



**BANK OF ENGLAND**

## Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 15 June 2016

**Publication date: 16 June 2016**

These are the minutes of the Monetary Policy Committee meeting ending on 15 June 2016.

They are available at <http://www.bankofengland.co.uk/publications/Pages/news/2016/006.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 13 July will be published on 14 July 2016.

## Monetary Policy Summary, June 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 15 June 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 was 0.3% in May and 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 attenuate over the next year. Core inflation also remains subdued.

The MPC set out its most recent detailed assessment of the economic outlook in the *May Inflation Report*. Relative to those projections, there has been limited news on the outlook for the global economy. Growth in the United Kingdom's major trading partners is expected to continue at a modest pace over the next three years. In China and other emerging markets, the prospects for activity are little changed and medium-term risks remain to the downside. Commodity prices have risen since the Committee's *May Report*, however, with sterling oil prices in particular having increased by around 10%.

In the weeks since the *May Report*, an increasing range of financial asset prices has become more sensitive to market perceptions of the likely outcome of the forthcoming EU referendum. On the evidence of the recent behaviour of the foreign exchange market, it appears increasingly likely that, were the UK to vote to leave the EU, sterling's exchange rate would fall further, perhaps sharply. This would be consistent with changes to the fundamentals underpinning the exchange rate, including worsening terms of trade, lower productivity, and higher risk premia. In addition, UK short-term interest rates and measures of UK bank funding costs appear to have been materially influenced by opinion polls about the referendum. These effects have also become evident in non-sterling assets: market contacts attribute much of the deterioration in global risk sentiment to increasing uncertainty ahead of the referendum. The outcome of the referendum continues to be the largest immediate risk facing UK financial markets, and possibly also global financial markets.

While consumer spending has been solid, there is growing evidence that uncertainty about the referendum is leading to delays to major economic decisions that are costly to reverse, including commercial and residential real estate transactions, car purchases, and business investment. As the Committee has previously noted, potential referendum effects are making economic data releases more difficult to interpret, and the Committee is being more cautious in drawing inferences from them than would normally be the case.

The MPC's projections in the *May Inflation Report* were conditioned on continued UK membership of the EU. On that assumption, returning inflation to the 2% target requires balancing the drag on inflation from external factors and the support from 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 which would risk being excessive and 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.

Consistent with the projections and conditioning assumptions set out in the *May Report*, including a gentle rise in interest rates over the forecast period, the MPC judges that it is more likely than not that Bank Rate will need to be higher by the end of the forecast period than at present to ensure inflation returns to the target in a sustainable manner. 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 economic circumstances.

As the Committee set out last month, the most significant risks to the MPC's forecast concern the referendum. A vote to leave the EU could materially alter the outlook for output and inflation, and therefore the appropriate setting of monetary policy. Households could defer consumption and firms delay investment, lowering labour demand and causing unemployment to rise. Through financial market and confidence channels, there are also risks of adverse spill-overs to the global economy. At the same time, supply growth is likely to be lower over the forecast period, reflecting slower capital accumulation and the need to reallocate resources. Sterling is also likely to depreciate further, perhaps sharply. This combination of influences on demand, supply and the exchange rate could lead to a materially lower path for growth and a notably higher path for inflation than in the central projections set out in the *May Inflation Report*. In such circumstances, the MPC would face a trade-off between stabilising inflation on the one hand and output and employment on the other. The implications for the direction of monetary policy will depend on the relative magnitudes of the demand, supply and exchange rate effects. The MPC will take whatever action is needed, following the outcome of the referendum, to ensure that inflation expectations remain well anchored and inflation returns to the target over the appropriate horizon.

Against that backdrop, at its meeting on 15 June, the MPC voted unanimously to maintain Bank Rate at 0.5% and to maintain the stock of purchased assets, financed by the issuance of central bank reserves, at £375 billion.

## Minutes of the Monetary Policy Committee meeting ending on 15 June 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 Market participants' assessments of the likelihood of a vote for the United Kingdom to leave the European Union in the forthcoming referendum had continued to be one of the main influences on financial markets. Since the Committee's previous meeting, this had become more apparent in a wider range of sterling assets and there had also been increasing evidence that uncertainty about the result was having an influence on some non-sterling asset prices.

