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MINUTES OF THE MONETARY POLICY COMMITTEE MEETING

6 and 7 November 2013

These are the minutes of the Monetary Policy Committee meeting held on 6 and 7 November 2013.

They are also available on the Internet

<http://www.bankofengland.co.uk/publications/minutes/Pages/mpc/pdf/2013/mpc1311.aspx>

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 Committee meets on a regular monthly basis and minutes of its meetings are released on the Wednesday of the second week after the meeting takes place. Accordingly, the minutes of the Committee meeting to be held on 4 and 5 December will be published on 18 December 2013.



MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 6 AND 7 NOVEMBER 2013

1 Before turning to its immediate policy decision, and against the background of its latest projections for output and inflation, the Committee discussed financial market developments; the international economy; money, credit, demand and output; and supply, costs and prices.

Financial markets

2 The month had seen signs of a tentative increase in risk appetite as some of the short-term uncertainties about monetary and fiscal policy had receded, particularly in the United States. But market participants expected this to be a temporary phenomenon and measures of volatility from options prices had fallen more at shorter horizons than at longer ones.

3 The expected path of short-term interest rates in the United Kingdom was similar to that at the time of the Committee's previous meeting, although it had fallen in the first half of October following disappointing US employment numbers before rising in reaction to more upbeat data. Longer-term forward interest rates had risen slightly. The first rise in Bank Rate was fully priced in by the middle of 2015, as had been the case last month. The path implied by market rates was higher than at the time of the *August Inflation Report*, while respondents to the Reuters survey had expected the first rise in Bank Rate to occur by the end of 2015, unchanged from August. Almost all respondents had expected the MPC to revise down its unemployment forecast in the *November Report*. The majority expected the first rise in Bank Rate to take place within two quarters of the 7% guidance threshold being reached.

4 The likely date at which markets expected the US FOMC to begin to reduce the pace of its asset purchases had been pushed back in response to poorer labour market data and the fallout from the US government shutdown and debt-ceiling agreement. US longer-term forward rates had risen by

around 20 basis points, however. Expectations of a loosening in monetary or liquidity policy by the ECB had increased in recent weeks, following weak data on euro-area inflation.

5 Equity prices had risen internationally, by between 5% and 7% on the FTSE All-Share, S&P 500 and Euro Stoxx indices. Since the beginning of July, euro-area equity prices had risen by more than their UK or US counterparts, although, unlike in the United Kingdom or United States, they remained substantially below their pre-crisis peaks. Corporate bond spreads in all currencies had continued to narrow.

6 The sterling effective exchange rate had risen by just under 0.5% on the month and, taking a 15-day average, was around 3% stronger than at the time of the August *Inflation Report*. Sterling had risen by almost 6% against the dollar and by just under 2% against the euro over this period. Having fallen over the summer, some emerging market currencies had begun to recover.

The international economy

7 Risks to the international economic outlook seemed both more balanced and more evenly spread geographically than they had done a year ago. But impediments to a normal recovery were still evident, particularly in the euro area.

8 Industrial production had risen by 1% in the euro area in August and it was likely that GDP growth in Q3 as a whole had been marginally stronger than previously expected, and only slightly weaker than the 0.3% rate seen in Q2. Stronger surveys of consumer confidence and industrial activity suggested that growth would continue into the fourth quarter at a similar rate, notwithstanding the slight slowing in activity suggested by the October Purchasing Managers' Index (PMI). The pace of growth thereafter would, however, depend on how much of a drag the adjustment in the public, banking and non-bank private sectors would prove to be, particularly in the periphery. There had been two developments this month that would affect this. First, the ECB had released information on its plans for a comprehensive assessment of euro-area bank balance sheets, comprising a supervisory risk assessment, an asset quality review and a stress test. While some important details were yet to be clarified, this exercise had the potential to improve transparency, force balance sheet repair, and restore confidence in the banking system.

9 Second, and set against that, twelve-month consumer price inflation in the euro area had fallen by 0.4 percentage points in October to 0.7%. Inflation had been drifting down for a number of months; even in those economies where there appeared less slack and more credit was available, such as Germany, inflation was below 2%. Persistent very low inflation across the euro area would make the process of rebalancing in the periphery more difficult, as it would require a more sustained period of nominal wage restraint to restore competitiveness.

