



BANK OF ENGLAND

Minutes of the Monetary Policy Committee meeting 8 and 9 April 2015

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These are the minutes of the Monetary Policy Committee meeting held on 8 and 9 April 2015.

They are also available on the Internet

<http://www.bankofengland.co.uk/publications/minutes/Pages/mpc/pdf/2015/apr.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 20 May 2015.

Minutes of the Monetary Policy Committee meeting held on 8 and 9 April 2015

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.

Financial markets

2 The commencement of the ECB's Public Sector Purchase Programme had been a significant event in financial markets during the month, although asset prices had also reacted to a range of domestic and overseas data and policy announcements.

3 Market contacts indicated that many were still digesting the details of the ECB's programme that had been announced on 5 March. In particular, contacts suggested that the Governing Council's decision not to purchase debt at yields below the ECB's deposit rate would skew purchases more towards longer-maturity debt than initially expected.

4 Long-term interest rates had fallen in a number of euro-area countries, with yields on French and German ten-year government debt down by around 20 basis points. Italian government yields were below those on equivalent UK gilts. Yields on Greek government debt had risen, however, reflecting uncertainty over the funding position of the Greek government. Long-term interest rates had fallen in the United States and United Kingdom by around 25 and 30 basis points respectively; it was possible that these falls in part reflected the impact of the ECB's purchases as sellers sought to rebalance their portfolios.

5 Shorter-term interest rates had also generally declined internationally, with a range of factors contributing, including the FOMC's latest forecasts and policy statement. OIS rates, 12-months forward, had fallen by around 15 basis points in the United Kingdom and the United States, and by around 5 basis points in the euro area. These rates suggested that an increase in Bank Rate to 0.75% was not fully priced in until September 2016, some time later than had been the case at the time of the February *Inflation Report*. The expected pace of tightening thereafter was exceptionally slow, at around 3 basis points per quarter; the comparable figure in the United States was 15 basis points per quarter. Furthermore, analysis of options prices suggested that market-implied expectations of the single most likely path for Bank Rate over the next few years lay below these mean expectations.

6 The euro had appreciated against the dollar over the month, having reached a twelve-year low in mid-March. This appreciation might have reflected some unwinding of the initial impact of the ECB's looser policy stance, but it was also consistent with greater weight being placed on economic data releases, which had generally surprised to the upside in the euro area and to the downside in the United States. The sterling effective exchange rate index had fallen by just over 1% on the month, though it remained 15% higher than its trough in March 2013. Measures of volatility implied by the prices of options on sterling had also increased, perhaps as market participants began to factor in the chances of a period of uncertainty following the forthcoming general election. Options prices suggested greater weight was being put on a further depreciation

of sterling than on an appreciation. It was not possible, however, precisely to disentangle the factors driving these exchange rate movements.

7 In nominal terms, equity prices in the United Kingdom, the United States and the euro area had all reached post-crisis highs during the first half of March, though they had since fallen back a little. The FTSE All-Share index had ended the month little changed from the Committee's previous meeting. Over the period since mid-2014, shares in companies with exposures predominantly to the advanced economies had outperformed those with high exposure to emerging markets.

The international economy

8 Over the month there had been continuing signs of momentum in euro-area activity, offset by surprising weakness in US data and a further softening in indicators of the Chinese economy and some other emerging markets.

9 In the euro area, indicators had suggested a strengthening economy. The area-wide composite Purchasing Managers' Index had increased by 0.7 points to 54.0 in March, the highest for almost a year, with indices in Spain and Ireland close to pre-crisis highs. The German IFO index had recorded its fifth successive monthly increase. Bank staff expected growth across the area as a whole of 0.4% in Q1 and around 0.5% in Q2, slightly stronger than anticipated at the time of the February *Inflation Report*. Movements in asset prices suggested that investors believed that the impact of the ECB's asset purchase programme could be larger than initially anticipated. During the month, ECB staff had raised their forecast of euro-area GDP growth in 2015 to 1.5%.

10 Although there had been a slight moderation in February's retail sales figures, recent months had seen a pickup in measures of euro-area household spending. The improvement had been most marked in Germany, where annual growth in retail sales had reached a record high in December. A range of factors had probably contributed. The one-off impact of the fall in oil prices and some modest growth in employment were leading to rising real income growth. Credit conditions had improved, with bank lending rates having fallen by almost 100 basis points in the periphery economies, and by 50 basis points in the core, since the middle of 2014. And consumer confidence, as measured by the European Commission survey, had picked up sharply to its highest level since 2007. It was likely that some of the improvement in confidence and credit conditions had come as a consequence of the ECB's purchase programme.

