

Publication date: 18 September 2013

MINUTES OF THE MONETARY POLICY COMMITTEE MEETING 3 AND 4 SEPTEMBER 2013

These are the minutes of the Monetary Policy Committee meeting held on 3 and 4 September 2013.

They are also available on the Internet

<http://www.bankofengland.co.uk/publications/minutes/Pages/mpc/pdf/2013/mpc1309.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 8 and 9 October will be published on 24 October 2013.



MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 3 AND 4 SEPTEMBER 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 There had been some substantial movements in financial asset prices, especially during the early part of the month. These came against the backdrop of monetary policy announcements in the United Kingdom, a string of positive UK economic data releases, and continued speculation over the prospects for the US Federal Reserve's large-scale asset purchase programme.

3 UK ten-year spot nominal gilt yields had increased by around 40 basis points, while market interest rates had risen by more at shorter maturities: one-year overnight index swap rates two years ahead had risen by nearly 60 basis points. Market prices implied that Bank Rate was expected to increase by a full 25 basis points by the middle of 2015, around six months earlier than at the time of the MPC's previous meeting. But, by contrast, the Thomson Reuters survey of economists indicated that the expected timing of the first increase in Bank Rate had been pushed out. The timing of movements in the UK and US yield curves had been correlated, suggesting a common cause, although sterling rates had generally increased by a little more than dollar ones. The sterling effective exchange rate had appreciated by 3½% and was at its highest since mid-January. Equity prices had fallen by 2% in the United Kingdom, less than the 3% decline seen in US markets, while share prices in the euro area had increased modestly.

4 Since its previous policy meeting, the MPC had provided guidance regarding the future path of monetary policy. The MPC expressed its intention not to raise Bank Rate above 0.5% or to reduce its stock of asset purchases at least until the headline LFS unemployment rate had fallen to 7%, subject to three 'knockout' conditions that would invalidate the guidance not being breached. These concerned the outlook for inflation 18-24 months ahead, the stability of measures of inflation expectations, and the impact of the monetary policy stance on financial stability. The Committee had been concerned

that the issuance of such guidance might be misinterpreted as constituting a diminution of its commitment to meeting the 2% inflation target in the medium term. In that context, it was reassuring that the increases in nominal yields over the month had largely reflected higher real yields.

5 There were several potential explanations for the movements in asset prices during the month. It seemed probable that much of the price movement seen in the United States had been associated with heightened speculation that the FOMC would announce a reduction in the pace of its asset purchase programme at its September meeting. It appeared that part of the increase in UK yields at shorter maturities reflected developments in US yields. In addition, UK rates had been supported by the positive flow of economic data during the month, which had been consistently stronger than market expectations. A final possibility was that the unemployment rate threshold announced by the MPC had been higher than some financial market participants had expected, or that the conditionality attached to the forward guidance – in the form of the three knockouts – had been more stringent. If that were the case, then it might also help to explain the increase in sterling yields, as market participants reassessed the outlook for Bank Rate. The reaction of market interest rates on the day of the MPC's announcement had been muted, however.

The international economy

6 The data regarding the global economy had been mixed during the month, with encouraging signs in the United Kingdom's major advanced-economy trading partners, but with downside risks appearing to intensify in some emerging economies.

7 Euro-area GDP had increased by 0.3% in 2013 Q2, compared with a reduction of 0.2% in the first quarter. That pickup in growth had been slightly more brisk than the Committee had judged likely at the time of the August *Inflation Report*. It was somewhat reassuring that the increase in output had been broadly based across countries within the area, albeit that German growth had probably been boosted by a weather-related recovery in output. Both the manufacturing and services area-wide purchasing managers' indices (PMIs) had increased in August.

8 These developments seemed consistent with, or a little better than, the modest recovery in the euro area underpinning the Committee's previous *Inflation Report* projections. Nevertheless, the scale of the adjustment challenge facing the euro area remained considerable. Although some time ahead,

the ECB's Asset Quality Review of banks' balance sheets, planned for the first half of 2014, would be an important determinant of the durability of the recovery.

9 In the United States, second-quarter GDP growth had been revised up to 0.6% as a result of stronger trade data. Data concerning the third quarter had been mixed, with increases in the manufacturing activity ISM index in July and August, and in the non-manufacturing ISM index in July, set against weaker-than-expected employment and durable goods orders figures. Overall, there seemed little reason to aim off the baseline assumption made at the time of the August *Inflation Report* for growth of around 0.5% a quarter in the second half of the year. Much of the commentary surrounding the US economic situation had centred on the likelihood or otherwise of the Federal Reserve reducing the pace of its large-scale asset purchases following the meeting of the FOMC in the middle of September.

