



BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 7 February 2018

Publication date: 8 February 2018

These are the minutes of the Monetary Policy Committee meeting ending on 7 February 2018.

They are available at <https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2018/february-2018>.

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 21 March will be published on 22 March 2018.

Monetary Policy Summary, February 2018

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 7 February 2018, 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.

The MPC's latest projections for output and inflation are set out in detail in the accompanying February *Inflation Report*. The global economy is growing at its fastest pace in seven years. The expansion is becoming increasingly broad-based and investment driven. Notwithstanding recent volatility in financial markets, global financial conditions remain supportive. UK net trade is benefiting from robust global demand and the past depreciation of sterling. Along with high rates of profitability, the low cost of capital and limited spare capacity, strong global activity is supporting business investment, although it remains restrained by Brexit-related uncertainties. Household consumption growth is expected to remain relatively subdued, reflecting weak real income growth. GDP growth is expected to average around 1¾% over the forecast, a slightly faster pace than was projected in November despite the updated projections being conditioned on the higher market-implied path for interest rates and stronger exchange rate prevailing in financial markets at the time of the forecast.

While modest by historical standards, that rate of growth is still expected to exceed the diminished rate of supply growth. Following its annual assessment of the supply side of the economy, the MPC judges that the UK economy has only a very limited degree of slack and that its supply capacity will grow only modestly over the forecast, averaging around 1½% per year. This reflects lower growth in labour supply and rates of productivity growth that are around half of their pre-crisis average. As growth in demand outpaces that of supply, a small margin of excess demand emerges by early 2020 and builds thereafter.

CPI inflation fell from 3.1% in November to 3.0% in December. Inflation is expected to remain around 3% in the short term, reflecting recent higher oil prices. More generally, sustained above-target inflation remains almost entirely due to the effects of higher import prices following sterling's past depreciation. These external forces slowly dissipate over the forecast, while domestic inflationary pressures are expected to rise. The firming of shorter-term measures of wage growth in recent quarters, and a range of survey indicators that suggests pay growth will rise further in response to the tightening labour market, give increasing confidence that growth in wages and unit labour costs will pick up to target-consistent rates. On balance, CPI inflation is projected to fall back gradually over the forecast but remain above the 2% target in the second and third years of the MPC's central projection.

As in previous *Reports*, the MPC's projections are conditioned on the average of a range of possible outcomes for the United Kingdom's eventual trading relationship with the European Union. The projections also assume that, in the interim, households and companies base their decisions on the expectation of a smooth adjustment to that new trading relationship. 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. 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.

Over the past year, a steady absorption of slack has reduced the degree to which it was appropriate for the MPC to accommodate an extended period of inflation above the target. Consequently, at its November 2017 meeting, the Committee tightened modestly the stance of monetary policy in order to return inflation sustainably to the target.

Since November, the prospect of a greater degree of excess demand over the forecast period and the expectation that inflation would remain above the target have further diminished the trade-off that the MPC is required to balance. It is therefore appropriate to set monetary policy so that inflation returns sustainably to its target at a more conventional horizon. The Committee judges that, were the economy to evolve broadly in line with the February *Inflation Report* projections, monetary policy would need to be tightened somewhat earlier and by a somewhat greater extent over the forecast period than anticipated at the time of the November *Report*, in order to return inflation sustainably to the target.

In light of these considerations, all members thought that the current policy stance remained appropriate to balance the demands of the MPC's remit. 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, 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 7 February 2018

1 Before turning to its immediate policy decision, and against the backdrop of its latest projections for output, inflation and unemployment, the Committee discussed financial market developments; the international economy; money, credit, demand and output; and supply, costs and prices.

Financial markets

2 Global equity prices had dropped sharply in the days immediately prior to this policy meeting and measures of volatility such as the VIX index had increased significantly. This had followed a lengthy period of rising equity prices and low volatility. It was too early to gauge how large and how persistent the market corrections were likely to be, or the extent to which they might affect real activity.

3 Since the Committee's previous meeting and the November *Inflation Report*, the implied path for Bank Rate from sterling money markets had steepened. Immediately prior to this MPC meeting, slightly more than three 25 basis point increases in Bank Rate had been priced in over the next three years, more than the 15-day average on which the February *Inflation Report* projections had been conditioned. That was itself somewhat steeper than the conditioning path used in the November *Report*, which had implied two 25 basis point increases over three years. Although market pricing implied little expectation of a rise in Bank Rate at the MPC's current meeting, a likelihood of around 50% was placed on a 25 basis point increase at the May meeting.

