



BANK OF ENGLAND

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

Publication date: 14 September 2017

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

They are available at <http://www.bankofengland.co.uk/publications/Pages/news/2017/006.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 1 November will be published on 2 November 2017.

Monetary Policy Summary, September 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 September 2017, the MPC voted by a majority of 7-2 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 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 August *Inflation Report*. That assessment depended importantly on three main judgments: 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 over the forecast period; and that subdued household spending growth is largely balanced by a pickup in other components of demand.

Since the August *Report*, the relatively limited news on activity points, if anything, to a slightly stronger picture than anticipated. GDP rose by 0.3% in the second quarter, as expected in the MPC's August projections, although initial estimates of private final demand were softer than anticipated. The unemployment rate has continued to decline, to 4.3%, its lowest in over 40 years and a little lower than forecast in August. Survey indicators are consistent with continued strength in employment growth. Evidence continues to accumulate that the rate of potential supply growth has slowed in recent years. Overall, the latest indicators are consistent with UK demand growing a little in excess of this diminished rate of potential supply growth, and the continued erosion of what is now a fairly limited degree of spare capacity. Underlying pay growth has shown some signs of recovery, albeit remaining modest.

The sterling exchange rate has been volatile and the price of oil has increased. Headline and core CPI inflation in August were slightly higher than anticipated. Twelve-month CPI inflation rose to 2.9% and is now expected to rise to above 3% in October.

The circumstances since the referendum on EU membership, and the accompanying depreciation of sterling, have been exceptional. 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. 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. Recent developments suggest that remaining spare capacity in the economy is being absorbed a little more rapidly than expected at the time of the August *Report*, and that inflation remains likely to overshoot the 2% target over the next three years.

All MPC members continue to judge that, if the economy follows a path broadly consistent with the August *Inflation Report* central projection, then monetary policy could need to be tightened by a somewhat greater extent over the forecast period than current market expectations. A majority of MPC members judge that, if the economy continues to follow a path consistent with the prospect of a continued erosion of slack and a gradual rise in underlying inflationary pressure then, with the further lessening in the trade-off that this would imply, some withdrawal of monetary stimulus is likely to be appropriate over the coming months in order to return inflation sustainably to target. All members agree that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

At this month's meeting, seven members thought that the current policy stance remained appropriate to balance the demands of the MPC's remit. Two members considered it appropriate to increase Bank Rate by 25 basis points. The Committee will undertake a full assessment of recent developments in the context of its November *Inflation Report* and accompanying economic projections.

There remain considerable risks to the outlook, which include the response of households, businesses and financial markets to developments related to the process of EU withdrawal. The MPC will respond to these developments as they occur insofar as they affect the behaviour of households and businesses, and the outlook for inflation. The Committee will continue to monitor closely the incoming evidence on these and other developments, 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 13 September 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 UK short-term interest rates had been broadly unchanged over the period as a whole since the Committee previously met, while long-term interest rates had decreased slightly. There had been a fall in yields at the start of the period, following the publication of the August *Inflation Report*, with market contacts reportedly placing emphasis on the small downward revisions to near-term GDP and wage growth contained in that forecast. Over the remainder of the period, UK rates had moved broadly in line with global yields, particularly at longer maturities. The first 25 basis point rise in Bank Rate was not fully priced in by financial markets until the second half of 2018. The majority of economists responding to a survey by Reuters had expected Bank Rate to remain at 0.25% until at least the end of 2018.

3 The ECB had left monetary policy rates and its asset purchase programme unchanged at its September meeting, confirming that the rate of asset purchases would be maintained until at least the end of the year and that it would make some decisions on the programme beyond that at its October meeting. There had been no policy meetings of the US Federal Open Market Committee (FOMC) since the MPC had previously met. Market contacts expected an announcement on the timing of the FOMC's balance sheet normalisation programme at its September meeting.

4 The sterling trade-weighted effective exchange rate index had depreciated by around 1% since the Committee's previous meeting. The Committee discussed various factors that may have contributed to this decline. In part, moves in sterling may have reflected developments overseas. In recent months, the reappraisal of euro-area growth prospects had pushed up the value of the euro against both the dollar and sterling. Sterling may also have been affected by domestic factors, in particular developments regarding the United Kingdom's ongoing negotiations with the European Union. The Committee noted that market expectations of the UK's future trading relationship with the EU and the transition to that relationship were likely to continue to exert a significant influence on sterling over the coming quarters.

