



BANK OF ENGLAND

Monetary policy summary and minutes of the Monetary Policy Committee meeting ending on 6 October 2015

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These are the minutes of the Monetary Policy Committee meeting ending on 6 October 2015.

They are available at <http://www.bankofengland.co.uk/publications/minutes/Documents/mpc/pdf/2015/oct.pdf>

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 4 November will be published on 5 November 2015.

Monetary policy summary, October 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 6 October, 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 was zero in August, well below the 2% target rate. Around three-quarters of that deviation reflects unusually low contributions from energy, food and other imported goods prices. The remaining quarter reflects the past weakness of domestic cost growth. Although rising, increases in labour costs remain lower than would be consistent with meeting the inflation target in the medium term, were they to persist at current rates. Core inflation remains subdued at around 1%, influenced both by restrained labour cost growth and by muted import cost growth, itself partly reflecting the continuing dampening influence of sterling's appreciation since mid-2013.

With inflation below the target, and the likelihood that at least some spare capacity remains in the economy, the MPC intends to set monetary policy so as to ensure that growth is sufficient to absorb any remaining underutilised resources. That will support domestic cost growth and is necessary to ensure that inflation is on track to return sustainably to the 2% target rate within two years.

The Committee will set out its next detailed assessment of the outlook for the economy in the forthcoming November *Inflation Report*. As in recent months, the outlook for growth remains characterised by a number of opposing influences. On the one hand, UK private final domestic demand, and consumer spending in particular, has been resilient, buttressed by the recovery in real income growth and productivity, supportive monetary policy, and robust business and consumer confidence. On the other hand, the on-going fiscal consolidation has had a restraining influence on activity and global growth has continued at below-average rates. Similarly, after the direct effects of past movements in international energy and food prices have washed out of the annual comparison, the outlook for inflation in the medium term will reflect the balance of two opposing forces: the extent to which domestic costs pressures build, set against any persisting external disinflationary pressure.

The most recent official estimates and survey data are consistent with a gentle deceleration in UK output growth since its peak at the beginning of 2014. The sharp declines in the unemployment rate seen since the middle of 2013 now appear to have levelled off. Some slowdown in the pace of the expansion and employment growth had been expected by the MPC as a natural consequence of the economy approaching a balance between its supply capacity and strengthening demand following the United Kingdom's gradual recovery from the financial crisis. Indeed, there is increasing evidence of developing capacity pressures in some segments of the economy, and of labour skill shortages in particular. Annual regular pay growth in the private sector has risen and now exceeds 3%. But encouraging improvements in productivity growth have so far limited the impact of that pickup in pay growth on businesses' overall costs, and therefore inflation.

A deterioration in the global demand environment would slow the pace of expansion further. That could occur, for example, were the slowdown currently underway in a range of emerging economies, including China, to intensify. Growth in the euro area, the United Kingdom's main trading partner, has so far remained relatively resilient. As always, the Committee will continue to monitor international developments, as well as evidence concerning the resilience of the domestic economy, to assess the outlook for inflation and activity in the United Kingdom, and set monetary policy as appropriate in the light of all of those factors.

There remains a range of views among MPC members about how each of the factors relevant for the outlook for inflation might evolve in future. At the Committee's meeting ending on 6 October, the majority of members judged that the current stance of monetary policy remained appropriate. Ian McCafferty preferred to increase Bank Rate by 25 basis points, given his view that building domestic cost pressures were likely to come to outweigh the dampening influence of the appreciation of sterling, causing inflation to overshoot the 2% target in the medium term.

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

Minutes of the Monetary Policy Committee meeting ending on 6 October 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 Asset prices had remained volatile since the Committee's previous meeting. The Committee reviewed developments in financial markets and discussed possible interpretations of them.

3 An important influence on asset prices over the month had been the Federal Open Market Committee's (FOMC's) decision to hold steady the level of official interest rates in the United States. While it had not been a surprise to many market participants that the target level of official rates had been left unchanged, the Bank's market contacts had highlighted the FOMC's concerns about China and other emerging markets in its accompanying communications. Following the announcement, equity indices in the United States, United Kingdom and euro area had fallen. Spreads on investment grade and high yield corporate debt denominated in dollars, sterling and euros had risen. Credit spreads had also widened in emerging markets. Some emerging market economies' exchange rates had depreciated against the dollar.