10 News from emerging economies had been less positive. In particular, the reversal of earlier capital flows into several emerging markets had continued – typically from those countries with weak external positions – amid increased concern about the strength of growth in those countries and the prospects for global liquidity if the FOMC began to wind down its asset purchases. While many emerging economies would be able to draw on considerable foreign exchange reserves to finance those capital outflows, others could be more vulnerable. Since June policymakers in several countries, including Brazil, Indonesia and Turkey, had responded to continued capital outflows by raising official interest rates, despite relatively weak growth. Some countries, such as India, had also adjusted capital controls to reduce net financial outflows.

11 The risk of a sustained period of weaker growth in some emerging economies might be expected to put downward pressure on global commodity prices in due course. But, over the month as a whole, the dollar price of Brent crude had increased by 6%, having spiked up and subsequently fallen back a little near the end of the month. That volatility seemed most likely to be related to escalating concerns over the consequences of possible military action in Syria, as well as continuing disruption to Libyan and Nigerian oil supply. The increase in oil prices, if sustained, would add a little to near-term inflationary pressures in the United Kingdom, although one third of its impact had been offset in sterling terms by the recent appreciation of the pound against the dollar.

Money, credit, demand and output

12 The estimate of GDP growth in the second quarter had been revised up a little to 0.7% in the second release. The initial estimates of the expenditure breakdown had suggested that growth had been fairly broadly based, with investment and export growth both a little stronger than the Committee had anticipated. Such initial estimates for the expenditure components were, however, highly uncertain. There were other reasons for caution. For instance, the strength of exports was concentrated in a couple of subsectors and appeared erratically strong by comparison with the growth of world trade volumes during Q2; and the large positive contribution to growth from stockbuilding would probably prove transient, especially if it were simply a bounceback from the temporary de-stocking observed in the first quarter.

13 Nevertheless, that modestly promising data release had been augmented by the continuing strengthening of the indicators of consumer spending in 2013 Q3 and further strong business surveys in August. The Markit/CIPS services activity index was broadly unchanged in August, after having increased sharply in July, and the manufacturing and construction indices had strengthened further. Consequently, the composite PMI was at its highest level since 1997. The CBI service sector survey had also strengthened in August. Overall, Bank staff estimated that the initial estimate of output growth in the third quarter would be around 0.7%, compared with the 0.5% expected at the time of the *August Inflation Report*. Moreover, the early indicators for activity in Q4 tentatively suggested further strengthening towards the end of the year. Overall, these data provided further evidence in support of the pickup in growth assumed at the time of the *August Inflation Report* and, if anything, posed an upside risk to that path.

14 Since the spring, and after several years of stasis, activity in the housing market had been picking up and, on the basis of recent indicators, gaining momentum. Although still well below pre-crisis norms, monthly mortgage approvals had increased by almost a third over the past year. And, according to the average of the main lenders' indices, nominal house prices in July stood around 4% higher than a year earlier and so had begun rising in real terms for the first time since mid-2010. In a confidential preview of the survey, the RICS current house price balance had risen to a level last seen at the end of 2009. There had also been signs of an easing in conditions in the commercial property market.

15 Increased housing market activity had the potential to support dwellings investment and spending on associated services, thereby boosting growth overall. And some rise in prices might provide a modest fillip to consumer spending and investment if, for example, the increase in collateral values helped to relax households' and small businesses' credit constraints. Nevertheless, the Committee noted that property market developments would become more of a concern if a period of rapid real house price increases appeared in prospect. The Committee noted the fact that the Financial Policy Committee and the Prudential Regulation Authority now had a range of instruments they could deploy to mitigate this.

Supply, costs and prices

16 Twelve-month CPI inflation had been 2.8% in July, in line with the Committee's and market participants' expectations. The outlook for inflation remained broadly as set out in the August *Inflation Report*. The 4% increase in the sterling price of oil would be likely to raise the near-term profile for inflation; while the appreciation of sterling, if sustained, would bear down on inflation further out, including in the 18-24 months ahead range pertinent for the forward guidance knockout.

17 The expectations of future inflation implied by financial market prices had risen only marginally on the month. And the most recent surveys of households' inflation expectations had shown no clear pattern. The Barclays Basix measures of expectations two and five years ahead and the YouGov/Citigroup measure five to ten years ahead had both increased in the latest data. But the Bank of England/NOP survey measures of expectations both two and five years ahead had declined. Revisions to the inflation projections of professional forecasters had typically been small. Overall, there seemed little to change the Committee's assessment at the time of the August *Inflation Report* that expectations remained consistent with hitting the 2% inflation target in the medium term.

18 Both whole economy and private sector annual regular pay growth had remained at around 1% in the three months to June. The earnings data, especially for total earnings, had recently been distorted by the impact of payments being delayed until after changes to the income tax schedule in April. But these distortive effects had mostly worked through the data, such that 1% was probably a reasonable guide to the underlying pace of annual pay growth. If anything, labour market surveys pointed to a modest pickup in wage growth. But the signal from these surveys was typically quite weak and there was, as yet, little evidence to contradict the Committee's judgement that annual earnings growth would remain around 1% throughout 2013.

