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# MINUTES OF THE MONETARY POLICY COMMITTEE MEETING

## 8 and 9 October 2013

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These are the minutes of the Monetary Policy Committee meeting held on 8 and 9 October 2013.

They are also available on the Internet

<http://www.bankofengland.co.uk/publications/minutes/Pages/mpc/pdf/2013/mpc1310.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 6 and 7 November will be published on 20 November 2013.



## MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 8 AND 9 OCTOBER 2013

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 Developments in financial markets over the month had largely reflected news emanating from the United States, including the FOMC's decision at its September meeting not to reduce the pace of its asset purchases, and political negotiations about the fiscal position. Although the US government shutdown and concerns over the debt ceiling had appeared to have only limited effects on broader financial markets, credit default swap premia on US government debt had increased and yields on US Treasury bills maturing in late October had risen to nearly 30 basis points, from around 2 basis points at the end of September.

3 Advanced economy market interest rates had generally risen in the early part of the month before falling back following the FOMC announcement. Overall, nominal UK ten-year forward gilt rates were nearly 30 basis points lower on the month, with smaller falls in US and euro-area rates. Shorter-term market rates had also fallen. Overnight index swap rates implied that Bank Rate was expected to increase by a full 25 basis points by June 2015. The median expectation from the Reuters survey of economists was that the first rise in Bank Rate would be in November 2015.

4 Although it was still lower than at the start of the year, the sterling effective exchange rate index (ERI) was around 3½% higher than in the run-up to the August *Inflation Report*. Over the month, the ERI had risen by 1%, driven in large part by a 4% rise against the US dollar, which had probably been partly associated with the US fiscal impasse. Part of the appreciation could reflect recent more positive data outturns in the United Kingdom than elsewhere. It was also possible that the risk

premium that investors demanded for holding sterling had fallen as the recovery had appeared to take hold and the financial system had continued to heal.

5 As an example of the broader improvement in bank funding conditions since mid-2012, Lloyds Banking Group had issued a five-year senior unsecured bond at a spread over swap rates of around 60 basis points in early October, compared with a spread of more than 300 basis points on a similar bond in January 2012. UK bank issuance in public markets was still limited, perhaps in part due to banks having an ample supply of retail deposits, as noted by respondents to the Bank's latest *Bank Liabilities Survey*.

6 The S&P 500 index had risen a little over the month as a whole, although it had fallen back following the FOMC's September decision not to reduce the pace of its asset purchases. The FTSE All-Share index had fallen a little. The Euro Stoxx 300 index had risen strongly.

### **The international economy**

7 Over 2013 so far, there had been signs that the mix of global growth was shifting, with the advanced economies continuing their gradual recovery but with some further slowing in the emerging economies. The latest IMF projections had suggested that this shift was likely to continue into 2014.

8 Following six quarters of contraction, euro-area output had risen by 0.3% in 2013 Q2 and had appeared likely to expand a little further in Q3. That was despite a sharp fall in industrial production in July, but was consistent with the further rise in the composite Purchasing Managers' Index, which reached 52.2 in September. The pace of expansion in the euro area over coming years was likely to be dampened by the impact of the continuing adjustment in the periphery, alongside the impaired banking system in the euro area more broadly. The extent to which growth would be held back by this adjustment was uncertain, but recent growth rates in some core countries had been somewhat reassuring.

9 There had been mixed evidence on US activity during the month: the non-manufacturing ISM index, which had been volatile but generally strong in recent months, fell markedly in September, but the manufacturing ISM index had risen a touch and core capital goods orders had strengthened in August. Housing market activity had fallen back, possibly reflecting rises in mortgage interest rates

since the spring. The partial government shutdown would make it harder to assess how the US recovery was progressing. The shutdown would directly depress US activity in the fourth quarter but, unless it was prolonged, the impact was likely to be small. Nevertheless, persistent uncertainty about the political situation could weigh on financial markets and on household and business confidence. The shutdown would also result in a delay to key data releases, such as non-farm payrolls.