5 Measures of implied volatilities in equity markets had picked up, reflecting growing geopolitical tensions and US political developments. Despite these factors pushing down on global equity prices at points over the month, the level of the main international equity indices had remained broadly unchanged. Corporate bond spreads had risen over the period.

The international economy

6 Over the period since the August *Inflation Report*, macroeconomic data released in the United Kingdom's major trading partners had remained strong and the oil price had risen. The Committee reviewed these developments and discussed the momentum in the global economy.

7 In the United States, quarterly GDP growth in 2017 Q2 had been revised up to 0.8% from 0.6% in the previous release that had been incorporated in the August *Report*. That reflected in part an upward revision to consumption growth, to 0.8%, suggesting a strong rebound from the weak reading in the first quarter. Overall, four-quarter US GDP growth had picked up to 2¼%, its fastest rate for almost two years. In addition, there had generally been upside news from the high-frequency indicators for Q3, including July non-farm payrolls, retail sales and durable goods. As a result, Bank staff projected that GDP would grow by 0.7% in the third quarter, 0.2 percentage points stronger than expected at the time of the August *Report*.

8 Output growth had also risen in the euro area. GDP growth in the second quarter had been confirmed at 0.6%, 0.1 percentage points weaker than expected at the time of the August *Inflation Report*. Four-quarter growth had nevertheless reached 2¼%, its fastest rate for more than six years. In contrast to Q1, in which growth had been accounted for primarily by net trade, domestic demand had provided the largest contribution to growth in Q2. The euro area composite purchasing managers' indices for August had remained strong; taken with other indicators such as business and consumer confidence, they pointed to solid growth of 0.5% in Q3.

9 Elsewhere, Japanese GDP had increased by 0.6% in Q2. This had mainly reflected strengthening personal consumption, and represented the fastest pace of quarterly growth for two years. In China, activity indicators had softened in July but remained at or above their 2016 averages; however, domestic demand had been supported in part by rapid credit growth, reinforcing concerns about financial stability over the medium term.

10 Overall, UK-weighted world GDP growth in Q2 had been slightly stronger than expected at the time of the August *Inflation Report*. The growth of world goods trade had eased somewhat but remained consistent with healthy global demand. Looking further ahead, global GDP growth was likely to remain strong compared to recent history. The Committee noted that, in contrast to much of the period since the global financial crisis, recent and prospective GDP growth was more evenly balanced across the major economies. Taken together with the rotation of growth from consumption towards investment, this suggested that global growth prospects were better than for some time.

11 Spot oil prices had risen by 12% in dollar terms relative to the 15-day average incorporated in the August *Report*. This had reflected a number of supply developments, including announcements from Saudi Arabia thought likely to promote compliance with the May OPEC agreement. There had been some volatility in oil prices arising from the disruption to production at refineries and the transportation of refined fuel in the United States following Hurricane Harvey. As a result, US gasoline futures prices and retail gasoline prices had also increased relatively sharply, which was likely to put upward pressure on overall consumer prices. US core PCE inflation had fallen slightly to 1.4% in July with the headline measure remaining at 1.4%. In the euro area, the flash estimate of core inflation had remained at 1.2% in August and headline inflation had risen to 1.5%.

Money, credit, demand and output

12 The ONS's second estimate of GDP growth in 2017 Q2 had been unrevised from the preliminary estimate, at 0.3%, in line with that assumed in the August *Inflation Report*. Output in the services sector had risen by 0.5%, while manufacturing and construction output had contracted over the quarter. Within the initial breakdown of GDP by expenditure, there had been notable weakness in private final domestic demand – including both household consumption and business investment – and in the contribution of net trade to GDP growth. The Committee discussed the extent to which those components of demand might strengthen in 2017 Q3 and the implications for overall GDP growth.

