BANK OF ENGLAND

MEETINGS OF THE MONETARY POLICY COMMITTEE
October 2015

A meeting of the Monetary Policy Committee was held on Friday 2 October 2015. 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

James Richardson was present as the Treasury representative

The following members of staff were present:

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

Transcript of the Monetary Policy Committee Meeting on

Friday 2 October 2015

Governor Carney. Good morning everyone. We'll start off with Andy, see if anything came out overnight. I don't have any data.

Andrew Haldane. So we've had the usual litany of PMIs internationally, and let me mention one or two of those. So Jon at the meeting yesterday, I think, covered the euro-area PMIs for manufacturing. But we've also now had in the US two sets of PMIs for manufacturing, which actually point in rather different directions. One of them ticking up a touch - that's the Markit measure - and the ISM measure was quite a bit lower, in fact its lowest reading since May 2013. So for manufacturing in the US, that's mixed. We had some Japanese PMIs for manufacturing, which fell. And we had some services PMIs for China, which were also weaker, and the last of those I think has caused the staff to shade down their nowcast for China in Q3 by 0.1 percentage points. The big international news of course will be with us today with the non-farm payrolls.

Turning domestically, what have we had? Well, we've had the manufacturing PMI for the UK for September. In the output series that was ever so slightly stronger. The expectation series was weaker, but if you take that together with the picture we saw earlier on the composites, it seems likely therefore that we'll have seen a weaker services picture, but we don't yet have that breakdown. In September we had the BCC Quarterly Economic Survey, which was reasonably positive, where the balance is still above average. A bit of a contrast there between the domestically facing and externally facing balances with the latter weaker. And then finally we had yesterday the REC Recruitment Survey for September. Not huge amounts of news in that I don't think. On the wages and salaries side, the balance was pretty much flat month on month, it remains around the top of the swathe although that difference isn't what it once was. Vacancies down ever so slightly, but most of the metrics are still in tight labour market territory. Thank you.

Governor Carney. Thank you Andy. Alright let's kick off starting with Ben.

Ben Broadbent. Thank you Governor. We had what I thought were useful discussions yesterday about gradualism, about exchange rate pass through and also the interaction between news in economic data and moves in financial markets.

Those moves have been significant since the last Inflation Report. In dollar terms, equity indices are down around 10% in the US, the euro area and the UK. We asked ourselves whether this reflected a downwards adjustment in markets' central expectation of global growth or an increase in the negative skew over possible future outcomes. My own view is that the second must have played at least some part. By my reckoning, if nothing else happened, you'd need a drop in the central forecast of earnings growth of close to 1 percentage point, in perpetuity, to produce a 10% fall in prices. Perpetuity is a long time; if it covered the next four years - still a reasonable period of time, but one that accounts for less than a quarter of the value of equities - given the kind of discount rates that apply to corporate earnings the drop in modal growth expectations would have to have been that much more severe, enough to drive the world as a whole into outright recession for four years. So I think it likely that risk premia have risen.

But in all probability both have been at work, to one degree or another. And perhaps, if businesses share those more pessimistic assumptions about future earnings, the distinction between mode and skew doesn't much matter: in a "q" model, investment would be expected to suffer either way.

As yet, there are few signs in the real economic data of such a slowdown. In emerging markets, the big commodity producers remain mired in recession; some other EM economies, particularly in South America, also look to be slowing. But the Chinese data, for what they're worth, have been reasonably steady, as have been those in much of the developed world. The euro area PMIs that we had yesterday were a touch softer this month, but still above the average for the rest of this year, and that average is itself higher than over any equivalent period since early 2011. The same goes for our forecasts of euro area GDP growth through 2015. We currently expect annual growth of 1.8% in the fourth quarter, a four-year high. US growth, while hardly spectacular, also appears to be holding up for the present. In the second half of the year it is projected at the same 2½ % annualised rate as in the first.

Indeed if there is anywhere in the developed world where there are signs of somewhat softer growth - albeit from relatively high rates - it's the UK. We now expect growth of 0.6% in the quarter just past, down from an earlier estimate of 0.7%. After pretty strong figures through 2013 and 2014, that would pull the annual rate of GDP growth to a two-year low of 2.7%. The peak was 3.7% according to the backcast.

Andy suggested yesterday that this might tell us r* hasn't been rising, or perhaps even falling. That's possible and if risk premia are higher, and fiscal tightening re-intensifying, perhaps those forces have further to run. But I don't think it's the only possible explanation for the slowdown in growth here.

First, cycles have a natural shape even when r* is stable: it's normal to see some slowing after the first flush of a recovery, during which investment in particular grows strongly. That's been exactly the shape of our forecasts, even against a backdrop of gently rising policy rates, for some time.

Second, the exchange rate has strengthened significantly during the past couple of years, more than it usually does in recoveries. That reflects slower domestic demand growth elsewhere and, over the past year, the effects of easing by the ECB. That easing would presumably help growth in the euro area, but the effects of sterling's appreciation may well be being felt first.

Third, if there had been things pushing down on r* they would have to have been pretty large to offset what has been a marked fall in lending spreads, particularly on mortgages. This fall now looks to be gaining traction in the housing market: after peaking in the low 70,000s, in late 2013 and early 2014, monthly mortgage approvals then fell to less than 60,000 a month last autumn; they've since rebounded to just over 70,000 again in the latest figures for August. There has been a similar pattern in both transactions and housing starts, all of which points to firmer growth of housing investment and some parts of durable consumption in the months ahead.

All that, coupled with a slight fall in the exchange rate, and our new assumptions on pass-through, represents a rather rich mix of news, one that will have to wait until November to be fully processed.

But I will try and give a brief guess of how I think it adds up. First the financial room for investment growth does look a little wider than before. The easing in credit supply will boost housing investment, probably by more than we expected in August. Better figures on FDI income, coupled with downward revisions to past business investment will have raised significantly estimates of the corporate financial balance. And unlike their US counterparts UK business seem to see more value in real productive capital than in buying back their own equity, although the recent drop in share prices might, of course, change that balance. Second, after steep falls in saving rates, and although those have been exaggerated by declines in contributions to pension funds, consumption growth can only be sustained by continuing growth in productivity. That is also the big picture for the economy as a whole.

Third, it may be that, having already been towards the lower end of the pack on global growth, we won't have to revise down our forecasts for the world as much as others, if at all. But those forecasts were hardly very strong, and there are good reasons, it seems to me, to retain a downside skew. Without a more significant reversal in the exchange rate, the world will not be lending much support to demand, even if we finally get some on FDI receipts.

And finally, on the nominal side, wage growth is clearly chugging along now at a healthier rate than it was a year ago and unit costs have also accelerated a little. But those growth rates don't look much faster right now, as we enter the second half of the year, than they did a few months ago. That doesn't mean we should abandon our forecast of further increases in unit cost growth in the quarters ahead; but nor does it mean, as far as I can see, we'll have to pull it forward.

So all, in all, I don't see much reason to alter my view from last month as far as policy is concerned. I therefore expect to vote next week for no change in either Bank Rate or asset purchases.

Governor Carney. Thank you Ben. I have Martin and then Jon.

Martin Weale. Thank you, Governor. As last month the main international issue seems to be the financial market consequences of the disturbances emanating from China after its modest or against sterling, no depreciation, and the weakness of the stock market and the response of the FOMC, which was itself strongly influenced by these.

