



BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 13 December 2017

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These are the minutes of the Monetary Policy Committee meeting ending on 13 December 2017.

They are available at <https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2017/december-2017>.

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 7 February 2018 will be published on 8 February 2018.

Monetary Policy Summary, December 2017

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 13 December 2017, the MPC voted unanimously to maintain Bank Rate at 0.5%. The Committee voted unanimously to maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £10 billion. The Committee also voted unanimously to maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435 billion.

In the MPC's most recent economic projections, set out in the November *Inflation Report*, GDP grew modestly over the next few years, at a pace just above its reduced rate of potential. Consumption growth remained sluggish in the near term before rising, in line with household incomes. Net trade was bolstered by the strong global expansion and the past depreciation of sterling. Business investment, while affected by uncertainties around Brexit, was projected to continue to grow at a modest pace, supported by strong global demand, high rates of profitability, the low cost of capital and limited spare capacity.

Unemployment was expected to remain low throughout the three-year forecast period, and domestic inflationary pressures were projected to pick up gradually as remaining spare capacity was absorbed and wage growth recovered. Nevertheless, reflecting the diminishing effect of sterling's depreciation, CPI inflation was forecast to decline from around 3% to approach the 2% target by the end of the three-year forecast period.

The recent news in the macroeconomic data has been mixed and relatively limited. Global growth has remained strong. Domestically, some activity indicators suggest GDP growth in Q4 might be slightly softer than in Q3. The measures announced in the Autumn Budget will lessen the drag on aggregate demand stemming from fiscal consolidation, relative to previous plans. The labour market remains tight, and surveys suggest this will continue. Although it is too early to arrive at a comprehensive view of the effect of November's rise in Bank Rate on the economy, the impact on interest rates faced by households and firms has been consistent with previous experience.

CPI inflation was 3.1% in November. It remains the case that inflation has been pushed above the target by the boost to import prices that resulted from the past depreciation of sterling. The MPC judges that inflation is likely to be close to its peak, and will decline towards the 2% target in the medium term. In line with the procedure set out in the MPC's remit, the Governor will be writing an open letter to the Chancellor of the Exchequer, accounting for the overshoot relative to the target and explaining the MPC's policy strategy to return inflation sustainably to the target. This letter will be published alongside the minutes of the February 2018 MPC meeting and the accompanying *Inflation Report*.

Developments regarding the United Kingdom's withdrawal from the European Union – and in particular the reaction of households, businesses and asset prices to them – remain the most significant influence on, and source of uncertainty about, the economic outlook. The Committee noted the progress in the Article 50

negotiations between the United Kingdom and the European Union. In such exceptional circumstances, the MPC's remit specifies that the Committee must balance any trade-off between the speed at which it intends to return inflation sustainably to the target and the support that monetary policy provides to jobs and activity.

The steady erosion of slack over the past year or so has reduced the degree to which it is appropriate for the MPC to accommodate an extended period of inflation above the target. Consequently, at its previous meeting, the MPC judged it appropriate to tighten modestly the stance of monetary policy in order to return inflation sustainably to the target, while continuing to provide significant support to jobs and activity. At this meeting, the Committee voted unanimously to maintain the current monetary stance. The Committee remains of the view that, were the economy to follow the path expected in the November *Inflation Report*, further modest increases in Bank Rate would be warranted over the next few years, in order to return inflation sustainably to the target. Any future increases in Bank Rate are expected to be at a gradual pace and to a limited extent. The Committee will monitor closely the incoming evidence on the evolving economic outlook, including the impact of last month's increase in Bank Rate, and stands ready to respond to developments as they unfold to ensure a sustainable return of inflation to the 2% target.

Minutes of the Monetary Policy Committee meeting ending on 13 December 2017

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 The sterling ERI had continued to respond to news regarding the United Kingdom's ongoing Article 50 negotiations with the European Union. It had risen since the November *Inflation Report*, partly as a result of progress in those negotiations.

