



BANK OF ENGLAND

Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 9 May 2018

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These are the minutes of the Monetary Policy Committee meeting ending on 9 May 2018.

They are available at <https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2018/may-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 20 June will be published on 21 June 2018.

Monetary Policy Summary, May 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 9 May 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.

The MPC's updated projections for inflation and activity are set out in the *May Inflation Report*. The outlook and the main factors shaping it are broadly similar to those set out in the previous *Report*.

The preliminary estimate of GDP growth in the first quarter was 0.1%, 0.3 percentage points lower than expected in February. This is likely in part to have reflected adverse weather in late February and early March. Survey indicators suggest that growth was somewhat stronger in Q1 than implied by the preliminary estimate.

Despite the near-term softness, the MPC's central forecast for economic activity is little changed from that in the previous *Report*. In the MPC's central forecast, conditioned on the gently rising path of Bank Rate implied by current market yields, GDP is expected to grow by around 1¼% per year on average over the forecast period. On the expenditure side, growth continues to rotate towards net trade and business investment and away from consumption. Although business investment is still restrained by Brexit-related uncertainties, it is being supported, like exports, by strong global demand and accommodative financial conditions. Household consumption growth remains subdued, in line with the modest growth in real income over the forecast period.

Wage growth and domestic cost pressures are firming gradually, broadly as expected. The MPC continues to judge that the UK economy has a very limited degree of slack. Hiring intentions have remained strong and, over the past three months, the unemployment rate has fallen slightly further. While modest by historical standards, the projected pace of GDP growth over the forecast is nonetheless slightly faster than the diminished rate of supply growth, which averages around 1½% per year. In the MPC's central projection, therefore, a small margin of excess demand still emerges by early 2020, feeding through into higher rates of pay growth and domestic cost pressures.

CPI inflation fell to 2.5% in March, lower than expected at the time of the February *Report*. The inflation rates of the most import-intensive components of the CPI appear to have peaked. The MPC judges that the impact of the past depreciation of sterling on CPI inflation, while remaining significant, is likely to fade a little faster than previously thought. Taking external and domestic influences together, CPI inflation is projected to fall back slightly more quickly than in February, reaching the target in two years. These projections are conditioned on a gently rising path for Bank Rate over the next three years.

In the exceptional circumstances presented by Brexit, as specified in its remit, the MPC has been balancing 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 prospect of excess demand over the forecast period has reduced the degree to which it is appropriate for the MPC to accommodate an extended period of inflation above the target. The Committee's best collective judgement therefore remains that, were the economy to develop broadly in line with the May *Inflation Report* projections, an ongoing tightening of monetary policy over the forecast period would be appropriate to return inflation sustainably to its target at a conventional horizon. As previously, however, that judgement relies on the economic data evolving broadly in line with the Committee's projections. For the majority of members, an increase in Bank Rate was not required at this meeting. All members agree that any future increases in Bank Rate are likely to be at a gradual pace and to a limited extent.

Minutes of the Monetary Policy Committee meeting ending on 9 May 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 Since the MPC's previous meeting, market participants had materially changed their views on the likely timing of the next movement in Bank Rate. Against a backdrop of weaker-than-expected economic data, in particular the preliminary estimate of UK GDP for 2018 Q1, the market-implied probability of a 25 basis point increase in Bank Rate at the current MPC meeting had decreased sharply since mid-April, to around 10%, having previously been stable at around 90% since mid-March. Further out, though, expectations were less changed, as market prices continued to imply that participants expected around three 25 basis point increases in Bank Rate over the next three years. The first 25 basis point rise in Bank Rate had now been priced in around the turn of the year.

3 Sterling had fallen by around 1% since the Committee's previous meeting. It had risen in the wake of the draft agreement on the withdrawal of the United Kingdom from the European Union on 19 March, and then fallen back, in line with the market's reappraisal of the near-term path for UK monetary policy. However, the conditioning path for sterling underpinning the May projections, which was based on the 15-day average to 2 May, was around 1% higher than that contained in the February *Report*.

