BANK OF ENGLAND

Minutes of the special Monetary Policy Committee meeting ending on 10 March 2020

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These are the minutes of the special Monetary Policy Committee meeting ending on 10 March 2020.

This meeting was convened by the Governor under the provisions of paragraph 10(2) of Schedule 3 to the Bank of England Act 1998, as amended by the Bank of England and Financial Services Act 2016.

They are available at https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2020/13march-2020.

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 25 March will be published on 26 March 2020.

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1 The Governor convened a special meeting of the Monetary Policy Committee (MPC) to consider the response of monetary policy to the economic shock from Covid-19. In these extraordinary circumstances, the meeting had been called under the provisions of paragraph 10(2) of Schedule 3 to the Bank of England Act 1998, as amended by the Bank of England and Financial Services Act 2016.

2 In the run-up to its special meeting, the MPC had, jointly with the Financial Policy Committee (FPC) and the Prudential Regulation Committee (PRC), been briefed by Bank staff on recent developments, including: monetary and financial conditions; the international economy; and current economic conditions. In preparation, Bank staff had been briefed extensively by health experts who had been advising the Government.

3 The MPC recognised that the front line of combatting the challenges of Covid-19 comprised the extraordinary efforts of NHS health professionals, carers, and volunteers across the country, as well as the exceptional support by the FCO to UK citizens abroad.

4 The Bank of England's role was to help UK businesses and households manage through an economic shock that could prove sharp and large, but should be temporary.

Monetary and financial conditions

5 Since the January MPC meeting, risk appetite in global financial markets had deteriorated substantially, reflecting an escalation of concerns about the global impact of Covid-19. The largest moves in advanced economies had taken place since 19 February, following the marked rise in the number of reported cases of the disease in Italy. Risky asset prices had fallen substantially, reflecting a combination of lower central growth expectations and an increase in perceived downside risks and risk aversion, partly offset subsequently by expectations of policy stimulus. Taken together, these asset price moves implied a material tightening in both UK and global financial conditions. Measures of option-implied volatility had picked up sharply, to historically elevated levels. There had been a marked decline in market liquidity and functioning, especially in fixed income markets.

6 Major equity indices had fallen sharply over the period since the MPC's January meeting as a whole, and some of the daily moves had been very large by historical standards. The S&P 500 equity index was down by 12%, the Eurostoxx by 21%, the FTSE All Share by 20% and the MSCI emerging market equities index by 12%. Both investment-grade and high-yield corporate bond spreads had widened materially over this period. Primary issuance had been affected severely. Global equity and corporate bond funds had seen substantial net outflows in the immediate period leading up to the MPC's special meeting.

7 UK bank funding costs had picked up. Wholesale unsecured funding spreads had increased somewhat, and were around 60 basis points higher than at the time of the MPC's previous meeting. Bank CDS spreads and option-adjusted spreads on UK banks' additional Tier 1 issuance had also risen. Major UK banks' equity prices had fallen markedly.

8 Short-term interest rates had fallen substantially over the period, in anticipation of a policy response from major central banks. On 3 March, the US Federal Open Market Committee had reduced the target range for the federal funds rate by 50 basis points, to 1 to 1¼%, and there had also been monetary responses from a number of other central banks, including the People's Bank of China, the Bank of Canada and the Reserve Bank of Australia. Market pricing implied that central banks were expected to take further monetary policy action. In the United Kingdom, market pricing had indicated an expectation that Bank Rate would be around 40 basis points lower by the time of the scheduled MPC meeting ending on 25 March.

9 Long-term interest rates had also fallen materially since the MPC's previous meeting, reaching record lows. Ten-year government bond yields were now lower by around 85 basis points in the United States, 45 basis points in Germany and 35 basis points in the United Kingdom. In part, this had reflected safe-haven flows. The US dollar had appreciated by around 2½% since the MPC's previous meeting, while sterling had depreciated by around 2%.

10 There had been a marked worsening in market functioning at the end of the week prior to the MPC's special meeting, both in the United Kingdom and globally. In fixed income markets, bid-offer spreads had widened, and market depth had become noticeably lower, contributing to some very sharp price moves. Foreign exchange swap market liquidity had also been very poor, although spot market functioning had been orderly. Forward Libor-OIS spreads had been volatile, and had widened significantly. Market contacts reported that this illiquidity had, in part, reflected operational constraints, as firms implemented contingency plans to mitigate the virus and minimised the risks they took on their balance sheets.

11 The Bank's Agency contacts had reported that there was limited evidence so far of any additional tightening in credit availability for businesses related to Covid-19, although companies noted that relatively widespread short-term bridging credit could be needed in the near future.

