



BANK OF ENGLAND

Monetary policy summary and minutes of the Monetary Policy Committee meeting ending on 9 September 2015

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

They are available at <http://www.bankofengland.co.uk/publications/minutes/Documents/mpc/pdf/2015/sep.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 6 October will be published on 8 October 2015.

Monetary policy summary, September 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 September 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 rose slightly to 0.1% in July but remains well below the 2% target rate. Around three quarters of the gap between inflation and the target reflects unusually low contributions from energy, food, and other imported goods prices. The remaining quarter reflects the past weakness of domestic cost growth, and unit labour costs in particular. Although pay growth has recovered somewhat since the turn of the year, the recent increase in productivity means that the annual rate of growth in unit wage costs is currently around 1% – lower than would be consistent with meeting the inflation target in the medium term, were it to persist. Additionally, sterling's appreciation since mid-2013 is having a continuing impact on the prices of imported goods. A combination of these factors has meant that the average of a range of measures of core inflation remains subdued, although it picked up slightly in July to a little over 1%.

Inflation is below the target and the Committee's best collective judgement is that there remain at least some underutilised resources in the economy. In that light, the Committee intends to set monetary policy in order to ensure that growth is sufficient to absorb the remaining economic slack so as to return inflation to the target within two years.

The Committee set out its most recent detailed assessment of the economic outlook in the August *Inflation Report*. The aim of returning inflation to the target within two years was thought likely to be achieved conditional upon Bank Rate following the gently rising path implied by the market yields prevailing at the time. Private domestic demand growth was forecast to be robust enough to eliminate the margin of spare capacity over the next year or so, despite the continuing fiscal consolidation and modest global growth. And that, in turn, was expected to result in the increase in domestic costs needed to return inflation to the target in the medium term, as the temporary negative impact on inflation of lower energy, food and import prices waned. In the third year of the projection, inflation was forecast to move slightly above the target as sustained growth led to a margin of excess demand.

The Committee noted in the August *Report* that the risks to the growth outlook were skewed moderately to the downside, in part reflecting risks to activity in the euro area and China. Developments since then have increased the risks to prospects in China, as well as to other emerging economies. This led to markedly higher volatility in commodity prices and global financial markets.

While these developments have the potential to add to the global headwinds to UK growth and inflation, they must be weighed against the prospects for a continued healthy domestic expansion. Domestic momentum is being underpinned by robust real income growth, supportive credit conditions, and elevated business and consumer confidence. The rate of unemployment has fallen by over 2 percentage points since the middle of 2013, although that decline has levelled off more recently. Global developments do not as yet appear sufficient to alter materially the central outlook described in the *August Report*, but the greater downside risks to the global environment merit close monitoring for any impact on domestic economic activity.

There remains a range of views among MPC members about the balance of risks to inflation relative to the target. At the Committee's meeting ending on 9 September 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 would otherwise be likely to lead to inflation overshooting the target in the medium term.

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 that 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 September 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 Chinese equity prices had fallen further since the Committee's previous meeting. In contrast to earlier falls, this month's developments in China had had broader effects on international financial markets and were the main focus of the Committee's discussion.

3 Two events in China had drawn particular attention this month. First, on 11 August the People's Bank of China had lowered the central parity of the Renminbi exchange rate against the dollar by 1.9% compared with the previous day. It also announced a change to the mechanism for determining the central parity of the Renminbi which led to a further depreciation. Second, against the backdrop of the policy measures to support the stock market announced by the Chinese authorities in June and July, the Shanghai Stock Exchange Composite Index had dropped by 8% on 24 August, leading to substantial falls in both advanced economy and emerging market equity indices. In total over the period since the MPC's previous meeting, equity prices had fallen by 5-10% in the United Kingdom, United States and euro area. Emerging market equity indices had also fallen significantly. In addition to these falls in cash equity markets, the VIX index of US equity implied volatility had risen sharply.

