FORECAST REFERENCE GUIDE
November 2015

(CAPD) and (GSID)

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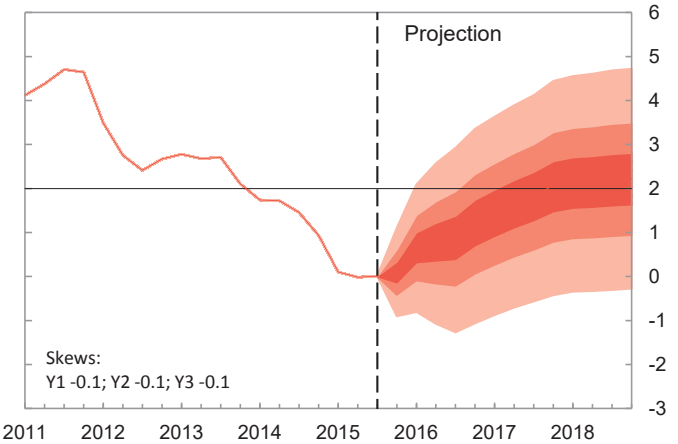
Overview

1. The November forecast

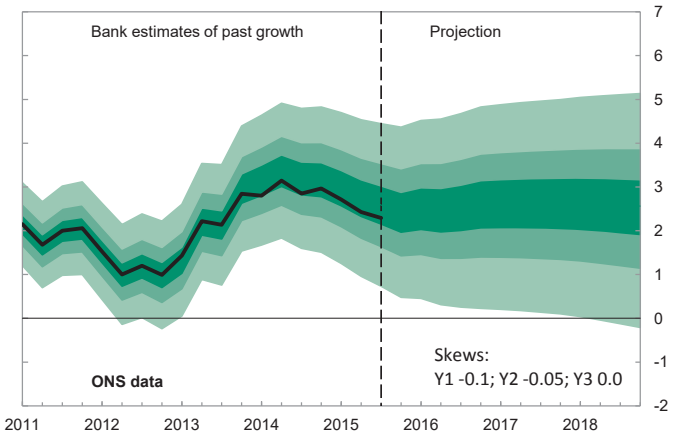
Inflation conditional on the market curve

Percentage increase in prices on a year earlier



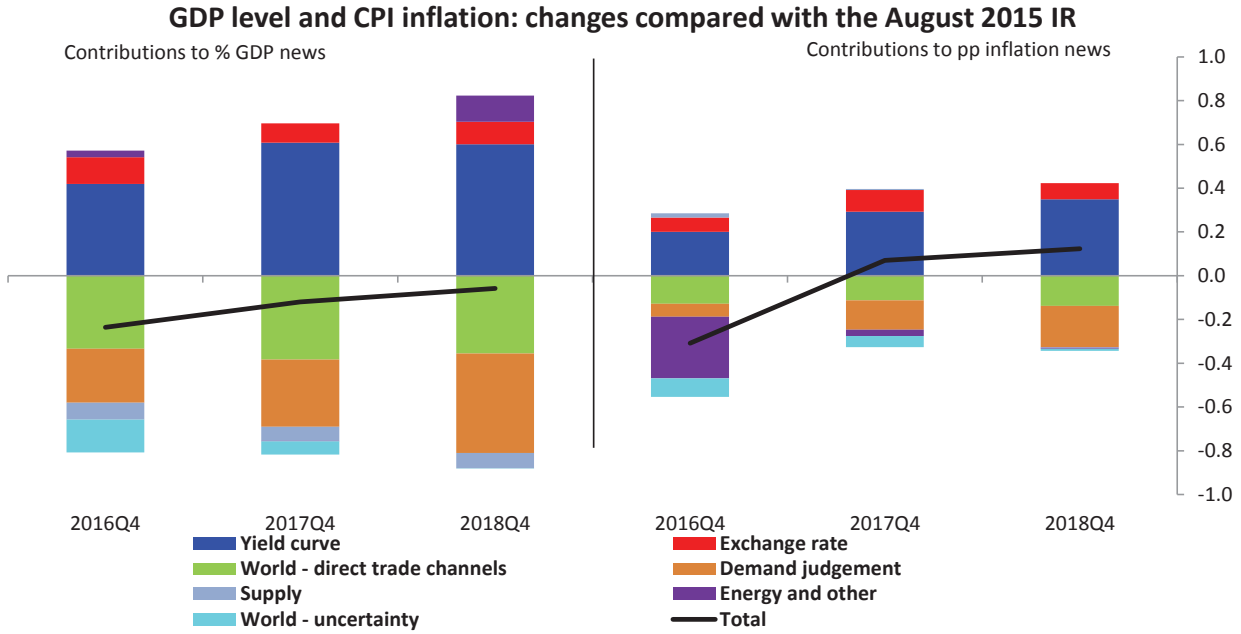
GDP growth conditional on the market curve

Percentage increases in output on a year earlier



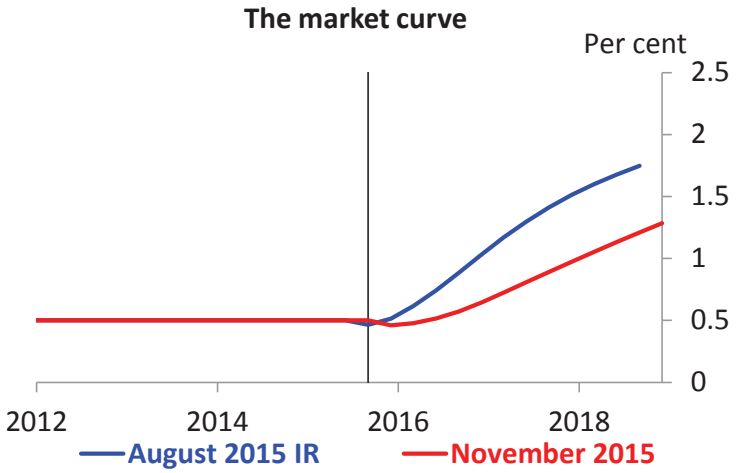
- **Inflation** starts the forecast at 0.0% in 2015Q3. Conditional on policy following the market curve, it rises gradually back towards target, only reaching 1% in 2016Q3, three quarters later than in the August forecast. But in the final year of the forecast it overshoots the target, reaching 2.1% in 2017Q4 and 2.2% in 2018Q4 (**LHS**).
- **GDP growth** starts at 2.6% in 2015Q3, falling back to 2.4% in 2015Q4. But the period of relative softness is only temporary, with growth picking up back to 2.7% in mid 2017, and ending the forecast at 2.5% (**RHS**).
- Although it is small in absolute terms, the overshoot in inflation is large by the standards of past forecasts – the last time inflation was 2.1% or higher at year 2 was in February 2013; it was last 2.2% or higher at year 3 in August 2005. And it is also marginally higher than the overshoot in the August *IR*. So this forecast sends a signal that the path for policy implied by the market curve is lower than would be appropriate given the outlook for demand and inflation.

