Essential Reading

November 2015 Benchmark Forecast Note

(CAPD,)

- The **world outlook** has weakened materially and the **yield curve** on which the forecast is conditioned has fallen to levels similar to February, reaching just 1.3% at Year 3 (**Chart 1**). That's 50bps lower than in August, reaching 0.75% in 2017Q2 – compared to 2016Q2 in August. Coupled with **sterling's depreciation** of 2.5% and little change in **credit spreads**, other things equal, looser monetary conditions provide a material boost to the forecast relative to August. That outweighs the downgrade to the world forecast such that the growth and inflation projections are materially stronger and the unemployment projection much lower than in August.
- Quarterly **GDP growth** settles at 0.7% over the forecast, compared to around 0.6% in August (**Chart 2**). The starting point for the **output gap** is very little changed at -0.4% in 2015Q4 (**Chart 3**). It turns positive from 2017Q1 onwards and ends at +0.5% with unemployment falling to 4.4% at Year 3. As a result, inflation rises materially above target to 2.2% at Year 2 and 2.4% at Year 3, although the near-term profile for **inflation** is weaker owing to further falls in oil and commodity prices (**Chart 4**).
- So, **taking all the judgments in the Benchmark forecast as given suggests the market curve is too low to keep inflation at target in the medium-term. The key judgement for the Committee this round is whether that's right or not.**
- **At the Benchmark meeting, we will take the Committee through the updated UK forecast; focusing on the signal we should take from the large moves in asset prices since August, in particular the likely impact of the fall in the yield curve. At the Key Issues meetings, we will focus on the outlook for private domestic demand and the global economy, respectively.**

Chart 1: The conditioning path for Bank rate reaches 1.3%

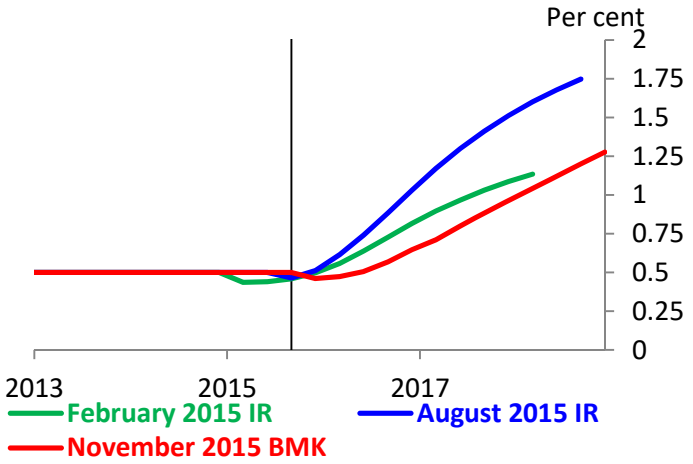


Chart 2: Quarterly GDP growth settles at 0.7, rather than 0.6%

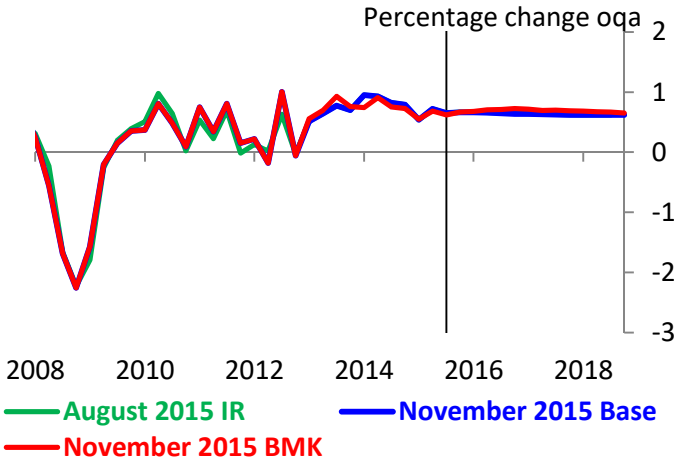


Chart 3: The output gap reaches +0.5% in Year 3

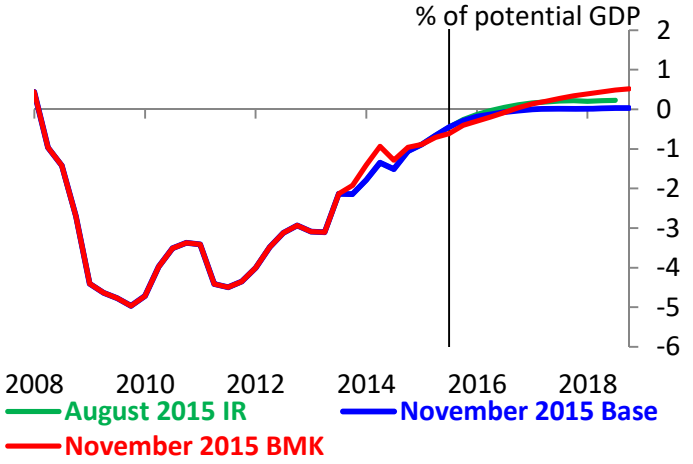
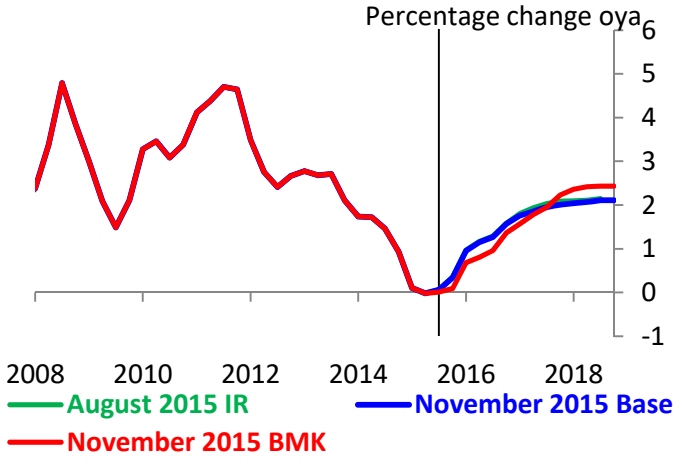


Chart 4: CPI inflation rises to 2.2% and 2.4% at Years 2 and 3



Note: To increase transparency, **the Benchmark forecast (red lines in the charts) excludes past MPC profiling judgements**. In practice, we have excluded just one of these: the judgement from May to raise inflation at Years 2 and 3 by making the output gap more positive. To compare changes in the forecast on a like-for-like basis, we have constructed a 'November Base' forecast (shown by the blue lines), removing that judgement from the August projections (the green lines). This November Base forecast has inflation at 2.0% and 2.1% at Years 2 and 3 and a closed output gap at Year 3.

INTRODUCTION

This note has three sections. The first section describes the narrative underlying the November Benchmark forecast. The second section outlines the key changes since August. The final section summarises the risks that were embodied in the August forecast, and sets out how the staff perceive those risks have changed.

SECTION 1: THE FORECAST NARRATIVE

1. Demand

August IR Key Judgement 1: Moderate global growth continues as international risks are contained.
August IR Key Judgement 2: Private domestic demand grows robustly, supported by sustained real income growth and a gradual decline in private sector savings.

- **Quarterly and annual GDP growth rates were 0.7% and 2.7%, respectively, in 2015 Q2.** That's **close to their average rates** as the ongoing drags from weak growth in productivity and world trade, monetary policy (including QE), sterling's appreciation since 2013 and the fiscal consolidation are offset by the boosts from looser credit conditions, strong growth in labour supply, the fall in oil prices and the dissipation of uncertainty, which we think are captured in the yellow bars (**Chart 5**).

