



BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 13 April 2016

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These are the minutes of the Monetary Policy Committee meeting ending on 13 April 2016.

They are available at <http://www.bankofengland.co.uk/publications/Pages/news/2016/004.aspx>

The Bank of England Act 1998 gives the Bank of England operational responsibility for setting monetary policy to meet the Government's inflation target. Operational decisions are taken by the Bank's Monetary Policy Committee. The minutes of the Committee meeting ending on 11 May 2016 will be published on 12 May 2016.

Monetary Policy Summary, April 2016

The Bank of England's Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target and in a way that helps to sustain growth and employment. At its meeting ending on 13 April 2016 the MPC voted unanimously to maintain Bank rate at 0.5%. The Committee also voted unanimously to maintain the stock of purchased assets financed by the issuance of central bank reserves at £375 billion.

Twelve-month CPI inflation increased to 0.5% in March but remains well below the 2% inflation target. This shortfall is due predominantly to unusually large drags from energy and food prices, which are expected to fade over the next year. Despite picking up, core inflation also remains subdued, a consequence of the past appreciation of sterling, weak global inflation and restrained domestic cost growth.

Returning inflation to the 2% target requires balancing the potentially lessening drag from external factors against expected gradual increases in domestic cost growth. Fully offsetting that drag over the short run would, in the MPC's judgement, involve too rapid an acceleration in domestic costs, one that would risk being excessive and would lead to undesirable volatility in output and employment. Given these considerations, the MPC intends to set monetary policy to ensure that growth is sufficient to return inflation to the target in around two years and keep it there in the absence of further shocks.

The MPC set out its most recent detailed assessment of the economic outlook in the February 2016 *Inflation Report*. Taking together all of the recent economic developments, the broad outlook for activity and inflation appears little changed.

There has been mixed news on near-term prospects for global growth. Immediate downside risks around Chinese activity have lessened; in the United States, indicators of GDP growth in the first quarter of the year have been disappointing, but those for the second quarter are more encouraging. Movements in the prices of risky assets suggest that investors have regained their risk appetite, possibly reflecting more positive global economic data and policy action by central banks. Nevertheless, given weak supply growth, the Committee continues to expect global growth to be somewhat subdued by historical standards.

Sterling has depreciated further over the past month. Risk-free interest rates in the United Kingdom and elsewhere have also declined. Together with rises in the prices of many risky assets, these movements should support economic activity. That said, the likelihood that much of the fall in sterling reflects uncertainty surrounding the forthcoming referendum on the United Kingdom's membership of the European Union raises questions regarding whether the lower level of sterling will persist and its net economic impact.

Domestically, growth has been steady, and the MPC continues to expect CPI inflation to rise over the next year. The pickup in the price of oil and sterling's recent depreciation will support that rise. There are some signs that uncertainty relating to the EU referendum has begun to weigh on certain areas of activity, as some decisions, including on capital expenditure and commercial property transactions, are being postponed pending the outcome of the vote. This might lead to some softening in growth during the first half of 2016.

At its meeting on 13 April, the MPC judged it appropriate to leave the stance of monetary policy unchanged. The MPC's best collective judgement is that it is more likely than not that Bank Rate will need to increase over the forecast period to ensure inflation returns to the target in a sustainable fashion. However, referendum effects are likely to make macroeconomic and financial market indicators harder to interpret over the next few months, and the Committee is likely to react more cautiously to data news over this period than would normally be the case.

All members agree that, given the likely persistence of the headwinds weighing on the economy, when Bank Rate does begin to rise, it is expected to do so more gradually and to a lower level than in recent cycles. This guidance is an expectation, not a promise. The actual path Bank Rate will follow over the next few years will depend on the economic circumstances.

Minutes of the Monetary Policy Committee meeting ending on 13 April 2016

1 Before turning to its immediate policy decision the Committee discussed financial market developments; the international economy; money, credit, demand and output; and supply, costs and prices.

Financial markets

2 In the period since the Committee's previous meeting there had been further declines in short-term and longer-term interest rates internationally, and the prices of risky assets had continued to unwind the falls seen at the beginning of the year. Sterling had depreciated further. Looking back over a longer time period, the previous six months had seen additional monetary stimulus in Japan and the euro area, an increase in official interest rates in the United States, concerns about the effectiveness of Chinese policy and the profitability of European banks, and greater focus on the UK referendum on membership of the European Union. The Committee considered the overall impact of these events on asset prices and on financial conditions in the United Kingdom.