4 The sterling exchange rate index had risen slightly since the MPC's previous meeting. The conditioning path for sterling underpinning the February projections was around 3% higher than that contained in the November *Inflation Report*. This primarily reflected a pronounced weakening in the US dollar, which had depreciated across a wide range of currencies.

5 Globally, government bond yields had generally risen, both since the November *Inflation Report* and the MPC's previous meeting. That had followed a period during 2017 when longer-term yields had not risen significantly, despite a rise in shorter-term rates, resulting in a generalised flattening in yield curves. For example, in the United States the spread between two-year and ten-year Treasury yields had fallen by around 80 basis points, reaching its lowest level since 2007, while the same measure in the United Kingdom had fallen by around 40 basis points. As yields had picked up recently, this spread had risen, by 12 basis points in the United States and 6 basis points in the United Kingdom since the start of 2018.

6 The recent upward shift in government bond yield curves appeared to have been driven largely by investors' expectations that buoyant global activity growth would lead central banks to remove what had been exceptional monetary accommodation more quickly than had previously been thought. Moreover, it was possible that improved confidence about the global outlook had led investors to raise slightly their estimates of the equilibrium global real interest rate. Estimates of term premia had nevertheless remained relatively compressed, and the Committee noted the possibility that an increase in these premia might weigh further on bond prices in the future.

The international economy

7 The near-term outlook for the global economy had strengthened further. The pickup in global growth over the past year had been notably broad-based, and four-quarter growth in PPP-weighted world GDP was now broadly in line with the average rate recorded over the decade prior to the financial crisis. Weighted business survey and other indicators of global activity had risen further, and to a greater extent, than official estimates of GDP growth to date. Looking ahead, the projections incorporated in the February *Inflation Report* were consistent with growth in PPP-weighted world GDP of a little over 4% in 2018.

8 According to the preliminary estimate, euro-area GDP had risen by 0.6% in 2017 Q4, slightly weaker than Bank staff's expectations in December. Growth in 2017 Q3 had been revised up to 0.7%, however, continuing a recent pattern of upward revisions to GDP. Other indicators of near-term growth had remained at historically elevated levels. The European Commission's Economic Sentiment Indicator had fallen slightly in January, but remained close to the 17-year high recorded at the end of 2017. The euro-area PMI composite output index had increased slightly in January, to its highest since mid-2006. Consequently, Bank staff were expecting euro-area GDP growth to pick up to 0.8% in 2018 Q1.

9 In the United States, GDP was estimated to have grown by 0.6% in 2017 Q4, slightly below the figure in Q3 and in line with Bank staff's expectations at the time of the MPC's previous meeting. Growth in private domestic demand had remained robust, and the slight decline in growth reflected components that had tended to be somewhat erratic, such as inventories and net trade. Real personal consumption had grown by 0.9% in Q4 relative to Q3 and the saving rate had fallen to its lowest level since 2005, supported by elevated consumer confidence alongside increases in financial and housing wealth. Shipments of non-defence capital goods excluding aircraft had risen for the eleventh consecutive month in December 2017. Non-farm payrolls had continued to increase at a solid pace in January 2018 and the unemployment rate, at 4.1%, had remained at its lowest level since 2000. Since the Committee's previous meeting, tax reform legislation had been signed into law, and updated estimates suggested that the fiscal stimulus provided by that legislation was likely to boost growth earlier, and by a somewhat larger degree, than had been previously assumed. Overall, Bank staff expected that activity would remain strong in 2018 H1, with GDP growth of 0.8% in Q1.

10 Broad-based momentum in global activity had driven continued strength in commodity prices. Spot dollar oil prices had risen by 4% since the MPC's December meeting, and by 17% relative to the 15-day average incorporated in the November 2017 *Inflation Report*. Industrial metal prices had risen by 8% since the Committee's previous meeting. Given its large share in global commodities consumption, developments in China had remained important for the outlook for commodity prices. GDP in China had risen by 6.9% in 2017, faster than in 2016. Market intelligence suggested that recent reforms by Chinese authorities to reduce overcapacity in metals production and to improve environmental protection could be additional factors supporting commodity prices. Set against that, in the oil market, US shale production was expected to continue to grow strongly over the coming year.

