MONETARY POLICY REPORT PRESS CONFERENCE

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Opening Remarks by Andrew Bailey, Governor

Can I add a welcome from me to this presentation of the February 2022 *Monetary Policy Report*.

The economic outlook

Let me start by talking about developments since November and the current economic outlook.

Global and UK activity continued to recover in the final quarter of 2021, returning to their pre-Covid-19 levels towards the end of the year. While the emergence of the Omicron variant is expected to have depressed UK activity somewhat in December and January, its economic impact is likely to be limited and of short duration.

But economic growth is restrained by the sharp rise in global energy and tradable goods prices. As this *Monetary Policy Report* went to press, sterling oil prices were almost 90% above their levels at the end of 2020. UK wholesale gas prices were almost 400% higher. Wholesale electricity prices had risen by more than 300%. The UK is a net importer of energy and tradable goods, and the rise in global prices will inevitably both put upward pressure on inflation and weigh on UK real income and spending. Beyond the near term, and conditioned on a market-implied path for Bank Rate that rises to around 1½% by the middle of 2023, UK GDP growth is expected to slow to subdued rates. A small margin of spare capacity is likely to emerge later this year and to build over the forecast period.

In the labour market, unemployment has continued to fall, despite the closure of the furlough scheme. According to the Labour Force Survey, the unemployment rate reached 4.1% in the three months to November. Demand for workers remains robust, with job churn elevated and the number of vacancies at a record high. Unemployment is projected to fall a little further over the coming months, before rising again owing to the impact of higher global energy and tradable goods prices on domestic demand. Reflecting the tight labour market, pay growth is somewhat above pre-pandemic rates at around 4%, and respondents to the Bank Agents' annual pay survey expect pay settlements to increase this year. In the Monetary Policy Committee's central projection, underlying pay growth is expected to rise to around 4¾% over the coming year, before falling to around 2½% over the medium term as labour market conditions ease.

Turning to inflation, UK consumer price inflation rose to 5.4% in December, well above its 2% target and almost 1 percentage point higher than expected at the time of the November *Monetary Policy Report*. Most of the overshoot in inflation, relative to the target, continues to reflect the more general rise in the price of globally traded goods. Higher energy prices explain nearly 1 percentage point of the rise in inflation since September. But rising domestic cost pressures, driven by a tight labour market, have also added to the upward pressure on consumer prices, albeit to a lesser extent. Core inflation – which strips out energy and other volatile items – picked up to 4.2% in December.

Inflation is expected to increase further in the coming months, peaking at around 7¼% in April when higher utility price caps are due to be implemented. In the central projection, the upward pressure on CPI inflation dissipates over time, however, as global energy prices stop rising and global supply constraints stabilise, while domestic cost pressures ease with demand weakening. The widening degree of spare capacity adds further to the downward pressure on inflation in the second half of the forecast. Conditional on the market-implied path for Bank Rate, consumer price inflation is projected to fall to a little above the 2% target in two years' time and below the target by a greater margin in three years.

In line with the usual convention, the Committee's forecast is conditioned on announced Government policy. And I should note that the Committee's forecast was closed before Ofgem's announcement on the level of the energy price cap and the Government's announcement of its policy response this morning. So the impact of these announcements is not included in the projection presented in this *Monetary Policy Report*. It is unlikely, however, that the policies will have a material impact on consumer price inflation beyond the second year of the forecast.

Risks around the outlook

However, the degree of uncertainty around the outlook remains unusually high.

Looking over the near term, upside risks to inflation are in full focus. In the Monetary Policy Committee's central projection, wage growth moderates as domestic demand weakens owing to the squeeze in real incomes from higher energy and tradable goods prices. Over the past few months, however, indicators of short-term inflation expectations have risen as inflation itself has picked up. The Bank Agents' survey captures a pick-up in expected pay settlements driven by higher consumer price inflation in addition to labour market tightness. Some firms report that they have started passing on higher labour costs to consumer prices. If these effects prove stronger or more persistent

that than assumed in the central projection, inflation could rise further. The MPC will continue to monitor indicators of expectations, and their impact, very closely.

