



**BANK OF ENGLAND**

## Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 14 June 2017

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These are the minutes of the Monetary Policy Committee meeting ending on 14 June 2017.

They are available at <http://www.bankofengland.co.uk/publications/Pages/news/2017/004.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 2 August will be published on 3 August 2017.

## Monetary Policy Summary, June 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 14 June 2017, the MPC voted by a majority of 5-3 to maintain Bank Rate at 0.25%. 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.

The MPC set out its most recent assessment of the outlook for inflation and activity in the *May Inflation Report*. That assessment depended importantly on three main judgements: that the lower level of sterling continues to boost consumer prices broadly as projected, and without adverse consequences for inflation expectations further ahead; that regular pay growth remains modest in the near term but picks up significantly over the forecast period; and that more subdued household spending growth is largely balanced by a pickup in other components of demand.

CPI inflation has been pushed above the 2% target by the impact of last year's sterling depreciation. It reached 2.9% in May, above the MPC's expectation. Inflation could rise above 3% by the autumn, and is likely to remain above the target for an extended period as sterling's depreciation continues to feed through into the prices of consumer goods and services. The 2½% fall in the exchange rate since the *May Inflation Report*, if sustained, will add to that imported inflationary impetus.

In contrast, pay growth has moderated further from already subdued rates, even as the unemployment rate has fallen to 4.6%, its lowest in over 40 years.

GDP growth declined markedly in the first quarter, in part reflecting weaker household spending. It remains to be seen how large and persistent this slowdown in consumption will prove. In recent months, there have been further signs of a slowing housing market and new car registrations have fallen sharply. Consumer confidence has remained relatively resilient, however, and employment has continued to rise. Outside the household sector, export indicators have strengthened, probably reflecting both the depreciation of sterling and increasingly robust global demand. Most surveys of investment intentions have remained above their historic averages. Surveys of general business activity suggest a modest recovery in GDP growth in the second quarter.

Monetary policy cannot prevent either the necessary real adjustment as the United Kingdom moves towards its new international trading arrangements or the weaker real income growth that is likely to accompany that adjustment over the next few years. Attempting to offset fully the effect of weaker sterling on inflation would be achievable only at the cost of higher unemployment and, in all likelihood, even weaker income growth. For this reason, the MPC's remit specifies that, in such exceptional circumstances, 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 projections that the Committee published in May showed that the economy was expected to operate with a small degree of spare capacity for most of the three-year forecast period, justifying the tolerance of some degree of above-target inflation. The continued growth of employment could suggest that spare capacity is being eroded, lessening the trade-off that the MPC is required to balance and, all else equal, reducing the MPC's tolerance of above-target inflation. Looking ahead, key considerations in judging the appropriate stance of monetary policy are the evolution of inflationary pressures, the persistence of weaker consumption and the degree to which it is offset by other components of demand.

In light of these considerations, five members thought that the current policy stance remained appropriate to balance the demands of the MPC's remit. Three members considered it appropriate to increase Bank Rate by 25 basis points. All members agreed that any increases in Bank Rate would be expected to be at a gradual pace and to a limited extent. The Committee will continue to monitor closely the incoming evidence, and stands ready to respond to changes in the economic outlook as they unfold to ensure a sustainable return of inflation to the 2% target.

## Minutes of the Monetary Policy Committee meeting ending on 14 June 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 Since the Committee's previous meeting, the most notable financial market movement had been the depreciation of the sterling exchange rate. Advanced economy interest rates had also fallen, particularly at longer maturities.

3 The sterling ERI had depreciated by 2½% compared with the fifteen working day average used in the May *Inflation Report*, with a substantial part of that move occurring immediately following the result of the UK general election. Measures of implied volatility of the exchange rate had not increased materially, except at shorter horizons. Sterling had reacted to shifts in opinion polls in the fortnight leading up to the election, as well as to the publication of the May *Inflation Report*, the UK April CPI release, and stronger euro-area data.

4 Short-term and long-term interest rates had declined globally since the previous MPC meeting. These moves in part appeared to reflect some weaker than expected US economic data, although the FOMC had, nonetheless, been expected to increase the target range for the federal funds rate from between ¾% and 1% to between 1% and 1¼% at its 14 June meeting. Euro-area interest rates had also fallen somewhat. At its 8 June meeting, the ECB Governing Council had left its main policy rates and asset purchase profile unchanged.