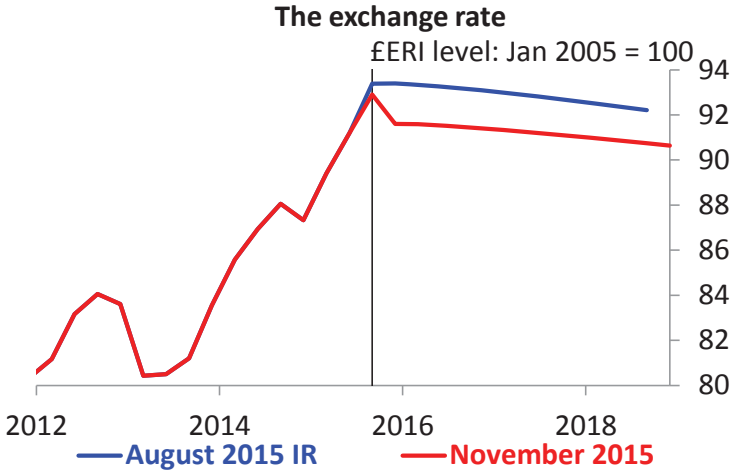
2. The news since August: lower yield curve, softer demand outlook



- **The level of GDP** ends the forecast around 0.1% lower than in the August IR (**LHS**), reflecting small downside news in supply. Over the forecast, the circa 2% fall in the **exchange rate** and 50bp fall in the **yield curve** offer significant stimulus to output (**slide 3**). However, that is broadly offset by a weaker world outlook - both from **direct trade channels** and from greater **uncertainty** in the near-term - along with an MPC judgement to lower **domestic demand** (**slide 3**).
- **CPI inflation** is lower than projected in the August IR in the near-term (**RHS**), in part reflecting lower **energy prices**. But inflation is expected to pick up to 2.1% at the 2yr horizon and 2.2% at the 3yr horizon. Over the medium-term, slightly above-target inflation is consistent with a positive output gap (**slide 21**), while relative to the August IR, the effects of the declines in the **yield curve** and the **exchange rate** dominate the weaker world outlook and the MPC judgement.

3. The news in asset prices





- The yield curve fell substantially this round, by up to 50bps at year 3 (**LHS**), and the exchange rate depreciated by almost 2% (**RHS**). Under our usual assumptions this would have boosted GDP by up to 0.7% and inflation by 0.4pp, all else equal (**slide 2**).
- Underpinning those assumed effects is an assumption that lower interest rates would have fed through to higher risky asset prices. But in fact risky asset prices fell – for instance equities were down around 4% over the quarter (although the effects of higher bank funding costs on credit spreads were offset by a judgement that the banking sector is becoming more competitive). At the same time estimates of term premia fell and measures of tail risks shifted to the downside.
- To the extent that these falls reflected downside news to the outlook for the world, we would arguably have captured their effects via the downgrades to our world forecast (**slide 7**). But the asset price falls could also have independent effects via wealth, or could have reflected a separate shock to confidence and perceptions of risk (See Analytical 7256338). This was one motivation for the MPC's judgement to lower demand in the forecast (**slide 2**).

4. The MPC's Key Judgements

The MPC's forecast is underpinned by 4 key judgements, which are shown below along with what they imply for key variables.

KJ1: Global growth remains well below past average rates as emerging economy growth recovers only a little from current weak rates and advanced economy growth remains modest

	Average 1998-2007	2015	2016	2017	2018
World GDP (UK-weighted)[c]	3	2 ¼ (2 ¼)	2 ¼ (2 ¾)	2 ½ (2 ¾)	2 ¼
World GDP (PPP-weighted)[d]	4	3 (3 ¼)	3 ¼ (3 ¾)	3 ¼ (3 ½)	3 ¼
Euro-area GDP[e]	2 ¼	1 ½ (1 ½)	1 ¾ (1 ¾)	1 ¾ (1 ¾)	1 ½
US GDP[f]	3	2 ½ (2 ½)	2 ½ (2 ¾)	2 ¼ (2 ¼)	2
Dollar oil prices[g]	39	49 (57)	56 (62)	59 (66)	62

KJ2: Domestically, productivity growth supports supply as the growth in labour supply slows

	Average 1998-2007	2015	2016	2017	2018
Productivity[h]	2 ¼	1 ¼ (1)	1 (1)	1 ½ (1 ½)	1 ¾
Participation rate[i]	63	63 ½ (63 ½)	63 ½ (63 ½)	63 ½ (63 ½)	63 ½
Average hours[j]	32 ¼	32 (32 ¼)	32 ¼ (32 ½)	32 ¼ (32 ¼)	32 ¼

KJ3: UK private demand remains resilient in the face of developments abroad and the continuing fiscal consolidation at home

	Average 1998-2007	2015	2016	2017	2018
Credit spreads[k]	¾[l]	2 ¼ (2)	2 (2)	2 (2)	2
Household saving ratio[m]	8 ¾	4 ¾ (5 ¼)	4 (5)	3 ¼ (4 ½)	2 ¾
Business investment to GDP ratio[n]	9 ¾	9 ¾ (10 ¾)	10 ¼ (11 ¼)	10 ¾ (12)	11 ¼

KJ4: The drag on CPI inflation from external factors gradually dissipates and wage and domestic cost growth strengthen

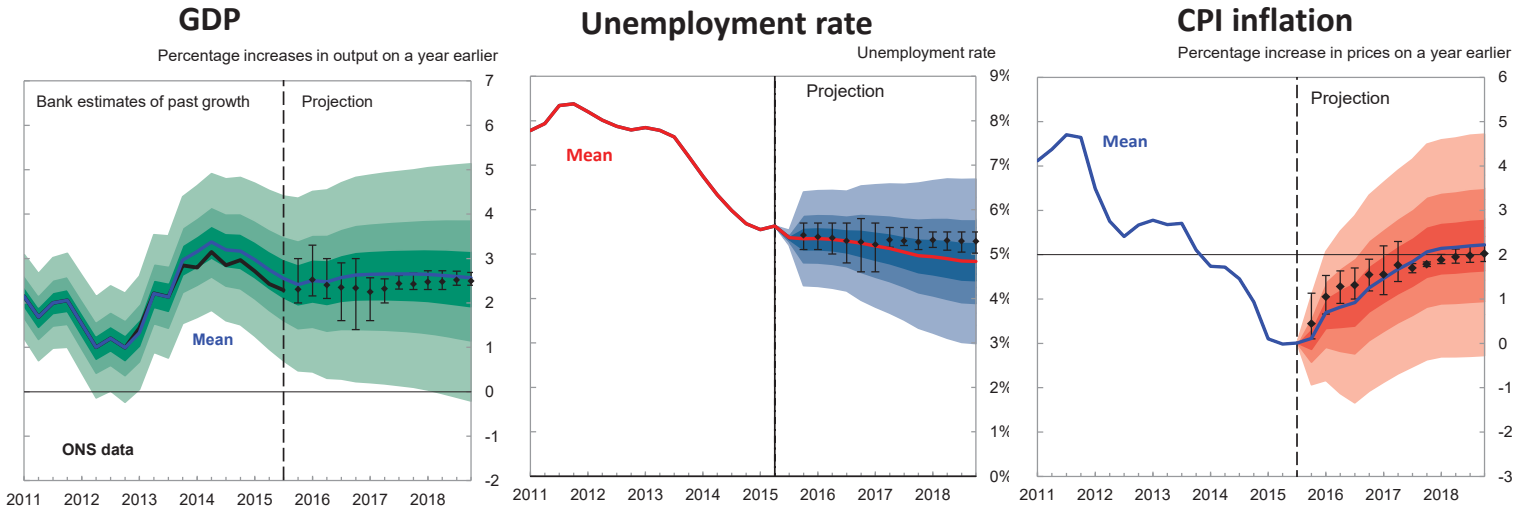
	Average 1998-2007	2015	2016	2017	2018
UK import prices[o]	¼	-4 ¾ (-5 ½)	¾ (¾)	1 (¾)	1
Unit labour costs[p]	3	2 (2)	2 ¾ (3)	2 ¾ (3)	2 ¾

5. Risks around the Key Judgements

This summary of the risks to the forecast was presented at Draft 1. The Committee saw the balance of risks as being slightly to the downside, and incorporated a downside skew of -0.1 on all three years for GDP, and -0.1, -0.05 and 0.0 in years 1, 2 and 3 on inflation.