4 The changes in the prices of risky assets since the August *Inflation Report* were consistent with market participants revising down their central assessment of the global outlook, in particular for emerging market economies. An alternative interpretation was that they reflected an increase in the probability of a tail event for global growth which might have boosted the required compensation for bearing risk. These explanations were unlikely to be mutually exclusive, however, and it was likely that the asset price movements reflected both influences.

5 Perhaps reflecting these factors, market interest rates in advanced economies had also fallen. UK forward short-term interest rates had risen following the release of domestic labour market data earlier in the month, but had then declined following the FOMC's announcement and the September release of US non-farm payrolls on 2 October. At the time of the Committee's meeting, the OIS curve had crossed 0.75% in February 2017, nine months later than at the time of the Committee's August *Inflation Report*. The three-year instantaneous forward rate stood at 1.3%, compared with the 1.7% incorporated in the conditioning assumption for the August *Inflation Report*. A majority of private sector economists surveyed by Reuters still expected Bank Rate to be raised in the first quarter of 2016, although there had been an increase in the proportion expecting a rate rise in the second quarter of next year.

6 Short-term interest rates had fallen in the United States, where implied expectations of the first increase in official interest rates had also been pushed back. In the euro area, too, short-term interest rates had declined and a majority of private sector economists responding to a survey conducted by Reuters continued to expect

an extension of the ECB's Public Sector Purchase Programme beyond its scheduled conclusion in September 2016.

7 A key question was the extent to which these falls in risk-free interest rates reflected a monetary stimulus that would act to bolster growth in advanced economies, or whether the declines would merely act to offset the impact of a weaker global environment. The Committee would need to return to this question in some detail during the production of its November *Inflation Report* projections.

8 In contrast to these asset prices, whose movements appeared to reflect global developments, those more closely tied to the prospects for activity in the United Kingdom had been less affected. For instance, since the August *Inflation Report* the share prices of companies in the FTSE All-Share index earning their revenues predominantly in the United Kingdom had fallen by less than the overall index, and had declined by considerably less than FTSE-listed firms with larger exposures to countries in the Asia Pacific region including China, some of which were in the extraction sector. Equity analysts' earnings forecasts for companies exposed primarily to the UK economy had been revised slightly higher over this period. That stood in contrast to the sharp falls in earnings forecasts for FTSE-listed companies earning a greater proportion of their revenues from the Asia Pacific region.

9 The sterling effective exchange rate index (ERI) had fallen by 1.5% on the month, and was around 2.5% lower than the fifteen-day average starting point used in the August *Inflation Report* projections. The depreciation over the period since the August *Report* largely reflected movements against the euro; sterling had also depreciated against the dollar, but appreciated against the currencies of some emerging market economies. Looking back over a longer period, the sterling ERI was 15% above its level in mid-2013.

The international economy

10 This month's data indicated that growth had been a little stronger than previously thought in the first half of the year in advanced economies, but weaker in emerging market economies. At a global level, activity would probably be weaker than expected in the second half of the year, despite the boost to commodity importers' real incomes from the reduction in oil prices. Key questions were how pronounced the on-going slowing in the emerging market economies would turn out to be, and to what extent this would spill over to activity in the advanced economies.

11 In the United States, Q2 GDP growth had been revised up by 0.1 percentage points to 1%. Non-farm payrolls had increased by 142,000 in September, weaker than the average of over 200,000 per month since 2011, and there had been downward revisions to earlier months. The unemployment rate had remained at 5.1%. Growth in Q2 had been supported by the unwinding of erratic factors that had depressed activity in Q1, including the West Coast port strike and poor weather in the North East. As these impacts dropped out, it remained likely that growth would fall back in Q3. With stockbuilding also likely to be weak, Bank staff's expectation of US GDP growth in Q3 was 0.5%.

