

Conditioning assumptions, MPC key judgements, and indicative projections May 2018

This document contains five tables of projections:

- Table 1 shows the conditioning assumptions used for the MPC's projections;
- Table 2 shows the MPC's mean projections for GDP, CPI inflation and LFS unemployment;
- Table 3 shows a summary of the headline forecast variables;
- Table 4 shows profiles that illustrate the MPC's key judgements as described in Section 5; and
- Table 5 shows indicative projections produced for the MPC by Bank staff to be consistent with the MPC's modal projections for GDP, inflation and unemployment.

The May 2018 projections in Tables 2, 3, 4 and 5 have been conditioned on the paths shown in Table 1, and the assumptions that the stock of purchased gilts remains at £435 billion and the stock of purchased corporate bonds remains at £10 billion throughout the forecast period, and on the Term Funding Scheme (TFS); all three of which are financed by the issuance of central bank reserves. The February 2018 projections were conditioned on the same asset purchase and TFS assumptions and market interest rates.

The '*Inflation Report fan charts May 2018*' document and the quarterly market interest rate paths are available in the 'Data from the May 2018 Inflation Report' section at www.bankofengland.co.uk/inflation-report/2018/may-2018.

Table 1 Forecast conditioning assumptions^{(a)(b)}

	Average 1998– 2007	Projections		
		2018	2019	2020
Bank Rate ^(c)	5.0	0.7	1.0	1.2
Sterling effective exchange rate ^(d)	100	80	80	80
Oil prices ^(e)	39	71	65	61
Gas prices ^(f)	29	55	49	44
Nominal government expenditure ^(g)	7¼	1¾	2½	2½

Sources: Bank of England, Bloomberg Finance L.P., Office for Budget Responsibility, ONS, Thomson Reuters Datastream and Bank calculations.

(a) The table shows the projections for financial market prices, wholesale energy prices and government spending projections that are used as conditioning assumptions for the MPC's projections for CPI inflation, GDP growth and the unemployment rate.

(b) Financial market data are based on averages in the 15 working days to 2 May 2018. Figures show the average level in Q4 of each year, unless otherwise stated.

(c) Per cent. The path for Bank Rate implied by forward market interest rates. The curves are based on overnight index swap rates.

(d) Index: January 2005 = 100. The convention is that the sterling exchange rate follows a path that is half way between the starting level of the sterling ERI and a path implied by interest rate differentials.

(e) Dollars per barrel. Projection based on monthly Brent futures prices.

(f) Pence per therm. Projection based on monthly natural gas futures.

(g) Annual average growth rate. Nominal general government consumption and investment. Projections are taken from the Office for Budget Responsibility's *Economic and Fiscal Outlook* associated with the Spring Statement 2018. Historical data based on NMRP+D7QK.

Table 2 The MPC's mean projections for GDP, CPI inflation and LFS unemployment

	Average 1998– 2007	Projections		
		2018	2019	2020
GDP ^(a)	2.9	1.4	1.7	1.7
CPI inflation ^(b)	1.6	2.2	2.1	2.0
LFS unemployment rate ^(c)	5.3	4.1	4.0	4.0

(a) Annual average growth in real GDP consistent with the mean projection for four-quarter growth in real GDP. The growth rates reported in this table exclude the backcast for GDP.

(b) Four-quarter inflation rate in Q4.

(c) LFS unemployment rate in Q4.

Table 3 Forecast summary^(a)

	Projections			
	2018 Q2	2019 Q2	2020 Q2	2021 Q2
GDP ^(b)	1.4 (1.8)	1.7 (1.7)	1.7 (1.7)	1.7
<i>Including backcast</i> ^(c)	1.7 (1.8)	1.7 (1.7)	1.7 (1.7)	1.7
CPI inflation ^(d)	2.4 (2.7)	2.1 (2.2)	2.0 (2.1)	2.0
LFS unemployment rate	4.1 (4.2)	4.0 (4.2)	4.0 (4.1)	4.0
Excess supply/Excess demand ^(e)	-¼ (-¼)	0 (0)	0 (0)	+¼
Bank Rate ^(f)	0.6 (0.5)	0.9 (0.9)	1.1 (1.1)	1.2

(a) Modal projections for GDP, CPI inflation, LFS unemployment and excess supply/excess demand. Figures in parentheses show the corresponding projections in the February 2018 *Inflation Report*. Projections were only available to 2021 Q1 in February.

(b) Four-quarter growth in real GDP. Excludes the backcast for GDP.