13 Household consumption was reported to have grown by only 0.1% in the second quarter, the weakest outturn since 2014 Q4 and slightly weaker than assumed in the August *Inflation Report*. The ONS had highlighted that a substantial part of that weakness reflected a fall in household expenditure on transport, which in turn was related to the sharp decline in new cars registered following the introduction of increased Vehicle Excise Duty on high-polluting vehicles in April. New car sales had since remained well below the levels seen earlier in the year, though they had recovered somewhat from their April lows, implying a slight boost to overall consumption growth in the third quarter. Consistent with the spending data, the Finance & Leasing Association had reported a sharp slowdown in new car finance in the second quarter. More broadly, there had been tentative signs of a modest tightening of lending criteria in the personal loan and credit card markets. In July, the twelve-month growth rate of aggregate consumer credit had fallen below 10% for the first time since April 2016.

14 Retail sales volumes had risen further in July. Combined with the indications from more timely survey data, retail spending was likely to rise modestly over the third quarter as a whole. Bank staff's preferred measure of GfK/EC consumer confidence had fallen in August to its lowest level since the end of 2013, although that was only slightly below its long run average. Recent weakness in confidence had been driven by households becoming more pessimistic about the general economic situation and their willingness to make major purchases. Most housing market data had, in contrast, been slightly firmer. House price inflation had picked up as measured by an average of lenders' indices in August, and mortgage approvals for house purchase and HMRC property transactions had risen in July. Data from the August RICS survey had remained weak, but overall there were some signs that secondary housing market demand had strengthened somewhat.

15 Business investment was estimated by the ONS to have been flat in 2017 Q2 on the quarter and compared with the same quarter in the previous year. That was weaker than the projection in the August *Inflation Report*, although official investment data were subject to significant revision over time. Bank lending to private non-financial corporations had been strong over the past few months, but that had partly been driven by a small number of M&A transactions that were unlikely to provide a strong signal about the outlook for business investment.

16 Excluding the volatile valuables component, net trade had subtracted 0.3 percentage points from GDP growth in the initial 2017 Q2 estimate. Goods exports on that basis had risen slightly on the quarter following two quarters of robust growth, while services exports had fallen slightly. The latest monthly trade data for July

had suggested an upward revision to net trade in goods, however, and goods exports excluding oil and erratics had risen by just over 4% on the month. More generally, negative contributions to growth from net trade had been recorded in all but one quarter over the past 18 months, despite the marked depreciation of sterling over that period and the relative strength of global demand. Recent survey indicators had, nevertheless, continued to suggest stronger growth in goods exports than had so far been reflected in the official data.

17 Since the Committee's last meeting, there had been relatively little news from surveys of companies' actual and expected output. As a result, Bank staff expected preliminary GDP growth of 0.3% in 2017 Q3, in line with the projection in the August *Inflation Report*. Taken together, business surveys had continued to point to slightly stronger growth. Approached from the expenditure side, the Committee judged that most early indicators were consistent with a somewhat stronger profile for consumption growth in Q3 than the 0.2% rate that had been incorporated into the *Inflation Report*. That could potentially also suggest an upside risk to GDP growth, particularly if the contribution of net trade rose as expected.

Supply, costs and prices

18 Twelve-month CPI inflation had risen to 2.9% in August, 0.2 percentage points higher than had been expected in the Committee's latest *Inflation Report* projections. The twelve-month change in CPI excluding food, alcohol, tobacco and energy had increased to 2.7%, also 0.2 percentage points above expectations and the highest core rate in over five years. More generally since the Committee's last meeting, developments in the oil market suggested greater near-term upward pressure on inflation from petrol prices. Twelve-month CPI inflation was now likely to rise to above 3% in October. The latest household indicators had, nevertheless, suggested that inflation expectations had remained well anchored.

19 The extent and timing of upward pressure on CPI inflation from import prices had been a key judgement underlying the Committee's *Inflation Report* projections for some time. Changes to import prices had tended to pass through only slowly to consumer prices, and the behaviour of consumer prices – especially those with high import weights – was so far broadly consistent with that pattern. Given the usual lags, further pass-through to consumer prices could be expected over time, even if import prices did not rise further.

