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# MINUTES OF THE MONETARY POLICY COMMITTEE MEETING 4 and 5 February 2015

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These are the minutes of the Monetary Policy Committee meeting held on 4 and 5 February 2015.

They are also available on the Internet

<http://www.bankofengland.co.uk/publications/minutes/Pages/mpc/pdf/2015/feb.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 4 and 5 March will be published on 18 March 2015.



## **MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 4 AND 5 FEBRUARY 2015**

1 Before turning to its immediate policy decision, and against the backdrop of its latest projections for output and inflation, the Committee discussed financial market developments; the international economy; money, credit, demand and output; and supply, costs and prices.

### **Financial markets**

2 There had been further increases in volatility on the month against the backdrop of the Greek elections, an escalation of the conflict in Ukraine and policy measures taken by central banks in several countries. The ECB had announced a programme of public and private sector asset purchases, the Swiss National Bank (SNB) had removed the ceiling on the value of the Swiss franc exchange rate, and a number of central banks had cut their policy rates or reserve requirements.

3 The ECB had announced that it would be purchasing €60 billion per month of sovereign, supranational and private sector debt until at least September 2016 in order to meet its inflation objective. The total quantity and time profile of purchases had been towards the upper end of market expectations, and initial analysis of asset price movements immediately following the announcement suggested that its impact had been significant.

4 Spreads between Greek and German government bonds had widened further following the results of the Greek general election. The ECB Governing Council had voted to remove a waiver on the use of Greek government bonds as collateral in its main refinancing operations. There had been only small changes in government bond spreads of other periphery economies.

5 The euro had continued to weaken relative to the US dollar and was 17% below its July level. The sterling effective exchange rate index had risen on the month by 2.6%, perhaps in part reflecting short-term rates of interest available in the United Kingdom higher than in many other advanced economies. There had been a sharp appreciation in the Swiss franc immediately

following the SNB's announcement on 15 January, but some of this had unwound and the franc had been more stable during the rest of the month.

6 Short-term interest rates in the United Kingdom had fallen a little on the month and, based on information from OIS rates, an increase in Bank Rate to 0.75% was fully priced in by June 2016. The expected pace of tightening thereafter had slowed further, with the implied level of Bank Rate at the end of 2017 below 1¼%.

7 Longer-term interest rates had also continued to fall. Ten-year benchmark gilt yields had fallen to a record low of 1.3%, nearly 80 basis points lower than at the time of the November *Inflation Report*, and the curve out to 50 years was below 2.2%. Ten-year forward rates had fallen in the United States, euro area and United Kingdom. To some extent, these declines represented the continuation of trends that were likely to have been driven by structural factors, such as longer-term growth and inflation expectations. It was also possible, however, that some of the most recent declines had been the result of increased expectations of central bank asset purchases in other countries, and the associated rebalancing of portfolios that such purchases were likely to bring about. It was notable that equity prices had generally continued to rise, with the Euro Stoxx in particular having increased by over 12% on the month.

8 Part of the falls in longer-term nominal interest rates in the major economies had reflected lower compensation for expected future inflation. The UK five-year RPI inflation break-even rate, five years forward, had fallen further and the fall this month had been bigger than recorded by the Citigroup/YouGov survey. These financial market and household measures of longer-term inflation expectations had fallen over the past year by 49 basis points and 55 basis points respectively. Nonetheless, this had brought RPI inflation break-even rates back only to levels seen on average in the decade prior to the financial crisis.

### **The international economy**

9 The source and impact of the fall in oil prices continued to be major factors in assessing the global outlook. External forecasters had generally revised up projections for growth in the main oil importing countries, while revising down forecasts for oil exporters. The IMF had also made

substantial downward revisions to its projections for a number of emerging market economies.

10 Brent crude oil prices had fallen further in the early part of the month, before stabilising at around \$45 per barrel, some 60% below their early-summer peaks. In the days leading up the Committee's meeting they had rebounded to over \$53 per barrel, however. Announcements of cuts to capital spending by a number of oil companies, early reports of mothballing of some oil rigs, together with revisions to oil production forecasts for 2015, had contributed to some of the bounce back. Other commodity prices had also fallen in the first half of the month, before recovering in the second half, although the magnitude of these moves had generally been much smaller than for oil.

