



BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 21 March 2018

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These are the minutes of the Monetary Policy Committee meeting ending on 21 March 2018.

They are available at <https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2018/march-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 9 May 2018 will be published on 10 May 2018.

Monetary Policy Summary, March 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 21 March 2018, the MPC voted by a majority of 7-2 to maintain Bank Rate at 0.5%. The Committee voted unanimously to maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £10 billion. The Committee also voted unanimously to maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435 billion.

In the MPC's most recent projections, set out in the February *Inflation Report*, GDP was expected to grow by around 1¾% per year on average over the forecast period. While modest by historical standards, that growth rate was expected to exceed the diminished rate of supply growth of the economy, which was projected to be around 1½% per year. As a result, a small margin of excess demand was projected to emerge by early 2020 and build thereafter. That pushed up on domestic costs, although CPI inflation fell back gradually as the effects of sterling's past depreciation faded. Inflation remained above the 2% target in the second and third years of the MPC's central projection.

Recent data releases are broadly consistent with the MPC's view of the medium-term outlook as set out in the February *Report*. The prospects for global GDP growth remain strong, and financial conditions continue to be accommodative, with little persistent effect from the recent financial market volatility. UK GDP growth in the fourth quarter was revised down slightly, to 0.4%, with the composition of demand implying less rotation towards net trade and business investment than anticipated at the time of the February *Report*. However, early estimates of the expenditure components of GDP are prone to revision, and other indicators of exports and investment point to a stronger picture. The latest activity indicators suggest that the underlying pace of GDP growth in the first quarter of 2018 remains similar to that in the final quarter of 2017.

CPI inflation fell from 3.0% in January to 2.7% in February. Inflation is expected to ease further in the short term although to remain above the 2% target. Pay growth continued to pick up. The unemployment rate remained low in the three months to January. The firming of shorter-term measures of wage growth in recent quarters and a range of survey indicators suggest pay growth will rise further in response to the tightening labour market. This provides increasing confidence that growth in wages and unit labour costs will pick up to target-consistent rates.

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 significant trade-off between the speed at which it intends to return inflation sustainably to the target and the support that monetary policy provides to jobs and activity. The steady absorption of slack has reduced the degree to which it is appropriate for the MPC to accommodate an extended period of inflation above the target.

As in February, the best collective judgement of the MPC remains that, given the prospect of excess demand over the forecast period, an ongoing tightening of monetary policy over the forecast period will be appropriate to return inflation sustainably to its target at a more conventional horizon. All members agree that any future increases in Bank Rate are likely to be at a gradual pace and to a limited extent. In light of these considerations, seven members thought that the current policy stance remained appropriate to balance the demands of the MPC's remit.

Minutes of the Monetary Policy Committee meeting ending on 21 March 2018

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 Movements in sterling financial markets had been fairly limited since the Committee's previous meeting. Instantaneous forward OIS rates had risen following the release of the February *Inflation Report*, although increases at the three-year horizon had since unwound. There remained little expectation of a rise in Bank Rate at the current MPC meeting, but the market-implied probability of a 25 basis point increase at the May meeting had increased to around 90%. A majority of economists responding to the latest Reuters survey had expected Bank Rate to rise to 0.75% by the end of the second quarter, and the modal response was for Bank Rate to increase to 1.25% by the end of 2019.

3 The sterling exchange rate index had risen by over 1% since the February MPC meeting, in part reflecting the announcement of a draft EU Withdrawal Agreement between the UK government and the European Commission. Measures of the implied volatility of sterling had remained higher than for other non-sterling major currency pairs.

4 Ten-year gilt yields had been broadly unchanged since the MPC's previous meeting, while yields on government bonds in the euro area had fallen a little. Ten-year US Treasury yields had increased slightly. The market-implied path of the federal funds rate had risen towards the median of FOMC participants' assessments of appropriate monetary policy published in December 2017. Market pricing had implied a 25 basis point increase at the March FOMC meeting, and for the federal funds rate to rise to around 2½% by the end of 2019.