3 Relative to the time of the November *Inflation Report*, short-term and longer-term interest rates were substantially lower across the major advanced economies, largely reflecting falls in real rates. In the United Kingdom, OIS rates suggested that market participants had pushed back considerably their expectations of the timing of the first rise in Bank Rate. Some of this reassessment of the likely path for monetary policy internationally was probably due to increased perceptions of risks to the global economic outlook.

4 Corporate bond spreads had risen sharply during January and February, but much of this rise had unwound, in part owing to the decision by the ECB to make investment-grade corporate bonds eligible in its asset-purchase programme. Non-financial investment grade spreads in dollars and sterling were broadly unchanged compared to the time of the November *Report*, with euro spreads slightly lower, and yields had fallen. Net issuance of corporate bonds had picked up a little in the first quarter. Similarly, while equity prices had also fallen in January and February, prices of UK equities had by and large recovered these losses and net equity issuance had been positive. It was likely, therefore, that credit conditions for larger companies were, if anything, looser than those during the autumn.

5 Sterling had depreciated by 10% since its recent peak in November and a mechanical treatment of this would imply that it, too, would act to make financial conditions more favourable for UK companies. However, analysis by Bank staff had suggested that a substantial proportion of the fall could be attributed to increased uncertainty surrounding the forthcoming referendum. To the extent that this uncertainty was leading to an increased risk premium on some UK assets, the net impact on financial conditions was less clear. Also, to the extent that any uncertainty affecting asset prices was resolved after the referendum, such effects might not persist.

6 Taken together, therefore, it was likely that financial conditions in the United Kingdom were broadly similar to, or a little looser than, those six months earlier, but the Committee would further consider movements in the

prices of risky assets, interest rates and exchange rates, alongside the shocks that had driven them, in the context of its forthcoming forecast round.

The international economy

7 Developments in the global economy since the Committee's previous meeting had been mixed, with differing implications both across regions and as regards near-term and more medium-term prospects.

8 In the United States, GDP growth in 2015 Q4 had been revised up slightly to 0.3%, but recent indicators had suggested that activity was likely to have disappointed in 2016 Q1, with monthly data for both household consumption and capital expenditure weakening. Bank staff expected growth of 0.2% compared with an expectation of 0.6% at the time of the February *Inflation Report*. Employment had grown solidly in the first months of the year, implying that labour productivity might have fallen in Q1, continuing the disappointing trend across the major advanced economies. There was some evidence that any slowdown in output growth might be temporary: consumer confidence had remained steady and most surveys of output growth had risen in March. At the same time, however, corporate profit margins, although still strong by historical standards, had fallen back over the previous year. As regards prices, there were signs that pressures were beginning to build after a long period of subdued inflation: core inflation on both the CPI and PCE measures had picked up quickly in recent months and was now close to 2%.

9 In the euro area, indicators had continued to point to growth of around 0.4% in the first quarter. The unemployment rate had fallen to 10.3% in February, the lowest rate since August 2011 and continuing the gentle but steady decline of the previous two and a half years. Looking forward, activity in the euro area would be boosted by the measures recently announced by the ECB: Bank staff estimated that, other things equal, they would raise the level of output by around ½% over the coming two years. It was not yet clear whether this would be sufficient to return inflation to target in a reasonable time-frame, however. Notwithstanding the far-reaching implications of the programme, for bank funding costs in particular, market measures of break-even inflation rates had fallen on the month.

10 In March, the Chinese authorities had announced new targets for growth in activity and credit in 2016, of 6.5% to 7% and 13% respectively, and had reiterated their commitment to doubling per capita incomes, relative to their 2010 level, by 2020. In the short term at least, this was likely to lead to Chinese GDP growth being stronger than the Committee had previously anticipated; Bank staff had revised up their estimate of growth in Q1 to 1.6%. This positive news might have contributed to the recent stabilisation of commodity prices and sharp pick up of capital inflows to emerging market economies. Looking further forward, however, a greater reliance on credit growth to underpin Chinese activity would increase the risk of loans going to projects that were riskier or where the prospective returns were lower. And, with any stimulus measures more likely to affect investment rather than consumption, the rebalancing of the Chinese economy towards the household sector could slow.