3 UK short-term interest rates were close to their level at the time of the November *Inflation Report*. A further 25 basis point increase in Bank Rate was fully priced in by the end of 2018. Around half of the economists responding to a survey by Reuters had expected Bank Rate to increase by this date. The Committee noted that its decision to increase Bank Rate by 25 basis points at its November meeting had fed through fully to sterling overnight interest rates.

4 In the United States, short-term interest rates had risen since the November *Report*, supported by stronger-than-expected economic data as well as US political developments, including the progress of the administration's tax reforms. The FOMC had not changed policy at its most recent meeting, but most financial market participants expected an increase in the federal funds rate at the December FOMC meeting. In the euro area, short-term interest rates had been relatively stable since the MPC's November meeting.

5 In contrast, long-term interest rates beyond the 15-year horizon had fallen across several countries. This had left them a little lower than at the beginning of the year, leading to an overall flattening in yield curves. This had been most notable in the United States, but was also the case, to a lesser extent, in the United Kingdom. The Committee noted that it was not unusual for yield curves to flatten as central banks began to tighten policy. It was possible that the falls in long rates this year reflected a reduction in investor optimism about medium-term growth prospects, but this seemed somewhat at odds with the increase in equity prices over the same period.

The international economy

6 Since the MPC's previous meeting, macroeconomic data released in the United Kingdom's main trading partners had continued to be strong.

7 In the United States, GDP growth in 2017 Q3 had been revised up slightly in the second estimate, to 0.8%. The upward revision had been relatively broadly based across expenditure components, with higher contributions to growth from business investment, residential investment and government expenditure. Although the near-term outlook for activity still looked healthy, high-frequency data covering Q4 had, on balance, been a little weaker than expected. As such, Bank staff now expected that GDP growth in Q4 would

be 0.6%, slightly lower than expected at the time of the MPC's previous meeting. The labour market had continued to be strong, with the unemployment rate remaining at 4.1% in November, its lowest level since December 2000. Despite the strength of activity, inflation had remained subdued, with annual core PCE inflation in October unchanged on the month at 1.4%. Since the Committee's previous meeting, tax reform legislation had passed both chambers of the US Congress. Despite uncertainty remaining over the final reconciled bill, the separate House and Senate versions were both in a form that looked likely to provide a small fiscal stimulus, in line with expectations at the time of the November *Inflation Report*.

8 In the euro area, GDP growth in the third quarter had been unrevised at 0.6% in the second release. Growth had been broad-based across countries, and the largest contributions had come from investment and household consumption, as in the previous quarter. Near-term activity indicators had pointed to continued strength in the economy; in particular, the purchasing managers' indices and business and consumer confidence surveys had suggested that GDP growth was likely to pick up slightly in 2017 Q4, to 0.7%. The unemployment rate had continued to fall, to 8.8%, and was now in line with the pre-crisis average. As in the United States, strong activity had not yet led to higher core inflation. The flash estimate of core HICP inflation had remained subdued, at 0.9% in November, while headline inflation had picked up slightly, to 1.5%.

9 In China, activity indicators for the fourth quarter, including industrial production and retail sales, had softened slightly, broadly in line with expectations. It looked likely that Chinese GDP would register growth of 6.8% in 2017. That would make it the first calendar year since 2010 in which growth had not declined. However, activity had been supported by looser fiscal policy and rapid credit growth, which potentially increased future downside risks. The Committee discussed the channels through which an adverse shock in China could transmit to the United Kingdom. The Financial Policy Committee's 2017 stress test had tested UK-owned banks' resilience to a very severe stress in China, and found that the banks had sufficient capital to withstand the shock. China's direct trade links to the United Kingdom had been rising, but were nonetheless modest. However, the broader impact of a downturn in China on the world economy would be considerable, particularly via South East Asia and commodity exporters, and there was evidence that global financial markets had become increasingly responsive to perceptions of Chinese stress.

