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# MINUTES OF THE MONETARY POLICY COMMITTEE MEETING

## 9 April 2014

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These are the minutes of the Monetary Policy Committee meeting held on 9 April 2014.

They are also available on the Internet

<http://www.bankofengland.co.uk/publications/minutes/Pages/mpc/pdf/2014/mpc1403.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 7 and 8 May will be published on 21 May 2014.



## **MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 9 APRIL 2014**

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. The Committee noted a letter from the Chancellor setting out the remit for the Committee over the following year, in accordance with Section 12 of the Bank of England Act.

### **Financial markets**

2 The most significant event in financial markets over the course of the month had been the reaction to the Federal Open Market Committee (FOMC) meeting on 19 March. As expected, the FOMC had announced a further \$10 billion reduction in the pace of its asset purchases and a move to a more qualitative form of forward guidance. But the policy statement and increases in some FOMC policymakers' expectations for the federal funds rate at the end of 2015 and 2016 had been interpreted by some market participants as a change in the FOMC's reaction function. As a consequence, the short end of the yield curve had steepened in the United States, with the one-year rates one year and two years ahead implied by overnight index swaps (OIS) rising by 11 and 25 basis points respectively shortly after the FOMC meeting.

3 Short-term market interest rates in the United Kingdom had continued to be positively correlated with corresponding rates in the United States and had also risen around the time of the FOMC meeting. But over the month as a whole, the one-year OIS rate one year ahead had risen by 11 basis points in the United Kingdom, less than the 18 basis point increase in the United States. Also, the date at which the first Bank Rate rise was fully priced in had remained unchanged at the spring of 2015, while the expected date of the first rise in the federal funds rate had been moved forward by two months to the late summer of 2015.

4 Implied volatilities around short-term interest rates had remained unusually low internationally, especially at the twelve-month horizon. This was somewhat surprising, as it could suggest that the demand for insurance against unexpected movements in short-term interest rates was low. Yet the

timing of when policy rates in advanced economies would eventually increase from the present exceptionally low levels was uncertain, as the data flow that would lead to monetary policy tightening was likely to be unpredictable.

5 Ten-year government bond yields had fallen slightly in the United States, United Kingdom and Germany. There had been larger falls in the euro-area periphery that would ease the debt burden and process of adjustment in those countries: for example, ten-year yields on Portuguese government bonds had fallen by 80 basis points.

6 The Euro Stoxx index had increased by 0.8%, having recovered from falls associated with the continuing political tensions between Ukraine and Russia earlier in the month. The US S&P 500 index and the UK FTSE All-Share index had fallen by 1.2% and 2.9% respectively. The underperformance of UK equities had partly reflected falls in the share prices of life insurance companies following announcements in the Budget of changes to pension regulations.

7 The sterling effective exchange rate remained around 10% above its recent trough in March 2013. The Chinese renminbi had depreciated by a further 1.1% against the dollar. Some of this fall had followed a widening by the Chinese authorities of the currency's permitted trading band.

### **The international economy**

8 There had been further signs of a strengthening recovery in the advanced economies, with modest positive news on euro-area activity and more evidence of continuing expansion in the United States. But weaker data from China had highlighted the continuing downside risks to global activity from the emerging economies.

9 Recent data suggested that the euro-area recovery was a little stronger than previously expected. Monthly indicators suggested that activity in Germany in particular had picked up markedly at the beginning of the year, in part boosted by mild weather. More generally, the composite output Purchasing Managers' Index (PMI) had remained at a level consistent with continuing moderate expansion. In the light of more positive data, Bank staff had revised up a little their expectation of euro-area growth in Q1 to around 0.5%. Growth might well fall back in Q2, but confidence had risen to its highest level since 2007 and forward-looking indicators pointed to further moderate growth over the remainder of the year. With sovereign yields falling, especially in the periphery countries, and

bank funding conditions improving, it was possible that credit conditions for businesses and households might ease somewhat. Against this, credit markets in the euro area remained impaired and any additional stimulus to demand from this source was likely to be limited.