10 In the United States, the data this month had on balance been disappointing but nonetheless pointed to growth of around 1% over the second half of the year. Non-farm payrolls had risen by just under 150,000 in September, in line with recent trends and well below the rates seen in previous recoveries. Consumer confidence had also fallen sharply in October, although it was likely that this had been due to the government shutdown and uncertainty over the outlook for fiscal policy. With a short-term agreement to raise the federal debt ceiling in place, confidence might well bounce back. Industrial production had risen in September and there had been increases in the October manufacturing and non-manufacturing PMIs. Growth was likely to pick up in 2014 as the impact of fiscal tightening lessened. But the weak tone of data outturns, together with the residual uncertainty over fiscal policy, meant the downside risks had become more evident.

11 In Asia, Chinese GDP growth in the year to Q3 had risen by 7.8%, slightly stronger than expected, and there had been increases in the manufacturing PMIs there and in Japan. The medium-term outlook for China would depend in part on the ability of the authorities to drive through measures to liberalise and rebalance the economy. It was possible that further detail on these reforms would be released in the coming months following the Party's Third Plenum. Forecasts for growth in several other large emerging economies had been revised down over the course of the year and probably now better reflected the scope for structural reforms to support activity. Some economies, particularly those with large current account deficits, remained vulnerable to a sharp reversal in capital inflows, however. Together these economies formed around one tenth of UK export demand.

12 Oil prices had fallen by a little more than 5% in dollar terms in the run-up to the meeting. Other commodity prices were little changed.

Money, credit, demand and output

13 Business survey indicators suggested continuing momentum in the recovery and growth strengthening over the second half of 2013. GDP on the preliminary estimate had risen by 0.8% in the third quarter, marginally more than expected, but a little less than the surveys had indicated. Growth had been fairly broadly based across sectors, with construction making a notable positive contribution. Bank staff's central expectation was for growth in Q4 of 0.9%, although indications from the surveys pointed to growth of over 1%.

14 In line with the usual pre-release arrangements, the Governor informed the Committee that goods imports had risen by 1.8% in September, while goods exports had fallen by 0.8%. Although surveys of exporters in Q3 were generally sending a significantly stronger signal than the official data, it was unlikely that the strength of external demand would be sufficient in the near term to underpin the domestic recovery.

15 Consumer confidence had continued to increase over recent months and, in the short term, the pickup in aggregate activity would continue to be driven by household spending, particularly on dwellings investment. Housing market transactions had risen further above 90,000 in September, having averaged around 75,000 per month from 2010 to 2012. Mortgage approvals had continued to increase, though this had yet to have a material impact on secured lending growth. The Nationwide and Halifax house price indices were rising at close to 1% per month for the United Kingdom as a whole, although there remained significant variation across regions.

16 A sustained upturn in the economy would be likely to require a pickup in business spending. Provisional ONS data indicated that business investment had fallen in Q2, although early estimates were prone to large revisions. Nonetheless, the underlying conditions for business investment appeared to have improved. The headwinds from credit constraints on the business sector had eased over the past year, as the cost and availability of bank credit had improved and sterling corporate bond spreads had fallen. Alongside this, the recovery in demand growth might have increased the internal funds available to some companies for investment; money holdings of non-financial corporates had been rising robustly. And uncertainty also appeared to be less of a drag on investment: in a recent survey by the Bank's Agents, a net balance of around 5% of businesses had reported that uncertainty about the economic outlook was pushing down on investment plans; in a similar survey conducted a

year earlier, that figure had been close to 50%. Over coming quarters, that reduction in uncertainty might prompt companies that had built up substantial financial surpluses to begin spending those funds.

17 Judging the adequacy of the capital stock needed to fulfil companies' production plans was particularly difficult at this juncture. Total output remained materially below its peak. But how much underutilised capacity companies might have scrapped during the downturn was difficult to estimate. Indeed, surveys had suggested a small and narrowing margin of spare capacity, and expectations of near-term growth had risen. Nonetheless, many businesses were likely still to have ample scope to increase production and some might want to wait for more evidence that the recovery was entrenched before increasing investment.

Supply, costs and prices

18 Twelve-month CPI inflation had remained at 2.7% in September. In line with the usual pre-release arrangements, an advance estimate for twelve-month CPI inflation of 2.2% for October had been provided via the Governor to the MPC, ahead of publication. This was lower than expected and it was possible that part of the fall reflected a smaller-than-anticipated contribution from university tuition fees. The lower oil price meant that inflation would probably fall a little further in the very near term, although there was likely to be volatility from month to month. Recent announcements of utility price rises would begin to raise inflation before the end of the year. By that point, the impact of the rise in the exchange rate since the summer might also be starting to make itself felt.

