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**MINUTES OF THE
MONETARY POLICY
COMMITTEE MEETING
5 and 6 February 2014**

These are the minutes of the Monetary Policy Committee meeting held on 5 and 6 February 2014.

They are also available on the Internet

<http://www.bankofengland.co.uk/publications/minutes/Pages/mpc/pdf/2014/mpc1402.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 5 and 6 March will be published on 19 March 2014.



MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 5 AND 6 FEBRUARY 2014

1 Before turning to its immediate policy decision, and against the background of its latest projections for output and inflation, the Committee discussed financial market developments; the international economy; money, credit, demand and output; and supply, costs and prices.

Financial markets

2 Volatility had risen and there had been some notable movements in financial asset prices both domestically, reflecting in particular the further unexpectedly large fall in the unemployment rate, and internationally, following concerns about the prospects for some emerging economies. UK short-term market interest rates had fallen on the month: having risen on the release of the unemployment data, they subsequently fell following comments from Committee members and as market concerns about some emerging economies intensified. The one-year rate, one year forward implied by overnight interest rate swaps had fallen by 13 basis points, while the first rise in Bank Rate was fully priced in by late Spring 2015, a little later than at the time of the January meeting. In contrast, respondents to the Reuters survey had brought forward their expectation of the first rise in Bank Rate from August to May 2015. They had also brought forward their expectation of the date at which unemployment was expected to reach the 7% threshold by around twelve months, such that their expectation of the interval between the threshold being met and the first rise in Bank Rate had extended considerably.

3 Short-term market interest rates had also declined in the United States and in the euro area, reflecting a combination of news related to their respective domestic economies and concerns about emerging economies. Longer-term interest rates were also lower: ten-year government bond yields had fallen by around 30 basis points in the United Kingdom, the United States and Germany. In contrast to emerging economies, market conditions for euro-area periphery countries had continued to be supportive, with governments and banks able to access capital markets on improved terms.

4 The sterling effective exchange rate had risen in the first part of the month, but had subsequently fallen back such that it was 0.6% lower than at the January meeting. However, that still left the fifteen-day average 3.6% higher than at the time of the November *Inflation Report*. The view of many foreign exchange market strategists was that sterling's appreciation over recent months had been supported by the strength of demand growth in the United Kingdom relative to other major advanced economies.

5 There had been falls in financial asset prices in many emerging economies. These had seemed to reflect a variety of country-specific factors which included concerns about non-bank lending institutions in China, and the challenging outlook and difficult policy choices currently facing a number of countries with significant external financing needs. These concerns about emerging economies had weighed on advanced economy equity prices. The FTSE All-Share, S&P 500 and Euro Stoxx indices had fallen by between 3½ and 5 % since the previous meeting, while the Japanese Nikkei 225 index had fallen by over 12%.

The international economy

6 There had been further signs of a strengthening recovery in the advanced economies, such that the risks to the global outlook were more balanced than of late. While the need for further adjustment in the euro area remained, the downside risks to a continued steady expansion of global activity had shifted somewhat away from the advanced economies and towards the emerging economies.

7 Among the emerging economies, the recent market volatility had been most pronounced for those countries facing idiosyncratic, and often political, uncertainty; there had been little sign yet of generalised contagion. There were, however, some more pervasive vulnerabilities. In recent years, many emerging economies had experienced strong capital inflows, rapid credit growth and, for some, rising external indebtedness. Those particularly reliant on short-term external borrowing were especially vulnerable to a reversal in capital flows. Some had tightened monetary policy to discourage outflows, but fiscal consolidation and in some cases structural reforms were also needed, which would often entail political costs.

8 Recent data suggested declining momentum in China's economy: GDP growth in the fourth quarter of 2013 had slowed to 1.8%, and the Purchasing Managers' Indices (PMI) for January had

fallen. Concerns about the robustness of a particular retail investment product had brought into focus the longer-term challenge facing the Chinese authorities in unwinding the vulnerabilities associated with the growth of non-bank lending.

9 There had, however, been more encouraging developments in the euro area. Industrial production had risen strongly in November, and GDP growth was likely to have been a little firmer than previously expected in the fourth quarter of 2013. The composite PMI had risen further in January and suggested that a moderate recovery was set to continue into 2014. There had been encouraging signs that the improvement in the current account positions of euro-area periphery countries was partly structural in nature, and not merely a cyclical response to the past sharp declines in activity; but the process of rebalancing in the euro area still had a long way to go, and very low rates of inflation across the area as a whole made that process more difficult.