10 Consumer price inflation in the euro area had fallen to 0.5% in March. This partly reflected a base effect arising from the timing of Easter that was expected to unwind in April. Lower inflation was also likely to reflect falling energy and food price inflation that would support real income growth. While inflation was likely to edge up if the euro-area recovery proceeded as expected, it remained below the European Central Bank's (ECB's) target and continued very low inflation could make the process of rebalancing in the euro area more difficult. Inflation expectations at the two-year horizon had also drifted down. While the Governing Council of the ECB had left policy unchanged at its April meeting, the ECB President had stated that members were unanimous in their commitment to using unconventional instruments within the ECB's mandate to cope with risks of a prolonged period of low inflation. The Monetary Policy Committee noted, nevertheless, that falls in key nominal interest rates in periphery countries meant that, despite weaker inflation, real rates there had fallen rather than risen.

11 In the United States, unusually adverse weather had obscured the underlying trends in the recent data. Nevertheless, there had been few surprises: industrial production had risen by 0.6% in February, non-farm payrolls had increased by 192,000 in March, both broadly as expected, and the composite Markit PMI output index had picked up further to a level consistent with continuing robust growth. With the unemployment rate nearing the 6½% threshold, the FOMC had updated its forward guidance and reaffirmed its view that a highly accommodative stance of monetary policy remained appropriate; its future policy decisions would be based on an assessment of a wide range of information, including measures of labour market conditions, indicators of inflation pressures, and readings on financial developments.

12 Recent data suggested declining momentum in China's economy: the rebound in the manufacturing PMI in March had been modest after a weak February outturn and the growth rates of retail sales, industrial production and fixed investment had fallen. While these data were likely to have been distorted by the timing of the lunar new year and similar base effects, slowing momentum in Chinese activity had prompted the announcement of a modest economic package to stimulate growth. But there continued to be concerns about the vulnerabilities generated by past rapid credit growth from non-bank lending institutions. There appeared to be scope for the Chinese authorities to provide further support to the economy and vulnerable institutions should the need arise, but at the risk of

complicating the process of rebalancing the economy in the medium term. Activity in other emerging market economies appeared to have stabilised as expected. Nonetheless several downside risks remained, including the possibility of renewed capital outflows in response to changed perceptions of the pace of monetary policy normalisation in the advanced economies and the potential for spillovers from any protracted slowdown in China.

13 One of the key risks to the global outlook was a sharper slowdown in China that could spill over to other countries. A slowdown in China might have a larger impact on the United Kingdom than would be implied by its 4% share of UK exports, through a combination of trade, financial and confidence channels, with an expected beneficial offset from lower commodity prices. But the effect was very uncertain and was likely to depend on what had caused the slowdown. On the one hand, there was a risk of a disorderly response in financial and commodity markets, with possibly large spillovers to other countries, if a slowdown were to be caused by instability in the Chinese financial system. Moreover, the monetary policy response in the advanced economies would be constrained by the effective lower bound on interest rates. But, on the other hand, a slowdown in the Chinese economy associated with a rebalancing of demand would have a less deleterious effect on other countries. Some members of the Committee noted that the Chinese economy had already slowed, and the weakness in the Japanese economy in the 1990s, then the second largest global economy, did not appear to have impeded UK growth materially. Members attached different weights to these arguments in considering the consequences of fluctuations in the Chinese economy.

14 Global price pressures had remained subdued. Metals prices had been weak: the S&P GSCI industrial metals index had fallen by 1% and briefly reached its lowest level since 2010. Oil prices had ended the month unchanged. In the other direction, the S&P GSCI agricultural index had risen by 16% over the past year, partly due to adverse weather in Latin America, but also as a reaction to heightened political tensions in Ukraine, which was a major grain exporter.