5 UK short-term interest rates had been lower than at the time of the Committee's previous meeting and at a similar level to that underpinning the May *Inflation Report* projections. Option-implied uncertainty around the path of Bank Rate over the next year had declined following the release of the *Report*. Gilt yields had fallen broadly in line with movements in US Treasury yields since the MPC's last meeting, with the majority of those declines accounted for by lower real interest rates.

6 There had been no clear pattern in the movement of international equity prices since the Committee's previous meeting. Since the start of the year, however, major advanced economy indices had risen strongly. The prices of UK-focused equities within the FTSE All-Share index had also increased, although they had underperformed relative to major indices. Equity prices of large US-based technology companies had increased particularly markedly over this period, but the strength in the S&P 500 index had been broad-based. That had contrasted with the period immediately following the US presidential election last year when companies that were more domestically focused and were identified as having a higher tax burden had outperformed.

7 The Committee's own expectations for near-term global growth had strengthened over this year, as had those of professional economic forecasters. The recovery in global equity prices during 2017 had perhaps

indicated that investors had taken an even more positive view of global growth prospects. This seemed somewhat difficult to square with the flattening in advanced economy government bond yield curves over the course of this year, however.

### **The international economy**

8 The data released since the MPC's previous meeting had remained consistent with robust near-term momentum in global activity, notwithstanding some softness in US GDP data for 2017 Q1. Global trade in particular, which had in the past been an informative cross-check on other high-frequency indicators of global activity, appeared to have strengthened recently. Although the three month on three month growth rate of world goods trade had slowed a little in March relative to February, at 1.4% it had remained above the average growth rate seen during the period since the financial crisis. Consistent with that, global measures of industrial production and capital goods orders had also strengthened in Q1, perhaps suggesting some rotation in the composition of global demand towards investment.

9 In the United States, GDP growth in 2017 Q1 had been revised up to 0.3%, although this was still much weaker than had originally been expected. Within this, consumption growth had also been revised up, to 0.2%, although this remained the weakest outturn since 2009. There had been further evidence that the weakness of growth in Q1 had been largely temporary, however. Indicators of consumption for April had been encouraging, and the labour market had remained strong: despite weaker growth in employment, the unemployment rate had fallen to 4.3% in May, its lowest level since 2001. Bank staff projected that GDP growth would recover to 0.8% in Q2. Core PCE inflation had fallen for the second month in a row, to 1.5%, its lowest rate since December 2015, although some of this appeared to reflect idiosyncratic factors.

10 In the euro area, GDP growth in 2017 Q1 had been revised up to 0.6%, with positive contributions from both consumption and investment. High-frequency indicators for Q2 had suggested that the recovery was likely to be maintained at around its current pace: the composite purchasing managers' indices had remained at elevated levels, business and consumer confidence indicators had continued to improve, and industrial production had been strong in April. In line with expectations, both headline and core HICP inflation, having picked up sharply in April, had fallen back again in May; core inflation had fallen back by 0.3 percentage points, to 0.9%.

11 GDP growth outturns for 2017 Q1 in major emerging markets had generally been a touch stronger than Bank staff had expected, including in Brazil, India, Mexico and Russia. In China, monthly activity indicators for April had remained fairly robust, and the modest tightening in credit conditions had as yet shown few signs of feeding into the real economy. Growth in the second half of 2017 was nevertheless expected to be slightly slower than in the first half.

## Money, credit, demand and output

12 Since the Committee's previous meeting, UK GDP growth in 2017 Q1 had been revised down by 0.1 percentage points to 0.2%, driven by lower service sector output than incorporated in the preliminary release. The updated estimate had indicated a slightly sharper slowdown relative to the 0.7% estimate for 2016 Q4. The Bank's backcast suggested that the estimate for Q1 would subsequently be revised up to 0.3%, but that was still 0.1 percentage points weaker than had been assumed in the *May Inflation Report*. Within the GDP data, the initial expenditure breakdown for Q1 had revealed a marked slowdown in household consumption growth, to its lowest rate in over two years. As at the previous MPC meeting, those developments had underscored the importance of two overarching questions for the growth outlook: the scale and persistence of the weakness in consumption in the face of low household real income growth; and the extent to which other components of demand – particularly business investment and net trade – were likely to provide countervailing support. The Committee's discussions focussed on the first of these questions.