(c) Four-quarter growth in real GDP.

(d) Four-quarter inflation rate.

(e) Per cent of potential GDP. A negative figure implies output is below potential and a positive that it is above.

(f) Per cent. The path for Bank Rate implied by forward market interest rates. The curves are based on overnight index swap rates.

Table 4 MPC key judgements^{(a)(b)}**Key Judgement 1: global growth remains robust**

	Average 1998– 2007	Projections		
		2018	2019	2020
World GDP (UK-weighted) ^(c)	3	3 (3)	2½ (2½)	2¼ (2¼)
World GDP (PPP-weighted) ^(d)	4	4 (4)	3¾ (3¾)	3½ (3½)
Euro-area GDP ^(e)	2¼	2½ (2¾)	2 (2)	1¾ (1¾)
US GDP ^(f)	3	3 (3)	2½ (2½)	1¾ (1¾)

Key Judgement 2: investment and net trade support UK demand, while consumption growth remains subdued

	Average 1998– 2007	Projections		
		2018	2019	2020
Household consumption contribution to GDP growth ^(g)	2¼	¾ (¾)	¾ (¾)	¾ (1)
Business investment contribution to GDP growth ^(h)	¼	¼ (¼)	¼ (¼)	½ (½)
Net trade contribution to GDP growth ⁽ⁱ⁾	-¼	¼ (½)	¼ (¼)	¼ (¼)
Business investment to GDP ratio ^(j)	9¾	9½ (9½)	9¾ (9¾)	10 (9¾)
Credit spreads ^(k)	¾ ^(l)	1½ (1¾)	1½ (1¾)	1½ (1¾)
Household saving ratio ^(m)	8½	5½ (5¾)	5½ (5¼)	5¼ (5)

Key Judgement 3: very little slack remains and the pace of potential supply growth is modest

	Average 1998– 2007	Projections		
		2018	2019	2020
Productivity ⁽ⁿ⁾	2¼	1¼ (1¼)	1¼ (1¼)	1 (1)
Participation rate ^(o)	63	63½ (63½)	63½ (63½)	63½ (63½)
Average hours ^(p)	32¼	32 (32)	32 (32)	32 (32)

Key Judgement 4: with demand outstripping potential supply, domestic inflationary pressures continue to build while the contribution from energy and import prices dissipates further

	Average 1998– 2007	Projections		
		2018	2019	2020
UK import prices ^(q)	¼	1¼ (1½)	-½ (¼)	-½ (-¼)
Dollar oil prices ^(r)	39	71 (67)	65 (63)	61 (60)
Unit labour costs ^(s)	3	2¾ (2)	2¼ (2¼)	2¼ (2¼)
Unit wage costs ^(t)	2½	2¼ (1¾)	2¼ (2¼)	2¼ (2¼)

Sources: Bank of England, BDCR Continental *SME Finance Monitor*, Bloomberg Finance L.P., British Household Panel Survey, Department for Business, Energy and Industrial Strategy, Eurostat, ICE/BoAML Global Research (used with permission), IMF *World Economic Outlook (WEO)*, ONS, US Bureau of Economic Analysis and Bank calculations.

(a) The MPC's projections for GDP growth, CPI inflation and unemployment (as presented in the fan charts) are underpinned by four key judgements. The mapping from the key judgements to individual variables is not precise, but the profiles in the table should be viewed as broadly consistent with the MPC's key judgements.

(b) Figures show annual average growth rates unless otherwise stated. Figures in parentheses show the corresponding projections in the February 2018 *Inflation Report*. Calculations for back data based on ONS data are shown using ONS series identifiers.

(c) Chained-volume measure. Constructed using real GDP growth rates of 180 countries weighted according to their shares in UK exports.

(d) Chained-volume measure. Constructed using real GDP growth rates of 181 countries weighted according to their shares in world GDP using the IMF's purchasing power parity (PPP) weights.

(e) Chained-volume measure.

(f) Chained-volume measure.

(g) Chained-volume measure. Includes non-profit institutions serving households. Household consumption data based on ABJR+HAYO. GDP data based on ABMI.

(h) Chained-volume measure. Business investment data based on GAN8. GDP data based on ABMI.

(i) Chained-volume measure. Exports less imports. Since 1998, exports based on (IKBK-OFNN/(BOKH/BQKO)). Since 1998, imports based on (IKBL-OFNN/(BOKH/BQKO)). Prior to 1998 the data exclude the impact of missing trader intra-community (MTIC) fraud, with net trade based on IKBK-IKBL. GDP data based on ABMI.