5 Global financial markets had been calmer following the period of volatility in early February. After falling sharply in the days immediately prior to the February MPC meeting, global equity prices had recovered somewhat over the following period and, in some cases, had returned to levels seen around the turn of the year. Measures of equity market implied volatility, such as the VIX, had stabilised at a higher level than had generally been seen during 2017 and so were now closer in line with their longer run averages. There had been less volatility in other financial markets. In particular, corporate bond spreads had remained around historically low levels.

6 The Committee discussed what recent developments might suggest about market participants' expectations for global growth and inflation. There was little evidence that expectations of global growth had been marked down. For example, equity analysts' forecasts for corporate earnings in 2018 had remained broadly unchanged, after rising sharply at the beginning of the year in the United States following the announcement of tax reforms. And the positive correlation between changes in US equity prices and Treasury yields, observed over much of the past 20 years, had weakened significantly following the period of volatility, which also suggested that demand news had not been the initial driver of market moves. In contrast, market

participants had appeared to respond to news on global inflationary pressures, including some upside surprises in US wage and consumer price data. Financial market indicators of inflation expectations had nevertheless been broadly stable, although the option-implied weight on low US inflation outturns over the coming years had decreased somewhat, consistent with a further reduction in deflationary risks.

The international economy

7 The outlook for the global economy had remained strong. In the euro area, GDP growth in 2017 Q4 had been 0.6%, in line with the previous release. Within this, investment growth and the net trade contribution had been stronger than expected, while consumption growth had been weaker. Bank staff expected that GDP growth would pick up in 2018 Q1, to 0.7%. This was slightly weaker than the 0.8% expected at the time of the February *Inflation Report*, but well above the post-crisis average quarterly growth rate. The euro-area PMI composite output index and consumer confidence had remained close to historically high levels, and industrial production growth had been strong, although all had fallen back in the most recent observations. The outlook for the euro area had become stronger and more broad-based over the previous year, although some risks remained.

8 In the United States, the second estimate of GDP growth in 2017 Q4 had been unrevised at 0.6%, with a slight downward revision to business investment offset by higher residential investment. Bank staff expected that GDP growth would pick up in 2018 Q1, to 0.7%. This was slightly lower than the 0.8% expected at the time of the February *Inflation Report*, but well above the post-crisis average. Since the MPC's previous meeting, consumer confidence had increased to its highest level since 2000, and non-farm payrolls had seen the largest monthly increase since July 2016. Several indicators had been somewhat weaker than expected, however, including personal consumption, durable goods orders, and international goods trade. Further support to demand would be provided by the Bipartisan Budget Act, signed into law on 9 February, which was likely to result in a significant increase in military and domestic federal government spending in 2018 and 2019.

9 The second estimate of Japanese GDP growth for 2017 Q4 had been revised up by 0.3 percentage points, to 0.4%, an eighth successive quarter of positive growth. In China, at the annual National People's Congress, the government had announced a growth target of around 6½% for 2018, removing both the reference to aiming higher if possible and a numerical credit target. News in other emerging markets had been mixed, with GDP growth in 2017 Q4 slightly stronger than market expectations in India and South Africa, but slightly weaker in Brazil and Mexico.

10 World goods trade had continued to grow strongly, increasing by 1.1% in 2017 Q4, compared to the previous quarter. But trade tensions had increased, with the United States having announced tariffs on imports of steel and aluminium, of 25% and 10% respectively, citing national security concerns. The direct effect of these tariffs on US growth and inflation was likely to be small, since steel and aluminium accounted for only around two to three per cent of total US goods imports, and the direct impact on those economies that supplied these commodities to the United States was also likely to be modest. But there was a risk of escalation. A

major increase in protectionism worldwide could have a significant negative impact on global growth and put upward pressure on global inflation.