Money, credit, demand and output

11 The 2015 Q4 national accounts release had contained upward revisions to GDP growth of 0.1 percentage points each to 2015 Q1 and Q4. The slowdown between 2014 and 2015 now looked shallower than had previously been the case, although average quarterly growth of 0.5% during 2015 remained below the 0.7% average registered in 2014. At the component level, growth in Q4 in all of the major output aggregates – services, production and construction – had been revised up. On the expenditure side, a downward revision to household consumption growth had been more than offset by upward revisions to other components, most notably net trade.

12 Business investment was estimated to have been weak in Q4. The 2% fall on the quarter had been largely driven by a sharp drop in extraction investment, a consequence of low oil prices. Forward looking indicators of investment intentions had softened in Q1.

13 Bank staff's summary measure of macroeconomic uncertainty had risen. The main drivers had been a rise in media references to uncertainty, of which nearly a half were linked explicitly to the referendum, and a pickup in exchange rate volatility. However, at the headline level there had been little evidence of a material effect on growth. Reported balances for actual and expected activity in the major business surveys had been mixed. Although weak industrial production data for February had led Bank staff to lower their nowcast of the Q1 preliminary GDP estimate to 0.4%, staff had not revised their expectations for mature estimates of 0.5% growth in each of the first two quarters of the year.

14 Nevertheless, there had been some signs that increased uncertainty might be beginning to weigh on demand. Business surveys had reported a softening in investment intentions, consistent with expenditure decisions being deferred pending the outcome of the referendum. The latest Deloitte survey of Chief Financial Officers had reported the highest level of external financial and economic uncertainty for three years. Some lenders had reported that, notwithstanding still-favourable credit availability, the demand for finance from some large companies had dipped somewhat, partly reflecting EU referendum uncertainty. At a sectoral level, transactions in commercial real estate had fallen by around 40% in Q1, with referendum uncertainty reported to have played a significant role. There had also been reports that some IPOs and private equity deals had been delayed. Taken together, these developments highlighted the risk that the economy could slow somewhat in Q2.

15 The Q4 national accounts release had shown that the household saving rate had continued the downward trend seen since 2010. The estimated saving rate was prone to revision and so should be treated with caution, but the Committee noted that consumer confidence had held up, with households continuing to report improvements in their own financial situation despite worsening confidence in the general economic outlook. Credit conditions also remained supportive of household demand. Despite some pickup in banks' funding costs in Q1, two-year mortgage rates had been broadly unchanged and growth in mortgage lending had been stable in January and February. Personal loan rates had also been broadly flat, and growth in consumer credit had

remained strong. It was, however, possible that referendum-related uncertainty would have a more pronounced effect on household sentiment and behaviour as the vote drew nearer.

16 Lower household saving had been one of the counterparts to the large current account deficit that had been reported in Q4. At 7% of GDP, this had been the largest deficit since quarterly data began in 1955, although heavy revisions to this series were not uncommon. The balances on net trade and primary and secondary income had all deteriorated, but the fall in the primary income balance had made the greatest contribution to the deterioration. The net rate of return on foreign direct investment (FDI) had declined sharply, reflecting both a fall in the rate of return on the UK's overseas investments and a rise in the rate paid overseas from FDI in the United Kingdom. The effect of the latter had been amplified by increased investment into the United Kingdom in recent years. It was possible that weaker rates of return on overseas investments would weigh on future household incomes if dividend payouts were subsequently reduced, although the size and timing of such an effect was uncertain.

Supply, costs and prices

17 Twelve-month CPI inflation had been 0.5% in March, roughly in line with Bank staff's expectation at the time of the February *Inflation Report*. A summary measure of core inflation calculated from a range of indicators had increased to 1.2% in March. Both had been boosted by a rise in airfares related to the timing of the Easter holidays, which was likely to unwind in April causing twelve-month inflation to drop back slightly. Nevertheless, Bank staff's expectation remained for a gradual pickup in CPI inflation over the next year as the impact of past falls in energy and food prices dissipated. The recent increase in oil prices and depreciation of sterling since November, if sustained, would support that rise. Evidence from the Markit/CIPS survey suggested that service-sector input prices had increased in March at their fastest rate for around eighteen months, and the corresponding output price index had risen to its highest since the start of 2014.