Chart 5 : Shock-based decomposition of GDP growth

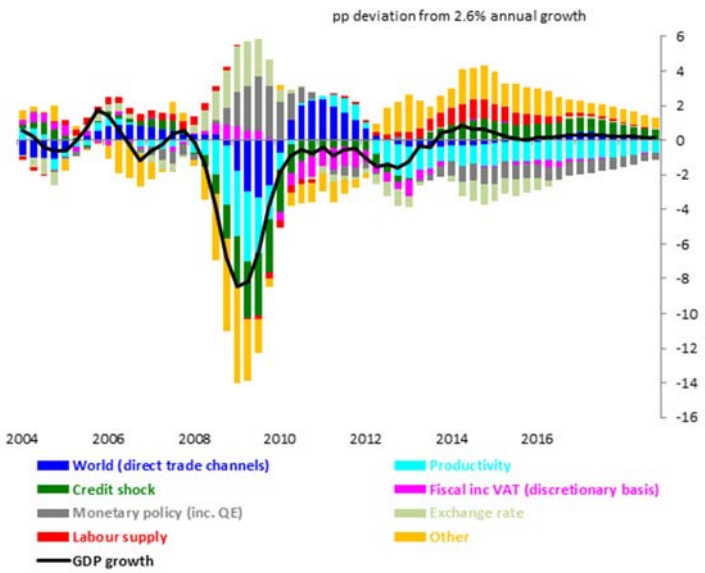
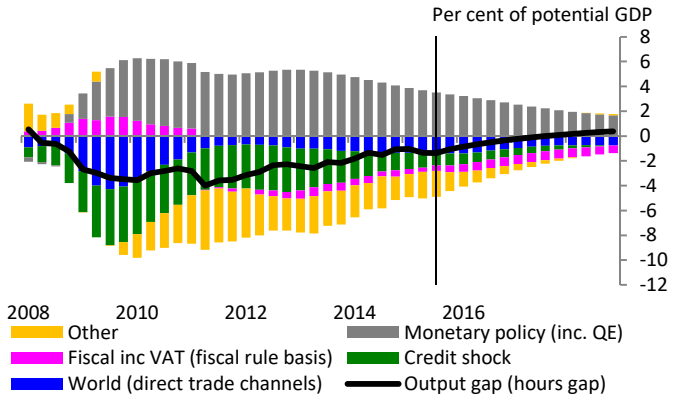


Chart 6: Shock-based decomposition of the output gap



- Although growth is now close to average, **the output gap starts the forecast slightly negative at around -½%.** The gap has been closing at a fast pace, and continues to do so over the forecast, turning positive in 2017Q1. The output gap has not closed as the combined drags on the level of GDP relative to potential from the credit shock, weakness in the world, fiscal policy and 'other' factors, which we interpret as capturing the contributions of uncertainty and other non-trade/credit spill-overs from the rest of the world related to the financial and euro area crises have outweighed the boost from monetary policy. Over the forecast, the boost from monetary policy fades less quickly than the drag from the credit, world and other (uncertainty) shocks unwind meaning the output gap turns positive and grows to around +½% (**Chart 6**). That is another manifestation of the market curve being too low given all the assumptions in the Benchmark forecast.

- **Quarterly GDP growth has slowed from rates of 0.8-0.9%s in early 2014** as the boosts from the easing of credit conditions, the dissipation of uncertainty and strong labour supply growth are now not as strong – and despite less of a drag from world trade and the boost from lower oil prices (**Chart 7**). Sterling's appreciation since 2013 has weighed on growth relatively consistently over 2014 and 2015. Consistent with that and the fall in oil prices, net trade has been the main contributor to the slowdown in

quarterly GDP growth rates between 2014 and 2015H2 in terms of the expenditure components, partly offset by stronger contributions from consumption and investment (**Charts 8 and 9**).[1]

Chart 7: Change in shock contributions to GDP growth

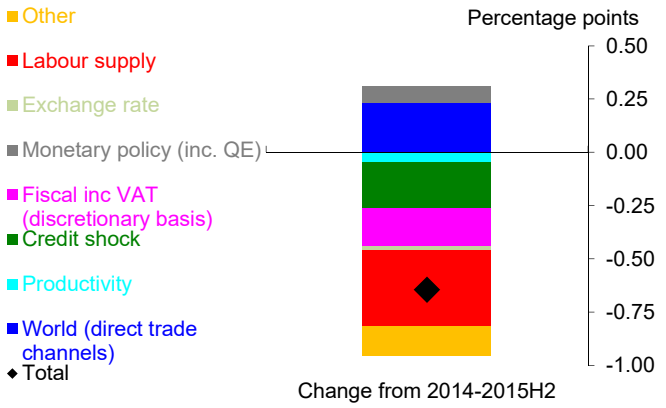


Chart 8: Expenditure contributions to quarterly GDP growth

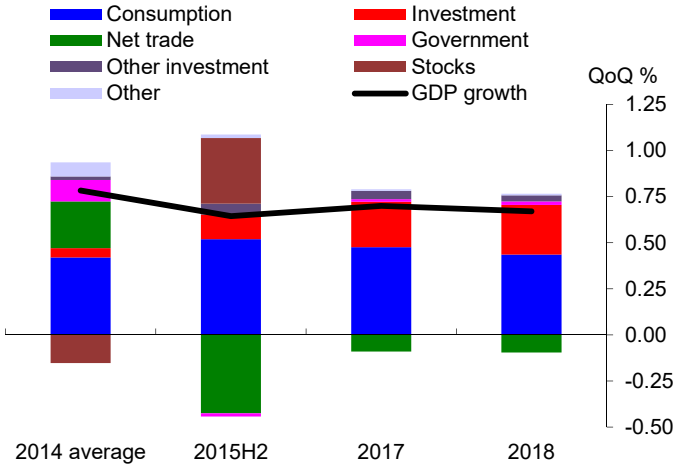
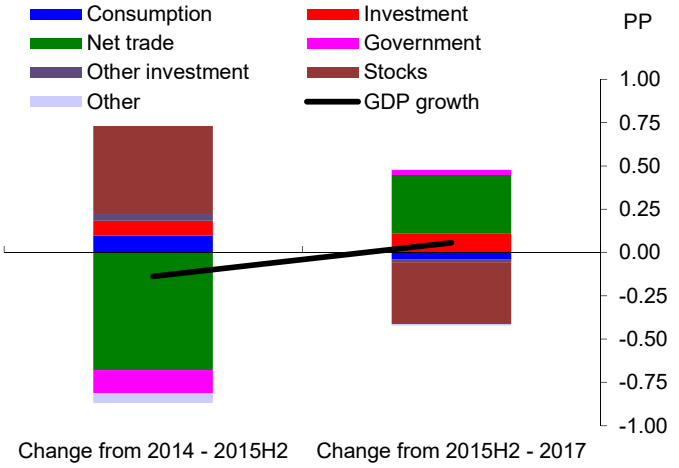


Chart 9: Change in expenditure contributions to quarterly GDP growth



- **GDP growth remains at 0.7% throughout the forecast** as the lessening drags from productivity and sterling's appreciation since 2013 offset the fading boosts from reduced uncertainty, lower credit spreads, labour supply and energy prices. Monetary policy and the fiscal consolidation continue to push down on growth, the latter continuing to detract 0.2-0.3pp from annual growth in each year of the forecast.
- Consistent with that, **the main source of growth is private domestic demand: it grows at close to 4% throughout the forecast and contributes 1pp more to growth than average throughout the forecast (Charts 10 and 11)** with business investment growing well above and consumption a little above their historical rates. They're strong enough to offset the drag from net trade and the negligible (and below average) contribution from government spending to leave overall GDP growth at around trend.

[1]

Chart 10: Contributions of expenditure components relative to pre-crisis average

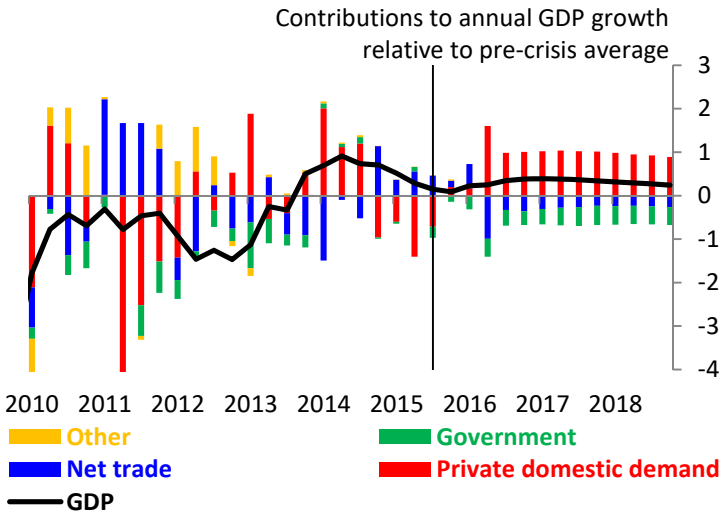
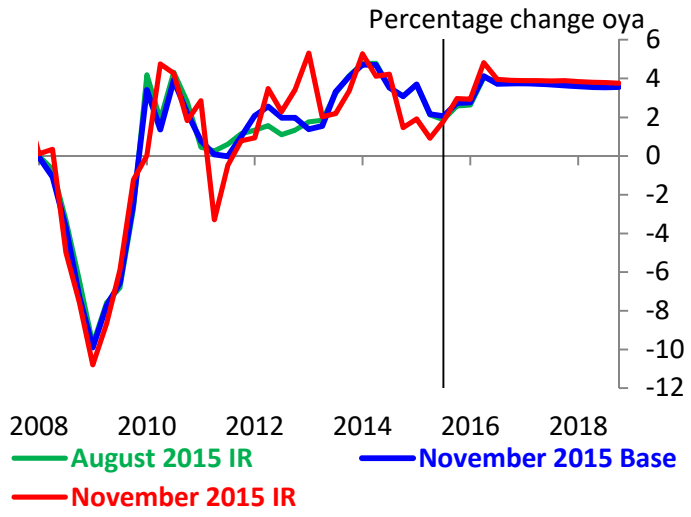