3 The strongest effects had continued to be on sterling exchange rates. While the effective exchange rate had fallen over the period as a whole since the Committee's previous meeting, this had masked two distinct periods. Sterling had appreciated by 3% between 13 and 27 May, as market participants had responded to a number of opinion polls pointing to a 'remain' vote. Following the subsequent release of opinion polls suggesting a lead for a 'leave' vote, sterling had depreciated, in some instances sharply. Implied volatilities in sterling foreign exchange options had risen further over the month, with one-month measures reaching their highest levels since October 2008. Options prices indicated that the price of protection against the risk of sterling depreciation compared with the price of protection against an appreciation had risen to its highest level for over a decade. Taken together with the increasingly strong correlation between the odds of a vote to leave the EU implied by betting markets and movements in the exchange rate, this evidence reinforced the Committee's May *Inflation Report* judgement that a substantial proportion of sterling's recent depreciation could be attributed to the risks around the referendum.

4 The referendum had also affected other sterling asset markets. Recent movements in UK short rates had been closely correlated with changes in market perceptions of the likelihood of a 'leave' vote, a relationship corroborated by market intelligence. This co-movement was also evident in changes in UK banks' credit default swap premia, relative to equivalent measures for banks in the euro area and the United States. The underperformance – relative to the FTSE All-Share index – of the equities of companies earning their revenues predominantly in the United Kingdom had persisted. Spreads on sterling investment grade corporate bonds had not fallen by as much as comparable dollar bonds in recent months.

5 There had also been some evidence of an influence of the EU referendum beyond sterling markets. For instance, the term structures of implied volatility in some euro bilateral exchange rates and the Euro Stoxx equity index were elevated at maturities around the referendum. Market contacts had attributed much of the deterioration in global risk sentiment to increasing uncertainty ahead of the referendum. Long-term interest rates across the advanced economies had fallen and remained low, with ten-year nominal yields close to or at historical lows in Germany and the United Kingdom. The Minutes of the April meeting of the Federal Open

Market Committee (FOMC) had referred to the possible impact on global financial markets of the EU referendum, as had a number of FOMC members in speeches and other public comments.

6 Overall, the outcome of the referendum on EU membership continued to be the largest immediate risk facing UK financial markets, and possibly also global financial markets. According to the Bank of America Merrill Lynch Global Fund Manager Survey, the referendum was considered the biggest tail risk. This was consistent with the Bank's own market intelligence.

7 In terms of other influences on financial markets, US non-farm payrolls data released in early June, which were weaker than expected, had been associated with a fall in short-term interest rates and a rise in equity markets in both the United States and the United Kingdom. The European Central Bank had begun to purchase corporate bonds; its earlier announcement of this had appeared to reduce corporate bond spreads. Looking ahead to the remainder of the year, there were a number of significant events that represented potential sources of financial market volatility, including the Greek bailout negotiations and elections in Japan, Spain and the United States.

8 Measures of inflation compensation from financial markets had changed little on the month. But, since mid-March, five year inflation swap rates five years forward had fallen by around 30 basis points in the United Kingdom, more than in the euro area or the United States. According to market contacts, it was possible that the fall in the UK measure reflected diminished inflation hedging by institutional investors in that market, which could be related in part to low liquidity and concerns about market volatility.

### **The international economy**

9 Global growth in UK-weighted terms was now estimated to have been stronger around the turn of the year than it had been a month ago, although the improvement was small and there appeared to have been little news on the pattern and strength of underlying momentum. The dollar oil price had risen by around 8% from its level at the time of the *May Inflation Report*, with some temporary supply disruptions having been at play in addition to resilient demand.

10 In the euro area, the most recent estimate of GDP growth in Q1 had affirmed the strong preliminary flash estimate of 0.6%. This had been boosted by a sharp rise in industrial production in January that had since unwound, implying a somewhat weaker outlook for growth in Q2. Bank staff had consequently revised down their Q2 GDP growth nowcast by 0.1 percentage points to 0.3%. Twelve-month HICP inflation had edged up to -0.1% in May according to the flash estimate, from -0.2% in April, and was broadly in line with expectations. It was still too early to gauge the impact of the ECB's stimulatory measures.

11 In the United States, the second estimate of GDP growth in Q1 had been revised up by 0.1 percentage points to 0.2%. Indicators for Q2, most notably solid growth in real consumption in April, suggested that this weakness was likely to prove temporary. However, the employment data for May had been weak, with the

38,000 rise in non-farm payrolls considerably below the consensus expectation of 160,000. Increases in March and April had been revised down by 59,000. Although the May figure had been depressed by 35,000 as a result of a strike by workers at Verizon and seasonal factors may have weighed on the estimate, implying a somewhat less weak underlying picture, financial market investors had pushed back their expectations of the timing of further policy tightening by the Fed. The labour market participation rate had fallen by 0.2 percentage points, further unwinding the strengthening in the earlier part of the year and adding to concerns that it might have weakened structurally. The unemployment rate of 4.7% implied that there was likely to be little slack remaining in the labour market. Unit labour cost growth had remained above historical average rates.