As yet, I do not see any reason to revise my view that the direct effects of the financial disturbances from China are likely to be small. The work ahead of the benchmark forecast for November suggests that, relative to what was in our forecast in August, and offset by policy adjustments, the disturbances have had no effect on Chinese growth, at least in the near term. World growth, on the other has been a bit weak but probably less so for UK-weighted GDP than in measures based on purchasing power parities which overstate the importance of developing countries. Upward revisions to euro area data have been encouraging.

The key issue over China remains whether developments there will start to have a material effect on business and consumer confidence, or on financial conditions in the advanced economies and in the United Kingdom in particular. So far I do not think that despite stock market weakness there is material evidence of this. There is of course a risk that things might worsen, for example if there is a run on the renminbi which China is unable to meet from its reserves. One point which did strike me was the increase in UK bank funding costs, perhaps as a consequence of some changes in conditions in international financial markets. But, despite this, it now seems that mortgage rates are likely to be lower than we had assumed in August and the financial conditions index suggests that overall financial conditions remain loose.

Bank staff have produced three important pieces of work over the last month, all of which are material to my vote. First of all, the direct evidence from the labour market suggests that the fall in unemployment has slowed substantially mainly because of increased labour market frictions which may leave the natural rate higher than I had thought. The actual unemployment rate, at 5.5% is unchanged from the February to April quarter and the August claimant count is very marginally up on July. The Agents' survey supports the idea that firms are having difficulty recruiting, as would be expected in a tight labour market. An analysis of the natural rate in the context of the Phillips curve points to a figure of u* of 5.3%. Taken together these observations suggest a situation where any further increase in labour demand seems likely to lead to an increase in wage pressures. It is also possible, of course, that the revival in inflation from its current value of zero, which we are forecasting for the end of the year, could lead to some increase in pay growth. This analysis served to strengthen the case for an increase in Bank Rate, especially if combined with the view that equilibrium hours worked per employee are a bit lower than previous evidence had suggested.

The observation is re-enforced to some extent by the latest estimates of labour cost growth from the national accounts. Unit labour costs rose by 0.45% in Q2 and 1.8% over four quarters to Q2.[1] On the other hand they were inflated to some extent by pension contributions. Unit wage costs rose by 1.5%. Even this, because it includes an estimate of movements in mixed income, is higher than the 1.2% computed from AWE and productivity growth.

Our August forecast for four-quarter growth of 2% in unit labour costs at the end of the year, but only for 1.3% to the second quarter of this year. At this stage I think it is too early to say that labour costs are clearly running ahead of our forecast; nevertheless even unit wage costs point to a picture which, at least for the time being, is a bit stronger than we had expected.

The second piece, which owes much to Kristin as well as Bank staff, was on exchange rate pass-through. While this suggested that the assumptions we made in August were largely consistent with what has been learnt since then, it also suggested that our current approach is rather unsatisfactory and should be complemented by an analysis in terms of primary shocks. In such a framework a pure exchange rate shock would probably be seen as originating from a shock to the risk premium on domestic currency relative to foreign currency. Anyway COMPASS may provide some sort of structural basis for looking at the effects of primary shocks on both the exchange rate and on domestic inflation. I would find it helpful to see an analysis of recent shocks using that as the structural framework within which to interpret them. At present, however, it seems that in the short term there is no good reason for deviating from the assumption we made in August.

[1] MPC Secretariat clarification: this figure is based on the Bank's backcast for GDP.

The third piece of work concerned the time profile of the effects of monetary policy changes on inflation. This suggested that the maximum impact in the UK probably comes after about five quarters, rather than the six to eight quarters or so that we had assumed earlier. This work suggested to me that policy adjustments need to anticipate actual inflation by rather less than I had assumed to be the case; this then presumably weakens the case for an immediate interest rate rise. At the same time further thought needs to be given to the issue bearing in mind what I have taken since February of last year to be a general aim of the Committee, that interest rate increases should, if possible, be gradual.

The essence of the point is that five quarter forecasts are almost certainly more volatile than eight quarter forecasts because the disturbances which push actual inflation away from its target are more attenuated after eight than five quarters. So targeting inflation at five quarters would be likely to imply greater interest rate volatility than targeting it at eight quarters. This greater volatility seems to me to imply greater risk of policy reversals and may also imply less in the way of gradualism. The issue blurs into the question you raised, Governor, because what is attenuated at eight quarters is more attenuated at twelve quarters. It suggests to me that a policy of focussing on inflation after slow-burn price level effects, such as those arising from exchange rate pass-through, have largely faded away, may deliver more gradual interest rate adjustment than would result from focussing on a horizon at which slow-burn effects are material. Anyway, I look forward to discussing the implications of the finding that the peak effects of monetary policy come earlier than we had previously thought.

As it stands, labour costs seem to be running a bit ahead of our forecast, and I find it hard to believe that the fall of the yield curve since our last meeting is consistent with the labour[2] target. The labour market data combined with the recent analysis, strengthened the case for an increase, but the work on transmission lags suggests prima facie that things are not as pressing as otherwise would be the case. Overall then, I'm expecting to vote for no change to Bank Rate and no change to our asset holdings.

Governor Carney. Thank you Martin. We'll take note of a couple of work items embedded in those comments. Jon and then Ian please.

Jon Cunliffe. Thank you very much. It has been for me a pretty uneventful month. There are a few small pieces of news that I'll comment on. Some go for me in one direction, some go the other way. But my big picture remains unchanged: the economy is evolving broadly in line with the August forecast.

There was little change in the international picture on the month. The latest outturns for world GDP disappointed relative to the August Inflation Report and the outlook looks a bit softer.

The US was a little stronger in the first half of the year, but there are indications it might be softening going into the second half. The staff have cut their expectation for Q3 by 0.1 percentage point to 0.5%. And eurozone growth in the first half of the year was likewise revised up. But looking forward the eurozone is a bit more vulnerable to EME slowdown than the US, and the ECB has as a result revised down its growth forecasts, citing emerging market-related risks and associated spillovers to asset prices.

I do think there is a little bit of a question mark over advanced economies now. I mean is growth slowing a touch, as Ian put it, as they throttle back a little to cruising speed? Or, having just about closed their output gaps, are they slowly beginning a gentle decent from the peak of a weak business cycle? I think that is a question but what does seem increasingly clear is that they are unlikely to climb appreciably further with a sustained period of above trend growth.

On China, I think the risk is that growth in the short term slows at a faster rate than we expected. That risk I think is perhaps a little less than we had last month given the authorities demonstration of their willingness to use policy levers vigorously. But as noted at Pre-MPC this will increase the challenges around the exchange rate. And using credit levers postpones action to deal with the debt. So overall, I think the tail risks in China have increased.

[2] MPC Secretariat clarification: speaker meant to say: "consistent with the inflation target".

Emerging market economies apart from China are clearly on a downward growth path. They continue to be under pressure from commodity price falls; capital outflows; the risk of US policy normalisation and contractionary moves in financial market prices. Russia and Brazil look particularly fragile. Indeed the staff have cut their estimate of PPP-weighted world growth in Q2 by 0.2 percentage points – about half of that was due to Brazil and Russia. Key question of course is how shocks from those will transmit to the UK.