11 At the same time, there remained significant short and long-term risks in relation to Greece and its financing needs. Since the announcement on 20 February to extend the existing financial support programme by four months, deposit outflows from banks in Greece had fallen back from their very elevated levels. Despite this improvement, uncertainties about the Greek government's funding position had re-emerged more recently. Deterioration in risk sentiment towards Greece had not so far spilled over to other euro-area countries.

12 News on activity in the rest of the world had on balance been disappointing. In the United States, a number of indicators had suggested a sharp slowing in growth in the first quarter. Capital goods orders had

fallen by 1.5% in February and exports had fallen by 1.6%. There had also been weakness in household spending, with retail sales falling by 0.6%, light vehicle sales by 2.6% and real consumption spending by 0.1%. Productivity growth remained disappointing. In addition there had been an unexpected slowdown in the pace of employment growth, with non-farm payrolls rising by only 126,000 in March, the smallest increase for over a year. Bank staff had revised down their expectation for GDP growth in the first quarter to 0.2%, from 0.6% at the time of the February *Report*.

13 Various temporary factors could have contributed to this weakness: severe winter weather in the North East was likely to have dampened activity there, and an extended West Coast port strike would have disrupted trade flows. Nonetheless, it was puzzling that, in contrast to the euro area, consumption growth might have weakened at a time when households were receiving a boost to real incomes from lower oil prices and the rising dollar. Although this recent weakness in US data presented risks to the US outlook, there was little evidence so far that the slowdown in growth would be more than short-lived.

14 A range of indicators of Chinese activity had also weakened. Although the variation in the timing of the Lunar New Year made seasonal adjustment difficult, it was likely that GDP growth had slowed in Q1 from the quarterly rates of around 1¼% that had been recorded during 2014. A lower target for growth of around 7% had been set for 2015 at the National People's Congress. Comments from the authorities suggested that they were ready to introduce stimulus measures should growth begin to fall short of this target. A number of other emerging markets were also experiencing slowing growth and, in the case of Russia, outright contraction.

15 Brent crude oil prices had fallen by 5% on the month in US dollar terms, with both the spot price and the futures curve returning close to those that had prevailed at the time of the February *Inflation Report*. It was possible to identify some downside risks in the short term. Oil inventories in the OECD remained unusually high for the time of year, meaning that the normal seasonal reduction in demand following the northern hemisphere winter might put more downward pressure on spot prices. The prospect of more oil coming onto the market from Iran, should an agreement be reached on its nuclear programme, could also weigh on prices.

Money, credit, demand and output

16 There had been little news in the domestic activity data, such that growth in the first half of the year was still expected to be at or around average historical rates. The outlook for both output and expenditure remained broadly similar to that underlying the February *Inflation Report*.

17 GDP growth in Q4 had been revised up slightly to 0.6%, reflecting a stronger estimate of services output. Growth for calendar year 2014 had also been revised up, by 0.2 percentage points, to 2.8%. In the latest vintage of data, it appeared that there had been a gentle slowing in the pace of activity through the year, with average quarterly growth of 0.9% in the first half of 2014 and 0.6% in the second half. This was broadly in line with the message from business surveys and other indicators.

18 Official data on output in January had been weaker than Bank staff had expected, with production output falling by 0.1%, services by 0.2%, and construction by 2.6%. In line with the usual pre-release arrangements,

an estimate of growth of 0.1% in the Index of Production for February had been provided to the Committee via the Governor, also a little weaker than expected. These sectoral output data were volatile and susceptible to revision, however, and the output surveys had generally been more upbeat. Both the BCC and CBI surveys had suggested that growth in Q1 had remained solid and the composite Markit/CIPS output and expectations series had both risen sharply in March.

19 Although consumption growth had been unexpectedly weak in Q4, indicators of household spending in the first quarter had been healthy. The GfK measure of consumer confidence had risen further in March and annual retail sales growth had been in excess of 5% in February. This strength in retail spending had been broadly based and was not surprising given the one-off boost to real incomes from lower oil prices. Bank staff expected growth in household consumption of 0.8% in Q1.

20 Business investment data for the second half of 2014 had been revised upwards. Estimates no longer implied a contraction in Q3 and the fall in Q4 was also more moderate than first reported. Surveys of investment intentions continued to be more upbeat, although those for the manufacturing sector had weakened in recent quarters. Contacts of the Bank's Agents, in line with the view of the BCC, indicated that uncertainty around the forthcoming election had had little appreciable impact on investment plans overall.

21 Housing investment in the latest vintage of data had fallen by 1.1% in Q4, weaker than the 0.8% growth in the provisional estimate. There had been relatively little news in either household credit conditions or house prices. The number of mortgage approvals had picked up slightly, to almost 62,000 in February, but remained broadly unchanged from its level six months earlier. It was possible that regulatory changes over the previous year, in particular the Mortgage Market Review, had had a more durable effect on borrower and lender behaviour than had first been anticipated.