12 The Japanese government had chosen to postpone its planned rise in the consumption tax, underlining the authorities' concerns about the robustness of demand and inflation. Further support from fiscal and/or monetary policy remained a possibility. In China, growth in total social financing and house price inflation had both moderated a touch, but remained elevated. Bank staff's nowcast for Q2 GDP growth in China remained fairly robust at 1.7%. But the financial risks that were likely to emanate from the expansion in credit supply associated with the pursuit of the GDP growth target remained a concern.

13 The official data suggested that Chinese rebalancing had continued in 2015, with a sharp acceleration in services output offsetting a sharp deceleration in manufacturing output. The MPC discussed how the ongoing rebalancing might affect other economies. It was possible that the rebalancing seen to date would be modest relative to what was still to come. In particular, there was scope for the share of consumption in GDP to rise significantly further from the 53% estimated in 2015, a rise of 4 percentage points since 2010. This was likely to entail falls in both the household saving rate and in the share of investment in GDP. Weaker investment spending relative to consumption would reduce Chinese import demand, and this was likely to have material implications for a number of other emerging markets. Slower growth in Chinese import demand might also directly affect some European countries, such as Germany. Slower, more consumption focused, GDP growth would also have a material impact on some energy and commodity markets, relative to the demand and supply patterns of recent years. More broadly, if Chinese savings were to decline by more than domestic investment, this would reduce the supply of funds to the rest of the world. This could provide some support for global real interest rates, especially when combined with decreased savings in oil exporters. Thus, even setting aside the potential volatility that might arise during the rebalancing process, the implications of Chinese economic developments for the rest of the world were likely to be substantial.

### **Money, credit, demand and output**

14 On balance, the news during the month on UK activity earlier in the year had been to the upside, counterbalanced by evidence on the effects of the forthcoming referendum. Some key business survey indicators had risen, and April had seen strong retail sales growth and a sizable jump in both industrial production and construction output.

15 The Committee discussed the extent to which uncertainty surrounding the United Kingdom's future membership of the European Union might be weighing on aggregate demand. Bank staff's summary measure of economic uncertainty had risen further, largely driven by increased media references to the referendum. An international comparison of uncertainty measures showed the United Kingdom to be an outlier. Past evidence suggested that a general increase in uncertainty led to households deferring consumption and businesses delaying investment, lowering labour demand and increasing unemployment.

16 Some recent business surveys had contained questions specifically on the effects of the referendum on recent activity, and a sizable minority of firms had reported discernible impacts. In the latest Markit/CIPS survey, 35% of firms had reported detrimental effects on business, while a previous survey by the BCC had found that 20% of firms had seen a negative effect on orders and sales. The size of the effects was unclear, however. In both of these surveys, less than 10% of firms reported "strongly" negative effects. More generally, the headline activity readings from the most recent business surveys had been encouraging, and an international comparison of composite activity indices did not show the United Kingdom as having been especially weak.

17 Heightened uncertainty was likely to be most detrimental for spending decisions that would be costly to reverse and therefore contained a high option value of waiting. The Bank's Agents had reported increased delays in corporate decision making, a factor that had also been noted in the most recent Deloitte survey of chief financial officers. The value of corporate real estate transactions in May had been 15% lower than in April and 29% lower than the monthly average for the first quarter, itself down 50% on the same period in 2015. The value of IPO and M&A activity had also weakened in the first half of this year compared with the same period in 2015. Although the weakness in M&A activity in Q1 might have been part of a global phenomenon, the more recent weakness appeared to have been more UK-specific. On the official data, business investment had been surprisingly weak for two consecutive quarters around the turn of the year, although these declines had largely pre-dated the announcement of the referendum date in February, and more recent surveys of investment intentions had, if anything, appeared to have stabilised.

18 Housing transactions had dropped sharply in April, although this had largely been expected as the surge in activity ahead of the changes to the stamp duty regime unwound. The recent RICS surveys had been very weak, however, with reports of significant declines in both new buyer enquiries and new instructions to sell being more consistent with an underlying softening in the housing market. It was likely that the uncertainty associated with the referendum had had some impact, although a range of factors, including some other recent policy changes, were also likely to have contributed.