11 The recent rise in oil prices would put upward pressure on inflation over the first half of 2018. In the euro area, the flash estimate of headline HICP inflation for January had decreased a little to 1.3%, while inflation

excluding energy, food, alcohol and tobacco had risen slightly to 1.0%. In the United States, headline annual PCE inflation had fallen slightly to 1.7% in December, and core PCE inflation had been unchanged at 1.5% for the second consecutive month. Average hourly earnings had risen by 2.9% in the year to January, above market expectations of a 2.6% increase and the strongest annual rate since mid-2009, while, in 2017 Q4, annual growth in the Employment Cost Index measure of wages and salaries was at its highest since 2008. Nevertheless, most measures of underlying global inflationary pressures had remained below their pre-crisis averages.

Money, credit, demand and output

12 The preliminary estimate of GDP growth in 2017 Q4 had been stronger than expected, at 0.5%. Relative to Bank staff's expectations, construction output had imparted less of a drag on growth, while growth in business services output had been unexpectedly strong. Distribution sector output growth had been weak, suggesting a subdued domestic picture that was likely in part to have been the product of the squeeze on household real incomes during 2017. This might suggest it had been the buoyant global environment that had lifted business services output, as well as having provided support for manufacturing output, which had continued to grow apace.

13 The Committee judged that the prospect was for continued growth in 2018 Q1, although the balance of evidence at this early stage pointed to growth being a touch lower, at 0.4%, than in 2017 Q4. Expectations balances from some of the major business surveys had implied a more marked slowing in activity, although some of these readings had been a little stronger in January. Other high-frequency indicators had suggested a more robust picture, and the resumption of oil production through the Forties pipeline in January following December's interruption would provide mechanical support to Q1 growth relative to Q4.

14 The Committee's latest central projection for GDP growth had the economy growing at a steady pace, albeit modest by historical standards, and the MPC discussed the risks around this. Revised expenditure data had shown greater evidence of a rotation in demand away from household consumption and towards net trade and business investment. Net trade was estimated to have contributed nearly half of UK growth during 2017. The continuation of this rotation was a feature of the MPC's forecast, with consumption forecast to grow at a slower rate than the economy as a whole as households adjusted to weak growth in their real incomes, though the latter was expected to rise somewhat over the forecast. The extent and duration of the global upswing would be a key driver of net trade and business investment, and the risks around that appeared tilted to the upside. In addition, the prospects for productivity growth and the evolution of Brexit negotiations would be key factors in determining the medium-term path of domestic demand. Recent confidence indicators and measures of investment intentions had been fairly stable, and although uncertainties were elevated they were not obviously skewed in one direction.

15 Twelve-month growth in consumer credit had remained robust in the 9-10% range. Credit conditions had remained accommodative, but there had been some further signs of tightening recently including, for example, a reduction in the maximum period of zero per cent balance transfer offers extended on credit cards. Regarding

secured credit, December had seen a drop in mortgage approvals, but it was unclear how much of a signal should be taken from this for the broader outlook. House price inflation, as measured by the average of the Halifax/Markit and Nationwide indices, had been a little stronger than expected at the end of 2017 but had weakened in January. According to the January Markit Household Finance Index, the median household expected a 25 basis point increase in Bank Rate around the middle of 2018. Corporate credit conditions had remained supportive, although firms expected that financing costs were likely to rise over the next 12 months, consistent with expectations that Bank Rate would increase over this period.

Supply, costs and prices

16 In December, twelve-month CPI inflation had fallen by 0.1 percentage points to 3.0%. This had been in line with Bank staff's forecast immediately prior to the release, but 0.3 percentage points higher than had been expected at the time of the previous *Inflation Report*. Since November, a key development had been the rise in the oil price, which had risen by 15% in sterling terms, pushing up on fuel prices. The contributions from recreational goods and airfares had also been higher than expected.

17 The overshoot of inflation, relative to the 2% target, predominantly reflected the boost to import prices that had resulted from sterling's depreciation following the vote to leave the European Union. That had raised the cost of imports and import-intensive goods and services.

