**MONETARY POLICY REPORT PRESS CONFERENCE**

Thursday 5 August 2021

Opening Remarks by Andrew Bailey, Governor

Hello, this is Andrew Bailey.

Welcome to this presentation of the Bank's August Monetary Policy Report.

**The economic outlook**

In some ways it is remarkable how little headline news there has been on activity in the economy since the May *Monetary Policy Report*. UK GDP in Q2 is expected to have risen slightly faster than expected, offset by slowing momentum in Q3, as suggested by higher-frequency indicators of card spending, consumer confidence and mobility, which have either levelled off or fallen slightly in recent weeks.

As a result, UK GDP is still expected to grow by 7¼% this year, with the economy recovering to its end 2019 level towards the end of the year. Thereafter, growth is forecast to be 6% next year, and then reverts to a trend rate of around 1½% in 2023.

In the labour market, we now expect the unemployment rate to be around a quarter of a percentage point lower in 2021 and 2022, declining to a level of 4¼% in 2022. This means that the profile for unemployment now looks very different to that envisaged last year, with no spike up as support measures come to an end. This points to the success of economic policy measures in avoiding a marked rise in unemployment in the face of such a large downturn in economic activity.

That said, the number of people unemployed is around a quarter of a million higher than prior to the pandemic. Just over one million people were still on the furlough scheme in mid to late July (either full or part-time), which stops at the end of September. And there were just under three quarters of a million more people counted as inactive in the labour market in the three months to May, of whom half were an addition to the numbers in full-time education. In all, that's around two million people, or 6% of the labour force.

The labour market challenge is now different, namely there is growing evidence of higher job vacancies and associated labour market tightness. The challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs. This is a crucial challenge.

Many adjustments are required to assess properly the pattern of pay growth during the Covid period, to deal with both base and compositional effects. Our assessment is that after making those adjustments, and despite the higher numbers in unemployment and the furlough scheme, pay growth appears to have returned to near pre-Covid levels. This may partly reflect frictions in the labour market.

The most substantial news since May has been in inflation – news which is marked by historical standards. We now expect inflation to peak at 4% in Q4 of this year and Q1 of next year. It then falls back to around 2½% at the end of 2022, returning to target in the second half of 2023.

More of the increase in inflation has come in prices of traded goods, reflecting a number of developments: annual base effects, most notably in oil prices, a global upturn in the prices of basic commodities, and evidence of supply bottlenecks, for instance in shipping and shortages of some key goods such as semiconductors.  This has been emphasised by the Bank's Agents, and in my meetings with firms around the country.

The recovery is also unbalanced in terms of the mix of aggregate demand, weighted towards goods and not services, reflecting the impact of Covid restrictions. This has tended to exacerbate the frictions in global supply chains.

A key question for the MPC is whether these pressures will be temporary, and thus avoid pressure on so-called second round effects, particularly through wage setting. Our view is that the pressures will reduce as demand continues to switch back towards services, supply bottlenecks are overcome and commodity prices stabilise.

**MPC's policy decision and guidance**

Turning to the immediate policy decision and the MPC's guidance.

The MPC has had policy guidance in place specifying that it does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably. As set out in the Minutes, at this meeting there were different views on the extent to which the conditions of the MPC's guidance had been met, though much less so on what should follow from that conclusion in terms of policy action.

All members agree that in judging the appropriate stance of monetary policy, the Committee will, as always, focus on the medium-term prospects for inflation, including medium-term inflation expectations, rather than factors that are likely to be transient. In particular, the Committee will not put undue weight on capacity pressures that are frictional in nature and likely to be temporary.

As I have outlined, in the MPC's central projections the economy experiences a temporary period of strong GDP growth and above-target CPI inflation, after which growth and inflation fall back, with inflation close to the target two and three years ahead.

The Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures.  In addition, there remain two-sided risks around the central path for inflation in the medium term. Risk management considerations also continue to have some force.