19 Other indicators of consumer demand had been mixed. Vehicle registrations had fallen in May, both on the month and in the three months to May relative to the previous three months, which could be evidence of an uncertainty effect. However, consumer confidence had been little changed in May. The balance relating to major purchases had risen, remaining above its historical average, while perceptions of the general economic situation had deteriorated. Retail sales had grown by a surprisingly strong 1.3% in April. Overall, it appeared

that, although referendum-related uncertainty was having a clear detrimental impact in certain areas of activity, its quantitative importance for GDP remained difficult to gauge.

### Supply, costs and prices

20 Twelve-month CPI inflation had been unchanged at 0.3% in May. Sterling oil prices had increased by 10% since the time of the *May Inflation Report*, which in the near term implied a greater contribution to CPI inflation from petrol prices. Offsetting that, however, intelligence from the Bank's Agents suggested that the prices of food and used vehicles were likely to grow somewhat less quickly than previously assumed. The net result of these factors was to leave the most likely path of CPI inflation over the next six months broadly unchanged from that described in the *May Inflation Report* – increasing to a little below 1% by the autumn as the drags from past declines in energy, food and some other goods' prices began to fade from the twelve-month calculation.

21 By contrast, measures of core inflation were expected to increase much more gradually over the rest of the year. The inflation rate of CPI excluding energy, food and tobacco had been 1.2% in the twelve months to May, and Bank staff estimated that it would probably increase by only a tenth of a percentage point or so by the end of the summer. A composite estimate of core inflation derived from a range of measures had been 1.0% in May, having been at or around that level for most of the previous year.

22 During the month, the Labour Force Survey dataset had been revised to incorporate the latest official population estimates. These revisions had been anticipated and already incorporated into the *May Inflation Report* projections and so contained little additional news. The latest figures – for March and April – had also contained few surprises. In the three months to April, unemployment had fallen slightly faster than expected to 5.0%, but employment growth, of 55,000, was materially slower than in the last quarter of 2015. Average hours worked had been a little stronger than expected, although these data were relatively volatile at the monthly frequency, with changes typically dominated by short-term movement in working patterns. The figures that LFS respondents reported as their usual working hours had been roughly stable for six months.

23 As anticipated, bonus payments had bounced back in March, following a weak February – especially in the financial sector. The recovery in bonus payments in March and April had nevertheless been greater than expected so that the annual growth of total average weekly earnings – at 2.0% in the three months to April – had been stronger than expected. Excluding bonus payments, pay growth had been only a touch stronger than assumed, at 2.3% in the three months to April by comparison with a year earlier. In the private sector, annual regular pay growth had been 2.4% in the three months to April, consistent with the *May Inflation Report* projections.

24 Taken as a whole, survey indicators of capacity pressures within firms had remained above their historical averages, but the spread of those indicators remained unusually wide, making it difficult to take a clear signal. Information from the Bank's Agents had suggested that recruitment difficulties remained greater than usual, but



that the proportion of firms reporting severe recruitment difficulties had roughly halved since the third quarter of 2015. Primarily, this was reported to reflect firms' less aggressive recruitment intentions. But there had also been reports from the Agents' contacts that recent staff training and process redesign within firms had reduced skills shortages somewhat.

25 The Bank/TNS survey measures of inflation expectations one and two years ahead had increased a little in May by comparison with the previous survey in February. In contrast to measures of longer-term inflation expectations derived from financial market prices, the Bank/TNS measure of expectations five years ahead had increased sharply, by 0.5 percentage points, to a little above its historical average. The Citigroup measure of expectations five-to-ten years ahead, however, had remained subdued.

### **The immediate policy decision**

26 The Committee set monetary policy to meet the 2% inflation target, and in a way that helped sustain growth and employment. Twelve-month CPI inflation had remained well below the target in May, at 0.3%. The shortfall relative to the target continued predominantly to reflect unusually large drags from energy and food prices. Core inflation had also remained subdued as a consequence of weak global price pressures, past movements in sterling and restrained domestic cost growth. Looking ahead, the anticipated pickup in inflation depended on both a lessening drag from external factors and an increase in domestic cost growth.

27 On balance, the news since the *May Inflation Report* had done little to change the MPC's assessment of the economic outlook at home and abroad or the main risks to that outlook. Domestically, productivity growth had remained weak. Inflation had remained below the target. There were good reasons to expect that the growth of domestic costs, and wages in particular, would continue to recover; but they had not yet done so to rates that would be consistent with meeting the inflation target in the medium term. Internationally, a modest pace of growth in the United Kingdom's main trading partners remained the most likely prospect.