4 Oil prices had also been volatile and at the end of the Committee's meeting were around 10% lower than the fifteen-day average incorporated in the August *Inflation Report*. Emerging market currencies had fallen sharply against the dollar. Other asset prices had also been somewhat affected. Dollar-denominated high-yield bond spreads had increased. Emerging market corporate bond spreads had widened, although they had remained below levels seen earlier in the year. Spreads of investment-grade corporate bonds denominated in dollars, sterling and euro had widened slightly.

5 According to the Bank's market contacts, market participants had become more concerned about the downside risks to the economic outlook for China and the policy challenges facing the Chinese authorities. This had implications for emerging market economies, especially those that were commodity exporters, and potentially also for the advanced economies.

6 Five-year inflation swap rates had fallen in the United Kingdom, United States and euro area. Expectations of the path of policy interest rates had also fallen slightly. In the United Kingdom, the OIS curve crossed 0.75% in October 2016, later than at the time of the Committee's August *Inflation Report*. The pace of tightening for the subsequent 100 basis points of increases in Bank Rate implied by short-term interest rates was little changed. Short-term interest rates had also fallen in the United States and implied expectations of the first increase in official interest rates by the Federal Reserve Open Market Committee had been pushed back somewhat. A majority of private sector economists surveyed by Reuters expected the European Central Bank

to extend its asset purchase programme beyond the scheduled September 2016 end-point, a change from the June survey when a majority had expected it to conclude on schedule and some had expected it to end before then.

7 The Committee noted that, in contrast to the sharp falls in equity markets, movements in government bond markets had been modest, with ten-year yields broadly unchanged in the United Kingdom, United States and Germany. It was possible that equity markets had hitherto been more optimistic than bond markets about global growth prospects and that the disparity between the two had now lessened.

8 In the foreign exchange market, there had been volatility in some currency pairs during the month. The sterling effective exchange rate had depreciated slightly since the Committee's previous meeting, and at the end of the Committee's meeting had been around 1% lower than the fifteen-day average used as the starting point for the August *Inflation Report* projections.

The international economy

9 Immediate concerns about tail risks from the Greek crisis had receded, but increased anxieties about prospects for China and other emerging markets had underlined the downside risks to global activity that the MPC had described in the August *Inflation Report*.

10 The outline agreement reached between the Greek government and its euro-area partners had reduced the likelihood of an intensification of the crisis in the near term, with the majority of the €86 billion package allocated to meeting due debt obligations and to bank recapitalisation. Longer-term challenges remained, however: the Greek authorities had committed to implementing structural reforms that had so far proved difficult, and there remained questions over the sustainability of Greece's debt position.

11 Events in China had highlighted the challenges faced by the authorities in liberalising and rebalancing the Chinese economy against a backdrop of slowing activity. China's sizable standing in the world economy – its share of world imports had risen steadily over the past decade or so, to around 10% – meant that demand prospects there were significant for the health of the global outlook. The Committee noted that, in addition to the fall in the oil price, industrial metals prices had dropped sharply. Any marked deterioration in the Chinese outlook could pose further problems for commodity exporting emerging economies, some of which were already contending with the effects of prospective monetary tightening in the United States.

12 Global activity news had been mixed during the month, with positive news in the United States coming alongside little news in the euro area and negative surprises elsewhere. US GDP growth in Q2 had been revised up sharply to 0.9%, from the first estimate of 0.6%. Business investment had been strong in July and, taken overall, the August employment report had been solid. Bank staff had retained their forecast of 0.6% growth in Q3. In the euro area, GDP growth in Q2 had been revised up by 0.1 percentage point to 0.4%, bringing it into line with the forecast at the time of the August *Inflation Report*. There had been little sign of uncertainty from Greece affecting aggregate demand across the euro area, and the composite PMI output index had risen to 54.3 in August, from 53.9 in July. Bank staff had maintained their expectation of 0.4% GDP growth

in Q3. Japanese GDP was estimated to have fallen by 0.4% in Q2. GDP in Brazil had contracted sharply, by 1.9%, and a number of other emerging economies were also facing slower growth.

Money, credit, demand and output

13 The Committee considered the latest data on domestic activity before turning to the question of how much the recent financial market turbulence and associated concerns about global activity were likely to affect UK growth.