20 A special survey conducted by the Bank's Agents had confirmed that companies' profit margins on UK sales had been squeezed over the past 18 months relative to normal. Over the next 18 months, companies had expected that squeeze to intensify slightly. The impact of non-labour costs including import prices was, nevertheless, expected to exert less of a drag on margins looking ahead. Respondents to the survey had also reported that they expected their pricing decisions and attempts to raise productivity to boost margins to a greater degree than in the recent past. More generally, the Committee noted that companies could respond in a number of other ways to higher costs, including by reducing nominal pay growth. That made it difficult to use margins as an independent cross-check on the outlook for inflation, although the Committee would continue to monitor closely all available indicators.

21 Recent momentum in measures of labour market quantities had persisted since the Committee's last meeting. LFS employment grew by 0.6% in the three months to July, slightly higher than expected at the time of

the August *Inflation Report*. Indicators of employment from business surveys had continued to point to relatively strong jobs growth heading into the second half of the year. The unemployment rate had fallen below the MPC's 4½% equilibrium estimate, to 4.3%, slightly lower than assumed in the August *Inflation Report*. There had, to date, been little sign of the levelling out in the unemployment rate that had been expected in a succession of recent *Inflation Report* projections. Indicators of recruitment difficulties had suggested that the degree of slack in the labour market was continuing to diminish.

22 Underlying pay growth had shown some signs of recovery, albeit remaining modest. Whole-economy total average weekly earnings in the three months to July had risen by 2.1% on a year earlier, stronger than the forecast consistent with the August *Inflation Report* projections, although some of that reflected upside news in bonuses. Growth in whole-economy regular pay had come in weaker than expected in the August *Inflation Report*, but private-sector regular pay growth had been in line with expectations. Measures of regular pay growth had been around 3% on a three month on three month annualised basis, while the permanent staff salaries component of the REC Report on Jobs had risen to its highest level since the end of 2015.

23 New data from the ONS suggested that compositional effects related to factors including the skills, industry and occupational mix of the workforce had pushed down average pay growth in the year to Q2. Empirical estimates by Bank staff suggested that these may have depressed annual growth of average weekly earnings by around 0.7 percentage points. That could also suggest upward pressure on measured growth of average wages as these effects unwound. As those compositional changes should have a similar effect on average productivity, however, the implications for unit wage costs were likely to be limited.

The immediate policy decision

24 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. The United Kingdom's exit from the European Union involved structural economic adjustments over which monetary policy had very little or no influence. It was nevertheless essential to take account of these evolving expectations in setting monetary policy insofar as they affected the outlook for activity and inflation. 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.

25 The MPC had set out its most recent assessment of the outlook for inflation and activity in the August *Inflation Report*. In the central projection, GDP growth remained sluggish in the near term as the squeeze on households' real income continued to weigh on consumption, before picking up over the remainder of the

forecast period. Business investment and net trade had been expected to firm up, and consumption growth to recover in line with modestly rising household incomes. Conditioned on the market path for interest rates prevailing at the time of the *August Report*, inflation was projected to remain above the target throughout the forecast period, reflecting entirely the effects of the referendum-related falls in sterling. The August projections implied that the economy was expected to operate with a small degree of spare capacity through most of the forecast period, justifying the tolerance of some degree of above-target inflation. By the end of the forecast, however, the trade-off had been eliminated; spare capacity was expected to have been fully absorbed and inflation remained above the target.

26 The Committee considered how the outlook, and the trade-off embodied within it, had changed since the August meeting. GDP had risen by 0.3% in the second quarter, as expected in the MPC's August projections. Although the initial breakdown of growth by expenditure component had shown notable weakness in consumption, business investment and net trade, these were early estimates that were prone to revision. Moreover, a substantial part of the weakness in household consumption in Q2 was related to a reduction in new car sales, which was expected to unwind partially in Q3. Looking beyond Q2, retail sales volumes had risen and housing market data had also generally been slightly firmer. Taken together, the Committee judged that most early indicators were consistent with a somewhat stronger profile for consumption growth in Q3 than had been incorporated into the *Inflation Report*. Net trade was also expected to pick up, bolstered by the past depreciation of sterling and robust global growth. Overall, the relatively limited news on demand had pointed, if anything, to a slightly stronger picture than anticipated in the *August Report*.