10 In the United States, GDP growth in the fourth quarter of 2013 had been slightly higher than the Committee had expected at 0.8%. Recent monthly data were likely to have been affected by unusually cold weather in the United States that made it difficult to discern underlying trends. Employment growth had been much weaker in December than in the preceding months. The Markit manufacturing PMI and the equivalent ISM measure had both fallen in January; but both the Markit services and ISM non-manufacturing PMIs had ticked up. The FOMC's announcement at its January meeting of a further reduction in the pace of its asset purchases had been widely expected, and attention had shifted to the outlook for fiscal policy given the proximity of the ceiling on the stock of federal debt.

11 The weakening of sentiment towards emerging economies had so far had little impact on commodity prices. Oil prices had fallen slightly on the month, but had changed little since November and remained within their trading range of the previous 18 months. Industrial metals prices had also fallen slightly on the month.

Money, credit, demand and output

12 The ONS's preliminary estimate showed that GDP in the fourth quarter of 2013 had grown by 0.7%. That had been in line with the Committee's expectation immediately prior to the release but 0.2 percentage points lower than expected at the time of the November *Inflation Report*, reflecting weak construction output. On the basis of historical revision patterns, and given the strength of

business surveys during the quarter, the Bank staff's central estimate for the mature data was 0.9%. In line with the usual pre-release arrangements, the Governor provided the Committee with an advance estimate that industrial production had risen by 0.4% in December; that was slightly weaker than the Bank staff had expected, but was not thought to contain material implications for subsequent releases of GDP in the fourth quarter.

13 The Bank staff's central expectation for GDP growth in the first quarter of 2014 was 0.9%, reflecting a bounce back in construction output but slightly slower services growth. The strength of the forward-looking components of the major business surveys suggested that the momentum in growth would be maintained in the second quarter.

14 With activity in the UK's main trading partners recovering only slowly, the upturn in the domestic economy had so far been characterised by a reduction in private savings. This reduction in savings had been supported by a revival in confidence and reduced uncertainty. This was evident in the GfK consumer confidence survey responses, which had indicated households' reduced fears of unemployment and rising optimism about their financial situation twelve months ahead. The fall in savings might also have reflected an easing in credit conditions, which were expected to continue to improve, supporting a further pickup in credit growth. In the near term, the recent trend of households funding consumption growth by saving less was likely to continue. Further out, continued household spending recovery would need to be driven more by income growth, which was expected to pick up only modestly; that meant consumption growth was likely to moderate. But there were risks to the outlook for consumption from the fall in households' saving. For example, if households had unrealistic expectations of rapid income growth they could cut spending quite sharply as they came to realise that income was not rising so fast. Highly-indebted households might be especially vulnerable.

15 The housing market revival had continued. The average of lenders' house price indices had risen by 0.9% in January, and most surveys suggested that recent rates of increase in house prices would continue in the short term. In the medium term, the Committee assumed that house prices would rise broadly in line with nominal incomes, although the timing and pace at which house price inflation would moderate was uncertain. The Committee expected that housing activity and prices would provide only modest direct support to consumption but that housing investment would boost GDP growth significantly over the next two years.

16 With household spending growth expected to slow, fiscal consolidation continuing, and with only a gradual recovery in the UK's main trading partners, business investment would need to pick up if the pace of expansion was to be maintained. Business investment had so far been weak as activity had increased. That had not been surprising: companies were likely to use spare capacity before investing in new capacity, and it seemed likely that they would want to see a sustained recovery in demand before having the confidence to make investment decisions that were costly to reverse. There were reasons to think the conditions for a pickup in business investment were now in place: large companies had good access to credit, although some smaller companies still faced difficulties; in aggregate, companies appeared to have healthy balance sheets; and investment intentions surveys were pointing to robust growth. Moreover, awareness of the Committee's policy guidance appeared to be high among businesses and seemed to have boosted their confidence and spending plans.

Supply, costs and prices

17 CPI inflation had fallen to 2.0% in December, the first time inflation had been at or below its target for just over four years. Inflation was expected to remain around 2.0% in the near term, although there was likely to be volatility from month to month.

18 There had been a decline in professional forecasters' inflation expectations, and a small fall in the probability they placed on inflation being more than one percentage point away from the target at the three year horizon. Measures of households' inflation expectations had fallen back since the sharp rises in October around the time that a number of utility companies had announced price rises. The YouGov/Citigroup survey had indicated a third consecutive monthly fall. At both the one year and five to ten-year horizons covered by the survey, household inflation expectations were now below their pre-crisis averages. Measures of UK inflation expectations five to ten years ahead derived from inflation swaps had fallen slightly on the month.

