



BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 9 December 2015

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These are the minutes of the Monetary Policy Committee meeting ending on 9 December 2015.

They are available at <http://www.bankofengland.co.uk/publications/minutes/Pages/mpc/pdf/2015/dec.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 minutes of the Committee meeting ending on 13 January 2016 will be published on 14 January 2016.

Monetary Policy Summary, December 2015

The Bank of England's Monetary Policy Committee (MPC) sets monetary policy in order to meet the 2% inflation target and in a way that helps to sustain growth and employment. At its meeting ending on 9 December 2015, the MPC voted by a majority of 8-1 to maintain Bank Rate at 0.5%. The Committee voted unanimously to maintain the stock of purchased assets financed by the issuance of central bank reserves at £375 billion.

Twelve-month CPI inflation remained at -0.1% in October, a little more than 2 percentage points below the inflation target. Inflation is expected to have been slightly positive in November, and is projected to rise further as some of the large falls in energy and food prices at the turn of last year drop out of the annual comparison. Nevertheless, core inflation remains subdued, and CPI inflation is expected to stay below 1% until the second half of next year.

The outlook for inflation reflects the balance between persistent drags from factors such as sterling and world export prices and prospective further increases in domestic cost growth. The MPC's objective is to return inflation to target sustainably; that is, without an overshoot once persistent disinflationary forces ultimately wane. Given these considerations, the MPC intends to set monetary policy to ensure that growth is sufficient to absorb remaining spare capacity in a manner that returns inflation to the target in around two years and keeps it there in the absence of further shocks.

The MPC set out its most recent detailed assessment of the economic outlook in the November *Inflation Report*. At that time, the Committee's central view was that if Bank Rate were to follow the gently rising path implied by the prevailing market yields then CPI inflation would exceed slightly the 2% target in two years and then rise further above it, reflecting modest excess demand. The MPC judged that the risks to this projection lay a little to the downside in the first two years, reflecting global factors.

There has not been much news on international activity relative to the forecasts contained in the November *Report*, with global growth having been stable at a rate well below historical averages. Prospects for domestic activity are also little changed on the month, with robust growth in private domestic spending continuing to counter-balance subdued demand growth overseas. Measures announced in the Government's Autumn Statement mean a slightly lower pace of deficit reduction in 2016 than was previously planned, although the fiscal consolidation will continue to weigh on growth over the forecast period.

The projected return of CPI inflation to the target depends on an increase in domestic cost growth sufficient to balance the drag on prices from very subdued global inflation and past increases in the value of sterling. Despite lower unemployment, nominal pay growth appears to have flattened off recently. This could reflect short-term volatility in the data. But earnings per worker could be affected by changes in the mix of employment, including a fall in average hours, in which case the impact on unit labour costs would be limited. It could also be that lower headline readings of inflation have acted to limit recent nominal pay growth, despite the tightening labour market. The balance between pay and productivity growth remains a key aspect of the MPC's policy assessment.

As in previous months, there is a range of views among MPC members about the balance of risks to inflation relative to the target in the medium term. At the Committee's meeting ending on 9 December, eight members judged it appropriate to leave the stance of monetary policy unchanged at present. Ian McCafferty preferred to increase Bank Rate by 25 basis points, given his view that the path of domestic costs was more likely to lead to inflation exceeding the target in the medium term than was embodied in the Committee's collective November projections.

All members agree that, given the likely persistence of the headwinds weighing on the economy, when Bank Rate does begin to rise, it is expected to do so more gradually and to a lower level than in recent cycles. This guidance is an expectation, not a promise. The actual path Bank Rate will follow over the next few years will depend on the economic circumstances.

Minutes of the Monetary Policy Committee meeting ending on 9 December 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 An important influence on financial markets over the period since the Committee's previous meeting had been overseas monetary policy: the anticipation and subsequent announcement of easing by the European Central Bank (ECB) on 3 December, and the increasing weight placed by market participants on a tightening by the Federal Open Market Committee (FOMC) at its meeting on 16 December. Against that backdrop, the Committee focussed its discussion on the recent asset price movements associated with this divergence in monetary policies.