10 The FOMC policy decision in September, together with domestic policy actions and some better economic news, had eased some of the immediate pressures on those emerging economies that had experienced capital outflows since May. The developments on the month had provided policymakers in those economies with more time to address underlying vulnerabilities, but the outlook remained sensitive to global developments.

11 Japanese output had expanded by 1.9% over the first half of 2013, following the significant policy measures introduced since the start of the year. Equity prices had risen by 60% since Autumn 2012, and there had been a marked improvement in business confidence more recently. Moreover, the policy measures appeared, as desired, to have boosted inflation expectations. The medium-term outlook for Japanese activity would, however, depend on the successful implementation of structural reforms, in particular to the labour market.

12 Dollar Brent oil prices had fallen by almost 5% on the month, with the fall in sterling oil prices a little larger at 8%. In contrast, many other commodity prices had been little changed.

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

13 UK GDP growth in the second quarter, at 0.7%, had not been revised. The revised breakdown of expenditure had, however, suggested less progress in rebalancing than did the previous release, with net trade making no contribution to growth. In addition, business investment had been estimated to have fallen by nearly 3%, although that looked at odds with other indicators such as companies' investment intentions.

14 Surveys had continued to point to strong growth in the second half of the year, with Markit/CIPS activity indices remaining at high levels in September, and a sharp pickup in the BCC output and orders balances in Q3. By themselves, surveys would point to growth of around 1% a quarter in the

second half of 2013. The Bank's Agents also judged that output growth had picked up to at least trend rates in Q3. There were limited official data on the third quarter, but industrial production had fallen by 1.1% in August. Overall, Bank staff estimated that growth in the second half of the year would remain around 0.7% a quarter or a little higher, stronger than expected at the time of the August *Inflation Report*.

15 The recovery in growth since the end of 2012 appeared in part to reflect a dissipation of uncertainty – for example, as the perceived tail risks in the euro area had receded – against the backdrop of considerable monetary stimulus. That was consistent with a survey carried out by the Bank's Agents that had shown a much smaller drag on companies' investment plans from uncertainty than in a similar survey a year earlier. It was possible that there could be a self-sustaining element to growth, with the recovery to date helping to reinforce business and household confidence.

16 The recovery in growth had also probably reflected easing credit conditions, as reduced euro-area concerns and the Funding for Lending Scheme had borne down on UK bank funding costs. That had led to an improvement in credit availability for businesses and households and lower interest rates on a range of products relative to those in mid-2012. The Bank's latest *Credit Conditions Survey* had suggested a further increase in credit availability for both households and businesses in 2013 Q3. Despite a rise in market interest rates since the time of the MPC's August meeting, quoted mortgage rates on most types of product had ticked down since the end of July, effective rates on new loans to companies had not changed in August, and investment grade corporate bond yields had changed little.

17 The fall in mortgage rates was one factor behind the recent revival in housing market activity. Mortgage approvals for house purchase had risen to around 62,000 in August. And housing investment had made a positive contribution to growth in the first half of the year. House price inflation had also begun to pick up: the average of the Halifax and Nationwide house price indices pointed to a rise of 0.6% on the month in September, with twelve-month house price inflation around 6%. In London, price rises had been larger. Although some measures, such as that produced by the Land Registry, had pointed to smaller price rises over the past year, they recorded prices later in the house purchase process and were therefore less timely indicators. The RICS three-month ahead house price expectations balance had increased again in September and was pointing to very strong price rises. But the RICS sales-to-stock ratio, historically well correlated with house price inflation, had been weaker. Overall, indicators pointed to continued house price rises. This would increase the

collateral available to both households and small businesses, which could provide some further support to activity.

18 One factor that would play a role in the housing and mortgage market in the following year was the mortgage guarantee component of the Help to Buy Scheme, the details of which had been released during the month. The scheme had been designed to help people with small deposits gain access to mortgage finance and should relax credit constraints for some would-be borrowers. It could therefore further support the revival in the housing market.

