Bank of England

May 2022

Monetary Policy Report

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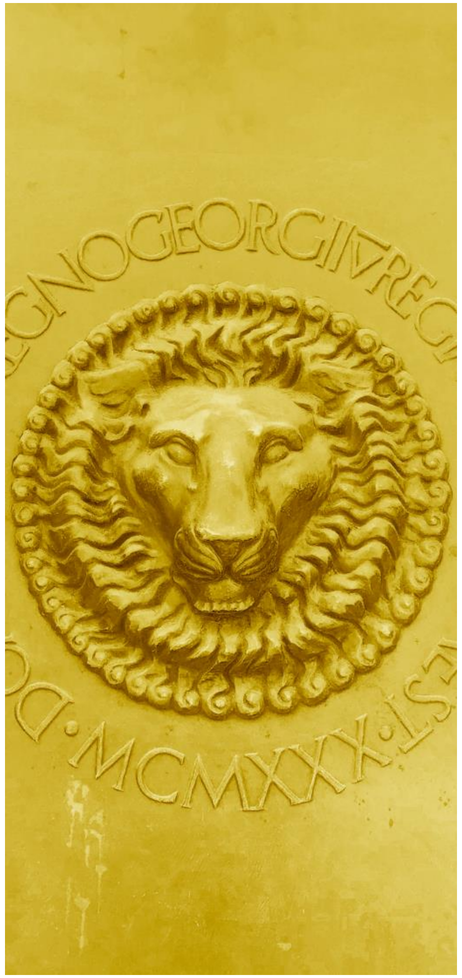
Friday 6 May 2022

Plan for the session



- Scene setting (Alan) – 5 minutes
- Quick tour of the Report (Fergal) – 20 minutes
- MPC perspective and policy (Huw) – 5 minutes
- Q&A with Huw and Fergal (please submit your questions via chat box and Alan will ask them) – 30 minutes

Main points from the MPR

Headlines

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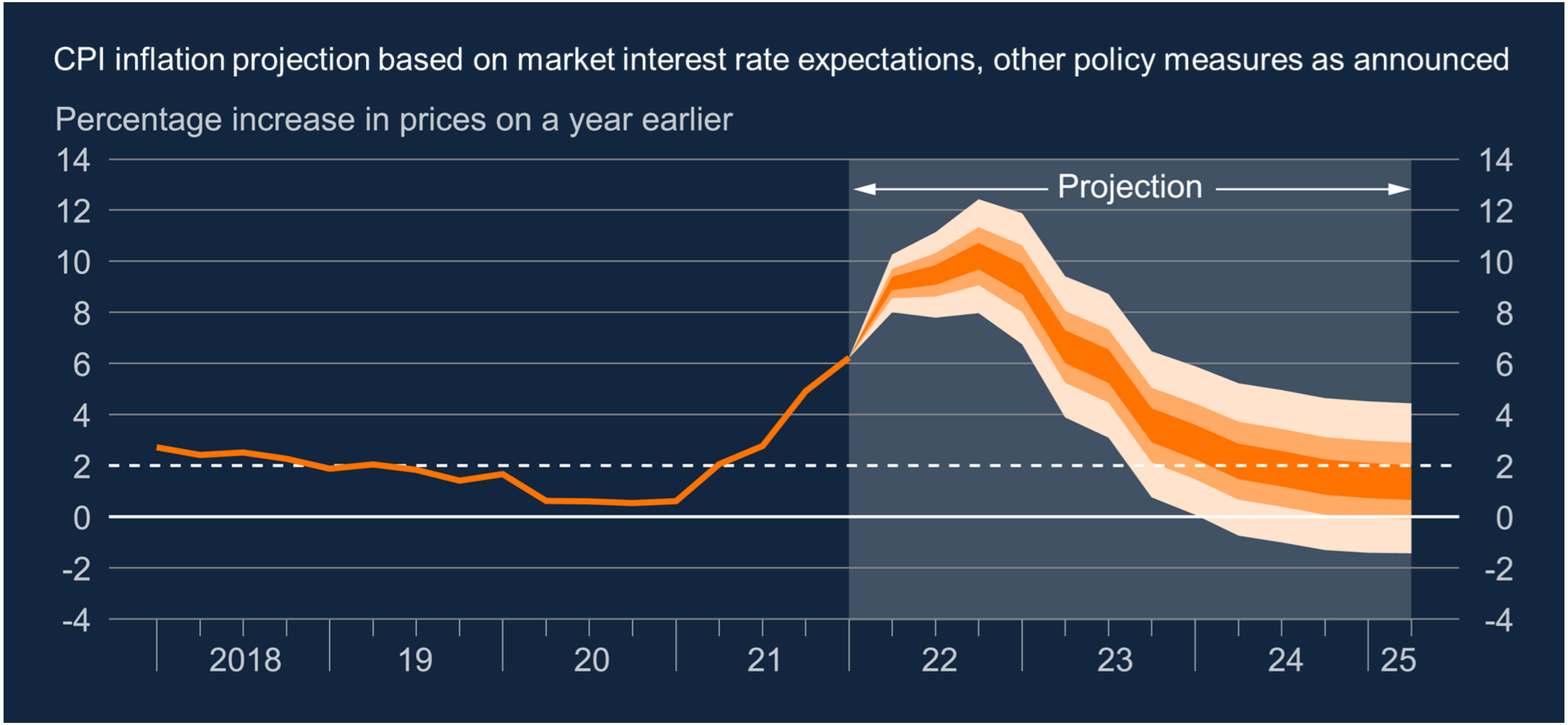
- But, as energy and tradables prices stabilise, inflation will fall back…
- …and falls back further as consumers rein in spending and spare capacity opens up
- Inflation is likely to be back at the 2% target in two years' time, and maybe below it further out

A forecast with two clear phases

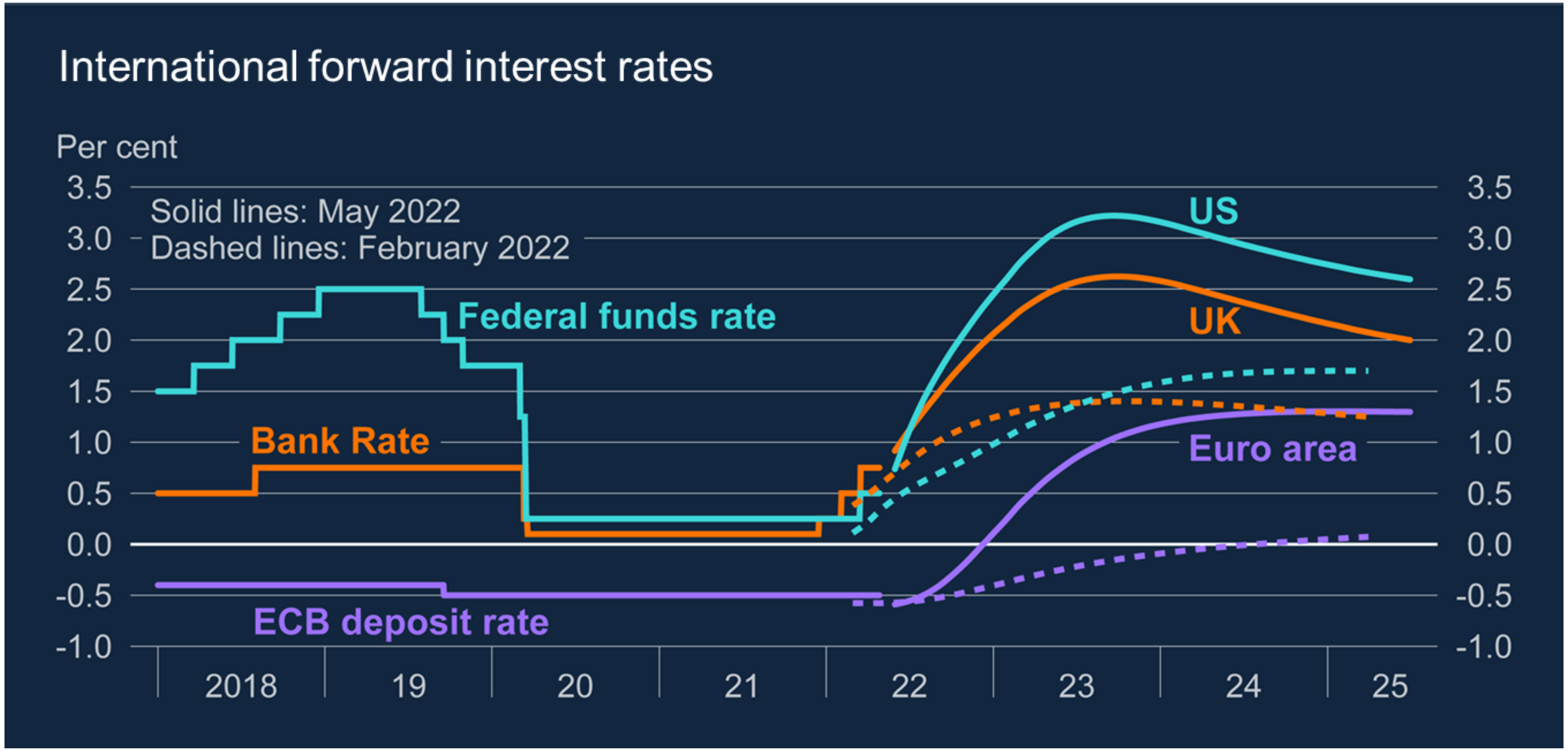


A forecast with two clear phases

	2022 Q2	2023 Q2	2024 Q2	2025 Q2
GDP (c) (four-quarter growth, %)	3.2 (3.2)	0.0 (1.2)	0.2 (1.0)	0.7
CPI inflation (d)	9.1 (7.0)	6.6 (3.5)	2.1 (1.9)	1.3
LFS unemployment rate	3.6 (3.9)	3.9 (4.4)	4.6 (4.7)	5.5
Excess supply/**Excess demand** (e)	**+½** (0)	-1¼ (-½)	-1¾ (-½)	-2¼
Bank Rate (f)	1.0 (0.7)	2.5 (1.4)	2.4 (1.4)	2.0

- GDP growth slows to below trend rates, with a fall in 2022Q4
- Inflation peaks in Q4 and then falls back below target
- Unemployment rises to 5.5%