The international economy

12 Data and surveys of international activity relating to earlier periods had been broadly in line with the stabilisation of global GDP growth embodied in the January *Monetary Policy Report* projections. There had, however, been notable weakness in business surveys relating to the period since concerns about Covid-19 had become elevated in various countries.

13 The fall in the JP Morgan global composite PMI in February had been the largest since October 2001. It had reached 46.1, its lowest level since 2009, indicating a sharp contraction in activity. Within this, the global manufacturing PMI had fallen steeply, reflecting the severe disruption from Covid-19 to demand, international

trade and supply chains. There had been falls in the output, new orders, new export orders, employment, output prices and future output sub-indices.

14 The weakness in survey indicators had been most apparent in China. The NBS manufacturing index had fallen to 35.7, with the new export orders component down to 28.7, and the Caixin services PMI had fallen to 26.5. These had been the weakest readings on record. In addition, higher-frequency data outturns had been weak, with exports in January and February having contracted by 17% on the same period a year earlier. This pointed to a broad-based contraction in economic activity in 2020 Q1, which largely reflected the implementation of significant measures to contain the spread of Covid-19, including widespread travel restrictions and factory closures throughout the country.

15 In advanced economies, the drop-off in survey indicators had been less pronounced so far, although there were already signs of some impact from Covid-19. In the United States, the manufacturing PMI had fallen slightly in February, with the production index particularly weak. In the euro area, both manufacturing and services PMIs had increased a little in February, although those surveys had been conducted before the outbreak of Covid-19 in Italy. In both the United States and the euro area, rises in the supplier delivery indices suggested that supply chains had been impacted by Covid-19. It was likely that near-term GDP growth would be much weaker than previously expected once the effects of Covid-19 were fully apparent.

16 In response to signs of weakening activity, several countries had announced a range of targeted fiscal measures, including temporary support for businesses and households facing cash flow pressures arising from Covid-19.

17 Spot oil prices had fallen very significantly since the MPC’s January meeting, by $23 per barrel, to $37. This had reflected general concerns about the weakness of global demand, followed by reported disagreements between major producers about the possibility of oil production cuts.

Current economic conditions

18 Official activity data and surveys released since the Committee’s previous meeting had generally been in line with, or marginally stronger than, the January *Monetary Policy Report* projections, in which UK GDP growth was expected to pick up modestly from the below-potential rates seen at the end of 2019.

19 However, these data related to the period before the escalation of concerns about the impact of Covid-19, which was likely to provide a sizable drag on activity in the coming months. Some respondents to February business surveys had highlighted potential impacts of Covid-19 on the economy, including on supply chains via extended supplier delivery times and the reduction in export demand for their products. One timely survey had been released by the Institute of Directors, which had been conducted between 28 February and 9 March. 21% of respondents had reported that Covid-19 posed a high or severe threat to their business, with 43% saying that it posed a moderate threat. A set of timely indicators of activity monitored by Bank staff had identified some widening adverse impacts of Covid-19.

20 The Bank's Agents had gathered intelligence on the initial economic impact of Covid-19. While the evidence was limited so far, its effects were broadening and moving fast. A number of manufacturers had reported disruption to supplies, particularly where they sourced components or inputs from China. Customer caution and travel restrictions imposed by companies and overseas authorities had led to lower demand within the hotel and transport sectors. Some supermarkets had reported stronger demand from stockpiling activity among consumers, as well as a sharp increase in home deliveries. However, there was some evidence of lower consumer demand for other products such as clothing, including through spillover effects from lower tourism. Generally, companies had reported that they were very uncertain about the severity and duration of the economic impact from Covid-19.

21 The most recent labour market data had been broadly in line with the January *Report*. The unemployment rate had remained at 3.8% in the three months to December. Whole economy total and regular pay growth had both softened, to 2.9% and 3.2% respectively, in the three months to December.

22 Twelve-month headline and core CPI inflation had increased to 1.8% and 1.6% respectively in January. The rebound in CPI inflation, from 1.3% in December, had been in line with the projection in the January *Report*. Core services CPI inflation had been unchanged at 2.1%, in contrast to an expected uptick and reflecting news in accommodation services and other transport services. In the January *Report* forecast, a renewed drag from energy prices pushed the CPI forecast for April to June down to 1.3%. The sharp fall in the oil futures curve had resulted in a lower short-term forecast for inflation. CPI inflation was now expected to fall back slightly in February and March, before dropping to around, and possibly below, 1% in April.