12 GDP growth in both the first and second quarters had been revised up in the euro area, to 0.5% and 0.4% respectively. Growth in the year to 2015 Q2, at 1.5%, had been at its highest rate since 2011 Q2. Euro-area industrial production had increased by 0.6% in July, driven by rises in Germany, Italy and Spain, while French industrial production had declined by 0.8%. Although the composite euro-area aggregate purchasing managers' index (PMI) had fallen moderately in September, it had remained above average. The decisive result of the general election in Greece had reduced the risk of political deadlock in the near term, but had not materially altered the medium-term risks. Nonetheless, the ECB had revised down its growth forecasts for the area as a whole for 2015 to 2017, citing a weaker outlook for emerging market economies. Bank staff had maintained their expectation of 0.4% GDP growth in Q3.

13 There had so far been few signs of a marked weakening in Chinese activity in the recent data, despite the increased concerns that had led to pronounced falls in Chinese equity prices and associated financial market volatility over the preceding few months. Official data for industrial production had suggested a pickup in growth of 0.1 percentage points to 6.1% in August, in line with its six-month average. Retail sales growth had increased further in August, rising by over 10% on a year earlier. The Chinese PMIs for September had been mixed, although there had been a notable weakening in the composite Caixin PMI. Bank staff continued to expect GDP growth of 1.6% in Q3, a similar pace to Q2. In response to the prospect of a downturn in growth, the Chinese authorities had made a number of stimulatory policy changes since June. Official benchmark interest rates had been reduced by 50 basis points and there had been several fiscal and financial reform measures. In addition, the Chinese authorities had lowered the central parity of the renminbi exchange rate against the dollar and announced a change to the mechanism for determining its central parity. In subsequent weeks, the Chinese authorities had appeared to have offset downward pressure on the renminbi by means of intervention in the foreign exchange market.

14 Growth in other emerging market economies had appeared to slow further in the second quarter, continuing the decline in growth seen over much of the past five years. The slowdown had been particularly acute in Latin America and the Commonwealth of Independent States. GDP in Brazil had fallen by around 2½% in the year to Q2, in Russia by around 5%, and in Ukraine by nearly 15%. At this stage, there was little hard evidence regarding activity beyond Q2 for these countries. But financial conditions had tightened further, with falls in equity prices and rising sovereign bond spreads, while some capital outflows had intensified.

15 Movements in oil prices also seemed consistent with a general slowing in demand prospects. Over the month as a whole, the dollar Brent spot oil price had changed little but was 13% lower than the fifteen-day average used as the starting point for the August *Inflation Report* projections. Analysis by Bank staff had suggested that, while a large part of the declines towards the end of 2014 appeared associated with news about supply trends, the declines since May appeared more to be the result of news about demand. Supply factors were still important, however, both in oil and other commodity markets, including metals and other minerals.

16 Committee members differed in their views as to whether recent developments in the global economy signalled that the most likely path for global activity was weaker than assumed previously, or whether they served simply to accentuate the downside risks that had already been taken into account in the August *Inflation Report* projections. On the one hand, for several years, expectations of a prospective recovery in

global growth had been frustrated by a number of events, highlighting the tensions in the global economic environment following the financial crisis. It was possible that the same would be true at the current juncture. In addition, even absent a pronounced realisation of the risks associated with the slowing in emerging market growth, it was possible that the sluggishness of productivity and output growth in the advanced economies, reflecting the legacy of the crisis, would be somewhat more persistent than assumed. On the other hand, the Committee's assumptions about global growth were already weak by comparison with both historical norms and other forecasters' expectations at the time of the August *Inflation Report*; the latter had now been revised down. Moreover, the slowdown in global activity had been more pronounced in a PPP-weighted measure of growth than in a measure of international activity weighted by its importance for UK exports. Activity in the euro area in particular had been relatively resilient, in part reflecting the policy actions of the ECB. The Committee would be able to undertake a fuller assessment of the cumulative news in the preparation of its forthcoming November forecasts.