Policy-rate expectations have moved sharply higher globally

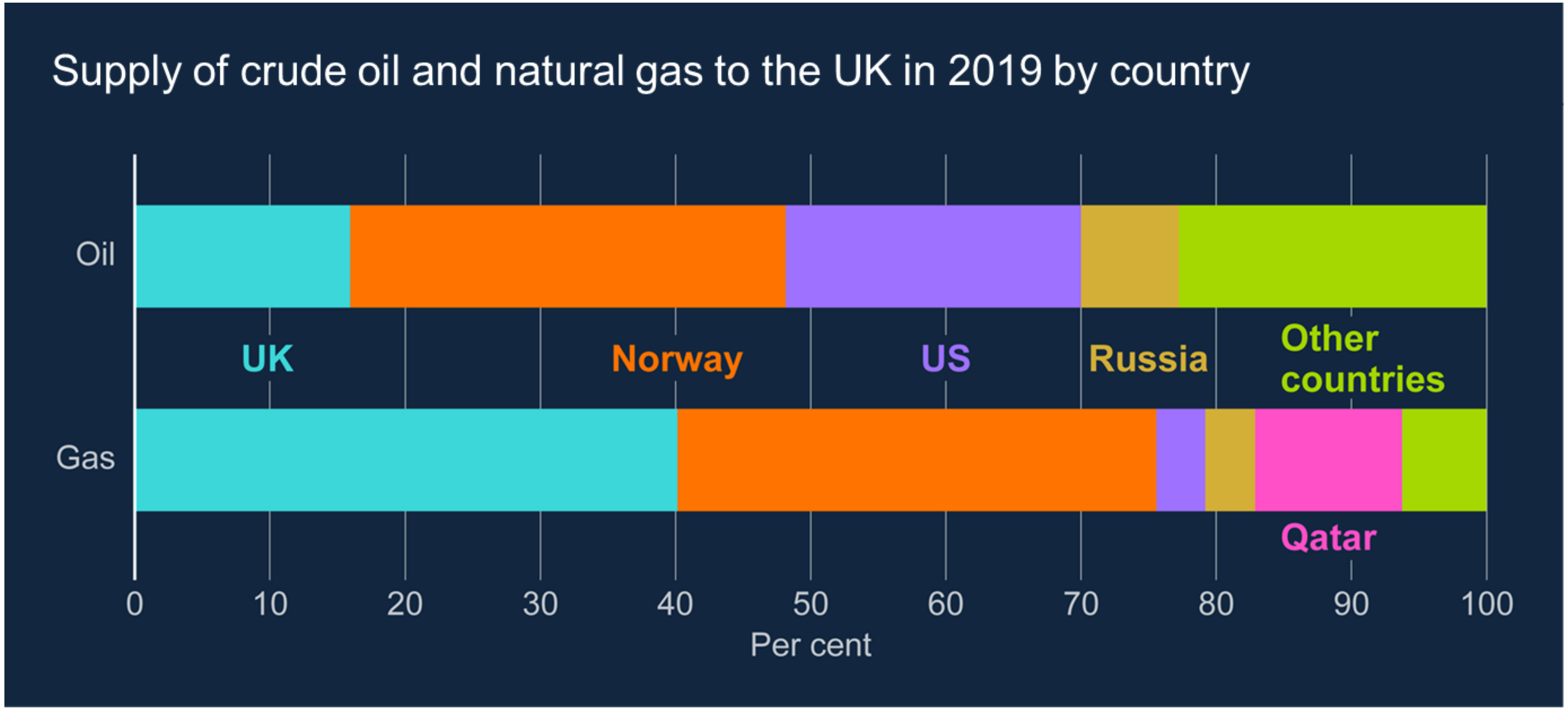


- Rate expectations have increased in US, UK and EA since Feb
- UK yield curve peaks at over 2.5%

Main points from the MPR

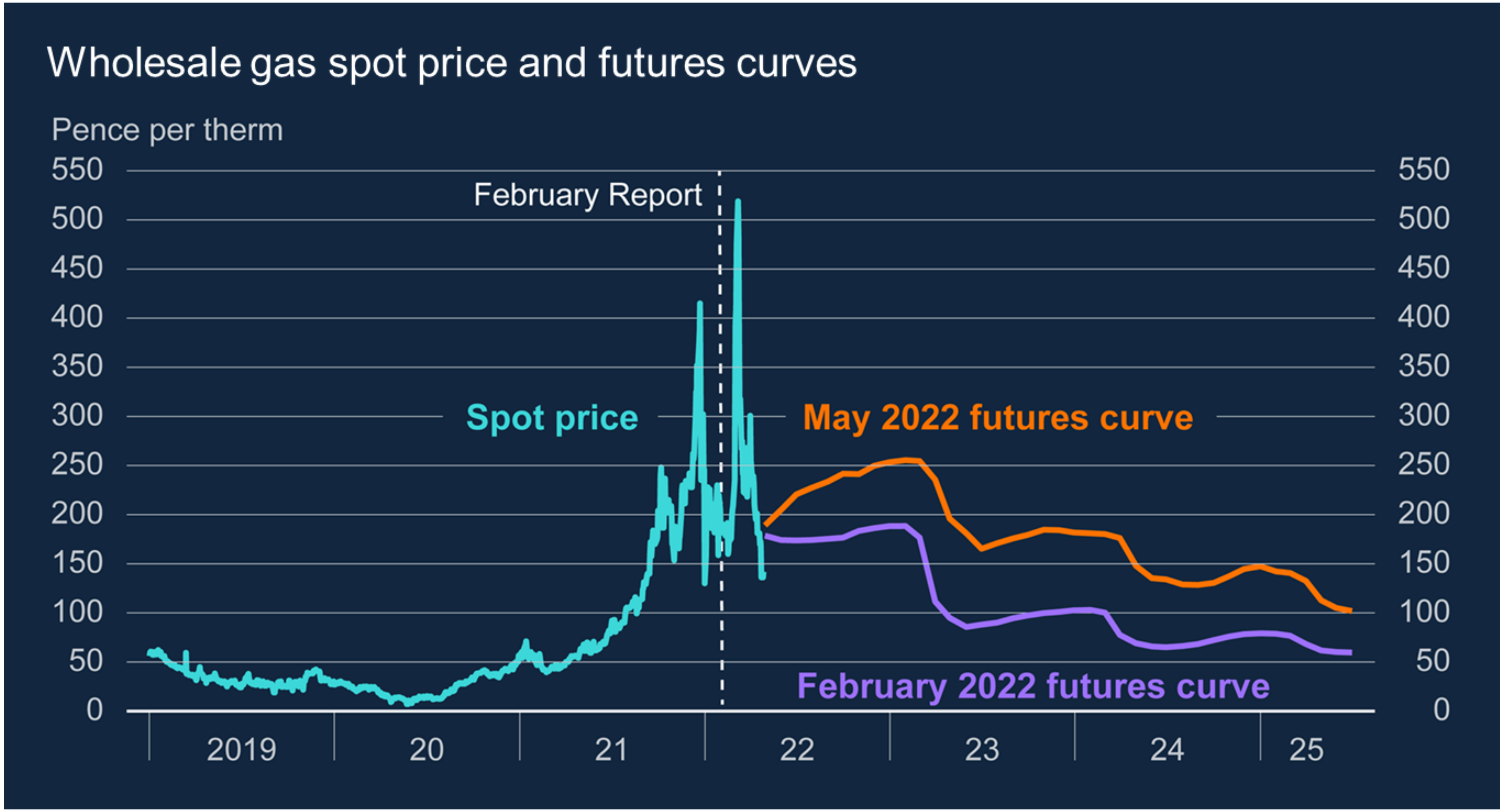
First half of the forecast

Russia is not a major source for UK energy



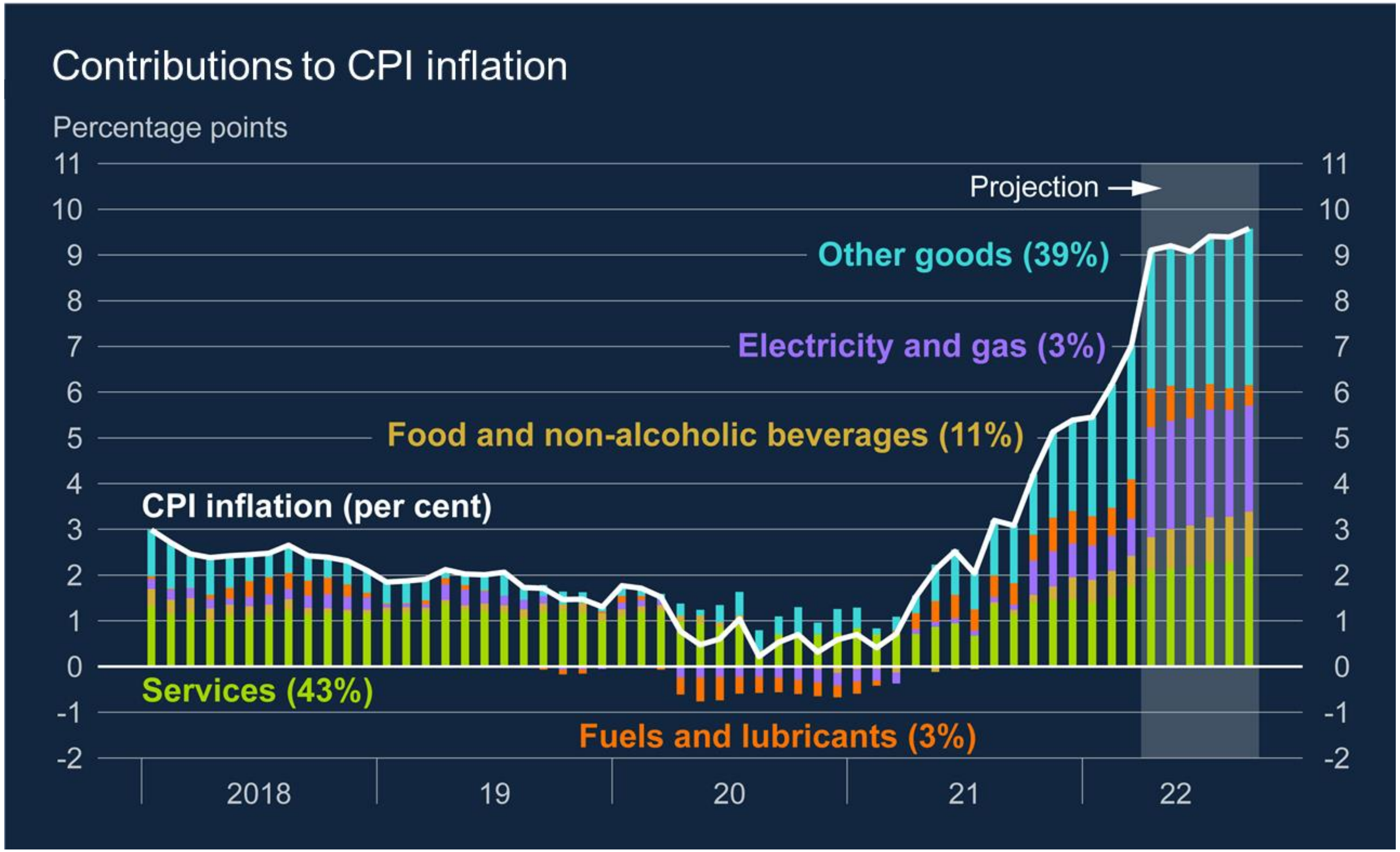
- UK imports relatively little oil and very little gas directly from Russia
- But prices UK pays set in global or European markets