19 The LFS unemployment rate, upon which the Committee's forward guidance threshold was based, had been 7.8% in the three months to June, the same as in the previous three months. The number of people employed had increased by almost 70,000, which, given the estimated growth in the size of the population, meant that the employment and inactivity rates had remained unchanged. The unemployment rate for the single month of June was estimated to have been 7.4%, which – in the context of the Committee's forward guidance threshold – had caused some market commentary. While the single-month unemployment data were a helpful input to the Committee's analysis, members did not place a great deal of weight on them: the single-month data did not, as yet, meet the statistical standards that the ONS required to qualify as a 'National Statistic'; they were volatile, being both based on a smaller sample than the three-month headline unemployment figures and scaled up from the survey sample in a more rudimentary way; and they were subject to cohort effects.

The immediate policy decision

20 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. At its previous policy meeting, the Committee had agreed its intention not 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). Members had all agreed that this forward guidance, and the articulation of the Committee's reaction function contained within it, should provide the framework and context for future monetary policy discussions.

21 There had been some notable developments over the month. Domestically, there were increased signs that the recovery was taking hold, which had been accompanied by an upward movement in sterling market interest rates. The GDP data for the second quarter had been revised up, and survey indicators of activity had been upbeat. Those data presented an upside risk to the growth profile described in the August *Inflation Report*. Internationally, there were signs that growth in the euro area – the United Kingdom's largest trading partner – had been stronger than the Committee had anticipated. But the downside risks presented by developments in several emerging economies had

increased. Oil prices had risen, which would probably push up the path for CPI inflation a little in the near term. But this had been partly offset by the appreciation of sterling, which itself was likely to dampen inflationary pressures somewhat in the medium term.

22 The LFS unemployment rate had remained at 7.8%, some way above the 7% forward guidance threshold. The announcement of the MPC's forward guidance had prompted increased attention among economists and market participants to the date on which the unemployment threshold would be reached. While this demonstrated an increased understanding of the Committee's intention to link monetary policy more explicitly to easily observable data outcomes, relatively small changes in assumptions regarding the future evolution of, for instance, productivity growth or labour market participation would have significant effects on when unemployment would be expected to reach the 7% threshold. The Committee agreed the need to emphasise in its public communication that the 7% threshold for the unemployment rate was not a 'trigger' that was mechanically linked to subsequent movements in Bank Rate. Rather, MPC members judged it to be a sensible point, in the absence of any of the knockouts being breached, to reassess the outlook for inflation and growth drawing on all of the relevant factors and data, much as the Committee had always done.

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

24 Against the backdrop of indicators of stronger near-term growth than seemed likely a month earlier, there were tentative signs that the degree of spare capacity within firms might be beginning to diminish. But it remained too early to assess how likely it was that effective supply capacity would increase as demand recovered, thus moderating any additional inflationary impetus resulting from that extra demand. If sustained, the appreciation of sterling meant that CPI inflation was marginally less likely than a month ago to be above 2.5% in 18-24 months' time.

25 There had been little news regarding medium-term inflation expectations. Measures derived from financial market prices had risen only marginally, and the evidence from household surveys was ambiguous. Revisions to professional forecasters' expectations for medium-term inflation were minor, and gave no particular signal. There was, therefore, little reason overall to shift the Committee's judgement that medium-term inflation expectations remained sufficiently well anchored.

26 The FPC had not met since the MPC's forward guidance had been announced. The MPC would await the FPC's assessment of the financial stability consequences of the current monetary stance in due course.

27 All Committee members agreed that none of the three knockout conditions that would invalidate the forward guidance announced in August had been breached. And unemployment remained above the 7% threshold. In that light, the guidance remained in place and no MPC member thought it appropriate to tighten the stance of policy at the current juncture. Members had different views about the extent to which a further loosening of the monetary stance might be warranted, based in part on their judgements about the speed with which the degree of slack in the economy might be reduced if the momentum in demand continued to grow. This remained difficult to judge, and there had been few developments to shed light on it since the Committee's previous meeting. Over the month the evidence was consistent with a recovery at least as strong as that expected at the time of the August *Inflation Report*. Were the recovery to falter, the case for further asset purchases would be stronger. But no member judged that further stimulus was appropriate at present.

28 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.

29 In the light of the Committee's forward guidance, and as described in a market notice of 5 September 2013, the Committee agreed to reinvest the £1.9 billion of cash flows associated with the redemption of the September 2013 gilt held in the Asset Purchase Facility.

30 In order to accommodate some members' attendance at international meetings in Washington DC on 10 October, the MPC's policy meeting scheduled for 9-10 October will take place on

8-9 October. The decision will still be announced at the originally scheduled time of 12.00 on 10 October.

31 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.