Chart 11: Private domestic demand growth



- In terms of the sectoral balances, the Benchmark forecast assumes a continuation of what we've seen over the past 2-3 years (**Chart 12**): with the private sector balance being the main counterpart to the fiscal consolidation, falling by a further 3pp over the forecast to -4.5%. Having narrowed from 6.4% of GDP in 2014Q4 to 3.7% in 2015Q2, the nominal current account position widens over the forecast to 5.4% at Year 3 as the trade balance worsens and the international income balance profile is flat.[2]

Chart 12: Sectoral financial balances

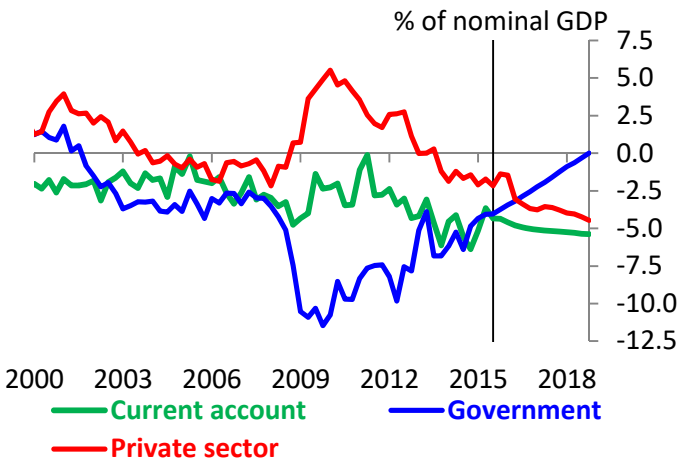
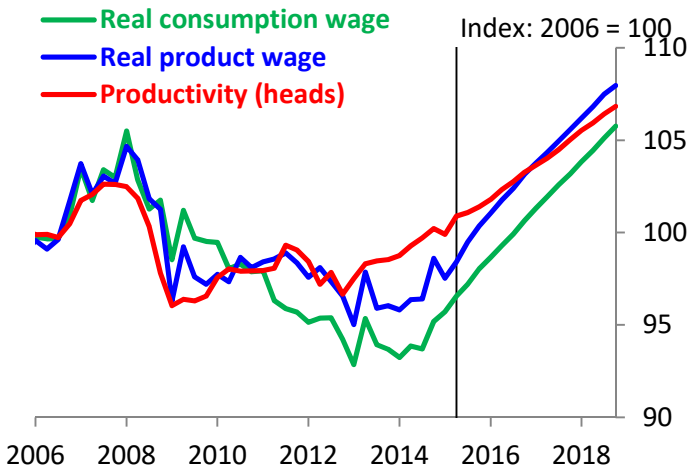


Chart 13: Real product wage, real consumption wage and productivity



- **Annual household spending growth has picked up strongly over the past couple of years to 3.0% in 2015 Q2**, supported by: the boost to real incomes from lower oil prices[3] and sterling's appreciation since 2013; and the fall in the household saving rate relating to reduced uncertainty and the loosening in credit conditions. Though consumption growth falls back slightly those factors, together with stronger growth in real wages as they catch up with (the recovery in) productivity over the forecast (**Chart 13**) continue to support it. So, abstracting from some near-term volatility relating to a prospective change in taxation of

[2] The latest estimate of the current account position appears in part to reflect data quality issues in the ONS data (see import prices section below). Putting more weight on the monthly nominal trade data would imply a current account deficit of around 5% in Q3 2015. We are going to investigate this further as the ONS intend to provide more clarity on trade data during the forecast round.

[3] The falls in oil prices seen over 2014H2 and, to a lesser extent, in 2015 have estimated to have supported consumption growth by between 0.2pp and 0.4pp in 2015Q2. That is consistent with a marginal propensity to consume out of the direct income boost of around 0.5-1.

dividends,[4] real income growth remains at around its current rate of 2½% (**Chart 14**) and the saving rate continues to fall. The revisions in the Blue Book mean the saving rate starts the forecast at 4.7% in 2015 Q2, around its lowest level since the 1960s (**Chart 15**). And it falls markedly further to 2.1% by the end of the forecast. However, **other metrics which we think are a better guide to household sustainability are a little more reassuring**: consumption to disposable income remains below its pre-crisis level; the household debt to income ratio is broadly flat; and net financial wealth to income is at its highest since 2000 (**Chart 16**).

Chart 14: Income growth decomposition

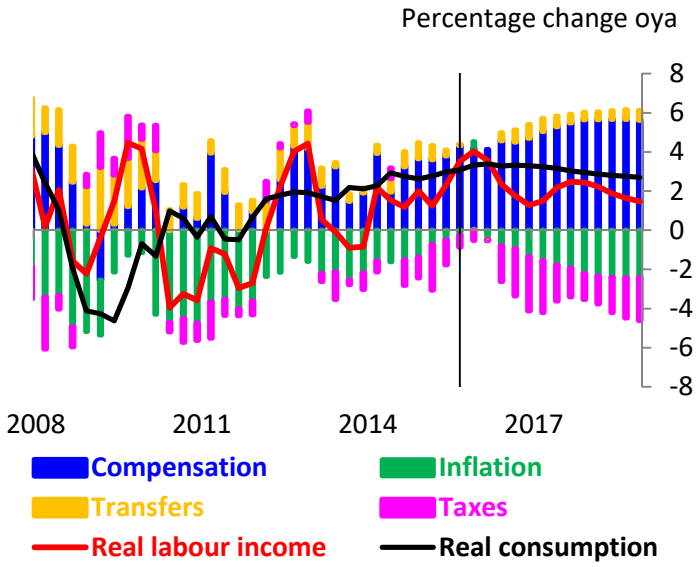


Chart 15: The savings rate

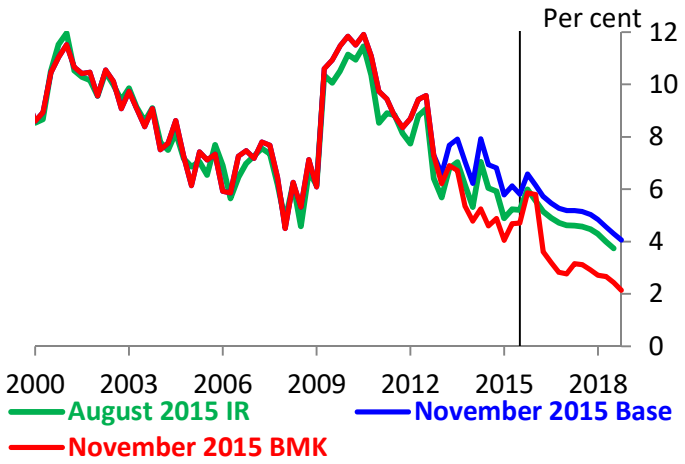


Chart 16: Household financial wealth to income ratio

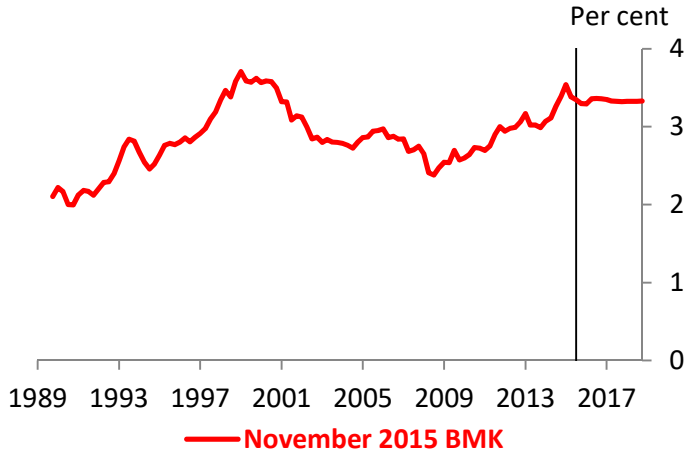
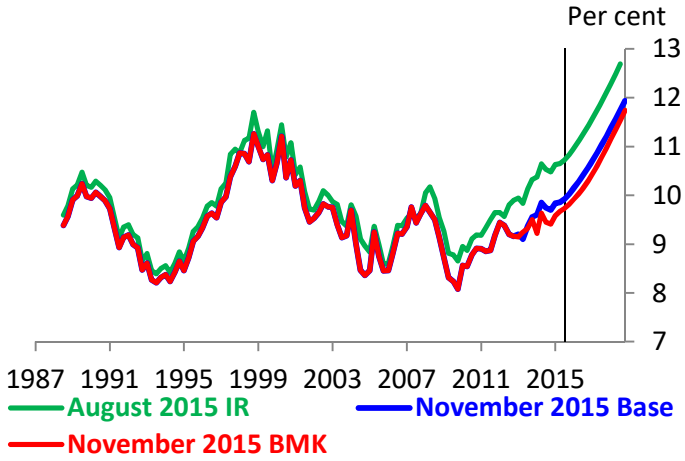