Money, credit, demand and output

17 The *Quarterly National Accounts* consistent with *Blue Book 2015* had suggested a broadly similar pattern of GDP growth in recent years to the previous vintage of data. But growth was estimated to have been stronger during 2011-13 than previously, revised up by between 0.4 and 0.5 percentage points per year, while growth during 2014 was estimated to have been a touch lower. Quarterly growth in 2015 Q1 and Q2 had not been revised, at 0.4% and 0.7% respectively. The data had retained the basic feature that output growth appeared to have peaked in early 2014, before gradually easing thereafter. In the year to 2015 Q2, output was now estimated to have increased by 2.4%, compared with the recent peak in growth of 3.1% in 2014 Q2.

18 The expansion had continued to be driven by private domestic demand, but there had been some revisions to the precise mix of spending, the implications of which would require further analysis. Consumption growth in 2015 Q2 had been revised up to 0.9%, taking it into line with the figure that had been incorporated in the August *Inflation Report*. Consumer spending had increased by 3.0% in the year to Q2, 0.2 percentage points weaker than in the previous data vintage. Household income growth was also estimated to have been weaker over the same period, largely because wages and salaries growth had been brought closer into line with the Average Weekly Earnings and Labour Force Survey employment data. Taken together, these revisions meant that the saving ratio had been revised down, and, over the first half of the year, was estimated to have been at its lowest rate since 1962. At face value, that implied that future consumption growth was likely to be more reliant on income growth, and the evolution of productivity that would determine it. Excluding flows into employment-related pension schemes, however, the comparison was less stark, with saving out of available income still higher than in the period immediately before the crisis.

19 The increase in business investment since the end of 2009 had been lowered to 35% from around 40%. That had left the ratio of business investment to GDP considerably lower than previously estimated. In part, that downward revision had reflected a re-classification of the activity of Network Rail and Transport for London from the private to the government sector, with limited economic significance. But most of the revision had arisen from new survey information. At the same time, corporate profits and the PNFC net financial balance had been

revised higher. That could suggest somewhat greater scope for companies to increase investment in the future. A range of business investment survey indicators continued to suggest solid investment intentions.

20 Another notable feature of the new dataset had been revisions to the balance of payments numbers. The revised estimates had shown a smaller current account deficit over the past year. In 2015 Q2, it was estimated to have been 3.6% of nominal GDP, after a peak of 6.3% in 2014 Q4. In the previous vintage of data, the deficit had peaked at 7.1% in 2014 Q3, and had improved only modestly since then. Around 40 per cent of the improvement over the past six months was a consequence of an increase in the primary income balance, which had also been revised up over much of the past two years, largely reflecting the incorporation of new data on foreign direct investment. A narrowing in the trade deficit, to 0.7%, had accounted for a further half of the narrowing of the current account deficit since its peak last year. That had reflected both a fall in imports and a rise in exports. The less negative picture on the income balance was encouraging although, as with the recent improvement in the trade balance, it was unclear this would persist. The drop in imports was due partly to erratic factors and the data were in any event heavily prone to revision.

21 Indicators of activity in the third quarter had been mixed. Output in the production sector had fallen by 0.4% in July. That was driven by a fall in manufacturing output, where past increases in sterling had continued to act as a drag on growth. Construction output had also been weak, falling by 1% in July, while service sector activity had risen by 0.2%. The Markit/CIPS composite output and expectations indices had both fallen in September, driven by the service sector, in contrast to the picture of steady growth that had been suggested by the BCC survey for Q3. Consumer confidence had remained at a high level. On balance, Bank staff continued to expect GDP growth of 0.6% in 2015 Q3, a little lower than in Q2.

22 One contributor to the gentle slowing in aggregate activity growth had been weaker housing investment. But more forward-looking indicators had improved. House price inflation had picked up gradually through 2015, marking a turnaround from 2014, with the average of the lenders' house price indices rising by 1.5% in Q3 compared with Q2. A net percentage balance of respondents of +33 had expected prices to rise in the next three months in the September RICS survey. Mortgage approvals for house purchase had risen to over 70,000 in August, slightly higher than anticipated, albeit below the levels thought likely a year ago. Net secured lending flows rose to £3.4 billion in August, the highest monthly flow since 2008. In part, that reflected support from the past easing in credit conditions. Interest rates on new mortgages had declined by an average of 0.6 percentage points in the year to August. Quoted rates on 90% loan-to-value (LTV) mortgages had fallen by 1.2 percentage points in the year to September, and although they accounted for only a small share of lending, the number of 95% LTV mortgage products available had increased sharply in September. Housing transactions had also risen in the year to August, by 5.7%. Overall, a modest strengthening in the housing market appeared to be in train, following a lull during 2014.