18 In the MPC's latest projections, CPI inflation was expected to fall back gradually, remaining above the 2% target in the second and third years of the MPC's forecast period. That profile reflected a number of domestic and external forces. The pass-through of the past depreciation of sterling was likely to make a positive, but diminishing, contribution over the forecast period. In the near term, the recent rise in global oil prices meant that the projected fall in inflation was more gradual than anticipated at the time of the November *Report*. It was possible that inflation could rise temporarily back above 3%.

19 There was now clearer evidence that domestic cost pressures were beginning to firm. Annual growth in whole-economy regular pay had been 2.4% in the three months to November, while whole-economy total pay had grown by 2.5%. Although these outturns had been close to staff expectations, there had been a sequence of small upside surprises in recent months, such that both of these releases were 0.3 percentage points higher than expected at the time of the November *Inflation Report*. In the latest data, annualised three month on three month growth in private sector regular pay had remained around 3%.

20 A survey of companies conducted by the Bank's Agents in December and January had recorded an average pay settlement in the private sector of 2.6% in 2017, higher than companies had expected in a similar survey a year ago. In 2018, the average private sector pay settlement was expected to be half a percentage point higher, at 3.1%. With the exception of construction, average pay settlements were predicted to rise in all sectors in 2018. Respondents to the survey had reported that the main factors pushing up total labour cost growth per employee were the ability to recruit and retain staff, employer pension contributions, higher consumer price inflation and the National Living Wage.

21 The main news in the official data on labour market quantities had been in participation and employment. In the three months to November, the participation rate had increased sharply to 63.6%. That had partly reflected a rebound in the participation rate of 18-24 year olds. The strength of participation had coincided with a pickup in employment in the three months to November, which increased by 0.3% relative to the previous non-overlapping three-month period. The majority of that increase had been reflected in greater full-time employment. The unemployment rate had been unchanged at 4.3%. Surveys of hiring intentions had remained firm. Average hours had weakened further, however, dragging down on total hours despite the rise in employment.

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 continued to be 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. Since the Committee's previous meeting, indicators of corporate and household confidence had not reacted significantly to the progress made in the first phase of the Article 50 negotiations.

23 In such exceptional circumstances, the MPC's remit specified that the Committee must balance any trade-off between the speed at which it intended to return inflation sustainably to the target and the support that monetary policy provided to jobs and activity. Over the past year or so, a steady absorption of slack 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 November 2017 meeting, the Committee had tightened modestly the stance of monetary policy in order to return inflation sustainably to the target. So far, the impact on interest rates faced by households and firms had appeared in line with past experience.

24 The Committee considered how the outlook had changed since its December meeting and the November *Inflation Report* projections.

25 The near-term outlook for the global economy had strengthened further and the projections incorporated in the February *Inflation Report* were consistent with growth in PPP-weighted world GDP of a little over 4% in 2018. Notwithstanding recent volatility in financial markets, global financial conditions remained supportive. The degree to which the UK economy would benefit from that further broad-based strength in global demand was an important judgement, given continuing Brexit-related uncertainties. Since the referendum on EU membership, UK GDP growth had slowed to the bottom of the range of G7 economies, having previously been at the top, and a similar pattern was observable in business investment growth. That decoupling was also evident in asset prices. In particular, UK-focused equity prices had significantly underperformed their international counterparts, and the usual positive correlation between UK-focused and overseas equities

appeared to have weakened. Set against that, direct trade channels appeared to have remained unimpaired, and net trade appeared to have contributed strongly to GDP growth last year, although these data were volatile.

26 In the MPC's central projections, UK net trade benefited from robust global demand and the past depreciation of sterling. Along with high rates of profitability, the low cost of capital and limited spare capacity, strong global activity was supporting business investment, although it remained restrained by Brexit-related uncertainties. Household consumption growth was expected to remain relatively subdued, reflecting weak real income growth.

27 In the February *Report*, GDP growth was expected to average around 1¾% per year over the forecast, a slightly faster pace than was projected in November despite the projections being conditioned on the higher market-implied path for interest rates and stronger exchange rate prevailing in financial markets at the time of the forecast. The preliminary estimate of GDP growth in 2017 Q4 had been stronger than expected, at 0.5%, and recent indicators suggested a slightly stronger near-term outlook for activity than in November.

