MONETARY POLICY REPORT PRESS CONFERENCE

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Opening Remarks by the Governor

At a time when news about the political and economic outlooks seems to arrive hourly, it's important not to lose sight of the big picture.

Globally, that picture has darkened. The world risks slipping into a low growth, low inflation rut caused by deep structural forces, limited policy space, and growing concerns over the fracturing of the global trading system. Over the past 18 months, global growth has slowed markedly, business investment has been weak, and trade has contracted.

Many of these dynamics occurred first in the UK – particularly the heavy drag on business investment from entrenched uncertainties over future trading arrangements.

Now, it has become possible that the picture in the UK could change, with the recent UK-EU Withdrawal Agreement creating the prospects for a pickup in UK growth. The pace of that recovery will depend critically on the extent to which uncertainty over the future UK-EU trading relationship actually dissipates and, to a lesser degree, by how much the global economy actually picks up.

Both are assumed in the MPC's latest projections; neither is assured.

In this context, and with inflationary pressures weak globally and contained domestically, monetary policy will need to be carefully calibrated to support a sustainable recovery.

Let me begin with the global outlook.

The Global Outlook

The world economy has moved from a broad-based expansion to a widespread slowdown. With growth decelerating from 4% around two years ago to 2.9% at present, the world economy is now expanding at its slowest pace since the end of 2009.

Trade-related uncertainties are clearly weighing on activity. Global trade has been falling since late 2018. Both the global manufacturing PMI and new export orders remain in contractionary territory, and the global services PMI is now softening as well. Investment growth has fallen, accounting for most of the slowing in GDP growth in both advanced and emerging economies.

The headwinds from elevated uncertainty are likely pushing down the global equilibrium interest rate, exacerbating concerns about limited monetary policy space.

In the MPC's latest projections, global growth remains subdued in the near term, consistent with significant protectionism and growing concerns over the reordering of the rules of global commerce.

Against those structural headwinds, the recent, material easing in monetary policies and financial conditions of most major economies is projected to support a gradual recovery in global growth to around potential rates by the end of the MPC's forecast period.

The UK outlook

In the UK, the underlying pace of growth has slowed below potential, and the economy is now operating with a small margin of excess supply. Quarterly GDP growth is expected to average just 0.2% this year, about half its pace in recent years.

Subdued UK growth partly reflects the weaker external backdrop, which is weighing on both net trade and investment.

But as has been the case for some time, Brexit uncertainties are dominating, weighing particularly hard on business investment, which unusually during an expansion, has contracted in five out of the past six quarters and is currently estimated to be just ½% higher than at the time of the referendum.

Consumer spending has proven more resilient to Brexit uncertainties, growing steadily in recent quarters, underpinned by strong employment and a pickup in real wage growth. However, there is now evidence of a degree of precautionary behaviour, with the latest data revealing that the household saving rate has drifted up since the start of 2018.

Moreover, uncertainty has weighed on the housing market, and recent data suggest the labour market could be beginning to soften. Employment growth contracted by 0.2% in the three months to August, the weakest outturn since May 2015. The number of vacancies has been falling continuously since the start of this year. The REC demand for staff index is at its lowest level since January 2012. And indicators of pay growth from the Agents and REC have fallen back.

The potential implications of the Withdrawal Agreement

The MPC projects that growth is likely to remain a little below potential in the near term, but will pick up thereafter.

That upturn in growth is underpinned by a judgement that the Brexit uncertainties facing businesses and households will decline gradually over the forecast period.

The MPC's standard practice is to condition its projections on government policy. Accordingly, our November projections are conditioned on an orderly transition to a deep free trade agreement consistent with the aims of the Political Declaration between the UK and the EU.

Although the details of that new trading relationship are still to be determined, the Withdrawal Agreement and a flexible extension to 31 January 2020 have probably reduced some of the Brexit uncertainties facing businesses and households, not least by lowering the perceived risks of No Deal significantly.

The fall in the perceived likelihood of a no-deal Brexit has also led to an appreciation of the sterling exchange rate, which has risen by around 4% over the past three months.

In the MPC's projections, the assumed reduction in Brexit-related uncertainties supports activity. In particular, four-quarter business investment growth picks up materially, from current negative rates to around 4½% by the end of the forecast – the fastest pace since the referendum – recouping around one third of the estimated investment shortfall since that vote. Household consumption rises broadly in line with real income growth over the forecast period as a whole, picking up from 1% currently to 1.5% in 2020 and 2% by 2022.

Demand is also supported by the gradual recovery in global growth, and a boost from UK fiscal policy reflecting the planned increase in spending announced by the Chancellor in his 2019 Spending Round.

Note that these projections are conditioned on the current market path for interest rates, which is consistent with Bank Rate being below its current level through 2022.

The extent of the pickup in UK growth is likely to be limited by continued weakness in growth in the supply capacity of the economy. Potential supply growth is projected to remain subdued relative to historical rates, averaging around 1¼% over the forecast period. That reflects a continuation of the post-crisis trend, as well as the impact of the UK transitioning to its new trading relationship with the EU.

Consistent with the provisions of the Withdrawal Agreement, the MPC's latest projections are now conditioned on the assumption that a greater proportion of the adjustment to the UK's new trading arrangements with the EU take place within the three-year forecast period, whereas previously, the MPC's projections have been conditioned on a stylised assumption of a smooth transition to an average of possible end-states, with the adjustment taking place gradually over many years.

Overall, given support from lower uncertainty, easier fiscal policy and stronger external demand, UK growth is projected to pick up from around 1% this year to 1.6% in 2020, 1.8% in 2021 and 2.1% in 2022. In the Committee's projections, excess demand emerges in 2021 and builds over the remainder of the forecast period, reaching a sizable 1¼% of potential GDP by the end.

The MPC judges that the risks around its projections for potential supply growth – and therefore GDP growth – are skewed to the downside in the second and third years of the forecast, reflecting the uncertainty around the exact nature of the FTA with the EU and the transition to it.

Inflation has been close to target recently. It is expected to decline to around 1¼% by the spring owing largely to the temporary effect of falls in regulated energy and water prices. While unit labour costs have been growing above target-consistent rates and core services inflation has begun to increase somewhat, employment growth has slowed and pay growth is likely to fall back in the near term.

In the second half of the MPC's forecast, however, as a significant margin of excess demand emerges, domestic inflationary pressures are expected to build. Conditioned on current market yields, CPI inflation is projected to rise to 2% in the second year of the MPC's forecast, and slightly above that towards the end of the forecast.

Policy

Let me return to the bigger picture.

For most of the period following the EU referendum, the degree of slack in the UK economy has been falling and global growth has been relatively strong. Recently, however, Brexit uncertainties and slower global growth have led to the re-emergence of a small margin of excess supply.

In the MPC's projections, we expect both trends to reverse. However, for now this is an expectation not a certainty.

If global growth fails to stabilise or if Brexit uncertainties remain entrenched, monetary policy may need to reinforce the expected recovery in UK GDP growth and inflation. Further ahead, provided these risks do not materialise and the economy recovers broadly in line with the MPC's latest projections, some modest tightening of policy, at a gradual pace and to a limited extent, may be needed to maintain inflation sustainably at the target.

At this meeting, the MPC judged that the current stance of monetary policy is appropriate.

However events unfold, it should not come as news that the MPC will set monetary policy consistent with a sustainable return of inflation to its 2% target.