Supply, costs and prices

23 Twelve-month CPI inflation had fallen to zero in August from 0.1% in July. Bank staff estimated that around three-quarters of the deviation of inflation from the 2% target reflected unusually weak contributions from food, energy and other imported goods prices, and expected that CPI inflation would remain around zero before picking up around the turn of the year, largely as the influence of the sharp falls in oil and food prices at the end of 2014 dropped out of the annual comparison. Nevertheless, it was likely that the inflation rate would remain below 1% until the spring, extending the probable sequence of open letters from the Governor to the Chancellor of the Exchequer until the middle of 2016. CPI inflation excluding food and energy had fallen back from 1.2% to 1.0% in August and the average of a wide range of measures of core inflation had fallen by 0.1 percentage points to 1.0%. An increase in core inflation would be required if the Committee were to meet its objective of returning CPI sustainably to the 2% target within two years. At that horizon, and in the absence of further movements in global energy prices, inflation would be determined by the balance between the offsetting influences of a continued increase in domestic cost pressures, on the one hand, and any persistent influence of subdued imported cost pressures on the other.

24 Compared with a year earlier, average weekly earnings in the three months to July had increased by 2.9% across the economy as a whole and by 3.4% in the private sector. These figures had been somewhat higher than anticipated, reflecting the unexpected strength of bonus payments, which had been volatile over the past few months. Excluding bonuses, annual regular pay growth had been 2.9% in the three months to July across the economy as a whole and 3.4% in the private sector, broadly as expected at the time of the Committee's *August Inflation Report*. Regular pay growth had increased by over a percentage point since the beginning of the year. In part, this was likely to have been a consequence of the diminution of spare capacity associated with the over 2 percentage point decline in the LFS unemployment rate that had occurred since the middle of 2013. That decline had levelled off more recently, however, with the LFS measure roughly stable at around 5½% since the beginning of the year, and the claimant count measure flat at 2.3% for the sixth month in a row. It remained unclear to what extent the flattening of the unemployment rate reflected a softening in labour demand, consistent with signs of a gentle reduction in the pace of output growth and faster productivity growth, or was the consequence of greater friction in matching labour supply and demand as unemployment approached its medium term sustainable rate. Recent analysis by Bank staff had suggested that labour market matching efficiency had declined even before the crisis.

25 A survey conducted for the Committee by the Bank's Agents suggested that labour skill shortages had become increasingly widespread, with just over half of the business contacts surveyed by the Agents reporting that hiring problems were constraining workforce expansion, albeit only slightly in most cases. Among the most common responses planned by businesses to those recruitment difficulties was to increase pay for new recruits or key existing staff, although there were fewer plans to increase pay for staff across the board. Other survey evidence had also suggested that skills shortages were greater than usual. In contrast to that, however, the average number of hours worked per employee – sometimes regarded as a measure of the intensity of labour utilisation – had fallen by 0.5% in the three months to July and remained considerably lower than the number of hours that LFS participants reported that they would be willing to work. On the face of it, this appeared to imply greater scope for output to expand without necessitating additional hiring. But, as the Committee had noted in

the past, there was evidence that LFS respondents' reported willingness to work additional hours had tended to overstate the increase in hours with which they would ultimately be satisfied. It was also possible that the decline in hours reflected in part a reduction in labour supply, for instance if the desire of some people to work longer hours was reduced as real wages had risen.