3 There had been sharp movements in asset prices over the month in both the euro area and United States, particularly on days of central bank policy statements and other communications. Ahead of the ECB decision on 3 December, short rates had fallen in the euro area and the euro effective exchange rate index had depreciated. The ECB had announced that it would cut its deposit rate by 10 basis points to minus 30 basis points and maintain the rate of asset purchases while extending its Asset Purchase Programme by six months to March 2017. Both were somewhat smaller in scale than market participants had anticipated. This had led to a sizable reaction in financial markets, including a rise in short and long-term interest rates in the euro area, an appreciation of the euro effective exchange rate and a fall in euro-area equity prices. In the United States, short-term interest rates had risen and the dollar effective exchange rate had appreciated since the Committee's previous meeting. This had reflected the increasing probability market participants attached to the FOMC raising its target range for the federal funds rate later in December.

4 Short-term interest rates had fallen slightly in the United Kingdom following the publication of the *Inflation Report* and the MPC Minutes on 5 November. The three-year instantaneous forward rate stood at 1.3% compared with 1.5% at the time of the Committee's previous meeting, but was little changed from the fifteen-day average on which the November *Report* had been conditioned. As well as domestic developments, movements in short-term interest rates had reflected developments in both the United States and euro area. In particular, short rates had fallen ahead of the ECB decision on 3 December and then risen afterwards.

5 The sterling effective exchange rate had fallen by around 2% on the month, although it too was little changed from the time of the November *Report*. Sterling had depreciated following the ECB announcement. The FTSE All-Share index was down 3% compared with the Committee's previous meeting.

6 A rise in US official interest rates later this month would be the first change in seven years and the first increase since June 2006. It remained to be seen what impact, if any, such a rise might have on financial conditions, including in the United Kingdom. While an increase in the federal funds rate was widely anticipated,

expectations of communications about the future path of policy were more diffuse. The reaction to any announcement could therefore not be judged with any precision.

The international economy

7 The month's international data had generally been consistent with the projections that the Committee had made in the November *Inflation Report*. Global growth had stabilised, although at well below past average rates. There had been little evidence yet of weakness in emerging market economies spilling over into advanced economies to a greater degree than had been expected at the time of the November *Report*.

8 Growth in emerging market economies as a whole looked to have stabilised in Q3, but as financial conditions had tightened it was possible that activity could ease in the period ahead, as anticipated in the November *Report*. There had remained a substantial degree of variation across countries, however, with growth in some emerging market economies such as India notably firm in Q3, in contrast to the 1.7% fall in Brazilian GDP. There had been a pickup in world trade in the three months to October, following falls earlier in the year, suggesting that so far, at least, trade spill-overs from the turbulence in emerging markets had not worsened, and that the earlier weakness may have reflected movements in stock levels. Although the prices of oil and some other commodities had fallen markedly on the month, in large part that was thought likely to have reflected supply conditions rather than further negative news on global demand. The downside risks to growth in emerging market economies remained, however, with the risk of an acceleration of capital outflows in reaction to any increase in US interest rates.

9 In the euro area, the news had been mixed and the near-term outlook for activity had been little changed. Euro-area GDP growth was estimated to have been 0.3% in 2015 Q3, a little lower than Bank staff had expected. But indicators of economic activity in Q4 continued to point to growth of around 0.4%, with the composite output purchasing managers' index (PMI) rising by 0.3 points to 54.2 in November, driven by increases in Germany, Italy and Spain. To date, there had been little evidence that the terrorist attacks in Paris had had a material impact at the macroeconomic level. The flash estimate of twelve-month HICP inflation in November had been 0.1%, unchanged from October, but slightly lower than Bank staff had expected. Market-based measures had continued to suggest weak medium-term inflation expectations.

10 Against a backdrop of weakness in core inflation and the continuing challenges faced by some euro-area economies in reducing debt levels, a key question remained the extent to which the euro area was likely to be affected by the slowdown in growth in emerging economies. Exports to emerging economies made up a somewhat higher share of euro-area GDP than in the United States or United Kingdom. Set against that, support from monetary policy, including from the measures announced by the ECB at its December meeting, would underpin activity and inflation over time, supplementing the existing boost from the easing in credit conditions, lower energy prices and the past substantial depreciation of the euro effective exchange rate.