18 There had been no official labour market data releases since the Committee had met in mid-March. Taken together, the two monthly data releases since the time of the February *Report* indicated that average hours worked per week had been somewhat higher than previously assumed, but that other labour market quantities had been roughly in line with expectations, as had the average weekly earnings data. Above average employment growth combined with only moderate output growth during 2015 implied that productivity growth had been subdued over the year as a whole.

19 For some time, the Committee had been expecting employment growth to slow as unemployment approached pre-crisis levels and productivity growth gradually recovered. Information from both the LFS and Workforce Jobs data sets indicated that employment growth had indeed declined from the peaks seen at the start of 2015, but had nevertheless remained above historical norms. Business survey indicators of employment growth and hiring intentions had also gradually softened over the previous year or so, although the number of job vacancies had remained very high, and the job-finding rates of those declared as both unemployed and inactive had continued to rise. There was as yet little evidence across the range of indicators that either the introduction of the National Living Wage or uncertainty surrounding the outcome of the

referendum on the UK's membership of the EU had much affected job creation, although there was some survey evidence that the latter might be affecting hiring intentions. It was noted that for these reasons survey evidence, and perhaps the official employment data too, might be more difficult to interpret over the next few months.

20 Annual regular pay growth in the private sector had increased to 2.4% in the three months to January, and high frequency measures indicated that the period of unusually weak pay growth in the middle of last year might have ended. According to the latest official data, unit labour costs had increased by 1.3% in the year to 2015 Q4.

21 Measures of inflation expectations implied by the prices of financial instruments had been roughly stable since the time of the Committee's previous meeting. Households' short and medium term inflation expectations had also been stable, according to the Citigroup survey that had been released during the month, although they remained well below their historical averages. And there was some survey evidence that companies' expectations of CPI inflation had fallen further.

The immediate policy decision

22 The Committee set monetary policy to meet the 2% inflation target, and in a way that helped sustain growth and employment. In pursuit of that objective, the Committee considered how recent developments had affected the balance of risks to the outlook.

23 Twelve-month CPI inflation had increased to 0.5% in March but remained well below the 2% target. The vast majority of the shortfall continued to reflect the effects of past falls in commodity prices and the appreciation of sterling. It was likely that CPI inflation would decline in April, as an Easter-related spike in airfares unwound. But inflation was expected to rise over the next year, albeit at a gradual pace, as the effects of past falls in energy and food prices and the past appreciation of sterling faded, with the pickup in the price of oil and sterling's depreciation since November supporting that rise.

24 Developments over the past month had done little to change the broad outlook for activity and inflation. Downside risks around near-term Chinese growth had lessened, following the authorities' announcement of plans to target only a modest slowing in demand in 2016 and some supportive activity indicators – although the achievement of a smooth rebalancing of the Chinese economy would remain a challenge. In contrast, the United States appeared to have been weak in Q1. Although this was likely to prove temporary on a quarterly basis, there remained a question mark over growth prospects in the medium term, especially in light of recent disappointing outturns for productivity. Movements in the prices of risky assets suggested that investors had regained their risk appetite, possibly reflecting more positive global economic data and policy action by central banks. Risk-free interest rates in the United Kingdom and elsewhere had generally fallen. Nevertheless, the Committee continued to expect global growth to be somewhat subdued by historical standards.

25 In the United Kingdom, growth had been steady at around 0.5% per quarter, and recent asset price movements should be supportive, although the likelihood that much of the fall in sterling reflected uncertainty

surrounding the forthcoming EU referendum raised questions regarding whether the lower level of sterling would persist and its net economic impact. Consumer confidence remained high, particularly in relation to households' own financial situations, with commensurate strength in consumer durables spending and consumer credit. The housing market had also probably been supportive, although recent developments relating to buy-to-let investments were likely to make it harder to discern the underlying evolution of the market over the next few months. The weakness in business investment in Q4 appeared largely due to a steep drop in investment in the extraction sector. Strong domestic demand alongside subdued global activity and weaker investment income from abroad, however, had further widened the United Kingdom's current account deficit to a record level.

