risk of an overshoot on the downside.

For the time being I am sticking with the second hypothesis - ‘slow motion’. I think the contours through which the vote will work through to the economy are similar to those set out in August but the timing of the impact will be slower and more protracted, as reflected in the November forecast.

Arguments to support this view include:

First, weakening business investment intentions. Most of the key measures of business investment intentions, such as, the BCC, EEF and Agents’ scores, have fallen since June, and are now around their 2011-12, or euro area crisis, levels. The CBI surveys look a bit brighter - they remain above their historical average though they have fallen back sharply more recently. Business output expectations series also remain below historical averages on the whole.

Second, a squeeze in consumers’ real incomes as inflation picks up. Annual growth in real consumer wages in the forecast falls from around 2% in the middle of 2016 to zero in the middle of 2017. Quarterly growth in real consumer wages in the forecast is zero in each of the next four quarters (starting in Q3). The fall in sterling - by 6% since the August IR - will boost net exports, notwithstanding our judgement to reduce the response of GDP, but it will probably take back that boost to growth by squeezing real incomes.

Third, an expected softening in consumer confidence. The resilience in consumer confidence so far has been noteworthy and could be driven by a large proportion of consumers thinking that the economic implications of Brexit are going to be positive, or at least relatively benign, and reading post referendum data in that light - whether due to confirmation bias or more rational reasons. For a large portion of households, references to ‘Brexit’ do not conjure up imagines of economic decline. Indeed, the UK’s most widely read newspapers have talked of a ‘Brexit boom’ in response to solid economic news. But, as consumer confidence has historically been negatively affected by increases in inflation, cautious decision-making by businesses would transmit to households and consumer spending on durables and house price growth has already slowed.

So turning to policy strategy and decision. In addition to stronger growth, the depreciation in sterling has been the other key economic development since the August forecast. This is the key reason why inflation peaks at 2.8% in the November forecast relative to a peak of 2.4% in the August forecast. It has bought the monetary policy trade-off between closing the output gap and returning inflation to target into sharper focus.

In the language of those trade-offs, my lambda is typically in the region of 0.5, and probably a bit lower when the output gap is small because bigger output gaps may be more likely to induce hysteresis type effects. But the lambda framework is only a partial measure of my policy preferences because it rests on a number of simplifying assumptions and does not fully account for various risks.

I think the risks around policy and the economic outlook are to the downside. Our ability to loosen policy remains more constrained than our ability to tighten. The prospect of becoming policy - constrained should, theoretically at least, weigh on agents’ expectations today. On the economic outlook, there remains a risk that there is an abrupt break in confidence when the impact of Brexit becomes clearer. This is my main fear, so I’m willing to take out insurance against this possibility by tolerating higher inflation.

On the other hand, the risks that our framework for thinking about Brexit is wrong or incomplete have clearly gone up. And the output gap is much smaller than when inflation overshot the target after the last sharp fall in sterling following the financial crisis. So the possibility of a bigger inflation overshoot has also increased. Inflation expectations - both market and survey implied - have increased. That looks more like a process of normalisation than anything to worry about but needs to be watched carefully.

Weighing these considerations, I provisionally vote to leave Bank rate and our asset purchase programmes unchanged. I would however remove any explicit forward guidance from our communications, signalling instead a neutral stance.

**Governor Carney.** OK. So over to me. In May we said that the policy response to a leave vote was not automatic but would depend on the balance of supply and demand and the exchange rate effects. In August with the sharp fall in sterling, a substantial weakening in survey measures, an abrupt drop in housing market activity, weaker investment intentions, plunging commercial real estate transactions, a rise in the cost of capital for UK-focused companies, softening inflation expectations, and a marked drop in consumer confidence, the balance of those effects warranted a package of easing measures. That package is working. Financial conditions overall have eased, confidence has recovered, momentum has been maintained. And we have made progress on its execution. As Ian indicated, by the end of the day we should be at 50% of the £60 billion of gilts, putting it on course for completion by February. We have already completed a quarter of the £10 billion corporate bond programme and, based on the plans that the banks have submitted to us so far, TFS drawings are expected to reach around £75 billion by the end of the draw-down period. And there are almost 40 banks in the programme.

Since August, as others have observed, the balance of supply, demand and exchange rate effects has shifted. Demand is much firmer than expected, suggesting a brighter start to 2017 and the possibility of a 'slow-motion' slowdown, as was referenced. Despite that, there has been a marked further fall in sterling, suggesting a more pessimistic view of supply in the years ahead, and there's been a notable pick-up in inflation break-evens. Stronger demand, weaker supply, and a lower exchange rate are creating a more challenging trade-off. And this possibility [of a slow-motion slowdown][3] – I will just re-emphasise – this is a possibility, which is why we said in May that the monetary policy response to Brexit would not be automatic.