19 Recent declines in inflation had been sharper than the Committee had expected last August, and could be accounted for by a number of idiosyncratic factors such as those relating to university tuition fees, petrol prices and food prices. None of those had seemed primarily to have been driven by imbalances between domestic supply and demand. Looking forward, the prospects for global price

pressures remained subdued. Domestic inflationary pressure would depend on the pace at which slack was absorbed and on the impact that slack had on wages and prices.

20 Employment had continued to grow at a faster pace than anticipated, with a rise of around 280,000 in the three months to November 2013, reflecting increases in both full-time and part-time employment. Self-employment had accounted for more than half of the latest employment increase. Average hours worked had risen slightly in the same period, and Labour Force Survey (LFS) microdata suggested that, in aggregate, people would like to work longer hours. Strong demand for labour had been concentrated in the private sector in the third quarter; the rise in employment had been spread across industries, and there had been particularly large increases in construction and real estate activities, according to Workforce Jobs data. Surveys continued to suggest strength in demand.

21 Rising employment had been accompanied by increased participation in the labour market: the size of the labour force had increased by 113,000 in the three months to November. Nevertheless, employment growth had been sufficiently rapid that unemployment had also fallen more sharply than anticipated. The LFS unemployment rate had fallen to 7.1% in the three months to November. A range of evidence suggested that the unemployment rate would probably reach the 7% threshold in data released in the next few months.

22 Pay growth had remained subdued. Whole-economy total pay had risen by 0.9% in the three months to November compared with the same period a year earlier. Evidence from a recent survey by the Bank's Agents suggested that wage growth would remain muted for the time being. Respondents had expected annual pay settlements to be only slightly higher in 2014 than in 2013. Other indicators pointed to a greater strengthening in wage growth, however: for example, the REC survey of pay for permanent staff in December had risen to its highest reading since October 2007 and had remained close to that high level in January.

23 With inflation expected to be close to the target, the key factors influencing wage growth over the medium term would be productivity and slack in the labour market. Productivity growth had remained weak and considerable labour market slack remained. The Committee's view was that unemployment, which remained above its equilibrium rate, was not the only form of labour market slack. In addition, the fact that, on balance, people in work wanted to extend their working hours would facilitate expansion, as would any further rise in labour force participation. These influences

were expected to bear down on wage growth. Nevertheless, as labour market slack and weak productivity growth started to unwind, wage growth was likely to pick up.

24 The extent to which higher wages would affect prices would depend partly on the extent to which unit labour cost growth increased as a result. In the post-crisis period, wages had adjusted slowly to the weakness in productivity, such that whole economy unit labour cost growth had been relatively robust, averaging around its pre-crisis average rate. More recently, unit labour cost growth had slowed, and would remain subdued if wages rose broadly in line with productivity growth.

The February 2014 GDP growth and inflation projections

25 In the Committee's central view, on the assumption that Bank Rate followed a path implied by market rates and the stock of purchased assets stayed at £375 billion, four-quarter GDP growth was expected to ease a little in the near term as the initial fillip from the release of pent-up demand faded. Thereafter, the recovery was projected to move to a firmer footing: a gradual revival in productivity underpinning a gentle pickup in pay growth and households' real incomes, while stronger demand and improved corporate sentiment drove a rebound in business investment. The strengthening of activity in the advanced economies meant that the risks around the global outlook were judged to be more balanced than of late. However, tensions in some emerging economies had resurfaced, and the need for further adjustment within the euro area continued to pose a risk to UK growth. At home, the main risks to the durability of the recovery were either that sustained weakness in productivity prevented a pickup in household incomes or that companies were slow to increase their capital expenditure in response to rising demand. But the possibility of a virtuous cycle in sentiment, spending and incomes meant there could be even greater near-term momentum in growth.

26 A gradual revival in productivity growth, together with a slight easing in the pace of expansion, was expected to lead to a marked slowing in the rate at which spare capacity was used up. As a consequence, unemployment was expected to fall less rapidly than in the recent past, with some spare capacity likely to remain even at the forecast horizon. The future path of unemployment was, however, highly uncertain. In particular, for a given growth profile, slack would be absorbed more quickly if the impediments to productivity growth were more deeply rooted and took longer to rectify. Alternatively, unemployment might fall more slowly if companies had greater capacity than the

Committee judged to expand output without increasing employment or if there was a period of catch-up in productivity as companies adopted a backlog of innovations and technical advances.