11 Brent spot oil prices had been little changed since the Committee's previous meeting, although they had remained around 5% lower than their recent high of around \$70 per barrel in January. This largely reflected stronger oil production in the United States, which had more than offset the fall in OPEC production following supply cuts agreed by its members last year. Industrial metals prices had fallen by 5% since early February, although they were around 12% higher than a year ago, reflecting the strength of world demand over that period.

12 In the US, both headline and core annual PCE inflation had remained stable in January, at 1.7% and 1.5% respectively, in line with expectations. Average hourly earnings growth for private employees had softened slightly in February. In the euro area, annual core HICP inflation had remained stable in February at 1.0%, in line with recent months, while the headline measure had continued to drift down, reflecting the lagged impact of earlier increases in energy prices.

Money, credit, demand and output

13 The ONS's second estimate of GDP growth had been revised down from 0.5% to 0.4% in 2017 Q4. Changes to the initial sectoral output estimates had been very small and so the overall downward revision to growth had primarily reflected the ONS's balancing across different measures of GDP.

14 The outlook for output growth in 2018 Q1 was complicated by a number of temporary erratic effects. Recent snow-related disruption was likely to have a measurable adverse effect on growth in the first quarter, although it was difficult to quantify the precise extent of this. There would be offsetting effects from mining and quarrying output, which as expected had rebounded strongly in January, reflecting the re-opening of the Forties oil and gas pipeline system. Other official data had been mixed. For example, manufacturing output had risen for the ninth consecutive month in January, whereas construction output – a series that was often revised substantially – was estimated to have fallen sharply. Composite CBI survey indicators had bounced back strongly so far this quarter. Overall, Bank staff's usual models suggested that underlying GDP would grow by around 0.4% in 2018 Q1, in line with the estimate incorporated in the February *Inflation Report*. After incorporating an initial judgement on the impact of the snow-related news, staff had revised down their estimate of headline GDP growth to 0.3%.

15 Early estimates of expenditure components had been published alongside the latest GDP data. In 2017 Q4, the largest contribution to growth had come from government consumption and investment, although government consumption had recently exhibited a tendency to be revised down subsequently. Private consumption had grown by 0.3%, in line with the projection in the February *Report*, and had grown at a similar quarterly pace over the previous year. Other indicators were broadly consistent with household spending continuing to grow in line with that rate in early 2018. Surveys of consumer confidence had remained broadly flat. Retail sales volumes had risen slightly in January. Mortgage approvals for house purchase had increased

in January, more than unwinding the weakness in December. Private car registrations, seasonally adjusted by Bank staff, had risen sharply in February, although that may have reflected a shift in the timing of purchases ahead of announced Vehicle Excise Duty changes on new diesel vehicles in April.

16 A key judgement in the February *Report* was that GDP growth would continue to rotate away from domestic consumption and towards external demand and investment. In 2017 Q4, net trade excluding valuables was estimated to have subtracted 0.1 percentage points from GDP growth, and business investment was reported to have been flat on the quarter, both somewhat weaker than expected in the February *Report*. But these early estimates were likely to be revised materially over time and some of the factors depressing growth were likely to be erratic. For instance, part of the recent weakness in goods exports had been accounted for by trade in fuels and may have reflected the temporary closure of the Forties pipeline in December. Other indicators also suggested a more positive outlook. Surveys of goods export orders had remained robust. The latest results from the Decision Maker Panel had provided tentative evidence that, since 2017 Q3, uncertainty related to Brexit may be having a less negative impact on four-quarter growth in nominal business investment, although that survey still implied a lower level of investment than would otherwise have been the case.

17 The Committee had been briefed by the Treasury representative on the Spring Statement and the Office for Budget Responsibility's associated *Economic and fiscal outlook*. These had contained no news on fiscal policy.

18 The Committee discussed financial conditions and their impact on growth. Wholesale bank funding spreads had risen recently, but had remained significantly lower than two years ago. Household lending spreads had fallen to a greater extent over that longer period and spreads on mortgages in particular had continued to compress recently. It was nevertheless striking that lower mortgage spreads had not yet led to a significant pickup in lending volumes. Non-price terms in some consumer credit markets had tightened slightly recently, but that had followed several years of loosening conditions. Spreads on lending to corporates had fallen markedly over recent years and surveys had suggested that finance was generally accessible across companies of all sizes. Overall, the Committee noted that financial conditions had remained highly accommodative.