13 The news in direct indicators of consumption growth had been mixed since the Committee's previous meeting. The official retail sales data had bounced back in April and indicators of consumer confidence had remained relatively resilient, at above their long-term averages. On the other hand, survey indicators of retail spending for May had weakened quite sharply. SMMT private car registrations had remained very weak: they had fallen by 4.2% in the year to May, compared with the same five months a year ago.

14 The Committee also discussed the extent to which the housing market posed additional risks to the outlook for demand. Most housing market indicators had weakened over recent months. House price inflation on the average of lenders' indices had turned negative in May on a three month on three month basis. Within that, the Nationwide index had recorded its longest run of negative monthly readings since the height of the financial crisis. The official UK house price index had, in contrast, been somewhat stronger than the lenders' indices, although it was a less timely indicator. Mortgage approvals for house purchase had fallen back to their lowest level since September, and net mortgage lending had been noticeably weak in April. New buyer enquiries in the RICS survey had fallen further, although there remained signs of tightness in indicators of secondary supply.

15 The recent weakness in housing demand appeared likely, in part, to have been driven by the same factors affecting broader consumer spending, and particularly by developments in real incomes. Buy-to-let activity had remained weak following the introduction of the additional stamp duty charge in April 2016. The phased removal of tax relief on interest payments for landlords may also have contributed to the weakening in the broader market. Given its relatively small market share, however, buy-to-let mortgages were unlikely to account for all of the recent weakness in approvals. CML data on mortgage completions covering the period of renewed declines in approvals had suggested that demand from first-time buyers and home movers had weakened, following a period around the turn of the year when first-time buyer activity had risen to its highest level for almost a decade.

16 In contrast to other housing data, indicators of primary market activity had strengthened recently. The 2017 Q1 National Accounts had shown the highest level of dwelling investment since 2006 Q1 and private

housing starts had risen by 26% on a year earlier, towards levels seen before the financial crisis. House builder equity prices had regained their pre-referendum levels. The increase in housing starts was consistent with greater near-term momentum in housing investment and construction, and there was some evidence that, in the past, such movements had presaged broader strength in the housing market. On this occasion, however, it was possible that some house builders might reassess their development plans if the weakness in the wider market persisted. That was also consistent with intelligence from the Bank's Agents.

17 Turning to news in other components of demand, business investment was estimated to have risen slightly in 2017 Q1, broadly in line with projections in the *May Inflation Report*. There had been no equivalent counterbalance to weakness in consumption growth from the external sector, however, with net trade contributing negatively to GDP growth in Q1 even after adjusting for distortions due to the treatment of non-monetary gold in the National Accounts. In contrast, surveys of export demand had risen markedly over recent months and the April trade data had shown a sharp rise in goods export volumes excluding oil and erratics.

18 Although the outlook remained uncertain, there had, on balance, been little clear news in the economic data to challenge the Committee's projection for moderate GDP growth over the remainder of the year. The Markit/CIPS composite output index had fallen in May to around its historical average, while the composite expectations index had risen slightly but remained a little below its mean. Composite CBI balances had fallen this month, but remained above their historical averages. Bank staff's expectation was for GDP growth of 0.4% in 2017 Q2, in line with the projection in the *May Inflation Report*.

### **Supply, costs and prices**

19 Twelve-month CPI inflation had increased to 2.9% in May, higher than had been expected in the Committee's *May Inflation Report* projections. The twelve-month change in CPI excluding food, alcohol, tobacco and energy had risen to 2.6%, also higher than expected in May. Bank staff's summary core inflation indicator, based on a number of different measurement approaches, had increased to 2.4%. The driving force behind the recent pickup in inflation had remained the depreciation of sterling associated with the UK's referendum on EU membership, although a number of indicators of domestically generated inflationary pressure had also increased over recent months. Twelve-month CPI inflation could rise above 3% by the autumn, and it was expected to remain above the 2% target for an extended period as the depreciation of sterling continued to feed through into the prices of consumer goods and services.