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

15 The estimate for UK GDP growth in the fourth quarter had remained unchanged at 0.7%. The mix of expenditure had been revised a little, but still pointed to a broadening of the recovery from household to business spending. Consumption growth in Q4 had been revised up to 0.3%, but remained weaker than earlier in the year. The contribution of net trade to Q4 growth had been revised

up to 1 percentage point on the back of very strong estimated export growth, some of which appeared unlikely to persist. While the trade deficit had narrowed in Q4, the overall current account deficit had remained at around 5½% of GDP, following a sharp deterioration in net investment income. Having averaged around ¼% of GDP over the previous year, the deficit on net investment income had widened to 2.5% of GDP in Q4. The suddenness of the latest deterioration in net investment income suggested that a portion might be erratic and reversed in due course.

16 Output had grown consistently across all sectors in January and February. Industrial production had risen by 0.9% in February, with manufacturing output growing by 1%. The signal from business surveys had remained strong in March, albeit a touch softer than in the previous three months. Bank staff's central expectation of the final estimate of growth in 2014 Q1 had been revised up to 1.0%, with growth in the second quarter expected to be only a little weaker.

17 Some of the near-term indicators suggested that household spending growth had strengthened in the first quarter. Retail sales had grown by 1.7% in February, above Bank staff's expectations, and new car registrations had risen by 2.5% in Q1, mainly due to a 6.2% increase in private registrations. But, against this, some housing market indicators had been weaker than expected. After several months of growth, loan approvals for house purchase had fallen by around 10% in February; it was not clear what had driven this fall. The average of the lenders' house price indices had fallen by 0.2% in March. Smoothing through the monthly volatility, however, house prices were growing nationally at a little under 1% a month on this measure, with stronger growth in London than in other parts of the country.

18 Household and business spending was likely to be supported by further easing in bank credit conditions. On the household side, credit conditions had improved markedly since the middle of 2012. Quoted two-year fixed rates on low loan to value (LTV) mortgages had fallen by around 140 basis points since the middle of 2012 and personal loan rates had fallen by over 250 basis points over the same period. The availability of high LTV mortgages had been increasing as lenders introduced new products, some of which were backed by the mortgage guarantee component of the Help to Buy scheme. Evidence from the Bank's *Credit Conditions Survey* had suggested that the availability of high LTV mortgages was expected to increase further over the coming three months, but some lenders were reported to have limited appetite for such lending. Interest rates on credit cards remained elevated.

19 On the corporate side, there was a clear difference between the credit conditions facing large companies with access to the capital markets and those facing small businesses. According to the *Deloitte CFO Survey*, credit was perceived to be cheaper and more easily available for large companies than at any time since the survey began in 2007. By contrast, a range of evidence, including business surveys, suggested that credit conditions for smaller businesses remained more stringent than before the financial crisis. But there were several indicators, including from the Bank's *Credit Conditions Survey*, suggesting that availability of credit for small businesses had improved over the past year. And, in a special survey conducted by the Bank's Agents, relatively few businesses had identified credit availability as a major concern.

20 Despite the improvement in credit supply conditions, bank lending to businesses had remained weak: the three-month annualised growth rate of lending to private non-financial corporations (PNFCs) had fallen to around -5% in February on the headline M4Lx measure. The fall in net lending to PNFCs over the past year largely reflected weaker net lending to the commercial real estate (CRE) sector. This in turn had been associated with an increase in loan repayments in the second half of the year, rather than weakness in gross lending. To some extent, the pickup in loan repayments was likely to be a reaction to a partial strengthening in the CRE market and greater competition from non-bank lenders allowing some CRE businesses to refinance their existing loan facilities outside the banking sector.

21 Overall, there appeared to be scope for further improvement in credit supply conditions, especially in some specific higher risk segments, such as lending to small businesses, the CRE sector and for high LTV mortgages. Nevertheless, it was likely that credit spreads would remain high relative to their pre-crisis levels for some time to come and continue to represent a headwind to activity that would limit the extent to which policy rates would need to rise to contain future inflationary pressure.

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

22 CPI inflation had fallen to 1.7% in February. In line with the usual pre-release arrangements, an advance estimate for CPI inflation of 1.6% for March had been provided via the Governor to the MPC, ahead of publication; that was in line with Bank staff's expectations. The near-term outlook had been revised down slightly, reflecting duty changes announced in the Budget, weak online food price data and lower sterling oil prices.

