

Publication date: 23 March 2011

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# **MINUTES OF THE MONETARY POLICY COMMITTEE MEETING 9 AND 10 MARCH 2011**

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These are the minutes of the Monetary Policy Committee meeting held on 9 and 10 March 2011.

They are also available on the Internet

<http://www.bankofengland.co.uk/publications/minutes/mpc/pdf/2011/mpc1103.pdf>

The Bank of England Act 1998 gives the Bank of England operational responsibility for setting interest rates 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 6 and 7 April will be published on 20 April 2011.



## **MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 9 AND 10 MARCH 2011**

1 Before turning to its immediate policy decision, the Committee discussed financial market developments; the international economy; money, credit, demand and output; and supply, costs and prices.

### **Financial markets**

2 Short-term sterling interest rates had changed little over the month as a whole. But, within the month, they had moved in response to data releases and public comments from Committee members. Market contacts reported a broad range of views on the probable near-term path of Bank Rate. But yields suggested that, on average, participants expected a 25 basis point increase around the middle of the year. Expectations over the probable timing of an increase in official euro-area interest rates had been brought forward during the month.

3 Longer-term sterling interest rates had declined during the month, with dollar and euro rates falling by a little more. That primarily reflected lower real yields, perhaps as a consequence of increased concerns over the possible impact on global economic activity of political tensions in the Middle East and North Africa, and the associated volatility in oil prices. There were signs of renewed concerns over the fiscal positions of some countries in the euro area, ahead of the EU summit meeting later in the month. Relative to the yields of German government bonds, those of Greek, Irish and Portuguese bonds had increased during the month.

4 There had been evidence of a reversal of capital flows into emerging market equity and bond funds. In part, that was likely to reflect a perception of improved economic prospects in the United States. But it might also have been a consequence of increased concerns over possible overheating in some emerging economies and a reduction in risk appetite in light of the political situation in the Middle East and North Africa.

5 Over the month, equity prices had fallen by around 2% in the United Kingdom, and by a little more in the euro area. But equity prices in the advanced economies had been broadly stable since the

beginning of the year, following substantial increases since the middle of 2010. Corporate bond prices had increased during the month in sterling, dollar and euro markets. Debt issuance by UK banks had continued at a reasonable rate during 2011.

6 There had been significant movements in some bilateral exchange rates, but the sterling effective exchange rate index had changed little over the month.

### **The international economy**

7 The available data had remained consistent with buoyant growth in global activity continuing into the first quarter of 2011, albeit unevenly from country to country. JP Morgan's global composite Purchasing Managers' Index (PMI) had risen further in February. The major development during the month, however, had been heightened political tension in the Middle East and North Africa, and its impact on the price of oil.

8 The recovery in the advanced economies had continued at a reasonable pace. Output was estimated to have increased in the fourth quarter of 2010 by 0.7% in the United States and by 0.3% in the euro area, with the latter figure most likely depressed by the impact of the bad weather in December. The divergence of experience within the euro area remained. Without the impact of the bad weather, German output would probably have increased at, or a little above, its historical average rate in 2010 Q4. Output in some peripheral European countries had grown only weakly or had fallen.

9 The latest indicators of activity in emerging economies had suggested continued rapid growth, although there were tentative signs of a modest slowing. Indian GDP growth in the year to 2010 Q4 had been lower than market expectations, although it remained above 8%, and Chinese money and credit growth had fallen back in January. It was possible that those signs of slowing growth reflected the impact of recent policy tightening.

10 The price of Brent crude oil had increased by 13% since the previous MPC meeting. By contrast with earlier increases in commodity prices, many of which had been associated with the strength of global demand, the most recent movements had reflected the potential impact on oil supply of political events in the Middle East and North Africa, particularly Libya. It was possible that the oil price spike would prove temporary: OECD oil inventories were above their historical averages, and OPEC

countries were thought to have more than adequate spare oil production capacity to make up the shortfall caused by the partial withdrawal of Libyan supply from the market. But it was also possible, if political tensions spread to other oil-producing countries, that the oil price might remain elevated or increase further. Information from financial options prices had indicated increased concern that the oil price might move sharply higher, particularly in the near term.