We made a large downward adjustment to our global growth forecast in November 2014 and we've made smaller downgrades in each of the three subsequent forecast rounds (we also extended the downside skew on growth in the last forecast round). I think we need to consider quite carefully global growth again in the forecast round and particularly this question of links to the UK.

On the UK, the Blue Book revisions did not change the big picture for me. The recovery over 2011 to 13 looks a bit stronger. But the recovery also looks more unbalanced than hoped – being driven to a greater extent by consumption, and I do worry about that a little. There has also been more of a drop in the savings ratio than we previously thought. As Andy pointed out, taken over the first half of the year, the saving ratio is at its lowest level since 1963. However, it appears that saving out of available income, which is closer to the old measure, has remained around the same level since the start of 2014, and is not as close to its pre-crisis lows as the overall savings ratio.

And I take a little comfort from that. It is clear though that the burst of precautionary saving that was associated with the crisis and the post-crisis period has come out of the system. The savings rate peaked at over 10% in the crisis and was around 10% as recently as 2012. And the fall in the savings rate may well reflect higher consumer confidence which again remained high in September on historic levels. That fall in the savings rate could also be due to an increase in financial wealth – eg, housing equity which allows households to reduce their precautionary savings. But going forward if households are unwilling to see savings out of disposable income reduce very much further, where I think we have pencilled in a drop in the savings ratio in the forecast, that could act as a gentle brake, I think, on consumption. And maybe it's worth noting, if the savings rate falls materially further, that may also give us something to think about from a macroprudential perspective.

I'm less clear about whether the revisions in the Blue Book should change my view of business investment. That is something I'd park and put to be explained in the forecast round.

And moving beyond the Blue Book, there were also continued signs that housing market activity is coming back to life. As Ben said, mortgage approvals have picked up further to 71,000 in August, which is a bit higher than we anticipated in the August Inflation Report; net secured lending flows rose to £3.4 billion in August, that's the highest monthly flow since May 2008, and quoted rates on higher LTV mortgages continued to fall; and we saw a marked increase in the number of high-LTV five-year mortgage products coming on the market in September; and the provisional September RICS data continues to suggest some near-term momentum in housing prices. This looks to me to be a resumption of a housing market expansion that was temporarily lulled by the MMR, the election and possibly by FPC policy actions. Some of these raise FPC questions, but, from an MPC prospective, it should provide some boost for growth.

And there are other factors that could provide a tailwind to growth. Since the August Inflation Report the yield curve is 50 basis points lower at year three; sterling ERI is around 2.3% lower; and the sterling oil curve is around 9% lower. Looking at the impact of these factors in isolation can of course be misleading – the moves can reflect bad news from elsewhere and we'll get a better picture from the forecast. But simply using a ready reckoner from the forecast team, which does look at them in isolation, the effect of these changes on their own would be to increase the level of GDP by 0.6% and inflation by 0.4 percentage points by the end of the forecast. So it is quite important that we work those through the forecast and understand them.

Going the other way, labour market prices evolved, I think, largely as expected. Whole economy and private sector regular pay growth were 2.9% and 3.3%, respectively, in the three months to July, which is broadly what we expected. Total hours were 0.3% lower than expected last month and 0.6% less than we expected at the August Inflation Report.

Alongside the recent pickup in pay, productivity growth has been slowly coming back to life. It increased 0.9% in Q2 and 0.3% in Q1. And the four-quarter growth rate in Q2 was 1.5% - which is the highest rate we've had since 2011. Two swallows don't make a summer and I accept that. But it is encouraging and staff have revised up their forecast for year on year productivity growth in the fourth quarter of this year from 1.1% to 1.6%. And it's true that unit labour costs have grown a little faster than we had projected – the outturn I think was 1.8% for the year to the second quarter versus our forecast of 1.3%, as Martin has said. But the Q2 unit labour cost outturn was boosted by a strong increase in non-wage labour costs (such as pensions) and that can be volatile. Annual growth for unit wage costs as opposed to labour costs was 1.5% in the second quarter of this year. So labour costs continue I think to me to run below the rate consistent with returning inflation to target, particularly given the need to offset sustained external disinflation.

And finally, inflation expectations remain important given that we're continuing to have low headline inflation. But there's not much news there – household expectations ticked up a bit; financial markets expectations ticked down a bit, but I remain content that inflation expectations are well anchored around the inflation target.

So overall, as I said at the outset, my big picture view remains unchanged and my indicative vote is for no change in Bank Rate and no change in the stock of assets purchased.

Governor Carney. Thank you Jon. So Ian and then Kristin please.

Ian McCafferty. Thank you, good morning everyone. I thought the presentations and debate at both Pre-MPC and at our Deliberation meeting were particularly rich this month, with some very interesting insights, which, given that the real economy news and data surprises this month were few, I think is to be commended.

The two key questions, for me, remain as they were last month, and come as no surprise:

- Is more marked slowdown in China and other EMEs still mostly a downside risk, or should we now be building more of it into our central outlook, and how material could it be for the UK?
- And secondly, what can we tell about the evolving balance between demand and supply in the UK, and hence the balance of risks around inflationary pressures in the latter part of the forecast horizon?

On the first: clearly, the tail risks of a disorderly sharp slowdown in China remain, but the latest data are still consistent with a glide path in line with our current forecasts, with Chinese domestic consumption helping offset the slowdown in manufacturing and business investment. As Jon pointed out, the authorities' intolerance of slower growth has led to a rapid policy response, and while this must give us worries about simply postponing an even bigger problem, it should help support the central expectations for the economy over the near to medium term.

As an aside, I do wonder whether the apportionment of all of the recent upheaval in financial markets to the China story slightly oversimplifies the narrative. China is clearly very central. But I also think that some of the recent revaluation in equities is a commodities story, pure and simple. Of course, at one level, China and commodities are intimately intertwined, but the fundamentals suggest to me that there may also be more of an underlying supply story, particularly in minerals, than our financial decomposition of recent price moves suggests. The narrative is similar to that for crude oil - a long steady build up in supply capacity, driven by high prices a few years ago, now coming home to roost. As with oil, minerals are not fully transparent markets, such that adjustment to such fundamentals is not instantaneous. To the extent that some of the recent equity weakness is a commodity story, that may provide a little reassurance that perceptions of China may not be quite as bad as the falls in equity markets would imply.

With regional economic cycles so out of kilter, weighting what is happening in the global economy in terms of its import to the UK is critical. In market prices, and UK-weighted, the growth slowdown in EMEs, relative to the generally positive data for the advanced economies, should not be overstated. Recent data on the US and the eurozone has been reassuring, and PMI data for these and other important trade partners for the UK - certainly up to last week, I haven't taken account of those that

Andy read out this morning - showed their composite PMIs, on balance, holding up, as improving services activity offset the softer readings for manufacturing.

For me, there is little to suggest that last month's conclusion - that developments in EMEs represent a sizeable downside risk for the UK, but one that is yet to crystallise, and that unless the EME slowdown leads to more widespread financial instability, or loss of business confidence here at home, the impact is likely to be limited - I don't think that that conclusion yet needs to be changed.

On the second of my questions, about the state of the economy here at home.

