



**BANK OF ENGLAND**

# Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 16 March 2016

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These are the minutes of the Monetary Policy Committee meeting ending on 16 March 2016.

They are available at <http://www.bankofengland.co.uk/publications/Pages/news/2016/003.aspx>

The Bank of England Act 1998 gives the Bank of England operational responsibility for setting monetary policy to meet the Government's inflation target. Operational decisions are taken by the Bank's Monetary Policy Committee. The minutes of the Committee meeting ending on 13 April will be published on 14 April 2016.

## Monetary Policy Summary, March 2016

The Bank of England's Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target and in a way that helps to sustain growth and employment. At its meeting ending on 16 March 2016, the MPC voted unanimously to maintain Bank Rate at 0.5%. The Committee also 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 to 0.3% in January. Inflation nonetheless remains well below the 2% inflation target. This is due predominantly to unusually large drags from energy and food prices, which are expected to fade in the coming months. But core inflation also remains subdued, a consequence of the past appreciation of sterling, weak global inflation and restrained domestic cost growth.

Returning inflation to the 2% target requires balancing the drag from external factors against increases in domestic cost growth. Fully offsetting that drag over the short run would, in the MPC's judgement, involve too rapid an acceleration in domestic costs, one that would risk being unsustainable and would lead to undesirable volatility in output and employment. Given these considerations, the MPC intends to set monetary policy to ensure that growth is sufficient to return inflation to the target in around two years and keep it there in the absence of further shocks.

The MPC set out its most recent detailed assessment of the economic outlook in the February *Inflation Report*. Over the medium term, growth in the advanced economies should continue to be supported by the boost to real incomes from low commodity prices, and to some degree by fiscal and monetary policy. But emerging market economies are likely to grow more slowly than in recent years and the risks to the MPC's central projection of only modest global growth lie to the downside. Data releases since the February *Inflation Report* show little change in the near-term outlook for growth in the United Kingdom's main trading partners.

In the United Kingdom, underlying growth of private domestic demand remains solid. A tighter labour market and rising productivity are expected to support real incomes and consumption. Consumer confidence and most surveys of business investment are above historical averages. And, in the past month, changes in asset prices have generally been supportive for UK growth and inflation. The prices of risky assets have rebounded. Relative to the conditioning assumptions that underlay the projections published in the Committee's February *Inflation Report*, oil prices have risen and UK short-term interest rates and sterling have fallen. Sterling has depreciated by around 9% in effective terms from its peak in mid-November 2015.

Set against that, there appears to be increased uncertainty surrounding the forthcoming referendum on UK membership of the European Union. That uncertainty is likely to have been a significant driver of the decline in sterling. It may also delay some spending decisions and depress growth of aggregate demand in the near term. Overall, however, the Committee judges the outlook for domestic activity to be little changed from the time of the February *Inflation Report*, with GDP expected to grow at around average rates over the forecast period.

Wage growth has evolved broadly as expected in the February *Inflation Report*. The return to higher rates of inflation should in time support wage gains. The MPC judges that inflation expectations remain well anchored,

though it remains watchful for signs that low inflation is having more persistent second-round effects on wages. Overall, while domestic cost growth over the past year has been below that necessary for inflation to return to the 2% target, its pace is expected to increase over time.

As in February, there is a range of views among MPC members about the balance of risks to inflation relative to the central projection presented in the February *Inflation Report*. At its meeting ending on 16 March, the MPC judged it appropriate to leave the stance of monetary policy unchanged. The MPC's best collective judgement is that it is more likely than not that Bank Rate will need to increase over the forecast period to ensure inflation returns to the target in a sustainable fashion.

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

## Minutes of the Monetary Policy Committee meeting ending on 16 March 2016

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 Having fallen in January and early February, the prices of a broad range of risky assets had risen over the period since the Committee's previous meeting. Sterling had depreciated further. The Committee reviewed the latest developments in financial markets, focussing its discussion on two issues: the extent to which recent movements in asset prices reflected developments in the real economy; and the influence of the forthcoming referendum on UK membership of the European Union on sterling asset prices.