28 In preparing the February *Report*, the MPC had undertaken its scheduled annual assessment of aggregate supply side conditions. A range of evidence suggested that unemployment was close to its equilibrium rate, which was now estimated to be 4¼%, slightly lower than estimated a year ago. Within companies, there appeared to be some scope to increase output by raising the average number of hours worked by employees, but indicators suggested that there was little capacity for companies to work their other resources more intensively. Overall, the Committee judged that only a very limited degree of spare capacity remained in the economy.

29 The outlook for growth in the economy's supply capacity was modest. The MPC judged that, notwithstanding a projected rise, structural productivity growth would remain weak relative to pre-crisis norms. Labour supply was also likely to rise more slowly than in recent years. These factors meant that the pace at which the economy could expand over the coming years without generating increased inflationary pressures was judged to be around 1½% per annum, lower than pre-crisis norms. Given the slightly stronger demand growth projected in this *Report*, the remaining very limited degree of spare capacity was absorbed more quickly than in November. A small margin of excess demand was projected to emerge by early 2020 and to build thereafter.

30 CPI inflation had fallen from 3.1% in November to 3.0% in December, 0.3 percentage points higher than had been expected at the time of the November *Inflation Report*, in part reflecting higher oil prices. As set out in the accompanying open letter from the Governor to the Chancellor of the Exchequer, inflation was projected to fall back gradually as the effects of sterling's past depreciation faded. In the near term, the recent rise in global oil prices meant that the projected fall in inflation was more gradual than anticipated at the time of the November *Report*.

31 Set against the waning influence of external price pressures, the outlook for inflation was underpinned by a continuing recovery in domestic cost pressures. Indicators of pay growth had risen recently, to a greater extent than expected at the time of the November *Inflation Report*. Annualised three month on three month growth in private sector regular average weekly earnings had been around 3% since the middle of 2017. A

recent survey by the Bank's Agents had shown that firms expected their average pay settlement to be half a percentage point higher in 2018 than in 2017. Recruitment difficulties had risen further. A further marked rise in annual earnings growth was likely in coming months as previous weak data dropped out of the calculation. The latest signs of a pickup in pay growth suggested that the tightness of the labour market would result in a rise in unit labour cost growth towards target-consistent rates. On balance, CPI inflation was projected to remain above the 2% target in the second and third years of the MPC's February central projection, despite those projections being conditioned on tighter monetary conditions than had been assumed in the November *Report*.

32 The Committee turned to the immediate policy decision.

33 The outlook for growth and inflation was likely to require some ongoing withdrawal of monetary stimulus. Since November, the prospect of a greater degree of excess demand over the forecast period and the expectation that inflation would remain above the target had further diminished the trade-off that the MPC was required to balance. It was therefore appropriate to set monetary policy so that inflation returned sustainably to its target at a more conventional horizon.

34 There were risks in both directions around the inflation outlook. On the upside, momentum in global growth might persist for longer and the boost to UK demand from global factors could prove greater than anticipated. Global inflationary pressures had also shown signs of building. The tightness of the domestic labour market could result in faster wage and unit labour cost growth. The predicted pickup in productivity growth was not assured.

35 On the downside, some business survey indicators of output had weakened. Recent housing and retail sales data had softened and, more generally, consumers might still respond to the past squeeze in real incomes to a greater degree than anticipated. And UK net trade could benefit by less from the pickup in global demand than had been the case recently. There was a possibility that the contribution of imported inflation pressures would diminish more rapidly than in the central projection.

36 In light of these considerations, all members thought that the current policy stance remained appropriate to balance the demands of the MPC's remit. The Committee also judged that, were the economy to evolve broadly in line with the February *Inflation Report* projections, monetary policy would need to be tightened somewhat earlier and by a somewhat greater degree over the forecast period than anticipated at the time of the November *Report*, in order to return inflation sustainably to the target.

37 All members agreed that 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, and stood ready to respond to developments as they unfolded to ensure a sustainable return of inflation to the 2% target.

38 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.

39 Consistent with the Committee's previous guidance, and as described in the market notice accompanying these minutes, the Committee agreed to reinvest £18.3 billion of cash flows associated with the redemptions of the March 2018 gilt held by the Asset Purchase Facility.

40 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

Clare Lombardelli 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 1 February as observer for the purpose of exercising oversight functions in his role as a member of the Bank's Court of Directors.