Gas futures curves are materially higher than in February



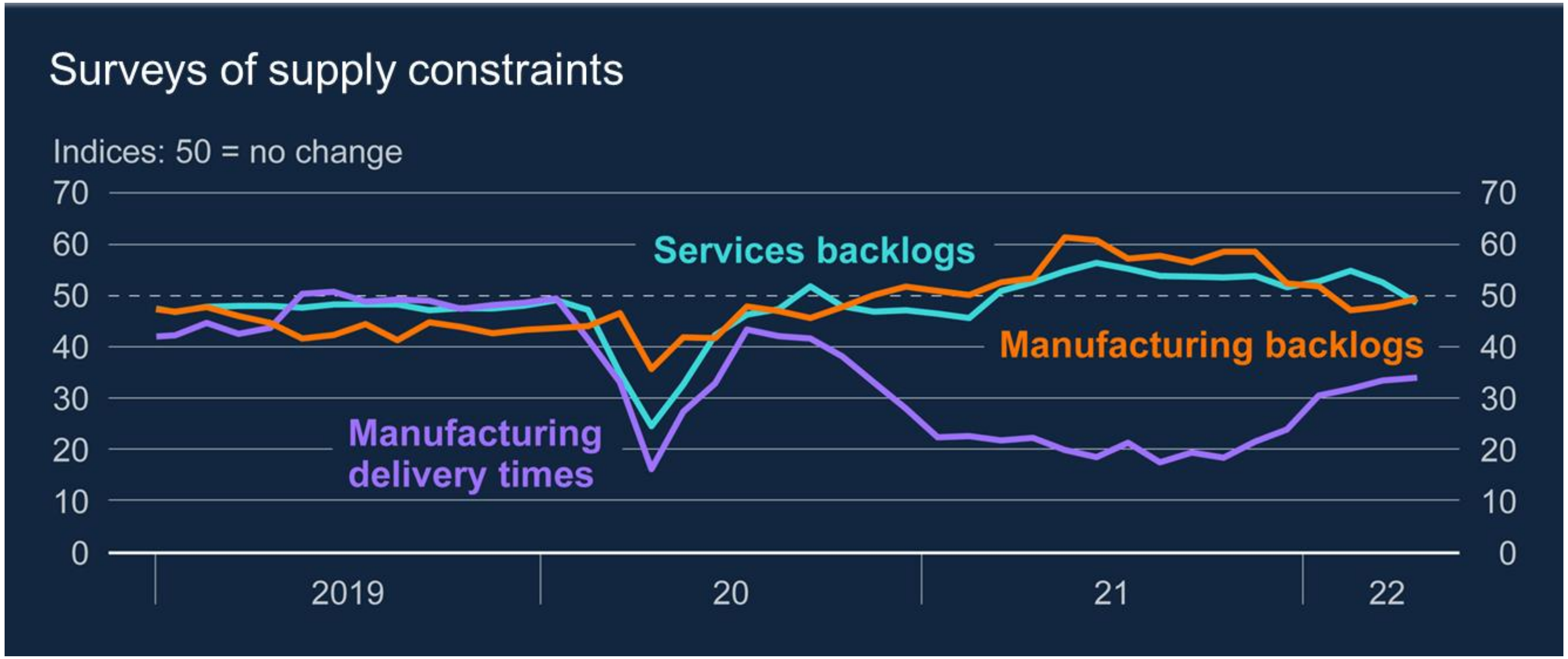
- Gas prices hit historic highs in the aftermath of the invasion
- Futures curve is well above February level
- This is likely to push Ofgem's energy price cap up by another 40% in October.

Energy and goods prices the major drivers behind the pick up in inflation



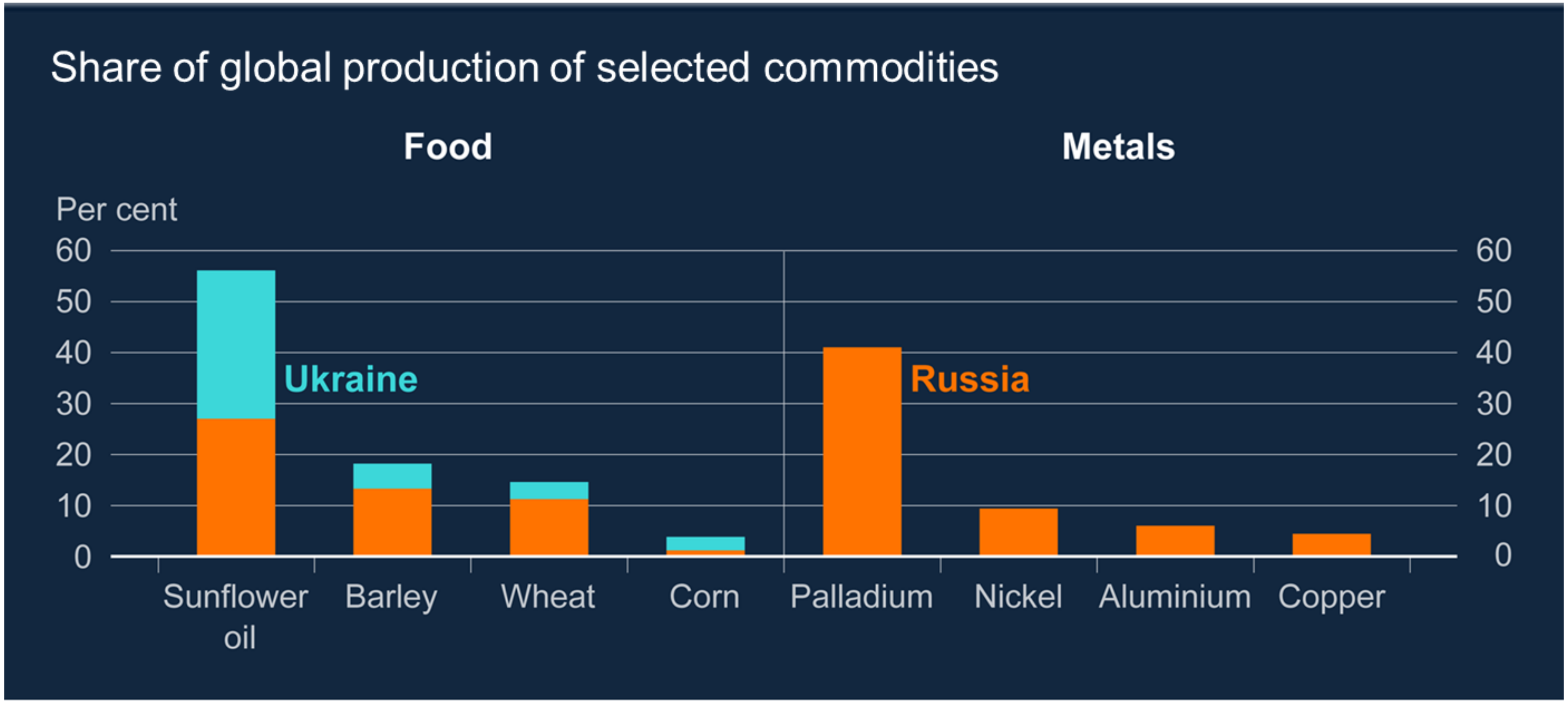
- Energy and other goods prices
- Services inflation also drifting higher
- Will rise further when the Ofgem price cap is reset in October

Bottlenecks seemed to be easing, prior to the invasion



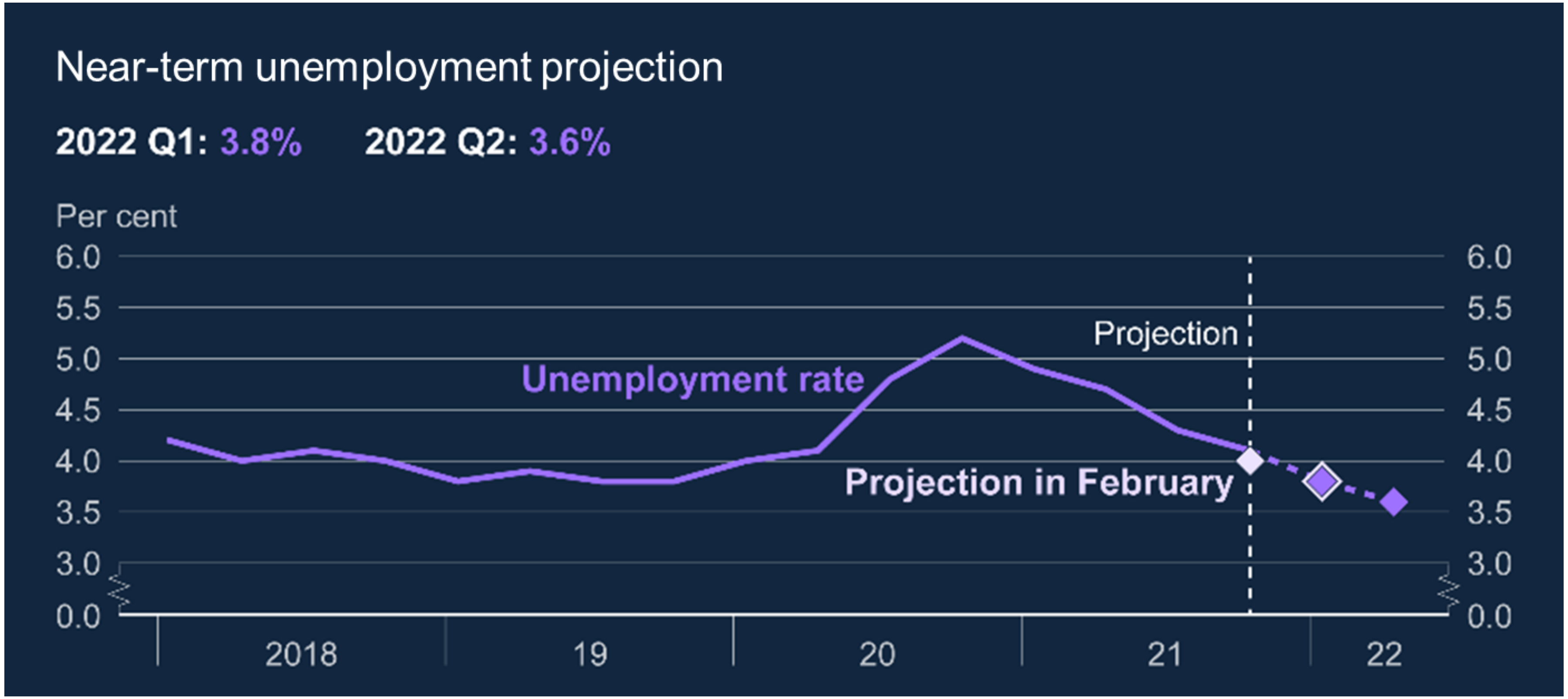
- Manufacuring delivery times had shortened
- Backlogs had eased a little

Russia and Ukraine major sources for food and metals



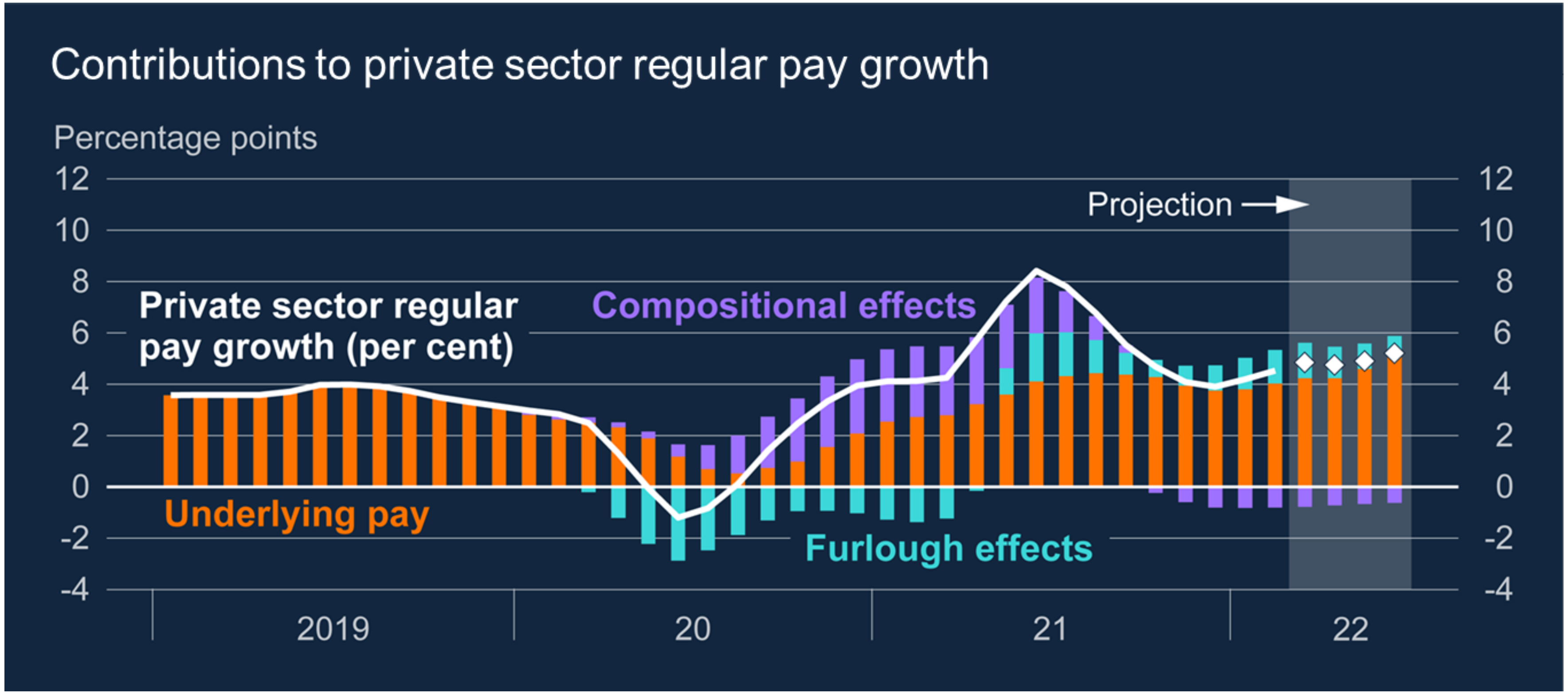
- Russia a major source of global production of some metals
- Both Ukraine and Russia major food producers.
- Covid restrictions in China also stricter.