11 In the United States, GDP had risen by 0.5% in Q3, 0.1 percentage points higher than previously estimated. Indicators of activity in Q4 had been a little weaker, however, and Bank staff had revised down their

expectation for growth in Q4 to 0.4%. It had appeared likely that the drag from stockbuilding, which was lower in Q3 than expected, would extend into Q4, and consumption had increased by only 0.1% in October, despite an increase in real personal disposable income of 0.4%. In contrast, employment growth had remained very firm, with non-farm payrolls rising by a little over 200,000 in November and upward revisions to past employment gains. Inflation had remained weak, at 0.2% on both the headline CPI and PCE measures. Measures of core inflation had been unchanged in October, at 1.9% and 1.3% on the CPI and PCE measures respectively. It was noted that US fiscal policy was expected to ease next year.

Money, credit, demand and output

12 There had been little news during the month about the pace and composition of the UK expansion, with robust private domestic demand having continued to counter-balance subdued external demand. GDP was estimated to have grown by 0.5% in 2015 Q3, unchanged from the initial estimate. Bank staff continued to expect an upward revision over time to 0.6%. There had been little news in the output split, with robust services and energy output more than offsetting outright falls in the construction and manufacturing sectors. The estimated expenditure composition of growth had been broadly similar to that incorporated in the November *Inflation Report*. Private consumption growth had been firm, at 0.7%. Business investment growth was estimated to have been a little higher than expected at 2.2%, while housing investment had been notably weaker – although estimates of both were highly uncertain at that stage in the data cycle. Net trade was estimated to have reduced GDP growth by 1.5 percentage points in Q3, unwinding the similar-sized positive contribution in Q2. But the ONS had indicated that the pattern of trade growth was likely to be revised to a smoother profile in due course, as previously flagged concerns with the trade data were addressed.

13 Indicators of activity in Q4 had suggested that growth would be maintained at a pace similar to that in Q3. Industrial production had risen by 0.1% in October. The Markit/CIPS composite PMI for output had been flat in November, with falls in the manufacturing and construction indices offset by an increase in the services component. The CBI's latest quarterly survey of the service sector had suggested a slight weakening in the pace of growth, albeit at an above-average rate. The GfK/EC measure of consumer confidence had fallen a little in November, although a set of indicators had suggested some reversal of the increased uncertainty that had been evident since concerns rose over the summer about prospects for global growth. Early anecdotal reports had suggested that spending around the Black Friday period had been stronger than last year, but the extent to which such spending had simply been displaced from other periods remained to be seen.

14 The Government had published its joint Spending Review and Autumn Statement. That had left the previously projected path for government borrowing broadly unchanged: it had continued to suggest a gradual decline in public sector net borrowing from around 5% of GDP in 2014/15 to close to zero in 2018/19. Although the overall decline over the next three years was broadly unchanged, borrowing was now expected to be a little higher in the near term. Provisional analysis of this near-term increase in projected borrowing suggested a modest boost to GDP of around 0.2% in 2016, although the impact of changes in the stance of fiscal policy on economic activity, including via effective tax rates on incomes, was highly uncertain. Although changes in borrowing, and its composition between spending and taxation changes, would be important in determining the

impact of the consolidation on economic activity, a range of other factors would also be material, including the proportion of households that were credit constrained and the extent to which changes had been anticipated.

15 The Autumn Statement had contained a number of measures relating to housing. Several of these related to house building, and the Help to Buy: Equity Loan scheme had been extended. One notable change had been the announcement of a three percentage point increase in the rate of stamp duty payable on the purchase of additional properties costing more than £40,000, such as buy-to-let properties, from April 2016. The impact of that change would require further analysis, but it seemed likely that it would prompt some transactions to be brought forward ahead of the change, while dampening activity further ahead. Mortgage approvals for house purchase had changed little in October, at around 70,000. House price inflation had weakened a little, to 5.4% in the three months to November on an annualised basis according to the average of the lenders' indices.

16 Against the backdrop of the continuing fiscal consolidation, and in view of the likelihood of increases in interest rates over time, the Committee considered the resilience of household balance sheets. According to the survey conducted on behalf of the Bank by NMG Consulting during September (and therefore pre-dating the latest announcements), around two thirds of households had expected to be affected by further fiscal consolidation. Around 60% of respondents had expected Bank Rate to be higher than 0.5% by September 2016. Over the past year, the survey suggested that there had been a modest improvement in mortgagors' balance sheet positions. The proportions of households with high mortgage debt to income and debt servicing ratios had fallen, while both mortgagor and renter households had considered unsecured debt payments less of a burden than a year earlier. In part, that was likely to have reflected increased household incomes over that period. Higher interest rates would increase the financial pressure on some households, but given the modest improvement in household balance sheets over the past year, households had appeared a little better placed to cope with a possible rise in interest rates.

