BANK OF ENGLAND

Monetary Policy Summary

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The Bank of England Act 1998 gives the Bank of England operational responsibility for setting monetary policy to meet the Government's inflation target. Operational decisions are taken by the Bank's Monetary Policy Committee. The minutes of the Committee meeting ending on 13 September will be published on 14 September 2017.

Monetary Policy Summary, August 2017

The Bank of England's Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. At its meeting ending on 2 August 2017, the MPC voted by a majority of 6-2 to maintain Bank Rate at 0.25%. The Committee voted unanimously to maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £10 billion. The Committee voted unanimously to maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435 billion. The Committee voted unanimously to close the drawdown period for the Term Funding Scheme (TFS) on 28 February 2018, as envisaged when the scheme was introduced.

The MPC's overall assessment of the outlook for inflation and activity in the August *Inflation Report* is broadly similar to that in May. In the MPC's central forecast, GDP growth remains sluggish in the near term as the squeeze on households' real incomes continues to weigh on consumption. Growth then picks up to just above its reduced potential rate over the balance of the forecast period. Net trade and business investment firm up, and consumption growth recovers in line with modestly rising household incomes. Net trade is bolstered by strong global growth and the past depreciation of sterling. The combination of high rates of profitability, especially in the export sector, the low cost of capital and limited spare capacity supports investment by UK firms over the forecast period, offsetting the effect of continued uncertainties around Brexit.

CPI inflation rose to 2.6% in June from 2.3% in March, as expected. The MPC expects inflation to rise further in coming months and to peak around 3% in October, as the past depreciation of sterling continues to pass through to consumer prices. Conditional on the current market yield curve, inflation is projected to remain above the MPC's target throughout the forecast period. This overshoot reflects entirely the effects of the referendum-related falls in sterling. As the effect of rising import prices on inflation diminishes, domestic inflationary pressures gradually pick up over the forecast period. As slack is absorbed, wage growth is projected to recover. In addition, margins in the consumer sector, having been squeezed by the pickup in import prices, are projected to be rebuilt. Consequently, inflation remains at a level slightly above the 2% target.

As in previous *Reports*, the MPC's projections are conditioned on the average of a range of possible outcomes for the United Kingdom's eventual trading relationship with the European Union. The projections also assume that, in the interim, households and companies base their decisions on the expectation of a smooth adjustment to that new trading relationship. Other important judgements include: that the lower level of sterling continues to boost consumer prices broadly as projected, and without adverse consequences for inflation expectations further ahead; that regular pay growth remains modest in the near term but picks up over the forecast period; and that subdued household spending growth is largely balanced by a pickup in other components of demand.

Monetary policy cannot prevent either the necessary real adjustment as the United Kingdom moves towards its new international trading arrangements or the weaker real income growth that is likely to accompany that adjustment over the next few years. Attempting to offset fully the effect of weaker sterling on inflation would be achievable only at the cost of higher unemployment and, in all likelihood, even weaker income growth. For this reason, the MPC's remit specifies that, in exceptional circumstances, the Committee must balance any trade-off between the speed at which it intends to return inflation sustainably to the target and the support that monetary policy provides to jobs and activity. Through most of the forecast period, the economy operates with a small degree of spare capacity and CPI inflation is well above the target. By the end of the forecast, that trade-off is eliminated. Spare capacity is fully absorbed, and inflation remains above the target.

The Committee judges that, given the assumptions underlying its projections including the closure of the drawdown period of the TFS, and allowing for the effects of the recent prudential decisions of the Financial Policy Committee and the Prudential Regulation Authority, some tightening of monetary policy would be required to achieve a sustainable return of inflation to the target. Specifically, if the economy follows a path broadly consistent with the August central projection, then monetary policy could need to be tightened by a somewhat greater extent over the forecast period than the path implied by the yield curve underlying the August projections.

In light of these considerations, six members thought that the current policy stance remained appropriate to balance the demands of the MPC's remit. Two members considered it appropriate to increase Bank Rate by 25 basis points. All members agreed that any increases in Bank Rate would be expected to be at a gradual pace and to a limited extent. The Committee will continue to monitor closely the incoming evidence, and stands ready to respond to changes in the economic outlook as they unfold to ensure a sustainable return of inflation to the 2% target.