Chart 17: Business investment to GDP ratio



- **Business investment grows at 9-10% per year and by Year 3, the business investment to GDP ratio rises to 11.7%, exceeding the previous high of 11.3% in 1998 (Chart 17).** Such growth rates are not exceptional, however, and the rise in the ratio is in line with previous recoveries. Robust growth reflects firms investing to expand capacity as uncertainty has dissipated,

[4] The July 2015 Budget announced changes to dividend taxation which will increase the effect tax rate from FY2016/17 onwards. We expect UK companies to bring forward some of the dividends they expect to pay over the next few years to 2015Q4 and 2016Q1. Dividends are lower from 2016Q2 onwards as a result – the forestalling just brings forward dividends that would have been distributed anyway. Not all of these dividends will go to UK households, as quite a lot of UK equity is held by overseas investors. Additionally, dividends paid to defined benefit pension funds will not affect household income because of the statistical treatment of these funds in the National Accounts. We have based the size of this effect on HMRC estimates – they expect an extra £7.3bn of household dividend income from equities directly held. We have grossed this up a little to around £9bn, to take account of dividends from equities in DC pension schemes (in total households hold far more equities in pension/insurance funds than directly, but many of these are foreign equities, and many pension assets are in DB schemes).

crowding in from the fiscal consolidation, the loosening in credit conditions and sterling's appreciation since 2013 making (relatively import intensive) investment goods cheaper.

- **Net trade detracts c0.4pp from growth per year (Chart 18) as the impact of the appreciation continues to come through and stronger demand in the UK relative to the rest of the world. The UK's exports share is more downward sloping than over the past few years (Chart 19). Growth in both advanced and emerging economies is a little below pre-crisis averages**. Relative to the past few years, however, growth in the advanced economies is a touch faster, while growth in China and some emerging economies is lower. **The central projection assumes an agreement is reached on Greece and sticks over the forecast.**

Chart 18: Contribution of net trade to GDP growth

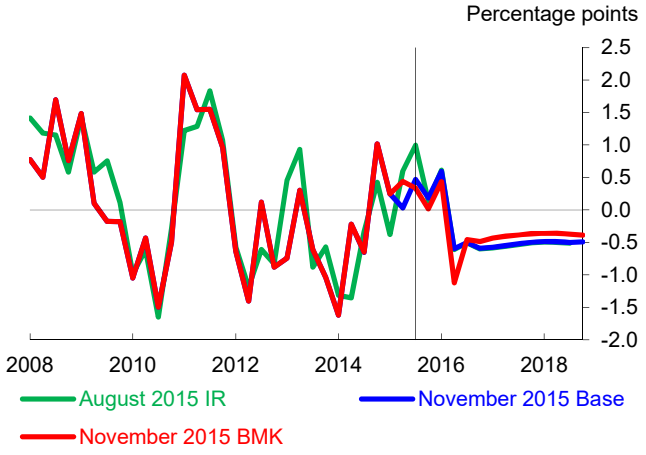
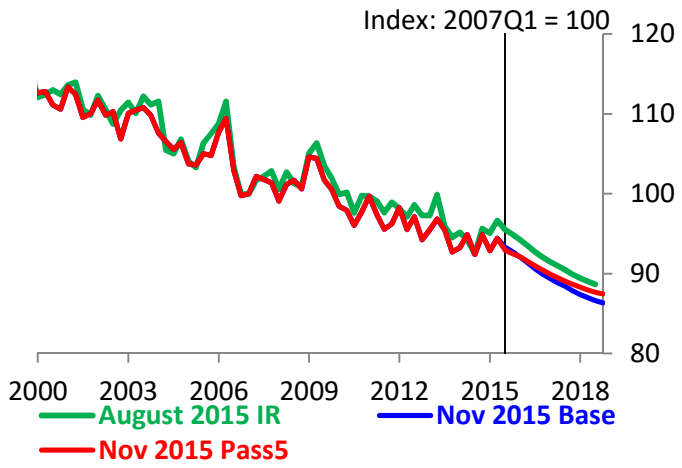


Chart 19: The export share



2. Supply and spare capacity

August IR Key Judgement 3: Wage growth continues to rise, underpinned by an absorption of slack and strengthening in productivity growth.

- **Growth in the economy's supply potential has picked up to 2½%, close to its long-run average.** Much of that reflects above average growth in labour supply reflecting strong population growth, a fall in u* and rising equilibrium average hours (**Chart 20**). And, **recently, productivity growth has finally started to pick up, rising by 1.5% in the year to 2015 Q2 (Chart 21).** Nevertheless, demand growth has outstripped supply growth over the past few years such that **the output gap has narrowed sharply from -4.5% in 2011 Q3 to -0.4% at the start of the forecast in 2015 Q4** – so, still consistent with the 'around ½%' language in the August *IR* (**Chart 22**). Within that, there is a negative labour market gap, mainly concentrated in average hours, but because we have interpreted some of the pick-up in productivity as cyclical that is partially offset by firms working above normal capacity.