27 In the Committee's central view, on the assumption that Bank Rate followed a path implied by market rates and the stock of purchased assets stayed at £375 billion, the near-term outlook for CPI inflation was lower than in November, reflecting unexpectedly weak inflation outturns, rises in utility price increases smaller than the Committee had assumed, and the impact of sterling's recent appreciation. Inflation was expected to remain at, or slightly below, the target over the forecast period, as the waning impetus from past increases in import prices and from administered and regulated prices was offset by a diminishing drag from spare capacity. The probability of CPI inflation being at or above the 2.5% knockout 18 to 24 months ahead remained around one third. The inflation outlook was sensitive to several factors. The path of inflation would depend on the pace at which slack was absorbed and the impact that slack had on wages and prices. It was possible that the recent unexpectedly sharp falls in inflation reflected underlying cost and price pressures that were weaker than currently judged. Inflation would also be sensitive to developments in commodity prices and the exchange rate, both of which could move sharply.

The immediate policy decision

28 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).

29 The news on the month had tended to strengthen the sense of the momentum of the domestic recovery. The first estimate of GDP for the fourth quarter of 2013 had shown growth broadly in line with the Committee's expectation immediately prior to the release, and the business surveys and employment data suggested that the momentum would carry forward into the next couple of quarters.

The Bank staff's estimates were for growth of a little under 1% per quarter in the first two quarters of 2014. Reduced uncertainty, easier credit conditions and the stimulative stance of monetary policy should support continued firm economic growth, with the expansion becoming more entrenched and broadly based. Abroad, there had been modest upside news about the euro-area economy and some amelioration of risks relating to the euro-area periphery. Against that, there had been heightened concerns about the risks relating to some emerging economies.

30 Robust growth had not so far been accompanied by a pickup in productivity. Employment gains had been exceptionally strong and unemployment had fallen more rapidly than expected. The unemployment rate had fallen to 7.1% in the three months to November, and data to be released in the next few months were likely to show it reaching the Committee's 7% threshold. Even so, the Committee judged that a degree of spare capacity remained, concentrated in the labour market. A strong short-term bounce in productivity growth as labour hoarding and externalities related to thin markets unwound now seemed less likely, and the Committee had revised down its judgement of the likely strength of the response of productivity to higher demand. But that did not rule out a revival through other mechanisms, such as enhanced capital allocation as the banking system normalised and the flow of credit increased. Moreover, the technological frontier was still advancing globally and there was scope for the United Kingdom to take advantage of that as a source of higher productivity.

31 Regarding its immediate policy decision, the Committee considered developments on the month in the context of the three 'knockouts' that would override the policy guidance announced in August.

32 CPI inflation had fallen back to 2.0% in December, and was likely to remain at around that level. In the near term, that reflected a contribution lower than expected previously from administered and regulated prices, the waning impetus from past increases in import prices, and disinflationary pressures resulting from sterling's recent appreciation. Global inflationary pressures were weak; the difficulties faced by some emerging economies perhaps suggested that the balance of risks was to the downside for global energy and industrial commodity prices. Nominal pay growth had remained weak, reflecting continued slack in the labour market and low productivity growth; but strong growth in employment was consistent with the degree of effective slack remaining within the economy being

somewhat less than previously thought. The probability of CPI inflation being above 2.5% 18 to 24 months ahead was judged to be around one third when conditioned on market expectations of Bank Rate.

33 Survey-based measures of professional forecasters' and of households' inflation expectations had declined on the month, as had financial market based measures. There was therefore no reason to alter the Committee's judgement that medium-term inflation expectations remained sufficiently well anchored.

34 The FPC had not met since 20 November 2013 when it 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.

35 All Committee members agreed that neither of the price stability 'knockout' conditions that would override the policy guidance provided in August had been breached; and there had been no change to the FPC judgement that the financial stability 'knockout' had not been breached. With unemployment remaining above the 7% threshold, the Committee's 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 Looking beyond the immediate decision, the Committee discussed how to set policy to achieve the 2% inflation target, while supporting the recovery, once the 7% unemployment threshold had been reached. Despite the sharp fall in unemployment, the Committee judged that there remained scope to absorb spare capacity further before raising Bank Rate. When Bank Rate did begin to rise, it expected that the appropriate path, so as to eliminate slack over the next two or three years and keep inflation close to target, would 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 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. The Committee intended to maintain the stock of purchased assets, including reinvesting the cash flows associated with maturing gilts, at least until the first rise in Bank Rate. Monetary policy might have a

role to play in mitigating risks to financial stability, but only as a last line of defence if those risks could not be contained by the substantial range of policy actions available to the FPC and other regulatory authorities.

37 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.

38 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

Dave Ramsden was present as the Treasury representative.