14 UK GDP growth in 2015 Q2 had, at 0.7%, not been revised; services growth had been slightly stronger than expected, offsetting what had been downside news in industrial production relative to the preliminary estimate. The first breakdown of aggregate expenditure had been broadly consistent with the *August Inflation Report* projections. Household consumption growth of 0.7% had been weaker than expected, but government consumption growth of 0.9% had been stronger than forecast. Net trade and stockbuilding had made broadly equal and offsetting contributions, as expected. Investment growth of 1% had been close to the Committee's expectation, although, within that, business investment growth had been substantially stronger and housing investment correspondingly weaker. These components tended to be volatile and were heavily prone to revision, however, and caution was warranted in drawing strong inferences from them. More generally, the Committee noted that the forthcoming revisions relating to the 2015 Blue Book had the potential to alter the picture on activity.

15 There had been some downside news on activity in Q3. Industrial production had been weaker than expected in July, and the output index of the Markit/CIPS composite PMI for August had fallen by 1.3 points to 55.3, its lowest level since May 2013. Bank staff had lowered their estimate of Q3 GDP growth to 0.6% from 0.7%. Nevertheless, the composite expectations index from the Markit/CIPS surveys had been steady, retail sales indicators had remained solid and consumer confidence had risen a little in August from already high levels. In addition, although house price news had been mixed, the RICS survey had suggested a supportive balance of demand versus supply, and mortgage approvals in July had been a little stronger than expected. All of these data, however, carried the caveat that they largely pre-dated the recent financial market turbulence.

16 It was too early to form a comprehensive assessment of the impact on the UK of the heightened concerns about China, global growth and the associated financial market perturbations. Although lower oil prices were likely to support activity here, the United Kingdom would not be immune to the effects of a further weakening in world trade, if that occurred. Moreover, a key lesson from the 2008 crisis had been that financial and uncertainty effects might have a potent adverse effect on aggregate demand. Some UK banks had sizable exposures to emerging markets, although the Committee noted that events to date had had no material impact on UK banks' funding costs. As such, although developments so far might imply a fairly muted effect on UK activity, the balance of risks was probably more skewed to the downside than the Committee had judged at the time of its August forecasts.

17 The combination of solid domestic demand and a subdued external environment led the Committee to consider the implications of the United Kingdom's large current account deficit. The deficit in 2014, of 6½% of GDP, had been a record high for the United Kingdom and the largest among developed economies. The question was to what extent this raised concerns about the balance and sustainability of demand. The deterioration in the external position had not reflected weakness in net trade – a potential sign of excessive growth in domestic demand – but an unprecedented deficit on the net income balance, the outlook for which was highly uncertain. The Committee took reassurance from the fact that private domestic credit growth did not appear excessive, and noted that the Financial Policy Committee, in its assessment of the nature of the capital flows financing the deficit, had not uncovered any particular vulnerabilities.

Supply, costs and prices

18 Twelve-month CPI inflation had edged up to 0.1% in July – slightly higher than the expectation of Bank staff, following less aggressive discounting than anticipated during the summer clothing and footwear sales. Although the near-term outlook for inflation remained broadly the same as at the time of the August *Inflation Report*, the recent increased volatility in oil prices, if it persisted, made CPI's near-term path somewhat less predictable. Excluding energy, food and tobacco, CPI inflation had increased by 0.4 percentage points to 1.2% in July, while the average of a wide range of measures of core inflation had risen more modestly to a little above 1%. Absent further moves in commodity prices or the sterling exchange rate, Bank staff continued to expect CPI inflation itself to increase to around 1% in the early months of 2016 as the impact of sharp falls in energy prices at the end of 2014 dropped out of the twelve-month comparison. The evolution of CPI inflation thereafter would depend mainly upon the path of domestic costs and how the prices of imported products were affected by past movements in the exchange rate.