10 Spot oil prices had increased by 13% relative to the 15-day average incorporated in the November *Inflation Report*, and, on average over the forecast period, the futures curve was 8% higher. Overall, the increase in prices in recent months had reflected both demand and supply factors. Weak oil supply growth had played a bigger role in the most recent increase, as OPEC crude output had reached its lowest level since May 2017, and excess supply in oil stocks had fallen. Compliance with the December 2016 OPEC/non-OPEC agreement to cut production had risen to 96%, the highest since the agreement began, and it had been extended to the end of 2018. Although the outlook for demand had remained high relative to historical averages, the International Energy Agency had slightly revised down its demand projections for 2017 and 2018, reflecting the impact of higher prices and milder winter temperatures.

Money, credit, demand and output

11 The ONS's second estimate of GDP growth in 2017 Q3 had been unrevised from the preliminary estimate, at 0.4%, as incorporated in the November *Inflation Report*. On the output side of the accounts, the picture had been little changed from the previous estimates. There had been more news in the associated breakdown of aggregate expenditure. In particular, household consumption was estimated to have grown by 0.6%, compared with a forecast of 0.3% growth in the November *Inflation Report*. Offsetting that had been a larger-than-expected drag from net trade, excluding valuables, and some unexpected weakness in both housing and business investment.

12 Considerable uncertainty surrounded expenditure growth estimates at this early stage in the data cycle, but, if confirmed, the growth in Q3 consumption would mark the strongest pace of expansion since 2016 Q2, and an acceleration following four consecutive quarters of slowing household demand. However, this figure had probably been boosted by erratic movements in energy consumption and car purchases, so the implications for future household demand were likely to be less than the headline news suggested. Higher-frequency indicators of consumption growth, such as consumer confidence, housing market indicators and reports from the Bank's Agents, had pointed to a slower pace of expansion in 2017 Q4, albeit a little above the 0.2% central forecast in the November *Inflation Report*.

13 More generally, available indicators of activity in Q4 had, on balance, been softer than expected. A number of business surveys had reported declines in expectations and confidence. In the official data, although the zero growth in industrial production in October had been broadly in line with expectations, the 1.7% fall in construction output had been weaker than forecast. The Committee noted, however, that there had been a recent tendency for initial estimates to overstate weakness in construction output. It was still early in the data cycle, but the available indicators so far suggested that GDP growth in Q4 might be somewhat below that registered in Q3.

14 The Autumn Budget had contained some upside news for aggregate demand over the next couple of years. The Office for Budget Responsibility's analysis of the economic outlook and of the measures announced by the government had indicated a shallower pace of structural budget consolidation in 2018/19 and 2019/20 than had previously been planned. This would lessen the drag that fiscal consolidation was having on GDP. Provisional estimates by Bank staff suggested that the level of GDP would be boosted by around 0.3% over the three-year forecast period, and that CPI inflation would be around 0.1 percentage points higher as a result of the measures.

15 At its previous meeting, the MPC had taken the decision to increase Bank Rate by 25 basis points to 0.5%, the first increase for more than ten years. It was too early to gauge fully the effect that this tightening was having on the economy. But the pass-through from the Bank Rate increase into the interest rates facing households had so far been consistent with previous experience.

Supply, costs and prices

16 Twelve-month CPI inflation had risen by 0.1 percentage points to 3.1% in November. This outturn had been 0.1 percentage points higher than Bank staff had expected immediately prior to the release, reflecting upside news in goods prices, particularly recreational goods and clothing and footwear, while services prices had been in line with expectations. CPI inflation in November stood 1.1 percentage points above the 2% target. This deviation from target was accounted for by the effects of the rise in import prices following sterling's depreciation. CPI inflation was expected to edge down gradually, to around 2½% by mid-2018, as the contribution from import prices fell back. Indicators of medium-term inflation expectations had remained consistent with the 2% target.