Supply, costs and prices

17 Twelve-month CPI inflation had remained at -0.1% in October, in line with Bank staff's expectation. At the component level there had been offsetting news in the volatile clothing and footwear and airfares components. Inflation was expected to have turned slightly positive in November and was projected thereafter to rise further as some of the large falls in energy and food prices at the turn of last year dropped out of the annual comparison. If the declines in the price of oil that had occurred in the days running up to the Committee's meeting were to persist, the expected path of CPI inflation in the spring would be slightly lower than at the time of the November *Inflation Report*. In any case, CPI inflation was expected to remain below 1% until the second half of next year. Core inflation had ticked up slightly in October but had remained subdued, with the average of a range of measures having risen to 1.1%, from 1.0% in September. And a survey conducted by the Bank's Agents had suggested that corporate pricing intentions had generally remained soft.

18 Whole economy average weekly earnings had grown by 3.0% in Q3 compared with a year earlier, 0.2 percentage points lower than expected at the time of the November *Report*. Private sector pay growth, which was arguably more directly relevant for CPI inflation, had been 3.4%, 0.3 percentage points below the

November forecast. That meant that pay growth had flattened off recently, a picture broadly corroborated by a range of survey measures. There had also been downside news on labour market quantities, with average hours worked some ½% lower than expected. This had meant that average hours had fallen by 1% since the start of the year. It also meant that although employment had been a little stronger than expected in Q3, and the unemployment rate a touch lower than forecast, total hours worked in Q3 had been 0.3% lower than had been expected in November. Given the GDP estimate for Q3, that implied a more favourable outturn for hourly productivity.

19 The Committee discussed what factors might account for the apparent flattening off in pay growth. Part of the explanation might lie in the fall in average hours. As a matter of arithmetic, average weekly earnings would fall alongside average hours if there had been no reduction in average pay per hour. Although the correlation between changes in average hours and changes in average weekly earnings was not high, this potential dynamic reinforced the importance of understanding and anticipating movements in average hours, and the Committee intended to revisit this issue in detail during the February 2016 forecast round. Another factor at play was so-called compositional effects. The apparent drag on annual pay growth from shifts in employment towards younger, less experienced workers had increased in Q3, to around one percentage point, reversing the shrinkage to around ½ a percentage point that had been recorded in Q2. This drag was likely to be transitory, but it was difficult to gauge for how long it would persist. To the extent that changes in hours and compositional shifts were reflected in productivity as well as pay, however, the implications for inflation were likely to be small. It was also noted that it was not possible to measure the impact of compositional changes on average weekly earnings with any great precision. A third potential factor behind weak pay growth was the low level of consumer price inflation seen during the course of the year, which might now be feeding more materially into pay negotiations. Weak inflation had been mentioned to the Bank's Agents more frequently in recent months as a factor holding down pay awards. In conclusion, although the flattening in pay growth had been unexpected, when taken alongside other developments it was less puzzling.

20 More relevant for inflation than average pay were measures of unit labour cost growth. The picture here was mixed, however. Estimated using national accounts data, unit labour cost growth in Q3 had been weaker than predicted at the time of the November *Report*. In contrast, unit wage costs measured using headline average weekly earnings had grown in line with the Committee's forecast, while using the regular pay component of average weekly earnings, unit wage cost growth had been a little stronger than expected in Q3. The outlook for pay and productivity remained central to the Committee's policy assessment.

The immediate policy decision

21 The Committee set monetary policy to meet the 2% target and in a way that helped sustain growth and employment. The MPC's objective was to return inflation to target sustainably; that is, without an overshoot once persistent disinflationary forces ultimately waned. Given these considerations, the MPC intended to set monetary policy to ensure that growth would be sufficient to absorb remaining spare capacity in a manner that returned inflation to the target in around two years and kept it there in the absence of further shocks.