Unemployment is likely to fall for another couple of quarters



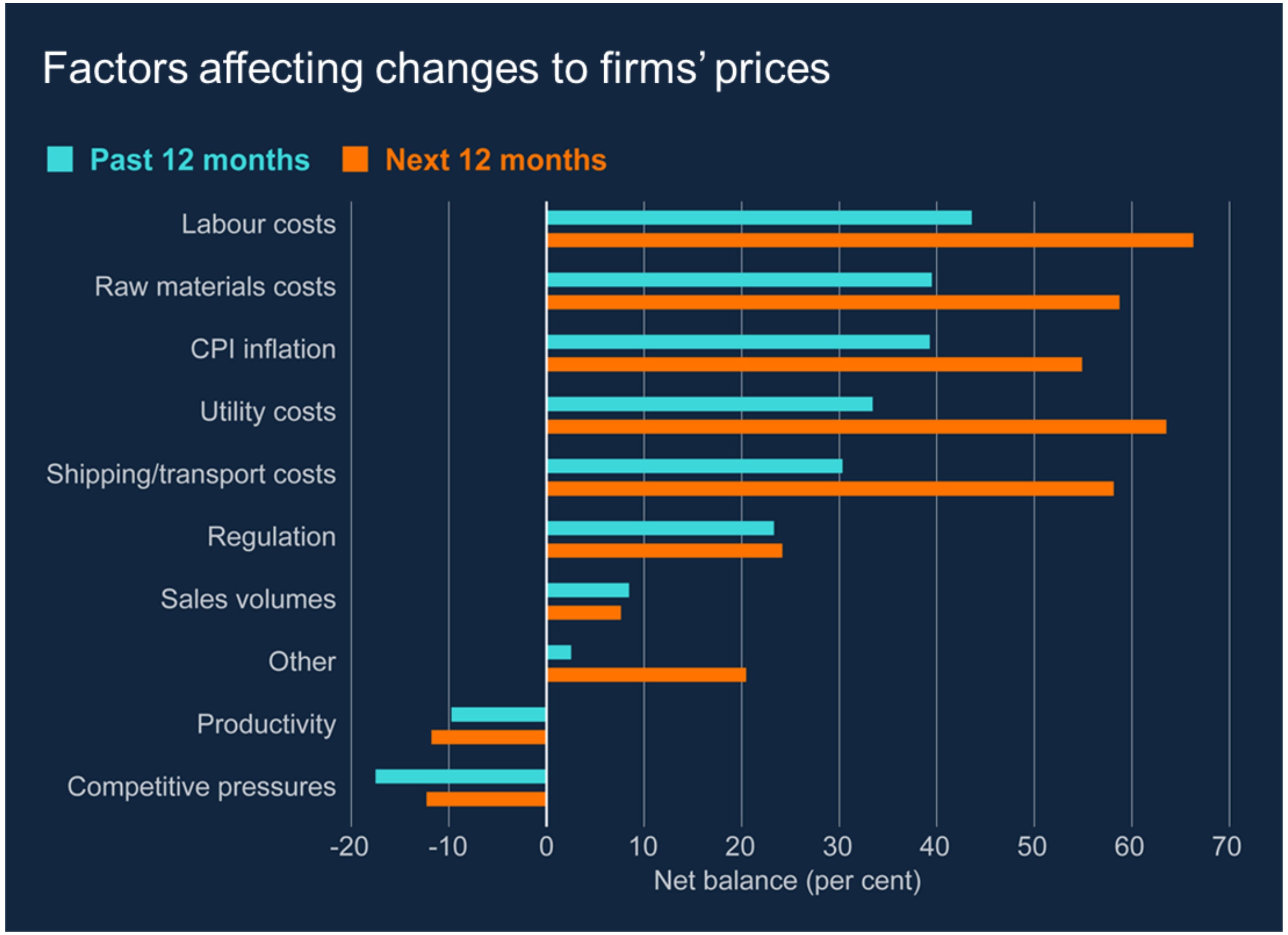
- Headline GDP in Q2 will be weak, but business sentiment continues to hold up
- Employment intentions consistent with unemployment falling to 3.6% in Q2

Pay growth above pre-pandemic rates and likely to rise further



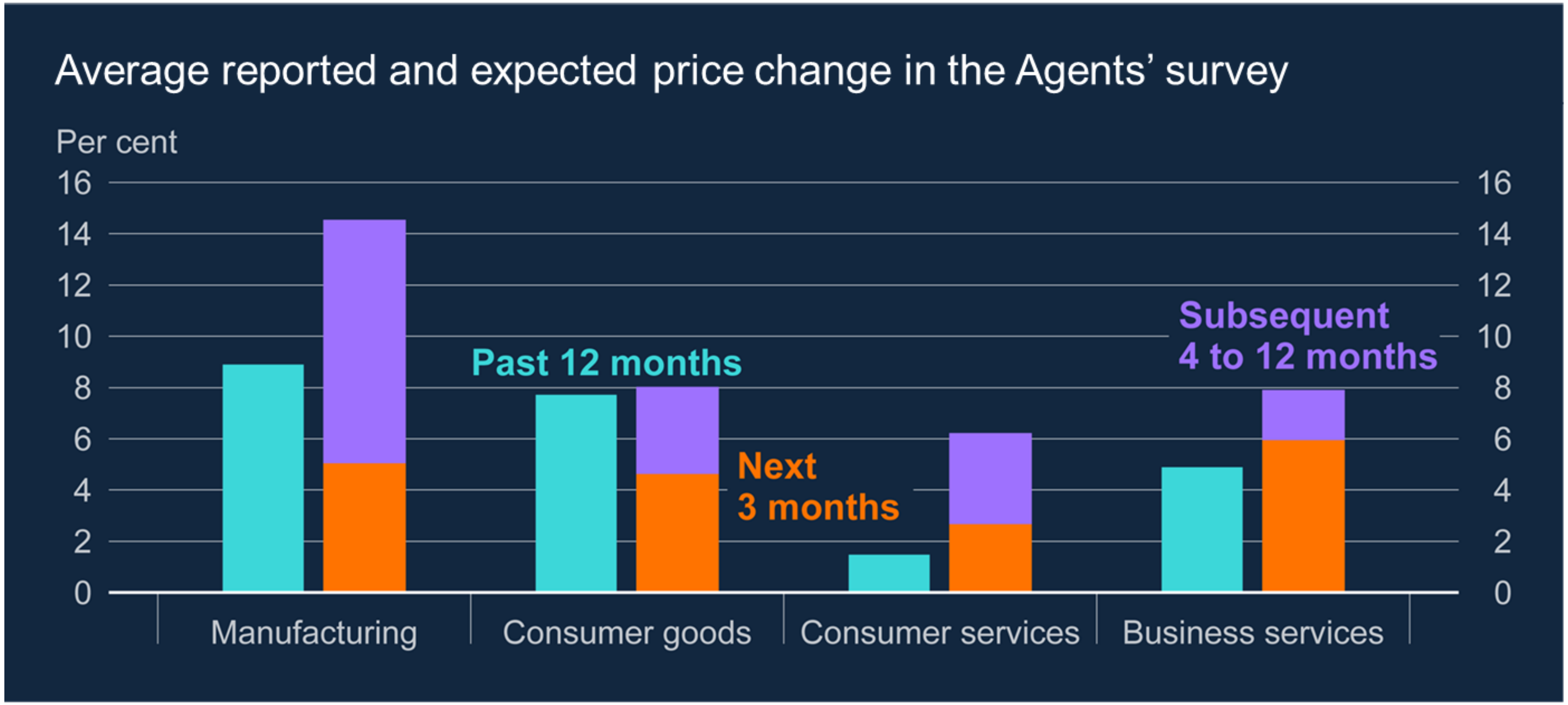
- Underlying pay is likely to go above 5% in coming months.
- Headline pay growth of 5¾% in 2022 as a whole

Business identify range of domestic and global factors pushing up prices



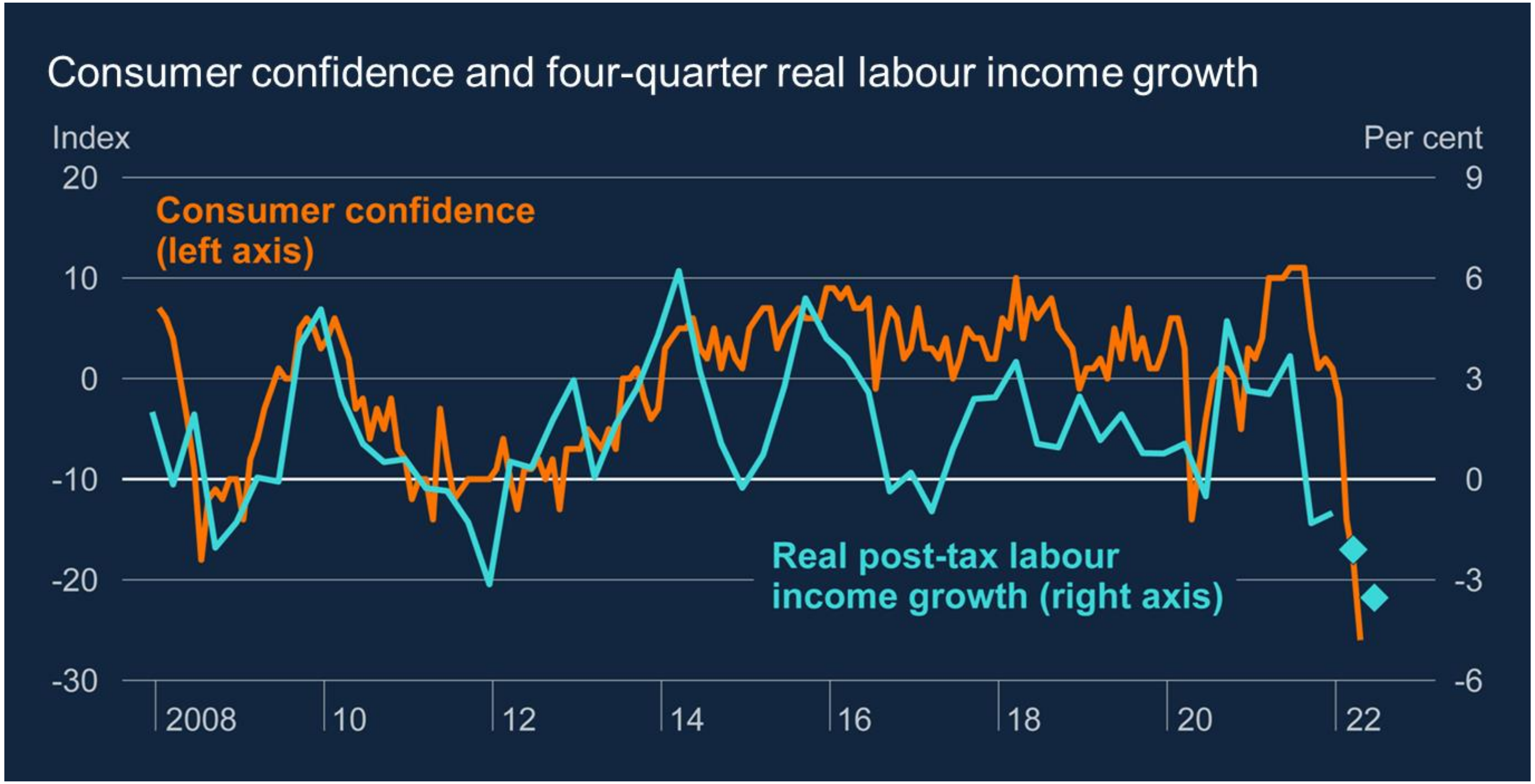
- Respondents to Agents' survey see the global influences on upward prices (raw materials, energy, shipping)…
- …but also identify labour costs and higher overall inflation as an issue