Overall, I find it hard to believe, in the wording of yesterday's discussion question, that the UK economy is "running out of steam". The balance of activity is clearly shifting, with a slowdown in manufacturing offset by solid growth in domestic services, such that the net impact on GDP growth over the coming quarters is likely, in my view, to be small. The best description is one in which the economy may be slowing slightly, from well above-trend growth to closer to trend growth.

I find it hard to draw any firm lessons for either consumption or business investment from the revisions in the Blue Book, but for both, current conditions – survey data, income and profit growth, credit conditions and levels of confidence - still look favourable. Jan's point about the support provided by a strengthening housing sector I think is also well made. As such, subject to some possible nuanced shading of our quarterly GDP numbers, the growth path in the August forecast, of close to 0.6% per quarter, still looks reasonable.

The news on the labour market though continues to give me cause for concern. The Agents' special survey gives support to my worries that frictional difficulties are becoming more prevalent, this month's jump in the employment data notwithstanding. Moreover, my concerns over the future absorption of what little remaining slack we have left have been compounded by the staff analysis. I have suggested in the past that both h* and p* are not necessarily stable through the cycle, but can exhibit a strong correlation with real income growth, as individuals can earn a desired income with fewer hours, and as household second earners adjust their hours in response to the rising income of the primary earner. If this relationship holds over our forecast, we should assume some declines in both h* and p* over that period, more consistent with the latest data on actual hours. The implication of this, though, is that, not only might the current level of slack be slightly smaller than our August estimate, but also that through 2016, remaining slack is likely to be absorbed slightly faster.

This tightening in the labour market is at one with another month of upside news on private sector wage growth, now 3.4%, half a point higher than expected. This pick up is happening at a traditionally quieter period of the year for wage negotiations and settlements, and generates upside risk, in my view, to our wage forecasts in 2016 and 2017. With productivity growth improving, but only slowly, this is driving unit labour costs higher. I side with Jon and others that continued GDP growth will probably lead to some further cyclical pick up in productivity growth, but for me the upside risks to wages leave me unconvinced that unit labour cost growth will still be consistent with our inflation target, even allowing for the drag from import price pass-through, by 2017.

To finish, I thought I'd just make a couple of comments on our policy strategy discussion yesterday.

In steering monetary policy, data dependency must remain the pole star. And on data dependent grounds, I believe, as in a couple of previous months,[3] that there is already a good case to start the process of policy normalisation. But, for me, the case is strengthened, at least a little, by my views on gradualism. Such views should only influence a policy decision at the margin, but I do believe that there are merits in attempting to follow a strategy that maximises the learning process and minimises the risk of disruption to both consumers and businesses.

It may well be that the actual path of interest rates turns out little different to that which would otherwise have been justified by shifts in r*, such that gradualism (rather than just being gradual, in Ben's distinction) need not be a significant distortion to the optimal policy path. Gradualism is not "lower for longer". However, communicating that we are sensitive to the uncertainties around the impact of initial rate changes after such a long period of stasis can do no harm, as long as we then

[3] MPC Secretariat clarification: the speaker meant to say: "as in previous months".

deliver. Such a strategy does not, to me, mean that, as was suggested yesterday, lift off has to be 'a lot earlier' than would otherwise be the case, but it does mean we should avoid starting too late.

As a result, I think next week I expect to vote for a 25 basis point rise in Bank Rate and no change in asset purchases.

Governor Carney. Thank you Ian. So Kristin and then Andy please.

Kristin Forbes. There is nothing more frustrating than having something important to do and then the message flashes on your computer screen "please wait, system update". You can't rush the process. You just need to wait and watch to ensure the update is progressing as expected. This month has been a similar "waiting to update". Our forecast expects the economy to evolve in a way that would justify tightening monetary policy soon. But we need to ensure that the economy is evolving as expected - and that the process of inflation heading back toward target is not becoming derailed.

Although there has been no news this month that makes me think this process is becoming derailed, continued falls in commodity prices have unfortunately turned what started as a "system update" to "five more updates to go", "four more to go", etc….

And, just as we know that watching your computer update is not a good use of time, this month I found more informative insights on monetary policy in other analysis. For my comments today, I'll discuss what I see as the key "updates" to my views on the UK economy and other insights - for output, the labour market, inflation, and the timing of rate adjustments.

First, the output data has come in roughly as expected. Evidence continues to suggest growth will moderate slightly in Q3, but remain above trend for the next few quarters. Manufacturing continues to be weak - such as the manufacturing index of production falling by 0.8% in July. But the service sector, about 80% of output, continues to chug along. On a global level, the slowdown in manufacturing and weakness in commodity exporters and emerging markets continues. But growth in our major trading partners - the euro area and US - remains solid, even slightly stronger than expected. The transition we discussed at length last month is playing out; slower growth in China and other EMs, which generates falls in commodity prices and slower growth in global trade, but largely counterbalanced in UK-weighted GDP by a pickup in key developed economies.

The main surprise for me this month was that despite the alarming continuum of bearish headlines, we still do not have solid evidence of a substantially sharper slowdown in the global economy than built into our forecast. I found it particularly striking that even Chinese activity hasn't shown a sharp deceleration since June in many sectors - such as for retail sales, industrial output, exports, and imports. We're certainly not out of the woods. But Martin's summary yesterday was superb: "I see evidence of China's slowdown everywhere except in China." Yes, some countries - such as Russia, Brazil and other commodity-exporters - will face major challenges as the commodity cycle fades and the contraction in capital flows interacts with domestic weakness. But a sharp enough slowdown in emerging markets to derail the UK recovery - even when incorporating second-round effects through the more vulnerable US and Germany - is still more a risk than a baseline.

Second, the labour market. I viewed this month's data as confirmation of my priors. Unemployment ticked down to 5.5%, but the continued stability in the claimant count around 2.3% for the sixth consecutive month, combined with the elevated vacancy rates, slowing job creation, minimal increase in hours worked, and shift to voluntary part-time self-employment, continues to indicate a labour market with minimal (if any) slack. The Agent's survey results were compelling in showing different dimensions of increased challenges hiring. This matches what I heard in two recent agency roundtables.

Although these data updates did not change my views on the tightness in the labour market, the staff analysis of the equilibrium unemployment rate did provide new insights for me. Noteworthy is the outward shift in the Beveridge curve showing that matching is less efficient - especially as this trend started before the crisis so it cannot fall into the large category of issues that may be just temporary crisis effects (versus structural changes). The fact that matching may be particularly hard for immigrants - so that immigration could simultaneously increase labour supply while reducing

matching efficiency - could explain some of what we've seen. This is far from definitive, however, and I would like to see more analysis of why matching efficiency has decreased.

Third, prices. Inflation was roughly as expected in August. Headline inflation at 0%; core inflation took back some of its upside surprise in July; service inflation was 2.3% and goods inflation at -2.0% - roughly around where they've been. Wages were somewhat stronger - only partially balanced by stronger productivity growth, so that unit labour costs increased. Inflation expectations remained roughly stable. But oil and commodity prices continue to fall, pulling down headline inflation just as it should have started to recover. Overall, yet another month of external pressures pulling down on prices. Even if most of the effect is temporary, the date when inflation starts to head away from zero is delayed.

