INFLATION REPORT PRESS CONFERENCE

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Opening Remarks by the Governor

The MPC has increased Bank Rate for the first time in a decade, raising it by ¼ percentage points to ½ percent.

In my remarks today, I will address three questions:

- Why has the MPC raised interest rates?
- What will be the impact of the change? and
- What will happen next?

Why has the MPC raised interest rates?

The MPC's primary objective is price stability, defined by the Government as a 2% CPI inflation target.

CPI inflation was 3% in September and it's expected to have risen a little further in October.

But it isn't so much where inflation is now, but where it's going that concerns us.

The MPC must set policy to achieve a sustainable return of inflation to the target. That is, we must aim to bring inflation back to target and keep it there once the effects of temporary factors – predominantly those caused by the referendum-related fall in sterling – dissipate.

In many respects, the decision today is straightforward: with inflation high, slack disappearing, and the economy growing at rates above its speed limit, inflation is unlikely to return to the 2% target without some increase in interest rates.

Of course, these are not normal times. Brexit will redefine the UK's relationship with our largest trade and investment partner. And it will have consequences for the movement of goods, services, people and capital as well as the real incomes of UK households.

The MPC has repeatedly emphasised that monetary policy cannot prevent either the necessary real adjustment to new trading arrangements or the weaker real income growth likely to accompany that adjustment. We can, however, support the economy during the adjustment process. In such exceptional circumstances, the MPC is required to balance any trade-off between the speed at which we return inflation sustainably to target with the support that monetary policy provides to jobs and activity.

At the time of the referendum, the MPC set out our framework for doing so, and we have followed it consistently ever since.

The Committee's assessment of the outlook for inflation and activity published today is broadly similar to our projections three months ago. In our forecast, conditioned on the gently rising path of Bank Rate implied by current market yields, GDP grows modestly over the next few years at rate just above its reduced rate of potential. Consumption growth remains sluggish in the near term before rising, in line with household incomes. Net trade is bolstered by the strong global expansion and the past depreciation of sterling. Business investment is affected by uncertainties around Brexit, but continues to grow at a solid pace supported by strong global demand, high rates of profitability, the low cost of capital and limited spare capacity.

The MPC judges that there is a little less slack at the start of the forecast period than in August. More fundamentally, the pace at which the economy can grow without generating inflationary pressures has fallen relative to pre-crisis norms. This reflects persistent weakness in productivity growth since the crisis and, more recently, the more limited availability of labour.

Over the next few years, modest demand growth is expected to use up the little spare capacity remaining in the economy. Domestic inflationary pressures are likely to build.

With unemployment at a 42 year low, inflation running above target and growth just above its new, lower speed limit, the time has come to ease our foot off the accelerator. That will help bring inflation back towards its 2% target, while still supporting jobs and growth.

What will be the impact of the change?

Changes in interest rates work through several channels. Rate increases obviously reduce the current cash flows of borrowers and increase those of savers. Interest rate increases also make it more attractive to save today to consume tomorrow and less attractive to borrow today to spend today. And interest rates are one of many influences on the exchange rate and other asset prices.

While the sheer novelty of the first increase in Bank Rate in a decade creates some uncertainty around its impact, there are reasons to expect it to be no larger than usual.

Households are generally well positioned for a rate increase. More are in work than ever before. Only about one fifth of people with mortgages have never experienced an increase in Bank Rate. Of those, almost half took out their mortgage after the FPC introduced its affordability stress in 2014, which requires mortgagors to be able to withstand an increase in their mortgage rate to around 7%.

Fully 60% of mortgages are now at fixed interest rates. Even with this Bank Rate increase, many households will re-finance onto lower interest rates than they are currently paying by around 30 basis points for those moving from an expiring two-year fixed rate deal to around 2 percentage points for someone refinancing an expiring five-year fixed rates deal.

Company balance sheets are generally in strong shape, with the share of profits required to meet monthly debt repayments falling to its lowest level for at least two decades.

Financial conditions remain highly supportive. And demand is growing strongly in the rest of the world, robustly so in our largest trading partner.

What will happen next?

As always, the Committee will monitor closely the incoming evidence on the economic outlook, including the impact of today’s increase in Bank Rate.

To be clear, even after today’s rate increase, monetary policy will provide significant support to jobs and activity. And the MPC continues to expect that any future increases in interest rates would be at a gradual pace and to a limited extent.

Current market yields, which are used to condition our forecasts, incorporate two further 25 basis point increases over the next three years. That gently rising path is consistent with inflation falling back over the next year and approaching the target by the end of the forecast period.

The MPC will, of course, react to developments to the extent they affect the outlook for inflation and activity.

Brexit remains the biggest determinant of that outlook. The decision to leave the European Union is already having a noticeable impact.

- The overshoot of inflation throughout the forecast predominantly reflects the effects on import prices of the referendum-related fall in sterling.

- Uncertainties associated with Brexit are weighing on domestic activity, which has slowed even as global growth has risen significantly.

- And Brexit-related constraints on investment and labour supply appear to be reinforcing the marked slowdown that has been evident in recent years in the rate at which the economy can grow without generating inflationary pressures.

The impact of Brexit on the forecast will evolve as negotiations progress. In particular, any resolution of the uncertainty about the nature of, and transition to, the UK's future relationship with the EU insofar as it affects the behaviour of households, businesses and financial market participants would prompt a reassessment of the economic outlook.

While the direction of that reassessment for activity and inflation is not automatic, the MPC's response will be consistent with its remit and the framework it has followed since the referendum. By continuing to balance the trade-off between the speed at which inflation is returned to target and the support that it provides to jobs and activity, monetary policy will continue to make its best contribution to the prosperity of the people of the United Kingdom.