Chart 20: Accounting for GDP growth

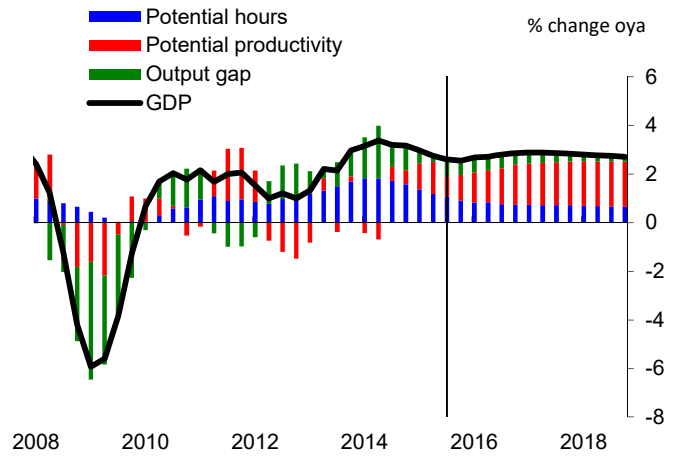


Chart 21: Productivity growth (in hours) over the forecast

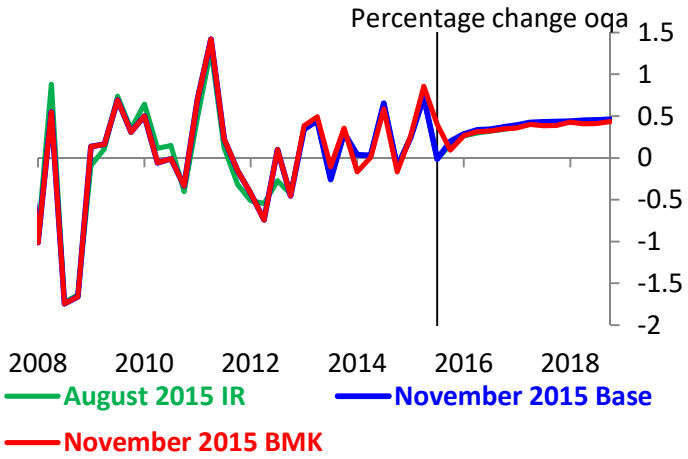


Chart 22: Accounting decomposition of the output gap

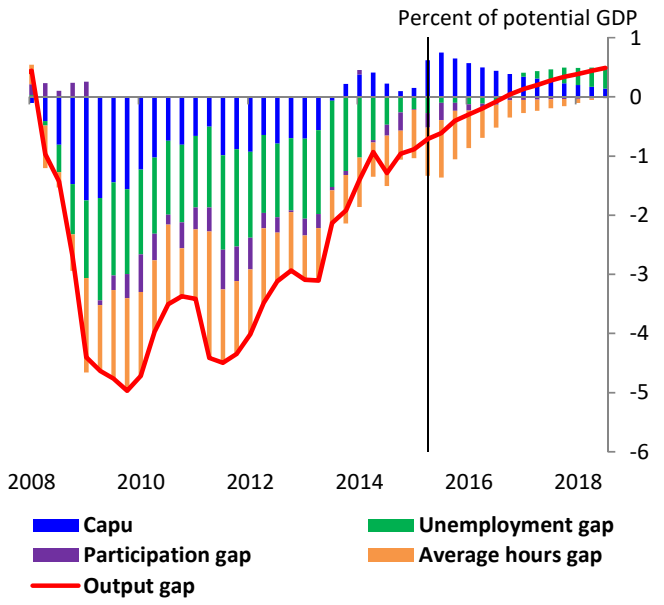
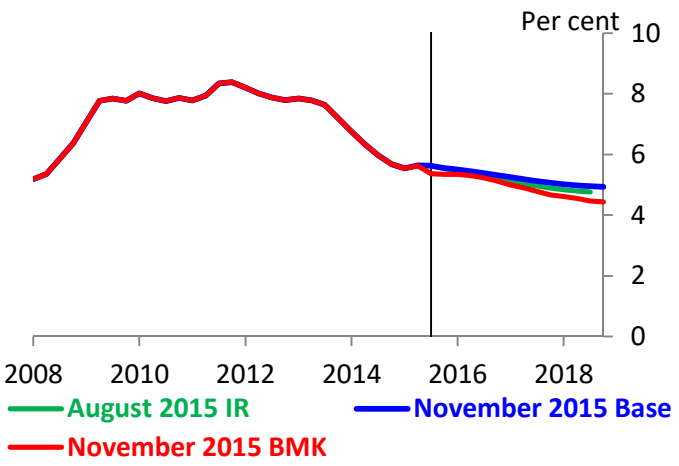


Chart 23: Unemployment forecast



- Slack continues to be absorbed over the forecast as demand growth continues to outstrip supply growth. T**he output gap turns positive in 2017Q1 and ends the forecast at +0.5%. Unemployment starts the forecast at 5.4% in 2015Q3 and falls to 4.4% by Year 3, well below our estimate of U* and the natural rate (Chart 23).**

- **Although supply growth remains close to 2.5%, it relies on a sustained pick-up in productivity growth** – as compositional effects unwind and the detrimental impact of the financial crisis continues to fade – as we think labour supply will not grow as strongly as it has done over the past few years. Because w**e have interpreted some of the recent pick-up in productivity as cyclical, in the short-term, productivity growth falls back before picking up to 1.7% by the end of the forecast, a little below its pre-crisis average.**

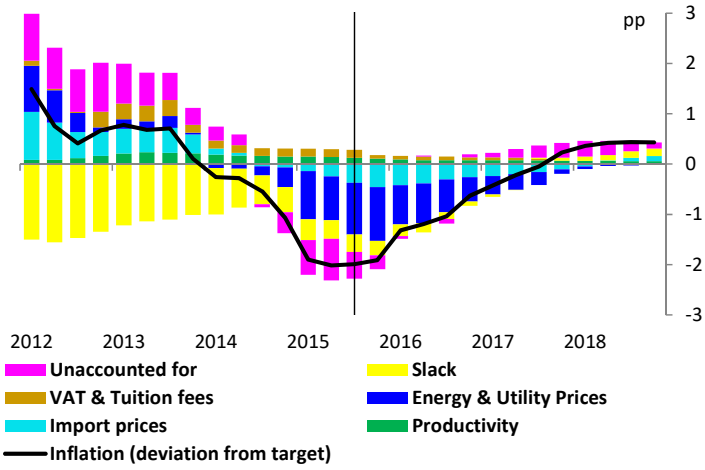
3. Costs and inflation

August IR Key Judgement 4: The drag on inflation from external factors dissipates, as stronger domestic cost growth returns inflation to the 2% target.

- **CPI inflation was 0.0% in 2015Q3 with energy, food and other goods prices accounting for c4/5th of the 2pp shortfall of inflation relative to target.** The weakness of other goods prices is consistent with our view that non-energy import prices are currently dragging on CPI inflation following sterling's appreciation since 2013. **The other 1/5th of the shortfall reflects past below average growth in wages and unit labour costs.**

- **Inflation picks up to 0.7% in 2016 Q1 and 1% in 2016 Q3 as the falls in energy and food prices drop out (Chart 24). It picks up further to overshoot the target at 2.2% and 2.4% at Years 2 and 3 as the drag from import prices wanes and unit labour cost growth picks up to above average rates given the positive output gap.** Inflation is a little stronger in the medium-term, however, than applying our usual rule-of-thumb for the impact of the output gap would imply. So, as has been the case for some time and we have discussed with you before, there are some positive 'unaccounted for' bars in our inflation accounting decomposition. On the face of it, these could pose a downside risk to

Chart 24: Accounting for deviations of inflation from target



the inflation projection, but as we will discuss at the Benchmark meeting, they reflect the fact that the slope of the Phillips curve is steeper in the multipliers we use to process news in the yield curve than for other demand shocks.

- **Private sector wage growth rose to 3.7% in 2015 Q3**, the highest rate since the onset of the crisis (**Chart 25**). This rise has been long-awaited given the sharp erosion of slack over the past couple of years, but **the *level* of wages remains below what we might have expected given its determinants.** Annual unit labour cost growth has also picked up though by varying degrees depending on which measure you look at: as outlined in a recent note by SEAD,[5] the various different measures give markedly different signals about recent developments, ranging between 1.2% and 2.2% in 2015Q2 (**Table A**). Private sector wage and unit labour cost growth (**Chart 26**) pick up to 5.0% (in line with the wage suite, **Chart 27**) and 3.5%, respectively, by the end of the forecast above their long-run averages and rates consistent with hitting the inflation target as the output gap turns positive, productivity growth picks up further and the inexplicable weakness in wages unwinds: growth in real wages outstrips that in productivity with the levels catch-up complete by Year 3 and so the labour share recovers to its pre-crisis level.

Chart 25: Private sector wages

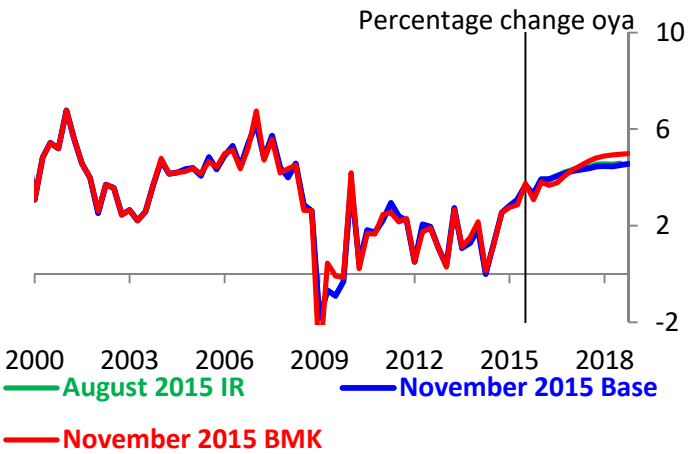


Table A: Annual growth in selected measures of unit labour costs

	2014 Q4	2015 Q1	2015 Q2
Whole economy			
ONS ULC (ex. backcast)	0.6	0.3	2.2
ULC inc. backcast	0.3	0.1	1.8
UWC inc. backcast	0.7	1.1	1.5
AWE / productivity	1.2	1.4	1.2
Private sector			
ULC inc. backcast	-1.0	-0.4	1.7

Chart 26: Unit labour costs decomposition

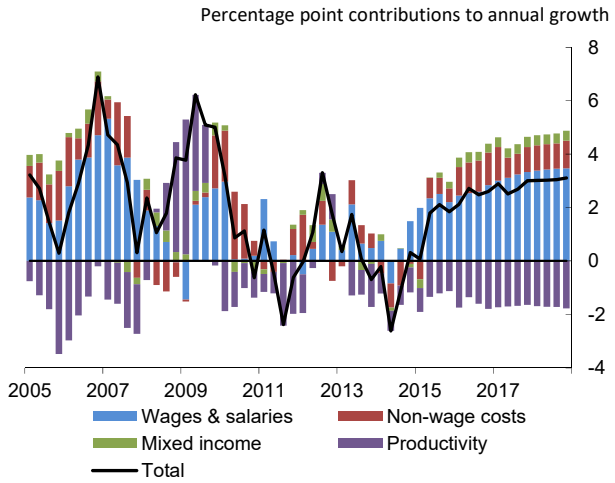
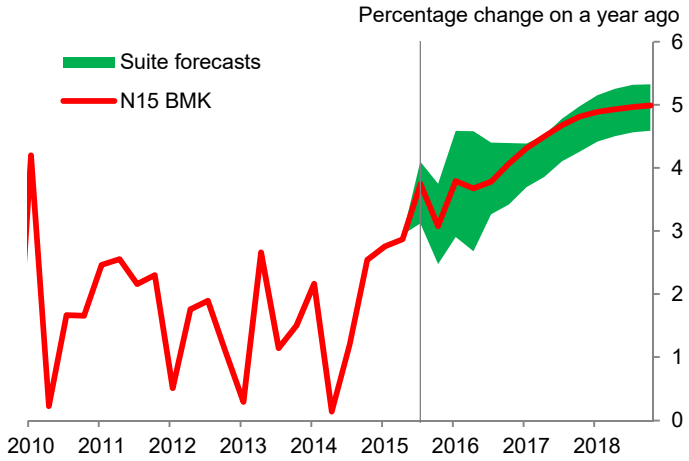