22 Export growth had been surprisingly strong in Q4, rising by 4.6%, and net trade had contributed 0.8 percentage points to GDP growth. The current account deficit had fallen to 5.6% of nominal GDP, from 6.1% in Q3. The data were volatile, however, and there was good reason for thinking this export strength was temporary. Indeed goods exports had fallen in February, according to an ONS pre-release estimate provided to the Committee. Survey indicators had also weakened, with the balance of companies reporting increased export deliveries in the BCC survey, for example, having fallen back from around +40 to +20 over the past year. The recent signs of improvement in the euro-area economy might provide some support, though it was possible that the strength of sterling would begin to weigh on export orders. In addition, there was little sign yet that the structural decline in exports of financial services following the financial crisis was being reversed to any material extent.

Supply, costs and prices

23 Twelve-month CPI inflation had fallen to zero in February from 0.3% in January, very slightly weaker than expected. In line with the usual pre-release arrangements, an advance estimate for CPI inflation of zero for March had been provided via the Governor to the MPC, ahead of publication. The Committee's remit would

again necessitate an exchange of letters between the Governor and the Chancellor of the Exchequer. Bank staff had made small downward revisions to their short-term inflation forecast in light of the reduction in excise duties announced in the Budget and the prospect of the strength of the sterling-euro exchange rate leading to lower food prices. It was probable that the twelve-month inflation rate would briefly turn slightly negative at some point in the coming months.

24 The fall in energy prices had been the largest single contributor to the declines in headline inflation in the United Kingdom and in many other countries since Summer 2014. Internationally, measures of core inflation that excluded food and energy prices had generally fallen by much less than headline inflation and had shown little or no correlation across countries. In the United Kingdom, a range of core inflation measures had declined by 0.5 percentage points or so over the previous year to around 1¼%. Much of this decline had been due to lower goods-price inflation and it was likely that the appreciation of sterling had been a factor: the decline in core goods inflation had been concentrated in the trade-intensive components. Indeed there was some evidence that pass-through of lower import prices might have been a little more rapid than the Committee had previously anticipated, in which case there might be less downward pressure to come from this source in future. Prices of imported consumer goods, which tended to be more sensitive to the sterling-US dollar exchange rate, had risen slightly.

25 Although measures of inflation expectations had fallen at all horizons since the end of 2013, there had been signs of stabilisation in some of the latest readings. The Deloitte CFO survey measure of companies' expectations two years ahead had fallen slightly this month, but households' longer-term inflation expectations had picked up slightly on both the Citigroup/YouGov and Barclays Basix measures. While they remained below series averages, the inflation rate expected by households remained above 2%. Taken together with indicators of household spending and confidence, it was unlikely that the low rate of actual inflation would lead households to delay any expenditure.

26 A key influence on inflation once the impact of lower oil prices began to fall out of the twelve-month calculation would be the behaviour of labour costs. Annual whole-economy regular pay growth on the AWE measure had fallen back to 1.6% in the three months to January and bonuses had been weak. Bank staff had revised down their expectation for annual total AWE growth in Q2 to 2.3%, from 2.6% at the time of the February *Inflation Report*. There was some evidence that this weakness in wage growth was shared by a number of other major advanced economies. Across the G7, wage inflation was below 2½% and it was difficult to account fully for it using past relationships between wage inflation, estimates of slack and productivity. This perhaps gave some weight to explanations that might be common across countries, such as a greater sensitivity of real wages to sluggish productivity, greater job insecurity moderating wage claims, or lower inflation expectations. In the United Kingdom, estimates implied that wage growth had also been depressed by a shift in the composition of employment growth towards individuals with lower educational attainment and in occupations and age cohorts that typically attracted lower pay levels. This effect was unlikely to persist. In any event, to the extent that such changes were mirrored in productivity, it was not clear that this would have material implications for inflationary pressure.

27 There had been little news in labour market quantities on the month: employment, unemployment, and inactivity rates had all been broadly in line with expectations from the February *Inflation Report* forecast. The claimant count had continued to decline by 0.1 percentage point per month and staff expected the LFS unemployment rate to fall to 5.4% in Q2.

28 Productivity had remained puzzlingly weak in recent quarters, with ONS data suggesting that output per hour had fallen by 1.4% between 2011 Q4 and 2014 Q4. High-productivity, capital-intensive sectors such as oil exploration continued to perform relatively poorly. The Committee would be taking stock of the outlook for productivity, capacity within firms and labour supply in the run-up to the May *Inflation Report*.