As others have observed, these dynamics are explained by consumers carrying on. Four quarter consumption was a solid 3% in the first half of the year. And there are signs of that momentum continuing in the second half. With the chance of becoming unemployed around two standard deviations below its mean, perceptions of job security remain strong. The NMG survey points to an only modest slowing in household spending intentions and consumer confidence has rebounded. Financial markets are less sanguine. The FX market is pricing an increased risk of a Brexit that's both more abrupt and more closed than previously assumed. Other forward-looking agents have also begun to adjust. Investment intentions have weakened and firms' demand uncertainty has tracked upwards.

Now, as Jan and others have suggested, there are two main ways that the household perceptions on the one hand can be reconciled with the markets' perceptions on the other. Either the prospects for openness in supply could improve as negotiations proceed, and the exchange rate could recover somewhat. Both of these would reduce inflationary pressures, at least to the extent to which demand has immediately tracked the improvement in perceived supply. Or there could be a reckoning in demand first as real incomes slow with higher prices and a weaker economy, and then the effects of lower openness on people's jobs and incomes begins to build. Obviously the first possibility is constructive and the second clearly is not. Unfortunately, at the moment, as long as foreign exchange markets price one thing and consumers another, we face a challenging trade-off. We can temporarily accommodate some of the inflationary effects of this mismatch, recognising that an aggressive policy response would push down on activity in employment, perhaps needlessly. Using the flexibility in our remit, we can tolerate some degree of temporary overshoot of inflation in order to support domestic activity during a period of considerable uncertainty and necessary adjustment in the economy.

As others have observed, there are limits to this approach, however. And the first limit is the extent to which higher inflation becomes embedded in inflation expectations. We need to be watchful on that front.

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[3] MPC Secretariat clarification.

Secondly, is the extent to which the market is far-sighted and households are adaptive. To the extent to which consumers have not anticipated that both the level of supply will be lower and that the economy's growth rate will fall, $r^*$ can rise as there is, in effect, an insufficient rise in savings, pushing up equilibrium interest rates, making monetary policy more stimulative, worsening the challenge. If this is the case, higher recorded inflation becomes embedded in domestically generated inflation via second-round effects. Ultimately, these occur via positive output gaps, and would imply inflation pressure from the external sector being compounded by rises in a subset of secured domestically focussed prices, particularly wages, increasing DGI. Third, we ignore at our peril any forces that drive inflation persistently away from the target over the two to three year horizon. Although more flexible than wages, the prices of import intensive goods are still sticky, so the inflation effects of the exchange rate can persist. Ignoring these would be counter to our remit and that's why we are not indifferent to the exchange rate and why 100% look-through strategy would not be appropriate.

These limits, the evolution of recent data, and the fact that the trade-off has become more challenging, suggest the following to me. First, as others have noted, our September guidance clearly has expired. (Or it was originally our August guidance which rolled into September.) And, consequently, I would not support easing at this meeting. Secondly, the forecast outcomes for inflation of 2.7% and 2.5% in years two and three, with output gaps of 0.7 and 0.6, and conditional upon the curve at the time, are roughly those chosen by a policymaker with a lambda of about a half, such that the inflation gap and the output gap are approximately balanced. This suggests to me a conditioning path that is flat in the near-term with a modest positive slope in the medium-term is about right. I think Michael made the distinction in his remarks between what's in the forecast and what's in the market at present.

Third, in light of that, I am minded to move to a neutral bias with regard to the next move in Bank Rate. And fourth, the risk to policies themselves reflect the different ways in which the reconciliation between the consumer and the foreign exchange market can happen. If the job market begins to slow and consumer confidence falls sharply after Article 50 is triggered, and exchange rate pass-through does not materialise to the extent we currently forecast, then there would be scope to provide further support to the economy. On the other hand, if the exchange rate continues to move in the direction of a hard Brexit – and there may be further exchange rate depreciation in store (I think at best we can say it's an inexact science estimating sustainable current account deficits) – that scope is much more limited, and in fact monetary conditions could have to be tightened to deliver a sustainable inflation path. I am minded to vote for no change in Bank Rate, no change in asset purchases. I will associate myself with the comments of Ian, echoed by others, on QE as an instrument and thinking about it in the round. I think there is quite a high bar for stopping a programme that's in place. It might have implications for ourselves or future MPCs in thinking about scaling initial QE announcements, and the pre-commitment element that comes into play. But it's something we can discuss – well, we can discuss at any time, but I suspect we will – further.