3 Equity prices had risen in the euro area, the United Kingdom and the United States since the Committee's previous meeting. In emerging market economies, the rebound in equity indices had been particularly marked. Measures of equity market volatility had fallen back from elevated levels seen earlier in the year. Non-financial corporate credit spreads had narrowed over the month. On 10 March, the ECB had announced a range of stimulatory measures, including a cut in its deposit rate of 10 basis points to minus 40 basis points; an increase in the size and scope of its Asset Purchase Programme; and a new series of targeted longer-term refinancing operations, enabling banks expanding their lending to the real economy to borrow funds from the ECB at a rate that could be as low as that on the ECB's deposit facility. These measures had affected a range of financial markets and there had been a further fall in corporate bond spreads. Overall, these increases in the prices of risky assets and falls in equity volatility were consistent with an improvement in risk appetite on the part of investors.

4 Short-term interest rates had been largely unchanged since the Committee's previous meeting, but there had been significant movements within that period. They had fallen in early February, following the Bank of Japan's move in late January to a system of tiered reserves remuneration with marginal balances incurring a negative interest rate. Market intelligence suggested this had led investors to reassess their views of the effective lower bound for official interest rates in other advanced economies. Short rates in the United States had then increased in response to stronger-than-expected data releases. Following the ECB policy announcement, short rates had risen in the euro area and internationally. Market contacts had noted in particular the ECB President's comments in the press conference, which they had interpreted as reducing the likelihood of further rate cuts. In the United Kingdom, despite some increases towards the end of the period, the three-year instantaneous forward rate was, at 0.8%, around 10 basis points lower than at the time of the Committee's previous meeting and around 30 basis points lower than in the conditioning assumption that underlay the projections published in the February *Inflation Report*.

5 The Committee discussed possible explanations for the recent movements in financial markets, both over the period of heightened volatility between the start of the year and early February and the subsequent rebound in the prices of risky assets. One possibility was that movements in financial markets had reflected investors'

reassessments of the central case for the global economic outlook. It was also possible that they had altered their perceptions of the risks to the global economy, including those from emerging markets. Changing market views of central banks' reaction functions, and of the efficacy of their actions more generally, had perhaps also played a role. Alternatively, changes in financial market prices may have been unrelated to changes in the economic outlook or central banks' response to it. Committee members attached different weights to these candidate hypotheses, with some noting that it was possible that market participants had reappraised the economic outlook, downside risks and central bank policy responses since the start of the year.

6 Relative to its peak in mid-November, sterling had fallen by around 9% in effective terms. Some of that depreciation reflected international factors, including the euro's broad-based appreciation following the ECB's December meeting and the dollar's appreciation around the time of the FOMC's December meeting. But market intelligence suggested that a large proportion of the depreciation had been driven by uncertainty surrounding the referendum on UK membership of the European Union. Sterling had fallen following the announcement by the Prime Minister that the referendum would take place on 23 June. Since then, market participants had increasingly focussed on how a possible vote to leave the EU would affect the UK's economic prospects. The sterling effective exchange rate had fallen by around 3% since the Committee's previous meeting and was 3% lower than the starting point of the conditioning assumption used in the February *Inflation Report*. Options prices continued to indicate that the price of protection against the risk of a sterling depreciation against the dollar compared with the price of protection against an appreciation was higher than in the second half of 2015. That negative skew had increased over the period since the Committee's previous meeting.

7 So far, there remained little evidence that the referendum had affected other UK asset prices. Spreads between UK gilt yields and those of other government bonds had been stable. The Committee would continue to monitor the influence of the referendum in driving sterling asset prices.

### **The international economy**

8 The news on the global economy during the month had been mixed. Euro-area GDP growth had been a little weaker than expected in 2015 Q4, at 0.3%, although the annual growth rate of 1.6% was above Bank staff's estimate of trend growth. Strong industrial production in January suggested slightly firmer growth in 2016 Q1, although some business survey readings had been soft. The news on inflation had been to the downside, with the flash estimate of HICP inflation having fallen to -0.2% in February and core inflation having fallen to 0.7%. These readings had provided the backdrop to the ECB's announcement of further stimulatory measures on 10 March.