Business across all sectors plan to raise prices by more than last year



- Businesses across all sectors plan to raise prices by more than last year, with a large chunk of that reported to be over the next three months

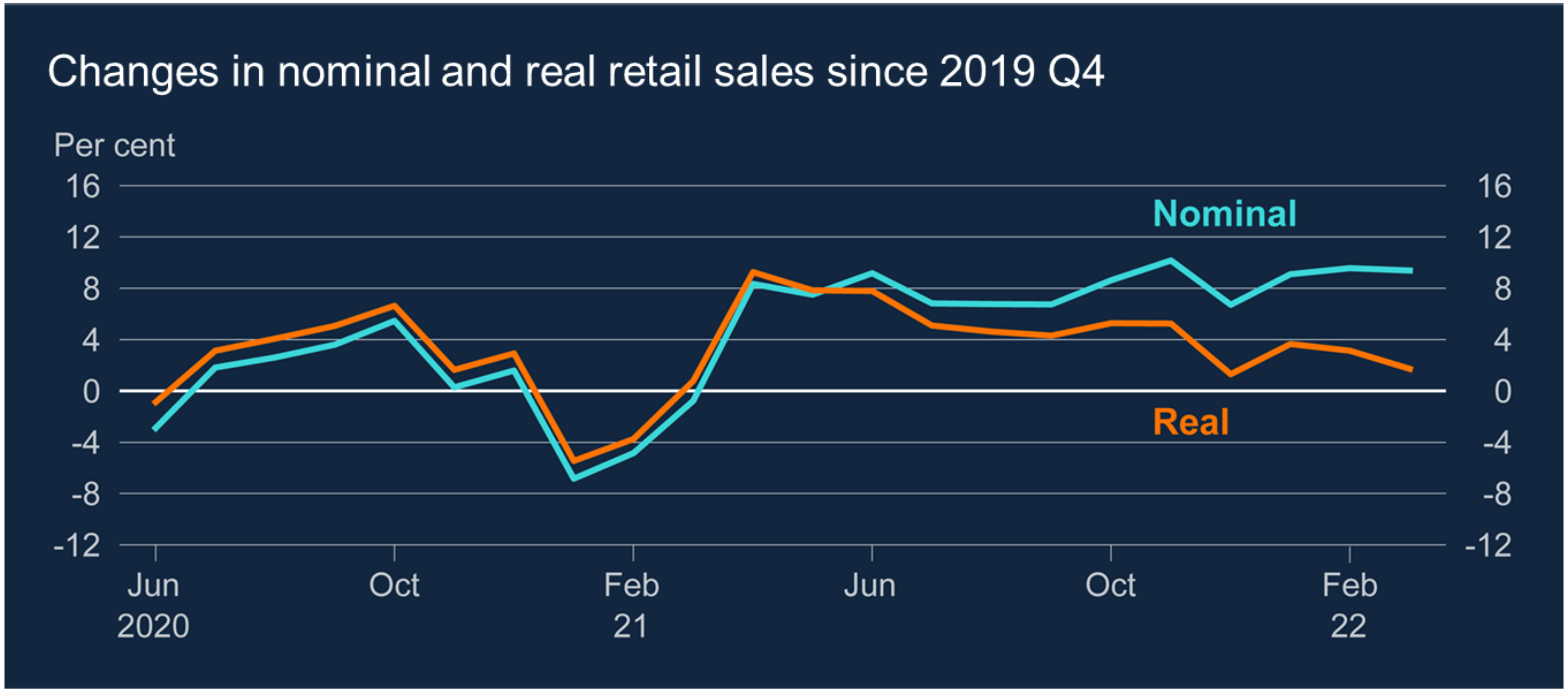
As real incomes have started to be squeezed, consumer confidence has fallen



- Labour income growth (measure most visible to households) already negative in real terms

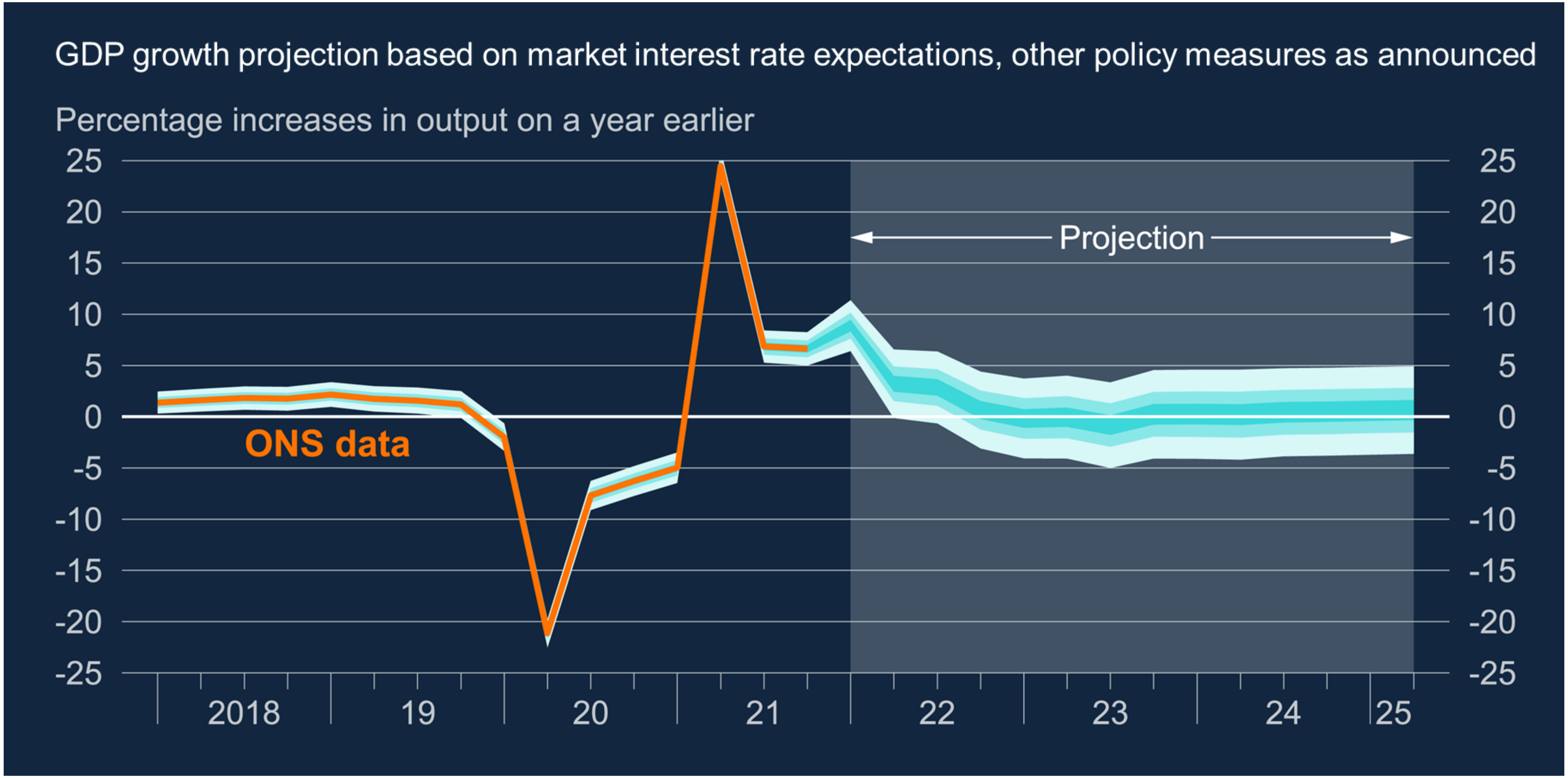
- GfK consumer confidence has fallen on all balances

Relatively flat nominal retail sales masks falling real spending



- What happens to spending?
- Early evidence suggests consumers are reacting to higher prices by maintaining nominal spending

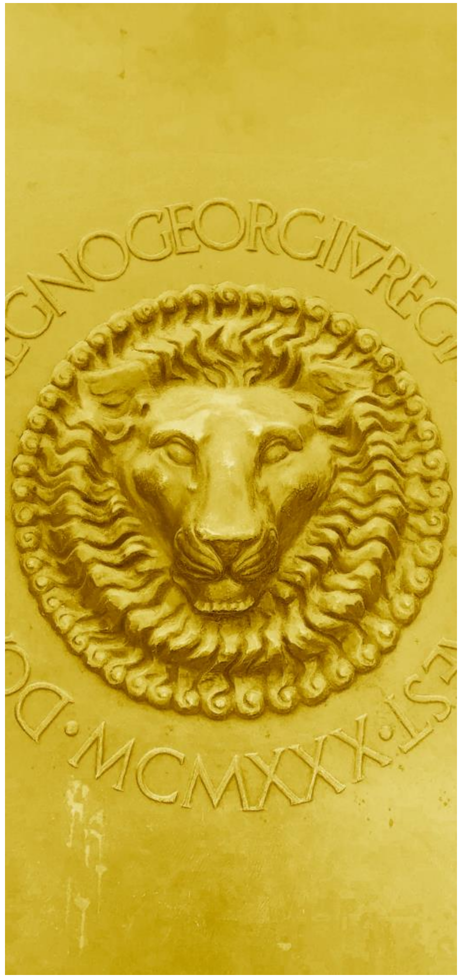
GDP growth weakens from here, with little or no growth next year