The immediate policy decision

29 The Committee set monetary policy to meet the 2% inflation target in the medium term, and in a way that helped to sustain growth and employment. The Committee had given guidance in its February 2014 *Inflation Report* on how it would seek to achieve the inflation target over the policy horizon. The central message of that guidance remained relevant: given the likely persistence of headwinds weighing on the economy, when Bank Rate did begin to rise, it was expected to do so more gradually than in previous cycles. Moreover, the persistence of those headwinds, together with the legacy of the financial crisis, meant that Bank Rate was expected to remain below average historical levels for some time to come. The actual path Bank Rate would follow over the next few years was uncertain, and would depend on economic circumstances. The Committee's guidance on the likely pace and extent of interest rate rises was an expectation, not a promise.

30 There had been little material news about the pace or composition of domestic activity, which still looked to be broadly in line with the February *Inflation Report* outlook. Indicators of household spending had firmed slightly, although the housing market remained flat, and upward revisions to business investment had brought the latest vintage of data more into line with the surveys of investment intentions. Those surveys remained consistent with relatively strong growth of business investment. The recent strength of export growth was unlikely to persist, however, and there were some signs that the appreciation of sterling might be weighing on export orders.

31 Developments overseas had been more significant. Although it was too early to be confident, a succession of firmer data suggested that growth in the euro-area economy was picking up, supported by a confluence of factors – improving credit conditions, a recovery in confidence, a lower oil price, accommodative monetary policy and a weaker currency. If stronger growth in the euro area was sustained, this would be beneficial for the UK economy, even allowing for any influence the ECB's asset purchase programme was having on the configuration of exchange rates. The sudden deceleration in US activity was surprising, particularly at a time when, as in the euro area and in the United Kingdom, consumers were benefitting from lower oil prices. There was a good chance that this weaker growth would prove temporary, although the continuing weakness of productivity growth was a concern for the longer term. For some members the recovery in the euro area was the most significant development on the month; for others, taking account of the slowing in US and Chinese activity, news from the global economy was broadly neutral. There were still risks from a

number of sources in advanced and emerging economies, however, including any disorderly outcome from a failure to reach agreement on a new Greek programme.

32 Long-term interest rates had declined globally, in part reflecting asset purchases by the ECB and Bank of Japan, and equity prices had risen further in the euro area and the United Kingdom. UK short-term interest rates had fallen, and it was likely that a range of factors lay behind this. The path of Bank Rate expected by financial markets was now exceptionally flat.

33 CPI inflation had fallen to zero in February and had stayed there in March. This would necessitate a further letter from the Governor to the Chancellor of the Exchequer which would be published alongside the *May Inflation Report*. Inflation was likely to turn slightly negative briefly at some point in the coming months and to remain low for the rest of the year, probably requiring further letters over that period. The path of inflation thereafter would depend on the way in which wages and prices responded to developments in the real economy.

34 The pickup in output growth of the past two years had been largely met by a significant reduction in slack in the economy, particularly in the labour market, rather than by any increase in productivity. Although there was considerable uncertainty about the remaining extent of labour market slack, it was unlikely that activity growth could be maintained at its current pace for long, without generating greater inflation in wages and prices, in the absence of some material improvement in labour productivity.

35 Although there had been some stabilisation in indicators of inflation expectations and most long-term measures were judged to be broadly consistent with the 2% target, there was still a risk of weak price pressures persisting for longer than would be consistent with bringing inflation back to target within two years. Wages remained relatively weak, both in the United Kingdom and to a certain extent internationally, although it was unclear if the moderation in AWE growth in the three months to January would continue. A further pickup in wage inflation would be necessary for labour cost growth to be consistent with meeting the target in the medium term. Set against that, it was possible that the appreciation of sterling was feeding through more quickly into the CPI than expected. That could mean less downward pressure on prices to come and a faster pickup in inflation when the effects of recent falls in energy and food prices dropped out of the annual comparison.

36 The Committee would be taking stock of the current position and outlook for supply growth, and hence the prospects for wages and prices, in the forthcoming forecast round.

37 Against this backdrop, all Committee members agreed that it was appropriate to leave the stance of monetary policy unchanged at this meeting, although two members regarded this month's decision as finely balanced. There was a range of views over the most likely future path of Bank Rate, but all members agreed that it was more likely than not that Bank Rate would rise over the three-year forecast period.

38 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.

39 The following members of the Committee were present:

Mark Carney, Governor
Ben Broadbent, Deputy Governor responsible for monetary policy
Jon Cunliffe, Deputy Governor responsible for financial stability
Nemat Shafik, Deputy Governor responsible for markets and banking
Kristin Forbes
Andrew Haldane
Ian McCafferty
David Miles
Martin Weale

Dave Ramsden was present as the Treasury representative.

As permitted under the Bank of England Act 1998, as amended by the Financial Services Act 2012, Don Robert was also present as an observer in his role as a member of the Oversight Committee of Court.