Key Judgements	Risks
KJ1: Global growth remains well below past average rates as emerging economy growth recovers only a little from current weak rates and advanced economy growth remains modest	Downside risks: • Severe slowdown in China • Sharper slowing in non-China EMEs • Euro-area policy actions insufficient to prevent low inflation becoming entrenched • Greece exits euro with contagion limited by policy response • FOMC policy tighter than implied by the market curve Upside risks: • Additional ECB policy • Stronger momentum in US consumption
KJ2: Domestically, productivity growth supports supply as the growth in labour supply slows	• The risks around the starting output gap are balanced, for example, as the wage residuals are around 0. On one hand, though, top-down filters suggest a larger output gap. On the other, the unemployment and average hours gaps could be smaller. • The risks to productivity growth have become more balanced.
KJ3: UK private demand remains resilient in the face of developments abroad and the continuing fiscal consolidation at home	• We may have built in too much or too little effect from increased risk aversion given developments abroad. • More generally, households and firms may be unwilling/unable to dis-save as much as in the central projection. • The impact of the fiscal consolidation may be larger. But its effects could have come through earlier and be less persistent. • The risks to productivity – and, therefore, income – growth have become more balanced.
KJ4: The drag on CPI inflation from external factors gradually dissipates and wage and domestic cost growth strengthen	• The risks around the starting output gap are balanced. • On the one hand, less of the inexplicable weakness in the level of wages may unwind. On the other, wage pressures may be greater than we're assuming when spare capacity is close to being used up. • We could be wrong about the speed and magnitude of pass-through of sterling's appreciation to import prices and CPI, but not obvious risks are in one particular direction. • The likely more protracted period of low inflation may cause inflation expectations to become less well anchored.

6. How the forecast compares to externals



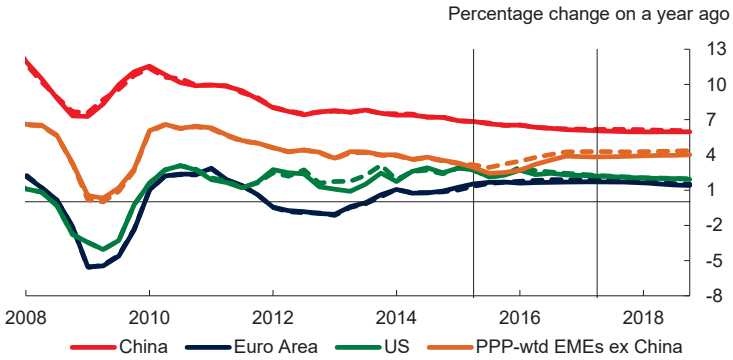
Diamonds represent the average external forecast, bars represent the range

- The **GDP growth** projection is a little below the average external forecast in 2015 but is stronger than most external forecasts in the medium term (**LHS**). Excluding the effect of the backcast, calendar year growth is projected at 2.4% in 2015, 2.5% in 2016 and 2.7% in 2017 (average external = 2.6%, 2.4% and 2.5%). The difference in the medium term is mainly accounted for by the MPC's forecast for consumption being stronger than the average external forecast (2.1pp and 1.9pp in 2016 and 2017 compared to 1.7pp and 1.5pp respectively).
- The **unemployment rate** is in line with the average external forecast over 2015 and the majority of 2016 (**centre**). Over the remainder of the forecast horizon the MPC's forecast falls faster than the average external forecaster and is at the bottom of the range of externals, reaching 4.8% at the end of 2018.
- The **inflation** forecast is broadly in line with the average external forecast over 2015, but the MPC's forecast is towards the bottom of the range of external forecasters for much of 2016 (**RHS**). After that the MPC's forecast rises back to the target more quickly than externals, reaching 2% in 2017Q4 and then overshooting, while the average external does not expect inflation to be back at target until 2018Q1.

Key Judgement 1: Global growth remains well below past average rates as emerging economy growth recovers only a little from current weak rates and advanced economy growth remains modest

7. The outlook for the world

EA, US, China and non-China EME GDP growth



GDP forecast comparison

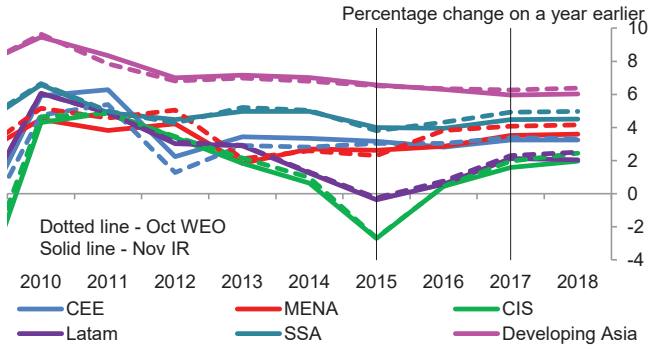
		Calendar-year growth rates (%) 2015	2016	2017
UK-weighted world GDP growth	Nov IR	2.2	2.3	2.4
	Consensus	2.4	2.5	
	WEO	2.1	2.5	2.6
PPP-weighted world GDP growth	Nov IR	3.0	3.3	3.4
	Consensus	3.1	3.5	
	WEO	3.1	3.6	3.8
Euro-area GDP growth	Nov IR	1.5	1.7	1.7
	Consensus	1.5	1.7	
	WEO	1.5	1.6	1.7
US GDP growth	Nov IR	2.5	2.4	2.2
	Consensus	2.5	2.6	
	WEO	2.6	2.8	2.8
China GDP growth	Nov IR	6.7	6.3	6.0
	Consensus	6.8	6.5	
	WEO	6.8	6.3	6.0
PPP-weighted non-China EMEs GDP growth	Nov IR	2.8	3.3	3.8
	Consensus			
	WEO	2.8	3.8	4.5

IR = Nov IR
Consensus = October
Oct WEO

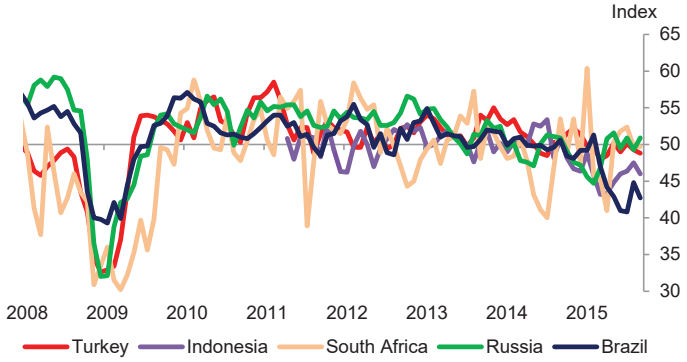
- World activity growth has once again surprised to the downside, and is expected to remain subdued before recovering modestly in 2016 (**LHS** and **RHS**). This reflects stronger cyclical and structural headwinds for non-China EMEs and Asia and spillovers to AEs.
- The **euro-area** is expected to grow modestly over 2016 supported by ECB's asset purchase and lower oil prices. But the negative spillovers from a slowdown of **non-China EMEs** and tightening financial conditions are expected to drag on euro-area growth.
- In the **US, GDP** growth slowed in Q3 to 0.4% oqa from 1.0% in Q2, as weak oil related investment dragged on growth. Throughout the forecast, US growth is projected to slow slightly as the dollar appreciation and tightening financial conditions weigh on growth.
- **Chinese GDP** growth is expected to slow slightly throughout the forecast period as it rebalances its economy. **Non-China EME GDP** growth is projected to pick up slightly in 2016 as activity stabilises in Russia, Brazil eventually emerges from recession and the drag on commodity producers from low oil prices diminishes. But potential growth is judged to be weaker than its pre-crisis average.