27 In contrast to the recent weakness of GDP growth, employment growth had been resilient. As a result, the unemployment rate had fallen to 4.3%, its lowest in over 40 years and a little lower than forecast in August. Indicators from business surveys continued to point to relatively strong jobs growth heading into the second half of the year. That might be expected to support household incomes, and hence consumption, even as increases in pay per worker remained modest. Recent activity and employment data had also pointed to weak productivity growth, corroborating the MPC's forecast for modest potential supply growth. Overall, the latest indicators had been consistent with UK demand growing a little in excess of this diminished rate of potential supply growth, and pointed to the continued erosion of the remaining limited degree of spare capacity in the economy.

28 Underlying pay growth had shown some signs of recovery, albeit remaining modest. The sterling exchange rate had been volatile and the price of oil had increased. Headline and core CPI inflation in August had been slightly stronger than expected. Twelve-month CPI inflation had risen to 2.9% and was now expected to rise to above 3% in October.

29 The circumstances since the referendum on EU membership, and the accompanying depreciation of sterling, had been exceptional. 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. As slack had continued to erode, 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.

30 The Committee had noted at its last meeting that, if the economy were to follow a path broadly consistent with the *August Inflation Report* central projection, then monetary policy could need to be tightened by a somewhat greater extent over the forecast than the path implied by the yield curve underlying the *August Report*. Since then, the economic data had been broadly in line with those projections. If anything, recent developments had suggested that the remaining spare capacity in the economy was being absorbed a little more rapidly than had been expected, and that inflation remained likely to overshoot the 2% target over the next three years.

31 For some members, these developments had further strengthened the case for an immediate tightening in monetary policy. A 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. Moreover, an earlier tightening of policy could mitigate the risks from a more sustained period of above-target inflationary pressure that might ultimately necessitate a more abrupt change in policy and hence a greater adjustment in growth and employment. In any case, policy would be set at each meeting taking account of the available information; there was therefore scope to reverse any decision to marginally tighten policy should incoming developments warrant it.

32 There were also arguments for leaving policy unchanged. The Q2 GDP data had been in line with the Committee's expectations in August, but the expenditure breakdown had appeared weak, with unanticipated weakness in consumption and business investment. Consumer confidence had also remained subdued. While there had been some signs of growing momentum in activity into the second half of the year – in particular stronger employment data, signs of a pickup in the housing market, and a partial rebound in new car sales – it was too soon to judge whether stronger consumption growth would be sufficient to offset continuing weakness in business investment. It was also unclear how sustained any increase in GDP growth might be over the medium term. And, although there had been a few more positive signs on wage growth, there was not yet evidence of the sustained pickup incorporated in the *August Inflation Report* projection. More generally, the Committee could undertake a full assessment of recent developments, and the data released over the next couple of months, in the context of its November forecast round.

33 All MPC members continued to judge that, if the economy were to follow a path broadly consistent with the *August Inflation Report* central projection, then monetary policy could need to be tightened by a somewhat greater extent over the forecast period than current market expectations.

34 A majority of MPC members judged that, if the economy continued to follow a path consistent with the prospect of a continued erosion of slack and a gradual rise in underlying inflationary pressure then, with the further lessening in the trade-off that this would imply, some withdrawal of monetary stimulus was likely to be appropriate over the coming months in order to return inflation sustainably to target.

35 All members agreed that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

36 There remained considerable risks to the outlook, which included the response of households, businesses and financial markets to developments related to the process of EU withdrawal. The MPC would respond to

them as they occurred insofar as they affected the behaviour of households and businesses, and the outlook for inflation. The Committee would continue to monitor closely the incoming evidence on these and other developments, and stood ready to respond to changes in 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 £435bn.

Regarding Bank Rate, seven members of the Committee (the Governor, Ben Broadbent, Jon Cunliffe, Dave Ramsden, Andrew Haldane, Silvana Tenreyro and Gertjan Vlieghe) voted in favour of the proposition. Two members (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 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

Richard Hughes 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, Anthony Habgood was also present on 7 September as observer for the purpose of exercising oversight functions in his role as a member of the Bank's Court of Directors.