22 There had not been much news on international activity relative to the forecasts contained in the November *Inflation Report*, with global growth having been stable at a rate well below historical averages. Tighter financial conditions could lead to a further weakening in emerging economies; but the spike in uncertainty that had been evident in financial markets during the summer had unwound. Although Q3 GDP growth in the euro area had been a touch disappointing, the recent PMIs had been more encouraging. In the United States, somewhat mixed news on activity had contrasted with a very firm employment report.

23 Prospects for private domestic activity had also appeared little changed on the month, with robust growth in private domestic spending having continued to act as a counter-weight to subdued demand growth overseas. Bank staff had continued to expect a similar pace of expansion of GDP in Q4 as had been seen in Q3. The measures announced in the Government's Autumn Statement might reduce the drag on demand in 2016 compared with the previous plans, but the full effects, particularly of measures relating to the housing market, would require more analysis to gauge. The Committee noted indications from the recent NMG survey that households' capacity to cope with higher interest rates had improved.

24 The more material news on the month had been in costs. The price of oil had fallen markedly again, increasing the likelihood that headline inflation rates would remain subdued, and nominal wage growth had levelled off.

25 There were a number of potential explanations for subdued nominal pay growth. The fall in average hours would tend arithmetically to reduce average weekly earnings, other things being equal, as well as reducing output per person. Also, although compositional effects in employment were difficult to estimate with precision, their apparent re-emergence in Q3 might imply that subdued wage growth had a productivity counterpart that was offsetting in unit wage costs. It was also possible that low inflation was itself acting to limit nominal wage growth. Some wage equations suggested that lagged inflation rates were an important determinant of pay growth; and some of the Agents' contacts had cited low inflation as having had a depressing influence on pay, acting against the upward pressure from recruitment difficulties. The Committee noted that this effect was likely to reverse in due course, however, as inflation increased.

26 The outlook for pay and productivity remained central to the Committee's policy assessment. There would need to be a sustained firming in domestic cost pressures, compared with their current rates, in order to return inflation to the 2% target in around two years' time.

27 Turning to the monetary policy stance, the Committee noted that while the ECB had recently announced further stimulatory measures, the probability attached by financial market participants to a tightening in US monetary policy at the FOMC's December meeting had risen to a high level. Meanwhile, market expectations for UK monetary policy were for a further period of unchanged interest rates. There was no mechanical link between UK policy and those of other central banks, and the UK policy stance would be determined ultimately by the inflation outlook here.

28 As in previous months, there was a range of views among Committee members about the outlook for activity and inflation, and therefore the balance of risks around the inflation target in the medium term. Eight members considered the current stance of monetary policy to be appropriate at this meeting. For one member,

the risks around domestic cost growth were to the upside, and were sufficient to justify an immediate increase in Bank Rate. As well as reducing the risk of inflation exceeding the target, this member believed that an immediate start to policy normalisation would facilitate a more gradual path for policy tightening over time, a desirable policy aim in itself.

29 All members agreed that the likely persistence of the headwinds restraining economic growth following the financial crisis meant that, when Bank Rate did begin to rise, it was expected to do so more gradually and to a lower level than in recent cycles. Such guidance, however, was an expectation and not a promise: the path that Bank Rate would actually follow over the next few years would depend on economic circumstances.

30 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, eight members of the Committee (the Governor, Ben Broadbent, Jon Cunliffe, Nemat Shafik, Kristin Forbes, Andrew Haldane, Gertjan Vlieghe and Martin Weale) voted in favour of the proposition. Ian McCafferty voted against the proposition, preferring to increase Bank Rate by 25 basis points.

Regarding the stock of purchased assets, the Committee voted unanimously in favour of the proposition.

31 Prior to its policy meeting, the MPC had been consulted ahead of the decisions by the Bank and HM Treasury to extend access to the Funding for Lending Scheme (FLS) until early 2018. The extension would provide participants with additional flexibility to draw unused drawing allowances earned for positive net lending, with funding remaining available to support further improvements in credit conditions for small and medium-sized enterprises (SMEs). The extension would continue the tapering of the scheme, while ensuring a continuation of the temporary support provided so as not to risk hindering the recovery in SME credit conditions. The tapering of allowances would result in a smooth withdrawal of this support and bring the drawdown window to a natural close after two years. The MPC had concluded that these changes would have no material impact on the stance of monetary policy.

32 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
Gertjan Vlieghe
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 on 3 December as an observer in his role as a member of the Oversight Committee of Court.