19 The medium-term indicators of inflation expectations quoted in the *Inflation Report* were typically modestly higher than they had been during the period between January 2008 and the introduction of forward guidance, although most measures of households' and companies' inflation expectations had remained close to past averages. An exception was the YouGov/Citigroup survey: both the one year and five to ten year ahead measures had risen sharply in October. It was likely, however, that this reflected news about utility prices and past experience had suggested that such rises generally proved to have a short-lived impact on longer-term inflation expectations.

20 Indicators of inflation expectations derived from the prices of financial instruments that referenced RPI inflation, such as inflation swaps, had changed little in recent months, although there

was tentative evidence that such expectations had become more sensitive to news on economic developments. Expected inflation three years ahead implied from swaps had remained around 3.0%, with expected inflation five to ten years ahead implied from swaps around 3.5%. These indicators reflected not only expected CPI inflation but also market participants' views about the future wedge between RPI and CPI inflation, together with a risk premium to compensate for uncertainty. Some market contacts estimated the long-run RPI-CPI gap to be around 0.9 to 1.0 percentage points on average, implying long-run expectations for CPI inflation of around 2½%. This estimate of the gap was lower than the Bank staff's estimate of around 1.3 percentage points, as well as the estimate by the Office for Budget Responsibility of 1.3 to 1.5 percentage points. Market participants contacted in October had commented that their modal expectations remained consistent with the 2% target, although their mean expectations were a little higher.

21 There had been little sign of higher inflation expectations feeding into larger wage increases. Pay growth had been volatile in the first half of the year, partly due to the reduction in the top rate of income tax in the spring, but the impact of this had faded and the data were probably now giving a cleaner read on pay pressures. Average weekly earnings in the private sector had risen by 1.1% in the three months to August compared with a year earlier, a little below its post-recession average, and well below its pre-recession average of around 4%. The erratic pattern of earnings growth had been mirrored in quarterly unit labour cost growth, which had fallen in Q1 and picked up sharply in Q2. Looking through this, annual unit labour cost growth has been close to its pre-crisis average. With productivity growth likely to outpace earnings growth in the near term, it was possible that unit labour costs would be lower in the second half of the year than they had been a year earlier. Over the medium term, real wage growth could be expected to pick up in line with productivity.

22 The LFS headline unemployment rate had fallen to 7.7% in the three months to August. This was down from 7.8% in Q2 and a touch lower than the central expectation at the time of the August *Inflation Report*. The claimant count, a more timely indicator of labour market conditions, had fallen to 4% in September, its lowest rate since January 2009. Bank staff's central projection for headline unemployment was 7.7% for Q3 and 7.6% for Q4, although the recent decline in the claimant count indicated that sharper declines were possible.

The November 2013 GDP growth and inflation projections

23 In the Committee's central view, four-quarter GDP growth was expected to pick up further in the near term as the lifting of uncertainty and the thawing of credit conditions continued to bolster demand growth. That near-term outlook was a little stronger than three months ago, primarily reflecting the increasingly positive tone of recent survey data. However, output was still more likely than not to remain below its pre-crisis peak until next spring. Further ahead, the pace of growth was likely to ease back a little in the second and third years of the forecast as some of the initial boost provided by the lifting of uncertainty and easing of credit conditions moderated. By the end of 2015, GDP growth was likely to be broadly the same as that projected in August. The November GDP projection assumed that Bank Rate evolved in line with the market curve, compared with the assumption of constant Bank Rate used three months ago. That did not reflect the Committee's view of the most likely path of Bank Rate; it was simply a reversion to the convention of using the market curve now that financial markets had been able to absorb the policy guidance provided in August. Under the alternative conditioning path of constant Bank Rate, the level of GDP was just under 1 percentage point higher by the end of the forecast period than if Bank Rate followed the market path. There was a range of views on the Committee about the risks to GDP growth. But, overall, the balance of risks was judged to be to the downside, as in August. That reflected the continuing challenges facing the euro area, as well as the risk that balance sheet repair proved to be a greater drag on growth in domestic spending.