### **Supply, costs and prices**

19 Twelve-month CPI inflation had fallen to 2.7% in August. In line with the usual pre-release arrangements, an advance estimate for twelve-month CPI inflation of 2.7% for September had been provided via the Governor to the MPC, ahead of publication. Those outturns were lower than expected at the time of the August *Inflation Report* and, although the component level data for September were not yet available, data up to August had suggested that the downside news was concentrated in more import-intensive components. The 8% fall in sterling oil prices on the month also suggested a somewhat lower outlook for CPI inflation over the coming year. Acting against that, the latest information had suggested that domestic energy prices might be increased by a little more than the rises of around 5% assumed at the time of the August *Inflation Report*, although it now seemed likely that those rises would happen later in the year. Further ahead, the recent appreciation of sterling would tend to bear down on inflation, reducing the likelihood of inflation being above 2.5% at the 18-24 month period relevant to the MPC's forward guidance 'knockout'.

20 Twelve-month growth in private sector regular pay had been 1.2% in the three months to July. There were some signs that pay growth was picking up from its very low levels: shorter-term measures of pay growth were above the twelve-month measures, and the REC permanent salaries index had risen for the fourth successive month in September to its highest level since February 2008. Some recovery in wage inflation was, however, to be expected as productivity growth recovered. In the second quarter, private sector hourly productivity had grown by 0.6%, the first rise in hourly productivity since 2011 Q2, and it looked likely to increase again in the third quarter. Taking wages and productivity together, the expectation in the August *Inflation Report* that the four-quarter change

in unit labour costs would be zero or modestly negative in the second half of 2013 remained broadly on track.

21 The headline LFS unemployment rate had fallen to 7.7% in the three months to July, and a fall in the claimant count measure in August, together with surveys of companies' employment intentions, had suggested that it would fall further over the rest of the year, probably at a faster pace than anticipated at the time of the *August Inflation Report*. The fall in unemployment in the three months to July appeared to reflect growth in full-time permanent jobs, and there was no reason to believe it to be erratic. Moreover, average hours had continued to rise such that total hours worked had increased by more than employment in heads in the three months to July. It now therefore seemed probable that unemployment would be lower, and output growth faster, in the second half of 2013 than expected at the time of the *August Inflation Report*.

22 Developments since the Committee's *August Inflation Report* suggested that slack had been eroded a little more quickly than anticipated. The BCC survey had shown a rise in capacity utilisation in the manufacturing and service sectors in the third quarter. The fall in unemployment had suggested a modest reduction in slack in the labour market. Although by itself, an increase in average hours worked could also signal less slack, their recent strength had in part appeared to reflect a continuation of a longer-term rise since the start of the recession, rather than a purely cyclical development. In particular, there had been a shift from public to private sector employment, where average hours worked were higher, and there was evidence from the Labour Force Survey that part-time employees wanted to work longer hours than they had in the past, perhaps reflecting the impact of the crisis on their household finances.

23 The evolution of unemployment and slack more broadly over coming quarters would depend on the extent to which the weakness in productivity in recent years had primarily reflected an endogenous response to the weakness in demand or had a more structural component. For example, measured productivity could rise quite quickly if companies no longer needed to allocate so much staff effort to winning business as demand picked up. But to the extent that productivity growth had been held back because the efficient allocation of resources had been impeded in recent years by the problems in the banking sector, it would probably take longer for productivity to recover. There remained a range of views among Committee members on the factors responsible for the recent weakness in productivity

and it was too soon to draw a firm conclusion from recent labour market outturns about the extent to which productivity would increase.

24 There had been little news on inflation expectations on the month. The YouGov/Citigroup survey of households had suggested that expectations had ticked down in September both one and five to ten years ahead. Measures derived from financial markets had changed little on the month.

### **The immediate policy decision**

25 The Committee set monetary policy to meet the 2% inflation target in the medium term, and in a way that avoided undesirable volatility in output in the short term. 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% 18-24 months ahead; the stability of measures of medium-term inflation expectations; and the impact of the stance of monetary policy on financial stability as judged by the Bank’s Financial Policy Committee (FPC).