Chart 27: Private sector wages and suite forecasts



- Sterling world export prices (excluding fuel) have fallen by around 5% over the past year, reflecting sterling's appreciation over that period (**Chart 28**). We think that Import prices are currently dragging on inflation by around 0.5pp at the start of the forecast. That starts to wane from the start of next year and with sterling's recent depreciation, import prices are no longer a drag on inflation at Year 3. Following data revisions in the Blue Book, there appear to be some issues with the measurement of

[5]

trade data. As a holding position, we have not taken an economic signal form revisions to the import price data and have projected import prices over the forecast based on sterling world export prices, assuming 60% pass-through.[6]

Chart 28: Transmission of sterling world export prices to inflation

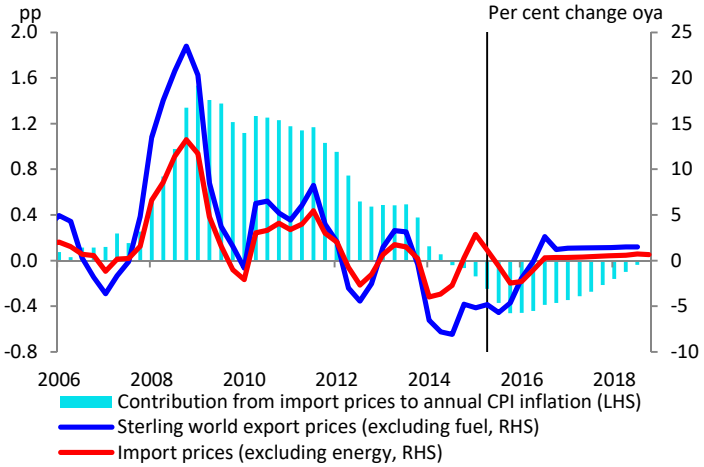
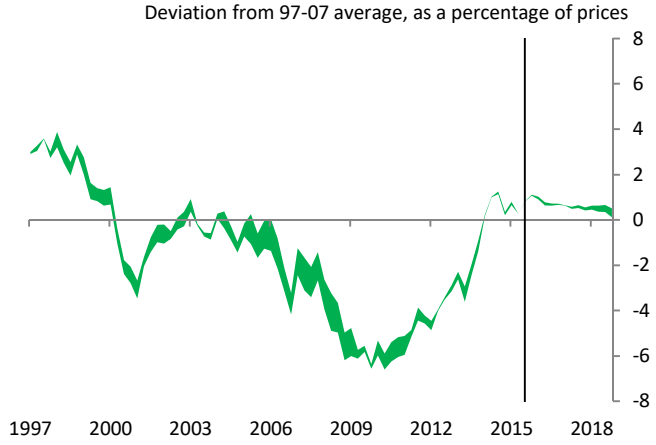


Chart 29: Estimates of consumer sector margins



- Despite the current low rate of inflation, it has outstripped cost growth over the past couple of years as real wages have over-adjusted to the weakness in productivity and firms are yet to fully pass through their lower imported costs. So **consumer sector margins have been rebuilt and are a little above their long-run average (Chart29).** Over the forecast, costs rise a little more quickly than inflation as real wages catch up to the level of productivity and firms fully pass through their lower imported costs. **Margins are therefore squeezed and end close to their long-run average.**

SECTION 2: NEWS SINCE THE AUGUST FORECAST

- **The Benchmark forecast is materially stronger than in August as the impact of the downgrade to the world outlook is smaller than the boost from looser monetary conditions – and, in particular, the large fall in the yield curve (Chart 30).**

Chart 30: Contributions to GDP and inflation news since August IR

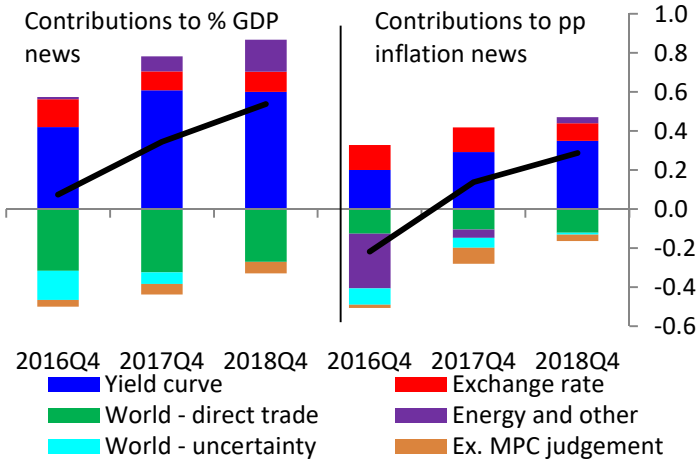
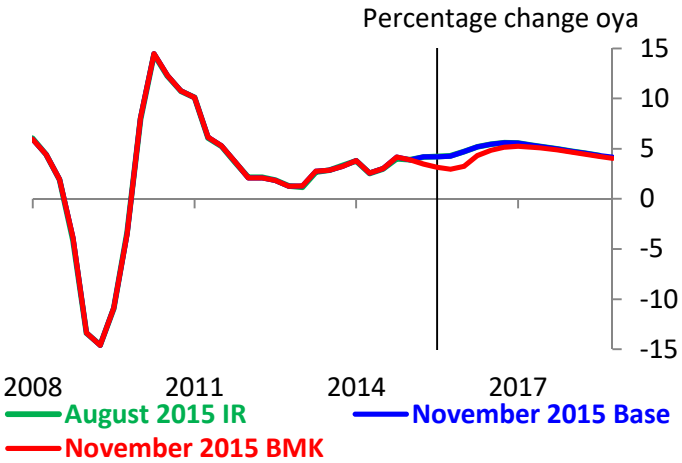


Chart 31: UK-weighted world GDP growth



- As a result, cumulative GDP growth is 0.6pp greater over the forecast such that: **quarterly GDP growth** is around 0.7% each quarter compared to 0.6% in the November Base; and **annual GDP growth** is 2.8%, 2.8% and 2.7% at Years 1, 2 and 3, compared

[6]

with 2.6%, 2.5% and 2.5% in the Base. As a result, the output gap reaches +0.5% at Year 3 compared with 0.0% in the Base and **inflation** is 2.2% and 2.4% at Years 2 and 3, compared to 2.0% and 2.1% in the Base.

- **We try to capture the impact of developments in the world through four main channels: trade, credit, broader asset price movements and uncertainty:**
  i) ID have revised down their view of the level of **world GDP** and **world trade** by ¾% and c2%, respectively, at Year 3 (**Chart 31**). This **trade channel** lowers the level of UK GDP by 0.3% over the forecast.
  ii) Market volatility associated with concerns over China and EMEs more broadly has pushed up on **UK banks' funding costs**. However these increases have so far been limited - 20bp over the past quarter, where we had expected a 10bp reduction - which is consistent with the view that the strengthening of UK banks' balance sheets over recent years has reduced their sensitivity to external shocks. Moreover, we have not revised our estimate of where banks funding spreads will be in the medium-term, such that this news unwinds over the first half of the forecast period. And, as discussed at pre-MPC, we have incorporated a Staff judgement to lower some steady-state spreads to reflect an intensification of competition in the banking sector. So, overall, **credit spreads are little changed.**[7] **Without this judgement, the level of UK GDP would be 0.2% lower.**
  iii) As set out in more detail in the accompanying note on asset price movements since the August IR[8], we have observed sharp falls in **risky asset prices** and **risk-free interest rates** since August (**Chart 32**) as concerns about the outlook for a number of EMEs have come to the fore. That has contributed to the material fall in the market profile, by around 50bps at Year 3 (see below).[9] [10] Related to developments in financial markets and the world growth outlook, indicators of **economic uncertainty** have increased recently – albeit from low levels (**Chart 33**).[11] The sharp rise in the monthly indicator is particularly striking and takes that measure of uncertainty back to levels last seen in early 2013. To take account of this non-trade spill-over from developments in the rest of the world, we included a small, temporary drag on growth (mainly through investment) which unwinds in the level of GDP by the end of the forecast. This effect is calibrated using an uncertainty VAR, described in **Haddow et al (2013).**

Taken together, the weaker world outlook has lowered the level of UK GDP and inflation by a peak impact of 0.4% and 0.2pp, respectively, and by 0.3% and 0.1pp at Year 3.