4 Global financial conditions had tightened modestly since the February *Inflation Report*, although they remained supportive by historical standards, and measures of implied volatility in equity, currency and interest rate markets continued to be historically low. Equity prices had fallen and investment grade corporate bond spreads had increased somewhat in major advanced economies, although these moves had been modest when set against the trends seen over most of the past year. Market contacts suggested that this weaker risk sentiment had reflected macroeconomic data outturns coming in somewhat below expectations, concerns over medium-term corporate earnings prospects in an environment of rising interest rates, and geopolitical news, particularly related to the likelihood of protectionist trade policies.

5 There had been little news on monetary policy in the euro area and the United States. On 26 April, the ECB Governing Council had left interest rates and asset purchases unchanged, in line with expectations. On 2 May, the FOMC had left the federal funds rate unchanged. Market pricing had continued to imply a high likelihood of a 25 basis point increase at the June FOMC meeting, and for the federal funds rate to rise to around 2½% by the end of 2019. At longer maturities, 10-year US Treasury yields had continued to pick up, exceeding 3% for the first time since 2014.

The international economy

6 Although the outlook for the global economy continued to be robust, the near-term news on activity had been somewhat weaker than expected at the time of the February *Inflation Report*.

7 According to the preliminary estimate, euro-area GDP had slowed from 0.7% in 2017 Q4 to 0.4% in 2018 Q1. This was 0.4 percentage points weaker than expected in the February *Inflation Report* and 0.3 percentage points weaker than expected at the time of the Committee's previous meeting. French GDP growth had fallen sharply in Q1 relative to the previous quarter, whereas Italian and Spanish growth had been unchanged. The available country-level estimates had tentatively suggested that a smaller contribution from net trade had partly accounted for the slowdown. There also appeared to have been some negative effects from adverse weather conditions. Nevertheless, taking a longer view, it remained the case that the outlook for the euro-area economy had become stronger and more broad-based over the past year or so. Bank staff expected that GDP growth would pick up again in Q2, to 0.6%. Indicators of near-term growth had remained at historically elevated levels, including the European Commission's Economic Sentiment Indicator and the euro-area PMI composite output index for April.

8 In the United States, GDP was estimated to have grown by 0.6% in 2018 Q1, 0.3 percentage points lower than expected in the February *Inflation Report*. GDP growth had eased slightly relative to 2017 Q4, primarily accounted for by a marked slowing in household consumption. However, much of this appeared to have reflected the fact that tax refunds had arrived later than usual, in March rather than in February, and that abnormal weather conditions had lifted spending in Q4. Bank staff therefore expected that GDP growth would pick up again in Q2, to 0.8%, as these temporary factors unwound and as recent changes to fiscal policy started to support demand.

9 In China, the seasonally adjusted estimate of quarterly GDP growth in 2018 Q1 had been 1.4%, slightly weaker than in the previous quarter. But annual growth in Q1, at 6.8%, had been in line with market expectations, and the PMIs had remained robust in April, such that Bank staff expected quarterly GDP growth to pick up slightly in Q2. Growth in other emerging markets was expected to remain fairly robust, and world goods trade had remained relatively strong, with a 3-month on 3-month growth rate of 2.3%. In a few emerging markets, signs of financial stress had emerged, however. Overall, the projections incorporated in the May *Inflation Report* were consistent with growth in PPP-weighted world GDP of 4% in 2018.

10 Brent spot oil prices had increased by around 13% since the Committee's previous meeting. Non-oil commodity prices, having picked up during 2017, had risen a little further over the course of 2018. Prices had responded to a range of supply factors, including the impact of US sanctions on Russia affecting its aluminium production, as well as uncertainty related to trade policy.