20 By contrast, pay growth had remained subdued. Annual economy-wide regular pay growth had been 1.7% in the three months to April, weaker than the assumption in the *May Report*. In the private sector, annual regular pay growth had been 2.0%, in line with the Committee's expectation.

21 Employment had increased by 109,000, or 0.3%, in the three months to April – slightly in excess of the *May Report* assumption and concentrated in an expansion of full-time employment. The increase in employment had been associated with a decline in the unemployment rate and a rise in the participation rate.

The unemployment rate had fallen to 4.6% in the three months to April, its lowest level since 1975. Against that backdrop, the Committee focussed its discussion on the apparent degree of momentum in the labour market.

22 In general, survey indicators pointed to a continued expansion of employment – at a less rapid pace than seen between 2013 and 2015, but with some indications that momentum was building. Information from the Markit/CIPS, BCC, and REC surveys, as well as from the Bank’s Agents, indicated a strengthening of employment growth between the first and second quarters.

23 Notwithstanding the increase in the participation rate in the most recent data, the evidence suggested that the continued resilience of employment growth reflected mostly an increase in labour demand from firms, rather than primarily an expansion of labour supply from households. The number of job vacancies in the three months to April had risen to a new record high, and there had been further signs of recruitment difficulties. A survey run by the Bank’s Agents during the month indicated that it had become more difficult for firms to recruit suitable employees over the past year, a result corroborated by other survey evidence.

24 If recent employment gains had largely reflected increased labour demand, however, it was striking that wage growth had remained so weak relative to historical norms. Evidence from the Bank’s Agents’ survey indicated that the most common response of firms to recruitment difficulties had been to increase pay awards selectively – for example, for new recruits and key existing staff – rather than across the board. Other common responses had been: to increase training and apprenticeship programmes; to increase spending on recruitment; to improve non-pay employment terms; and to explore ways to substitute capital for labour through, for example, greater automation.

25 The continued weakness of productivity growth had probably played a significant role in limiting pay awards. It was also possible that there was a greater pool of available labour than implied by the unemployment rate alone. Measures of under-employment including those looking for additional employment or wishing to work longer hours had declined over the past year, but remained above the lows prevailing before the financial crisis. The number of individuals categorised in the LFS as inactive, but who said that they would like to find employment, had followed a similar pattern.

26 Over recent decades, there had tended to be a link between the number of people moving from one job to another and rates of pay growth. Those job-to-job flows had recently recovered to around pre-crisis norms. It was possible that employees remained reluctant to lose the security of existing employment by moving into new positions, which had helped moderate wage demands. The Committee would continue to monitor closely the evidence in support of these hypotheses and others regarding the weakness of pay growth over the coming months.



## The immediate policy decision

27 The MPC sets monetary policy to meet the 2% inflation target, and in a way that supports activity 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 importantly influenced by the expectations of households, firms and financial markets about the nature of the transition and of the United Kingdom's new long-term economic relationships with the EU and other countries. These involved structural economic adjustments over which monetary policy had very little or no influence. It was nevertheless essential to take account of these evolving views in the setting of monetary policy because of the impact they had on activity and inflation in the nearer term. The MPC's remit specified that in such exceptional circumstances the Committee must balance any trade-off between the speed at which it intended to return inflation to the target and the support that monetary policy provided to jobs and activity.

28 The Committee had set out its most recent economic projections in the *May Inflation Report*. In the central projection, consumption growth remained subdued, before picking up towards the end of the three-year forecast period, as real income growth recovered. This period of modest consumption growth was largely balanced by increased net trade and investment, such that quarterly GDP growth remained broadly in line with growth in potential supply. Conditioned on the market path for interest rates prevailing at the time of the *May Report*, inflation was projected to remain above the target, as a result of higher import prices. The *May* projections showed that the economy was expected to operate with a small degree of spare capacity for most of the three-year forecast period, justifying the tolerance of some degree of above-target inflation.