11 There were several channels through which persistently higher oil prices could affect the UK and global economies. First, dearer oil would add directly to consumer price inflation via increases in the prices of fuel, energy and energy-intensive goods and services, though whether that would lead to more generalised inflationary pressure would depend on whether it caused employees to push for higher pay increases. Second, the downward adjustment to real incomes would be likely to depress spending outside the oil-producing regions, dampening global growth and, therefore, the prospects for UK exports. Third, volatile oil prices and persistent geopolitical tensions in oil-producing regions added to the general sense of uncertainty over economic prospects, and could adversely affect household and business confidence, as well as discouraging the holding of risky assets among financial investors. Finally, it was possible that higher oil prices would also be associated with an adverse impact on global productive capacity, including in the United Kingdom.

### **Money, credit, demand and output**

12 Updated estimates from the ONS indicated that GDP had fallen by 0.6% in 2010 Q4; a marginally larger decline than previously estimated. Abstracting from the impact of the bad weather in December, the ONS estimated that output had been broadly flat. The key question remained whether that slowdown would prove temporary or whether it presaged a more prolonged period of weak growth.

13 The most recent indicators of output had tended to support the view that growth had resumed in the first quarter. Taken together, the CIPS/Markit survey indices for manufacturing and service sector output in February were at levels comparable to those seen in the third quarter of 2010, when GDP had grown at around its historical average rate. Other survey indicators had given a similar signal and appeared broadly consistent with the central view embodied in the February *Inflation Report* projections, which was for a modest recovery in underlying GDP growth in 2011 Q1, after accounting for the likely bounce-back from the effects of the snow in Q4. The index of business expectations for

the following twelve months from the CIPS/Markit service sector survey had increased fairly sharply in February and was now more consistent with the rate of growth implied by the activity balance.

14 By contrast, indicators regarding household expenditure had been much weaker. The latest official data indicated that real consumer spending had not increased at all during the second half of 2010, and had risen by only 0.4% over the year as a whole. The volume of retail sales had rebounded in January from weather-related weakness in December, probably buoyed by some spending brought forward to the start of January in advance of the increase in VAT. But reports from the Bank's Agents and weekly spending indicators suggested that consumer demand had weakened during the second half of January and early February. Moreover, indicators of consumer confidence had fallen sharply since the turn of the year. Given the available data, it was not yet clear whether the apparent weakness in consumer spending at the end of 2010 and in early 2011 was associated with commensurate weakness in household income growth or an increase in saving.

15 Although net trade had reduced GDP growth in the fourth quarter of 2010, that was in very large part because of an unusually large contribution from imports of aircraft that was highly unlikely to persist. The monthly trade data for January had been reasonably encouraging.

16 Nominal spending had continued to grow robustly in 2010 Q4, despite the impact of the bad weather, with nominal domestic demand and total final expenditure in the year to Q4 growing more rapidly than in the decade leading up to the financial crisis. This might provide a positive signal about households' and businesses' willingness to spend. But, if private demand were not very responsive to price changes in the short term, it might simply have been a mechanical consequence of tax changes and other factors that had raised inflation and so nominal spending.

17 M4, excluding the holdings of interbank intermediaries, had grown at an annualised rate of 4.9% in the three months to January. The twelve-month growth rate had been 2.1%, which remained below pre-crisis norms. As the Committee had previously noted, money growth could remain weak relative to the growth of nominal spending in the future if companies became less reliant on bank credit to fund investment or if banks continued to increase their capital. Credit growth had remained weak. It remained the case that the reduction in the various borrowing rates faced by most businesses and households had been significantly less than the reduction in Bank Rate since autumn 2008, and in some instances had risen.

## Supply, costs and prices

18 Twelve-month CPI inflation had risen to 4.0% in January from 3.7% in December. Around one-third of that increase had reflected an increased contribution from petrol and diesel prices. The remainder of the increase had been spread across a broad range of goods and services and seemed likely to reflect primarily the increase in the standard rate of VAT to 20% at the beginning of the year. The degree to which businesses would ultimately pass through the increase in VAT to consumer prices was surrounded by considerable uncertainty. But it was likely that the Committee would learn more about the degree of pass-through over the coming months.

19 In line with the usual pre-release arrangements, the Governor informed the Committee that producer input prices had increased by 1.1% in February, causing the twelve-month growth rate to increase to 14.6%. That increase had mainly reflected rising crude oil prices. Producer output prices had increased by 0.5% in February, so that the twelve-month growth rate had increased to 5.3%. Increases in the prices of petroleum products, food, tobacco and alcoholic beverages had largely accounted for the increase on the month.

20 For several months, one of the key risks to the inflation outlook had been that the persistence of inflation above the 2% target might cause businesses and households to expect higher inflation in future, leading them to set higher prices and wages, and making it more costly for the Committee to meet the inflation target in the medium term. The increase in oil prices during the month had exacerbated that risk.