So on my initial read of that is that it's 9-0 for no change in Bank Rate, and 9-0 in favour of maintaining the current asset purchase programmes. There is some pretty clear guidance on guidance, and neutrality and the nuance around that, which we obviously should look to capture in the minutes but also in the MPS. And some very helpful comments on the direction of why the economy has evolved as it has relative to our original expectation, what that suggests for the nature of going forward, which I think can provide some helpful colour and nuance to what we currently have in the Inflation Report. And probably the best way to try to capture that is in the MPS, Section 5 and then cascade it back through the document. OK. So with that I'll close the official part of this meeting and thank everyone.

**A meeting of the Monetary Policy Committee was held on Wednesday 2 November 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

The following members of staff were present:

Gareth Ramsay, Director, Monetary Analysis
James Bell, MPC Secretariat
James Talbot, MPC Secretariat
Melissa Davey, Editor of Inflation Report

**Transcript of the Monetary Policy Committee Meeting on**

**Wednesday 2 November 2016**

**Governor Carney.** I call this meeting to order. We are going to start with two updates, first on financial markets with Minouche and then Andy on the most recent data. So Minouche, please.

> **Nemat Shafik.** The developments in financial markets had been a continuation of recent trends but attention has shifted a little away from Brexit and a little more toward the US election. Let me sum up what that means for key asset classes.
>
> Short rates and gilt yields initially continued to move higher, but the fall-out of the reopening of the FBI investigation into Hillary Clinton's emails has contributed to a decline in yields across the board. The probability of a rate cut for the UK has disappeared in the current yield curve. The SONIA curve increases over the coming years to reach just 54 basis points in year three. The 10 year gilt yield is at 1.22, around 10 basis points higher than at the time of Pre-MPC, with that move split evenly between real and inflation compensation. That's also 30 basis points higher than when we last made a decision on interest rates. The exchange rate has remained sensitive to political news. It's appreciated today on reports that the High Court will rule tomorrow morning at 10.00 on the issue of parliamentary challenge to the Government's Brexit plans. Cable is now 1.23, which is a little higher than at the time of pre-MPC, partly also reflecting Trump-related dollar weakness. And, in keeping with the slight risk off tone, equities are down a little – by about 1% since Pre-MPC.
>
> Finally, just a word on central bank actions. Since Pre-MPC, the Bank of Japan has kept policy on hold but has pushed back the time at which they hope to achieve the 2% target to 2018. The Fed's going to announce its decision at 6pm tonight. No change is expected but the market implies a 62% probability of a Fed rate rise in December. That's it.

**Governor Carney.** OK. Good. Thank you Minouche. Andy, please.

> **Andrew Haldane.** Thank you Governor. Starting domestically, we'd already seen the headline of PMIs for October. We now have the sectoral breakdown, and there we saw manufacturing down a bit, construction up a bit and, by residual, although it's not out until tomorrow, services will be up a bit too. We had Nationwide house prices for October. They were flat on the month but the three-month on three-month annualised is still around the middle of the pack at 5%.
> Then internationally we had, earlier this week, Q3 GDP for the euro area and inflation. Both came in a touch lower than our expectation at 0.3 and 0.5 respectively, but in both cases that only was a touch. And then on PMIs internationally, we had a couple of strong US manufacturing PMIs for October, and also some strong Chinese PMIs, both manufacturing and non-manufacturing for October. I think that's all. Thank you.

**Governor Carney.** OK. Very good. Alright, so let's turn to the formal decision. I'm going to invite votes on three propositions. The first that Bank Rate be maintained at 0.25%. The second that the Bank continue with the programme of sterling non-financial corporate bond purchases totalling up to £10 billion, financed by the issuance of central bank reserves. And thirdly that the Bank continue with the programme of £60 billion of UK government bond purchases to take the total stock of these purchase to £435 billion, financed again by the issuance of central bank reserves. And I'll try and go in the order we had at the indicative meeting. I'll start with Ben.

> **Ben Broadbent.** Thank you. I vote for all three propositions.

**Governor Carney**. Minouche?

> **Nemat Shafik.** I support all three propositions.

**Governor Carney.** Ian?

> **Ian McCafferty.** I support all three propositions.

**Governor Carney.** Michael?

**Michael Saunders.** I vote for all three propositions.

**Governor Carney.** Jan please?

**Gertjan Vlieghe.** I vote for all three propositions.

**Governor Carney.** Andy?

**Andrew Haldane.** I support all three propositions.

**Governor Carney.** Kristin?

**Kristin Forbes.** I vote for all three propositions.

**Governor Carney.** Jon?

**Jon Cunliffe.** I vote for all three propositions.

**Governor Carney.** And I vote for all three propositions, which is the same vote as everyone. 9-0 on all three. Work to do on the Minutes. So, unless anyone has any other business, I close the formal bit and head downstairs.