The immediate policy decision

23 The MPC sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment.

24 At the time of the Committee's January meeting and prior to the escalation of the spread of Covid-19, UK GDP growth had slowed and CPI inflation had been below the MPC's 2% target. There had been signs in the most recent indicators that global growth had stabilised and that the near-term uncertainties facing domestic businesses and households had receded. UK GDP growth had been projected to recover over the forecast period in the January *Monetary Policy Report*, supported by a pickup in global activity and a further decline in Brexit uncertainties, as well as the Government's measures announced in *Spending Round 2019*.

25 In the period following the MPC's previous meeting, the spread of Covid-19 and the measures that were likely to be needed to contain the virus had evolved rapidly, with significant associated impacts now expected on economic activity. The Committee considered: the epidemiological evidence on the potential spread of Covid-19; the evidence available so far on its economic impact; the channels through which the disease was likely to affect the UK economy; and the appropriate monetary policy response, taking into regard the actions of other Bank policy committees and the fiscal response of the UK government.

26 Taken together, the sharp asset price movements since the MPC's previous meeting implied a material tightening in financial conditions, and were consistent with a marked deterioration in risk appetite and the outlook for global and UK growth. There had been notable weakness in business surveys relating to the period since concerns about Covid-19 had become elevated in various countries. The weakness in survey indicators had been most apparent in China and pointed to a broad-based contraction in activity.

27 Oil prices had fallen by about 40% since the MPC's previous meeting, reflecting both demand and supply factors. That was likely to result in a lower short-term inflation forecast, which would now incorporate a fall in CPI inflation to close to, and possibly below, 1% in the spring.

28 There was little evidence available yet to assess the impact of Covid-19 on the UK economy. Some respondents to February business surveys had highlighted the effects of the virus on supply chains via extended supplier delivery times and the reduction in export demand for their products. Intelligence from the Bank's Agents suggested that demand in some sectors was beginning to be affected.

29 Although the magnitude of the shock from Covid-19 was highly uncertain, the MPC judged it likely that activity would weaken materially over the coming months. This shock would affect both supply and demand in the economy.

30 The supply capacity of the economy was likely to be reduced temporarily through a number of channels. Some people would be unable to work for a period of time and many were likely to need to adjust their working arrangements. Disruptions to supply chains could also constrain companies' production.

31 There were also likely to be significant demand effects. People who were isolated at home would probably spend less. Others might cut back on forms of consumption that could be delayed or involved social activities. There could be substantial broader uncertainty effects, including on major purchases and for corporate investment plans. Demand for UK exports would reduce as global GDP growth and trade was affected. In addition, substantial falls in risky asset prices would dampen spending. The resulting weaker activity, alongside the temporary, but significant, disruptions to supply chains could challenge cash flows and increase demand for short-term credit from households and for working capital from companies.

32 Ahead of the Budget on 11 March, the HM Treasury representative briefed the MPC on the measures to be announced. The Budget would include a package targeted directly at addressing the challenges likely to be associated with the spread of Covid-19 within the United Kingdom. This would include: extra spending on the NHS; changes to Statutory Sick Pay rules; changes to the timing of welfare payments; and a number of other measures for businesses including Time to Pay and relief on business rates.

33 The Committee decided, in these extraordinary circumstances, to act in concert with HM Treasury in order to ensure that the various initiatives to be announced were complementary and that they would, collectively, have maximum impact. Such an approach remained consistent with the MPC's independent responsibilities.

34 The Budget would also announce a significant medium-term fiscal loosening, in addition to the short-term increase in public expenditure in *Spending Round 2019* that had already been incorporated in the MPC's January projections. Government investment would now be materially higher in the medium term, with a focus on large-scale infrastructure projects. The MPC would consider the full macroeconomic implications of these measures following the Budget and ahead of its next, regularly scheduled, policy meeting.

35 The Governor briefed the MPC on the actions that had been agreed by the FPC and the PRC in response to the economic shock from Covid-19.

36 The FPC would announce a reduction in the UK countercyclical capital buffer rate to 0% of banks' exposures to UK borrowers with immediate effect, and expected to maintain that rate for at least 12 months, so that any subsequent increase would not take effect until March 2022 at the earliest. The release of the countercyclical capital buffer would support up to £190 billion of bank lending to businesses. That was equivalent to 13 times banks' net lending to businesses in 2019. Given the resilience of the banking system, businesses and households should be able to rely on banks to meet their need for credit to bridge through a period of economic disruption.