So what have I learned about cost pressures this month? Firms are responding to a tighter labour market by improving productivity. Recent productivity gains are probably not a data blip, but likely to persist. This will slow, but not stop, the growth in unit labour costs. Balancing that, I'm also more comfortable with less pass-through from sterling's past appreciation. I won't repeat yesterday's discussion, but the work I've done with [redacted] has convinced me that the pass-through from exchange rates to import prices and inflation can change sharply over time. To understand this, we need to consider why the exchange rate moved. Accounting for this can explain the surprisingly high degree of pass-through during the crisis, and lower pass-through recently. It has made me comfortable with our current approach of assuming about 60% pass-through as a starting point in the future, but adjusting this when we have an understanding of why the exchange rate is moving. This framework should improve our ability to forecast the impact of currency movements on inflation in the future - and even if not in real time - it should improve our forecasts over a horizon that matters.

Finally, the timing of adjustments to interest rates. Here was the one area where I found the data surprising. The date implied for "lift-off" by the OIS curve shifted out to January 2017. Even with the usual caveats on this measure's sensitivity, this was news to me. Yes – lift-off may have moved out due to recent weakness in commodity prices, risks to global demand, moderation in Q3 UK growth, and stronger UK productivity growth. I also found the staff analysis indicating that the lag for monetary policy to be effective may be closer to 1 to 1½ years instead of 1½ to 2 years comforting. But other forces - such as the strength in the US and euro area, tightness in UK labour market, and support for less pass-through, suggest that UK inflation is still on track to begin recovering soon. Also, what I learned from the uncertainty surrounding the Fed's meeting in September, is that we do not want to be in a position where an increase in interest rates is a serious consideration internally, but would come as a surprise externally.

So I'm still waiting for the great computer of the UK economy to update and will not vote to raise rates now. I'm hoping that Microsoft (aka the global economy) doesn't sneak in yet another update that will slow the recovery of UK inflation.

Governor Carney. Might even get some productivity out of it. Very good. So Andy and then Jan please.

Andrew Haldane. Thank you. Starting with the world scene, the key issues seem to me to be:

First, the extent of the likely slowdown among emerging market economies; and second, the extent to which advanced economies are able to pick up the resulting global slack.

On the first of those, my sense is that the emerging market bloc is likely to see, at best, a continuation of the moderation in growth rates we've seen since 2010; and, at worst, could see a somewhat sharper moderation with a few crises thrown in. Because, for them, it's an alignment of structural factors that appear to point in a downwards direction, factors - I think - well highlighted in the IMF's latest World Economic Outlook.

These include:

First, the continuing down-dip in the commodity price cycle, where prices have fallen a further 3 or 4% over the month.

Second, the cumulative overhang of overseas debt. Citibank estimate that, since 2008, around $5 trillion of capital has flowed into emerging markets. Which in turn has generated a surge in domestic credit creation, asset prices and investment. That surge has now clearly ceased and, at least in some emerging markets, is reversing. In China alone reserves have fallen $450 billion over the past year and that is before we take any account of any further falls during September.

Third, a decent chunk of this overseas borrowing has been conducted in dollars and by the corporate sector. The IMF estimates EME corporates having around $4 trillion of dollar debt. The strength of the dollar against emerging market currencies, coupled with a prospective rise in US rates, is thus likely to cast a pretty long shadow over the private sector in emerging markets.

And fourth, exacerbated by the first three, unstable politics.

These problems differ in scale of course across different EMEs, but the bonds that tie EMEs together - trade, financial and confidence - mean that the combined effect is likely to be greater than the sum of its national parts. For me, that means our August IR forecasts for EME growth may need to be significantly re-profiled.

Whether this affects the central path for global growth then hinges on whether advanced economies can fill the gap. Or, if you like, whether the income effects of weaker EMEs is counterbalanced by the substitution effects of capital flowing back into advanced economies, and improved terms of trade for commodity-importers etc. On the plus side, activity indices so far are holding up fairly well, at least in the US and most of the euro area. And that further fall in commodity prices will of course provide a further boost to real incomes.

A further supporting factor is the reflow of capital from emerging markets back into advanced economies. The impact of this reflow on underlying activity could be modest if it went into safe government assets but, at current yields I don’t think that is especially likely. And, so far at least, there is relatively modest evidence of that being the case.

Indeed, more encouragingly, some of my conversations with market contacts and companies suggest that European companies may instead be the recipients. Corporate restructuring deals, especially in parts of Southern Europe, are said to be picking up pace, financed with money from the East. Indeed that might help explain some of the strength of the euro over the past few months. If this activity continued in scale it could be good news not just for near-term activity in the euro area, but prospectively for medium-term productivity as well.

Corporate activity in the US also appears to be pretty buoyant, with M&A activity at a cyclical peak, financed with cheap capital market debt. Now whether this corporate restructuring activity, both in the euro-area and the US, translates into higher business investment - a missing ingredient from recovery in both blocs so far - strikes me as a more open question. One militating factor here is the recent tightening of corporate credit conditions. Another is the rise in uncertainty about the global outlook. At present it’s too soon to tell what the balance of these factors will be.

Turning domestically, the underlying activity picture seems to be one of continuing solid growth around a gently slowing trend. The latest Blue Book revisions make somewhat clear both of these aspects of the UK’s expansion since 2014. And the evidence we have for Q3 and Q4, while partial and mixed at this stage, are also consistent with a continuation of that gentle, controlled descent. Yesterday, Ian and Jan invoked trains and planes to explain this trajectory. So let me complete the troika by invoking automobiles.

Comparing this year with last, economic growth in the UK has moved down a gear. Unsurprisingly, given the strength of sterling and the weakness of world trade, manufacturing is leading that gear-shift. My recent agency visit to Northern Ireland brought home to me the sapping effect of sterling’s strength on manufacturing activity. It is services, however, where the news is probably more interesting, more important and in some ways more surprising. The backward-looking news on services has suggested continuing strength. But the forward-looking surveys are decidedly more mixed.

The CIPS output and expectations series for services, on which we tend to place greatest weight, have now fallen for four or five months in a row, albeit from high levels. If I have done my arithmetic correctly, that fall is likely to have been particularly pronounced during September. Whether this drift down in services growth is firm or fleeting will be a key issue in gauging the strength of the UK economy in the period ahead.

Finally on the nominal side, overall there has been relatively little news in either wages or prices relative to the August Inflation Report. Underlying measures of both, be it core inflation or unit wage costs, remain for the moment between a half and one percentage point shy of the levels necessary to return inflation to target. And I await further evidence of that gap closing, not just in expectation but in reality.

There has been a little bit more action on inflation expectations, with some convergence across measures. Households' inflation expectations are relatively little changed at the bottom of the pack. But, most recently, companies' inflation expectations have nudged down a touch to lie closer to them. Only around a third of companies now believe inflation will be 2% or higher two years hence, compared to around a quarter of households. For the first time, a small minority of the professional forecasters we survey now expect inflation to be 2% or above at the two year horizon. Market-based inflation expectations measures have also fallen, though once again by less in the UK than elsewhere and they remain in line with historical averages.

How do we interpret this? I think the language of anchored versus unanchored inflation expectations is too binary to capture the underlying position.

A ship can be anchored even when the rope fixing it is fraying. I would interpret what we have seen over the past year as a fraying of the anchor rope. Are expectations well-anchored? Frayed knot. Put differently, it would not take as large a deflationary wind as in the past to cast adrift inflationary expectations. And I say that because last month's minutes emphasized the upside risks to our inflation profile, which I can see do exist. But I think it is important the minutes also discuss those potential downside risks, not least given external perceptions.

