INFLATION REPORT PRESS CONFERENCE

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Opening Remarks by the Governor

This has been a notable week for anniversaries. On Monday, the nation celebrated the centenary of women gaining the vote. And, in the category of words not deeds, today marks a quarter of a century since the first *Inflation Report*. Though the style of the Report may have changed over the years, the Bank's commitment to explaining monetary policy independently and transparently has not.

So what is the picture painted in the 101st edition?

Demand and Supply Growth

One truth universally acknowledged is the current strength of the world economy.

Global growth is stronger, broader and healthier than it has been for some time. The global economy is growing at its fastest pace in seven years; 90% of the world is now growing at above-trend rates; and the global expansion is being increasingly driven by investment.

UK net trade is benefiting from this robust global demand and the past depreciation of sterling. Whereas it usually drags on growth, net trade is currently contributing substantially and is likely to continue supporting activity over the forecast period. British exporters are in a sweet spot, with sterling down around 16% overall (and around 20% against the euro) in anticipation of a Brexit that has not yet happened.

Along with high rates of profitability, the low cost of capital, and diminishing spare capacity, strong global activity is also supporting business investment. Nevertheless investment is being restrained by Brexit-related uncertainties. This remains the shallowest investment recovery in more than half a century.

Consumption growth has also been sluggish, as households adjust to the real income squeeze. Growth in household spending halved since the referendum, and is expected to remain relatively subdued over the next three years, reflecting weak real income growth.

On the whole, and despite the projections being conditioned on less supportive monetary conditions prevailing in financial markets, GDP growth is expected to average around 1¾% over the forecast period, a little stronger than projected in November.

While modest by historic standards, this demand growth is still expected to exceed the diminished rate of supply growth over the forecast period.

Following its annual assessment of the supply side of the economy, the MPC judges that very little spare capacity remains and that supply capacity will grow only modestly over the forecast, averaging around 1½% a year. This reflects lower growth in labour supply and productivity growth at rates around half its pre-crisis average.

With growth in demand outpacing of supply, a small margin of excess demand emerges by early 2020 and builds thereafter.

Inflation

CPI inflation fell from 3.1% in November to 3.0% in December. Inflation is expected to remain close to recent rates in the short term, slightly higher than the projection made three months ago largely as a consequence of recent higher oil prices. It is possible that inflation could rise back above 3% temporarily in the short term.

More generally, sustained above-target inflation remains almost entirely due to the effects of higher import prices following sterling's past depreciation. This impact of import prices on

CPI inflation is still expected to diminish slowly, with import prices pushing marginally up inflation at the end of the three-year forecast period.

While the contribution from external factors slowly dissipates, domestic inflationary pressures are likely to firm as the economy moves from excess supply into excess demand. Unemployment has continued to fall, recently reaching its lowest level since 1975. The firming of shorter-term measures of wage growth in recent quarters, and a range of survey indicators that suggests pay growth will rise further in response to the tightening labour market, give increasing confidence that growth in wages and unit labour costs will pick up to target-consistent rates.

The balance of these effects means that CPI inflation is projected to fall back gradually over the forecast although it remains above the 2% target in the second and third years of the MPC's central projection.

Forecasts

As has been the case for some time, developments regarding the United Kingdom's withdrawal from the European Union are the most significant influences on, and sources of uncertainty about, the economic outlook.

But the fact that Brexit negotiations entail significant uncertainty doesn't mean forecasting is impossible. It is useful to step back to assess how the economy has performed relative to the MPC's expectations in order to understand the forces at work on it.

- Over the past year, the MPC has been at the upper end of forecasts for the global and UK economies. We have been right about those directions though the global economy has been even stronger than we had expected while the UK economy has been broadly in line with our forecast last February.

- The MPC has expected a rotation of demand in the UK away from household consumption and towards net exports and investment. This appears to be happening, particularly with net trade contributing importantly to UK growth this year. And household spending growth has been restrained by the real income squeeze, a squeeze that is expected to ease but not end over the next few years.

- The MPC has also been expecting a firming of wages as the labour market tightens and the rate of productivity growth recovers somewhat. Both appear to be underway.

- And finally, imported inflationary pressures arising from the referendum-related fall in sterling have been in line with our expectations and are still expected to be the predominant cause of the overshoot of inflation throughout our forecast.

Policy

In the exceptional circumstances prevailing since the referendum, the MPC has set policy to balance the trade-off between the speed at which inflation returns to target and the support that monetary policy provides to jobs and activity. Our understanding of the contours of economic developments since the referendum has meant this strategy has worked with employment rising and slack steadily being absorbed despite the sharp hit to household real incomes.

As outlined in my letter today to the Chancellor, the steady absorption of slack has reduced the degree to which it is appropriate for the MPC to accommodate an extended period of inflation above the target. Consequently, in November, the MPC began to remove some stimulus, raising Bank Rate by ¼ percentage points to ½ per cent.

Three months on, the prospect of a greater degree of excess demand and the expectation that inflation would remain above the target over the forecast period have further diminished the trade-off that the MPC is required to balance.

The MPC judges that, were the economy to evolve broadly in line with its February *Inflation Report* projections, monetary policy would need to be tightened somewhat earlier and by a somewhat greater extent over the forecast period than it anticipated at the time of the November *Report*, in order to return inflation sustainably to the target. All members agree that any future increases in Bank Rate are expected to be at a gradual pace and to a limited extent.

The economic outlook will continue to evolve. There will be ups and downs in financial markets. The Brexit process will twist and turn before it is concluded.

Whatever happens, the Committee will monitor developments closely and will respond to ensure that inflation returns sustainably to the 2% target.

This principled, consistent and transparent approach to monetary policy is the best contribution that the MPC can make to monetary stability and therefore to the good of the people of the United Kingdom in these exceptional circumstances.