11 Due in large part to the impact of lower oil prices, the flash estimate of euro-area inflation had shown a further fall in the headline measure, to -0.6% in January. Core inflation had dropped to 0.6% from 0.7%. Indicators of output in the euro area continued to point to growth of 0.2% in Q4 and 0.3% in Q1; the improvement in sentiment in Germany in particular had continued. There appeared to have been no immediate impact on measures of industrial or consumer confidence across the euro area as a whole in response to the uncertainty following the Greek election. Activity later in the year and into 2016 would be supported by lower oil prices and the loosening in monetary policy by the ECB.

12 GDP in the United States had risen by 0.7% in Q4, a little less than higher frequency indicators had suggested. Abstracting from volatile movements in government spending, net trade and stocks, private final domestic demand growth had continued to pick up and employment growth had remained firm. The Conference Board measure of consumer confidence had risen strongly in January.

13 Chinese GDP had risen by 7.4% in 2014, carrying on the gradual downward trend in the calendar-year growth rate. Growth was likely to slow further in 2015 as the economy continued to rebalance away from capital spending and towards consumption. There were some signs that property prices were stabilising in the larger cities, though the impact of the property slowdown was still being felt in a number of sectors.

## **Money, credit, demand and output**

14 As more data had become available, it was becoming a little more evident that growth in the United Kingdom had slowed somewhat at the end of 2014. The most high frequency indicators released since the beginning of the year had improved, however, perhaps as the impact of lower oil prices had begun to be felt.

15 GDP growth was estimated by the ONS to have moderated from 0.7% in 2014 Q3 to 0.5% in Q4, 0.1 percentage points weaker than Bank staff had anticipated immediately in advance of the data release. Service sector output had grown by 0.8%, the same rate as in Q3, while manufacturing output growth had slowed a little, from 0.3% to 0.1%. The reduction in GDP growth had been mostly accounted for by a fall in construction output of close to 2%, weaker than was implied by recent surveys. Bank staff expected GDP growth in the final vintage of data for Q4 to be revised up a little to 0.6%.

16 Recent survey indicators had suggested that the moderation in GDP growth at the end of 2014 might be short-lived. The composite CIPS output index had picked up in January, reversing most of the fall in December, and was a little above its historical average. The output balance in the CBI Industrial Trends Survey had been broadly unchanged in the three months to January, having fallen markedly in the previous quarter, and survey expectations pointed to positive growth. Overall, the surveys remained consistent with growth around its historical average and Bank staff continued to expect GDP growth in the final vintage of data to be 0.7% in 2015 Q1.

17 In the near term, a number of indicators were consistent with robust underlying consumption growth. Retail sales had risen by 2.3% in Q4, the fastest quarterly growth rate since 2002. The GfK measure of consumer confidence had picked up in January and remained at the upper end of its historical range, driven by improvements in households' confidence in their own financial position. This was likely to have been supported by several factors including the effects of lower energy prices, early signs of growth in real household incomes and further evidence of pass-through from lower market interest rates to mortgage rates. The average quoted rate on new two-year fixed rate mortgages at a 75 per cent loan-to-value ratio had fallen further in January, to 2%. While lower nominal interest rates would improve the cash flow of borrower households,

the effect on consumer spending might be tempered somewhat by falls in households' inflation expectations that meant that real interest rates on new loans had risen since the November *Inflation Report*.

18 There had been mixed signals from the housing market. Mortgage approvals for house purchase had risen slightly in December to a little over 60,000, the first increase for six months, and the average of the lenders' house price indices had grown by 1.1% in January, a much bigger rise than expected, although this had been driven by 2% growth in the more volatile Halifax index. In contrast to these positive signals, provisional data from the RICS survey for January had suggested a slight weakening in the housing market. The net balance of market practitioners expecting prices to increase over the next three months had fallen back from +14 in December to close to zero in January, its lowest level since January 2013.

19 Business investment, which had risen robustly since 2010, reflecting an improvement in demand and companies' credit conditions, was expected to continue to grow strongly and contribute to solid growth in private domestic demand. Despite weakening in the official data in Q3, indicators of business investment intentions had continued to hold up and remained above average levels. It was likely that investment intentions were supported by improving financial conditions, particularly in the corporate bond and equity markets. Yields on investment grade corporate bonds had fallen by around 20 basis points on the month and were around 80 basis points below their Q3 average.