For those reasons, I am minded this month to leave unchanged Bank Rate and the stock of asset purchases. Thank you.

Governor Carney. Thank you Andy. Minouche please. Sorry, Jan and then Minouche, I'm sorry.

Gertjan Vlieghe. Thank you. I don't think we have had much news since last month.

On the asset price front, equities have stayed low, advanced economy bond yields moved a little lower, and markets pushed out the date of the first Fed and Bank of England hike. And the pound weakened.

There was not much news on global activity data, with US and European data showing neither a strong acceleration nor a marked slowdown. Advanced economy growth seems to have stabilised at around 2% in the past couple of years.

Emerging economy growth, on the other hand, is on a declining path. Set against persistent expectations of an improving path, that has cumulated to quite a large downward surprise. In a forward-looking sense, if markets have revised their outlook from an improving growth path to a flat or slightly declining one, that's quite a large revision to future GDP, and such an expectations "reset" may be what was mostly behind some of the equity market correction over the summer. Reduced confidence in EM policymakers' ability is likely another reason.

There are some signs that the slowdown in China may be bottoming out temporarily as earlier stimulus takes effect, although I would interpret that as a minor upswing around a trend decline in growth. There was some more downside news on Brazil and Russia.

Last month I talked about my big picture global outlook of a world that was weighed down by high debt and weak demographics, with the US and UK in relatively better shape, having taken some

steps to improve their debt situation. Recent developments are, to my mind, entirely consistent with that framework.

Turning to the domestic news on the month, there seemed to be no clear direction to it. After the blue book revisions, it remains the case that growth peaked in the first half of 2014, and has been slowing slightly since then. Manufacturing has been slowing quite markedly, services much less so. The unemployment rate has flatlined. Last month I interpreted the UK data as showing signs of slightly slowing demand growth but slightly improving supply growth, and that still seems an appropriate characterisation.

Thinking about the UK growth outlook from here, I think there is a tension between the positives of an improving housing market and easing mortgage conditions, and the negatives of renewed fiscal tightening as well as a strong exchange rate in a subdued global growth environment. With growth currently roughly in line with potential, even small deviations can make the difference between an output gap path that is closing gradually, and one that starts opening up again slowly.

On the price front, I am encouraged by the fact that short-term indicators of core inflation are showing some signs of bottoming out. My reading of labour cost pressure remains that it is somewhat higher than a year ago, but not obviously gathering further momentum. I note that survey indicators of pay are mostly stable.

In order to be persuaded that we are seeing the beginning of a tight labour market putting upward pressure on pay, I would like to see a clearer uptrend across a wide range of pay indicators. In that same vein, unit wage cost growth of 1.5% in the year to Q2 remains too low to be consistent with the medium-term inflation target.

We spent some time yesterday discussing the merits of gradualism, in the sense of whether a gradual path of rate normalisation is desirable in its own right.

First, let me say that I agree with the guidance that the future path of interest rates is likely to be gradual and limited. But I see this largely as a consequence of my economic outlook where global deleveraging and demographic headwinds, as well as local fiscal and exchange rate headwinds, mean that the equilibrium real rate rises only very gradually at best, and will, for many years, remain well below the levels seen in previous decades. If it turns out that these headwinds are not as severe as I thought, I would find it appropriate to raise rates more quickly. I put far more weight on being able to respond to such revisions in the outlook, than on the idea of being gradual for independent reasons.

When thinking about monetary policy strategy, I do put weight on the asymmetry problem. By that, I mean that I am more confident of our ability to tighten significantly from here than our ability to ease significantly. While I agree that rate cuts are possible, there is little room before we hit the actual zero bound, and after that it is not far before we hit the effective lower bound at which we might see substitution from deposits into cash. Concerning asset purchases, I see no impediment to further purchases, but I do worry that incremental waves have had smaller and smaller effects on growth and inflation. On balance, I therefore conclude that our easing measures would be less effective than our tightening measures, which is of course not the same as saying we cannot ease –clearly we can.

At the margin, this asymmetry would make me wait slightly longer before tightening. I think about this in the following way: if I had some distribution of unconstrained optimal policy paths for monetary policy in response to shocks, this would by definition lead to a symmetric distribution of inflation outcomes around the target at the policy horizon. By truncating the distribution of monetary policy paths on the downside, we create a distribution of inflation outcomes that is skewed to the downside, ie, the mean will be below the target. To even that out, there is an argument to wait slightly longer before tightening, to offset the downside skew to inflation. If we also have a downside skew to the distribution of growth risks, that strengthens the argument for waiting even further.

To summarise: the data, while consistent with a rising path of rates at some point, is not strong enough in my view to warrant a near-term tightening. I would want to see more evidence that demand growth is not slowing any further relative to supply, that pay growth is picking up, and that

core inflation has indeed bottomed out. I put little weight on gradualism arguments, so I do not feel we need to start soon to avoid a steep path. My central forecast is for a gradual path, based on slow-moving debt and demographic fundamentals. A concern about the asymmetry of monetary policy effectiveness would, at the margin, make me wait slightly longer, even once the data shows a more decisive case for tightening.

So I am inclined to vote for no change in Bank Rate and no change in asset purchases.

Governor Carney. Thank you Jan. Minouche.

Nemat Shafik. With all of the focus on turmoil overseas, it would be very tempting to fall into the trap of thinking that the outlook is overwhelmingly gloomy. I fully expect dark clouds to be forming over Lima as some of us set off to the annual meetings there. China is going through what increasingly appears to be a painful deceleration; output is shrinking in Brazil and Russia – two former darlings of the commentariat. Japan appears on the brink of a technical recession. And closer to home it seems increasingly likely that ECB will be obliged to take another round of QE.

But a look at the data in the UK suggests that the economy is continuing, slowly but surely, on the path to normality. Growth seems set to continue at a solid – if unspectacular pace over the coming quarters. Spare capacity in the labour market continues to narrow marginally. And – perhaps reflecting increasing recruitment difficulties – productivity is now growing at a pretty healthy 1.5%. Wage growth too has recovered somewhat, though I notice something of a plateau in recent quarters.

To take stock of how we are progressing, I took a look at how some key macro variables in the UK compare to those in previous lift offs in the UK. And the results were as you expect: the real variables – growth, employment and unemployment – are either at or beyond the level at which rates were raised in past episodes of tightening. But the nominal side is lagging behind – with labour costs, core and headline inflation still some way below the level at which rates were previously raised. This reminded me a bit of Kristin's tug-of-war between the real team and the nominal team, with the nominal team not doing so well. Of course such an exercise of comparing to past tightening cycles is fraught with limitations: each cycle is different, and structural changes in the economy mean comparisons over such a long period of time may not be fair. But I do think the juxtaposition of real strength and nominal weakness is a neat summary of the narrative for why, over the last six years since the recovery started, Bank Rate is still at a record low.

Moreover, I am convinced by the case for both gradual rate hikes and gradualism in this tightening cycle, which Ben helped us think through yesterday. First, the headwinds of fiscal consolidation, private debt overhang and sluggish world growth look set to ease only gradually. And second I believe the case for raising rates more slowly than would be prescribed by a historic Taylor rule is compelling given the specifics of this recovery. There remains considerable uncertainty about how the nominal side of the economy will behave in the coming years – as typified by the uncertainty of how quickly core inflation will recover and this warrants caution. And this is all the more pertinent given the proximity of the zero lower bound and our limited understanding of the effects of unconventional monetary policy.