Main points from the MPR

Key judgements on the second half of the forecast

Four key judgements



1. Prices of commodities and other tradables stabilise

MPC conditioning assumptions for energy

	Averages				Projections		
	1998–2007	2010–19	2020	2021	2022	2023	2024
Bank Rate [c]	5.0	0.5	0.1	0.1 (0.1)	1.9 (1.2)	2.6 (1.4)	2.2 (1.3)
Sterling effective exchange rate [d]	100	82	78	82 (82)	81 (83)	81 (82)	81 (82)
Oil prices [e]	39	78	45	79 (79)	97 (82)	97 (82)	97 (82)
Gas prices [f]	29	53	41	238 (232)	242 (152)	242 (152)	242 (152)
Nominal government expenditure [g]	7½	2¼	11¾	7½ (9¼)	2 ¾ (-½)	3 (3)	2½ (4¾)

- MPC assume wholesale energy prices unchanged after six months…

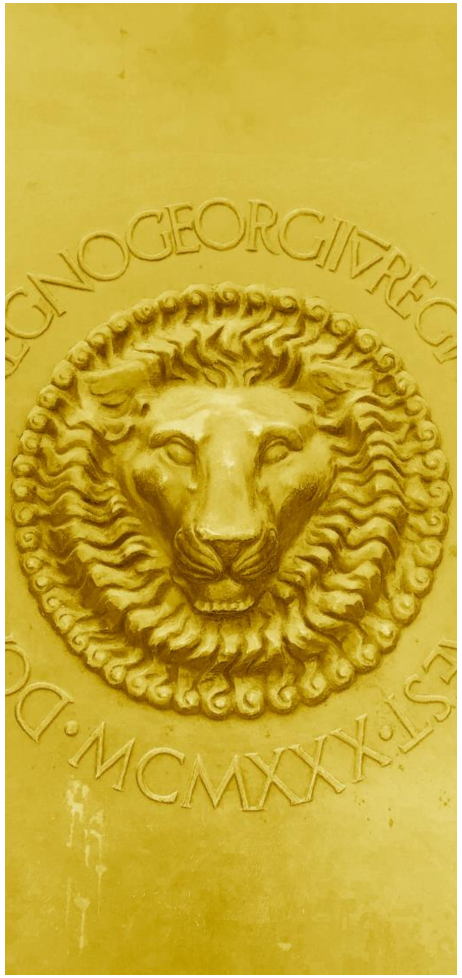
If energy prices follow their futures curves, activity will be stronger and inflation lower further out

GDP growth, excess supply/demand and CPI inflation in the MPC's central projection and in the alternative scenario in which energy prices follow their futures curves throughout the forecast period

Per cent	2022 Q2	2023 Q2	2024 Q2	2025 Q2
Central projection				
GDP	3.2	0	0.2	0.7
Excess supply/**Excess demand**	½	-1¼	-1¾	-2¼
CPI inflation	9.1	6.6	2.1	1.3
Alternative scenario				
GDP	3.2	0.3	0.6	0.9
Excess supply/**Excess demand**	½	-1	-1¼	-1½
CPI inflation	9.1	6.0	1.4	0.7

- …if they fall back in line with futures curves, activity will be stronger and inflation lower further out.

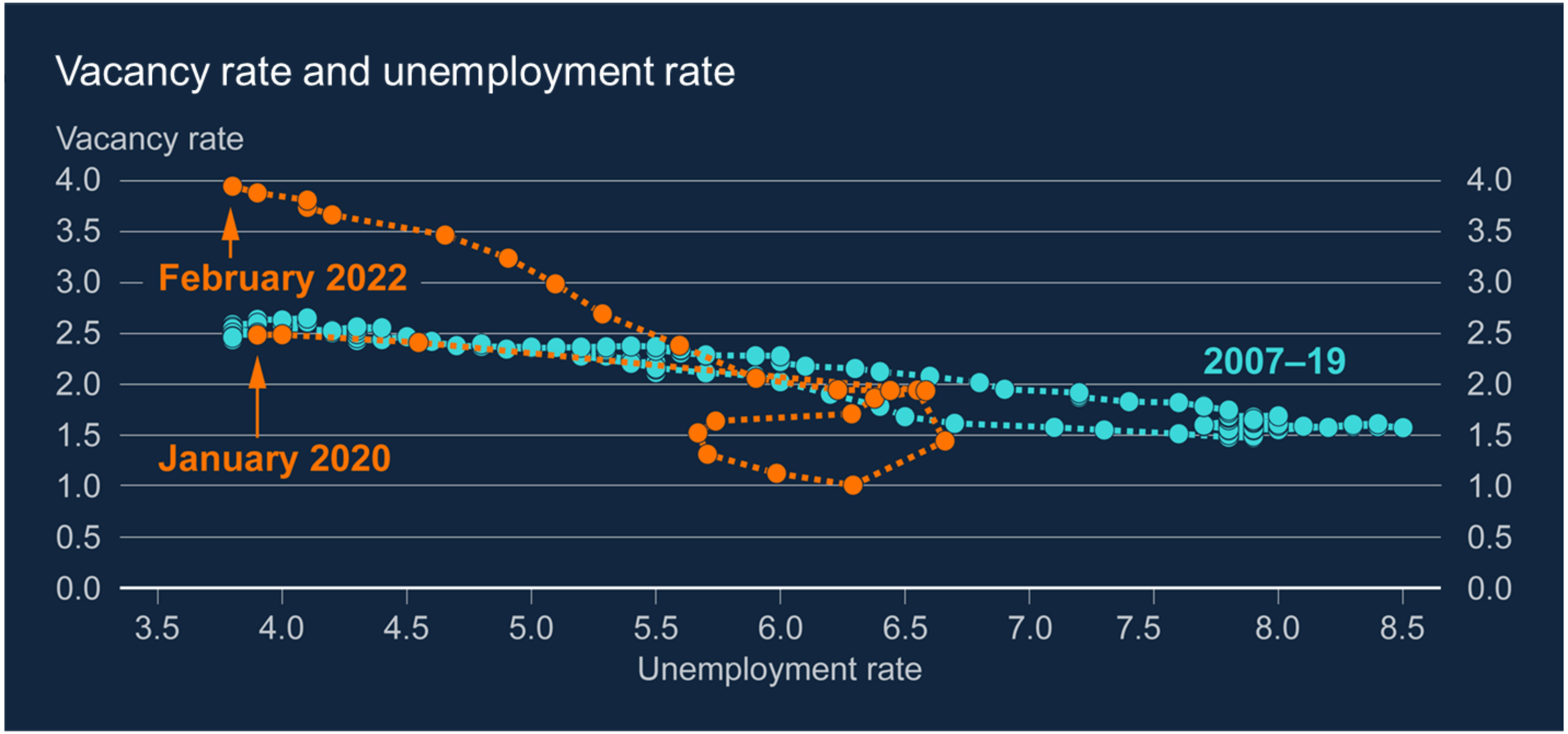
Four key judgements



1. Prices of commodities and other tradables stabilise

2. Beyond the near term, the labour market turns down

The labour market is undoubtedly very tight

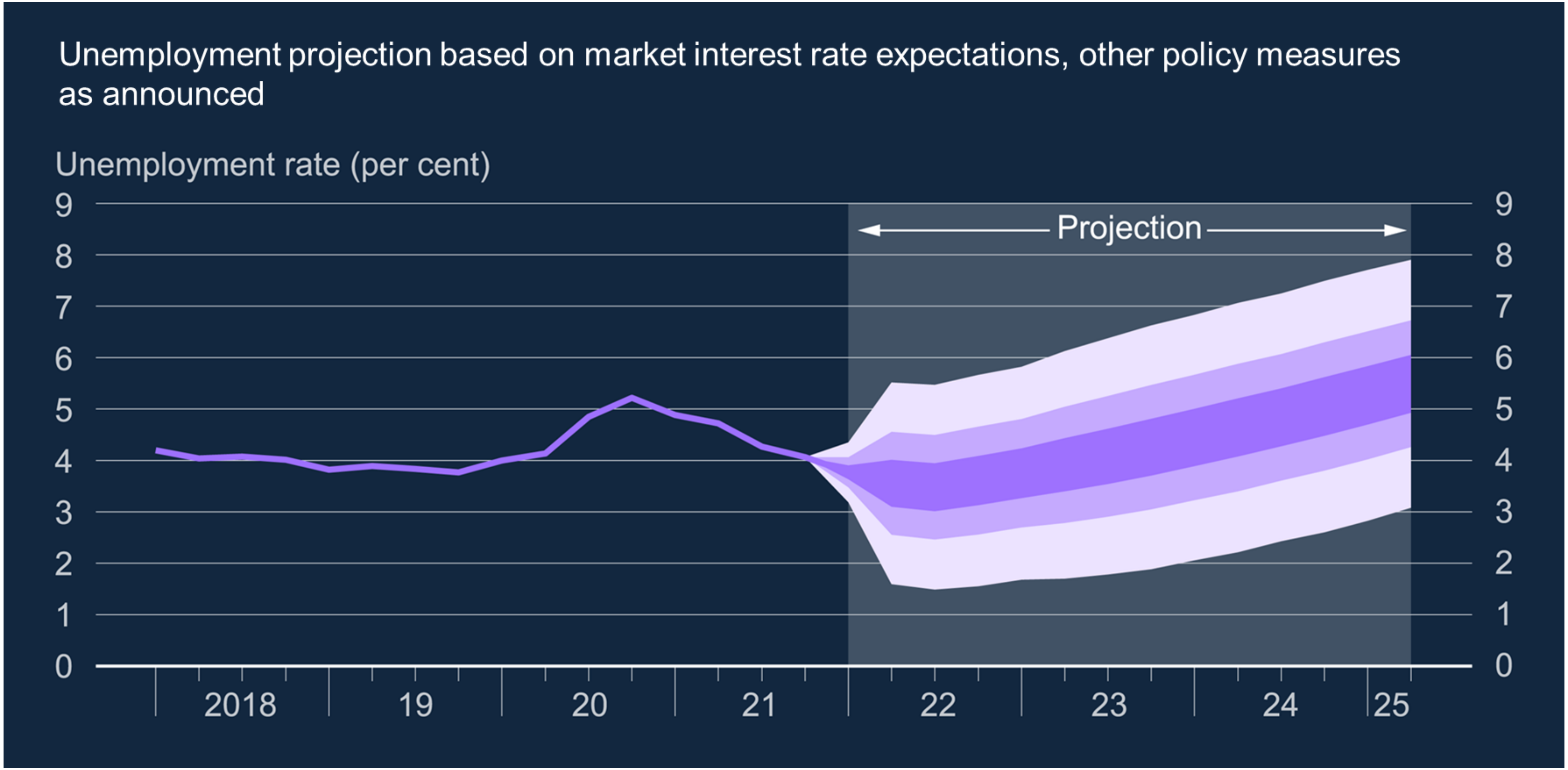


- Vacancies are much higher than they were the last time unemployment was at this level
- The Beveridge Curve has shifted out

Labour market "inactivity" has also risen further

- Despite strong labour demand, inactivity continues to rise
- So higher inactivity may be be more persistent