26 There had been signs that uncertainty relating to the EU referendum had begun to weigh on certain areas of activity. Media references to uncertainty had jumped, though the impact of this on household spending was unclear. The likelihood that some business decisions would be delayed pending the outcome of the vote was consistent with the easing in survey measures of investment intentions, reports of the postponement of IPOs and private equity deals and a softening in corporate credit demand. The fall in commercial property transactions in Q1 had been particularly striking. Thus, there might be some softening in growth during the first half of 2016.

27 Although employment growth had slowed, it remained above historical norms and vacancies were high. It was possible that any near-term dip in GDP growth could weigh on employment intentions. The recovery in productivity had remained lacklustre, but, alongside muted wage inflation, this implied growth in unit wage costs that was below levels consistent with meeting the inflation target in the medium term.

28 The appropriate policy stance depended on an assessment of the nature and likely persistence of shocks hitting the economy. The Committee noted that referendum effects were likely to make macroeconomic and financial market indicators harder to interpret over the next few months. As a result, the Committee was likely to react more cautiously to data news over this period than would normally be the case.

29 The Committee considered the likely implications for monetary policy of a vote to leave the European Union. Such a vote might result in an extended period of uncertainty about the economic outlook, including about the prospects for export growth. This uncertainty would be likely to push down on demand in the short run. Uncertainty regarding the supply side of the economy might also increase, reflecting any alterations to product or labour market regulation, adjustments in labour flows or changes in the rate of technology adoption as a result of different arrangements governing foreign trade and capital flows. A vote to leave could have significant implications for asset prices, in particular the exchange rate. The MPC would have to make careful judgements about the net effects of these potential influences on demand, supply and inflation. Ultimately, monetary policy would be set in order to meet the inflation target, while also ensuring that inflation expectations remained anchored. Whatever the outcome of the referendum, the MPC would use its tools to achieve its inflation remit.

30 Taking into consideration all of the recent developments, the Committee was unanimous in concluding that maintaining the current stance of policy was appropriate at this meeting. The Committee's best collective judgement was that it was more likely than not that Bank Rate would need to increase over the forecast period

to ensure inflation returned to the target in a sustainable fashion, although there remained a range of views about the outlook for activity and inflation and the associated risks.

31 All members agreed that, given the likely persistence of the headwinds weighing on the economy, when Bank Rate did begin to rise, it was expected to do so more gradually and to a lower level than in recent cycles. Such guidance, however, was an expectation and not a promise: the path that Bank Rate would actually follow over the next few years would depend on economic circumstances.

32 The Governor invited the Committee to vote on the propositions that:

Bank Rate should be maintained at 0.5%;

The Bank of England should maintain the stock of purchased assets financed by the issuance of central bank reserves at £375 billion.

Regarding Bank Rate, the Committee voted unanimously in favour of the proposition.

Regarding the stock of purchased assets, the Committee voted unanimously in favour of the proposition.

33 During its policy meeting, the Committee had received a briefing from the Deputy Governor responsible for financial stability on the Financial Policy Committee's (FPC) most recent assessment. The global macroeconomic environment had continued to be challenging, with some previously identified risks having crystallised and others having increased. Domestically, the FPC remained alert to potential threats to financial stability from pockets of strong growth in lending to households, including consumer credit and buy-to-let mortgages. These risks had been supplemented by risks around the EU referendum. The FPC had increased the countercyclical capital buffer rate for UK exposures from 0% to 0.5%, which would be applied in conjunction with a lifting by the Prudential Regulation Authority (PRA) Board of the overlapping aspects of Pillar 2 supervisory capital buffers. The PRA had also provided supervisory guidance to clarify its expectations for underwriting standards in the buy-to-let market.

34 The following members of the Committee were present:

Mark Carney, Governor
Ben Broadbent, Deputy Governor responsible for monetary policy
Jon Cunliffe, Deputy Governor responsible for financial stability
Nemat Shafik, Deputy Governor responsible for markets and banking
Kristin Forbes
Andrew Haldane
Ian McCafferty
Gertjan Vlieghe
Martin Weale

Clare Lombardelli was present as the Treasury representative.

As permitted under the Bank of England Act 1998, as amended by the Financial Services Act 2012, Anthony Habgood was also present on 6 April as an observer in his role as a member of the Oversight Committee of Court.