8. Non-China EMEs

Differences in contribution relative to the October WEO



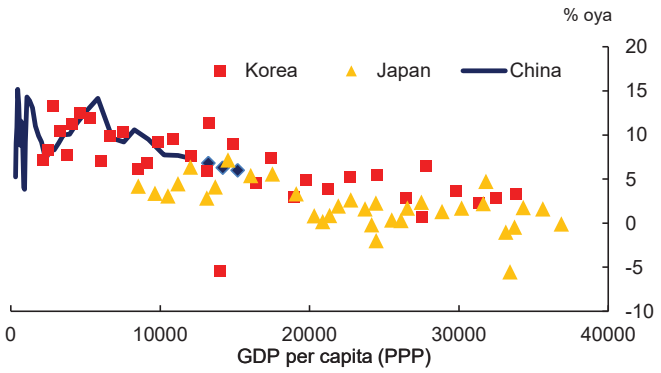
PMIs for selected non-China EMEs



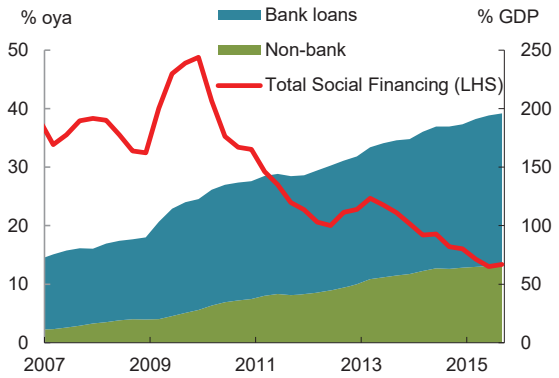
- Q2 GDP across a number of non-China EMEs were disappointing, but particularly for Russia and Brazil, due to spillovers from a slowdown in China, and a deterioration in the terms of trade from lower commodity prices exacerbated by idiosyncratic challenges. PPP-weighted non-China EME growth slowed to 2.9% oya from 3.3% in 2015Q1. But it is forecast to pick up modestly throughout the forecast period to 4.0% by 2018Q4.
- The central projection assumes a 0.5pp weaker non-China EMEs growth relative to the October WEO by the end of the forecast period, driven mainly by a weaker outlook for **Russia** and **Latam** (**LHS**). This reflects primarily data released since the WEO cut-off (16 September), rather than a fundamental difference in views to the IMF.
- The PMIs in a number of non-China EMEs also point to a continued contraction of activity in these countries, particularly in **Brazil** (**RHS**).
- A Chinese hard landing (**slide 9**) and lower commodity prices (**slide 18**) are significant downside risks to the forecast.

9. The outlook for China

Chinese convergence path



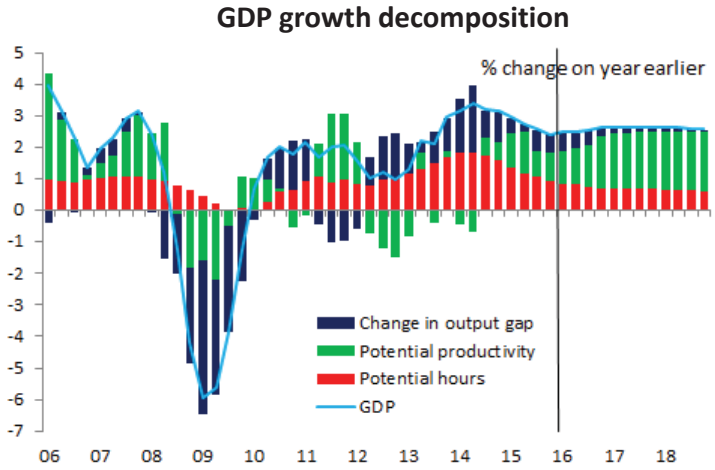
Total social financing

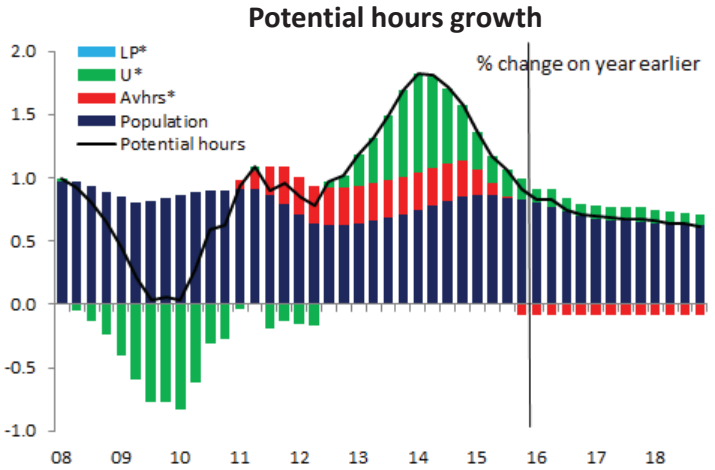


- Chinese GDP in 2015Q3 slowed to 6.7% oya , a little stronger than expected, from 6.9% in 2015Q2. The central projection incorporates further slowing in Chinese growth over the forecast period to 6.1% in 2018Q4.
- **China** has been slowing for a number of years, consistent with past episodes of catchup growth in Asia, such as **Korea** and **Japan**. The trend is expected to continue (**LHS**).
- The Chinese authorities continue to grapple with the challenge of maintaining growth against a backdrop of rapidly expanding credit. This has led to an unprecedented rise in its **debt** to around 200% of GDP (**RHS**). The ability of the Chinese authorities to continue managing debt overhang while maintaining rapid growth depends on policy space which is now being used up as benchmark interest rates are cut and reserves are drawn down.
- Although the central projection does not reflect a sharp slowdown in China, there are downside risks that could lead to a hard landing.

Key Judgement 2: Domestically, productivity growth supports supply as the growth in labour supply slows

10. Accounting for potential GDP growth

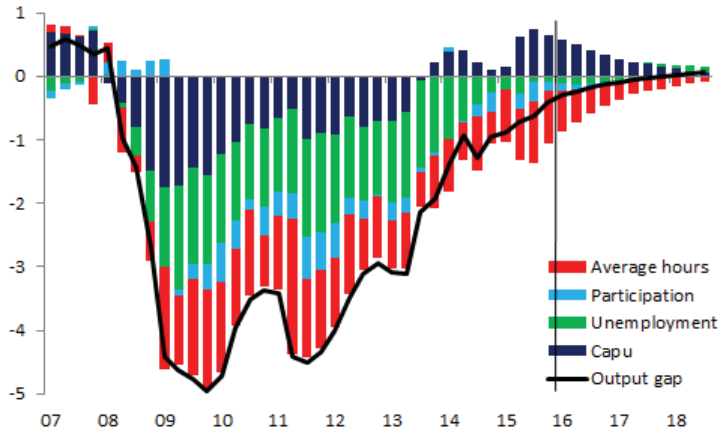




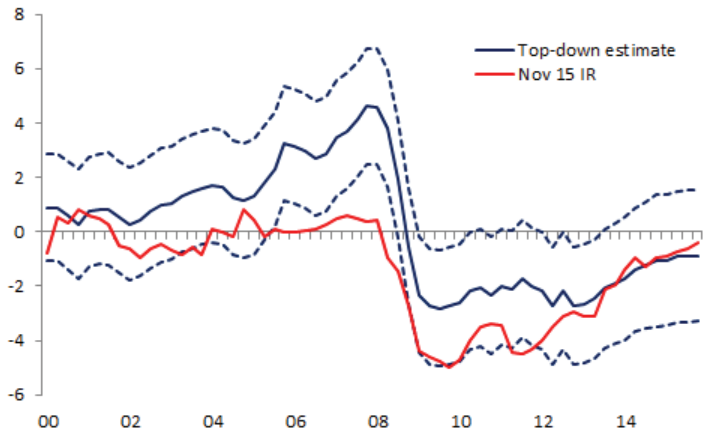
- We think that GDP growth has continued to outstrip growth in potential supply over the last few quarters, resulting in a further narrowing of the **output gap** (**Slide 11**), to around ½% in 2015Q4 . Within potential supply, growth in **potential hours** has slowed materially from the rapid pace in 2014, though remains moderately above trend. But set against that, **potential productivity** growth has started to strengthen somewhat (**LHS**).
- Over the forecast, the output gap is projected to narrow slowly over the next couple of years, reaching zero in late-2017 and turning slightly positive thereafter. Contributing to that, GDP growth is projected to be broadly flat, but potential supply growth is expected to strengthen steadily as further gradual improvements in **potential productivity** growth outweigh further slowing in **potential hours** growth. By the end of the forecast potential productivity growth has picked up to 1.9%
- The expected slowing in potential hours growth reflects a variety of factors: slower **population growth** due to slower migration, slower declines in **U*** as unemployment itself falls more slowly than in recent quarters, and small declines in **average hours** (**RHS**, .