11 Although the increase in commodity prices over the past year had been putting some upward pressure on consumer price inflation in advanced economies, the news on inflation itself had been more mixed. In the United States, underlying wage and price inflation had continued to build gradually. In March, annual headline and core PCE inflation had both picked up by 0.3 percentage points, to 2.0% and 1.9% respectively. The pickup in the annual rate of inflation over the previous two months had in part reflected the fading of some

transitory factors that had suppressed annual rates over 2017, such as a one-off fall in the price level of cellular telephone services. Four-quarter growth in wages and salaries had picked up to 2.7% in 2018 Q1, from 2.6% in 2017 Q4, reaching its highest rate since 2008, although remaining some way below the pre-crisis average. In the euro area, though, the flash estimate of annual core HICP inflation in April had fallen by 0.3 percentage points to 0.7%, a sharper fall than expected, which had also been the main driver of the fall in headline HICP inflation, to 1.2%.

Money, credit, demand and output

12 The preliminary estimate of UK GDP growth for 2018 Q1 had been 0.1%, and four-quarter growth had fallen to 1.2%, the weakest in five years. The quarterly growth outturn had been 0.2 percentage points lower than Bank staff's expectation at the time of the March MPC meeting, and 0.3 percentage points lower than expected in the February *Inflation Report*. At the component level, there had been notable weakness in construction output and a slowing in private non-distribution services activity.

13 Three factors, which were not mutually exclusive, may have lain behind the surprise. First, although it was clear that the disruptive weather conditions during the quarter had affected output in certain sectors – depressing construction and retail activity, for example, and boosting energy output – it was impossible to quantify these effects precisely, and the adverse weather might have had a larger impact than prior estimates had suggested. If this were the case, it was likely that growth in Q2 would be commensurately stronger.

14 Second, it was possible that the preliminary estimate had understated the true pace of growth. Downward bias in early estimates of GDP growth had, historically, been particularly marked in Q1s; quarters affected by heavy snowfall had, in the past, been subject to above-average upward revisions; and construction sector output estimates had, in recent years, tended to be revised up over time.

15 A third possibility was that there had been a softening in underlying demand, although the assessment of this was hampered by the likely presence but uncertain size of weather effects in some of the indicators. The news flow on the retail sector had been particularly downbeat. Retail sales volumes had fallen in Q1; Ernst & Young had reported that retailers' profit warnings had been at their highest rate since at least 2012; the Bank's Agents had reported increased concerns about a rise in retail insolvencies in Q1; and data from Retail Research suggested that more employees had been affected by their companies entering administration in 2018 so far than during the whole of 2017.

16 Although retail sector indicators were not always a good guide to consumer spending, other indicators of household demand had also been lacklustre. The housing market had remained soft, with property transactions having fallen by 3.6% in Q1 and house price inflation relatively subdued. The flow of consumer credit had fallen markedly in March, which appeared consistent with weaker household demand. There had also been evidence, however, of a tightening in consumer credit conditions in recent months, including from the Bank's *Credit Conditions Survey*.

17 The measures of money to which the Committee paid closest attention had been growing at rates broadly similar to that of nominal GDP. For example, the twelve-month growth rate of M4 excluding intermediate other financial corporations, having fallen from rates of around 7% a year ago, had been 3.8% in March 2018.

18 The labour market had continued to perform robustly, which, together with falling consumer price inflation, had supported growth in real household income. Also, the IHS Markit/CIPS surveys for (non-distribution) services and construction had shown an improvement in activity growth in April, which might imply a resumption of stronger growth in Q2.

19 Taking all of these factors together, the MPC's assessment was that there had been a slowing in GDP in Q1, but this was likely to have been overstated in the preliminary estimate. Given past patterns in revisions, the Committee's central view was that Q1 growth would be revised up over time to around 0.3%. Partly reflecting some recovery from weather-related disruption, the MPC expected stronger growth, of around 0.4%, in Q2.

Supply, costs and prices

20 In March, twelve-month CPI inflation had fallen by 0.2 percentage points to 2.5%. That had been 0.1 percentage points below Bank staff's forecast immediately prior to the release and 0.4 percentage points lower than had been expected at the time of the previous *Inflation Report*. The downside news relative to the February *Inflation Report* had been spread across a number of categories, and had partly reflected changes to the CPI component weights by the ONS.