20 There were downside risks to the positive outlook for business investment growth, however. Increased uncertainty about the global outlook might cause some businesses to delay capital investment. It was also possible that political uncertainty ahead of May's general election would have a similar impact, although there was no evidence to suggest that there had been an effect so far. More concretely, intelligence from the oil industry suggested that North Sea energy companies were likely to cut back their capital spending plans, partly as a result of the fall in oil prices. That was likely to exert a drag on overall investment growth in coming years, although it might be offset to some extent by a pickup in investment in other sectors, albeit with a longer lag, as the fall in oil prices improved the demand outlook and reduced production costs.

## Supply, costs and prices

21 At its previous meeting the Committee had been given access to an advance estimate of twelve-month CPI inflation of 0.5% for December 2014. The detailed data behind that number had been released during the month, with the make-up of the aggregate inflation rate broadly as Bank staff had expected. Over the past month, the largest utility companies had announced cuts in domestic gas prices, averaging 4½%, which would be implemented between January and May. This and, more significantly, the 13% decline in sterling oil prices that had occurred since the CPI data were collected in December, were likely to cause CPI inflation to fall to around zero in the February data and to remain close to that level for several months. It was more likely than not that CPI inflation would dip briefly below zero at some point in the first half of 2015.

22 Around two-thirds, or about one percentage point, of the deviation of CPI inflation from the 2% target in December related to unusually low contributions from movements in energy, food and other goods prices. The remaining one third, or around 0.5 percentage points, appeared to reflect more generalised subdued inflationary pressures that had resulted from weak growth in domestic costs, and particularly wages.

23 The direct energy component of the CPI had subtracted 0.5 percentage points from headline inflation in December, compared with an average positive contribution of 0.3 percentage points in the years leading up to the financial crisis. Food prices had fallen by 1.7% in the year to December having typically increased by almost 2% per year in the pre-crisis decade. And sterling's appreciation after mid-2013 had weakened the inflation rates of imported goods prices. In the absence of continued declines in commodity prices or a renewed appreciation of sterling, the influence of these factors on CPI inflation was likely to prove temporary. Indeed, the global price of oil had stabilised during the month and edged back upwards towards the end of it. Once the impact of these factors dropped out of the twelve-month CPI calculation towards the end of the year, the measured inflation rate was likely to rise fairly sharply. Where inflation would settle after that period of volatility in the near term would depend on how firms' labour costs evolved.

24 Private sector regular pay, on the AWE measure, was 2.2% higher in the three months to November compared with the same period a year earlier. By comparison with the previous three months, pay had increased at an annualised pace of over 4%. Although the three-month growth rate was expected to fall back in the data around the turn of the year, the pickup in pay growth had

been somewhat faster than had been anticipated at the time of the November *Inflation Report*. In combination with upward revisions to estimates of firms' non-wage labour costs in the latest National Accounts, this implied that unit labour costs would probably be more buoyant in the near term than assumed in the Committee's projections three months earlier.

25 In the Committee's latest February *Inflation Report* central projection, four-quarter whole-economy total pay growth was assumed to edge upwards to around 4% by the beginning of 2017. But there was a risk that wages would increase more rapidly than that. Information from a range of surveys suggested that the labour market had continued to tighten and that this was likely to put upward pressure on pay growth. Surveys of employment intentions had generally remained robust; unemployment had fallen back to 5.8% in November, while the more timely claimant count continued to fall and the number of job vacancies had continued to rise; the average number of hours worked per employee had risen; and business surveys typically implied that the intensity of factor utilisation was above normal levels. Moreover, the evidence suggested that over much of the past 18 months average pay growth had been dampened by a composition of employment gains that had been disproportionately skewed towards jobs attracting below-average wages, such as lower-skilled ones. By contrast, employment growth in 2014 Q3, the latest period for which detailed data were available, had been accounted for by an increase among high-skilled occupations and full-time workers. If this continued, measures of average pay growth were likely to pick up more rapidly than otherwise.