At this meeting, the Committee judged that the existing stance of monetary policy remained appropriate.

Should the economy evolve broadly in line with the central projections in the August *Monetary Policy Report*, some modest tightening of monetary policy over the forecast period is likely to be necessary to be consistent with meeting the inflation target sustainably in the medium term.

**Review of the mix of monetary policy tools to deliver tighter policy**

The MPC has recently reviewed its strategy for the mix of policy instruments to deliver tighter monetary policy, when the economic circumstances warrant it.

In today's *Report* we have provided very clear guidance about how the MPC intends to reduce the stock of purchased assets in the future.

Since the financial crisis, many central banks have set their policy rates at low levels and used asset purchase programmes to support economic activity and meet their inflation targets.

At some point, the stance of UK monetary policy may need to tighten to achieve the 2% inflation target. The MPC has a number of tools to do that and, as set out in the box in today's *Report,* a range of factors influence the MPC's strategy for the mix of its monetary policy tools.

The Committee's preference is to use Bank Rate as its active instrument when adjusting the stance of monetary policy in most circumstances. The MPC has greater certainty around how changes in Bank Rate affect the economy compared with its other policy tools.

There is uncertainty about the impact of reducing the stock of purchased assets, and thus reserves held by banks with the Bank of England, on monetary conditions, but the MPC judges that, when conducted in a gradual and predictable manner and when markets are functioning normally, it is likely to be smaller than that of asset purchases. The judgement about when and how it is appropriate to begin the reduction of the stock of purchased assets is affected by its expected impact. It is likely that the MPC will judge it appropriate to begin to reduce the stock of purchased assets at a time when markets are functioning normally.

The MPC also judges that there are benefits to reducing the stock of purchased assets by initially stopping reinvestment in maturing assets that the Bank's Asset Purchase Facility already holds. This would have the benefit of providing a predictable and gradual path for the reduction in the stock.

Weighing all the factors together, the MPC intends to begin to reduce the stock of purchased assets, by ceasing to reinvest maturing UK government bonds, when Bank Rate has risen to 0.5% and if appropriate given the economic circumstances. That level of Bank Rate is lower than the MPC's previous assessment of the threshold for reducing the stock of purchased assets, which was previously 1.5%. In part that reflects the MPC's judgement that setting a negative Bank Rate is now part of its monetary policy toolkit, as well as its view that the impact of reducing the stock of purchased assets on monetary conditions is likely to be smaller than that of asset purchases on average over the past.

The MPC envisages beginning the process of actively selling assets later, and will consider it only once Bank Rate has risen to at least 1%, depending on economic circumstances at the time. Any asset sales will be conducted in a predictable manner over a period of time so as not to disrupt the functioning of financial markets.

The MPC will of course monitor the impact of the reduction in the stock of purchased assets, and may amend or reverse the process if needed to meet its 2% inflation target. Decisions on Bank Rate will be based on the economic circumstances at the time, and will take into account the impact of the intended profile for the stock of purchased assets on overall monetary conditions. While the MPC will monitor the reduction in the stock of purchased assets on a continual basis, it also intends to review its parameters no later than two years after the process begins. In conclusion, I should emphasise that the future steady state stock of reserves held by banks with the Bank of England will be larger than that held before the financial crisis and the introduction of asset purchases by the Bank.

**Conclusion**

To conclude on the current stance of monetary policy. The recovery will be bumpy given the nature and severity of the shock. The MPC takes the risk of persistently higher inflation very seriously.

The MPC sets monetary policy to meet the inflation target, and in a way that helps to sustain growth and employment, which we state in the opening sentence of our Reports. Our remit makes clear that it is appropriate to focus on inflation in the medium term. The MPC's view is that there are good reasons to suggest that above-target inflation will be temporary. But if this outlook appears to be in jeopardy, the MPC will not hesitate to act.

Thank you.