9 The MPC discussed some of the challenges facing the euro-area economy. The steady expansion in activity over the past couple of years had been underpinned by improving credit conditions, lower oil prices, supportive monetary policy and a lessening drag from fiscal policy. It seemed likely that the boost from the first two of these would fade, placing more of a burden on policy to support demand. Also, despite some notable improvements in the current account positions of the so-called 'periphery' economies – from significant deficits

prior to the global financial crisis to balance or modest surplus in the latest readings – net international investment positions still showed large stocks of external liabilities relative to assets. To reduce these materially, current account surpluses would probably need to rise further and persist for a period of many years. The muted outlook for global demand suggested that eliminating this potential source of vulnerability would be challenging.

10 In the United States quarterly GDP growth in Q4 had been revised up slightly to 0.3%. Growth was expected to pick up to around 0.5% in Q1, 0.1 percentage points lower than anticipated in the February *Inflation Report*. Employment growth had remained strong and inflation had been firmer than expected.

11 In China, the authorities had announced a target range for GDP growth of 6½% to 7% in 2016, only modestly lower than the 2015 target of around 7%. Borrowing by non-state entities, as measured by total social financing, had grown by a record 13.8% in the twelve months to January, and this had moderated only slightly to 13.2% in February, suggesting that credit expansion was likely to play an increasing role in supporting demand. Recent official clarification of the exchange rate policy appeared to have provided some reassurance to investors, and the pace of decline in Chinese foreign currency reserves had slowed markedly in February.

12 The oil price had risen by \$5 per barrel since the previous MPC meeting, to around \$37 per barrel. Improved expectations of Chinese activity following the announced growth target were likely to have been one factor driving this, although there had also been some negative developments on the outlook for oil supply.

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

13 UK GDP was estimated to have grown by 0.5% on the quarter in 2015 Q4, unchanged from the initial estimate. There had been relatively little news in the output split in the second estimate of Q4 GDP growth: service sector output had risen by 0.7%, while industrial production had fallen by 0.5% and construction had shrunk by 0.4% on the quarter. The construction data had, however, been subsequently revised to suggest a small rise in output on the quarter.

14 On the expenditure side, private consumption had grown by 3.1% in the four quarters to 2015 Q4, its strongest annual growth rate since 2007. Private consumption growth in Q4 had been in line with expectations at 0.7%. There had, however, been news in the other expenditure components. Government consumption had been stronger than expected, whereas net trade had exerted a larger drag on GDP growth in Q4 than expected in the February *Inflation Report*. Business investment had been much weaker than projected, falling by 2.1%, whereas housing investment had been much stronger than expected, growing by 4% in Q4. These expenditure components tended to be volatile and were highly uncertain at this stage of the data cycle. The ONS had indicated that the Q4 estimate of business investment could reflect disposals of transport equipment, which might subsequently unwind in Q1.

15 Nominal GDP growth had slowed during 2015, to an annual rate of 1.9% in Q4. Within that, the implied GDP deflator had been flat in the year to Q4, such that nominal and real GDP had grown at the same rate.

Nominal GDP growth had tended in the past to be more heavily revised than real GDP growth and reductions in the contributions of net trade and stockbuilding – two of the more volatile components of nominal GDP – had more than accounted for the slowing in nominal GDP growth in 2015.

16 Indicators of activity in Q1 had been mixed, but taken together, suggested that real GDP growth would be maintained at a similar pace to that in Q4. The Markit/CIPS composite output index for February had fallen by just over three points to its lowest level since April 2013, the latest intelligence from the Bank's Agents' was consistent with a further easing of output growth in Q1 and the output balance from the CBI service sector survey had also fallen to just below its long-run average in Q1. By contrast, industrial production in January had been stronger than expected, and construction output had been in line with expectations. Some members noted that business surveys were sometimes affected by sentiment as well as actual output, but that was unlikely to account for the major part of the decline in the survey measures.