26 The number of people employed had increased by 42,000 or 0.1% in the three months to July, compared with the previous three months, and by 1.3% compared with a year earlier. The latest increase had been centred among the self-employed and within that those classified as working part-time. These data perhaps indicated that the sharp slowdown in employment growth evident in the previous month's data had been exaggerated by data volatility. Surveys had continued to suggest reasonably robust hiring intentions, albeit at a pace a little less rapid than earlier in the year. The number of job vacancies had risen a little in the three months to August, following small declines earlier in the year, and remained near a series high.

27 In addition to increasing staff training and apprenticeship schemes, the Agents' survey had suggested that another common response to a tightening labour market would be to use existing staff more productively. The employment data, in combination with the latest GDP figures and Bank staff estimates of the likely pattern of data revisions, suggested that output per hour worked had increased by around 1½% in the year to 2015 Q2, with output per head employed increasing by a similar amount. Those figures were likely to have been flattered, however, by the volatility in the employment numbers in the second quarter. If the resumption of employment growth seen in the July data were to continue, measured productivity growth would be expected to fall back somewhat in the third quarter. Nevertheless, there was growing, albeit not conclusive, evidence that underlying productivity growth appeared to be recovering somewhat after several years of stagnation.

28 Firms' domestic costs, and so domestic inflationary pressure, were determined by the balance between the increase in the cost of employing labour and productivity growth. The latest ONS official estimates implied that unit labour costs had increased by 2.2% in the year to 2015 Q2. However, on the basis of survey evidence and the past history of data revisions, Bank staff expected estimates of output growth, and therefore productivity growth, over the past year to be revised up. Taking this into account implied annual growth in unit labour costs of around 1.8%. Moreover, these figures included estimates of the imputed expenses associated with firms' contributions to employee pension schemes, which may be a less relevant indicator of firms' current marginal production costs. Excluding those, and other non-wage costs, implied an increase in unit wage costs of around 1.5%. An alternative indicator of unit wage costs, constructed from the AWE measure of the pay growth of employees and LFS employment figures, suggested something lower still, at around 1.2%. Overall, although annual unit wage cost growth had increased over the past few quarters, probably reflecting the past tightening of the labour market, it remained lower than would be consistent with meeting the 2% inflation target in the medium term, were it to persist at current rates, even if external influences were no longer weighing on inflation at that horizon.

29 Regarding external cost pressures, the Committee focussed its discussion on the impact on import prices of movements in the exchange rate. Although the sterling ERI had depreciated by around 2.5% since the time of the August *Inflation Report*, the broader appreciation of sterling since mid-2013 was likely to continue to bear down on import price growth, and therefore CPI inflation, for a period. The extent of that dampening influence

on inflation was uncertain, however. Over the past year, the decline in the prices of UK imports excluding fuels had been somewhat less marked than might have been expected given the change in world export prices and movements in the sterling exchange rate. Recent work by Bank staff suggested that, on average, only around 60 per cent of movements in the ERI tended to get passed through into sterling UK import prices within a year or so. A number of reasons had been advanced in the research literature as to why this phenomenon might occur – for instance the prevalence of so-called pricing-to-market effects. One possibility of particular pertinence was the significance of the currency used for invoicing trade flows. A large proportion of UK imports were invoiced in US dollars regardless of their country of origin. This implied that movements in the sterling-dollar bilateral exchange rate probably had a greater impact on UK import prices than the dollar's weight in the sterling ERI might imply. The recent relative stability of the sterling-dollar rate, by comparison with the wider set of bilateral exchange rates encapsulated in the sterling ERI, was therefore likely to have been one of the causes of the more limited response of import prices to the generalised appreciation of sterling that had been observed.

30 More broadly, the pass-through of exchange rate movements to UK import prices would depend on the underlying reason that the exchange rate had moved, with empirical evidence that the pass-through of movements associated with shifts in relative international demand conditions was more limited than for similarly sized movements associated with supply developments. Committee members also noted, however, that in practice it was difficult to identify the underlying cause of exchange rate movements in real time. An assumption of fairly rapid but incomplete pass-through to import prices, based on the average of past experience, was probably a reasonable starting point, although this could then be refined over time as evidence emerged on whether the factors behind exchange rate movements differed substantially from the past. Members noted that the ultimate impact of movements in the exchange rate on CPI inflation was more protracted, given the time it typically required for import prices to feed through to retail prices. The Committee would review the issue further during the preparation of its November *Inflation Report*.