37 The release of the countercyclical capital buffer would reinforce the expectations of the FPC and the PRC that all elements of banks' capital and liquidity buffers could be drawn down as necessary to support the economy through this temporary shock. In addition, the Prudential Regulation Authority (PRA) would set out its supervisory expectation that banks should not increase dividends or other distributions, such as bonuses, in response to these policy actions. In response to the material fall in government bond yields in recent weeks, the PRC would also invite requests from insurance companies to use the flexibility in Solvency II regulations to recalculate the transitional measures that smoothed the impact of market movements. This would support market functioning.

38 Even with those significant policy measures, the MPC judged that there was likely to be a material near-term weakening of activity related to Covid-19. Such a fall in activity, if left unaddressed, could lead to longer-lasting effects on the medium-term prospects for the economy. In addition, any temporary weakness in activity would probably reflect a greater fall in demand than in supply, opening up a wider margin of spare capacity in the economy for a period.

39 The MPC agreed that in these extraordinary circumstances, and alongside other policy responses, there was a role for monetary policy to help UK businesses and households bridge a sharp but temporary reduction in activity. Monetary policy stimulus would help to keep firms in business and people in jobs, and help to prevent a temporary disruption from causing longer-lasting economic harm.

40 The Committee discussed the extent to which Bank Rate should be reduced. Given the likely scale of the economic shock from Covid-19 and the desire to help businesses and households bridge across it, a strong case could be made for a large reduction in interest rates at this meeting. All MPC members agreed that a 50 basis point reduction in Bank Rate was warranted. The Committee would learn more about the scale and propagation of the shock, and its impact on the economy, over coming weeks and months.

41 This reduction in Bank Rate would help to support business and consumer confidence at a difficult time, to bolster the cash flows of businesses and households, and to reduce the cost, and improve the availability, of finance.

42 With interest rates low, it was likely to be difficult for some banks and building societies to reduce deposit rates much further, which in turn could limit their ability to cut their lending rates. In order to mitigate these pressures and maximise the effectiveness of monetary policy, the MPC considered the establishment of a scheme that would provide funding to banks and building societies at rates at, or very close to, Bank Rate. Such a scheme could also provide participants with a cost-effective source of funding to support lending to the real economy, and provide insurance against adverse conditions in bank funding markets. A scheme that provided additional funding to banks that expanded net lending could also support the supply of credit to businesses and households. The MPC judged that it was particularly important to incentivise lending to the small and medium-sized enterprises (SMEs) that typically bore the brunt of contractions in the supply of credit during periods of heightened risk aversion and economic downturns.

43 In order to meet these objectives, the MPC discussed launching a Term Funding scheme with additional incentives for Small and Medium-sized Enterprises (TFSME) that would, over the next year, offer four-year funding of at least 5% of participants' stock of real economy lending at interest rates at, or very close to, Bank Rate. Banks would be able to access another pound of funding for every pound that their non-SME net lending expanded, with five pounds available for each pound of positive net lending to SMEs. Experience from the Term Funding Scheme launched in 2016 suggested that the TFSME could provide in excess of £100 billion in term funding to banks and building societies.

44 Should the MPC need to provide further monetary stimulus, there were a number of options at its disposal, including cutting Bank Rate further, enlarging the TFSME, and expanding asset purchases.

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

Bank Rate should be reduced by 50 basis points to 0.25%;

The Bank of England should introduce a Term Funding scheme with additional incentives for Small and Medium-sized Enterprises, financed by the issuance of central bank reserves, that would: help reinforce the transmission of the reduction in Bank Rate; provide participants with a cost-effective funding backstop; and incentivise banks to provide credit to bridge economic disruption, particularly to SMEs by providing an additional five pounds of funding for every pound of positive net lending to them;

The Bank of England should maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £10 billion;

The Bank of England should maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435 billion.

The Committee voted unanimously in favour of all four propositions.

46 The Committee agreed to announce its policy decision as part of a Bank of England statement on measures to respond to the economic shock from Covid-19 that was due to be released on 11 March 2020. It also agreed that the minutes of this meeting would be released on 13 March 2020.

47 The Bank would issue a Market Notice on the TFSME on 11 March 2020.

48 The Committee agreed a remote attendance procedure for MPC meetings during the period of the Covid-19 outbreak in the United Kingdom, should it be required.

49 The following members of the Committee were present:

Mark Carney, Chair
Ben Broadbent
Jon Cunliffe
Andrew Haldane
Jonathan Haskel
Dave Ramsden
Michael Saunders
Silvana Tenreyro
Gertjan Vlieghe

Clare Lombardelli was present as the Treasury representative.

Andrew Bailey was present as an observer.

As permitted under the Bank of England Act 1998, as amended by the Bank of England and Financial Services Act 2016, Bradley Fried was present, as an observer for the purpose of exercising oversight functions in his role as a member of the Bank's Court of Directors.