26 But it was also possible that wage growth would turn out weaker than assumed. There remained an unusually high proportion of individuals reporting that they were currently working part time but wanted to find full-time employment. For some Committee members, the possibility that the ready supply of labour was greater than had previously been assumed was a plausible explanation for why wage growth over the past 18 months or so had been somewhat weaker than would have been suggested by the average historical relationship between pay, productivity and the unemployment rate. Other members, however, thought it more plausible that it was simply taking longer than usual for a tightening labour market to feed through to increased pay growth, given the severity of the financial crisis and recession, and the degree of job insecurity and stress to corporate balance sheets that it had generated.



27 It was also possible that wage growth would be influenced by the weakness of headline CPI inflation. There was a chance that this would lead to lower pay deals than otherwise, especially if it were accompanied by a perception that inflation would be below the target not just in the near term, but in the medium term too. In a survey by the Bank's Agents, inflation expectations was the most cited factor likely to bear down on labour cost growth in 2015 compared to 2014.

### **The February 2015 growth and inflation projections**

28 The Committee's central view, on the assumption that Bank Rate followed a path implied by market interest rates and the stock of purchased assets stayed at £375 billion, was that four-quarter GDP growth was likely to settle a little below current rates of around 3% for much of the forecast period before easing back a little further to around its historical average rate. Over the forecast period, domestic demand growth was expected to be supported initially by lower energy and food prices and further out by higher productivity growth. Net exports were expected to detract from growth. The central outlook for GDP growth was a little stronger than that in November for much of the forecast period. That reflected the impact of lower oil prices on UK activity, as well as the lower implied path for Bank Rate. Considerable uncertainty about the outlook, stemming in particular from world activity and domestic supply growth, remained. The Committee judged the risks around the outlook to be balanced, as in November.

29 Although employment growth was expected to slow over the forecast period, the unemployment rate was likely to fall further. The best collective view of the MPC was that slack was currently in the region of ½% of GDP. There was uncertainty around that judgement and a range of views on the Committee about both the current degree of slack and how quickly it would narrow, but in the central projection it was likely to be absorbed by the middle of the forecast period.

30 Inflation was judged likely to remain close to zero for most of 2015, reflecting past falls in energy, food and other import prices and some continued drag from domestic slack. The near-term projection was considerably lower than it was three months ago and it was more likely than not that CPI inflation would dip briefly below zero at some point in the first half of 2015. Moreover, the MPC judged that the period of low inflation expected over 2015 posed a downside risk to inflation over the first half of the projection: the factors pulling down inflation could prove

more persistent than expected or a period of low inflation could be reflected in weaker wage pressures. Further out, the profile hinged on the outlook for domestic inflationary pressures. In the central projection, the gradual pickup in productivity growth and declines in slack were associated with a rise in four-quarter wage and unit labour cost growth, to rates consistent with the MPC's 2% target. CPI inflation was therefore judged likely to return to the 2% target by the two-year point, before rising a little further. Although there was considerable uncertainty around the medium-term outlook, the risks around the central projection were judged to be balanced from the two-year point. Taking into account the central projection and the risks around it, the Committee's best collective judgement was that inflation was about as likely to be above as below the 2% target from early 2017, a slightly higher inflation profile than judged likely three months earlier, reflecting the slightly stronger growth outlook.

### **The immediate policy decision**

31 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 only gradually, and more slowly 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.

32 Central banks internationally had taken a number of policy measures during the month and long-term interest rates had continued to decline. Part of that decline might have reflected perceptions of a more pessimistic global nominal growth outlook on the part of market participants. But, in combination with both lower short-term sterling interest rates and the boost to real incomes from the considerable reduction in oil prices over the past three months, the decline was likely to provide some support to UK growth prospects. Accordingly, in the Committee's best collective judgement, and as described in the February *Inflation Report*, GDP

growth was likely to be a little stronger over the next few years than had been assumed in the Committee's projections from three months earlier. And for some Committee members, there was a risk that the decline in the oil price might provide a somewhat greater boost to global demand than assumed in the central projection. Nevertheless, the financial market developments of the past month served as a reminder that the growth outlook remained sensitive to global developments, and developments in the rest of Europe in particular.