23 Measures of households' inflation expectations had generally fallen. The YouGov/Citigroup survey in March had indicated that median inflation expectations had fallen further below their pre-crisis averages at both the one-year and five to ten-year horizons covered by the survey. And median one year ahead inflation expectations from the Barclays Basix survey had fallen to their lowest reading since the survey began in 1986. Around 75% of respondents to the *Deloitte CFO Survey* expected CPI inflation to be between 1.5% and 2.5% in two years' time, up from 45% three months earlier when a majority of respondents had expected inflation to be above 2.5%. Lower median inflation expectations in these surveys reflected more respondents expecting inflation to be at levels consistent with the inflation target, rather than more respondents expecting very low inflation rates. That was consistent with evidence from financial markets, where the premium paid to provide protection against deflation in the United Kingdom had remained low in comparison with other countries.

24 Employment had increased by 105,000 in the three months to January, a slower rate of increase than throughout most of 2013. This, together with stronger growth in output, meant that productivity growth appeared to have increased around the turn of the year. The unemployment rate had remained at 7.2% in the three months to January, higher than expected at the time of the February *Inflation Report*. The number of unemployed had fallen by 63,000 in the three months to January compared with three months earlier, within that the number of long-term unemployed had fallen by 38,000. The claimant count figures for February pointed to a continuing fall in unemployment.

25 A striking feature of the recent labour market data had been the strength in self-employment. Self-employment had risen by over 200,000 in the three months to January at the same time as there had been a fall in the number of employees. And self-employment had accounted for almost half of the rise in employment since 2010. It was possible that some of the increase had come about in reaction to benefit caps, changes in pension entitlements and rules surrounding access to in-work benefits. A key question was whether the amount of slack in the labour market was understated by measured unemployment, as might be the case if many of the self-employed were underemployed and searching for work as employees. There was some evidence against this. First, part of the rise in self-employment appeared to be a continuation of a longer-term secular trend, rather than a cyclical response to a lack of other employment opportunities. Consistent with that, higher self-employment did not appear to have been associated with inflows of people recently made redundant. Second, survey evidence suggested that the self-employed were only slightly more likely to be looking for another job than were employees. For some, self-employment might have been chosen as an

alternative to retirement, rather than as an alternative to employment. Nevertheless, it was possible that some of the self-employed were underemployed and would be more productive as employees were more jobs to become available. Members of the Committee held a range of views about the extent to which self-employment represented a form of labour market slack. They noted that this would be tested when more jobs became available.

26 Another noteworthy feature of the recent labour market data was evidence that earnings growth was beginning to pick up. Private sector regular pay growth had risen to 1.6% in the three months to January compared with the same period a year earlier. A base effect associated with tax forestalling a year earlier meant that this exaggerated the underlying increase somewhat. But the annualised growth rate in private sector regular pay had risen by 0.6 percentage points to 2.1% in the latest three months compared with the previous three months, suggesting an underlying pickup in wage growth. Other evidence also pointed to building momentum in pay. For example, respondents to the latest REC survey reported that starting salaries for people placed in permanent jobs had increased sharply in March. A pickup in pay growth, supported by strengthening productivity growth, was consistent with the Committee's central view set out in the February *Inflation Report*, and was required for real incomes to grow sustainably without generating inflationary pressure. But cost pressures would rise if pay were to accelerate without an equivalent pickup in productivity growth.

### **The immediate policy decision**

27 The Committee set monetary policy to meet the 2% inflation target in the medium term, but in a way that helped to sustain the recovery. In pursuit of that objective, the Committee had, at the time of its August 2013 *Inflation Report*, provided guidance regarding the 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 purchased assets 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 to 24 months ahead; whether measures of medium-term inflation expectations remained sufficiently well anchored; and the impact of the stance of monetary policy on financial stability, as judged by the Bank's Financial Policy Committee (FPC).