11. The output gap

Output gap decomposition



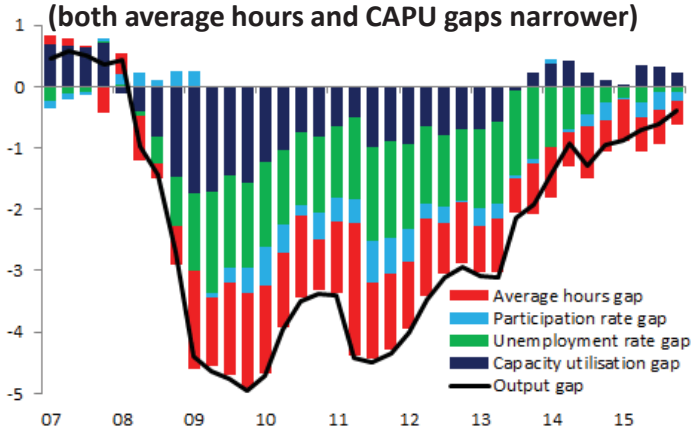
Top-down and bottom-up output gap estimates



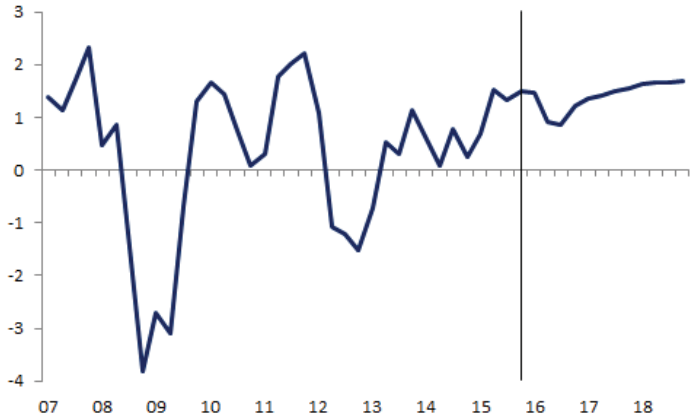
- Having narrowed rapidly through 2012 & 2013, the **output gap** has closed at a somewhat slower pace in recent quarters, and it starts the forecast at 0.4% in 2015Q4 (**LHS**). A modest pace of narrowing continues in the forecast: the output gap is expected to reach zero in late-2017 and turn slightly positive thereafter.
- Having fallen more swiftly than anticipated since the August 2015 IR, the **unemployment rate** starts the forecast at 5.3%: around 0.1pps above our estimate of U*, and around ¼ppt above our estimate of the natural rate. The unemployment rate is projected to fall slowly but steadily over the forecast, reaching 4.8% in 2018Q4, moderately below our estimate of U* of around 5% at that time. Positive **capacity utilisation** is offset by a negative **average hours gap**, while the **participation gap** is all but closed.
- The output gap estimate for Q4 2015 is a touch (0.1pps) wider than in August. That reflects a balance between our **top-down** and **bottom-up** estimates (**RHS**). From our bottom-up estimates, hours worked have recently been notably weaker than expected, but that has been partly offset by survey measures of capacity utilisation picking up. SEAD's top-down measure of the output gap was also a touch wider than in August.

12. The balance of supply

Indicative alternative output gap decomposition (both average hours and CAPU gaps narrower)



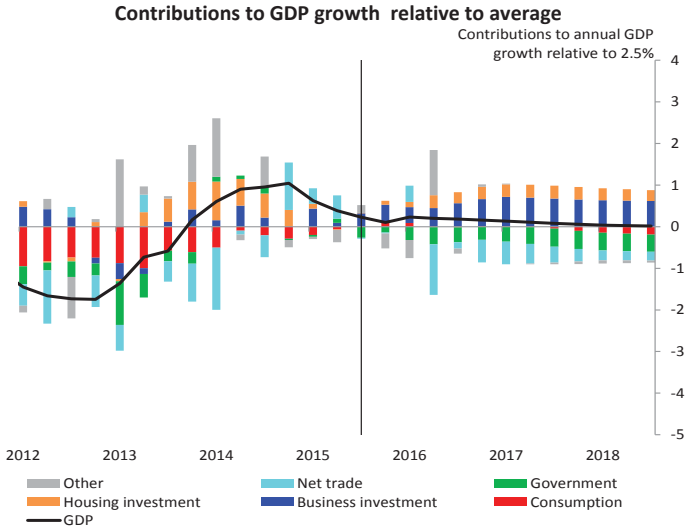
Productivity (hours) growth (% YoY)

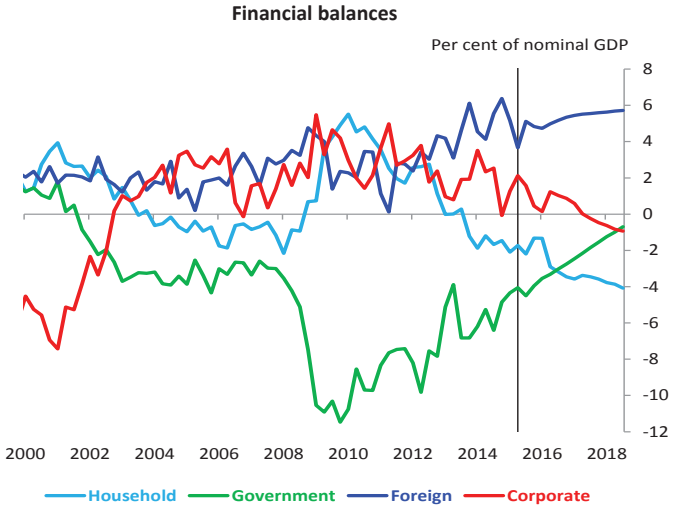


- Within our current estimate of the output gap, a significant negative average hours gap is partly offset by above-average **capacity utilisation** (CAPU). However, the risks are likely skewed to the equilibrium level of **average hours** (avhrs*) being lower than our current estimate, but capacity utilisation being somewhat closer to equilibrium than our current estimate.
- Treating much of the recent increase in productivity as cyclical means that productivity growth picks up relatively little over the forecast (**RHS**): the underlying pickup in structural productivity growth **(Slide 11**) is offset by the unwinding cyclical boost.
- Adjusting our central estimates more into line with those risks would yield a more balanced composition of the output gap: narrowing both the **average hours** and **CAPU** gaps (**LHS**). The composition of potential supply - but not the aggregate - over the forecast would also change: stronger productivity per hour growth (as less of the recent growth would be cyclical), but slower growth in average hours (as there would be less of a gap to close). The impact on demand and inflation over the forecast would be minimal.
- However, making such changes might be better undertaken as part of the next broader supply stocktake.