21 The most recent indicators of inflation expectations had been mixed. The Citi/YouGov survey measure of household inflation expectations over the next five to ten years had dropped back slightly in February. By contrast, the Bank of England/GfK NOP survey had suggested that expectations for inflation one, two and five years ahead had increased again in February by comparison with the previous survey in November 2010. Measures of financial market participants' expectations of medium-term inflation had changed little on the month. These measures remained below the levels seen a year earlier, although they had edged up since Autumn 2010. Cross-country evidence suggested that it was typical for measures of medium-term inflation expectations to move in the same direction as a persistent deviation of inflation from its target, but for those movements to be reversed after inflation returned towards its target.

22 Measures of uncertainty over the level of inflation six to ten years ahead derived from financial options prices had more than doubled since the start of 2008. One possibility was that market participants increasingly expected that inflation would be more volatile in the future than it had been during the decade that led up to the financial crisis – perhaps because of a perception that the shocks affecting inflation would be more frequent, larger, or more persistent. But it was also possible that market participants had altered their views about the speed with which the MPC would seek to offset those influences on inflation.

23 It was unlikely that any increase in inflation expectations would lead to a sustained increase in inflation itself without also being associated with a pickup in wage growth. Whole-economy regular pay had increased by 2.3% in the three months to December by comparison with a year earlier – that growth rate had changed little in recent months and remained below its pre-recession average. There were some early indications that private sector wage settlements had increased at the beginning of the year. But the coverage of the available data was at this stage limited and heavily influenced by previously agreed multi-year settlements, including those linked to actual inflation. It was likely that private sector settlements would increase during 2011, in part reflecting a recovery in productivity, although they were likely to stay significantly below the rate of inflation. Wage freezes in the public sector were expected to weigh on pay growth in the economy as a whole.

24 Total employment had fallen by 68,000 in the three months to December by comparison with the previous three months. That had been the result of declines in the numbers of part-time employees and the self-employed: the number of full-time employees had increased between the third and fourth quarters of 2010. Average hours worked per person employed had risen. Most survey indicators generally remained consistent with modest growth in employment, while the REC/Markit survey had suggested a more pronounced increase in businesses' demand for staff in February.

### **The immediate policy decision**

25 Inflation had risen to well above the 2% target as a consequence of higher energy and other commodity prices, increased VAT and the past depreciation of sterling. The Committee's judgment remained that inflation was likely to fall back in the medium term, as the impact of those factors dissipated and as a margin of spare economic capacity persisted. For some time, the Committee had

set monetary policy so as to balance substantial opposing risks to that medium-term outlook for inflation.

26 The key downside risk was that continued weakness in activity, relative to the supply capacity of the economy, could cause inflation to fall below the target in the medium term, once the impact of the factors temporarily raising it had faded. It was too early to assess the extent to which activity had recovered since the slowdown in growth at the end of 2010. Evidence from the latest business surveys on output and employment prospects pointed to some recovery. But it was unclear whether demand growth would be sufficient to erode spare supply capacity as the economy underwent a necessary rebalancing away from public and private consumption and towards net trade and investment. On the one hand, there were some signs that the improvement in the net trade position that had been expected following sterling's depreciation was becoming more apparent. But on the other, the most recent concurrent indicators of consumer spending and sentiment had deteriorated sharply. And it was possible that they presaged a more sustained period of weak spending growth, perhaps as the impacts of the fiscal consolidation and near-term above-target inflation on household finances became more readily apparent. The net impact of these two forces on overall demand growth remained a key uncertainty.

27 On the upside, the period of elevated inflation could persist for longer than the Committee expected. That might happen if the expected persistence of inflation above the target in the near term caused expectations of higher future inflation to become ingrained, leading businesses and households to set higher prices and wages. Inflation had risen to 4% in January, and would very likely rise further over the coming months: there was a significant risk that inflation would exceed 5% in the near term. How much of the increase in January related to the pass-through of the increase in VAT was as yet unclear. Information on inflation expectations from household surveys had been mixed on the month, while measures derived from financial markets had changed little. And, while there were some signs that private sector wage settlements had picked up at the beginning of the year, they provided only very tentative evidence of higher pay pressures. Inflation might also persist above the target if externally generated inflation pressures continued and were not offset by exchange rate movements, or if there were further pass-through from the past depreciation of sterling.

28 A substantial development during the month had been the increase in oil prices reflecting heightened political tension in the Middle East and North Africa, and its possible impact on oil supply.