28 As the LFS headline unemployment rate had neared the 7% threshold, the Committee had provided further guidance regarding the setting of monetary policy once the unemployment threshold

was reached. That guidance had been described in the February 2014 *Inflation Report* and stated that when Bank Rate did begin to rise, the appropriate path so as to eliminate slack over the next two to three years and keep inflation close to the target was expected to be gradual. The actual path of Bank Rate over the next few years would, however, depend on economic developments. Even when the economy had returned to normal levels of capacity, and inflation was close to the target, the appropriate level of Bank Rate was likely to be materially below the 5% level set on average by the Committee prior to the financial crisis.

29 Having fallen sharply through the second half of 2013, the LFS headline unemployment rate had been unchanged at 7.2% in the three months to January, and so remained above the 7% threshold set out in the Committee's policy guidance of August 2013. The Committee's assessment of the outlook and immediate policy decision therefore continued to be framed with reference to the guidance provided in August, including the three knockout conditions specified at that time.

30 There had been little change to the outlook for global activity, where the recovery appeared to be strengthening in the advanced economies and slowing a touch in the emerging economies. While there was a possibility of a more robust global recovery than currently expected, weaker data from China highlighted that downside risks to global activity remained. Committee members had a range of views on how material those risks would be for the UK economy. Global inflationary pressures were subdued, especially in the euro area where there was a risk that very low inflation would hinder the rebalancing process. The low levels of implied volatility for a range of asset prices seemed surprising. Some increase in asset price volatility was likely as monetary policy in the advanced economies was brought back to a more normal setting. Monetary conditions had tightened a little over the month: the one-year rate one year ahead implied by overnight index swaps had risen by just over 10 basis points in the United Kingdom and by around 20 basis points in the United States. The sterling effective exchange rate had changed little in March but remained around 10% higher than its most recent trough a year earlier.

31 The domestic recovery was building momentum, with some signs of a modest rebalancing towards investment. The recent strength of both the business surveys and activity indicators was consistent with quarterly growth of close to 1% in the first half of the year. Demand was likely to be bolstered by improving business and consumer confidence and easier credit conditions. But there were downside risks to activity were the recent widening of the current account deficit to 5½% of GDP,

driven by lower net investment income, to persist. Some housing market indicators had been a little weaker on the month, but house prices still showed considerable momentum, especially in London.

32 With employment growth slowing in recent months, it was likely that productivity had started to rise after several years of stagnation, thereby providing the foundation for more sustained real income growth. Nominal wage growth had picked up a little in recent months and it was possible that a sustainable rise in real wages and incomes, consistent with a durable recovery in demand and output, was in prospect. Cost pressures would rise if pay were to accelerate without an equivalent pickup in productivity growth. But there was also a risk that nominal wage growth would remain weak even as productivity picked up and that this would intensify the downward pressure on inflation. This would partly depend on whether the recent substantial rise in self-employment represented the continuation of a secular trend, reflecting personal preferences and changing industrial structures, or a disguised form of labour market slack. More generally, there was considerable uncertainty about the amount of slack remaining within the economy and Committee members had a range of opinions on this and the outlook for inflation in the medium term.

33 Regarding the knockout conditions, near-term inflationary pressure appeared to have eased further. CPI inflation had fallen to 1.6% in March. While inflation was likely to pick up somewhat in the coming months, all members agreed that the probability that it would be above 2.5% in 18–24 months time remained less than 50%. In addition, the news on inflation expectations had been mainly to the downside, such that medium-term inflation expectations remained sufficiently well anchored.

34 At its meeting on 19 March 2014, the FPC had agreed that, in the 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.

35 All Committee members agreed that neither of the price stability knockout conditions that would override the policy guidance provided in August 2013 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 August 2013 policy guidance therefore remained in place and no member thought it appropriate to tighten, or to loosen, the stance of monetary policy at the current juncture.

36 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 purchased assets 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 purchased assets, the Committee voted unanimously in favour of the proposition.

37 The following members of the Committee were present:

Mark Carney, Governor  
Charles Bean, Deputy Governor responsible for monetary policy  
Jon Cunliffe, Deputy Governor responsible for financial stability  
Ben Broadbent  
Spencer Dale  
Paul Fisher  
Ian McCafferty  
David Miles  
Martin Weale

Sharon White was present as the Treasury representative.