29 The Committee considered how the outlook, and the trade-off embodied within it, had changed since the *May* meeting. CPI inflation had risen further above target to 2.9%, which was higher than had been expected. Measures of core inflation had also been higher than expected. Coupled with the effect of the 2½% depreciation of the sterling ERI since the *May Inflation Report*, this meant the overshoot of inflation relative to the target might be somewhat greater than previously supposed.

30 In the labour market, regular pay growth had moderated further, to 1.7% in the whole economy and 2.0% in the private sector. This had been despite signs that the labour market had continued to tighten, with the unemployment rate falling to 4.6%, its lowest in over 40 years. Survey information on recruitment intentions and difficulties, as well as the strength of vacancies, implied that labour demand had remained fairly robust.

31 The initial expenditure breakdown of GDP for the first quarter had confirmed a marked slowdown in household consumption growth. It remained to be seen how large and persistent this slowdown in consumption would prove. There had been further signs of a slowing housing market, new car registrations had remained weak after falling sharply in April, and the latest survey indicators of retail spending had weakened. On the other hand, survey measures of consumer confidence had remained relatively resilient, employment had continued to rise, and the official retail sales data had bounced back in April, following the sharp fall in March.

32 Export indicators had strengthened, probably reflecting both the depreciation of sterling and increasingly robust global demand. The global economy had firmed since the start of the year, with further signs that the softness in recorded growth in Q1, particularly in the United States, would be temporary. Major advanced economy equity indices had risen substantially this year. Most surveys of UK investment intentions had remained above their historic averages. More generally, surveys of general business activity in the United Kingdom had suggested a modest recovery in GDP growth in the second quarter.

33 Overall, the degree of spare capacity in the economy appeared limited but, at the same time, the inflation overshoot relative to the target could be more pronounced than previously thought. This lessened the trade-off that the MPC was required to balance and, all else equal, reduced the MPC's tolerance of above-target inflation. The Committee discussed the appropriate response of monetary policy.

34 Given this change in the trade-off, there were arguments in favour of a moderate tightening in monetary policy. Headline, core and some domestically focussed inflation measures had picked up further. Inflation was projected to overshoot the target by more than previously expected, and to remain above it throughout the three-year forecast period. Slack in the labour market appeared to have diminished, and demand for labour remained strong. Growth in business investment and net trade appeared on track to compensate for weaker consumption. The withdrawal of part of the stimulus that the Committee had injected in August last year would help to moderate the inflation overshoot while leaving monetary policy very supportive.

35 But there were also arguments in favour of leaving the policy rate unchanged. A slowdown in household consumption, and GDP as a whole, had recently begun, and it was too early to judge with confidence how large and persistent it would prove to be. Although consumer confidence had held up, there had been further signs of a slowing housing market and new car registrations had fallen sharply. It was as yet unclear to what degree weaker consumption would be offset by other components of demand. A period of slower than expected growth could see a margin of slack re-opening. Wage growth had remained subdued, despite low unemployment.

36 Different members of the Committee placed different weights on these arguments. On balance, for five members, the current policy stance was still appropriate to balance the demands of the Committee's remit. For three members, the outlook now justified an immediate increase in Bank Rate. All Committee members agreed that any increases in Bank Rate would be expected to be at a gradual pace and to a limited extent. The Committee would continue to monitor closely the incoming evidence, and monetary policy could respond to changes to the economic outlook as they unfolded to ensure a sustainable return of inflation to the 2% target.

37 The Governor invited the Committee to vote on the propositions that:

Bank Rate be maintained at 0.25%;

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

Regarding Bank Rate, five members of the Committee (the Governor, Ben Broadbent, Jon Cunliffe, Andrew Haldane and Gertjan Vlieghe) voted in favour of the proposition. Three members (Kristin Forbes, Ian McCafferty and Michael Saunders) 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 second and third propositions.

38 Finally, the Governor expressed his appreciation to Kristin Forbes for her contribution as a member of the Committee.

39 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  
Kristin Forbes  
Andrew Haldane  
Ian McCafferty  
Michael Saunders  
Gertjan Vlieghe

Dave Ramsden was present as the Treasury representative.

As permitted under the Bank of England Act 1998, as amended by the Bank of England and Financial Services Act 2016, Dido Harding was also present on 7 and 12 June, as an observer, for the purposes of exercising oversight functions in her role as a member of the Bank's Court of Directors.