31 News on inflation expectations had been mixed. In financial markets, five-year inflation swap rates five years ahead had fallen in the United Kingdom, as well as in the United States and euro area. In the United Kingdom and euro area, these measures had remained above their troughs in early 2015, whereas in the United States they were below that low point. This month's evidence from the Citigroup/YouGov and Barclays Basix surveys suggested that UK households' expectations of inflation one and two ahead had increased slightly, but remained well below their series averages at these and longer horizons. In contrast, according to Deloitte's 2015 Q3 survey of large companies almost 40 per cent of Chief Financial Officers expected CPI inflation to be less than 1.5% two years ahead, compared with 30 per cent in the previous survey for Q2. Only around 5 per cent of CFOs expected CPI inflation to be above 2.5% in two years' time.

The immediate policy decision

32 The Committee set monetary policy to meet the 2% inflation target and in a way that helped sustain growth and employment. At the present time, with inflation below the target and the likelihood of at least some spare capacity remaining in the economy, the MPC intended to set monetary policy so as to ensure that growth

was sufficient to absorb any remaining underutilised resources. That would support domestic cost growth and was necessary to ensure that inflation was on track to return sustainably to the 2% target rate within two years.

33 The outlook for growth remained characterised by a number of opposing influences. On the one hand, UK private final domestic demand, and consumer spending in particular, had been resilient, buttressed by the recovery in real income growth and productivity, supportive monetary policy and robust business and consumer confidence. On the other hand, the on-going fiscal consolidation had had a restraining influence on activity and global growth had continued at below-average rates.

34 Regarding UK growth, a comprehensive update of the National Accounts contained in *Blue Book 2015* had been released during the month. At an aggregate level, this had confirmed the recent picture of resilient activity, but with a gentle deceleration of growth from above its historical average in 2014 to 2.4% in the year to 2015 Q2. Evidence from business surveys, taken as a whole, had also been consistent with an easing in the pace of activity over that period. On the basis of those survey indicators and other official data, Bank staff estimated that output had probably increased by around 0.6% in the third quarter. Although it was possible that the modest slowing in output growth over the past year, in conjunction with the continued implementation of the Government's fiscal deficit reduction plans, might presage a slightly weaker outlook than had previously been assumed, such gentle decelerations in the pace of expansion from above trend growth rates were typical of past economic cycles. On that view, the recent data were consistent with the natural consequences of the economy approaching a balance between its supply capacity and strengthening demand following the United Kingdom's gradual recovery from the financial crisis.

35 Beneath the aggregate figures, the new data had continued to suggest that the expansion had been underpinned by strong private sector final demand but there had been some news about its composition. Household consumption growth had been revised up in 2015 Q2. With downward revisions to estimated income, the savings ratio had been revised down to stand at its lowest for over 50 years in 2015 H1. One possible implication was that, for the strength of consumer spending to be sustained, it would need to rely to a greater extent on income growth and, ultimately therefore, improvements in productivity. However, much of the decline in the saving ratio reflected the impact of flows into employment-related pension schemes. Stripping out those effects, measured saving out of available income had remained higher. In addition, there was emerging evidence that productivity growth did indeed appear to be recovering after several years of stagnation. And this, along with the modest strengthening in the housing market, strong consumer confidence and the near-term outlook for low consumer price inflation would act to support real household spending.

36 The growth of business investment had been revised down materially over the past few years. This evidence of somewhat less momentum in capital expenditure than previously thought had to be weighed against upward revisions to corporate profits, the generally supportive conditions for raising finance, and survey measures pointing to solid investment intentions. A fuller analysis of the implications of the new information contained in *Blue Book 2015* would be possible as the Committee prepared its November *Inflation Report* projections.