17 In the MPC's central projection in the November *Inflation Report*, the effects of rising import prices on CPI inflation diminished over the next few years, and domestic inflationary pressures gradually picked up, as remaining spare capacity was absorbed and wage growth recovered. News since the November *Report* had been broadly in line with these expectations. Taking a slightly longer-run perspective, since the start of sterling's depreciation in 2015, import prices had risen significantly, but by less than would have been expected given the experience of previous sharp increases in the sterling value of world export prices. The MPC continued to judge that the impact on import costs would in due course increase towards the level implied by historical precedents. The impact of import prices on CPI inflation, by contrast, had been broadly in line with expectations.

18 Whole-economy regular pay had increased by 2.3% in the year to the three months to October, in line with expectations. Pay growth including bonuses had also been in line with expectations, at 2.5%. Changes in the composition of the workforce had continued to push down somewhat on annual pay growth, by around ½ percentage point, which had primarily reflected a higher proportion of less-educated workers being in employment than a year ago. There had also been an increasing divergence between the pay growth of workers who switched jobs, who had seen wage increases similar to the pre-crisis period, and those remaining in their jobs, who had seen lower increases.

19 The most recent developments in labour market quantities had been difficult to assess. Employment had fallen in the three months to October, by 56,000 compared to the previous three months, leaving the employment rate a touch below expectations, at 60.7%. Average hours had also been somewhat lower than expected. Inactivity had risen markedly in the latest three-month period, compared to the previous three months. Together, these developments had left the rate of unemployment unchanged at 4.3%. The sharp rise in inactivity was unusual for a period outside a cyclical downturn, and it seemed likely that these latest estimates had been affected by sampling variation. Surveys suggested that the labour market remained tight, with vacancies and recruitment difficulties at historically elevated levels.

20 The latest data on net migration had been slightly lower than the ONS's principal projection. In the year to 2017 Q2, net inward migration had fallen to 230,000, lower by 106,000 than its peak in 2016 Q2, of which around three-quarters was accounted for by a fall in net migration of citizens of other EU countries. The majority of the fall in total immigration had been accounted for by a decrease in those looking for work, while the

number of those immigrating with a definite job had been the same as a year earlier. If persistent, these trends would tend to push down on the UK's workforce growth, which had been rapid in recent years compared to other advanced economies.

21 The MPC would be conducting its scheduled reassessment of supply-side conditions in the run-up to the February 2018 *Inflation Report*.

The immediate policy decision

22 The MPC sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. In pursuing that objective, the main challenges for the Committee had remained to assess the economic implications of the United Kingdom withdrawing from the European Union and to identify the appropriate policy response to that changing outlook, including to the substantial depreciation of sterling that had been associated with the decision. During the negotiation period, those economic implications would be influenced significantly by the expectations of households, firms and financial markets about the United Kingdom's eventual economic relationships with the European Union and other countries, and the transition to them.

23 The MPC had set out its most recent economic projections in the November *Inflation Report*, conditioned on the gently rising path of Bank Rate implied by market yields. In those projections, GDP grew modestly over the next few years, at a pace just above its reduced rate of potential. Consumption growth remained sluggish in the near term before rising, in line with household incomes. Net trade was bolstered by the strong global expansion and the past depreciation of sterling. Business investment, while affected by uncertainties around Brexit, was projected to continue to grow at a modest pace, supported by strong global demand, high rates of profitability, the low cost of capital and limited spare capacity.

24 Unemployment was expected to remain low throughout the three-year forecast period, and domestic inflationary pressures were projected to pick up gradually as remaining spare capacity was absorbed and wage growth recovered. Nevertheless, reflecting the diminishing effect of sterling's depreciation, CPI inflation was forecast to decline from around 3% to approach the 2% target by the end of the three-year forecast period.

25 The period since the Committee's previous meeting had contained two significant events regarding the macroeconomic outlook. First, the measures announced in the Autumn Budget would lessen the drag on aggregate demand stemming from fiscal consolidation, relative to previous plans. Provisional estimates by Bank staff suggested that the level of GDP would be boosted by around 0.3% over the three-year forecast period, and that CPI inflation would be around 0.1 percentage points higher as a result of the measures.