17 The outlook for consumption and the housing market in Q1 had remained robust, in line with expectations. Retail sales growth had increased in January and new car registrations had remained strong in February. In addition, while households' confidence in the general economic situation over the next twelve months had deteriorated in February, that stood in contrast to households' confidence in their personal financial situation and their appetite to make major purchases, which had remained at historically high levels. Activity in the housing market had also picked up: having risen by 18% through the course of 2015, mortgage approvals for house purchase had grown further in January 2016 to around 75,000. Data from the Council of Mortgage Lenders suggested that much of the increase on the month reflected a rise in the number of approvals for the purchase of buy-to-let properties. It was likely that most of the rise in approvals had reflected transactions being brought forwards ahead of the forthcoming change in stamp duty payable on the purchase of additional properties announced in the 2015 Autumn Statement. According to the average of the lenders' indices, house price inflation had also picked up in the three months to February to 8.8% on an annualised basis.

18 The Committee discussed how the risks to the outlook had evolved since the February *Inflation Report*. The latest composite expectations index from the Markit/CIPS survey had been steady. Notwithstanding that, a measure of overall economic uncertainty, based on financial market indicators, media searches and survey data, had risen above its long-run average for the first time in almost three years in February. Part of that rise was likely to reflect uncertainty relating to the referendum on UK membership of the European Union. In that regard, the Markit/CIPS survey had pointed to a weakening of the growth in orders for investment goods in the manufacturing sector, although the latest CBI service sector survey suggested that the number of firms planning to invest in land and buildings was at its highest level since 2007.

19 During its policy meeting, the Committee had received a briefing from the Treasury representative on the aggregate fiscal plans that had been announced in Budget 2016 on 16 March. The Committee would analyse the implications of the Budget more fully as a part of the preparation of its May *Report*.

## Supply, costs and prices

20 Twelve-month CPI inflation had risen to 0.3% in January, 0.1 percentage points lower than forecast by Bank staff. The downside surprise was largely due to changes in component weights, and had not led staff to change their near-term inflation forecast materially. The Committee discussed the likelihood that inflation would continue along a gentle upward path, reaching the 2% target in around two years' time, as in the February *Inflation Report* projection.

21 At the time of the February *Inflation Report*, CPI inflation had been expected to rise to around 1% at the turn of the year. Much of the projected increase was driven by the expectation that unusually weak inflation outturns twelve months earlier would not be repeated this year. These were concentrated in non-core items such as energy and food: the expected rise in core inflation during the rest of this year was more modest, although the recent depreciation of sterling, were it to persist, could introduce upside risks to that forecast. Looking beyond the year end, an analysis of the inflation forecast based on the outlook for individual components implied that the projected rise might require a fairly pronounced strengthening in consumer services inflation. Although this conclusion was sensitive to the assumptions made about the outlook for other components, it would be consistent with the Committee's expectation that growth in private sector wages and unit labour costs would pick up.

22 There had been mixed news on inflation expectations during the month. The YouGov/Citigroup survey of households had reported increases in expected inflation at both the one-year and five-to-ten-year horizons, although the levels of both remained some way below their pre-crisis averages. The Bank/TNS quarterly survey, by contrast, had recorded falls in inflation expectations one and two years ahead and no change in expectations five years ahead. In financial markets, inflation swaps implied that there had been little change in five-year inflation expectations five years ahead since the February *Inflation Report*.

23 There remained a question of the extent to which the recent low inflation outturns might exert downward pressure on wage growth, imparting some persistence into the inflation process. Regression analysis indicated that the responsiveness of inflation expectations to inflation outturns was statistically significant at short horizons, albeit substantially less than one-for-one. The empirical evidence also supported the idea that these expectations had a significant influence on pay growth. This suggested that some effect was likely to be present in the current wage data, a sentiment supported by reports from the Bank's Agents, and one that had been factored into the February *Inflation Report* analysis, both in the central projection for inflation and as a near-term downside risk.

24 The February labour market statistics release had contained material upside news in average hours relative to the expectation at the time of the February *Inflation Report*: at 32.2 hours per week this figure was 0.7% higher than expected. The March labour market statistics release had shown that this strength had been maintained. Otherwise, there had been relatively little news on the labour market since the previous MPC meeting. Both the unemployment rate and average earnings growth had been higher than expected, but only marginally so. The Committee noted that the estimated drag on average earnings growth from so-called compositional effects had fallen, to around  $\frac{1}{4}$  percentage points in Q4 from around  $\frac{3}{4}$  percentage points in Q3.