As inflation comes down over the medium term, however, downside risks come into sharper focus. The Committee's forecast is conditioned on paths for oil, gas and electricity prices that follow their respective futures curves for the first six months, and beyond that – given the inherent unpredictability of these prices – remain constant. Given the shape of those futures curves, this assumption implies that, beyond that six-month horizon, the assumed paths of wholesale energy prices remain a long way above the levels that markets expect currently expect. If energy prices were to fall back to the levels implied by futures curves, the degree of excess supply and unemployment would be around ½ percentage point lower by the end of the forecast period. CPI inflation would fall towards target more rapidly and, conditional on the current market-implied path for Bank Rate, would be around ¾ percentage points below the target in two and three years' time.

The monetary policy decision

I will now turn to the immediate monetary policy decision.

The Monetary Policy Committee's Remit is clear that the inflation target applies at all times, reflecting the primacy of monetary policy's price stability objective. The Remit also recognises that there will be occasions when inflation departs from the target as a result of shocks and disturbances. In the recent unprecedented circumstances, the economy has been subject to very large and repeated shocks. The continued sharp rises in global energy and tradable goods prices will necessarily both put upward pressure on inflation and weigh on UK real aggregate income and spending. Monetary policy is unable to prevent this. The role of monetary policy is to ensure that, as the economy adapts to this shock to real incomes, it does so in a way that is consistent with consumer price inflation returning sustainably to the 2% target in the medium term, while minimising undesirable volatility in output.

Given the current tightness of the labour market and continuing signs of greater persistence in domestic cost and price pressures, the Committee judges that an increase in Bank Rate of 0.25 percentage points is warranted at this meeting.

Consistent with the MPC's existing guidance from the August 2021 *Monetary Policy Report*, the Committee agreed at this meeting that the Bank of England should cease to reinvest maturities falling due from its stock of UK government bond purchases. The Committee further agreed that the

Bank of England should start to unwind its stock of sterling non-financial investment-grade corporate bonds.

Let me finish with some thoughts on the future. This is not a standard demand-driven rise in Bank Rate. The predominant cause of higher inflation is an extreme example of what economists describe as a terms-of-trade shock. Import prices – in particular those of energy and traded goods – have risen very significantly. This raises the cost of living for all of us and reduces real national income. We have not raised interest rates today because the economy is roaring away. The economy is only now back to the size it was immediately before the pandemic, a couple of years ago. An increase in Bank Rate is necessary because it is unlikely that inflation will return to target without it. We face the risk that some of the higher imported inflation could become engrained within the domestic economy, leading to a longer period of high inflation. Given the uncertainties, however, it should be no surprise that the exact size of the response was a close call in the Monetary Policy Committee.

We should keep things in perspective. Today we have increased Bank Rate by 25 basis points to 0.5%. That is a change that will be felt by households and businesses around the UK. But rates nevertheless remain very low by historical standards.

The extent of any further tightening in monetary policy will depend on the medium-term prospects for inflation. The MPC judges that, if the economy develops broadly in line with the February *Report* central projections, some further modest tightening in monetary policy is likely to be appropriate in the coming months. It would be a mistake to extrapolate simplistically from what we have done today and assume that rates are now on an inevitable long march upwards. The pace and extent of any further monetary tightening will, as always, depend on how the economy evolves and on a number of developments which are highly uncertain. We face a trade-off between strong inflation and weakening growth. For example, domestic wage and cost pressures could continue to build and the increase in imported costs may not ease off as expected. Conversely, as illustrated in an alternative scenario in the *Monetary Policy Report*, developments in wholesale gas prices could cause inflation to fall below target in two and three years' time. There is much uncertainty. The Monetary Policy Committee will, it scarcely needs to be said, remain very vigilant.

With that, Ben, Dave and I will be happy to take your questions.