26 The second significant event had been the progress made in the first phase of the Article 50 negotiations, which was expected to allow them to proceed to their second phase, and for a transition period to be put in place. This would reduce the likelihood of a disorderly exit, and was likely to support household and corporate confidence. These developments would be given more detailed consideration in the February forecast round.

27 The recent news in the macroeconomic data had been mixed and relatively limited. The sterling exchange rate had remained sensitive to developments relating to the negotiations on withdrawal from the European Union, and had strengthened since the November *Inflation Report*. Global growth had remained strong. Domestically, some activity indicators had suggested GDP growth in Q4 might be slightly softer than in Q3. The labour market had remained tight, and surveys had suggested this would continue. Earnings growth had been broadly as expected during 2017, though it had disappointed in previous years. The Committee continued to expect that the annual rate of pay growth would pick up in the early part of next year, though there remained uncertainties around that projection. Overall, the general assessment of demand growing at a pace just above its reduced rate of potential, generating a gradual pickup in domestic inflationary pressures, seemed intact.

28 CPI inflation had been 3.1% in November. As the Committee had expected at the time of the November *Inflation Report*, and in line with the procedure set out in the MPC's remit, this meant that the Governor would be required to write an open letter to the Chancellor of the Exchequer, accounting for the overshoot relative to the target and explaining the MPC's policy strategy to return inflation sustainably to the target. This letter would be published alongside the minutes of the February 2018 MPC meeting and the accompanying *Inflation Report*. In and of themselves, the small differences between the pattern of CPI over the past two months and what had been expected at the time of the November *Report* did not materially alter the outlook. It remained the case that inflation had been pushed above the target by the boost to import prices that had resulted from the past depreciation of sterling. And the MPC continued to judge that inflation was likely to be close to its peak, and would decline towards the 2% target in the medium term. The policy challenge remained to balance the speed with which inflation was returned sustainably to the target with the support that monetary policy was able to provide to jobs and activity.

29 Although it was too early to arrive at a comprehensive view of the effect of November's rise in Bank Rate on the economy, the impact on interest rates faced by households and firms had been consistent with previous experience. The latest Bank of England/TNS *Inflation Attitudes Survey*, which had been conducted in the days immediately following the November rate increase, had contained encouraging signs that the general public accepted the case for higher interest rates, and believed that interest rates were likely to rise further.

30 Developments regarding the United Kingdom's withdrawal from the European Union – and in particular the reaction of households, businesses and asset prices to them – had remained the most significant influence on, and source of uncertainty about, the economic outlook. In such exceptional circumstances, the MPC's remit specifies that the Committee must balance any trade-off between the speed at which it intends to return inflation sustainably to the target and the support that monetary policy provides to jobs and activity.

31 The steady erosion of slack over the past year or so had reduced the degree to which it was appropriate for the MPC to accommodate an extended period of inflation above the target. Consequently, at its previous meeting, the MPC had judged it appropriate to tighten modestly the stance of monetary policy in order to return inflation sustainably to the target, while continuing to provide significant support to jobs and activity. At this meeting, the Committee voted unanimously to maintain the current monetary stance. The Committee remained of the view that, were the economy to follow the path expected in the November *Inflation Report*, further modest

increases in Bank Rate would be warranted over the next few years, in order to return inflation sustainably to the target. Any future increases in Bank Rate were expected to be at a gradual pace and to a limited extent. The Committee would monitor closely the incoming evidence on the evolving economic outlook, including the impact of last month's increase in Bank Rate, and stood ready to respond to developments as they unfolded to ensure a sustainable return of inflation to the 2% target.

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 sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £10 billion;

The Bank of England should maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435bn.

The Committee voted unanimously in favour of all three propositions.

33 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
Dave Ramsden, Deputy Governor responsible for markets and banking
Andrew Haldane
Ian McCafferty
Michael Saunders
Silvana Tenreyro
Gertjan Vlieghe

34 Richard Hughes was present as the Treasury representative.