Of course this is not without risks. In particular that we ultimately end up overshooting the inflation target and face a choice between reneging on our gradual guidance or risking de-anchoring inflation expectations. But I believe those risks are remote:

The current slope of the yield curve allows us plenty of room to increase more quickly and remain true to our "gradual" guidance;

And after such a long period of inflation undershoots, it is difficult to conceive we will easily lose control of inflation expectation on the upside.

Adding to the case for waiting is a perception I have that the risks to the nominal environment remain skewed to the downside. I find it very plausible that we will experience further downside surprises in inflation over the coming year.

On the domestic front, wage growth of 2.9% is still not far enough above productivity for me to be very confident domestically generated inflation will drive headline inflation back to target.

Moreover it seems likely that a degree of slack in the world economy will mean that global real marginal cost is likely to be low. Although spare capacity is close to exhausted in the US and UK, the output gap of the average economy in the world is probably still negative. The eurozone and China in particular seem likely to continue to exert disinflationary pressures on the price of tradable goods and services in the UK.

And there is distinct risk of a messy outcome in emerging markets if the transition to lower potential output growth is mismanaged. Confidence in emerging market policymakers is diminishing quickly, and in the worst case scenario an acceleration of capital outflows coupled with a further deterioration in growth prospects could be enough to trigger a full blown crisis, particularly given the fragility inherent in the build-up of EM debt that both Andy and Jan have mentioned in recent years.

So now I am at risk of falling into the trap of drawing attention to what I said at the start: overly focussing on the dismal world news and the dark clouds to the detriment of the domestic data where there are some rays of sunshine. So let me end by just re-emphasising the main message I took away from this month which is that the process of normalisation in the UK seems to be on track – the domestic private sector has thus far kept its head while all around have been losing theirs. But for the moment the balance of risks around inflation mean that the benefits of taking a more gradual approach outweigh the risks. And so this month I intend to vote for no change in Bank Rate and no change in the stock of purchased assets.

Governor Carney. Thank you Minouche. Thanks everyone. Let me join others in complementing the rich analysis provided by staff for this round, and I guess the insights from the discussion yesterday which I think will persist, and we'll pick up some of those discussions in the November forecast round.

I, like Minouche and Jon, are headed to these pessimistic IMF meetings, so I thought it would actually make sense to take stock of the emerging world prior to going there. So I can be relatively objective, and I'm going to concentrate on that, I think. A number of domestic developments have been well-covered.

First, to just step back on the emerging world, big picture. The emerging markets enjoyed an abnormally strong post-crisis surge. They were able to have significant policy easing, which had huge traction, because of the banking systems that worked and robust private balance sheets at the start. China stimulated massively in 2009/10, 3 points of fiscal, and on top of that a 30% aggregate increase in credit in one year - directly increasing credit in one year, it's remarkable. The spillovers through trade and commodity price channels helping, through the super-cycle, a number of emerging economies. Huge capital inflows pushed, and sustained by, quantitative easing. And this process of corporate re-leveraging [supported][4] investment and also broader domestic credit growth.

This has been reversing for some time, and, as a few of you have noted, emerging market growth has notched down for each of the last five years. It has persistently disappointed. If you look at forecasts and outturns, it has consistently disappointed. Now running at about 3% at present, so cut in half from the 6% level post-crisis, I think Andy mentioned. The causes of that, China, I'll talk about that in a moment. Reversal of commodity cycle - not unrelated. Exhaustion of fiscal and monetary policy space. Domestic political constraints beginning to bind, not surprisingly as growth slows. And this year, it has been persistent this year, large capital outflows that are feeding strains in the corporate sector, and I think that's going to get worse.

As we discussed very briefly at Pre-MPC, this is broad based. It is not idiosyncratic. The idiosyncrasy in the entire emerging world is India. It is a relatively closed economy, reformist government, initial bounce. Everywhere else, it's moved down. For Q2, over half the downside was in Latin America and Russia, but there are signs of a sharper slowdown in non-Japan Asia, which would be consistent with a broader trend and there's reason to expect that that may accelerate. And for each of the past three years this emerging market slowing has swamped some modest acceleration in the advanced economies as a whole, leading to lower global growth over that prospect.

[4] MPC Secretariat clarification.

The question is whether this could intensify, and that largely, but not exclusively, centres on China. I would say that the risk of a major accident is reduced by better policy frameworks and more flexible exchange rates (with one notable exception). Despite the dollar borrowing, there has been a lot of local currency borrowing, particularly of governments and banks. On the whole, they are slightly better off, as it were, than in the run-in to previous crises. But it is challenges in emerging markets that are feeding, and also have to be addressed. A difficult cycle of very low nominal growth: global nominal growth is running at 3 percentage points, down 2 percentage points from pre-crisis rates.

How much does this matter for the UK? I'll come to that in a moment. I'll just preview though: one of the upsides of having the worst trade performance in the G20 (quite surprising in terms of relative market share - the UK has lost the most over the course of the last decade. I thought Canada was the worst, but I double-checked the numbers and it was the UK) the upside of that, of course, is there's less of a direct impact - I mean, pure genius.

As others have noted, the risk here is really non-linearities around confidence and financial market spillovers. I think Ben and others have covered them well. On the spectrum, I think the financial market developments over the course of the last several months have reflected greater risk aversion and some greater pessimism. I would side more towards Jan's end of the spectrum in terms of a real, discounting back. Lower growth coupled with higher risk of an accident.

One thing I would flag, and we'll go through the other numbers because people have. Credit spreads have widened quite significantly, across both investment grade and high yield markets, across advanced economies. Sort of 40 basis points since August in investment grade, 140-150 in high yield. Those are big moves. And those have been sustained moves, consistent with risk aversion, but to the extent to which that persists, may be material.

Proximate causes of all this, I think, unfortunately, policy-makers do bear some of the blame. I think the Fed very recently. The reason I mention the Fed is that I think it is relevant to us in terms of what to try to avoid. Maybe unintentionally putting a much bigger weight on international factors and confusingly widening the arguments and their reaction function hasn't helped matters. Certainly the recognition that Chinese policy-makers too are fallible, like the rest of us, has played into this. I don't think the second reality, which staff have highlighted to us quite effectively in both August and September, that the Chinese also face budget constraints, both fiscal and constraints on the reserve side. I don't think that the renminbi has dropped in the market as a whole, it's gradually going to come to the fore. And the real risk here is a currency shock centred on China, as Martin highlighted.

I join others in noting that, on official data, again looking a little further back, the Chinese slowdown has been gradual, it's been significant. They've been on a glide path from 3% quarterly growth to about half that now, and a range of indicators support that view. Nominal growth, I mentioned this last time, has plummeted from 20% per annum to 6%, so it's in the context of 200% debt to GDP. That is significant, and gives a sense of the policy challenge. Domestic monetary conditions in China have tightened. That's exacerbated by: very large official on balance sheet NPL; official on balance sheet unrecognised NPL; and then there's a huge contingent overhang depending on how local government debt is restructured.