21 Recent developments in energy prices were likely to push up the path of CPI inflation over the coming months. Oil prices had risen since the February *Inflation Report* and this would raise fuel prices. In addition, some large household energy companies had announced that their gas and electricity prices would increase, with other providers expected to announce similar rises.

22 Further out, the conditioning assumption for oil prices underlying the May *Inflation Report* led energy prices to exert downward pressure on inflation. The oil futures curve on which the MPC's May forecast had been conditioned was downward sloping, such that the contribution from fuel prices to inflation was expected to fall to below average from the end of 2018.

23 The diminishing impact of imported inflation was also expected to contribute to declining CPI inflation. Imported inflation, stemming from sterling's depreciation around the vote to leave the European Union, had been the predominant factor driving CPI inflation above the target. There had been evidence that the positive contribution it was making to inflation had begun to decline, however. Inflation in the more import-intensive components of the CPI basket had peaked towards the end of 2017 and had fallen quite sharply since then. The lagged pass-through of the past depreciation was likely to exert some upward pressure on CPI inflation relative to the target throughout the forecast period, although its impact appeared to be slightly smaller than previously thought, and was expected to continue to wane.

24 Domestic cost pressures were continuing to build gradually, broadly as expected. While annual growth in whole-economy total pay growth had been weaker than expected in the three months to February at 2.8%, whole-economy regular pay growth had risen, as expected, to 2.8%. The downside news in total pay had been accounted for by bonus payments, which tended to be volatile and were unlikely to provide a more sustained signal about the outlook for earnings. Survey indicators and early data on pay settlements had also been consistent with somewhat firmer pay growth in 2018. Growth in unit wage costs, which measure total pay per unit of output produced, had increased to 2.4% in the year to 2017 Q4, from 1.3% in Q3, and were now more consistent with the inflation target.

25 Domestic cost pressures had been supported by the absorption of slack in the economy. Since the February *Inflation Report*, unemployment had fallen further, and by slightly more than had been expected. The unemployment rate in the three months to February had been 4.2%, close to the Committee's central estimate of the equilibrium rate of unemployment. The single-month unemployment rate in February had been 4.0%, which suggested that the three-month unemployment rate could fall a little more in the coming months. That suggested employment growth in early 2018 could be stronger than expected in February. Expectations of hiring from surveys continued to point to healthy labour demand. However, average hours worked had been weaker than expected at the time of the February *Inflation Report*. In Q4, they had remained a little below employees' reported desired hours, perhaps suggestive of a small amount of labour market slack.

26 Higher-than-expected employment growth in Q1 alongside lower-than-expected GDP growth would mean that productivity growth had been weaker than expected in the February *Inflation Report*. The MPC continued to expect productivity growth to increase from recent rates, but there was a risk that it would remain low. However, to the extent that weaker outturns for productivity were echoed in pay growth, there would not necessarily be implications for unit wage costs, and hence inflation.

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.

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 The Committee considered how the outlook had changed since its March meeting and the February *Inflation Report*. The updated forecast and the main factors shaping it were broadly similar to those set out in the February *Report*.

30 There had been a slight softening in momentum in the global economy in 2018 Q1, with activity weaker than expected in a number of key countries and regions. Nevertheless, the projections incorporated in the May *Inflation Report* were still consistent with robust growth in PPP-weighted GDP of 4% in 2018. Global financial conditions had remained supportive.

31 The preliminary estimate of UK GDP growth in the first quarter had been 0.1%, 0.3 percentage points lower than expected in February. This was likely in part to have reflected adverse weather in late February and early March. Survey indicators, and evidence from the Bank's Agents, suggested that growth had been somewhat stronger in Q1 than implied by the preliminary estimate.

32 The MPC's central forecast for economic activity was little changed from that in the previous *Report*. Following a period of weakness at the start of this year, and conditioned on the gently rising path of Bank Rate implied by current market yields, GDP was expected to grow by around 1¾% per year on average over the forecast period.