26 The news on the month had continued to suggest a robust recovery in activity in the United Kingdom. Monetary stimulus remained considerable and confidence appeared to be rising. On their own, the business surveys were pointing to an increase in output of around 2% over the second half of the year, although the Bank staff’s latest projection was lower. The revival in the housing market was likely to provide a fillip to both dwellings investment and consumer spending. Moreover, recent increases in market interest rates had been partially reversed, and credit availability had continued to improve. The rise in the sterling exchange rate would reduce the extent to which imported prices were squeezing households’ real incomes, and therefore the drag on consumption. But set against that, the exchange rate appreciation would support import growth and dampen export growth in the medium term. More generally, the main factor determining the pace of export growth would be the level of global activity. Here the news had been mixed. The outlook for the United States seemed slightly softer on the month, the recovery in the euro area remained modest, and there remained a risk of a sharp slowdown in emerging economies. Overall, therefore, there was a risk that the recovery in the United Kingdom might be less well balanced between exports and domestic consumption than was



ultimately needed. The latest data suggested that the current account deficit had averaged around 4% of GDP in the four quarters to 2013 Q2.

27 The headline LFS unemployment rate had fallen but, at 7.7% in the three months to July, remained well above the Committee's 7% forward guidance threshold. The recent reduction in the unemployment rate indicated that slack in the economy was, as anticipated, being eroded as activity picked up. If anything, that was occurring a little faster than envisaged at the time of the August *Inflation Report*, although it remained unusually difficult to gauge the effective degree of slack in the economy. It was encouraging that private sector hourly productivity had grown at close to its trend rate in the second quarter following two years of falling productivity. But it was too early to draw a strong inference about future prospects from the latest data. Within the framework provided by forward guidance, the Committee would continue to monitor closely the evolution of the labour market, productivity, and a range of indicators of economic capacity pressures and the domestic inflationary pressures resulting from them.

28 The Committee considered developments on the month in the context of the three knockouts that would override the forward guidance announced in August.

29 The appreciation of sterling since the August *Inflation Report* would lower import costs, which reduced the probability of CPI inflation being above 2.5% in 18-24 months time. There had been less news on domestically generated inflationary pressures. Productivity growth had begun to pick up and that appeared to have been accompanied by a modest strengthening in pay growth, but overall there had been little news on the likely path of unit labour costs in the second half of the year. Forthcoming pay settlements in early 2014, likely to be the first against a backdrop of rising demand and productivity for some time, would be informative. More generally, the Committee would continue to monitor early indicators of pricing behaviour for signs of rising domestic inflationary pressure.

30 There had been little news regarding medium-term inflation expectations. Financial market based measures had been broadly flat, and the one household measure released during the month had ticked down. There was, therefore, little reason to alter the Committee's judgement that medium-term inflation expectations remained sufficiently well anchored.

31 At its meeting on 18 September 2013, the FPC had agreed that, in light of its assessment of the current risks to financial stability, the stance of UK monetary policy did not pose a significant threat to financial stability that could not be contained by the substantial range of mitigating policy actions available to the FPC, the Financial Conduct Authority and the Prudential Regulation Authority in a way consistent with their objectives. This had been communicated to the MPC in advance of its meeting.

32 All Committee members agreed that neither of the price stability knockout conditions that would override the forward guidance provided in August had been breached; and the FPC had agreed that the financial stability knockout had not been breached. With unemployment remaining above the 7% threshold, the Committee's forward guidance therefore remained in place and no MPC member thought it appropriate to tighten the stance of monetary policy at the current juncture. Market rates had fallen back over the month and output appeared to be expanding at least as fast as expected at the time of the August *Inflation Report*. All members therefore agreed that there was currently little case for increasing the degree of monetary stimulus further.

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 £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.

34 Finally, the Governor expressed his appreciation to Paul Tucker for the personal contributions that he had made in establishing the monetary policy framework, to the work of the MPC since becoming a member in 2002, and to the Bank more broadly during his long and distinguished career, most recently as Deputy Governor responsible for financial stability.

35 The following members of the Committee were present:

Mark Carney, Governor

Charles Bean, Deputy Governor responsible for monetary policy

Paul Tucker, Deputy Governor responsible for financial stability

Ben Broadbent

Spencer Dale

Paul Fisher

Ian McCafferty

David Miles

Martin Weale

Dave Ramsden was present as the Treasury representative.

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