Chart 32: Equity, currency and commodity indices

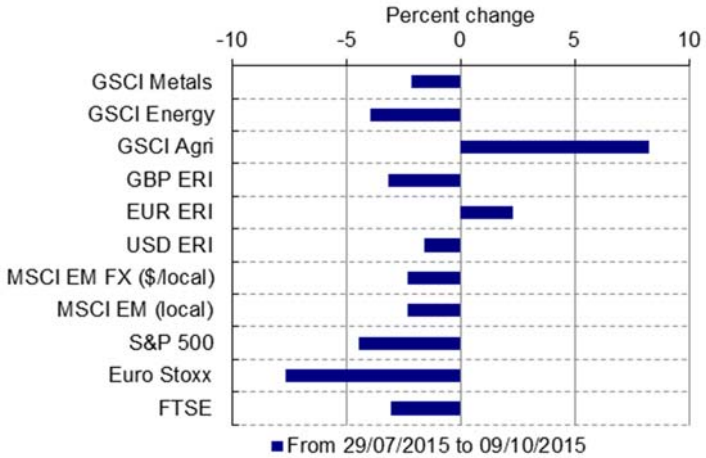
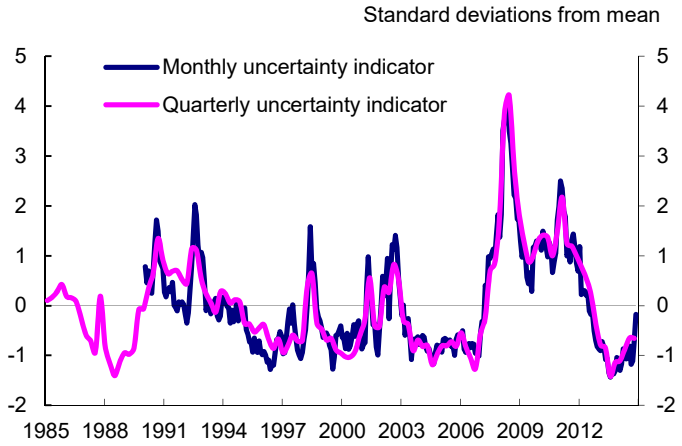


Chart 33: Uncertainty indicators



- This impact of a weaker world outlook has been outweighed by the boost from the **large fall in the yield curve** since August. At its peak, it is 60bps lower than in August and now rises to just 1.3% at Year 3. On its own, this boosts the level of GDP and inflation by 0.6% and 0.3pp, respectively, at Year 3.

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[7] Credit spreads in the November 2015 forecast

[8] .

[9] How should the fall in the market curve since August affect the forecast?

[10]

[11] Macroeconomic uncertainty: what is it, how can we measure it and why does it matter? Quarterly Bulletin 2013Q2.

- The **exchange rate** has depreciated by around 2.5% and oil and commodity prices have fallen, providing a further boost to GDP (**Chart 30**). We have processed the exchange rate news under the assumption of 60% pass-through to non-fuel import prices.
- The expenditure composition of GDP has been revised in the **2015 Blue Book**[12] such that business investment is weaker and consumption and net trade stronger than in August. We have not taken a signal for growth rates from changes to the expenditure mix and have locked in the levels news for each component over the forecast. Consumption and investment growth are stronger over the forecast (**Chart 34**), however, owing to the lower yield curve, and net trade is a little less negative due to sterling's depreciation.
- The **savings rate** ends the forecast at 2.1%, much lower than 4.3% in the Base forecast (**Chart 15, above**). That reflects both downward revisions to the savings rate in the back data, and a more downward sloping profile over the forecast stemming from the lower yield curve. The near-term profile for households' **real income growth** (and the savings rate) is affected by new information about companies' plans for dividend pay-outs in response to tax changes announced in the last Budget (see above).
- As we have locked in the downside news on investment, the **business investment** to GDP ratio ends the forecast c1pp lower than in August at 11.7%. There are risks to this treatment: on one hand, the lower level of the investment/GDP ratio could mean there is more scope for investment to catch up in future. On the other hand, we are already forecasting robust growth in investment and there's a risk that the weakness in investment persists. Part of the downward revision reflects a small reclassification of investment by TfL and Network Rail from business investment to government investment so the revisions to **total investment** therefore give a cleaner read that underlying investment has been weaker than previously thought (**Chart 35**).

Chart 34: Blue Book data revisions and expenditure contributions to changes to the GDP forecast

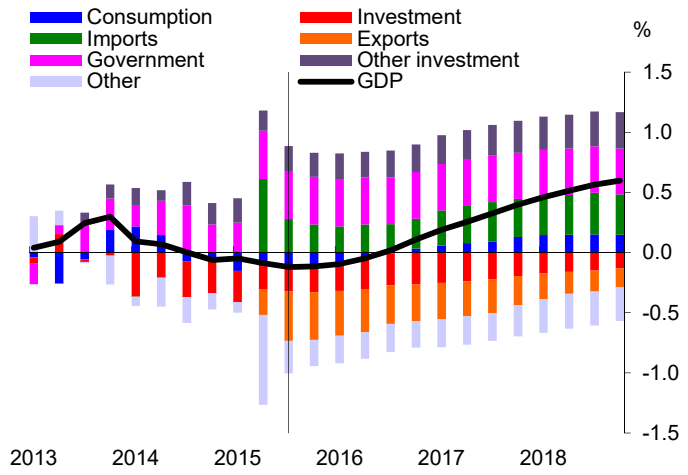
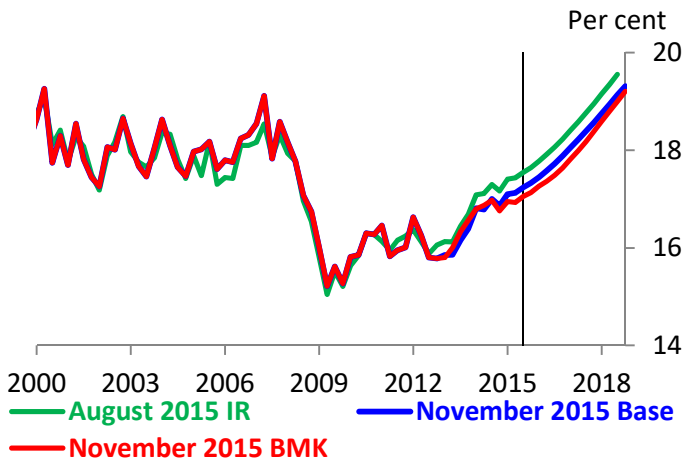


Chart 35: Total investment to GDP ratio



- In line with the Committee's steer, the starting level of the output gap has been informed by our top-down filter estimate. They are pointing to a 0.1pp wider output gap than at the time of the August *IR,* leaving our estimates at -0.6% in 2015Q3 and -0.4% in 2015Q4 (**Table B**). Q4 is the quarter that will be quoted in the IR and so slack remains 'around ½%'. It is still the case that the degree of slack identified by the top-down filter approach in absolute terms is more negative than the central case in the Benchmark forecast (**Chart 36**).

[12]

Chart 36: Top-down filter estimate of the output gap

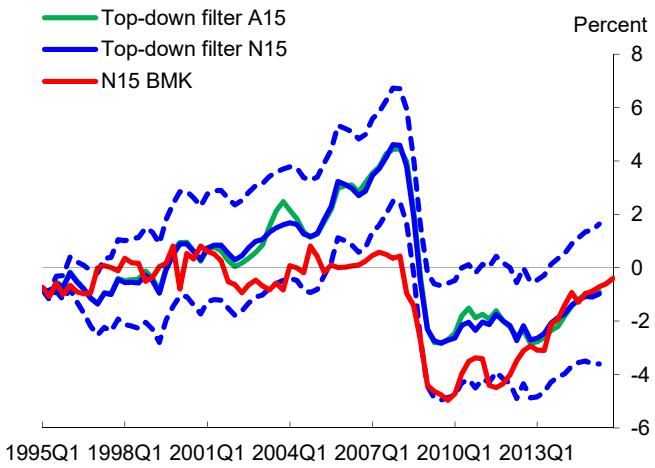
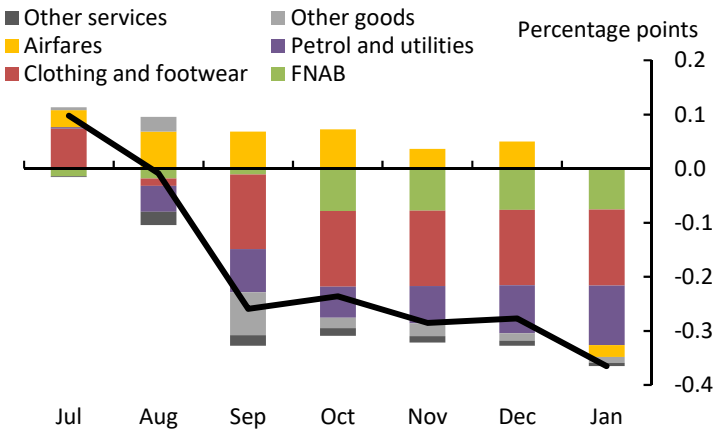