19 The February *Inflation Report* projections had been underpinned by a judgement that, in aggregate, spreads on bank lending would rise gradually over the forecast period, reversing a little less than half of the fall observed over the past two years. That would be consistent with some unwind in the compression of bank funding spreads and competitive pressures abating somewhat in lending markets.

Supply, costs and prices

20 In February, twelve-month CPI inflation had fallen by 0.3 percentage points to 2.7%, 0.2 percentage points lower than had been expected at the time of the previous *Inflation Report*. That news had partly reflected changes to the CPI component weights by the ONS, which had pushed down on inflation. Annual core CPI

inflation excluding energy, food, alcoholic beverages and tobacco had fallen from 2.7% in January to 2.4% in February.

21 In the MPC's central projection in the February *Inflation Report*, CPI inflation was expected to ease gradually. 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. The pass-through of the depreciation was likely to make a positive, but diminishing, contribution to inflation over the forecast period. By contrast, domestic cost pressures were expected to firm.

22 A range of measures of domestically generated inflation had picked up slightly further in recent months, although they had generally remained below target-consistent levels. Indicators of profit margins, including from surveys of companies and the Agents' company visit scores, had presented mixed signals but did not suggest that margins had risen over the past year.

23 Wage growth had risen in the latest labour market release, in line with expectations at the time of the February *Report*. Annual whole-economy total pay growth had picked up to 2.8% in the three months to January and whole-economy regular pay growth had risen to 2.6%. Surveys, including by the Agents, had also suggested higher pay deals since last autumn. These trends were consistent with the February *Report* projection of strengthening wage growth.

24 Employment had grown by 0.5% in the three months to January compared with the three months to October, broadly consistent with expectations at the time of the February *Inflation Report*. The unemployment rate had fallen back to 4.3% in the three months to January, as expected. Surveys of firms' hiring intentions had remained robust. Job-to-job flow rates had continued to pick up in the fourth quarter and were now back to pre-crisis average levels, with voluntary job-to-job rates slightly above their pre-crisis average. Vacancies had also continued to pick up in the three months to February compared with the three months to November. Taken together with the continued strengthening in wage growth, these measures suggested that the labour market remained tight.

25 Average hours had fallen unusually sharply over the second half of last year, by around 2% at an annualised rate. Taken together with the output data, this meant that, over the same period, hourly productivity had increased at its fastest pace for almost seven years. Average hours were a volatile series, however, and they had bounced back in the data for the three months to January, to slightly above the level expected at the time of the February *Inflation Report*. That suggested that hourly productivity was likely to fall in 2018 Q1. Growth in output per head – which had tended to be a much smoother measure than hourly productivity – had been more subdued during the second half of 2017 and was likely to remain weak at the start of 2018.

26 According to the latest data from the ONS, net long-term migration had been 244,000 in the year to 2017 Q3, in line with the ONS's principal projection incorporated in the February *Inflation Report*. That was lower than the corresponding figure for 2016 Q3, but was slightly higher than in the four quarters to 2017 Q2. The number of EU citizens coming to the United Kingdom had continued to decline in the third quarter, but this had been offset by an increase in non-EU migration, which had partly reflected an increase in students coming to the United Kingdom.

The immediate policy decision

27 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, a draft Withdrawal Agreement, including an implementation period ending on 31 December 2020, had been agreed between the UK government and the European Commission ahead of the European Council meeting on 23 March.

28 In such exceptional circumstances, the MPC's remit specified that the Committee must balance any significant trade-off between the speed at which it intends to return inflation sustainably to the target and the support that monetary policy provides to jobs and activity. The steady 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. It was therefore appropriate to set monetary policy so that inflation returned sustainably to its target at a more conventional horizon.