24 As the recovery in demand growth was expected to be accompanied by a gradual rise in productivity growth, only a gentle decline in the unemployment rate was in prospect. A broadly stable participation rate and a modest rise in average hours worked also slowed the rate at which labour market slack was eroded. The projected decline in the unemployment rate was a little faster than anticipated three months ago. This primarily reflected stronger near-term output growth rather than a change of view about the underlying prospects for productivity. Under the alternative assumption of constant Bank Rate, unemployment was projected to fall a little more quickly. As in August, the risks around the central projection for unemployment were judged to be tilted to the upside, reflecting both the balance of risks to demand and the possibility that there was more hidden slack in the economy than implied by the central view. The Committee's latest projections, assuming Bank Rate rose in line with the market curve, implied around a two-in-five chance that the unemployment rate would have

reached the 7% policy threshold by the end of 2014. The corresponding figures for the end of 2015 and 2016 were around three in five and around two in three respectively.

25 Under the assumption that Bank Rate rose in line with market yields, CPI inflation was projected to fall a little further in the near term, and remain around, or a little below, the 2% target thereafter. The impetus from import prices was assumed to fade and a gradual recovery in productivity growth, together with a persistent margin of spare capacity in the economy, was expected to curb domestic price pressures. Compared with August, inflation was lower, particularly so in the first half of the forecast period. That lower profile reflected both the unexpectedly low inflation outturns and the recent appreciation of sterling. In August, the Committee had agreed that its policy guidance would cease to hold either if medium-term inflation expectations were judged to be insufficiently well anchored, or if, in the MPC's view, inflation was more likely than not to be above 2.5% 18 to 24 months ahead. And the Committee's latest projections implied a roughly one-in-three chance that inflation would be above 2.5% 18 to 24 months ahead. That compared with a figure of around two in five in the *August Report*. Under the alternative conditioning path of constant Bank Rate, CPI inflation was higher throughout the forecast period, reflecting the more accommodative stance of monetary policy, but only a little above 2% by the end. This reflected the assumption that the additional activity under a constant Bank Rate was associated with higher productivity, thus moderating its inflationary impact. The constant rate projection, like the market rate projection, was predicated on inflation expectations remaining anchored.

The immediate policy decision

26 The Committee was setting monetary policy to meet the 2% inflation target in the medium term, but in a way that helped to sustain the recovery. In pursuit of that objective, the Committee had, at the time of the *August Inflation Report*, provided guidance regarding the future path of monetary policy. That guidance stated that the Committee did not intend to raise Bank Rate from its current level of 0.5% or to reduce its stock of asset purchases at least until the LFS headline unemployment rate had fallen to a threshold of 7%, subject to three 'knockout' conditions, relating to: the judged likelihood that inflation would not exceed 2.5% 18 to 24 months ahead; whether measures of medium-term inflation expectations remained sufficiently well anchored; and the impact of the stance of monetary policy on financial stability as judged by the Bank's Financial Policy Committee (FPC).

27 The news on the month had continued to suggest a sustained recovery in activity in the United Kingdom. Momentum had picked up further since the time of the *August Report* and it was likely that GDP would grow at a little above its long-term average rate during the second half of the year. Indeed, business surveys and indicators of the housing market were if anything pointing to an even faster rate of expansion, although they had also suggested a faster rate of growth in Q3 than the 0.8% the ONS had published in its preliminary estimate. It was possible to identify distinct upside and downside risks to activity growth thereafter. To the upside, greater confidence in the recovery, together with an easing of constraints on credit supply, might lead companies to release some of the precautionary balances they had built up in recent years, either for redistribution back to households in the form of dividends, or to fund more vigorous increases in capital expenditure. To the downside, the process of balance sheet repair in the household and banking sectors, alongside slow growth in real incomes, might put a brake on the rate of growth of consumer spending before a recovery in business investment had become established. The UK economy remained vulnerable to disorderly adjustment in the euro area and in some emerging economies. And with the upturn in the euro area fragile and in its early stages, it was possible, too, that the rebalancing process in the periphery might prove an even greater drag on growth, particularly at low rates of euro-area inflation. With the external environment unlikely, therefore, to be an engine of UK growth, and given that the domestic fiscal consolidation would continue over the forecast period at around its current rate, a successful handover from household to business spending would play a crucial role in underpinning the recovery in the medium term.