Key Judgement 3: UK private demand remains resilient in the face of developments abroad and the continuing fiscal consolidation at home

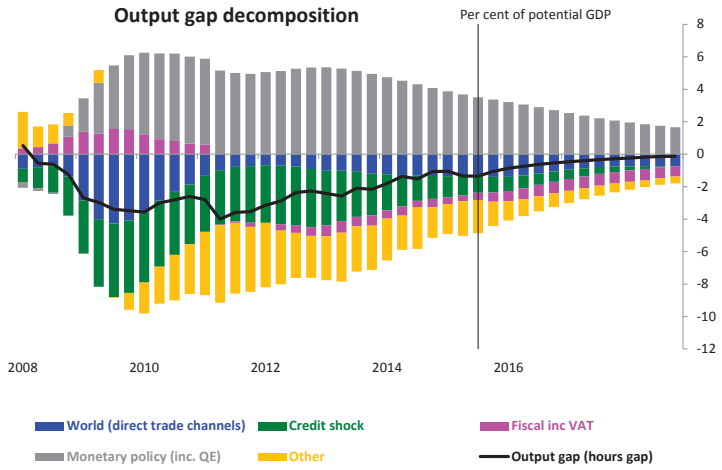
13. Accounting for GDP growth

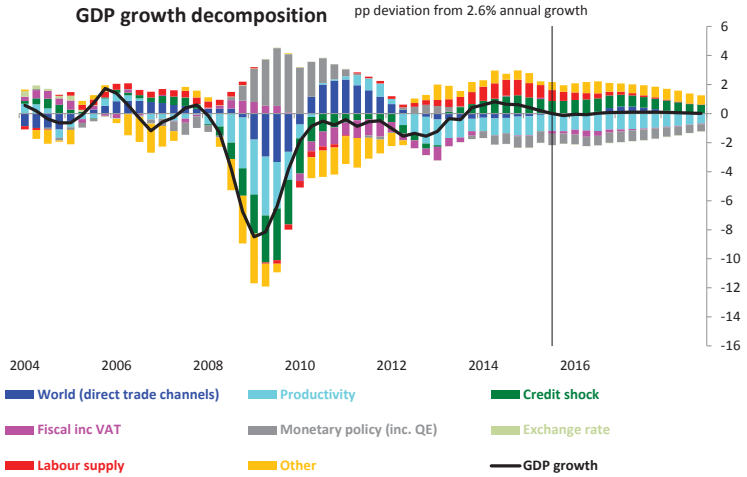




- Over the forecast, GDP growth is accounted for by strength in private domestic demand. External demand is weak: **net trade** and **government spending** weigh on annual growth by almost 1pp relative to average (**slide 17**). Offsetting that, **consumption** grows at around average rates, with weak income growth manifesting instead in a falling savings rate, while **housing investment** grows strongly relative to average (**slide 15**). And **business investment** growth is robust, particularly in the first half of the forecast (**slide 16**).
- On the incomes side, private demand is reflected in falling private saving. Over the forecast, declining **private sector** financial balances are the counterpart of the continued upwards slope in the **government** financial balance; the **current account** deficit is broadly flat over the forecast. The flat current account reflects a very slight deterioration in the nominal trade balance over the forecast, together with a judgement that net income from abroad will not rebound from its recent decline.

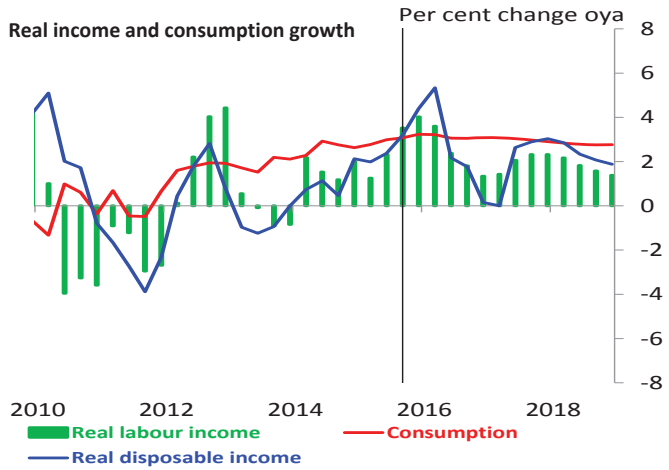
14. Explaining GDP growth

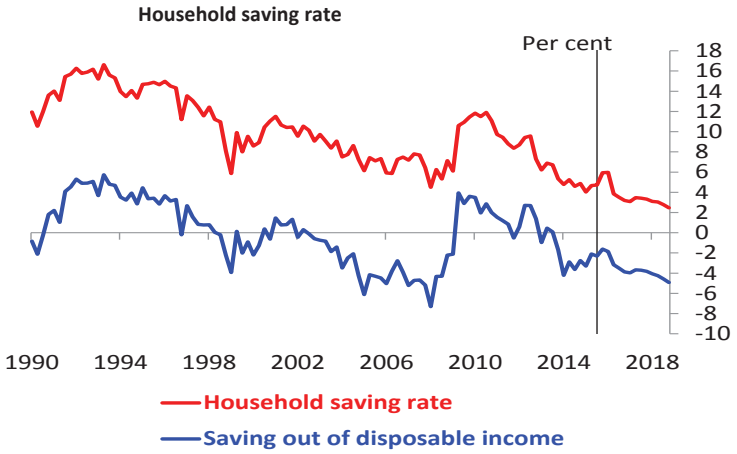




- Since the crisis and over the forecast, negative demand shocks originating from **world trade** and **credit** have weighed on GDP and the output gap (**both charts**), as have **other negative shocks**: increased uncertainty, deleveraging and non-trade spillovers. These headwinds to demand fade gradually over the forecast (**LHS**), contributing positively to GDP growth (**RHS**).
- The drag from the **fiscal consolidation**, however, continues to increase (**slide 17**): it drags on growth throughout the forecast (**RHS**). And weak supply growth also drags on GDP growth, with continuing weakness in **productivity** more than offsetting the continued boost from **labour supply** (**slide 15**).
- Positive demand shocks from looser **monetary policy**, have so far partially offset these headwinds (**LHS**). Over the forecast the boost from policy fades, dragging on GDP growth (**RHS**). But the lingering effect is enough to offset the remaining drag from other headwinds, leaving the output gap very slightly positive at the end of the forecast.

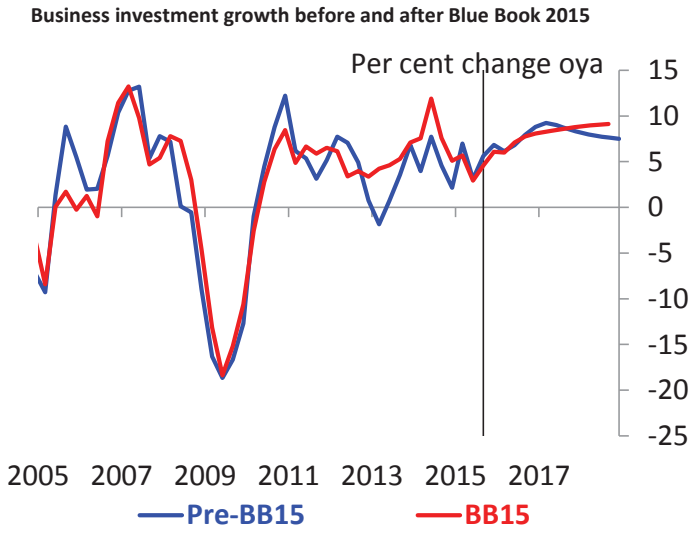
15. UK private demand: consumption and housing