That highlighted the scope for further abrupt changes in global prices, which would affect the outlook for both inflation and activity. Unless the increase in the oil price quickly reversed, it would very likely lead inflation in the near term to rise further above the target than previously expected, adding to the risk that expectations of medium-term inflation would rise. But, in addition, higher oil prices related to such supply concerns might be expected to dent global growth prospects and, potentially, business, household and investor confidence. They would also be likely to result in a reduction in the level of real incomes and hence spending by UK households.

29 Overall, while the main considerations for the Committee's policy decision had remained the same, recent developments had appeared to increase the degree of uncertainty over the medium-term outlook for both activity and inflation – something that had been reflected in financial market measures of uncertainty over the likely path of Bank Rate. Nevertheless, the balance between the upside and downside risks to the medium-term inflation outlook had probably not shifted significantly over the month.

30 For some members, the case for an immediate withdrawal of some of the current monetary stimulus remained compelling. For them, the upside risks to the medium-term inflation outlook from the possibility that inflation expectations might increase and the potential for further global price pressures outweighed the downside risk associated with uncertainty about the strength of the recovery. The near-term outlook for inflation had deteriorated further, with a material chance that inflation would exceed 5% later this year. This added to the risk of the perception arising that the Committee was more prepared to tolerate persistent deviations of inflation from the target than in the past. If that perception took hold, in the absence of an offsetting policy response, inflation would be more likely to remain above the target in the medium term. In the view of these members, it remained most likely that the weakness of growth around the turn of the year would prove temporary, although their views differed as to the likely strength of the recovery thereafter. For one of these members, the outlook for growth and inflation was significantly stronger than had been embodied in the Committee's February *Inflation Report* projections, and recent developments had supported that view. That member noted that the prospective strength of imported inflationary pressures, and therefore goods prices, combined with the resilience of service price inflation, meant that CPI inflation was unlikely to return to the target with Bank Rate at its current level.

31 Other members concluded that an increase in Bank Rate was not yet appropriate. While the recent information on the prospects for UK net trade had been encouraging, it was not yet clear that the weakness in output growth seen in the latter part of 2010 would prove temporary, particularly in light of the latest indicators of a further weakening in consumer spending. There remained differences of view between these members on the likelihood of the upside risk associated with an increase in inflation expectations materialising. Some thought that this risk remained limited, given that the near-term outlook for inflation could be explained by reference to changes in energy and other commodity prices, VAT and the sterling exchange rate. Others thought that this risk had risen, given further upwards revisions to the near-term outlook for inflation, and that the case for an increase in Bank Rate had strengthened in recent months. Overall, the uncertainty created by both developments in the oil market and the recent indicators of household spending and confidence meant that there remained merit in waiting to see how those factors evolved before altering the stance of monetary policy. The Committee would learn more over coming months about the effect of the recent increase in the standard rate of VAT and, therefore, also about the other forces affecting inflation.

32 For one member, the balance of risks to inflation continued to warrant an expansion of the Committee's programme of asset purchases, financed by the issuance of central bank reserves, because it was likely that inflation would fall to below the target in the medium term. For this member, the weakening of consumer spending since mid-2010 supported the view that inflation would be weaker than assumed in the Committee's February *Inflation Report*. Recent wage settlements remained well below inflation and productivity developments, also pushing down on medium-term inflation. This member recognised the risk that a sustained upward trend in medium-term inflation expectations or global price pressures could outweigh the forces pushing down on inflation, but did not see this risk as material.

33 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 £200 billion.

Regarding Bank Rate, six members of the Committee (the Governor, Charles Bean, Paul Tucker, Paul Fisher, David Miles and Adam Posen) voted in favour of the proposition. Three members of the Committee voted against the proposition. Andrew Sentance preferred to increase Bank Rate by 50 basis points. Spencer Dale and Martin Weale preferred to increase Bank Rate by 25 basis points.

Regarding the stock of asset purchases, eight members of the Committee (the Governor, Charles Bean, Paul Tucker, Spencer Dale, Paul Fisher, David Miles, Andrew Sentance and Martin Weale) voted in favour of the proposition. Adam Posen voted against the proposition, preferring to increase the size of the asset purchase programme by £50 billion to a total of £250 billion.

34 The following members of the Committee were present:

Mervyn King, Governor  
Charles Bean, Deputy Governor responsible for monetary policy  
Paul Tucker, Deputy Governor responsible for financial stability  
Spencer Dale  
Paul Fisher  
David Miles  
Adam Posen  
Andrew Sentance  
Martin Weale

Dave Ramsden was present as the Treasury representative.