28 The scope for activity to increase without putting undue upward pressure on inflation depended critically on the extent to which the unprecedented weakness in labour productivity seen over recent years would unwind as demand recovered. The stronger the revival in productivity, the slower would be the absorption of spare capacity in the labour market. Labour productivity growth had picked up in the first half of 2013, suggesting that stronger demand was likely to elicit some response in productivity. The recent increase in demand had, however, also led to a further edging down in the unemployment rate. The headline LFS unemployment rate had fallen to 7.7% in the three months to August, a touch lower than expected at the time of the Committee's previous forecast, and the decline in the claimant count indicated that LFS unemployment might fall further in the coming months. There remained a range of views on the Committee about the factors that had led to the recent weakness in productivity and about the extent to which productivity would rise as demand increased. But there was little in the recent data to alter those views materially and the MPC's best collective

judgement remained that productivity was likely to increase over the forecast period as the economy recovered, albeit by less than demand, such that slack in the economy was eroded only gradually.

29 The fall in CPI inflation to 2.2% in October was welcome, and, although the announced increases in utility prices would raise inflation in the coming months, the near-term outlook for inflation was materially closer to target than envisaged three months ago. The appreciation in sterling would put some further downward pressure on prices next year, although it was unclear how much of this would be passed through to consumer prices, given the more favourable domestic demand environment. Nonetheless, the probability of CPI inflation being at or above 2.5% 18 to 24 months ahead was judged to be lower than in August, at around one third when conditioned on market expectations for the path of Bank Rate. And a gradual revival in productivity growth and a persistent margin of spare capacity was likely to contain domestic price pressures, ensuring that inflation was close to target in the medium term, despite a continuing elevated contribution from administered and regulated prices.

30 Set against that, some indicators of inflation expectations had risen. But these moves were thought to be of little economic significance. Moreover, there were few indications that higher inflation expectations were currently a major consideration in wage demands or companies' planning assumptions, and the lower rate of inflation might itself reduce expectations. Overall, the Committee judged that medium-term inflation expectations remained sufficiently well anchored.

31 All Committee members agreed that neither of the price stability knockout conditions that would override the forward guidance provided in August had been breached. The FPC had continued to judge that the financial stability knockout had not been breached. With unemployment remaining above the 7% threshold, the Committee's policy guidance therefore remained in place.

32 Market interest rates had risen over the past three months, though it was likely, given the significant improvement in the tone of recent data releases, that market participants would have expected a rise in Bank Rate even earlier without the Committee's guidance. The higher expected path for Bank Rate was in itself likely to slow the pace of activity growth and put some downward pressure on inflation. The Committee's central projection for the level of output in three years' time was just under 1% higher when conditioned on constant Bank Rate, compared with a forecast conditioned on

the market path, while the central projection for inflation was around a quarter of a percentage point higher at the two and three-year point, and only slightly above the 2% target.

33 There were uncertainties over the durability of the recovery and the extent to which supply growth would keep pace with demand. There were also risks surrounding wage and price-setting. It was therefore highly unlikely that growth and inflation would evolve exactly in line with the central projections, regardless of the conditioning assumption for Bank Rate. But, with the proviso that medium-term inflation expectations remained sufficiently well anchored, the projections for growth and inflation under constant Bank Rate underlined that there could be a case for not raising Bank Rate immediately when the 7% unemployment threshold was reached. Once unemployment had reached 7%, the Committee would reassess what it had learned about the nature of the recovery. In the meantime, the Committee would continue to judge the appropriate stance for policy each month in line with the guidance given in August.

34 Jon Cunliffe, who had recently joined the Committee, indicated that he would judge the appropriate stance for policy in line with the guidance framework adopted by the Committee.

35 The Governor invited the Committee to vote on the propositions that:

Bank Rate should be maintained at 0.5%;

The Bank of England should maintain the stock of asset purchases financed by the issuance of central bank reserves at £375 billion.

Regarding Bank Rate, the Committee voted unanimously in favour of the proposition.

Regarding the stock of asset purchases, the Committee voted unanimously in favour of the proposition.

36 The following members of the Committee were present:

Mark Carney, Governor

Charles Bean, Deputy Governor responsible for monetary policy

Jon Cunliffe, Deputy Governor responsible for financial stability

Ben Broadbent

Spencer Dale

Paul Fisher

Ian McCafferty

David Miles

Martin Weale

James Richardson was present as the Treasury representative.

As permitted under the Bank of England Act 1998, as amended by the Financial Services Act 2012, Dave Prentis was also present as an observer in his role as a member of the Oversight Committee of Court.