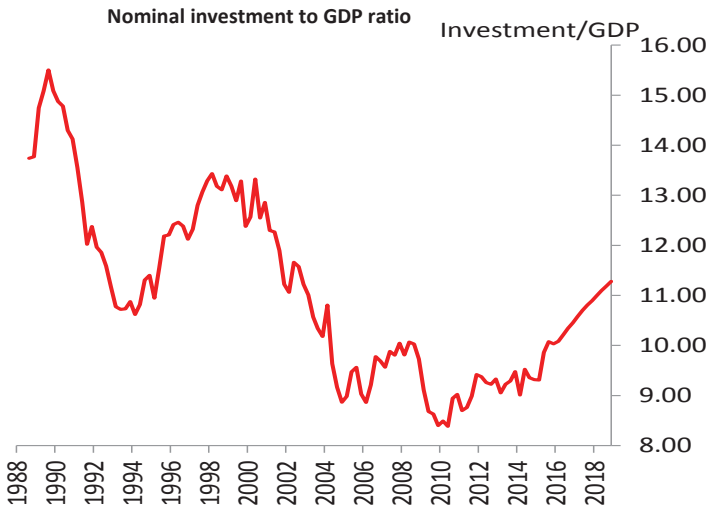




- **Consumption** growth has picked up since 2011 (**LHS**), to around average rates. The saving ratio has consistently fallen from its crisis highs (**RHS**), reflecting more easily accessible credit, improvements in households' balance sheets and a recovery in the housing market. Over the more recent past, **real labour** and **real household incomes** have also grown robustly as wage growth has picked up and import and oil prices have fallen.
- Over the forecast, **consumption** continues to grow at around average rates; but **household income** growth is somewhat weaker, reflecting the slow recovery in wages and the fiscal consolidation. So households continue to reduce their saving over the forecast: the saving ratio ends at 2.5%. This is its lowest level since the 1960s; on the other hand, household wealth to income ratios are higher than at any point since 2000, suggesting there may be space for households to reduce the level of precautionary saving over the future.
- Housing investment has slowed in recent quarters, perhaps reflecting biting supply constraints. Over 2016 growth is expected to pick up and then remain stable; but housing investment's share of GDP remains below its pre-crisis average throughout.

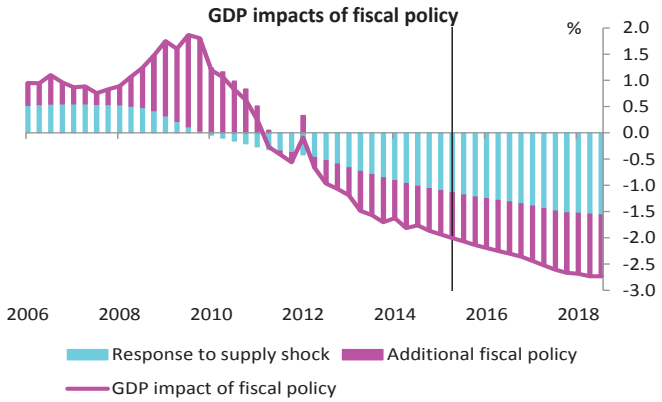
16. UK private demand: investment





- Business investment has grown at an annual rate of around 5% over the past two years, following downward revisions in the Blue Book. The level of business investment was also revised lower in earlier periods, although this largely reflects a classification change (**LHS**).
- **Investment** expands robustly over the forecast, supported by the low real cost of capital, low macroeconomic uncertainty, and the low level of corporate gearing. Growth peaks in 2017 (**LHS**), but its share in GDP continues to rise throughout the forecast (**RHS**); this profile is broadly in line with the forecasts from a suite of VECMs, shown at Key Issues, although the uncertainty around these is very large.
- For more on the risks to UK private demand, see the .

17. Developments abroad and the fiscal consolidation

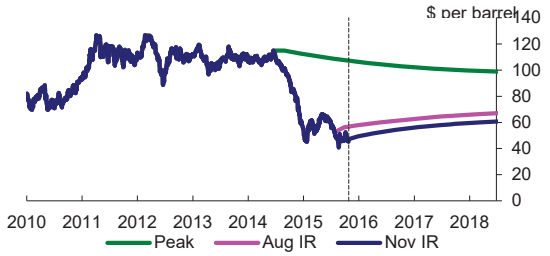


- The government first announced its plans for fiscal consolidation in the 2010 Budget, and reiterated its commitment to further cuts over (and beyond) the forecast horizon in the July 2015 Budget. We estimate that fiscal policy is currently dragging on the level of GDP by 2% (**LHS**). That drag is forecast to widen to just under 3% by the end of the forecast horizon.
- Part of the fiscal consolidation was (and will be) a **necessary adjustment of the government** to the large, negative supply shock that hit the UK. **Additional consolidation measures** have dragged further (and will continue to do so) over the forecast.
- Our estimates of the effects of the consolidation cover more than just the direct effects on spending. Government spending itself is broadly flat over the forecast – this is below its historic average (**slide 13**), but not enough to drag on GDP. But we also assume substantial negative second round impacts via incomes and private demand.
- Continued weakness in world activity drags on UK export demand. On top of that, the **export share** continues its long-standing downward trend (**RHS**); and over the forecast, the continued impacts of the large appreciation of sterling since 2013 push down further on UK exports relative to world demand.

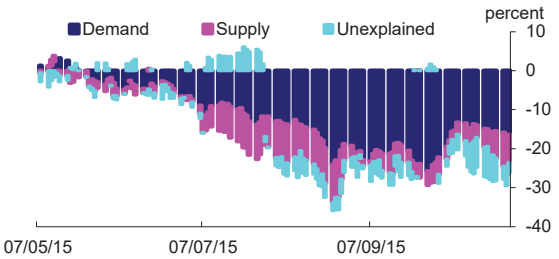
Key Judgement 4: The drag on CPI inflation from external factors gradually dissipates and wage and domestic cost growth strengthen

18. Commodities

Oil futures curves

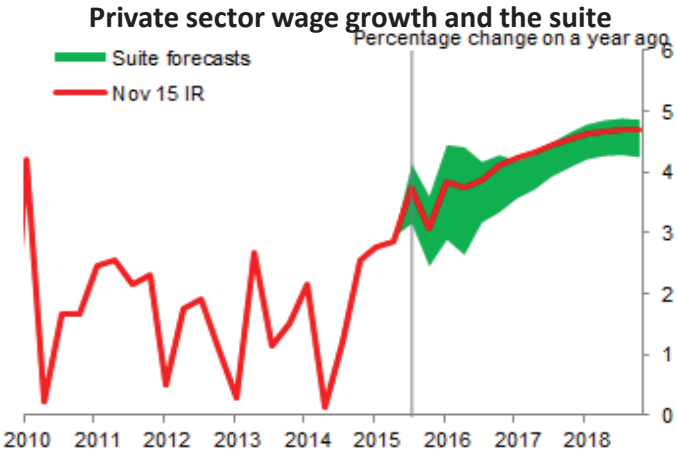


Asset price based decomposition of oil price



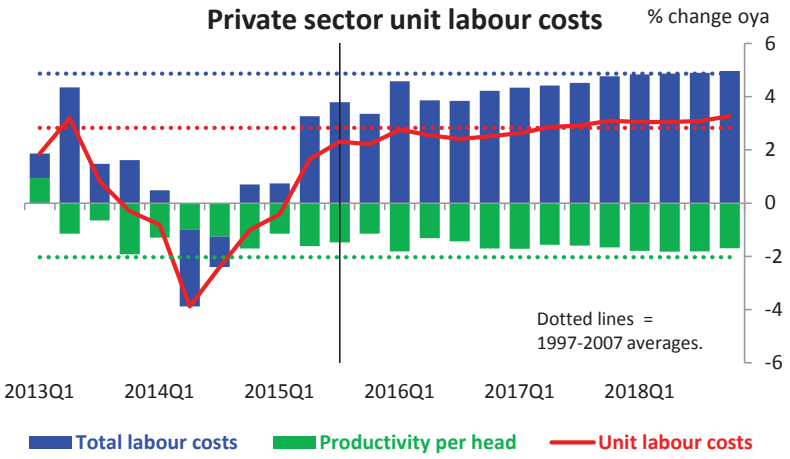
- The spot price of **Brent crude** underpinning the November *IR* was 10% lower than the August IR price, and around 60% lower than its **peak** of $115pb in June 2014, to $47pb (**LHS**). Prices across the curve were 11% and 44% lower than the August IR and June peak, respectively.
- The fall in oil prices since its May 2015 peak appears to primarily reflect demand factors (**RHS**)**.** Concerns over weakness in Chinese demand (s**lide 9**) and growth concerns over other emerging markets (**slide 8**) have added downward pressure to oil prices. Meanwhile, oil supply has proved surprisingly resilient to low prices, and the IEA expect oil production to outstrip consumption throughout 2016, although the production/consumption imbalance is expected to narrow.
- The **futures curve** underpinning the November *IR* suggests a gradual rise in the oil price to around $62pb by the end of the forecast. But there is a lot of uncertainty around the path of future prices. Further weakness in Chinese demand and the knock-on effect on world demand are a major downside risk to oil prices. Additionally, the expectation of Iranian oil coming on to the market in 2016Q1 has added downward pressure to oil prices, with market participants expecting an increase of Iranian oil production of around 0.5mbpd over the coming year.
- **NOCs** prices have fallen and are 4% lower than the August IR across the curve, primarily reflecting weakness in demand.