29 In the MPC's most recent projections, set out in the February *Inflation Report*, GDP had been expected to grow by around 1¾% per year on average over the forecast period. While modest by historical standards, that growth rate exceeded the diminished rate of supply growth of the economy, which was projected to be around 1½% per year. As a result, a small margin of excess demand had been projected to emerge by early 2020 and build thereafter. That was expected to push up on domestic costs, although CPI inflation was expected to fall back gradually as the effects of sterling's past depreciation on import prices faded. Inflation remained above the 2% target in the second and third years of the MPC's central projection.

30 The Committee reviewed the extent to which the outlook had changed since the February *Report*.

31 The prospects for the world economy had remained strong. In the United States and the euro area, Bank staff had revised down slightly their expectation for GDP growth in the first quarter of 2018. But, in both economies, output growth was expected to remain well above its post-crisis average rates. The Committee noted that, although the direct impact of recent US tariff announcements was likely to be limited, a major increase in protectionism worldwide could have a significant negative impact on global growth and push up on inflation.

32 The global outlook had been supported by accommodative financial conditions. There had been little persistent effect from recent financial market volatility, with global equity prices recovering and measures of equity market volatility stabilising at somewhat higher levels. Wholesale bank funding spreads had risen recently, but had remained significantly lower than two years ago. Taken together with more intense competition in the banking sector, UK household and corporate lending spreads had fallen markedly.

33 UK GDP growth in 2017 Q4 had been revised down slightly, to 0.4%. The first release of the expenditure data for the fourth quarter suggested that there had been less rotation in demand than anticipated at the time of the February *Report*. But these early estimates were prone to significant revision. Staff expected the underlying pace of growth in the first quarter of 2018 to remain similar to that in the final quarter of 2017. Any snow-related disruption to economic activity in 2018 Q1 was likely to be temporary.

34 CPI inflation had fallen from 3.0% in January to 2.7% in February, slightly weaker than expected at the time of the February *Inflation Report*.

35 A key feature of the February *Inflation Report* projection for CPI inflation was that, as the impact of the past depreciation of sterling moderated, domestic cost pressures would continue to strengthen. A range of measures of domestically generated inflation had picked up slightly further in recent months, although they generally remained below target-consistent levels. Wage growth had also increased steadily, as expected.

36 The unemployment rate had remained low. More generally, the official data and other indicators suggested that the margin of spare capacity within the labour market was limited. Alongside the increase in job-to-job flow rates, that could strengthen workers' bargaining power, pushing up wages further, in line with the MPC's forecast. Taken together, this provided increasing confidence that growth in wages and unit labour costs would pick up to target-consistent rates.

37 The Committee turned to the immediate policy decision. Data released since the February *Report* appeared to have few implications for the medium-term outlook and were broadly consistent with the MPC's views set out in that *Report*.

38 As in February, the best collective judgement of the MPC remained that, given the prospect of excess demand over the forecast period, an ongoing tightening of monetary policy over the forecast period would be appropriate to return inflation sustainably to its target at a more conventional horizon. All members agreed that any future increases in Bank Rate were likely to be at a gradual pace and to a limited extent.

39 For the majority of members, however, that did not require an increase in Bank Rate at this meeting. There had been few surprises in recent economic data and the February *Inflation Report* projections, conditioned on a gently rising path of Bank Rate, had appeared broadly on track. The May forecast round would enable the Committee to undertake a fuller assessment of the underlying momentum in the economy, the degree of slack remaining and the extent of domestic inflationary pressures.

40 Two members favoured an immediate increase in Bank Rate. These members noted the widespread evidence that slack was largely used up and that pay growth was picking up, presenting upside risks to inflation in the medium term. A modest tightening of monetary policy at this meeting could mitigate the risks from a more sustained period of above-target inflation that might ultimately necessitate a more abrupt change in policy and hence a greater adjustment in growth and employment.

41 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 bonds, 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 £435 billion.

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.

42 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.