Table B: Arriving at the output gap constraints

	2015 Q2	2015 Q3	2015 Q4
August IR	**-0.7**	**-0.5**	**-0.3**
Top-down filter (Aug IR)	-0.9	-0.8	n/a
Top-down filter (Nov BMK)	-1.0	-0.9	-0.8
News in top-down filter	**-0.1**	**-0.1**	
August IR updated for labour market news (trends unchanged)	-0.8	-1.0	-0.7
August IR updated for labour market news plus CAPU surveys at face value	-0.7	-0.6	-0.4
November Benchmark	**-0.7**	**-0.6**	**-0.4**
News since August IR	**0.0**	**-0.2**	**-0.1**

- Total hours were 0.6% weaker than expected in Q3, mainly reflecting lower average hours. As we have not changed the labour market star variables between the annual supply stocktakes that would mechanically widen the output gap by around ½pp. So, as last round, we have offset this by making CAPU more positive. It starts the forecast at +0.75%, which as it happens is in line with the average estimates from the CAPU surveys.
- By assuming more positive CAPU, we have therefore treated the recent upside news in productivity as cyclical rather than structural. As CAPU largely unwinds over the forecast, productivity growth is a little weaker (cumulatively 0.4pp lower than in the Base at Year 3). We will discuss alternative treatments with the Committee at the Benchmark meeting, but they have minimal effects on the key headline variables.
- As the cumulative growth in GDP over the forecast is stronger the output gap reaches +0.5% at Year 3, much more positive than the 0.0% in the Base. The **unemployment rate** starts the forecast at 5.4% in 2015Q4, 0.2pp lower than the start point in the Base (**Chart 23, above**). It falls to 4.4% at Year 3, compared to 4.9% in the Base, given the stronger outlook for GDP growth.
- Correspondingly, **wage** growth is stronger over the forecast than in the Base, with annual private sector wage growth picking up from 3.7% in 2015Q3 to 5.0% in 2018Q4 (**Chart 25, above**). **Unit labour cost growth** is also correspondingly higher reaching 3½% at Year 3.
- The near-term outlook for **inflation** is markedly lower than in August (**Chart 37**).[13] Falls in oil and commodity prices as well as downside news in clothing and footwear prices largely account have lowered the STIF by 0.3pp over the remainder of 2015 and into early 2016. As a result, inflation now only picks up to 0.7% in 2016 Q1, compared with 1.0% in August and 1.4% in May. Further out, inflation is materially stronger given the now positive output gap and sterling's depreciation and is 0.2pp and 0.3pp higher at Years 2 and 3 at 2.2% and 2.4%, respectively.

Chart 37: News in the STIF since August



[13]

SECTION 3: RISKS TO THE CENTRAL PROJECTION

The GDP projections in the August forecast embodied a downside skew of 0.1% at Years 1, 2 and 3 attributed to the risks stemming from abroad (**Table C**). The risks around the domestic projection were broadly balanced. This downside skew on GDP was not translated into a skew on inflation in the medium term, with the risks to the inflation forecast broadly balanced over the forecast (the MPC maintained a small downside skew on inflation at Year 1, given the risk that exchange rate pass-through could be higher than assumed in August). The degree of uncertainty around both the GDP and inflation projections was unchanged between the May and August forecasts.

Table C: Summary of the risks embodied in the August *IR* GDP and inflation projections

Source:	Key Judgements	Skew on:		Uncertainty around:	
		GDP	Inflation	GDP	Inflation
International risks	Global growth (KJ1)	Downside (-0.1, -0.1, -0.1)	Balanced	Unchanged since May	Unchanged since May
Domestic risks	Private domestic demand (KJ2)	Balanced	Balanced	Unchanged since May	Unchanged since May
	Wage growth (KJ3)	Balanced	Balanced		
	Inflation (KJ4)	Balanced	Near-term downside (-0.15, 0.0, 0.0)		

Key: red = downside skew/more uncertain, blue = balanced skew/unchanged uncertainty, green = upside skew/less uncertain.

Table D below presents a set of risks to the Committee's Key Judgements that have been prepared by staff. The MPC will be presented with material to help assess some of these risks during the Key Issues meetings. The list is not exhaustive and is intended to highlight the staff's perceptions of some of the more material risks to the Key Judgements.

As well as the risks to specific Key Judgements outlined in the table, there are a number of risks that affect all Key Judgements. For example, the forecast assumes that unconventional monetary policy is effective and as such the zero lower bound is not binding. And there are risks that policy may be more or less stimulatory than in the central case, given demand headwinds and tailwinds (in particular, the fall in yields since August may be indicating we are underweighting some demand headwinds relative to financial market participants).

Table D: Risks around the August *IR* Key Judgements

	GDP risk (medium-term)	Inflation risk (near-term)	Inflation risk (medium-term)	Changes since August
Key Judgement 1: moderate global growth continues as international risks are contained				
Risks to inflation from the oil price to downside in the near-term and upside further out	↓	↓	↑	Unchanged: Near-term downside risks remain due to high inventories and the possible return of Iranian production in early 2016. Further out, low prices could trigger a greater supply response than implied by the futures curve.
Euro-area policy actions insufficient to prevent low inflation becoming entrenched	↓		↓	Unchanged: Low inflation outturns and the recent weakness in the oil price have increased near-term deflationary pressures. But the ECB appear more likely to announce an extension of their QE programme.
Greece exits Euro with contagion limited by policy response	↓	↓	↓	Unchanged: We continue to assume that a programme for Greece proceeds without any major interruptions. But the risk of Grexit remains material.

Global risk sentiment worsens as a result of continued euro-area weakness and/or US monetary policy tightening	↓		↓	Unchanged: The risk of a snapback in risk premia remains
Severe slowdown in China	↓		↓	Increased: The recent volatility in China raises the risk that the authorities will be unable to engineer a gradual rebalancing.
Key Judgement 2: private domestic demand grows robustly, supported by sustained real income growth and a gradual decline in private sector savings				
Households and firms are unwilling to dis-save as much as in the central projection	↓		↓	Unchanged: weaker investment and stronger consumption data revisions could make you more/less optimistic than in the past, revisions to net property income from abroad may mean private sector dis-saving is less necessary.
The impact of the fiscal consolidation may be larger. But its effects could have come through earlier and be less persistent.	↔		↔	Unchanged: no new information since August 2015 Fiscal Key Issue.
Key Judgement 3: wage growth continues to rise, underpinned by an absorption of slack and strengthening in productivity growth				
Productivity growth picks up to pre-crisis averages	↔		↔	More confident: more of the upside news in productivity could be structural than we have assumed.
The previous weakness in wages may not unwind as anticipated. But labour market tightness could put more upward pressure on wages than we have assumed.	↔		↔	Unchanged: wage growth has increased since 2013/14 but the latest outturn was lower than expected.
The output gap may be narrower (wider) than we have assumed.	↔		↔	Unchanged: Filter estimates of the output gap are wider than we have assumed. Average hours have come in weaker than expected. But, evidence that U* may be higher than assumed, and average hours star may be lower.[14]
Key Judgement 4: the drag on inflation from external factors dissipates, as stronger domestic cost growth returns inflation to the 2% target^				
Risks to the oil price to the downside	↑		↓	Unchanged: Near-term downside risks remain due to high inventories and the possible return of Iranian production in early 2016.
Quicker pass-through of the appreciation to import prices and CPI	?	↓	↑	Unchanged: Differential movements in $ and € could lead to different timing of pass-through to CPI. Faster pass-through could help explain current weakness of inflation.
Inflation expectations become less well anchored, for example given the weak near-term inflation outlook	↓	↓	↓	Unchanged: household expectations have stabilised, but some indicators have deteriorated (e.g. CFO expectations), and headline inflation a little weaker than expected.[15]
Skews on MPC fan charts at Years 1, 2 and 3 from August IR				
	(-0.1,-0.1,-0.1)		(-0.15,0.0,0.0)	

^The risks around this judgement relate to the central projection for inflation, rather than inflation relative to the target. Depending on where the forecast ends up, the wording of this Key Judgement may have to be revised to reflect any overshoot of inflation in the central case.

[14]

[15]