Unemployment picks up towards the end of the year and rises to 5½% by the end



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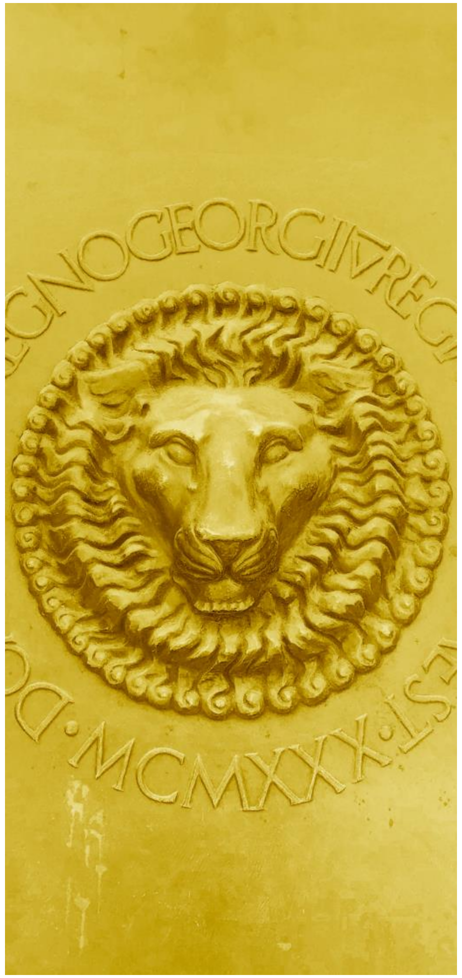

1. Prices of commodities and other tradables stabilise

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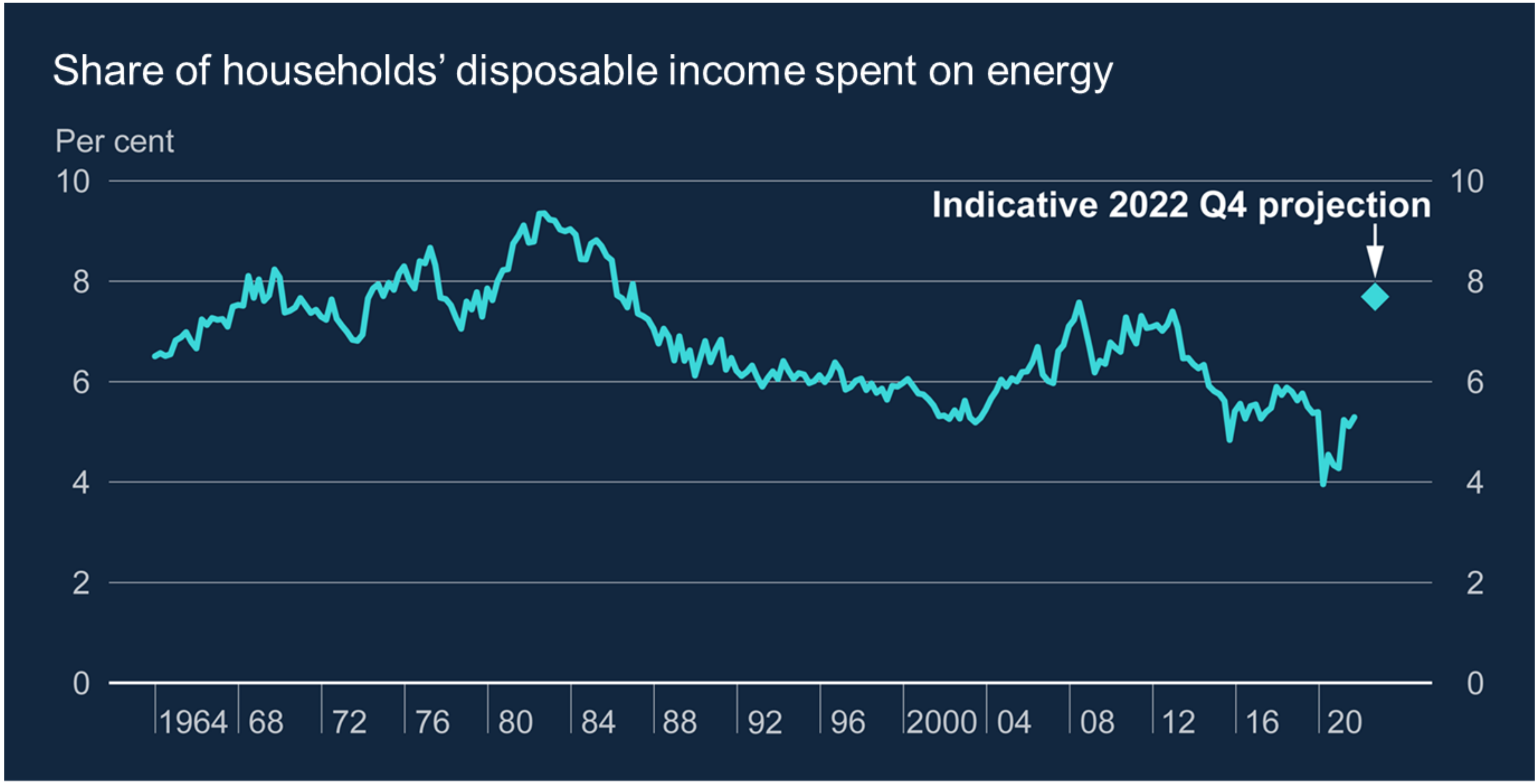
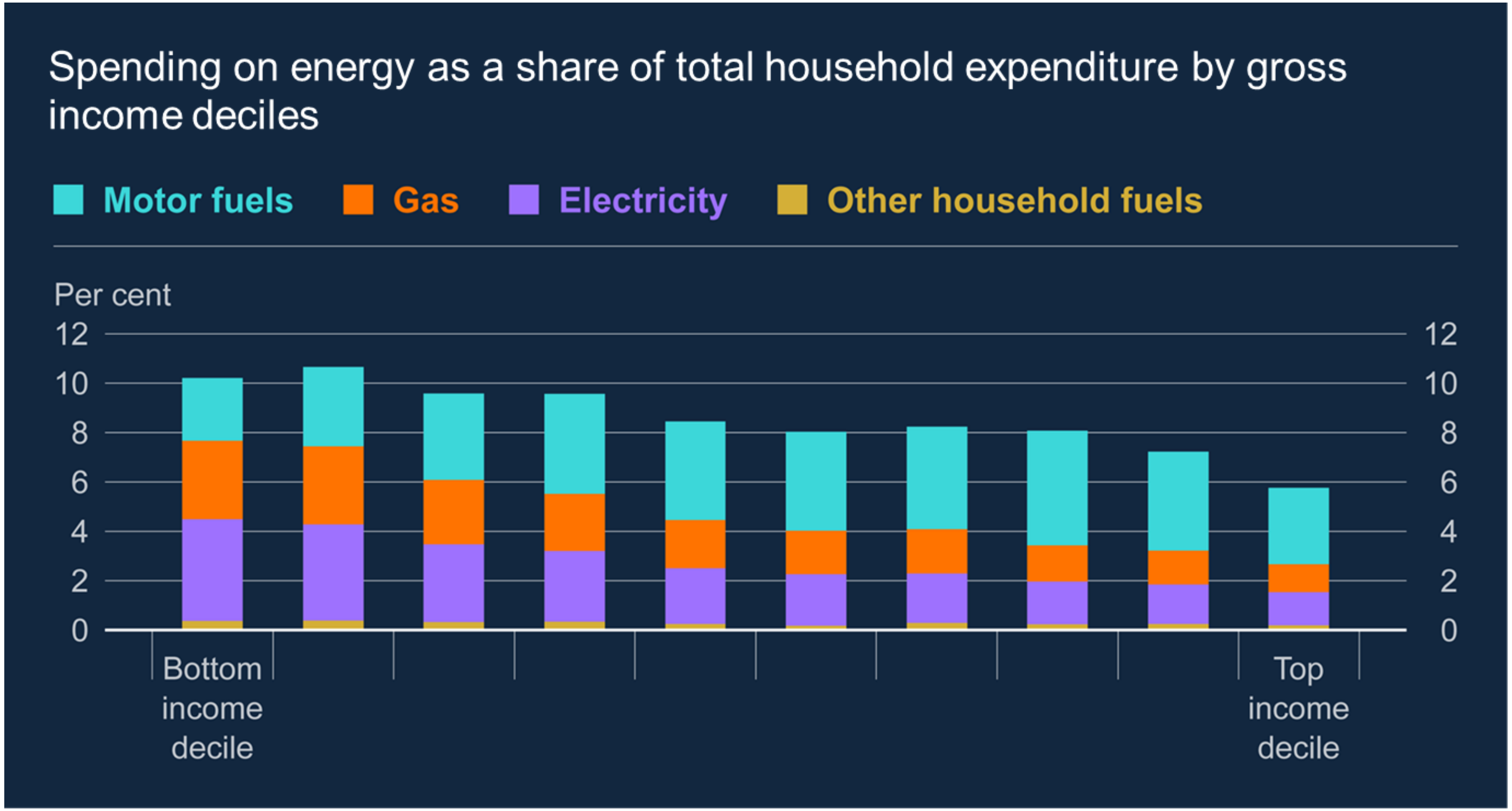
3. The squeeze on incomes leads to a slowing in demand

The share of income spent on energy is likely to increase this year



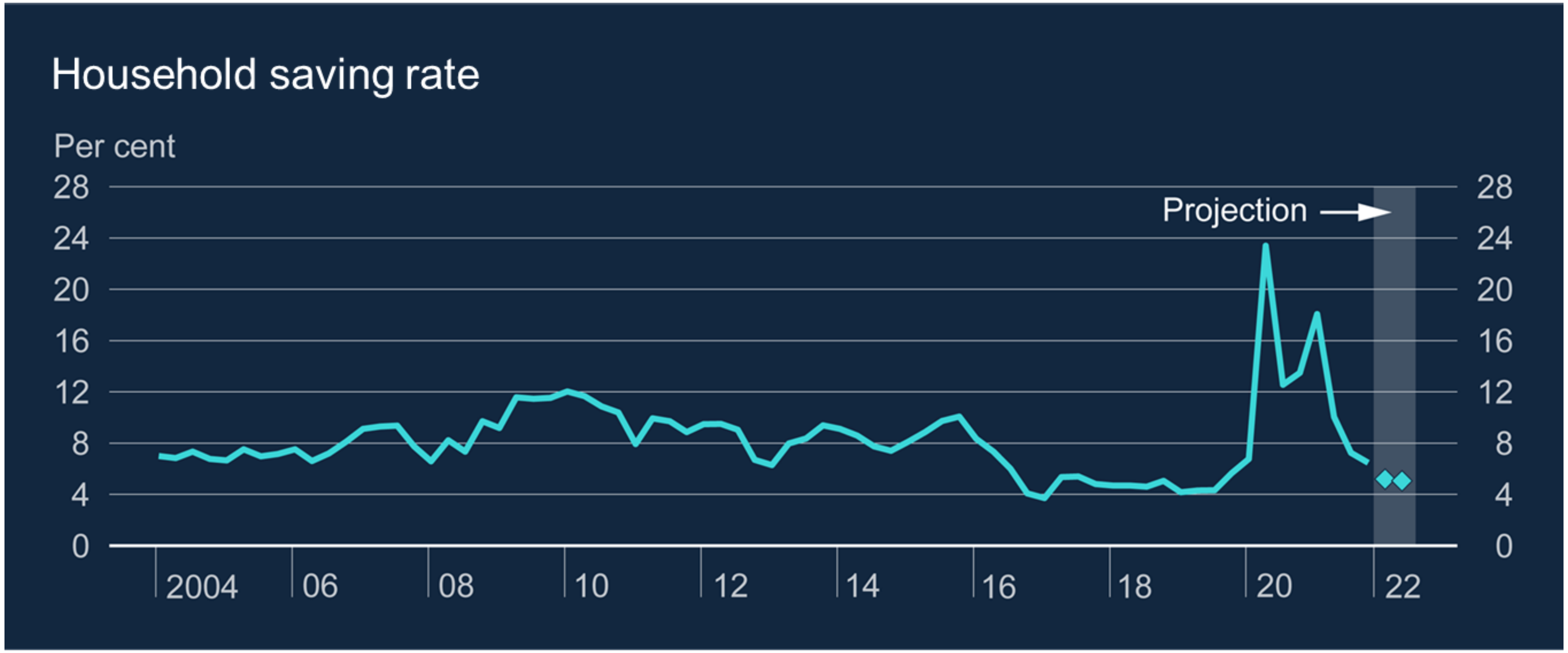
- Households may spend close to 8% of their disposable income on energy by Q4
- Difficult to substitute away from, so less income to spend elsewhere