19 Annual whole economy regular pay growth had been 2.8% in the three months to June, with private sector regular pay increasing by 3.3% on a similar basis – both in line with the assumptions underlying the August *Inflation Report* projections. Bonus payments and, therefore, total pay growth in the June data had been somewhat weaker than assumed a month earlier, however, following larger upside surprises in the preceding couple of months. Abstracting from the volatility introduced by bonuses, regular pay growth in both the private sector and whole economy had increased by over a percentage point since the start of the year. Indicators from business surveys appeared consistent with pay growth roughly in the range of 2-3%.

20 Signs that employment had levelled off, albeit possibly temporarily, had been reinforced by the June data. Both total hours worked and the number of people employed had fallen by 0.2% in the second quarter as a whole. The LFS unemployment rate had increased fractionally to 5.6% in 2015 Q2 from 5.5% in Q1. And the claimant count measure had been flat at 2.3% for the five months from March to July. Survey indicators of past and expected employment growth had remained rather stronger than the official data, perhaps indicating that volatility in the latter had over-stated the extent of the slowdown. Nevertheless, some of the survey indicators had also softened in recent months.

21 Although its underlying extent may have been exaggerated in the official data, the slowing in employment growth suggested some weakening in firms' demand for labour. That was also apparent in falls in the CBI, Markit/CIPS and REC survey measures of firms' employment intentions over the past few months. That weakening in labour demand could reflect either weaker prospective output growth or faster growth in underlying productivity. It was also possible, however, that weak employment growth partly reflected the consequence of a tight labour market making hiring appropriately skilled employees more difficult. Surveys indicated that recruitment difficulties and skills shortages were above average and rising. Further, recent improvements in real incomes may have reduced the incentive or necessity for some people to work beyond retirement age or to increase their hours, resulting in a reduction in the supply of labour.

22 The recovery in pay growth since the turn of the year was likely in part to be a lagged response to the labour market tightening seen over the previous 18 months or so. However, it was also possible that part of the recent pickup in the AWE measure of wage growth related to the changing composition of employment growth. Evidence from the LFS suggested that a shift in the composition of employment growth towards those individuals in industries and occupations that typically attracted lower average pay levels and those with fewer qualifications might have lowered annual AWE growth by around 1 percentage point relative to average during much of 2014. Although one could not be confident in the precise estimates, this effect appeared to have diminished in the most recent data to something like ½ percentage point.

23 Identifying the source of the pickup in pay growth was important for the assessment of the degree of inflationary pressure that would result from it. To the extent that higher pay reflected a tightening labour market, then it was likely to feed through into higher consumer price inflation in time. But, to the extent that it reflected the shifting composition of employment growth, higher average pay was likely to be accompanied by higher average productivity, offsetting at least some of the impact on firms' production costs and therefore inflationary pressure. Given the small decline in employment, output per worker had risen by 1% in the second quarter and by around 1½% in the year to Q2. Whole economy unit wage costs – wages relative to productivity – had increased by around 1% in the year to 2015 Q2.

The immediate policy decision

24 The Committee set monetary policy to meet the 2% inflation target and in a way that helped to sustain growth and employment. Events during the month had again highlighted the contrast between continued strength in private domestic demand in the United Kingdom and a subdued global outlook. Global developments did not as yet appear sufficient to alter materially the central outlook described in the *August Report*, but the greater downside risks to the global environment merited close monitoring for any impact on domestic economic activity.

25 The outlook for domestic activity appeared similar to that at the time of the *August Inflation Report*. The expenditure breakdown of Q2 GDP had been broadly similar to that in the *August Report*. Some downside news on household consumption had been offset by unexpectedly strong business investment, but given their susceptibility to revision, these estimates should be treated with caution. Employment growth had fallen back,

but labour market surveys remained more buoyant. Consumer confidence had remained high and a range of indicators suggested that activity in the housing market was rising. Although Bank staff had lowered slightly their estimate of GDP growth in Q3, reflecting some unexpected weakness in services activity, forward looking indicators had continued to point to steady near-term growth in aggregate demand.