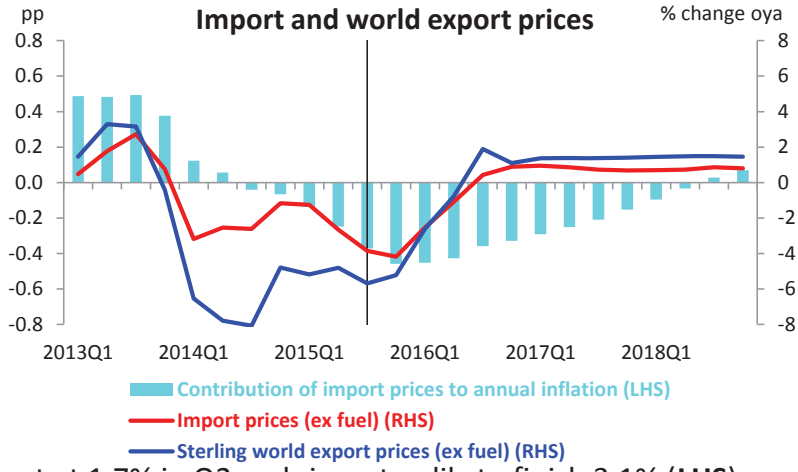
19. The outlook for wages



- After a prolonged period of weakness, **pay growth** in the private sector has been notably stronger over the last year (**LHS**), and is now broadly where we'd expect it to be given its main determinants (the residuals from our suite of wage equations are on average close to zero, although the range is unusually wide).
- Over the forecast, wage growth is close to our **wage suite models** – conditional on an underlying recovery in productivity (**slide 10**) and a shrinking labour market gap (**slide 11**), as well as a judgement that real wages are below their equilibrium level and will catch up over the forecast; this latter assumption is built into some of the wage suite models.
- The catchup in wages is also evident in a chart of **real wages** and **productivity** (**RHS**). **Real wages** starts have fallen by more than **productivity** since the crisis – the suite models attribute part of this weakness to the drag from the output gap over the past, but cannot explain the full extent of the weakness (they produce a string of negative residuals in the past few years). The shortfall in wages gradually closes, and so the labour share rises over the forecast. Much of the catch up comes through nominal wages rather than prices, so that private sector unit labour cost growth is above historic averages for much of the forecast (**slide 20**).

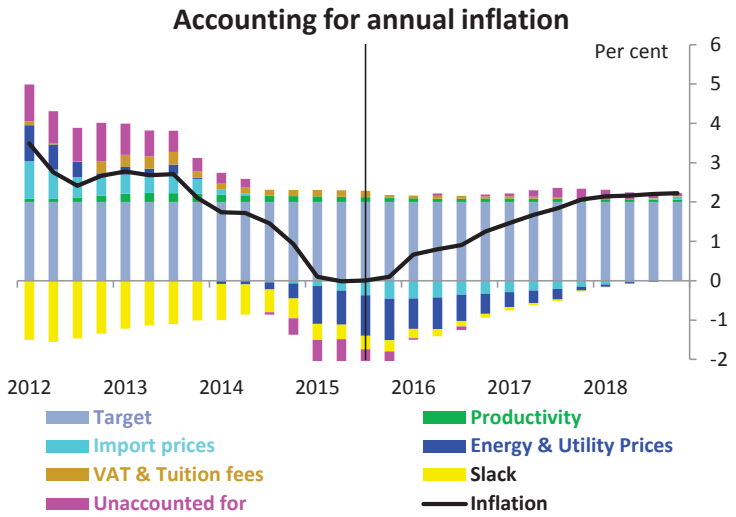
20. Labour and import costs

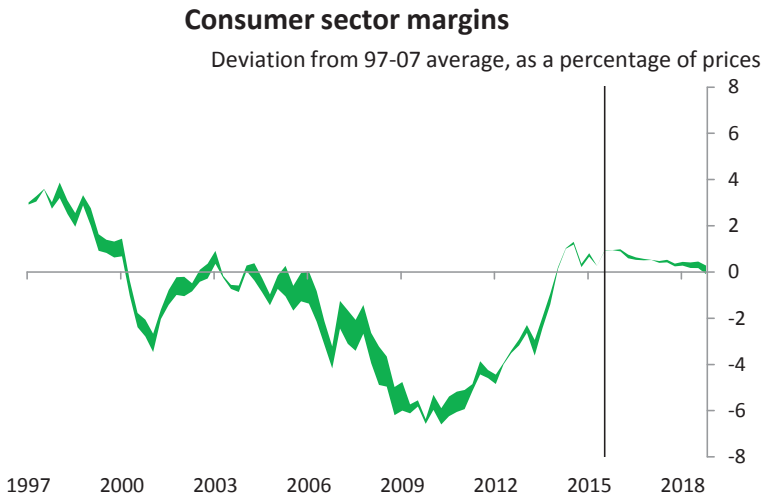




- Private sector **unit labour cost** growth starts the forecast at 1.7% in Q2 and rises steadily to finish 3.1% (**LHS**), above its historic average (dotted line): **total labour cost** growth outpaces the relatively slow pickup in **productivity growth** that we have assumed in the central case (**slide 10**). Whole economy ULCs accelerate by less, with the strength in private sector costs offset by continued downward pressure on public sector wages from the fiscal consolidation.
- The rise in private sector ULCs does not primarily reflect demand pressures – the output gap is negative for most of the forecast and only ends very marginally positive (**slide 11**). Instead it reflects our assumption that the level of real wages will catch up to the level of productivity over the forecast (**slide 19**).
- Non-fuel **import prices**, which have been falling since 2013 as sterling has appreciated, continue to fall over the first few quarters of the forecast (**RHS**). But with the resumption of **world export price** growth and a downward sloping exchange rate path (**slide 6**) that fall comes to an end in mid 2016, so that import costs grow moderately over the rest of the forecast. Given our assumptions about the speed of passthrough, however, we think import prices are currently dragging on inflation and will continue to do so for some time: the **drag from import prices** peaks near the start of the forecast and then declines, becoming very small by 2018.

21. The outlook for inflation





- Inflation starts the forecast at 0.0%. The current weakness largely reflects downward pressure from **energy** (**slide 18**) and **import prices** (**slide 20**), together with a continued drag from the remaining **output gap** (**slide 11**) and some additional factors such as food prices which are **unaccounted for** in this decomposition (**LHS**).
- Although import prices have been falling since mid-2013, slow pass-through to consumer prices means that their contribution to annual CPI inflation has only recently turned negative, and continues to drag until 2018; energy and utility prices do the same. That slow pass-through, together with the recovering labour share (**slide 19**), means **margins in the consumer sector** fall back over the forecast (**RHS**).
- By the end of the forecast the drag from all these factors has dissipated. The slightly positive **output gap**, increasing **import prices** and continued weakness in **productivity** push inflation slightly above target, to 2.1% in year 2 and 2.2% in year 3 (**LHS**). We cannot, however, fully account for the strength of inflation in these terms; positive **unaccounted for** contributions over the forecast may reflect the differential effects of different shocks in our models, which this simple decomposition cannot capture (has details).