Weak productivity data in 2015 Q4 meant that unit wage costs calculated from Average Weekly Earnings had risen by around 1½% in the year to 2015 Q4, and slightly faster in the last two quarters.

### **The immediate policy decision**

25 The Committee set monetary policy to meet the 2% inflation target, and in a way that helped sustain growth and employment. In pursuit of that objective, the Committee considered how recent developments had affected the balance of risks to the outlook.

26 Twelve-month CPI inflation had risen to 0.3% in January, but nonetheless remained well below the 2% target. The vast majority of the shortfall reflected the impact of falls in commodity prices and the past appreciation of sterling. The outlook for inflation would therefore depend on the persistence of these influences, the extent to which, in the United Kingdom, demand grew in excess of supply, and how rapidly the pressure of demand on supply would outweigh any other forces currently depressing wage and price inflation.

27 In the euro area, the latest data releases had suggested GDP growth in the first quarter of 2016 was likely to be similar to that assumed at the time of the February *Inflation Report*. The ECB had announced a range of stimulatory measures, which should support activity. In the United States, growth was expected to pick up in Q1 but to a rate slightly below the February forecast. Investors had drawn reassurance from several developments in China, including the authorities' announcement of its growth target for 2016 and a clarification of Chinese exchange rate policy. But the challenges facing emerging markets remained and the risks to the MPC's central projection of only modest global growth continued to lie to the downside. The oil price had risen sharply, reflecting a combination of expectations of increased Chinese demand and weaker oil supply.

28 While the prices of risky assets had risen over the period since the Committee's previous meeting, short-term interest rates had fallen in a number of economies in February. The latter could reflect a number of factors, including reduced optimism about the global economic outlook and a reappraisal by market participants of the effective lower bound for official interest rates. Taken together, and if sustained, the loosening in financial conditions resulting from these asset price movements would tend to support economic activity in the United Kingdom and overseas.

29 Sterling had depreciated by around 3% in effective terms relative to the starting point of the conditioning assumption that underlay the projections published in the Committee's February *Report* and by around 9% from its peak in mid-November 2015. It was typically difficult to identify the causes of changes in the exchange rate, but in this instance it seemed likely that a significant proportion of the recent decline in sterling reflected uncertainty surrounding the forthcoming referendum on UK membership of the EU. That might have implications for the effect of the latest depreciation on GDP growth and inflation.

30 In the United Kingdom, the second estimate of growth in Q4 was 0.5%, unchanged from the initial estimate. Indicators of output in Q1 had been mixed, but suggested that growth would be maintained at a similar pace to Q4. In terms of the expenditure components of GDP, in the fourth quarter private consumption

growth had remained robust and the latest indicators pointed to that strength continuing. By contrast, business investment had been unexpectedly weak, although the Committee noted that this component of GDP was volatile and its measurement at this stage of the data cycle was particularly uncertain. Indicators of investment had been mixed for Q1 so far.

31 There had been limited news on the labour market. Wage growth had evolved broadly as expected in the February *Report*. A key judgement remained how wages would respond to the past declines in unemployment and the prospective increase in inflation. The latest survey measures of inflation expectations had provided conflicting signals, and inflation swaps suggested five-year inflation expectations, five years forward were little changed since the February *Report*. The Committee remained watchful for signs that low inflation was having more persistent second-round effects on wages.

32 The near-term outlook for CPI inflation and core inflation had changed little from that at the time of the February *Report*. As in February, there was a range of views among MPC members about the balance of risks to inflation relative to the best collective judgement presented in the February *Inflation Report*.

33 Against that backdrop, all members of the Committee thought that maintaining the current stance of policy was appropriate at this meeting. The Committee's best collective judgement was that it was more likely than not that Bank Rate would need to increase over the forecast period to ensure inflation returned to the target in a sustainable fashion. There continued to be a spread of views among members about the outlook for activity and inflation, in particular regarding: the response of wage settlements to the fall in unemployment and the prospective increase in CPI inflation; the impact of exchange rate movements; and on the degree to which companies would seek to increase margins through raising prices.

34 All members agreed that, 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 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.

35 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.

36 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 10 March as an observer in his role as a member of the Oversight Committee of Court.