33 Domestically, the initial estimate of GDP growth in Q4 had been a little weaker than anticipated. But this appeared to have been driven by a potentially erratic decline in construction output. The data that had become available in the early weeks of 2015 had generally been positive. The Markit/CIPS activity indices had recovered in January and households' confidence in their financial situations had increased. Retail sales volumes had grown at the fastest quarterly pace in over a decade at the end of 2014. Some of these factors were likely to have been influenced positively by the reduction in oil prices.

34 CPI inflation had fallen well below the 2% target to 0.5% in the December data. Given the reduction in the oil price since then, inflation was set to decline further – probably to around zero – in the spring, and stay at around that level for several months. It was more likely than not that CPI inflation would dip briefly below zero at some point in the first half of the year. The Committee judged that around two-thirds of the shortfall in inflation in December relative to the target was related to the impact of factors that would probably prove temporary: the reduction in the level of oil and other commodity prices, and the appreciation of sterling after mid-2013. Absent further such movements in commodity prices or sterling, the effect of these factors on twelve-month CPI inflation would dissipate towards the end of 2015, causing inflation to pick up towards the target fairly sharply.

35 The more enduring influence on inflation in the medium term, however, would be developments in domestic cost growth, whose weakness – especially manifest in wages – the Committee judged to be responsible for around one-third of the shortfall of inflation relative to the target seen in the December CPI data. Annual wage growth was expected to recover gradually to around 4% over the next two years, but there were risks on either side of this outlook. Wage growth had surprised to the upside over the past three months. It was possible that there was less spare capacity than the Committee had assumed, and that existing slack might be absorbed more

rapidly, resulting in greater pay and inflationary pressures. But, set against that, it was possible that the degree of economic slack, especially in the labour market, was greater than the Committee had assumed or might become so if global activity disappointed and UK demand growth weakened. It was also possible that the weakness of inflation itself, especially if it were persistently to influence expectations of future inflation, would feed back to lower pay growth thereby delaying the point at which inflation would rise back to meet the 2% target. The Committee judged, however, that inflation expectations remained consistent with the 2% target.

36 In accordance with the MPC's remit, the decline in inflation to more than one percentage point below the target required the Governor to send an open letter to the Chancellor describing, among other things, the horizon over which the MPC thought it appropriate to seek to return inflation to the target. That letter was to be published alongside the February *Inflation Report*. In general, the appropriate horizon would depend on the trade-off between the speed with which inflation returned to target and the consequences of that for output and employment. The Committee noted that, with inflation below the target and unemployment above its long-run sustainable rate, there was no immediate trade-off between returning inflation to the target and supporting economic activity. Indeed, for inflation to return to the target, it would be necessary to eliminate the remaining degree of economic slack. The Committee therefore judged it appropriate to return inflation to the target as quickly as possible after the effects of energy and food prices movements had abated. In practice, this meant that the Committee would seek to set monetary policy so that it was likely that inflation would return to the 2% target within two years.

37 In the light of that aim, and the Committee's latest set of economic projections, all Committee members agreed that it was appropriate to leave the stance of monetary policy unchanged at this meeting. For two members, the immediate policy decision remained finely balanced: given the outlook for inflation beyond the short term, there could well be a case for an increase in Bank Rate later in the year. All members viewed it as more likely than not that Bank Rate would increase over the next three years; for one member, the next change in the stance of monetary policy was roughly as likely to be a loosening as a tightening.

38 Were the downside risks to underlying inflationary pressure to materialise, market expectations of the future path of interest rates could adjust to reflect an even more gradual and limited path for Bank Rate increases than was currently priced. The Committee could also decide

to expand the Asset Purchase Facility or to cut Bank Rate further towards zero from its current level of 0.5%. The scope for downward adjustments in Bank Rate reflected, in part, the fact that the UK banking sector was now operating with substantially more capital than in the immediate aftermath of the crisis. Reductions in Bank Rate to below 0.5% were therefore less likely to have undesirable effects on the supply of credit to the UK economy than previously judged by the MPC.

39 Were the upside risks to underlying inflationary pressure to materialise, it would be appropriate for Bank Rate to increase more quickly than embodied in current market yields – the likelihood remained that any such increases would still be more gradual and limited than in previous tightening cycles.

40 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.

41 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