26 The international news had been mixed, although, on balance, the downside risks to world activity had probably increased. The upward revisions to US and euro area GDP and the pickup in euro-area PMIs had been encouraging, as from a UK trade-weighted perspective these economies were of particular importance. The outline agreement between Greece and its euro-area partners had reduced the likelihood of further harm to activity and confidence from that source, at least in the near term. By contrast, concerns about China and other emerging economies had grown. This had resulted in sharp falls in the prices of risky assets, including in advanced economy markets, and declines in commodity prices. The latter might provide some countervailing support to spending in commodity-importing economies. It was unclear how the situation might evolve, however, and what the impact on global activity might be. Some caution was due in drawing out major trends from short-term developments: the Chinese authorities were managing a complicated economic transition, and some volatility during the adjustment process was to be expected. Nevertheless, the combination of slower growth in Chinese demand, weak commodity prices and the prospect of monetary tightening in the United States was likely to have an adverse effect on a number of emerging economies, whose importance in the world economy had grown significantly in recent years.

27 The near-term outlook for CPI inflation was little changed since the time of the *August Inflation Report*, reflecting, on the one hand, the lower price of oil, and on the other, stronger core inflation. CPI inflation was likely to remain close to zero for a few more months before picking up around the turn of the year, but volatility in the oil price injected additional uncertainty into this near-term path. Further ahead, the path of inflation would depend upon the evolution of domestic costs and on any medium-term effect of movements in the exchange rate on the prices of imported products.

28 Wage growth had picked up over the past year, reflecting the past tightening in the labour market. However, the recent slowing in employment alongside steady output growth implied that productivity had risen, offsetting the effect of higher wage growth on unit wage costs. Annual unit wage cost growth of around 1% in Q2 was some way short of what was likely to be needed to return CPI inflation sustainably to the 2% target. On one view, the slowing employment data might imply that labour demand had plateaued, and that this would keep pay growth muted. Further improvements in productivity might also limit growth in unit wage costs. On another view, however, the slowdown in employment might reflect greater hiring difficulties, consistent with survey evidence of skill shortages, with the likely consequence of more rapid growth in pay.

29 For eight members, the current policy stance remained appropriate. Although the downside risks emanating from overseas had risen, it would be premature to draw strong inferences from this month's events for the likely path of activity in the United Kingdom. At the same time, private domestic demand growth had remained strong. Uncertainty about the near-term path of inflation had increased, but a pickup around the turn of the year remained likely. Over the month, there had been counter-balancing news of a lower oil price, on the one hand, and signs that core inflation might be firming, on the other. It remained unclear to what extent lower

unemployment would translate into accelerating unit wage costs. There was also considerable uncertainty about the extent of pass-through from movements in the exchange rate to inflation. Some of these members nevertheless saw continued upside risks to inflation relative to the target.

30 For one member these risks were sufficient to justify an immediate increase in Bank Rate. The outlook for private domestic demand growth was robust, with consumer and business confidence at high levels. Labour market indicators suggested a degree of tightness that was likely to generate more rapid growth in pay than in the Committee's August *Inflation Report* central forecast, adding to other signs that underlying inflationary pressures had begun to build. Although the turbulence emanating from China raised downside risks that warranted monitoring, it was premature to assume that the effects of developments to date would have a material effect on this UK outlook. Moreover, this member believed that an earlier start to policy normalisation would facilitate a more gradual path for policy tightening, a desirable policy aim in itself, while also reducing the risk of a period in which inflation remained above the target at the end of the forecast period.

31 All Committee members agreed that the central message of the February 2014 *Inflation Report* guidance remained relevant. Given the likely persistence of the headwinds weighing on the economy, when Bank Rate did begin to rise it was expected to do so more gradually than in previous cycles. Moreover, the persistence of those headwinds, together with the legacy of the financial crisis, meant that Bank Rate was expected to remain below average historical levels for some time to come. This guidance was an expectation, not a promise, however. The actual path that Bank Rate would follow over the next few years was uncertain, and would depend on the economic circumstances.

32 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.

33 In order to accommodate some members' attendance at international meetings in Peru on Wednesday 7 October, the October MPC meeting will conclude on Tuesday 6 October. The decision and minutes of the meeting will still be released at the originally scheduled time of 12.00 noon on 8 October.

34 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, Anthony Habgood was also present on 2 September as an observer in his role as a member of the Oversight Committee of Court.