Energy price shock likely to hit lower income groups disproportionately



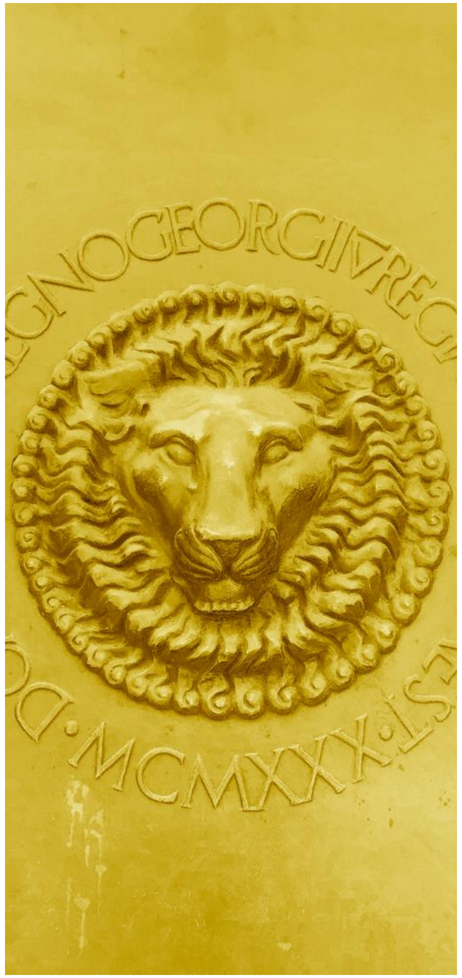
- Those on lower incomes tend to have higher marginal propensities to consume

The household sector as a whole built up savings during the pandemic



- Households as a whole have room to draw down savings
- But these are concentrated among those with higher incomes
- Risks on both sides

Four key judgements



1. Prices of commodities and other tradables stabilise

2. Beyond the near term, the labour market turns down

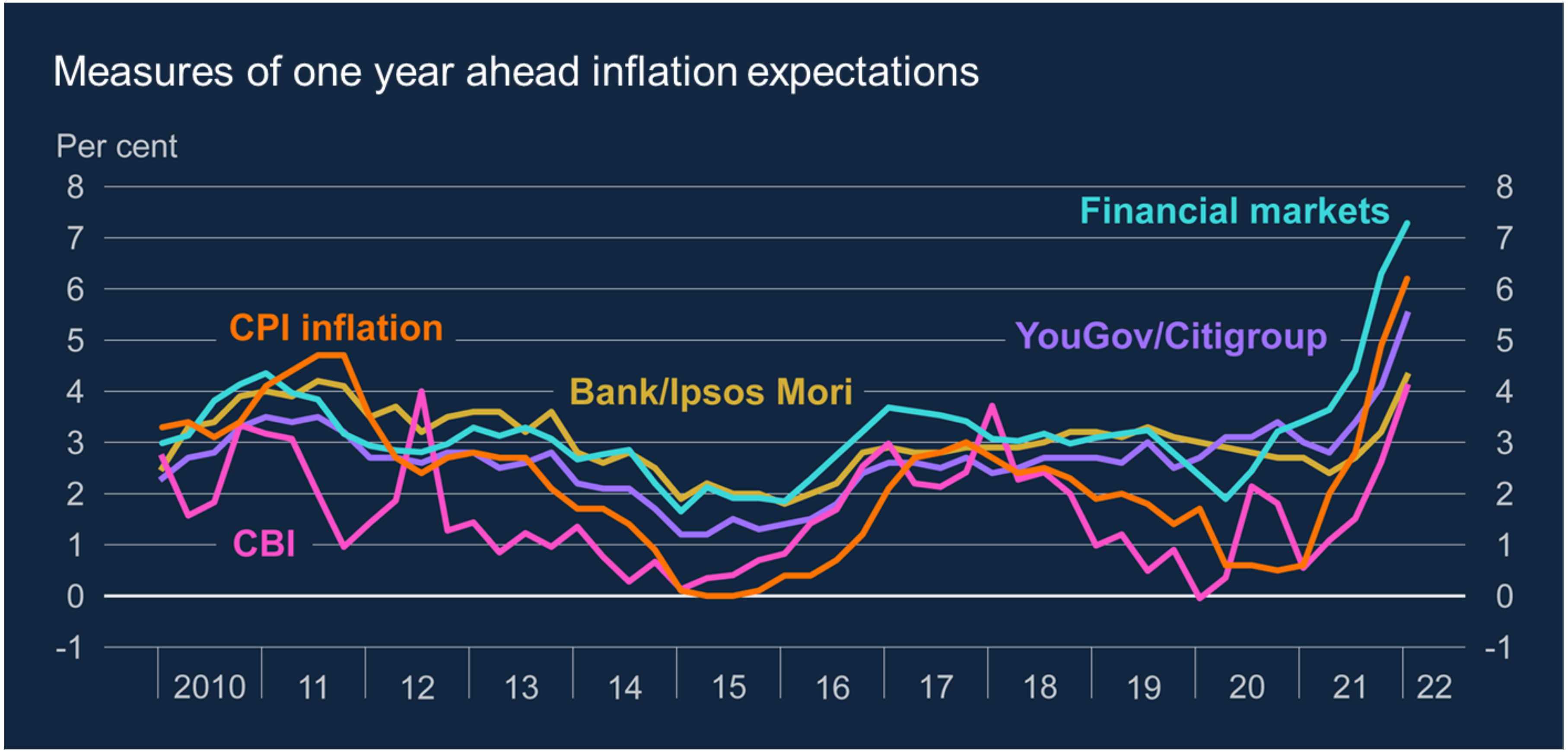
3. The squeeze on incomes leads to a slowing in demand

4. Domestic price pressure build, but fade again as spare capacity opens up

Pay growth indicators if anything suggest upside risks in the near-term

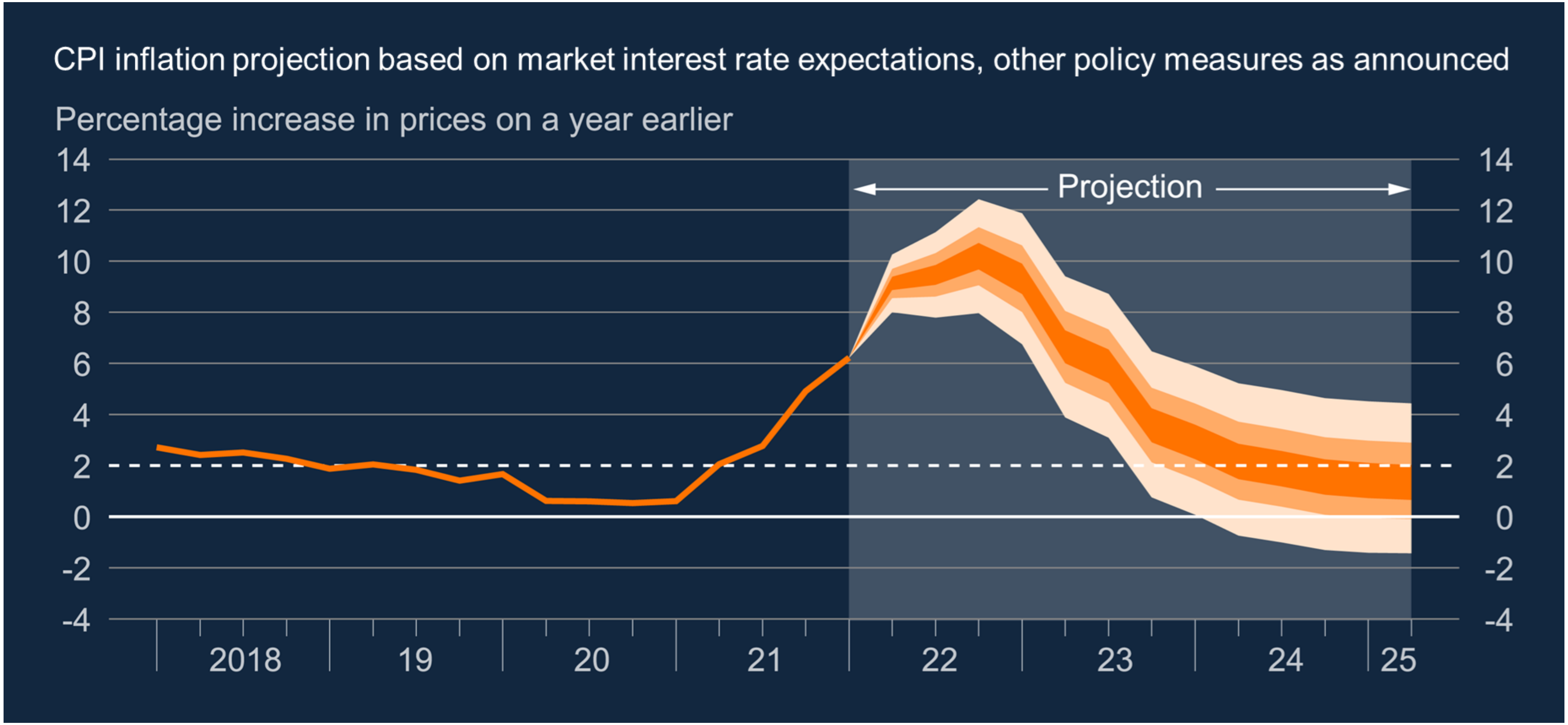
- High frequency indicators corroborate the pickup and suggest upside risks

Higher inflation also a factor in wage setting



- Labour market tightness likely to a major factor, but focus too on recent and prospective inflation outturns

Upside risks in years 2 and 3, but central forecast for inflation finishes below target



MPC perspective and policy

MPC perspective and policy

- Material exacerbation of both near-term peak in CPI inflation, and prospective negative impact on activity and medium-term inflationary pressures.
- MPC has voted to increase Bank Rate by 25bps, given current labour market tightness, continuing signs of robust domestic price pressures, and risk that those pressures will persist.
- Vote was by a majority of 6 to 3. Minority members voted for 50bp increase.
- Most members judge that some degree of further tightening in policy may still be appropriate in the coming months, and see two-sided risks around this judgement. Some members judge that risks around activity and inflation over policy horizon are more evenly balanced and this guidance is not appropriate.

Q&A

Menti poll: Do you think the economic growth forecasts set out in the May MPR look (a) too strong; (b) too weak; or (c) about right?

Help for SMEs interested in corporate responsibility programs:

Free Online resources:

Covering a wide range of Corporate Responsibility issues (including supporting the local community, reducing environmental impact, being a responsible employer, and improving responsible leadership).

Link: https://theheartofthecity.com/hub/

Climate Action Toolkit

Developed in collaboration with sustainability and climate change experts, and bespoke for SMEs. The four modules give any business the chance to develop a net zero action plan in four easily digestible modules.

Link: https://theheartofthecity.com/climate/

Course: Foundations for Responsible Business

This programme supports SMEs to develop a responsible business approach, focused on people, environment and community. Workshops and guidance from experts in all areas of CSR coach businesses to do well by doing good.

Link: https://theheartofthecity.com/membership/foundation-programme/

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