28 Although these underlying factors remained central to the outlook, the main focus of the Committee's policy discussion this month concerned the difficulty in identifying the underlying momentum in the domestic economy, amidst the influence on activity of uncertainty related to the EU referendum. Measures of uncertainty had increased further over the past month, with the UK a clear outlier internationally. And there had been growing evidence that uncertainty about the outcome of the referendum was leading to delays to major economic decisions that were costly or difficult to reverse. In the corporate sector, this included a sharp decline in the value of commercial real estate transactions and M&A, and reports of delayed business investment. Evidence from the Bank's Agents had suggested increased delays in corporate decision making, which was corroborated by a Deloitte survey of chief financial officers. Survey information from Markit/CIPS and the BCC showed that for a material proportion of responding firms the referendum was having a detrimental effect on business activity, sometimes significantly so. Regarding households, both car purchases and residential

housing activity had declined, although it was difficult to isolate the extent to which these effects related to the referendum or a more general underlying slowing.

29 By contrast, some UK activity data had remained resilient, particularly regarding other consumer spending. Retail sales growth had been stronger than expected in April. And consumer confidence indicators had, as a whole, remained healthy. Industrial production had surprised to the upside in April, although some of that movement was likely to prove erratic. A number of business activity surveys had ticked up in May.

30 As the Committee had previously noted, potential referendum effects were making economic data releases more difficult to interpret, and the Committee was being more cautious in drawing inferences from them than would normally be the case.

31 It was clear that the EU referendum was having an influence on financial markets, with evidence that changes in the likelihood of a 'leave' vote was having an increasingly widespread impact on asset prices. Uncertainty about the result of the referendum had continued to have a strong effect on sterling exchange rates, with some sharp movements in sterling during the month following the release of opinion polls. In addition, UK short-term interest rates and measures of UK bank funding costs appeared to have been materially influenced by opinion polls about the referendum. These effects had also become evident in non-sterling assets: market contacts had attributed much of the deterioration in global risk sentiment to increasing uncertainty ahead of the referendum. The outcome of the referendum continued to be the largest immediate risk facing UK financial markets, and possibly also global financial markets.

32 A vote to leave the European Union could materially affect the outlook for output and inflation. In the face of greater uncertainty about the UK's trading arrangements, sterling was likely to depreciate further, perhaps sharply. The behaviour of sterling in response to opinion polls over the past month made this seem increasingly probable. Past evidence suggested that a general increase in uncertainty led to households deferring consumption and businesses delaying investment, lowering labour demand and increasing unemployment. Asset prices might fall, leading to tighter financial conditions with further deleterious effects on consumption and investment. Through financial market and confidence channels, there were also risks of adverse spill-overs to the global economy. Slower capital accumulation and the need to reallocate resources across the economy in response to changing trading and investment patterns would be likely to reduce potential supply over the forecast period.

33 Taken together, the combination of movements in demand, supply and the exchange rate could lead to a materially lower path for growth and a notably higher path for inflation than in the projections set out in the *May Inflation Report*. In those circumstances, the MPC would face a trade-off between stabilising inflation on the one hand and output and employment on the other. The implications for the direction of monetary policy would depend on the relative magnitudes of the demand, supply and exchange rate effects. The MPC would take whatever action was needed, following the outcome of the referendum, to ensure that inflation expectations remained well anchored and inflation returned to the target over the appropriate horizon.

34 Taking into consideration all of the recent developments, all Committee members judged it appropriate to maintain the current stance of policy at this meeting.

35 The MPC's projections in the May *Inflation Report* were conditioned on continued UK membership of the EU. On that assumption, the MPC judged it more likely than not that Bank Rate would need to be higher at the end of that period than at present in order to return inflation to the target in a sustainable manner. 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.

36 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.

37 During the course of its meeting, the MPC was briefed on the Bank's contingency planning for the referendum. The issues discussed included:

- the more intensive supervision by the Prudential Regulation Authority of major financial institutions to ensure they had sufficient liquidity, including in foreign currencies;
- the Bank's sterling liquidity facilities, including the additional Indexed Long-Term Repo (ILTR) operations, announced by the Bank on 7 March for the weeks around the EU referendum. These and other facilities meant the Bank was well placed to address liquidity needs and support the functioning of financial markets;
- the access of many banks with foreign operations to liquidity facilities of foreign central banks;
- the Bank's continuing weekly dollar repo operations and its maintenance of swap lines with other central banks; and
- a number of financial stability measures available to the Financial Policy Committee.

38 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

Dave Ramsden was present as the Treasury representative.

As permitted under the Bank of England Act 1998, as amended by the Financial Services Act 2012, Don Robert was also present on 13 June as an observer in his role as a member of the Oversight Committee of Court.