37 Regarding international activity, GDP growth in both the euro area and the United States in the first half of the year had been revised up. Output growth was likely to remain steady in the United States in the second half of the year, and there had been continued signs of a recovery in the euro area. Annual euro-area GDP growth was at its highest for four years. Outside the advanced economies, a continued slowdown in emerging market growth remained evident, most notably in Brazil and Russia. Despite increased concern about growth prospects in China and the associated reduction and volatility in risky asset prices, Chinese activity indicators to date had been steady and the authorities had implemented a range of stimulatory policy initiatives. Although there remained a risk that emerging market prospects might deteriorate further, there had so far been few signs of a material effect on business and consumer confidence in the advanced economies. For some members, recent developments in the global economy indicated that prospects were probably somewhat weaker than had been assumed at the time of the *August Inflation Report*. But for others, these developments had so far served only to accentuate the downside risks to the outlook for international activity which had been noted in the Committee's previous forecasts. As with domestic prospects, the November *Inflation Report* would provide an opportunity for the Committee to reassess the accumulated evidence regarding the international environment in full.

38 The near-term outlook for CPI inflation appeared slightly weaker than at the time of the August *Inflation Report*, in part reflecting the further decline in the oil price. CPI inflation was likely to remain close to zero before picking up around the turn of the year. But it now appeared likely to remain below 1% until spring 2016. The outlook for inflation in the medium term, after the direct effects of past movements in international energy and food prices have washed out of the annual comparison, was of more relevance to the setting of monetary policy, however. At that horizon, the path of inflation would reflect the balance of two opposing forces: the extent to which domestic costs pressures built, set against any persisting external disinflationary pressure.

39 Although the exchange rate had depreciated slightly since the August *Inflation Report*, its substantial appreciation since mid-2013 continued to depress import price growth and so CPI inflation. The speed and extent of pass-through of changes in the exchange rate to import prices and final consumer prices was uncertain, and likely to vary over time depending for instance on the underlying economic reason for the change in the exchange rate. The Committee discussed past episodes when it had been possible to identify why the exchange rate had moved but noted it was typically difficult to do this contemporaneously. In any event, it seemed likely that the past appreciation of sterling would continue to exert downward pressure on CPI inflation for a period, and that domestic cost pressures would need to be commensurately stronger in order to return inflation sustainably to the 2% target.

40 Wage growth had strengthened over the past year, reflecting the past tightening of the labour market. The LFS unemployment rate had fallen by over 2 percentage points over the past two years, levelling off in recent months, and was close to Bank staff's estimate of its medium term equilibrium rate. There was some evidence of an additional margin of spare labour market capacity in the shortfall between the number of hours per week worked by employees and the number they reported that they would be willing to work, but it was difficult to be precise about the size of any remaining slack from that source, or its significance for inflationary pressures. Reports of increasingly widespread skill shortages, including from the Bank's Agents, indicated that whatever spare capacity remained was diminishing and might, in aggregate, be fairly limited, in some sectors at

least. Increased pay growth, however, needed to be set alongside the encouraging signs that productivity growth was at last beginning to recover, even abstracting from the volatility in the numbers associated with recent pattern of employment growth. This had restrained the impact of higher pay on firms' overall costs, and therefore inflationary pressure. Consequently, although having risen over the past few quarters, the Committee judged that increases in unit labour costs remained lower than would be consistent with CPI inflation returning sustainably to the 2% target, were they to persist at current rates.

41 As in previous months, there was a range of views among Committee members about the outlook for activity and inflation. Consequently there were some differences of view about the balance of risks to inflation around the target in the medium term, with individual members placing differing weights on the risks from developments in the domestic labour market and those associated with the prospects for global growth. Some members of the Committee noted recent evidence that lags in the response of inflation to interest rate changes appeared a bit shorter than previously thought. For eight members, the current stance of monetary policy remained appropriate at this meeting in order to meet the Committee's aim of supporting growth at a rate sufficient to absorb the remaining degree of spare capacity in the economy, and so returning inflation to the target within two years. For one member, the likely prospective increase in domestic costs was 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.

42 All members agreed that the likely persistence of the headwinds restraining economic growth following the financial crisis mean 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.

43 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.

44 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

James Richardson was present as the Treasury representative.