33 On the expenditure side, growth had continued to rotate towards net trade and business investment and away from consumption. Net trade had contributed positively to growth in 2017 and was projected to continue to do so throughout the forecast period, partly reflecting the support to UK exports from strong overseas demand and the lower sterling exchange rate. Like exports, business investment was being supported by strong global demand and accommodative financial conditions; however, it was still being restrained by Brexit-related uncertainties, such that the pace of growth had been more modest than would be expected at this stage of the economic cycle, relative to investment growth in other countries, and given healthy corporate balance sheets and highly accommodative financial conditions.

34 Household consumption growth had remained subdued, in line with the modest growth in real income over the forecast period. The savings rate was projected to remain around its current relatively low level. Given the recent weakness in consumer credit and the housing market, there was somewhat greater-than-usual uncertainty about the near-term momentum in consumer spending and the extent to which households would adjust their spending and saving to the past fall in their real incomes.

35 Domestic cost pressures were firming gradually, broadly as expected. The MPC continued to judge that the UK economy had a very limited degree of slack. Hiring intentions had remained strong and, over the past three months, the unemployment rate had fallen slightly further. Whole-economy average weekly earnings growth had picked up from just over 2% in 2017 H1 to 2.8% in the three months to February 2018.

36 While modest by historical standards, the projected pace of GDP growth over the forecast was slightly faster than the diminished rate of supply growth, which was projected to average around 1½% per year. In the MPC's central projection, therefore, a small margin of excess demand emerged by early 2020, feeding through into higher rates of pay growth and firmer domestic cost pressures.

37 CPI inflation fell to 2.5% in March, notably lower than expected at the time of the *February Report*. The inflation rates of the most import-intensive components of the CPI appeared to have peaked. The MPC judged that the impact of the past depreciation of sterling on CPI inflation, while remaining significant, was likely to fade a little faster than previously thought. Taking external and domestic influences together, CPI inflation was projected to fall back slightly more quickly than in February, reaching the target in two years. These projections were conditioned on a path for Bank Rate that embodied around three 25 basis point rises over the next three years.

38 The Committee turned to the immediate policy decision. As in March, the best collective judgement of the MPC remained that, were the economy to evolve in line with the *May Inflation Report* projections, an ongoing tightening of monetary policy over the forecast period would be appropriate to return inflation sustainably to its target at a 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, an increase in Bank Rate was not required at this meeting. The recent weakness in data for the first quarter had been consistent with a temporary soft patch, with few implications for the current degree of slack or for the outlook for the UK economy. The conditions for steady growth had remained in place, the labour market had continued to be strong, and survey indicators had suggested that activity growth would pick up again in Q2.

40 CPI inflation was likely to be somewhat lower in the near term, given the Committee's judgement to reduce the extent to which sterling's depreciation was projected to push up import prices. But the medium-term profile was only a little lower, as domestic costs had been picking up broadly in line with expectations, and only a modest pickup in activity would be required to move the economy into excess demand.

41 For these members, there was value in seeing how the data unfolded over the coming months, to discern whether the softness in Q1 might persist, and to learn more about the extent to which the economy was evolving in line with the *May Inflation Report* projections. At this meeting, the costs to waiting for additional information were likely to be modest, given the need for only limited tightening over the forecast period to return inflation sustainably to the target.

42 Two members favoured an immediate increase in Bank Rate. They put more weight on trends in business surveys and labour market data, and judged the weakness in the Q1 GDP data to be temporary or erratic, heavily affected by adverse weather. For these members, the near-term softness in CPI inflation could be explained by the reduced pace of pass-through from sterling's depreciation, and hence would not materially affect the profile of inflation in the medium term. The labour market had continued to be strong, there was widespread evidence that slack was largely used up, and pay and domestic costs had continued to pick up broadly as expected. These members continued to judge that a modest tightening of monetary policy at this

meeting could mitigate the risks of a more sustained period of above-target inflation that might ultimately necessitate a more abrupt subsequent change in policy and hence a greater adjustment in growth and employment.

43 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 £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.

44 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 2 May, and Don Robert on 4 May, as observers for the purposes of exercising oversight functions in their roles as members of the Bank's Court of Directors.