(j) Annual average. Chained-volume business investment as a percentage of GDP. Business investment data based on GAN8. GDP data based on ABMI.

(k) Level in Q4. Percentage point spread over reference rates. Based on a weighted average of household and corporate loan and deposit spreads over appropriate risk-free rates. Indexed to equal zero in 2007 Q3.

(l) Based on the weighted average of spreads for households and large companies over 2003 and 2004 relative to the level in 2007 Q3. Data used to construct the SME spread are not available for that period.

The period is chosen as broadly representative of one where spreads were neither unusually tight nor unusually loose.

(m) Annual average. Percentage of total available household resources. Based on NRJS.

(n) GDP per hour worked. GDP data based on ABMI. Hours worked based on YBUS.

(o) Level in Q4. Percentage of the 16+ population. Based on MGWG.

(p) Level in Q4. Average weekly hours worked, in main job and second job. Based on YBUS/MGRZ.

(q) Four-quarter inflation rate in Q4.

(r) Average level in Q4. Dollars per barrel. Projection based on monthly Brent futures prices.

(s) Four-quarter growth in unit labour costs in Q4. Whole-economy total labour costs divided by GDP at market prices, based on the mode of the MPC's GDP backcast. Total labour costs comprise compensation of employees and the labour share multiplied by mixed income.

(t) Four-quarter growth in unit wage costs in Q4. Whole-economy total wage costs divided by GDP at market prices, based on the mode of the MPC's GDP backcast. Total wage costs are wages and salaries and the labour share multiplied by mixed income.

Table 5 Indicative projections consistent with MPC's modal projections^(a)

	Average 1998– 2007	Projections			Memo: mean forecast error ^(b)	Memo: level in 2017 ^(c)
		2018	2019	2020		
Annual average growth rate						
Household consumption ^(d)	3½	1 (1¼)	1¼ (1¼)	1¼ (1¼)	1¼	1,296
Business investment ^(e)	1¾	2¾ (3)	4 (3¾)	4½ (4¼)	6¼	183
Housing investment ^(f)	3¼	-¼ (¼)	½ (½)	½ (¾)	9	96
Exports ^(g)	4½	3¼ (3¼)	2¼ (1¼)	1½ (½)	4¾	558
Imports ^(h)	6	2 (1¼)	1¼ (¼)	1 (0)	4¾	594
Real post-tax household income ⁽ⁱ⁾	3¼	1½ (1¾)	1 (½)	1¼ (1¼)	1¼	1,366
Four-quarter growth rate in Q4						
Employment ^(j)	1	1 (½)	½ (½)	½ (½)	1	32 ^(k)
Average weekly earnings ^(l)	4¼	2¾ (3)	3¼ (3¼)	3½ (3½)	1½	512 ^(m)

(a) These projections are produced by Bank staff for the MPC to be consistent with the MPC's modal projections for GDP growth, CPI inflation and unemployment. Figures show annual average growth rates unless otherwise stated. Figures in parentheses show the corresponding projections in the February 2018 *Inflation Report*. Calculations for back data are shown using ONS series identifiers.

(b) Root mean squared errors of one year ahead forecasts made between February 2003 and February 2017.

(c) £ billion chained-volume measure (reference year 2015) in 2017 unless otherwise stated.

(d) Chained-volume measure. Includes non-profit institutions serving households. Based on ABJR+HAYO.

(e) Chained-volume measure. Based on CAN8.

(f) Chained-volume measure. Whole-economy measure. Includes new dwellings, improvements and spending on services associated with the sale and purchase of property. Based on DFEG+L635+L637.

(g) Chained-volume measure. The historical data exclude the impact of missing trader intra-community (MTIC) fraud. Since 1998 based on IKBK-OFNN/(BOKH/BQKO). Prior to 1998 based on IKBK.

(h) Chained-volume measure. The historical data exclude the impact of MTIC fraud. Since 1998 based on IKBK-OFNN/(BOKH/BQKO). Prior to 1998 based on IKBK.

(i) Total available household resources deflated by the consumer expenditure deflator. Based on RPQK/((ABJQ+HAYE)/(ABJR+HAYO)).

(j) Based on MGRZ.

(k) People aged 16+ employed in 2017 Q4, millions.

(l) Whole-economy total pay. Growth rates since 2001 based on KAB9. Prior to 2001, growth rates are based on historical estimates of AWE, with ONS series identifier MD9M.

(m) Average pounds sterling earned per week in 2017 Q4.