So while the PBOC has cut, I think they'll loosen further. Their transmission channel is somewhat strained. Fiscal policy, the signals are loosening; they will loosen that further, and I join others in expecting that the intolerance of slow growth (I forget whose phrase that was, it is well put, Jon) will in the near-term support things. And we are not seeing the evidence of the Chinese slowdown in the numbers, maybe today's PMI slightly notwithstanding. I suspect we won't, but we are going to see it in policy and that tail risk is going to increase. And I think the prospect of much slower medium-term growth in China continues to go up.

I think we are all familiar with the staff estimates of spillovers of Chinese slowdown and broader Asian slowdown to the UK. Roughly 10 basis points over three years. You have 3% slower Chinese growth, 0.3% off UK GDP, and the bulk of that coming through the euro area. That's from a linear model and obviously using a longer history to estimate the coefficients. There is reason to expect that the impact could be stronger. If you look at the IMF analysis of the impact of slowing in China on Asia - and this is on a Chinese shock - they get a 50% stronger propagation of Chinese slowing due to deeper integration. And if there is a sharper slowdown associated with - and this is imperfect analysis but in talking to Lagarde and others - if the currency moves 10% - and we're going to go through some of this analysis actually next week, so I'm previewing some of the pessimism - that downside risk is a percentage point off EU growth cumulative over the next two years,

because the exchange rate channel is probably quite significant. Now it's not clear where sterling will go in that world. Often we go in between, so we'll see.

OK. Overall, we need to balance these risks - and I gave a stronger sense of the risks just then - against advanced economy growth, which is certainly tracking broadly as expected, notwithstanding the rhetoric of the Fed and the ECB. We will have to process the overall financial market moves in our forecast, including pretty large shifts in our curve since the last meeting. I think we will do the normal forecasting process. If it persists and holds, I think we do have to take a step back and think about how much of that is stimulus. How much of that is a shock to risk (a la Barro and Rietz), and the second order effect of that on the cost of capital and broader financial conditions.

And I will just flag one thing which I think we should review for the November forecast if we can - given the Committee turnover and given time - is what's called the 'forward guidance puzzle'. But it is in fact a structural factor of the model that you get a much bigger stimulus because agents pull forward the certainty of lower rates in the future which is much more simulative than actual lower rates in the present. And that's a structural aspect of DSGE models, which is quite powerful in both directions, but overstates, I would suggest, the impact of given moves.

I think as a whole I do come down, though, with all these factors that this is a skew, not a change to the mode. I very much agree with the messages we had, with less analysis, last time and the points people have made. The judgement is how to respond to such skews. We could, you know, as a central bank, ease with the shifting mean. They could signal flexibility, or they could state the modal course. The ECB has chosen the middle path thus far, signal flexibility. I suspect they're going to ease, but ease using the excuse of global slowdown, consistent with providing the stimulus they would have had to do in order to meet their target is certainly a possibility, but just tactical, so maybe more tactical. I think the Fed clearly has shown the - since it is transcripted - the challenges of getting communication precisely right, that we all share. Given the fact that the UK is one of the least affected economies on direct channels, which is clear and evident - clear in terms of the analysis and evident I would say in terms of the data - importantly absent, non-linear contagion [is more important].[5] And the biggest risk on the contagion front here is through a couple of our banks that have very large exposure directly to China, and much larger exposure to non-Japan Asia, so if there is a broader problem this will be a sort of jump, not jump to distress, but jump to difficult funding conditions and we've seen a bit of that in the market already.

But given that we're one of the least affected economies, given this is a skew, not the central, I think it's very important that we maintain - at least from a personal perspective - maintain my strategic orientation towards tightening. I think we have to acknowledge that persistent global weakness, nominal weakness, will likely extend our string of letters. I'm less concerned about inflation expectations, but it does put a premium - all of this puts a premium on - highlighting and tracking underlying firming in price pressures that a number, in fact all of you have mentioned, whether it's through wages, unit labour costs and I'd be a little careful on the unit labour cost numbers we get. You can have a pretty big swing between the backcast and the contemporaneous numbers, as you know. And I think core inflation could be quite useful in coming months if it comes in as we expect in order to show some of the strengthening. So I expect to vote next week for no change in Bank Rate, no change in asset purchases. And it's not a vote, but with the expected next move being up, even though risks have increased.

So thank you for that. We will just cut for now, and take stock when we meet on Wednesday, sorry Tuesday.

[5] MPC Secretariat clarification.

A meeting of the Monetary Policy Committee was held on Tuesday 6 October 2015. 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

James Richardson was present as the Treasury representative

The following members of staff were present:

Gareth Ramsay, Director, Monetary Analysis

James Bell, MPC Secretariat

Chris Young, MPC Secretariat

Melissa Davey, Editor of Inflation Report

Transcript of the Monetary Policy Committee Meeting on

Tuesday 6 October 2015

Governor Carney. Well good afternoon everyone. I will start by turning to Andy to give us an update on recent data releases.

> **Andrew Haldane**. Thank you Governor. One or two bits and pieces. Starting internationally, since we last met we've had the US payrolls data, which came in weaker than expectations. I think you've all had a chance to see those in some detail so I won't go through any of that detail. We've also had a full set of PMIs now, in particular covering the service sector components. And looking at those, whether it be the euro area, the US or globally, they came in weak in September. That's a pattern mirrored in the PMIs for the UK. In September we saw the composites at Pre-MPC, but the breakdown now shows that the weakness in September was focussed in services in the UK. Other couple of bits on the UK data front, we had new car registrations this morning, which were up 0.6% in September, that's still pretty strong. And then we had Halifax house price indices for September, which was down 0.9% but that follows a really sharp rise in August of 2.7%, so taken in the round the average of house price indices remains not too far away from our August Inflation Report projections. Thank you Governor.

Governor Carney. OK, thank you very much Andy. OK so let's turn to the decision. I would like to go in, with good discussions and deliberations in the same order that we took our preliminary views as last time. Starting with Ben Broadbent.

> **Ben Broadbent**. Thank you. I confirm my vote for no change neither in interest rates or the stock of purchased assets.

Governor Carney. Thank you Ben. Martin Weale please.

> **Martin Weale**. I'm voting for no change to the Bank Rate and no change to the stock of purchased assets. Thank you Governor.

Governor Carney. Jon Cunliffe.

> **Jon Cunliffe**. I confirm my vote, no change in Bank Rate and no change in the stock of purchased assets.

Governor Carney. Thank you. Ian McCafferty please.

> **Ian McCafferty**. I continue to vote for an increase of 25 basis points in the Bank Rate, no change in asset purchases.

Governor Carney. Kristin Forbes please.

> **Kristin Forbes**. I continue to vote for no change in rates and no change in asset purchases.

Governor Carney. Andy Haldane please.

> **Andrew Haldane**. I confirm no change, no change. Thank you.

Governor Carney. OK, Jan Vlieghe please.

> **Gertjan Vlieghe**. No change in Bank Rate, no change in asset purchases.

Governor Carney. Minouche Shafik.

> **Nemat Shafik**. Confirm no change in Bank Rate, no change in asset purchases.

Governor Carney. And I will also confirm no change in Bank Rate, no change in asset purchases, which means that nine vote for no change in asset purchases, eight votes for no change in Bank Rate and one vote, Ian McCafferty's for a 25 basis point increase in Bank Rate. Thank you very much.